PREFACE

It gives me an immense pleasure to present this compilation of all questions of ICAI at one place for all my dearest students. I have done this just to ensure that a student’s time is not wasted in searching questions from the ICAI study material for their practice.

It has all the questions along with the solutions of study material relevant for May/ Nov 2020 attempt students of New Course as well as old course.

The students do not have to refer any other material for their practice after doing this material. It is comprehensive in every sense.

A student shall endeavour to read this booklet at least twice before exams to have firm grip on this mammoth subject.

God Bless you all.

CA Aarish Khan.
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CA AARISH KHAN.
EXERCISE

Question 1
Mr. Bhargava, a leading advocate on corporate law, decided to reduce his practice and to accept briefs only for paying his taxes and making charities with the fees received on such briefs. In a particular case, he agreed to appear to defend one company in the Supreme Court on the condition that he would be provided with Rs. 5 lacs for a public charitable trust that he would create. He defended the company and was paid the sum by the company. He created a trust of that sum by executing a trust deed. Decide whether the amount received by Mr. Bhargava is assessable in his hands as income from profession.

Answer
In the instant case, the trust was created by Mr. Bhargava himself out of his professional income. The client did not create the trust. The client did not impose any obligation in the nature of a trust binding on Mr. Bhargava. Thus, there is no diversion of the money to the trust before it became professional income in the hands of Mr. Bhargava. This case is one of application of professional income and not of diversion of income by overriding title. Therefore, the amount received by Mr. Bhargava is chargeable to tax under the head “Profits and gains of business or profession”.

Question 2
XYZ Ltd. took over the running business of a sole-proprietor by a sale deed. As per the sale deed, XYZ Ltd. undertook to pay overriding charges of Rs. 15,000 p.a. to the wife of the sole-proprietor in addition to the sale consideration. The sale deed also specifically mentioned that the amount was charged on the net profits of XYZ Ltd., who had accepted that obligation as a condition of purchase of the going concern. Is the payment of overriding charges by XYZ Ltd. to the wife of the sole-proprietor in the nature of diversion of income or application of income? Discuss.

Answer
This issue came up for consideration before the Allahabad High Court in Jit & Pal X-Rays (P.) Ltd. v. CIT (2004) 267 ITR 370 (All). The Allahabad High Court observed that the overriding charge which had been created in favour of the wife of the sole-proprietor was an integral part of the sale deed by which the going concern was transferred to the assessee. The obligation, therefore, was attached to the very source of income i.e. the going concern transferred to the assessee by the sale deed. The sale deed also specifically mentioned that the amount in question was charged on the net profits of the assessee-company and the assessee-company had accepted that obligation as a condition of purchase of the going concern. Hence, it is clearly a case of diversion of income by an overriding charge and not a mere application of income.

Question 3
MKG Agency is a partnership firm consisting of father and three major sons. The partnership deed provided that after the death of father, the business shall be continued by the sons, subject to the condition that the firm shall pay 20% of the profits to the mother. Father died in March, 2019. In the previous year 2019-20, the reconstituted firm paid Rs. 1 lakh (equivalent to 20% of the profits) to the mother and claimed the amount as deduction from its income. Examine the correctness of the claim of the firm.
Answer
The issue raised in the problem is based on the concept of diversion of income by overriding title, which is well recognised in the income-tax law. In the instant case, the amount of Rs. 1 lakh, being 20% of profits of the firm, paid to the mother gets diverted at source by the charge created in her favour as per the terms of the partnership deed. Such income does not reach the assessee-firm.
Rather, such income stands diverted to the other person as such other person has a better title on such income than the title of the assessee. The firm might have received the said amount but it so received for and on behalf of the mother, who possesses the overriding title. Therefore, the amount paid to the mother should be excluded from the income of the firm. This view has been confirmed in CIT vs. Nariman B. Bharucha & Sons (1981) 130 ITR 863 (Bom).

Question 4
Anand was the Karta of HUF. He died leaving behind his major son Prem, his widow, his grandmother and brother’s wife. Can the HUF retain its status as such or the surviving persons would become co-owners?

Answer
In the case of Gowli Buddanna v. CIT (1966) 60 ITR 293 (SC), the Supreme Court has made it clear that there need not be more than one male member to form a HUF as a taxable entity under the Income-tax Act, 1961. The expression “Hindu Undivided family” in the Act is used in the sense in which it is understood under the personal law of the Hindus.
Under the Hindu system of law, a joint family may consist of a single male member and the widows of the deceased male members and the Income-tax Act, 1961 does not mandate that it should consist of at least two male members. Therefore, property of a joint Hindu family does not cease to belong to the family merely because the family is represented by a single co-parcener who possesses the right which an owner of property may posses.
Therefore, the HUF would retain its status as such.

Question 5
Mr. C borrowed on Hundi, a sum of Rs. 25,000 by way of bearer cheque on 11-09-2019 and repaid the same with interest amounting to Rs. 30,000 by account payee cheque on 12-10-2019.
The Assessing Officer (AO) wants to treat the amount borrowed as income during the previous year. Is the action of AO valid?

Answer
Section 69D provides that where any amount is borrowed on a hundi or any amount due thereon is repaid otherwise than by way of an account-payee cheque drawn on a bank, the amount so borrowed or repaid shall be deemed to be the income of the person borrowing or repaying the amount for the previous year in which the amount was so borrowed or repaid, as the case may be.
In this case, Mr. C has borrowed Rs. 25,000 on Hundi by way of bearer cheque. Therefore, it shall be deemed to be income of Mr. C for the previous year 2019-20. Since the repayment of the same along with interest was made by way of account payee cheque, the same would not be hit by the provisions of section 69D. Therefore, the action of the Assessing Officer treating the amount borrowed as income during the previous year is valid in law.
Question 6
The Assessing Officer found, during the course of assessment of a firm, that it had paid rent in respect of its business premises amounting to Rs. 60,000, which was not debited in the books of account for the year ending 31.3.2020. The firm did not explain the source for payment of rent. The Assessing Officer proposes to make an addition of Rs. 60,000 in the hands of the firm for the assessment year 202-21. The firm claims that even if the addition is made, the sum of Rs. 60,000 should be allowed as deduction while computing its business income since it has been expended for purposes of its business. Examine the claim of the firm.

Answer
The claim of the firm for deduction of the sum of Rs. 60,000 in computing its business income is not tenable. The action of the Assessing Officer in making the addition of Rs. 60,000, being the payment of rent not debited in the books of account (for which the firm failed to explain the source of payment) is correct in law since the same is an unexplained expenditure under section 69C. The proviso to section 69C states that such unexplained expenditure, which is deemed to be the income of the assessee, shall not be allowed as a deduction under any head of income. Therefore, the claim of the firm is not tenable.

ADDITIONAL ILLUSTRATIONS FOR PRACTICE:

Illustration 1
Mr. X has a total income of Rs. 12,00,000 comprising of his salary income and interest on fixed deposit. Compute his tax liability.

Solution
Computation of Tax liability
Tax liability = Rs. 1,12,500 + 30% of Rs. 2,00,000 = Rs. 1,72,500
Alternatively:

<table>
<thead>
<tr>
<th>First</th>
<th>Rs. 2,50,000</th>
<th>- Nil</th>
<th>= Rs. 12,500</th>
</tr>
</thead>
<tbody>
<tr>
<td>Next</td>
<td>Rs. 2,50,000 – Rs. 5,00,000</td>
<td>@ 5% of Rs. 2,50,000</td>
<td>= Rs. 1,25,000</td>
</tr>
<tr>
<td>Next</td>
<td>Rs. 5,00,000 – Rs. 10,00,000</td>
<td>@ 20% of Rs. 5,00,000</td>
<td>= Rs. 1,00,000</td>
</tr>
<tr>
<td>Balance</td>
<td>i.e. Rs. 12,00,000 minus Rs. 10,00,000</td>
<td>@ 30% of Rs. 2,00,000</td>
<td>= Rs. 60,000</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>= Rs. 1,72,500</td>
</tr>
</tbody>
</table>

Illustration 2
Compute the tax liability of Mr. A (aged 42), having total income of Rs. 51 lakhs for the Assessment Year 2020-21. Assume that his total income comprises of “Salary income”, “Income under the head house property” and “Interest from Saving Bank Account”.

1.3
### Solution

#### Computation of tax liability of Mr. A for the A.Y. 2020-21

(A)  Tax payable including surcharge on total income of Rs. 51,00,000

<table>
<thead>
<tr>
<th>Income Range</th>
<th>Tax Payable</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rs. 2,50,000 – Rs. 5,00,000 @ 5%</td>
<td>Rs. 12,500</td>
</tr>
<tr>
<td>Rs. 5,00,000 – Rs. 10,00,000 @ 20%</td>
<td>Rs. 1,00,000</td>
</tr>
<tr>
<td>Rs. 10,00,000 – Rs. 51,00,000 @30%</td>
<td>Rs. 12,30,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>Rs. 13,42,500</td>
</tr>
</tbody>
</table>

*Add: Surcharge @ 10%*

**Rs. 1,34,250**

**Rs. 14,76,750**

(B)  Tax Payable on total income of Rs. 50 lakhs (Rs. 12,500 plus Rs. 1,00,000 plus Rs. 12,00,000)

<table>
<thead>
<tr>
<th>Income Range</th>
<th>Tax Payable</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rs. 1,00,000 – Rs. 12,00,000</td>
<td>Rs. 13,12,500</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>Rs. 13,12,500</td>
</tr>
</tbody>
</table>

(C)  Excess tax payable (A)-(B)

<table>
<thead>
<tr>
<th>Tax Payable</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rs. 1,64,250</td>
</tr>
</tbody>
</table>

(D)  Marginal Relief (Rs. 1,64,250 – Rs. 1,00,000, being the amount of income in excess of Rs. 50,00,000)

<table>
<thead>
<tr>
<th>Tax Payable</th>
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</thead>
<tbody>
<tr>
<td>Rs. 64,250</td>
</tr>
</tbody>
</table>

**Tax payable (A)-(D) [Excluding cess]**

<table>
<thead>
<tr>
<th>Tax Payable</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rs. 31,93,750</td>
</tr>
</tbody>
</table>

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### Illustration 3

Compute the tax liability of Mr. A (aged 42), having total income of Rs. 1,01,00,000 for the Assessment Year 2020-21. Assume that his total income comprises of “Salary income”, “Income under the head house property” and “Interest from fixed deposit Account”.

#### Solution

#### Computation of tax liability of Mr. A for the A.Y. 2020-21

(A)  Tax payable including surcharge on total income of Rs. 1,01,000,000

<table>
<thead>
<tr>
<th>Income Range</th>
<th>Tax Payable</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rs. 2,50,000 – Rs. 5,00,000 @ 5%</td>
<td>Rs. 12,500</td>
</tr>
<tr>
<td>Rs. 5,00,000 – Rs. 10,00,000 @ 20%</td>
<td>Rs. 1,00,000</td>
</tr>
<tr>
<td>Rs. 10,00,000 – Rs. 1,01,000,000 @30%</td>
<td>Rs. 27,30,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>Rs. 28,42,500</td>
</tr>
</tbody>
</table>

*Add: Surcharge @ 15%*

**Rs. 4,26,375**

**Rs. 32,68,875**

(B)  Tax Payable on total income of Rs. 1 crore [(Rs. 12,500 plus Rs. 1,00,000 plus Rs. 27,00,000) plus surcharge@10%]

<table>
<thead>
<tr>
<th>Tax Payable</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rs. 30,93,750</td>
</tr>
</tbody>
</table>

(C)  Excess tax payable (A)-(B)

<table>
<thead>
<tr>
<th>Tax Payable</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rs. 1,75,125</td>
</tr>
</tbody>
</table>

(D)  Marginal Relief (Rs. 1,75,125 – Rs. 1,00,000, being the amount of income in excess of Rs. 1,00,00,000)

<table>
<thead>
<tr>
<th>Tax Payable</th>
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<tbody>
<tr>
<td>Rs. 75,125</td>
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**Tax payable (A)-(D) [Excluding Cess]**

<table>
<thead>
<tr>
<th>Tax Payable</th>
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</thead>
<tbody>
<tr>
<td>Rs. 31,93,750</td>
</tr>
</tbody>
</table>
Illustration 4
Compute the marginal relief available to X Ltd., a domestic company, assuming that the total income of X Ltd. is Rs. 1,01,00,000 for A.Y.2020-21 and the total income does not include any income in the nature of capital gains.
[Note - The gross receipts of X Ltd. for the P.Y.2017-18 is Rs. 402 crore]
Solution
The tax payable on total income of Rs. 1,01,00,000 of X Ltd. computed @32.1% (including surcharge @7%) is Rs. 32,42,100. However, the tax cannot exceed Rs. 31,00,000 (i.e., the tax of Rs. 30,00,000 payable on total income of Rs. 1 crore plus Rs. 1,00,000, being the amount of total income exceeding Rs. 1 crore). Therefore, the tax payable on Rs. 1,01,00,000 would be Rs. 31,00,000. The marginal relief is Rs. 1,42,100 (i.e., Rs. 32,42,100 - Rs. 31,00,000).

Illustration 5
Compute the marginal relief available to Y Ltd., a domestic company, assuming that the total income of Y Ltd. for A.Y.2020-21 is Rs. 10,01,00,000 and the total income does not include any income in the nature of capital gains.
[Note - The gross receipts of Y Ltd. for the P.Y.2017-18 is Rs. 410 crore]
Solution
The tax payable on total income of Rs. 10,01,00,000 of Y Ltd. computed@ 33.6% (including surcharge@12%) is Rs. 3,36,33,600. However, the tax cannot exceed Rs. 3,22,00,000 [i.e., the tax of Rs. 3,21,00,000 (32.1% of Rs. 10 crore) payable on total income of Rs. 10 crore plus Rs. 1,00,000, being the amount of total income exceeding Rs. 10 crore]. Therefore, the tax payable on Rs. 10,01,00,000 would be Rs. 3,22,00,000. The marginal relief is Rs. 14,33,600 (i.e., Rs. 3,36,33,600 - Rs. 3,22,00,000).
CHAPTER 2 - RESIDENCE AND SCOPE OF TOTAL INCOME

EXERCISE

Question 1

The business of a HUF is transacted from Australia and all the policy decisions are taken there. Mr. E, the karta of the HUF, who was born in Kolkata, visits India during the P.Y.2019-20 after 15 years. He comes to India on 1.4.2019 and leaves for Australia on 1.12.2019. Determine the residential status of Mr. E and the HUF for A.Y. 2020-21.

Answer

(a) During the P.Y.2019-20, Mr. E has stayed in India for 245 days (i.e. 30+31+30+31+31+ 30+31+30+1 days). Therefore, he is a resident. However, since he has come to India after 15 years, he does not satisfy any of the conditions for being ordinarily resident. Therefore, the residential status of Mr. E for the P.Y.2019-20 is resident but not ordinarily resident.

(b) Since the business of the HUF is transacted from Australia and nothing is mentioned regarding its control and management, it is assumed that the control and management is also wholly outside India. Therefore, the HUF is a non-resident for the P.Y.2019-20.

Question 2

From the following particulars of income furnished by Mr. Anirudh pertaining to the year ended 31.3.2020, compute the total income for the assessment year 2020-21, if he is:

(i) Resident and ordinary resident;
(ii) Resident but not ordinarily resident;
(iii) Non-resident

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) Short term capital gains on sale of shares in Indian Company received in Germany</td>
<td>15,000</td>
</tr>
<tr>
<td>(b) Dividend from a Japanese Company received in Japan</td>
<td>10,000</td>
</tr>
<tr>
<td>(c) Rent from property in London deposited in a bank in London, later on remitted to India through approved banking channels</td>
<td>75,000</td>
</tr>
<tr>
<td>(d) Dividend from RP Ltd., an Indian Company</td>
<td>6,000</td>
</tr>
<tr>
<td>(e) Agricultural income from lands in Gujarat</td>
<td>25,000</td>
</tr>
</tbody>
</table>

Answer

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

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Resident &amp; ordinarily resident (Rs.)</th>
<th>Resident but not ordinarily resident (Rs.)</th>
<th>Non-Resident (Rs.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1) Short term capital gains on sale of shares of an Indian company, received in Germany</td>
<td>15,000</td>
<td>15,000</td>
<td>15,000</td>
</tr>
<tr>
<td>2) Dividend from a Japanese company, received in Japan</td>
<td>10,000</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>3) Rent from property in London deposited in a bank in London [See Note (i) below]</td>
<td>52,500</td>
<td>-</td>
<td>-</td>
</tr>
</tbody>
</table>
4) Dividend from RP Ltd., an Indian Company [See Note (ii) below]
5) Agricultural income from land in Gujarat [See Note (iii) below]

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rent received (assumed as gross annual value)</td>
<td>75,000</td>
</tr>
<tr>
<td>Less: Deduction under section 24 (30% of Rs.75,000)</td>
<td>22,500</td>
</tr>
<tr>
<td>Income from house property</td>
<td>52,500</td>
</tr>
</tbody>
</table>

Total Income 77,500 15,000 15,000

Notes:
(i) It has been assumed that the rental income is the gross annual value of the property. Therefore, deduction @30% under section 24, has been provided and the net income so computed is taken into account for determining the total income of a resident and ordinarily resident.

(ii) Dividend received from Indian company upto Rs. 10 lakh is exempt under section 10(34).

(iii) Agricultural income is exempt under section 10(1).

Question 3
Poulomi, a chartered accountant, is presently working in a firm in India. She has received an offer for the post of Chief Financial Officer from a company at Singapore. As per the offer letter, she should join the company at any time between 1st September, 2019 and 31st October, 2019. She approaches you for your advice on the following issues to mitigate her tax liability in India:
(i) Date by which she should leave India to join the company;
(ii) Direct credit of part of her salary to her bank account in Kolkata maintained jointly with her mother to meet requirement of her family;
(iii) Period for which she should stay in India when she comes on leave.

Answer
The following category of individuals will be treated as resident in India only if the period of their stay in India during the relevant previous year is 182 days or more :-
(a) Indian citizens, who leave India in any previous year, *inter alia*, for purposes of employment outside India, or
(b) Indian citizen or person of Indian origin engaged outside India, *inter alia*, in an employment, who comes on a visit to India in any previous year.

(i) Since Poulomi is leaving India for the purpose of employment outside India, she will be treated as resident only if the period of her stay during the previous year amounts to 182 days or more. Therefore, Poulomi should leave India on or before 28th September, 2019, in which case, her stay in India during the previous year would be less than 182 days and she would become non-resident for the purpose of taxability in India. In such a case, only the income which accrues or arises in India or which is deemed to accrue or arise in India or received or deemed to be received in India shall be taxable.

The income earned by her in Singapore would not be chargeable to tax in India for A.Y. 2020-21, if she leaves India on or before 28th September, 2019.

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

(iii) In case Poulomi visits India after taking up employment outside India, she would be covered in the exception provided in (b) above and she will be treated as resident only if the period of her stay during the relevant previous year amounts to 182 days or more.

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

**ADDITIONAL ILLUSTRATIONS FOR PRACTICE:**

**Illustration 1**

Mr. Anand is an Indian citizen and a member of the crew of a Singapore bound Indian ship engaged in carriage of passengers in international traffic departing from Chennai port on 6\(^{th}\) June, 2019. From the following details for the P.Y. 2019-20, determine the residential status of Mr. Anand for A.Y. 2020-21, assuming that his stay in India in the last 4 previous years (preceding P.Y. 2019-20) is 400 days and last seven previous years (preceding P.Y. 2019-20) is 750 days:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>Date entered into the Continuous Discharge Certificate in respect of joining the ship by Mr. Anand</td>
<td>6th June, 2019</td>
</tr>
<tr>
<td>Date entered into the Continuous Discharge Certificate in respect of signing off from the ship by Mr. Anand</td>
<td>9th December, 2019</td>
</tr>
</tbody>
</table>

**Solution**

In this case, the voyage is undertaken by an Indian ship engaged in the carriage of passengers in international traffic, originating from a port in India (i.e., the Chennai port) and having its destination at a port outside India (i.e., the Singapore port). Hence, the voyage is an eligible voyage for the purposes of section 6(1).

Therefore, the period beginning from 6th June, 2019 and ending on 9th December, 2019, being the dates entered into the Continuous Discharge Certificate in respect of joining the ship and signing off from the ship by Mr. Anand, an Indian citizen who is a member of the crew of the ship, has to be excluded for computing the period of his stay in India. Accordingly, 187 days [25+31+31+30+31+30+9] have to be excluded from the period of his stay in India. Consequently, Mr. Anand’s period of stay in India during the P.Y.2019-20 would be 179 days [i.e., 366 days – 187 days]. Since his period of stay in India during the P.Y.2019-20 is less than 182 days, he is a non-resident for A.Y.2020-21.

**Note** - Since the residential status of Mr. Anand is “non-resident” for A.Y.2020-21 consequent to his number of days of stay in P.Y.2019-20 being less than 182 days, his period of stay in the earlier previous years become irrelevant.
Illustration 2

Brett Lee, an Australian cricket player visits India for 100 days in every financial year. This has been his practice for the past 10 financial years. Find out his residential status for the assessment year 2020-21.

Solution

Determination of Residential Status of Mr. Brett Lee for the A.Y. 2020-21:

Period of stay during previous year 2019-20 = 100 days

Calculation of period of stay during 4 preceding previous years (100 × 4 = 400 days)

<table>
<thead>
<tr>
<th>Year</th>
<th>Days</th>
</tr>
</thead>
<tbody>
<tr>
<td>2018-19</td>
<td>100</td>
</tr>
<tr>
<td>2017-18</td>
<td>100</td>
</tr>
<tr>
<td>2016-17</td>
<td>100</td>
</tr>
<tr>
<td>2015-16</td>
<td>100</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>400 days</strong></td>
</tr>
</tbody>
</table>

Mr. Brett Lee has been in India for a period more than 60 days during previous year 2019-20 and for a period of more than 365 days during the 4 immediately preceding previous years. Therefore, since he satisfies one of the basic conditions under section 6(1), he is a resident for the assessment year 2020-21.

Computation of period of stay during 7 preceding previous years = 100 × 7 = 700 days

<table>
<thead>
<tr>
<th>Year</th>
<th>Days</th>
</tr>
</thead>
<tbody>
<tr>
<td>2018-19</td>
<td>100</td>
</tr>
<tr>
<td>2017-18</td>
<td>100</td>
</tr>
<tr>
<td>2016-17</td>
<td>100</td>
</tr>
<tr>
<td>2015-16</td>
<td>100</td>
</tr>
<tr>
<td>2014-15</td>
<td>100</td>
</tr>
<tr>
<td>2013-14</td>
<td>100</td>
</tr>
<tr>
<td>2012-13</td>
<td>100</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>700 days</strong></td>
</tr>
</tbody>
</table>

Since his period of stay in India during the past 7 previous years is less than 730 days, he is a not-ordinarily resident during the assessment year 2020-21. (See Note below)

Therefore, Mr. Brett Lee is a resident but not ordinarily resident during the previous year 2018-19 relevant to the assessment year 2020-21.

Note: A not-ordinarily resident person is one who satisfies any one of the conditions specified under section 6(6), i.e.,

(i) If such individual has been non-resident in India in any 9 out of the 10 previous years preceding the relevant previous year, or

(ii) If such individual has during the 7 previous years preceding the relevant previous year been in India for a period of 729 days or less.

In this case, since Mr. Brett Lee satisfies condition (ii), he is a not-ordinary resident for the A.Y. 2020-21.
CHAPTER 3 - INCOME WHICH DO NOT FORM PART OF TOTAL INCOME

EXERCISE

Question 1
Examine with reasons, based on the provisions of the Act, as to chargeability of the following receipts to tax in the assessment year 2020-21:

(i) Rent of Rs. 60,000 charged from tenants occupying houses constructed on the land situated in India and used for agricultural purposes. The tenants, working in the nearby industrial area, occupy these houses for their own residential purposes.

(ii) Income of Rs. 75,000 derived by Anand Nursery from the sale of seedlings grown without carrying out all the basic operations on land.

(iii) Mr. Gaitonde, born and brought up in the State of Sikkim, had a net profit of Rs. 2,25,000 from the business located in Sikkim and interest of Rs. 55,000 on the securities/bonds issued by the Government of Rajasthan.

Answer

(i) As per section 10(1), agricultural income is exempt from tax. The meaning and scope of agricultural income is defined in section 2(1A). According to Explanation 2 to section 2(1A), any income derived from any building from the use of such building for any purpose (including letting for residential purposes or for the purpose of any business or profession) other than agriculture shall not be agricultural income. It appears in this case that the house was occupied by tenants for residential purposes. Therefore, the rent of Rs. 60,000 from letting out of houses constructed on agricultural land for residential purposes shall not be treated as agricultural income by virtue of Explanation 2 to section 2(1A). Hence, such income would be chargeable to tax.

(ii) Explanation 3 to section 2(1A) provides that the income derived from saplings or seedlings grown in a nursery shall be deemed to be agricultural income, whether or not the basic operations were carried out on land. Accordingly, the income of Rs. 75,000 derived by Anand Nursery from the sale of seedlings grown without carrying out all the basic operations on land shall be treated as agricultural income and exempt from tax under section 10(1).

(iii) Section 10(26AAA) exempts the income which accrues or arises to a Sikkimese individual from any source in the State of Sikkim and the income by way of dividend or interest on securities. Therefore, the income of Mr. Gaitonde from a business located in Sikkim and interest income on the securities/bonds of Government of Rajasthan shall not be subject to tax.

Question 2
Rudra Ltd. has one unit at Special Economic Zone (SEZ) and other unit at Domestic Tariff Area (DTA). The company provides the following details for the previous year 2019-20.

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rudra Ltd. (Rs.)</th>
<th>Unit in DTA (Rs.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Sales</td>
<td>6,00,00,000</td>
<td>2,00,00,000</td>
</tr>
<tr>
<td>Export Sales</td>
<td>4,60,00,000</td>
<td>1,60,00,000</td>
</tr>
<tr>
<td>Net Profit</td>
<td>80,00,000</td>
<td>20,00,000</td>
</tr>
</tbody>
</table>
Calculate the eligible deduction under section 10AA of the Income-tax Act, 1961, for the Assessment Year 2020-21, in the following situations:

(i) If both the units were set up and start manufacturing from 22-05-2012.
(ii) If both the units were set up and start manufacturing from 14-05-2016.

**Answer**

**Computation of deduction under section 10AA of the Income-tax Act, 1961**

As per section 10AA, in computing the total income of Rudra Ltd. from its unit located in a Special Economic Zone (SEZ), which begins to manufacture or produce articles or things or provide any services during the previous year relevant to the assessment year commencing on or after 01.04.2006 but before 1st April 2021, there shall be allowed a deduction of 100% of the profit and gains derived from export of such articles or things or from services for a period of five consecutive assessment years beginning with the assessment year relevant to the previous year in which the Unit begins to manufacture or produce such articles or things or provide services, as the case may be, and 50% of such profits for further five assessment years subject to fulfillment of other conditions specified in section 10AA.

**Computation of eligible deduction under section 10AA [See Working Note below]:**

(i) **If Unit in SEZ was set up and began manufacturing from 22-05-2012:**

Since A.Y. 2020-21 is the 8th assessment year from A.Y. 2013-14, relevant to the previous year 2012-13, in which the SEZ unit began manufacturing of articles or things, it shall be eligible for deduction of 50% of the profits derived from export of such articles or things, assuming all the other conditions specified in section 10AA are fulfilled.

\[
\text{Profit of Unit in SEZ} \times \frac{\text{Export turnover of Unit in SEZ}}{\text{Total turnover of Unit in SEZ}} \times 50\%
\]

\[
= \frac{\text{Rs. 60 lakhs}}{\text{Rs. 400 lakhs}} \times 50\% = \text{Rs. 22.50 lakhs}
\]

(ii) **If Unit in SEZ was set up and began manufacturing from 14-05-2016:**

Since A.Y.2020-21 is the 4th assessment year from A.Y. 2017-18, relevant to the previous year 2016-17, in which the SEZ unit began manufacturing of articles or things, it shall be eligible for deduction of 100% of the profits derived from export of such articles or things, assuming all the other conditions specified in section 10AA are fulfilled.

\[
\text{Profit of Unit in SEZ} \times \frac{\text{Export turnover of Unit in SEZ}}{\text{Total turnover of Unit in SEZ}} \times 100\%
\]

\[
= \frac{\text{Rs. 60 lakhs}}{\text{Rs. 400 lakhs}} \times 100\% = \text{Rs. 45 lakhs}
\]

The unit set up in Domestic Tariff Area is not eligible for the benefit of deduction under section 10AA in respect of its export profits, in both the situations.

**Working Note:**

**Computation of total sales, export sales and net profit of unit in SEZ**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rudra Ltd. (Rs.)</th>
<th>Unit in DTA (Rs.)</th>
<th>Unit in SEZ (Rs.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Sales</td>
<td>6,00,00,000</td>
<td>2,00,00,000</td>
<td>4,00,00,000</td>
</tr>
<tr>
<td>Export Sales</td>
<td>4,60,00,000</td>
<td>1,60,00,000</td>
<td>3,00,00,000</td>
</tr>
<tr>
<td>Net Profit</td>
<td>80,00,000</td>
<td>20,00,000</td>
<td>60,00,000</td>
</tr>
</tbody>
</table>

3.2
ADDITIONAL ILLUSTRATIONS FOR PRACTICE:

Illustration 1

Mr. C manufactures latex from the rubber plants grown by him in India. These are then sold in the market for Rs. 30 lacs. The cost of growing rubber plants is Rs. 10 lacs and that of manufacturing latex is Rs. 8 lacs. Compute his total income.

Solution

The total income of Mr. C comprises of agricultural income and business income. Total profits from the sale of latex = Rs. 30 lacs – Rs. 10 lacs – Rs. 8 lacs = Rs. 12 lacs.

Agricultural income = 65% of Rs. 12 lacs. = Rs. 7.8 lacs

Business income = 35% of Rs. 12 lacs. = Rs. 4.2 lacs

Illustration 2

Ankur, the owner of a land situated in Kerala used for growing thereon different types of fruits, paddy, vegetables and flowers, received from Yahoo Movies Ltd., Chennai, Rs. 5 lacs as rent towards the use of this land for shooting of a film. The amount so received was accounted by him in the books as revenue derived from land and claimed to be exempt under section 10(1). He now wants to confirm from you whether the amount has been correctly treated by him as agricultural income.

Solution

The income received by Mr. Ankur from a filmmaker for allowing them to shoot a film in the agricultural land owned by him is not in the nature of agricultural income because it was neither received by him against the sale of agricultural produce obtained nor for carrying out the normal agricultural operations on the land. The amount paid was only for the purpose of shooting of a film on such land.

To claim exemption in respect of agricultural income under section 10(1), the conditions contained in section 2(1A)(a) to (c) have to be first complied with/ fulfilled by the assessee. The Madras High Court in the case of B. Nagi Reddi v. CIT (2002) 258 ITR 719, following the judgment of Apex Court in the case of CIT v Raja Benoy Kumar Sahas Roy (1957) 32 ITR 466, has held, on identical facts, that the income derived for allowing a shooting of film in the agricultural land cannot be treated as agricultural income, as it has no nexus with the land, except that it was carried out on agricultural land.

Illustration 3

Mr. X, a resident, has provided the following particulars of his income for the P.Y. 2019-20.

i. Income from salary (computed) - Rs. 1,80,000
ii. Income from house property (computed) - Rs. 2,00,000
iii. Agricultural income from a land in Jaipur - Rs. 2,80,000
iv. Expenses incurred for earning agricultural income - Rs. 1,70,000

Compute his tax liability assuming his age is -
(a) 45 years
(b) 70 years

Solution

Computation of total income of Mr. X for the A.Y.2019-20

(a) Computation of tax liability (age 45 years)

For the purpose of partial integration of taxes, Mr. X has satisfied both the conditions i.e.
1. Net agricultural income exceeds Rs. 5,000 p.a., and
2. Non-agricultural income exceeds the basic exemption limit of Rs. 2,50,000.

His tax liability is computed in the following manner:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income from salary</td>
<td>1,80,000</td>
<td></td>
</tr>
<tr>
<td>Income from house property</td>
<td>2,00,000</td>
<td></td>
</tr>
<tr>
<td>Net agricultural income [ Rs. 2,80,000 – Rs. 1,70,000 ]</td>
<td>310,000</td>
<td></td>
</tr>
<tr>
<td>Less: Exempt under section 10(1)</td>
<td>(3,10,000)</td>
<td>-</td>
</tr>
<tr>
<td>Gross Total Income</td>
<td>5,30,000</td>
<td></td>
</tr>
<tr>
<td>Less: Deductions under Chapter VI-A</td>
<td></td>
<td>-</td>
</tr>
<tr>
<td>Total Income</td>
<td>5,30,000</td>
<td></td>
</tr>
</tbody>
</table>

Step 1 : Rs. 5,30,000 + Rs. 3,10,000 = Rs. 8,40,000
Tax on Rs. 8,40,000 = Rs. 80,500
(i.e., 5% of Rs. 2,50,000 plus 20% of Rs. 3,40,000)

Step 2 : Rs. 3,10,000 + Rs. 2,50,000 = Rs. 5,60,000
Tax on Rs. 5,60,000 = Rs. 24,500
(i.e. 5% of Rs. 2,50,000 plus 20% of Rs. 60,000)

Step 3 : Rs. 80,500 – Rs. 24,500 = Rs. 56,000

Step 4 & 5 : Total tax payable = Rs. 56,000
= Rs. 56,000 + 4% of Rs. 56,000 = Rs. 58,240.

(b) Computation of tax liability (age 70 years)

For the purpose of partial integration of taxes, Mr. X has satisfied both the conditions i.e.
1. Net agricultural income exceeds Rs. 5,000 p.a., and
2. Non-agricultural income exceeds the basic exemption limit of Rs. 3,00,000.

His tax liability is computed in the following manner:

Step 1 : Rs. 5,30,000 + Rs. 3,10,000 = Rs. 8,40,000.
Tax on Rs. 8,40,000 = Rs. 78,000
(i.e. 5% of Rs. 2,00,000 plus 20% of Rs. 3,40,000)

Step 2 : Rs. 3,10,000 + Rs. 3,00,000 = Rs. 6,10,000.
Tax on Rs. 6,10,000 = Rs. 32,000
(i.e. 5% of Rs. 2,00,000 plus 20% of Rs. 1,10,000)

Step 3 : Rs. 78,000 – Rs. 32,000 = Rs. 46,000

Step 4 & 5 : Total tax payable = Rs. 46,000 = Rs. 46,000 + 4% of Rs. 46,000
= Rs. 47,840.

Illustration 4

An amount of Rs. 5 lacs was paid on 17.3.2020 to the parents of Amit by the Government of Chattisgarh as compensation to the aggrieved family, whose only son Amit lost his life in Maoist local bus bomb blast in Dantewada.

Examine with reasons, whether the amount of compensation received is chargeable to tax in A.Y. 2020-21?
Solution
As per section 10(10BC), the meaning of “disaster” shall be derived from Disaster Management Act, 2005 which defines disaster to mean a catastrophe, mishap, calamity or grave occurrence in any area, arising from natural or manmade causes, or by accident or negligence. It should have the effect of causing substantial loss of life or human suffering or damage to, and destruction of property, or damage to, or degradation of environment. It should be of such a nature or magnitude to be beyond the coping capacity of the community of the affected area.
If, for this reason, any compensation is paid by the Central Government or by a State Government or by a local authority, then the same will be exempt from tax. Accordingly, the amount of Rs. 5 Lacs received by the parents of deceased Amit from the Government of Chattisgarh for the disaster because of Dantewada bus bomb blast is exempt under section 10(10BC).

Illustration 5
Ms. J, a Sikkimese woman, married Mr. K, a non-Sikkimese, on 1st January, 2008. During the previous year 2019-20, she received rent of Rs. 12 lacs from letting out of house properties situated in the State of Sikkim. Is she liable to income-tax for assessment year 2020-21? Will your answer be different, if she had married Mr. K on 16th April, 2008?

Solution
Section 10(26AAA) provides that the following income, which accrues or arises to a Sikkimese individual, shall be exempt from income-tax:
(a) Income from any source in the State of Sikkim; and
(b) Income by way of dividend or interest on securities.
However, the aforesaid exemption will not be available to a Sikkimese woman, who marries a non-Sikkimese individual on or after 1st April, 2008.
Since Ms. J, the assessee, married Mr. K on 1st January, 2008, income derived by her by way of rent from properties situated in the State of Sikkim shall be exempt under section 10(26AAA).
However, if she had married Mr. K on 16th April, 2008, the exemption would not be available.
Note: The restriction in section 10(26AAA) applies only to Sikkimese women and not to men who are eligible for the exemption in respect of the above said incomes regardless of their marrying Sikkimese or non-Sikkimese women.

Illustration 6
Y Ltd. furnishes you the following information for the year ended 31.3.2020:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs. (in lacs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total turnover of Unit A located in SEZ</td>
<td>100</td>
</tr>
<tr>
<td>Profit of the business of Unit A</td>
<td>30</td>
</tr>
<tr>
<td>Export turnover of Unit A</td>
<td>50</td>
</tr>
<tr>
<td>Total turnover of Unit B located in DTA</td>
<td>200</td>
</tr>
<tr>
<td>Profit of the business of Unit B</td>
<td>20</td>
</tr>
</tbody>
</table>

Compute deduction under section 10AA for the A.Y. 2020-21, assuming that Y Ltd. commenced operations in SEZ and DTA in the year 2016-17.
Solution

100% of the profit derived from export of articles or things or services is eligible for deduction under section 10AA, assuming that F.Y. 2019-20 falls within the first five year period commencing from the year of manufacture or production of articles or things or provision of services by the Unit in SEZ. As per section 10AA(7), the profit derived from export of articles or things or services shall be the amount which bears to the profits of the business of the undertaking, being the Unit, the same proportion as the export turnover in respect of articles or things or services bears to the total turnover of the business carried on by the undertaking.

Deduction under section 10AA

\[
\text{Deduction under section 10AA} = \text{Profit of the business of Unit A} \times \frac{\text{Export Turnover of Unit A}}{\text{Total Turnover of Unit A}}
\]

\[
= \text{Rs. 30 lakhs} \times \frac{50}{100}
\]

= Rs. 15 lakhs

Note – No deduction under section 10AA is allowable in respect of profits of business of Unit B located in DTA.

***************************************************************************
EXERCISE

Question 1
Examine the correctness or otherwise of the following case in the context of provisions contained in the Income-tax Act, 1961 relevant/applicable for the assessment year 2020-21:

(i) Nargis, working as Regional Area Sales Manager of Pincer Marketing Ltd., was paid salary and a commission based as a percentage on the volume of sales effected by her. Nargis claimed the expenses incurred by her for earning the commission in the return of income, which were disallowed by the Assessing Officer.

(ii) An amount of Rs. 12,50,000 paid by XYZ Ltd., after approval by the board, to a hospital in UK for the heart surgery of its managing director was charged under medical expenses. The Assessing Officer, while completing the assessment of the company, taxed the amount so paid by the company as a perquisite in the hands of its Managing Director.

Answer

(i) The facts of this case are similar to the case decided by the Madras High Court in CIT v. R. Rajendran (2003) 260 ITR 0476, where it was held that since the assessee was employed as a regional sales manager and the commission paid to him is based on the volume of sales effected, such commission was obviously paid to the employee as an encouragement to effect a higher level of sales. The commission paid in addition to what the employee was getting as a fixed salary would also constitute/ form part of salary. When the commission is chargeable as salary, then no deduction is allowable in respect of any expenditure incurred to earn the commission.

Therefore, in this case, the claim made by Nargis is not valid and the expenses incurred for earning commission are not allowable as deduction while computing her salary income.

(ii) A Managing Director generally occupies the dual capacity of being a director as well as an employee of the company. In this case, assuming that the Managing Director is also an employee of XYZ Ltd., clause (vi) of the proviso to section 17(2) would get attracted. Clause (vi) of the proviso to section 17(2) provides that any expenditure incurred by the employer on medical treatment of the employee outside India shall be excluded from perquisite only to the extent permitted by RBI. Therefore, the expenditure on medical treatment of the Managing Director outside India shall be excluded from perquisite to the extent permitted by RBI as per clause (vi) of the proviso to section 17(2). If it is assumed that the entire amount is permitted by RBI, there would be no perquisite chargeable in the hands of the Managing Director. Therefore, in such a case, the action of the Assessing Officer in taxing the entire amount paid by the company as a perquisite in the hands of the Managing Director is incorrect.

This question can also be answered by applying the rationale of the Allahabad High Court ruling in CIT v. D.P. Kanodia (2008) 296 ITR 0616. In that case, the High Court observed that the reimbursement by the company of medical expenditure incurred outside India by the director cannot be considered as an amenity or benefit provided by the company to its director, and therefore the provisions of section
17(2)(iii)(a) would not be attracted. Therefore, such reimbursement was not a perquisite within the meaning of section 17(2)(iii)(a).

Hence, applying the rationale of the above case to the facts of this case, the action of the Assessing Officer in taxing the amount paid by the company as a perquisite in the hands of the Managing Director is incorrect.

Question 2
Mr. X is a Member of Legislative Assembly. He underwent an open heart surgery abroad in respect of which he received Rs. 5 Lacs from the State Government towards reimbursement of his medical expenses. The Assessing Officer contended that such amount is taxable as a perquisite under section 17. Examine the correctness of the contention of the Assessing Officer.

Answer
The facts of this case are similar to the facts in CIT v. Shiv Charan Mathur (2008) 306 ITR 126 (Raj.). In the instant case, the High Court observed that MPs and MLAs do not fall within the meaning of “employees”. They are elected by the public, their election constituencies and it is consequent upon such election that they acquire constitutional position and are in charge of constitutional functions and obligations. The remuneration received by them, after swearing in, cannot be said to be salary within the meaning of section 15, since the basic ingredient of employer-employee relationship is missing in such cases.

Therefore, the remuneration received by MPs and MLAs is taxable under the head “Income from Other Sources” and not under the head “Salaries”. When the provisions of section 15 are not attracted to the remuneration received by MPs and MLAs, the provisions of section 17 also would not apply as section 17 only extends the definition of salary by providing that certain items mentioned therein would be included in salary as “perquisites”. Thus, reimbursement of medical expenditure (incurred for open heart surgery abroad) to an MLA cannot be taxed as a perquisite under section 17.

Applying the above ruling to the case on hand, the contention of the Assessing Officer is not correct.

Question 3
Mr. Kadam is entitled to a salary of Rs. 40,000 per month. He is given an option by his employer either to take house rent allowance or a rent free accommodation which is owned by the company. The HRA amount payable was Rs. 7,000 per month. The rent for the hired accommodation was Rs. 6,000 per month at New Delhi. Advice Mr. Kadam whether it would be beneficial for him to avail HRA or Rent Free Accommodation. Give your advice on the basis of “Net Take Home Cash benefits”.

Answer

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Option I – HRA (Rs.)</th>
<th>Option II – RFA (Rs.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Basic Salary (Rs. 40,000 × 12 Months)</td>
<td>4,80,000</td>
<td>4,80,000</td>
</tr>
<tr>
<td>Perquisite value of rent-free accommodation (15% of Rs. 4,80,000)</td>
<td>N.A.</td>
<td>72,000</td>
</tr>
<tr>
<td>House rent Allowance (Rs. 7,000 × 12 Months)</td>
<td>Rs. 84,000</td>
<td></td>
</tr>
</tbody>
</table>
Less: Exempt u/s 10(13A) – least of the following -
- 50% of Basic Salary Rs. 2,40,000
- Actual HRA received Rs. 84,000
- Rent less 10% of salary Rs. 24,000 Rs. 24,000

| Gross Salary | 5,40,000 | 5,52,000 |
| Net Salary | 50,000 | 50,000 |
| Total Income | 4,90,000 | 5,02,000 |
| Tax on total income | 12,000 | 12,900 |
| Less: Rebate u/s 87A – Lower of Rs. 12,500 or income-tax of Rs. 12,000, since total income does not exceed Rs. 5,00,000 | Nil | 12,900 |
| Add: Health and Education cess@4% | Nil | 516 |
| Total tax payable | Nil | 13,416 |
| Tax Payable (Rounded off) | Nil | 13,420 |

**Cash Flow Statement**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Option I – HRA</th>
<th>Option II – RFA</th>
</tr>
</thead>
<tbody>
<tr>
<td>Inflow: Salary</td>
<td>5,64,000</td>
<td>4,80,000</td>
</tr>
<tr>
<td>Less: Outflow: Rent paid</td>
<td>(72,000)</td>
<td>-</td>
</tr>
<tr>
<td>Tax on total income</td>
<td>Nil</td>
<td>(13,420)</td>
</tr>
<tr>
<td>Net Inflow</td>
<td>4,92,000</td>
<td>4,66,580</td>
</tr>
</tbody>
</table>

Since the net cash inflow under option I (HRA) is higher than in Option II (RFA), it is beneficial for Mr. Kadam to avail Option I, i.e., House Rent Allowance.

**Question 4**

Mr. M is working with MNO Limited for the last 10 years. He was granted an option on 1.7.2017 by the company to purchase 800 equity shares at a price of Rs. 250 per share. The period during which the option can be exercised to purchase 800 shares at a predetermined price of Rs. 250 per share commencing on 1.7.2017 and ending on 31.3.2019. Mr. M exercised the option on 15.3.2019 to purchase 500 shares. Fair market value on the said date was Rs. 6490 on the Bombay Stock Exchange and Rs. 6500 on the National Stock Exchange. The NSE has recorded the higher volume of trading in that share.

The company has allotted him 500 shares on 24th April, 2019. The fair market value on the date of allotment was Rs. 7100 per share on NSE and Rs. 7110 on the BSE that has recorded the higher volume of trading in that share. The option was granted for making available rights in the nature of intellectual property rights.

Determine the taxability of perquisite. Does it make any difference if the option was granted for providing technical know-how?

**Answer**

The perquisite of sweat equity shares shall be taxable in the previous year 2019-20 (assessment year 2020-21), being the previous year of allotment of such shares. The value of sweat equity shares shall be the fair market value of such shares on the date on which the option is exercised by the assessee, as reduced by any amount actually paid by, or recovered from, the assessee in respect of such shares.
As per Rule 3(8) of the Income-tax Rules, 1962, the fair market value of a share on the date of exercising the option shall be the price of the share on the recognized stock exchange which records the highest volume of trading in such shares, in case the shares are listed on more than one recognised stock exchange.

Hence, the value of taxable perquisite for sweat equity shares

= FMV on the date of exercising the option on the NSE (since it recorded higher volume that BSE) - Amount recovered from the employee

= (500 × Rs. 6500) - (500 × Rs. 250)

= Rs. 32,50,000 - Rs. 1,25,000 = Rs. 31,25,000

As per section 17(2)(vi), “sweat equity shares” means equity shares issued by a company to its employees or directors at a discount or for consideration other than cash for providing technical knowhow or making available rights in the nature of intellectual property rights or value additions, by whatever name called.

Therefore, this provision is equally applicable whether the sweat equity shares option was granted for making available rights in the nature of intellectual property rights or for providing technical know-how.

**Question 5**

Ajay is employed as senior executive of Manu Ltd. Manu Ltd offers rights to its existing shareholders in the ratio 1:1 on 15th February 2020 at Rs. 150 per share. Ajay was offered 500 shares at Rs. 150, which he exercised. On these facts, you are consulted by Ajay as to:

(a) The tax consequences for the assessment year 2020-21 assuming that fair market value on the date of exercise of option is Rs. 300.

(b) If Ajay is already a shareholder of 250 shares, allotted in public issue will it make any difference?

**Answer**

(a) As per section 17(2)(vi), the value of any specified security or sweat equity shares allotted or transferred, directly or indirectly, by the employer, or former employer, free of cost or at concessional rate to the assessee employee is taxable as perquisite. The meaning of the terms ‘specified security’, ‘sweat equity shares’, ‘fair market value’ are dealt with in the Explanation given therein.

The fair market value of the shares so determined in accordance with the method as may be prescribed less the amount actually recovered from the employee, shall be the value of perquisite chargeable to tax.

The value of perquisite would be:

<table>
<thead>
<tr>
<th>Description</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fair market value of shares determined as per the prescribed method in Income- tax Rules, 1962 = 500 shares @ Rs. 300 each</td>
<td>150,000</td>
</tr>
<tr>
<td>Less: Amount recovered from the employee = 500 shares @ Rs. 150 per share</td>
<td>75,000</td>
</tr>
<tr>
<td><strong>Value of perquisite chargeable to tax</strong></td>
<td>75,000</td>
</tr>
</tbody>
</table>

As per section 49(2AA), the cost of acquisition of specified security or sweat equity shares referred to in section 17(2)(vi) shall be the fair market value which has been taken into account for the purpose of perquisite valuation.
(b) In case the employee is a shareholder and was allotted shares in the same manner as was allotted to other shareholders by the company without any concession/reduction in value then the question of valuation of perquisite would not arise.

**ADDITIONAL ILLUSTRATIONS FOR PRACTICE:**

**Illustration 1**

Mr. Raj Kumar has the following receipts from his employer:

<table>
<thead>
<tr>
<th></th>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Basic pay</td>
<td>Rs. 3,000p.m.</td>
</tr>
<tr>
<td>2</td>
<td>Dearness allowance (D.A.)</td>
<td>Rs. 600 p.m.</td>
</tr>
<tr>
<td>3</td>
<td>Commission</td>
<td>Rs. 6,000 p.a.</td>
</tr>
<tr>
<td>4</td>
<td>Motor car for personal use (expenditure met by the employer)</td>
<td>Rs. 500 p.m</td>
</tr>
<tr>
<td>5</td>
<td>House rent allowance</td>
<td>Rs. 900 p.m.</td>
</tr>
</tbody>
</table>

Find out the amount of HRA eligible for exemption to Mr. Raj Kumar assuming that he paid a rent of Rs. 1,000 p.m. for his accommodation at Kanpur. DA forms part of salary for retirement benefits.

**Solution**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>HRA received</td>
<td>Rs. 10,800</td>
</tr>
<tr>
<td>Less: Exempt under section 10(13A)</td>
<td>Rs. 7,680</td>
</tr>
<tr>
<td>Taxable HRA</td>
<td>Rs. 3,120</td>
</tr>
</tbody>
</table>

**Note:** Exemption shall be least of the following three limits:

(a) the actual amount received (Rs. 900 × 12) = Rs. 10,800

(b) excess of the actual rent paid by the assessee over 10% of his salary

= Rent Paid - 10% of salary for the relevant period

= (Rs. 1,000×12) - 10% of [(Rs. 3,000+Rs. 600)×12] = Rs. 12,000 - Rs. 4,320 = Rs. 7,680

(c) 40% salary as his accommodation is situated at Kanpur

= 40% of [(Rs. 3,000+Rs. 600)×12] = Rs. 17,280

**Note:** For the purpose of exemption under section 10(13A), salary includes dearness allowance only when the terms of employment so provide but excludes all other allowances and perquisites.

**Illustration 2**

Mr. Mohit is employed with XY Ltd. on a basic salary of Rs. 10,000 p.m. He is also entitled to dearness allowance @ 100% of basic salary, 50% of which is included in salary as per terms of employment. The company gives him house rent allowance of Rs. 6,000 p.m. which was increased to Rs. 7,000 p.m. with effect from 1.01.2020. He also got an increment of Rs. 1,000 p.m. in his basic salary with effect from 1.02.2020. Rent paid by him during the previous year 2019-20 is as under:

- April and May, 2019 - Nil, as he stayed with his parents
- June to October, 2019 - Rs. 6,000 p.m. for an accommodation in Ghaziabad
- November, 2019 to March, 2020 - Rs. 8,000 p.m. for an accommodation in Delhi.

Compute his gross salary for assessment year 2020-21.
Solution

### Computation of gross salary of Mr. Mohit for A.Y. 2020-21

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Basic salary [(Rs. 10,000 \times 10) + (Rs. 11,000 \times 2)]</td>
<td>1,22,000</td>
</tr>
<tr>
<td>Dearness Allowance (100% of basic salary)</td>
<td>1,22,000</td>
</tr>
<tr>
<td>House Rent Allowance (See Note below)</td>
<td>21,300</td>
</tr>
<tr>
<td><strong>Gross Salary</strong></td>
<td><strong>2,65,300</strong></td>
</tr>
</tbody>
</table>

**Note:** Computation of Taxable House Rent Allowance (HRA)

<table>
<thead>
<tr>
<th>Particulars</th>
<th>April-May (Rs.)</th>
<th>June-Oct (Rs.)</th>
<th>Nov-Dec (Rs.)</th>
<th>Jan (Rs.)</th>
<th>Feb-March (Rs.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Basic salary per month</td>
<td>10,000</td>
<td>10,000</td>
<td>10,000</td>
<td>10,000</td>
<td>11,000</td>
</tr>
<tr>
<td>Dearness allowance (included in salary as per terms of employment) (50% of basic salary)</td>
<td>5,000</td>
<td>5,000</td>
<td>5,000</td>
<td>5,000</td>
<td>5,500</td>
</tr>
<tr>
<td>Salary per month for the purpose of computation of house rent allowance</td>
<td>15,000</td>
<td>15,000</td>
<td>15,000</td>
<td>15,000</td>
<td>16,500</td>
</tr>
<tr>
<td>Relevant period (in months)</td>
<td>2</td>
<td>5</td>
<td>2</td>
<td>1</td>
<td>2</td>
</tr>
<tr>
<td>Salary for the relevant period (Salary per month × relevant period)</td>
<td>30,000</td>
<td>75,000</td>
<td>30,000</td>
<td>15,000</td>
<td>33,000</td>
</tr>
<tr>
<td>Rent paid for the relevant period</td>
<td>Nil</td>
<td>30,000</td>
<td>(Rs. 8,000 × 5)</td>
<td>8,000</td>
<td>(Rs. 8,000 × 2)</td>
</tr>
<tr>
<td>House rent allowance (HRA) received during the relevant period (A)</td>
<td>12,000</td>
<td>30,000</td>
<td>12,000</td>
<td>7,000</td>
<td>14,000</td>
</tr>
<tr>
<td>Least of the following is exempt [u/s 10(13A)]</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. Actual HRA received</td>
<td>12,000</td>
<td>30,000</td>
<td>12,000</td>
<td>7,000</td>
<td>14,000</td>
</tr>
<tr>
<td>2. Rent paid – 10% of salary</td>
<td>N.A.</td>
<td>22,500</td>
<td>13,000</td>
<td>6,500</td>
<td>12,700</td>
</tr>
<tr>
<td>3. 40% of salary (Residence at Ghaziabad–June to Oct, 2017)</td>
<td>N.A.</td>
<td>30,000</td>
<td>15,000</td>
<td>7,500</td>
<td>16,500</td>
</tr>
<tr>
<td>50% of salary (Residence at Delhi–Nov’17-March’18)</td>
<td>N.A.</td>
<td>(40% × Rs. 75,000)</td>
<td>(50% × Rs. 30,000)</td>
<td>(50% × Rs. 15,000)</td>
<td>(50% × Rs. 33,000)</td>
</tr>
<tr>
<td>Exempt HRA (B)</td>
<td>Nil</td>
<td>22,500</td>
<td>12,000</td>
<td>6,500</td>
<td>12,700</td>
</tr>
<tr>
<td>Taxable HRA (Actual HRA – Exempt HRA) (A-B)</td>
<td>12,000</td>
<td>7,500</td>
<td>Nil</td>
<td>500</td>
<td>1,300</td>
</tr>
</tbody>
</table>

Taxable HRA (total) = Rs. 12,000 + Rs. 7,500 + Rs. 500 + Rs. 1,300 = Rs. 21,300

**Illustration 3**

Mr. Srikant has two sons. He is in receipt of children education allowance of Rs. 150 p.m. for his elder son and Rs. 70 p.m. for his younger son. Both his sons are going to school. He also receives the following allowances:

- **Transport allowance**: Rs. 1,800 p.m.
Tribal area allowance : Rs. 500 p.m.
Compute his taxable allowances.

Solution
Taxable allowance in the hands of Mr. Srikant is computed as under -

<table>
<thead>
<tr>
<th>Allowance</th>
<th>Calculation</th>
<th>Allowance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Children Education Allowance:</td>
<td></td>
<td>Rs. 600</td>
</tr>
<tr>
<td>Elder son [(Rs. 150 – Rs. 100) p.m. × 12 months] =</td>
<td></td>
<td>Rs. 600</td>
</tr>
<tr>
<td>Younger son [(Rs. 70 – Rs. 70) p.m. × 12 months] =</td>
<td>Nil</td>
<td>Rs. 600</td>
</tr>
<tr>
<td>Transport allowance [(Rs. 1,800 × 12 months] =</td>
<td></td>
<td>Rs. 21,600</td>
</tr>
<tr>
<td>Tribal area allowance [(Rs. 500 – Rs. 200) p.m. × 12 months] =</td>
<td></td>
<td>Rs. 3,600</td>
</tr>
<tr>
<td><strong>Taxable allowances</strong></td>
<td></td>
<td><strong>Rs. 25,800</strong></td>
</tr>
</tbody>
</table>

Illustration 4
Ayush, an employee of a management consultancy firm, was sent to UK in connection with a project of the firm's client for two months in the previous year. In addition to his salary, the firm paid per diem allowance for the period when he worked in UK to meet expenses on boarding and lodging. Tax was not deducted at source from such allowance by the employer. Ayush did not include such allowance in computation of his taxable salary for the relevant assessment year. In course of assessment of Ayush under section 143(3), the Assessing Officer sent a notice to him asking him to explain why the per diem allowance received by him should not be charged to tax? Ayush has sought your advice.

Solution
Per-diem allowance is exempt from tax under section 10(14)(i) read with Rule 2BB, as it is an allowance granted and spent to meet the ordinary daily charges incurred by an employee on account of absence from his normal place of duty. Rule 2BB exempts the allowance granted to meet the ordinary daily charges incurred by an employee on account of his absence from his normal place of duty.

In the given case, Mr. Ayush was posted for a period of 2 months outside his normal place of duty and the allowance was paid to meet the boarding and lodging. Therefore, the allowance would fall under section 10(14)(i) read with Rule 2BB and would hence be exempt, assuming that expenditure to that extent was actually incurred for his boarding and lodging.

Illustration 5
Mr. Sagar retired on 1.10.2019 receiving Rs. 5,000 p.m. as pension. On 1.2.2020, he commuted 60% of his pension and received Rs. 3,00,000 as commuted pension. You are required to compute his taxable pension assuming:

a. He is a government employee.

b. He is a non-government employee, receiving gratuity of Rs. 5,00,000 at the time of retirement.

c. He is a non-government employee and is not in receipt of gratuity at the time of retirement.
Solution

(a) He is a government employee.

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Uncommuted pension received (October – March)</td>
<td>Rs. 24,000</td>
</tr>
<tr>
<td>[((\text{Rs.} , 5,000 \times 4 \text{ months}) + (40% \text{ of } \text{Rs.} , 5,000 \times 2 \text{ months}))]</td>
<td></td>
</tr>
<tr>
<td>Commuted pension received</td>
<td>Rs. 3,00,000</td>
</tr>
<tr>
<td>Less: Exempt u/s 10(10A)</td>
<td>Rs. 3,00,000</td>
</tr>
<tr>
<td>Taxable pension</td>
<td>Rs. 24,000</td>
</tr>
</tbody>
</table>

(b) He is a non-government employee, receiving gratuity Rs. 5,00,000 at the time of retirement.

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Uncommuted pension received (October – March)</td>
<td>Rs. 24,000</td>
</tr>
<tr>
<td>[((\text{Rs.} , 5,000 \times 4 \text{ months}) + (40% \text{ of } \text{Rs.} , 5,000 \times 2 \text{ months}))]</td>
<td></td>
</tr>
<tr>
<td>Commuted pension received</td>
<td>Rs. 3,00,000</td>
</tr>
<tr>
<td>Less: Exempt u/s 10(10A)</td>
<td>Rs. 1,66,667</td>
</tr>
<tr>
<td>Taxable pension</td>
<td>Rs. 1,33,333</td>
</tr>
</tbody>
</table>

(c) He is a non-government employee and is not in receipt of gratuity at the time of retirement.

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Uncommuted pension received (October – March)</td>
<td>Rs. 24,000</td>
</tr>
<tr>
<td>[((\text{Rs.} , 5,000 \times 4 \text{ months}) + (40% \text{ of } \text{Rs.} , 5,000 \times 2 \text{ months}))]</td>
<td></td>
</tr>
<tr>
<td>Commuted pension received</td>
<td>Rs. 3,00,000</td>
</tr>
<tr>
<td>Less: Exempt u/s 10(10A)</td>
<td>Rs. 2,50,000</td>
</tr>
<tr>
<td>Taxable pension</td>
<td>Rs. 74,000</td>
</tr>
</tbody>
</table>

Illustration 6

Mr. Ravi retired on 15.6.2019 after completion of 26 years 8 months of service and received gratuity of Rs. 6,00,000. At the time of retirement, his salary was:

- Basic Salary : Rs. 5,000 p.m.
- Dearness Allowance : Rs. 3,000 p.m. (60% of which is for retirement benefits)
- Commission : 1% of turnover (turnover in the last 12 months was Rs. 12,00,000)
- Bonus : Rs. 12,000 p.a.

Compute his taxable gratuity assuming:

(a) He is non-government employee and covered by the Payment of Gratuity Act 1972.
(b) He is non-government employee and not covered by Payment of Gratuity Act 1972.
(c) He is a Government employee.

Solution

(a) He is covered by the Payment of Gratuity Act 1972.

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gratuity received at the time of retirement</td>
<td>Rs. 6,00,000</td>
</tr>
<tr>
<td>Less: Exemption under section 10(10)</td>
<td></td>
</tr>
</tbody>
</table>
Least of the following:

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>i. Gratuity received</td>
<td>Rs. 6,00,000</td>
</tr>
<tr>
<td>ii. Statutory limit</td>
<td>Rs. 20,00,000</td>
</tr>
<tr>
<td>iii. 15 days salary based on last drawn salary for each completed year of service or part thereof in excess of 6 months</td>
<td>Rs. 1,24,615</td>
</tr>
</tbody>
</table>

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>$rac{15}{26} \times$ last drawn salary $\times$ years of service</td>
<td>Rs. 1,24,615</td>
</tr>
<tr>
<td>$rac{15}{26} \times (Rs. 5,000 + Rs. 3,000) \times 27$</td>
<td>Rs. 1,24,615</td>
</tr>
</tbody>
</table>

Taxable Gratuity | Rs. 4,75,385 |

(b) **He is not covered by the Payment of Gratuity Act 1972.**

Gratuity received at the time of retirement | Rs. 6,00,000 |
Less: Exemption under section 10(10) (Note) | Rs. 1,01,400 |
**Taxable Gratuity** | Rs. 4,98,600 |

*Note:* Exemption under section 10(10) is least of the following:

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>i. Gratuity received</td>
<td>Rs. 6,00,000</td>
</tr>
<tr>
<td>ii. Statutory limit</td>
<td>Rs. 20,00,000</td>
</tr>
<tr>
<td>iii. Half month’s salary based on average salary of last 10 months preceding the month of retirement for each completed year of service.</td>
<td></td>
</tr>
</tbody>
</table>

i.e. $\frac{1}{2} \times $ Average salary $\times$ years of service

$$= \frac{1}{2} \times \left[ \frac{(5,000 \times 10) + (3,000 \times 60\% \times 10) + (1\% \times 12,00,000 \times \frac{10}{12})}{10} \right] \times 26$$

$$= Rs. 1,01,400$$

(c) **He is a government employee**

Gratuity received at the time of retirement | Rs. 6,00,000 |
Less : Exemption under section 10(10) | Rs. 6,00,000 |
**Taxable gratuity** | Nil |

**Illustration 7**

Mr. Gupta retired on 1.12.2019 after 20 years 10 months of service, receiving leave salary of Rs. 5,00,000. Other details of his salary income are:

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Basic Salary</td>
<td>Rs. 5,000 p.m. (Rs. 1,000 was increased w.e.f. 1.4.2019)</td>
</tr>
<tr>
<td>Dearness Allowance</td>
<td>Rs. 3,000 p.m. (60% of which is for retirement benefits)</td>
</tr>
<tr>
<td>Commission</td>
<td>Rs. 500 p.m.</td>
</tr>
<tr>
<td>Bonus</td>
<td>Rs. 1,000 p.m.</td>
</tr>
</tbody>
</table>

Leave availed during service : 480 days

He was entitled to 30 days leave every year.

You are required to compute his taxable leave salary assuming:

(a) **He is a government employee.**
(b) He is a non government employee.

Solution

(a) He is a government employee.

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Leave Salary received at the time of retirement</td>
<td>Rs. 5,00,000</td>
</tr>
<tr>
<td>Less : Exemption under section 10(10AA)</td>
<td>Rs. 5,00,000</td>
</tr>
<tr>
<td>Taxable Leave salary</td>
<td>Nil</td>
</tr>
</tbody>
</table>

(b) He is a non-government employee

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Leave Salary received at the time of retirement</td>
<td>Rs. 5,00,000</td>
</tr>
<tr>
<td>Less : Exempt under section 10(10AA) [See Note below]</td>
<td>Rs. 26,400</td>
</tr>
<tr>
<td>Taxable Leave Salary</td>
<td>Rs. 4,73,600</td>
</tr>
</tbody>
</table>

Note: Exemption under section 10(10AA) is least of the following:

(i) Leave salary received                                                   Rs. 5,00,000
(ii) Statutory limit                                                        Rs. 3,00,000
(iii) 10 months salary based on average salary of last 10 months

\[
\text{Leavedue (in days) } \times \frac{\text{Average salary p.m}}{30 \text{ days}} = \left[ 10 \times \frac{\text{Salary of last 10 months i.e. Feb - Nov}}{10 \text{ months}} \right]
\]

\[
= \left[ 10 \times \frac{(5000 \times 8) + (4000 \times 2) + 60\% \times 3000 \times 10}{10 \text{ months}} \right]
\]

\[
= \text{Rs. 66,000}
\]

(iv) Cash equivalent of leave standing at the credit of the employee based on the average salary of last 10 months (max. 30 days per year of service)

\[
\text{Leave Due} = \text{Leave allowed – Leave taken}
\]

\[
= (30 \text{ days per year } \times 20 \text{ years } ) - 480 \text{ days}
\]

\[
= 120 \text{ days}
\]

\[
= \left[ \text{Leavedue (in days) } \times \frac{\text{Average salary p.m}}{30 \text{ days}} \right]
\]

\[
= \left[ \frac{120 \times 66,000}{30 \times 10} \right]
\]

\[
= \text{Rs. 26,400}
\]

Illustration 8

Mr. A retires from service on December 31, 2019, after 25 years of service. Following are the particulars of his income/investments for the previous year 2019-20:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Basic pay @ Rs. 16,000 per month for 9 months</td>
<td>1,44,000</td>
</tr>
<tr>
<td>Darness pay (50% forms part of the retirement benefits) Rs. 8,000 per month for 9 months</td>
<td>72,000</td>
</tr>
<tr>
<td>Lumpsum payment received from the Unrecognized Provident Fund</td>
<td>6,00,000</td>
</tr>
<tr>
<td>Deposits in the PPF account</td>
<td>40,000</td>
</tr>
</tbody>
</table>

Out of the amount received from the unrecognized provident fund, the employer’s contribution was Rs. 2,20,000 and the interest thereon Rs. 50,000. The employee’s contribution was Rs. 2,70,000 and the interest thereon Rs. 60,000. What is the taxable portion of the amount...
received from the unrecognized provident fund in the hands of Mr. A for the assessment year 2020-21?

Solution
Taxable portion of the amount received from the URPF in the hands of Mr. A for the A.Y. 2020-21 is computed hereunder:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Amount taxable under the head “Salaries”:</strong></td>
<td></td>
</tr>
<tr>
<td>Employer’s share in the payment received from the URPF</td>
<td>2,20,000</td>
</tr>
<tr>
<td>Interest on the employer’s share</td>
<td>50,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>2,70,000</td>
</tr>
<tr>
<td><strong>Amount taxable under the head “Income from Other Sources”:</strong></td>
<td></td>
</tr>
<tr>
<td>Interest on the employee’s share</td>
<td>60,000</td>
</tr>
<tr>
<td><strong>Total amount taxable from the amount received from the fund</strong></td>
<td>3,30,000</td>
</tr>
</tbody>
</table>

Note: Since the employee is not eligible for deduction under section 80C for contribution to URPF at the time of such contribution, the employee’s share received from the URPF is not taxable at the time of withdrawal as this amount has already been taxed as his salary income.

Illustration 9
*Will your answer be any different if the fund mentioned above was a recognised provident fund?*

Solution
Since the fund is a recognised one, and the maturity is taking place after a service of 25 years, the entire amount received on the maturity of the RPF will be fully exempt from tax.

Illustration 10
*Mr. B is working in XYZ Ltd. and has given the details of his income for the P.Y. 2019-20. You are required to compute his gross salary from the details given below:*  
| Basic Salary | Rs. 10,000 p.m. |
| D.A. (50% is for retirement benefits) | Rs. 8,000 p.m. |
| Commission as a percentage of turnover | 0.1% |
| Turnover during the year | Rs. 50,00,000 |
| Bonus | Rs. 40,000 |
| Gratuity | Rs. 25,000 |
| His own contribution in the RPF | Rs. 20,000 |
| Employer’s contribution to RPF | 20% of his basic salary |
| Interest accrued in the RPF @ 13% p.a. | Rs. 13,000 |

Solution
*Computation of Gross Salary of Mr. B for the A.Y. 2020-21*

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Basic Salary [ Rs. 10,000 × 12]</td>
<td>1,20,000</td>
</tr>
<tr>
<td>Dearness Allowance [Rs. 8,000 × 12]</td>
<td>96,000</td>
</tr>
<tr>
<td>Commission on turnover [0.1% × Rs. 50,00,000]</td>
<td>5,000</td>
</tr>
<tr>
<td>Bonus</td>
<td>40,000</td>
</tr>
<tr>
<td>Gratuity [Note 1]</td>
<td>25,000</td>
</tr>
<tr>
<td>Employee’s contribution to RPF [Note 2]</td>
<td>-</td>
</tr>
</tbody>
</table>
Employers contribution to RPF [20% of Rs. 1,20,000] 24,000
Less : Exempt [Note 3] 20,760 3,240
Interest accrued in the RPF @ 13% p.a. 13,000
Less : Exempt @ 9.5% p.a. 9,500 3,500
Gross Salary 2,92,740

Note 1: Gratuity received during service is fully taxable.
Note 2: Employee’s contribution to RPF is not taxable. It is eligible for deduction under section 80C.
Note 3: Employers contribution in the RPF is exempt up to 12% of the salary.
i.e., 12% of [Basic Salary + Dearness Allowance forming part of retirement benefits + Commission based on turnover] = 12% of [Rs. 1,20,000 + (50% × Rs. 96,000) + Rs. 5,000] = 12% of Rs. 1,73,000 = Rs. 20,760

Illustration 11
Mr. Dutta received voluntary retirement compensation of Rs. 7,00,000 after 30 years 4 months of service. He still has 6 years of service left. At the time of voluntary retirement, he was drawing basic salary Rs. 20,000 p.m.; Dearness allowance (which forms part of pay) Rs. 5,000 p.m. Compute his taxable voluntary retirement compensation, assuming that he does not claim any relief under section 89.

Solution
Voluntary retirement compensation received Rs. 7,00,000
Less: Exemption under section 10(10C) [See Note below] Rs. 5,00,000
Taxable voluntary retirement compensation Rs. 2,00,000

Note: Exemption is to the extent of least of the following:
(i) Compensation actually received = Rs. 7,00,000
(ii) Statutory limit = Rs. 5,00,000
(iii) Last drawn salary × 3 × completed years of service
     = (Rs. 20,000 + Rs. 5,000) × 3 × 30 years = Rs. 22,50,000
(iv) Last drawn salary × remaining months of service
     = (Rs. 20,000 + Rs. 5,000) × 6 × 12 months = Rs. 18,00,000

Illustration 12
Mr. D went on a holiday on 25.12.2019 to Delhi with his wife and three children (one son – age 5 years; twin daughters – age 2 years). They went by flight (economy class) and the total cost of tickets reimbursed by his employer was Rs. 60,000 (Rs. 45,000 for adults and Rs. 15,000 for the three minor children). Compute the amount of LTC exempt.

Solution
Since the son’s age is more than the twin daughters, Mr. D can avail exemption for all his three children. The restriction of two children is not applicable to multiple births after one child. The holiday being in India and the journey being performed by air (economy class), the entire reimbursement met by the employer is fully exempt.
Illustration 13

In the above illustration 12, will there be any difference if among his three children the twins were 5 years old and the son 3 years old? Discuss.

Solution

Since the twins’ age is more than the son, Mr. D cannot avail for exemption for all his three children. LTC exemption can be availed in respect of only two children. Taxable LTC

\[
15,000 \times \frac{1}{3} = \text{Rs. 5,000}
\]

LTC exempt is only Rs.55,000 (i.e. Rs.60,000–Rs.5,000)

Illustration 14

Compute the taxable value of the perquisite in respect of medical facilities received by Mr. G from his employer during the P.Y.2019-20:

Medical premium paid for insuring health of Mr. G  Rs. 7,000
Treatment of Mr. G by his family doctor  Rs. 5,000
Treatment of MRs. G in a Government hospital  Rs. 25,000
Treatment of Mr. G’s grandfather in a private clinic  Rs. 12,000
Treatment of Mr. G’s mother (68 years and dependant) by family doctor  Rs. 8,000
Treatment of Mr. G’s sister (dependant) in a nursing home  Rs. 3,000
Treatment of Mr. G’s brother (independent)  Rs. 6,000
Treatment of Mr. G’s father (75 years and dependant) abroad  Rs. 50,000
Expenses of staying abroad of the patient and attendant  Rs. 30,000
Limit specified by RBI  Rs. 75,000

Solution

\[
\begin{array}{|l|c|}
\hline
\text{Computation of taxable value of perquisite in the hands of Mr. G} & \text{Rs.} \\
\hline
\text{Treatment of MRs. G in a Government hospital} & 50,000 \\
\text{Treatment of Mr. G’s father (75 years and dependant) abroad} & 30,000 \\
\text{Expenses of staying abroad of the patient and attendant} & 80,000 \\
\text{Less: Exempt up to limit specified by RBI} & 75,000 \\
\text{Medical premium paid for insuring health of Mr. G} & - \\
\text{Treatment of Mr. G by his family doctor} & 5,000 \\
\text{Treatment of Mr. G’s mother (dependant) by family doctor} & 8,000 \\
\text{Treatment of Mr. G’s sister (dependant) in a nursing home} & 3,000 \\
\text{Treatment of Mr. G’s grandfather in a private clinic} & 12,000 \\
\text{Treatment of Mr. G’s brother (independent)} & 6,000 \\
\hline
\text{Taxable value of perquisite} & 39,000 \\
\hline
\end{array}
\]

Note: Grandfather and independent brother are not included within the meaning of family of Mr. G.
Illustration 15
Mr. C is a Finance Manager in ABC Ltd. The company has provided him with rent-free unfurnished accommodation in Mumbai. He gives you the following particulars:

- **Basic salary**: Rs. 6,000 p.m.
- **Dearness Allowance**: Rs. 2,000 p.m. (30% is for retirement benefits)
- **Bonus**: Rs. 1,500 p.m.

Even though the company allotted the house to him on 1.4.2019, he occupied the same only from 1.11.2019. Calculate the taxable value of the perquisite for A.Y. 2020-21.

**Solution**

Value of the rent free unfurnished accommodation

\[
= 15\% \text{ of salary for the relevant period} \\
= 15\% \left( [\text{Rs. } 6,000 \times 5] + [\text{Rs. } 2,000 \times 30\% \times 5] + [\text{Rs. } 1,500 \times 5] \right) \quad \text{[See Note below]} \\
= 15\% \text{ of } \text{Rs. } 40,500 = \text{Rs. } 6,075.
\]

**Note:** Since Mr. C occupies the house only from 1.11.2019, we have to include the salary due to him only in respect of months during which he has occupied the accommodation. Hence salary for 5 months (i.e. from 1.11.2018 to 31.03.2020) will be considered.

Illustration 16

Using the data given in the previous illustration 15, compute the value of the perquisite if Mr. C is required to pay a rent of Rs. 1,000 p.m. to the company, for the use of this accommodation.

**Solution**

First of all, we have to see whether there is a concession in the matter of rent. In the case of accommodation owned by the employer in cities having a population exceeding 25 lakh, there would be deemed to be a concession in the matter of rent if 15% of salary exceeds rent recoverable from the employee.

In this case, 15% of salary would be Rs. 6,075 (i.e. 15% of Rs. 40,500). The rent paid by the employee is Rs. 5,000 (i.e., Rs. 1,000 \times 5). Since 15% of salary exceeds the rent recovered from the employee, there is a deemed concession in the matter of rent. Once there is a deemed concession, the provisions of Rule 3(1) would be applicable in computing the taxable perquisite.

Value of the rent free unfurnished accommodation

\[
\begin{align*}
\text{Value} & = \text{Rs. } 6,075 \\
\text{Less: Rent paid by the employee (Rs. } 1,000 \times 5) & = \text{Rs. } 5,000 \\
\text{Perquisite value of unfurnished accommodation given at concessional rent} & = \text{Rs. } 1,075
\end{align*}
\]

Illustration 17

Using the data given in illustration 15, compute the value of the perquisite if ABC Ltd. has taken this accommodation on a lease rent of Rs. 1,200 p.m. and Mr. C is required to pay a rent of Rs. 1,000 p.m. to the company, for the use of this accommodation.

**Solution**

Here again, we have to see whether there is a concession in the matter of rent. In the case of accommodation taken on lease by the employer, there would be deemed to be a concession in the matter of rent if the rent paid by the employer or 15% of salary, whichever is lower, exceeds rent recoverable from the employee.
In this case, 15% of salary is Rs. 6,075 (i.e. 15% of Rs. 40,500). Rent paid by the employer is Rs. 6,000 (i.e. Rs. 1,200 × 5). The lower of the two is Rs. 6,000, which exceeds the rent paid by the employee i.e. Rs. 5,000 (Rs. 1,000 × 5). Therefore, there is a deemed concession in the matter of rent. Once there is a deemed concession, the provisions of Rule 3(1) would be applicable in computing the taxable perquisite.

<table>
<thead>
<tr>
<th>Description</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Value of the rent free unfurnished accommodation [Note]</td>
<td>Rs. 6,000</td>
</tr>
<tr>
<td>Less: Rent paid by the employee (Rs. 1,000 × 5)</td>
<td>Rs. 5,000</td>
</tr>
<tr>
<td>Value of unfurnished accommodation given at concessional rent</td>
<td>Rs. 1,000</td>
</tr>
<tr>
<td>Note: Value of the rent free unfurnished accommodation is lower of</td>
<td></td>
</tr>
<tr>
<td>(i) Lease rent paid by the company for relevant period Rs. 1,200 × 5</td>
<td>Rs. 6,000</td>
</tr>
<tr>
<td>(ii) 15% of salary for the relevant period (computed earlier)</td>
<td>Rs. 6,075</td>
</tr>
</tbody>
</table>

**Illustration 18**

*Using the data given in illustration 16, compute the value of the perquisite if ABC Ltd. has provided a television (WDV Rs. 10,000; Cost Rs. 25,000) and two air conditioners Rs. The rent paid by the company for the air conditioners is Rs. 400 p.m. each. The television was provided on 1.1.2020. However, Mr. C is required to pay a rent of Rs. 1,000 p.m. to the company, for the use of this furnished accommodation.*

**Solution**

Here again, we have to see whether there is a concession in the matter of rent. In the case of accommodation owned by the employer in a city having a population exceeding Rs. 25 lakh, there would be deemed to be a concession in the matter of rent if 15% of salary exceeds rent recoverable from the employee. In case of furnished accommodation, the excess of hire charges paid or 10% p.a. of the cost of furniture, as the case may be, over and above the charges paid or payable by the employee has to be added to the value arrived at above to determine whether there is a concession in the matter of rent.

In this case, 15% of salary is Rs. 6,075 (i.e. 15% of Rs. 40,500). Rent paid by the employee is Rs. 5,000 (i.e. Rs. 1,000 × 5). The value of furniture of Rs. 4,625 (See Note below) is to be added to 15% of salary. The deemed concession in the matter of rent is Rs. 6,075 + Rs. 4,625 = Rs. 5,000 = Rs. 5,700. Once there is a deemed concession, the provisions of Rule 3(1) would be applicable in computing the taxable perquisite.

<table>
<thead>
<tr>
<th>Description</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Value of the rent free unfurnished accommodation (computed earlier)</td>
<td>Rs. 6,075</td>
</tr>
<tr>
<td>Add: Value of furniture provided by the employer [Note]</td>
<td>Rs. 4,625</td>
</tr>
<tr>
<td>Value of rent free furnished accommodation</td>
<td>Rs. 10,700</td>
</tr>
<tr>
<td>Less: Rent paid by the employee (Rs. 1,000 × 5)</td>
<td>Rs. 5,000</td>
</tr>
<tr>
<td>Value of furnished accommodation given at concessional rent</td>
<td>Rs. 5,700</td>
</tr>
</tbody>
</table>

**Note:** Value of the furniture provided = (Rs. 400 p.m. × 2 × 5 months) + (Rs. 25,000 × 10% p.a. for 3 months) = Rs. 4,000 + Rs. 625 = Rs. 4,625

**Illustration 19**

*Using the data given in illustration 18 above, compute the value of the perquisite if Mr. C is a government employee. The licence fees determined by the Government for this accommodation was Rs. 700 p.m.*
Solution
In the case of Government employees, the excess of licence fees determined by the employer as increased by the value of furniture and fixture over and above the rent recovered/recoverable from the employee and the charges paid or payable for furniture by the employee would be deemed to be the concession in the matter of rent. Therefore, the deemed concession in the matter of rent is Rs. 3,125 [i.e. Rs. 3,500 (licence fees: Rs. 700 × 5) + Rs. 4,625 (Value of furniture) – Rs. 5,000 (Rs. 1,000 × 5)]. Once there is a deemed concession, the provisions of Rule 3(1) would be applicable in computing the taxable perquisite.

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Value of the rent free unfurnished accommodation</td>
<td>Rs. 3,500</td>
</tr>
<tr>
<td>Add: Value of furniture provided by the employer</td>
<td>Rs. 4,625</td>
</tr>
<tr>
<td>Value of rent free furnished accommodation</td>
<td>Rs. 8,125</td>
</tr>
<tr>
<td>Less: Rent paid by the employee</td>
<td>Rs. 5,000</td>
</tr>
<tr>
<td>Perquisite value of furnished accommodation</td>
<td>Rs. 3,125</td>
</tr>
</tbody>
</table>

Illustration 20
Mr. X and Mr. Y are working for M/s. Gama Ltd. As per salary fixation norms, the following perquisites were offered:

(i) For Mr. X, who engaged a domestic servant for Rs. 500 per month, his employer reimbursed the entire salary paid to the domestic servant i.e. Rs. 500 per month.
(ii) For Mr. Y, he was provided with a domestic servant @ Rs. 500 per month as part of remuneration package.

You are required to comment on the taxability of the above in the hands of Mr. X and Mr. Y, who are not specified employees.

Solution
In the case of Mr. X, it becomes an obligation which the employee would have discharged even if the employer did not reimburse the same. Hence, the perquisite will be covered under section 17(2)(iv) and will be taxable in the hands of Mr. X. This is taxable in the case of all employees.

In the case of Mr. Y, it cannot be considered as an obligation which the employee would meet. The employee might choose not to have a domestic servant. This is taxable only in the case of specified employees covered by section 17(2)(iii). Hence, there is no perquisite element in the hands of Mr. Y.

Illustration 21
Ranjit has taken an interest-free loan of Rs. 10 lacs from his company. The amount is utilized by him for purchasing a house on 30-06-2018. The house is self-occupied. As per the scheme of the company, loan would be recovered in 40 equal monthly instalments recoverable immediately after the completion of 18th month from the date of purchase. Assuming the SBI lending rate of similar loan on 1.4.2019 was 9.75%. Calculate the perquisite value of such loan in the hands of Ranjit for the assessment year 2020-21. Is it possible to get deduction of perquisite value of interest under section 24(b)? Does it make any difference, if the house is given on rent?

Solution
First instalment will be due on 1st January, 2020. Amount of instalment will be:
Rs. 10,00,000 ÷ 40 = Rs. 25,000.
Therefore, value for perquisite for interest-free loan will be calculated by applying the interest rate charged by the State Bank of India on the first day of the relevant previous year, on the outstanding amount of loan as reduced by the interest, if any, actually paid by the employee. Therefore, the value of perquisite will be as follows:

<table>
<thead>
<tr>
<th>Period</th>
<th>Value Calculation</th>
<th>Amount (Rs.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>From April 19 to Dec. 19</td>
<td>(Rs. 10,00,000 x 9.75% x 9/12)</td>
<td>73,125</td>
</tr>
<tr>
<td>For the month of Jan. 20</td>
<td>(Rs. 9,75,000 x 9.75% x 1/12)</td>
<td>7,922</td>
</tr>
<tr>
<td>For the month of Feb. 20</td>
<td>(Rs. 9,50,000 x 9.75% x 1/12)</td>
<td>7,719</td>
</tr>
<tr>
<td>For the month of Mar. 20</td>
<td>(Rs. 9,25,000 x 9.75% x 1/12)</td>
<td>7,516</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td><strong>96,282</strong></td>
</tr>
</tbody>
</table>

Therefore, the perquisite value of interest-free loan will be Rs. 96,282.

Interest on capital borrowed for the purchase, construction, re-construction, repair or renewals of house property is deductible under section 24(b). In this case, capital is borrowed from the employer without interest. There is no interest paid or payable in respect of the amount of loan of Rs. 10 lacs. Consequently, no deduction under section 24(b) would be available, whether the house is self-occupied or let out.

**Illustration 22**

Find out the taxable value of perquisite from the following particulars in case of an employee to whom the following assets held by the company were sold on 13.6.2019:

<table>
<thead>
<tr>
<th></th>
<th>Car</th>
<th>Laptop</th>
<th>Furniture</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost of Purchase (May 2016) (Rs.)</td>
<td>8,72,000</td>
<td>1,22,500</td>
<td>35,000</td>
</tr>
<tr>
<td>Sale Price (Rs.)</td>
<td>5,15,000</td>
<td>25,000</td>
<td>10,000</td>
</tr>
</tbody>
</table>

The assets transferred by the company shall be considered for the purpose of valuation of perquisites under section 17(2) of the Act read with Rules. The value of perquisite in respect of assets transferred is determined after allowing normal wear & tear for the period of use of such assets by employer.

<table>
<thead>
<tr>
<th></th>
<th>Car</th>
<th>Laptop</th>
<th>Furniture</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rate of Depreciation</td>
<td>20%</td>
<td>50%</td>
<td>10%</td>
</tr>
<tr>
<td>Basis of Depreciation</td>
<td>WDV</td>
<td>WDV</td>
<td>SLM</td>
</tr>
<tr>
<td>Cost of asset to company – May 2016</td>
<td>8,72,000</td>
<td>1,22,500</td>
<td>35,000</td>
</tr>
<tr>
<td>Less: Normal wear &amp; tear upto May, 2017</td>
<td>1,74,400</td>
<td>61,250</td>
<td>3,500</td>
</tr>
<tr>
<td>Balance, in May, 2018</td>
<td>6,97,600</td>
<td>61,250</td>
<td>31,500</td>
</tr>
<tr>
<td>Less: Sale value on 13.06.2018</td>
<td>5,15,000</td>
<td>25,000</td>
<td>10,000</td>
</tr>
<tr>
<td><strong>Value of Perquisite</strong></td>
<td><strong>43,080</strong></td>
<td><strong>5,625</strong></td>
<td><strong>18,000</strong></td>
</tr>
</tbody>
</table>

**Note:** As per Rule 3(7) of Income-tax Rules, 1962 normal wear and tear has to be calculated at the aforementioned prescribed rates applying Straight Line Method (SLM) to Furniture and Written Down Value (WDV) method to Laptop and Car.
Illustration 23

X Ltd. provided the following perquisites to its employee Mr. Y for the P.Y. 2019-20 –

1. Accommodation taken on lease by X Ltd. for Rs. 15,000 p.m. Rs. 5,000 p.m. is recovered from the salary of Mr. Y.

2. Furniture, for which the hire charges paid by X Ltd. is Rs. 3,000 p.m. No amount is recovered from the employee in respect of the same.

3. A Santro Car which is owned by X Ltd. and given to Mr. Y to be used both for official and personal purposes. All running and maintenance expenses are fully met by the employer. He is also provided with a chauffeur.

4. A gift voucher of Rs. 10,000 on his birthday.

Compute the value of perquisites chargeable to tax for the A.Y. 2020-21, assuming his salary for perquisite valuation to be Rs. 10 lakh.

Solution

Computation of the value of perquisites chargeable to tax in the hands of Mr. Y for the A.Y. 2020-21

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Amount in Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1) Value of concessional accommodation</td>
<td></td>
</tr>
<tr>
<td>Actual amount of lease rental paid by X Ltd.</td>
<td>1,80,000</td>
</tr>
<tr>
<td>15% of salary i.e., 15% of Rs. 10,00,000</td>
<td>1,50,000</td>
</tr>
<tr>
<td>Lower of the above</td>
<td>1,50,000</td>
</tr>
<tr>
<td>Less: Rent paid by Mr. Y (Rs. 5,000 × 12)</td>
<td>60,000</td>
</tr>
<tr>
<td>Add: Hire charges paid by X Ltd. for furniture provided for the use of Mr. Y (Rs. 3,000 × 12)</td>
<td>36,000</td>
</tr>
<tr>
<td>(2) Perquisite value of Santro car owned by X Ltd. and provided to Mr. Y for his personal and official use [(Rs. 1,800 + Rs. 900) × 12]</td>
<td>32,400</td>
</tr>
<tr>
<td>(3) Value of gift voucher</td>
<td>10,000</td>
</tr>
<tr>
<td><strong>Value of perquisites chargeable to tax</strong></td>
<td><strong>1,68,400</strong></td>
</tr>
</tbody>
</table>

* An alternate view possible is that only the sum in excess of Rs. 5,000 is taxable. In such a case, the value of perquisite would be Rs. 5,000

Illustration 24

Mr. Goyal receives the following emoluments during the previous year ending 31.03.2020.

Basic pay Rs. 40,000
Dearness Allowance Rs. 15,000
Commission Rs. 10,000
Entertainment allowance Rs. 4,000
Medical expenses reimbursed Rs. 25,000
Professional tax paid Rs. 2,000 (Rs. 1,000 was paid by his employer)

Mr. Goyal contributes Rs. 5,000 towards recognized provident fund. He has no other income.

Determine the income from salary for A.Y. 2020-21, if Mr. Goyal is a State Government employee.
### Solution

**Computation of salary of Mr. Goyal for the A.Y.2020-21**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Basic Salary</td>
<td>40,000</td>
<td></td>
</tr>
<tr>
<td>Dearness Allowance</td>
<td>15,000</td>
<td></td>
</tr>
<tr>
<td>Commission</td>
<td>10,000</td>
<td></td>
</tr>
<tr>
<td>Entertainment Allowance received</td>
<td>4,000</td>
<td></td>
</tr>
<tr>
<td>Employee’s contribution to RPF [Note]</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Medical expenses reimbursed</td>
<td>25,000</td>
<td></td>
</tr>
<tr>
<td>Professional tax paid by the employer</td>
<td>1,000</td>
<td></td>
</tr>
<tr>
<td><strong>Gross Salary</strong></td>
<td><strong>95,000</strong></td>
<td></td>
</tr>
</tbody>
</table>

*Less: Deductions under section 16*

- under section 16(ia) – Standard deduction of upto Rs. 50,000
- under section 16(ii) - Entertainment allowance being lower of:
  - (a) Allowance received
  - (b) One fifth of basic salary \([1/5 \times Rs. 40,000]\)
  - (c) Statutory amount
- under section 16(iii) Professional tax paid

| Income from Salary                                   | 39,000 |

**Note:** Employee’s contribution to RPF is not taxable. It is eligible for deduction u/s 80C.

********************************************************************************

4.19
CHAPTER 5 – INCOME FROM HOUSE PROPERTY

EXERCISE

Question 1
People Housing Ltd. is engaged in the business of constructing residential and commercial properties. One of the building properties was included in the closing stock in the Balance Sheet. The said building was let out for a monthly rent as suitable buyers could not be found. All other buildings had been sold by the company. Examine with reasons whether the income by way of rent from the unsold property is assessable as income from business or income from house property.

What would be your answer, if the main objective of the company was to hold properties and earn income by letting out of these properties?

Answer
(a) Under section 22, the charging section for “Income from house property”, the only exception provided is the income derived from property used/occupied by the assessee for his own business. Therefore, income derived from letting out of house property will be taxable under the head “Income from house property”. It will be so taxable even if property is held by the assessee as stock-in-trade of his business.

As per section 23(5), income from house property held as stock-in-trade would be exempt for a period of one year from the end of the financial year in which certificate of completion was obtained from the competent authority. However, for availing such exemption, the property should not be let out during the said period. Section 23(5) provides for exemption in respect of house property held as stock-in-trade for a certain period subject to fulfilment of the condition stated therein. It implies that income from house property held as stock-in-trade –

(i) beyond the said period; or

(ii) not eligible for such exemption even during the said period due to non-fulfilment of the stated condition,

would be taxable under the same head of income i.e., “Income from house property”.

In effect, where exemption provisions are provided under a particular head of income, it can be inferred that the income, but for such exemption, would be taxable only under that head of income.

Note – In the case of New Delhi Hotels Ltd. v. ACIT (2014) 360 ITR 187, the Delhi High Court followed its own decision in the case of CIT vs. Discovery Estates Pvt. Ltd/CIT vs. Discovery Holding Pvt. Ltd., wherein it was held in the case of rental income derived from unsold flats which were shown as stock-in-trade in the books of the assessee should be assessed under the head “Income from house property” and not under the head “Profits and gains from business and profession”.

This decision is in sync with the intent of the provisions of section 22 and 23(5) discussed above.

(b) The Supreme Court, in Chennai Properties and Investments Ltd. v. CIT (2015) 373 ITR 673, held that where holding of properties and earning income by letting out of these properties is the main objective of the company as laid out in its Memorandum of Association and the entire income of the company as per its return of income accepted by the Assessing Officer comprises of income from letting out of such properties, such income would be assessable as “Profits and gains of business or profession.”
Further, in case of Rayala Corporation (P) Ltd. v. Asstt. CIT (2016) 386 ITR 500, the Supreme Court held that since the business of the company is to lease out its property and earn rent therefrom, the rental income earned by the company is chargeable to tax as its business income and not income from house property.

Applying the rationale of above rulings if the main objective of the company is to hold the properties and earn income by letting out of the properties, the income from letting out of properties would be chargeable to tax as “Profits and gains of business or profession”.

**Question 2**
A Hindu undivided family owns a property which has been let out to a firm carrying on business. The family is a partner of the firm through its Karta. No rent has been charged by the HUF from the firm for use of the premises by the firm. The Assessing Officer, however, has taxed the family on the notional income from property based on municipal valuation. Is this decision justified?

**Answer**
Under section 22, the annual value of a property is chargeable to tax under the head “Income from house property” in the hands of the owner. However, this section specifically excludes property occupied for the purposes of own business or profession of the assessee, the profits of which are chargeable to income-tax. In CIT v. Shri. Champalal Jeevraj (1995) 215 ITR 289 (Mad), it was observed that where the Karta of the HUF is a partner in the firm in his representative capacity and the firm occupied a portion of the house belonging to the HUF, the benefit of exclusion under section 22 was available to the HUF. Hence, the income from the said property shall not be chargeable to tax under the head “Income from house property”. Therefore, in this case, the action of the Assessing Officer is not correct.

**Question 3**
In the following cases, examine under which head of income the receipt would be assessed-
(a) Anirudh let out his property to Abhinav. Abhinav sublets it. How is sub-letting receipt to be assessed in the hands of Abhinav?
(b) Anish has built a house on a leasehold land. He has let-out the above property and has considered the rent from such property under the head "Income from other sources" and deducted expenses on repairs, security charges, insurance and collection charges in all amounting to 50% of receipts.

**Answer**
(a) Sub-letting receipt is to be assessed as “Income from Other Sources” or as “Profits and gains of business or profession” in hands of Mr. Abhinav, depending upon the facts and circumstances of each case. It is not assessable as income from house property, since one of the conditions for assessing an income under this head is that the assessee should be the owner of the property i.e. owner of the building and the land appurtenant thereto. In this case, since Abhinav is not the owner of the house property, sub-letting receipt cannot be assessed under the head “Income from house property”.
(b) Since Anish is the owner of the property (building), in this case, the receipt would be assessable as “Income from house property”. The ownership of land is not a pre-
requisite for assessment of income under this head. 30% of Net Annual Value is allowed as a deduction under section 24.

Question 4
Rajesh owns a house in Hyderabad. During the previous year 2019-20, 3/4th portion of the house was self-occupied and 1/4th portion was let out for residential purposes at a rent of Rs. 12,000 p.m. The tenant vacated the property on February 29th 2020. The property was vacant during March, 2020. Rent for the months of January 2020 and February 2020 could not be realised in spite of the owner's efforts. All the conditions prescribed under Rule 4 are satisfied.

Municipal value of the property is Rs. 4,00,000 p.a., fair rent is Rs. 4,40,000 p.a. and standard rent is Rs. 4,80,000. He paid municipal taxes @10% of municipal value during the year. A loan of Rs. 30,00,000 was taken by him during the year 2010 for acquiring the property. Interest on loan paid during the previous year 2019-20 was Rs. 1,48,000. Compute Rajesh’s income from house property for the A.Y. 2020-21.

Answer
There are two units of the house. Unit I with 3/4th area is used by Rajesh for self-occupation throughout the year and no benefit is derived from that unit, hence, it will be treated as self-occupied and its annual value will be nil. Unit 2 with 1/4th area is let-out during the previous year and its annual value has to be determined as per section 23(1).

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unit I (3/4th area – self-occupied)</td>
<td></td>
</tr>
<tr>
<td>Annual Value</td>
<td>Nil</td>
</tr>
<tr>
<td>Less: Deduction under section 24(b)</td>
<td></td>
</tr>
<tr>
<td>3/4th of Rs. 1,48,000</td>
<td>1,11,000</td>
</tr>
<tr>
<td>Income from Unit I (self-occupied)</td>
<td>(1,11,000)</td>
</tr>
<tr>
<td>Unit II (1/4th area – let out)</td>
<td></td>
</tr>
<tr>
<td>Computation of GAV</td>
<td></td>
</tr>
<tr>
<td>Step 1 – Computation of Expected Rent (ER)</td>
<td>1,10,000</td>
</tr>
<tr>
<td>ER = Higher of municipal valuation (MV) and fair rent (FR), but restricted to standard rent (SR). However, in this case, standard rent of Rs. 1,20,000 (1/4th of Rs. 4,80,000) is more than the higher of MV of Rs. 1,00,000 (1/4th of Rs. 4,00,000) and FR of Rs. 1,10,000 (1/4th of Rs. 4,40,000). Hence the higher of MV and FR is the ER. In this case, it is the fair rent.</td>
<td></td>
</tr>
<tr>
<td>Step 2 – Computation of actual rent received/ receivable Rs. 12,000× 9 = 1,08,000</td>
<td>1,08,000</td>
</tr>
<tr>
<td>[The property was let-out for 11 months. However, rent for 2 months i.e., January and February, 2018 could not be realized. As per Explanation to section 23(1), actual rent should not include any amount of rent which is not capable of being realized. Therefore, actual rent has been computed for 9 months]</td>
<td></td>
</tr>
<tr>
<td>Step 3 – GAV is the higher of ER and actual rent received/receivable. However, as per section 23(1)(c), where the let-out property is vacant for part of the year and owing to vacancy, the actual rent is lower than the ER, then the actual rent</td>
<td>1,08,000</td>
</tr>
</tbody>
</table>
received would be the GAV of the property. In this case, the actual rent is lower than the ER owing to vacancy, since had the property not been vacant in March 2018, the actual rent would have been Rs. 1,20,000 (i.e. Rs. 1,08,000 + Rs. 12,000), which is higher than the ER of Rs. 1,10,000. Therefore, in this case, section 23(1)(c) would apply and the actual rent of Rs. 1,08,000 would be the GAV, since it is lower than the ER owing to vacancy.

**Gross Annual Value (GAV)**

| Less: Municipal taxes paid by the owner during the previous year relating to let-out portion |
|----------------------------------|------------------|
| 1/4th of (10% of Rs. 4,00,000) = Rs. 40,000/4 = Rs. 10,000 |

**Net Annual Value (NAV)**

| Less: Deductions under section 24 |
|----------------------------------|------------------|
| (a) 30% of NAV = 30% of Rs. 98,000 |
| (b) Interest paid on borrowed capital (relating to let out portion) [1/4th of Rs. 1,48,000] |

| Income from Unit II (let-out) |
|-----------------------------|------------------|
| Loss under the head "Income from house property" (-1,11,000 + 31,600) |

**Question 5**

*During the financial year 2019-20, Mr. A received a sum of Rs. 1,80,000 (Rs. 60,000 p.a.) by way of arrears for the last three years as the Government department (tenant) enhanced the rate of rent with retrospective effect. Will the sum of Rs. 1,80,000 be taxable in the assessment year 2020-21? Can it be spread over the last three years?*

**Answer**

As per section 25A, the arrears of rent shall be taxable in the previous year in which such arrears are received. The assessee shall be allowed deduction @ 30% of such amount received. Further, it is not necessary that the assessee should be owner of such house property in the previous year in which such arrears are received.

As the arrear rent of Rs. 1,80,000 is received in the previous year 2019-20, the same is taxable in the A.Y.2020-21. Thus, the net sum of Rs. 1,26,000 (i.e. Rs. 1,80,000 – Rs. 54,000) shall be chargeable to tax under the head “Income from house property”.

There is no provision in the Income-tax Act, 1961, enabling the assessee to spread over the arrears of rent over the last three years.
ADDITIONAL ILLUSTRATIONS FOR PRACTICE:

Illustration 1

Jayashree owns five houses in Chennai, all of which are let-out. Compute the GAV of each house from the information given below –

<table>
<thead>
<tr>
<th>Particulars</th>
<th>House I (Rs.)</th>
<th>House II (Rs.)</th>
<th>House III (Rs.)</th>
<th>House IV (Rs.)</th>
<th>House V (Rs.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Municipal Value</td>
<td>80,000</td>
<td>55,000</td>
<td>65,000</td>
<td>24,000</td>
<td>80,000</td>
</tr>
<tr>
<td>Fair Rent</td>
<td>90,000</td>
<td>60,000</td>
<td>65,000</td>
<td>25,000</td>
<td>75,000</td>
</tr>
<tr>
<td>Standard Rent</td>
<td>N.A.</td>
<td>75,000</td>
<td>58,000</td>
<td>N.A.</td>
<td>78,000</td>
</tr>
<tr>
<td>Actual rent received/ receivable</td>
<td>72,000</td>
<td>72,000</td>
<td>60,000</td>
<td>30,000</td>
<td>72,000</td>
</tr>
</tbody>
</table>

Solution

As per section 23(1), Gross Annual Value (GAV) is the higher of Expected rent and actual rent received. Expected rent is higher of municipal value and fair rent but restricted to standard rent.

Computation of GAV of each house owned by Jayashree

<table>
<thead>
<tr>
<th>Particulars</th>
<th>House I (Rs.)</th>
<th>House II (Rs.)</th>
<th>House III (Rs.)</th>
<th>House IV (Rs.)</th>
<th>House V (Rs.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i) Municipal value</td>
<td>80,000</td>
<td>55,000</td>
<td>65,000</td>
<td>24,000</td>
<td>80,000</td>
</tr>
<tr>
<td>(ii) Fair rent</td>
<td>90,000</td>
<td>60,000</td>
<td>65,000</td>
<td>25,000</td>
<td>75,000</td>
</tr>
<tr>
<td>(iii) Higher of (i) &amp; (ii)</td>
<td>90,000</td>
<td>60,000</td>
<td>65,000</td>
<td>25,000</td>
<td>80,000</td>
</tr>
<tr>
<td>(iv) Standard rent</td>
<td>N.A.</td>
<td>75,000</td>
<td>58,000</td>
<td>N.A.</td>
<td>78,000</td>
</tr>
<tr>
<td>(v) Expected rent</td>
<td>90,000</td>
<td>60,000</td>
<td>58,000</td>
<td>25,000</td>
<td>78,000</td>
</tr>
<tr>
<td>[Lower of (iii) &amp; (iv)]</td>
<td>90,000</td>
<td>60,000</td>
<td>58,000</td>
<td>25,000</td>
<td>78,000</td>
</tr>
<tr>
<td>(vi) Actual rent</td>
<td>72,000</td>
<td>72,000</td>
<td>60,000</td>
<td>30,000</td>
<td>72,000</td>
</tr>
<tr>
<td>received/ receivable</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>GAV [Higher of (v) &amp; (vi)]</td>
<td>90,000</td>
<td>72,000</td>
<td>60,000</td>
<td>30,000</td>
<td>78,000</td>
</tr>
</tbody>
</table>

Illustration 2

Rajesh, a British national, is a resident and ordinarily resident in India during the P.Y.2019-20. He owns a house in London, which he has let out at £ 10,000 p.m. The municipal taxes paid to the Municipal Corporation of London is £ 8,000 during the P.Y.2019-20. The value of one £ in Indian rupee to be taken at Rs. 92.50. Compute Rajesh’s Net Annual Value of the property for the A.Y. 2020-21.

Solution

For the P.Y.2019-20, Mr. Rajesh, a British national, is resident and ordinarily resident in India. Therefore, income received by him by way of rent of the house property located in London is to be included in the total income in India. Municipal taxes paid in London is to be allowed as deduction from the gross annual value.
Computation of Net Annual Value of the property of Mr. Rajesh for A.Y.2020-21

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross Annual Value (£ 10,000 × 12 × Rs. 92.50)</td>
<td>1,11,00,000</td>
</tr>
<tr>
<td>Less: Municipal taxes paid (£ 8,000 × Rs. 92.50)</td>
<td>7,40,000</td>
</tr>
<tr>
<td>Net Annual Value (NAV)</td>
<td>1,03,60,000</td>
</tr>
</tbody>
</table>

Illustration 3

Arvind had taken a loan of Rs. 5,00,000 for construction of property on 1.10.2018. Interest was payable @10% p.a. The construction was completed on 30.6.2019. No principal repayment has been made up to 31.3.2020. Compute the interest allowable as deduction under section 24 for the A.Y.2020-21.

Solution

Interest for the year (1.4.2019 to 31.3.2020) = 10% of Rs. 5,00,000 = Rs. 50,000

Pre-construction interest = 10% of Rs. 5,00,000 for 6 months (from 1.10.2018 to 31.3.2019)

= Rs. 25,000

Pre-construction interest to be allowed in 5 equal annual installments of Rs. 5,000 from the year of completion of construction i.e. in this case, P.Y. 2019-20.

Therefore, total interest deduction under section 24 = Rs. 50,000 + Rs. 5,000 = Rs. 55,000.

(2) Deduction in respect of one self-occupied property where annual value is nil

(i) In this case, the assessee will be allowed a deduction on account of interest (including 1/5th of the accumulated interest of pre-construction period) as under—

<table>
<thead>
<tr>
<th>S. No.</th>
<th>Conditions</th>
<th>Amount of Deduction</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a)</td>
<td>Loan borrowed before 1.4.99: Where the property has been acquired,</td>
<td>Actual interest payable subject to maximum of Rs. 30,000.</td>
</tr>
<tr>
<td></td>
<td>constructed, repaired, renewed or reconstructed with borrowed capital</td>
<td></td>
</tr>
<tr>
<td></td>
<td>before 1.4.99.</td>
<td></td>
</tr>
<tr>
<td>(b)</td>
<td>Loan borrowed on or after 1.4.99: (i) Where the property is acquired or</td>
<td>Actual interest payable subject to maximum of Rs. 2,00,000, if certificate mentioned in (2) below is obtained.</td>
</tr>
<tr>
<td></td>
<td>constructed with capital borrowed on or after 1.4.99 and such acquisition</td>
<td></td>
</tr>
<tr>
<td></td>
<td>or construction is completed within 5 years from the end of the financial</td>
<td></td>
</tr>
<tr>
<td></td>
<td>year in which the capital was borrowed.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(ii) Where the property is repaired, renewed or reconstructed with capital</td>
<td>Actual interest payable subject to a maximum of Rs. 30,000.</td>
</tr>
<tr>
<td></td>
<td>borrowed on or after 1.4.99.</td>
<td></td>
</tr>
</tbody>
</table>

However, the total interest deduction under (a) and (b) cannot exceed Rs. 2,00,000.

Illustration 4

Mr. Manas owns two house properties one at Bombay, wherein his family resides and the other at Delhi, which is unoccupied. He lives in Chandigarh for his employment purposes in a rented house. For acquisition of house property at Bombay, he has taken a loan of Rs. 30 lakh@10% p.a. on 1.4.2018. He has not repaid any amount so far. In respect of house property at Delhi, he has taken a loan of Rs. 5 lakh@11% p.a. on
1.10.2018 towards repairs. Compute the deduction which would be available to him under section 24(b) for A.Y.2020-21 in respect of interest payable on such loan.

Solution
Mr. Manas can claim benefit of Nil Annual Value in respect of his house property at Bombay and Delhi, since no benefit is derived by him from such properties, and he cannot occupy such properties due to reason of his employment at Chandigarh, where he lives in a rented house.

Computation of deduction u/s 24(b) for A.Y.2020-21

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>I Interest on loan taken for acquisition of residential house property at Bombay</td>
<td></td>
</tr>
<tr>
<td>30,00,000 x 10% = Rs. 3,00,000</td>
<td></td>
</tr>
<tr>
<td>Restricted to Rs. 2,00,000</td>
<td>2,00,000</td>
</tr>
<tr>
<td>II Interest on loan taken for repair of residential house property at Delhi</td>
<td></td>
</tr>
<tr>
<td>Rs. 5,00,000 x 11% = Rs. 55,000</td>
<td></td>
</tr>
<tr>
<td>Restricted to Rs. 30,000</td>
<td>30,000</td>
</tr>
<tr>
<td>Total interest</td>
<td>2,30,000</td>
</tr>
<tr>
<td>Deduction under section 24(b) in respect of (I) and (II) above to be restricted to</td>
<td>2,00,000</td>
</tr>
</tbody>
</table>

Illustration 5

P, an individual, borrowed Rs. 20,00,000 for repair of his self-occupied house property and paid interest of Rs. 1,60,000 thereon during the financial year 2019-20. What is the amount of interest allowable as deduction under section 24 for the assessment year 2020-21?

Solution

Section 24(b) provides that where the self-occupied house property has been acquired, constructed, repaired, renewed or reconstructed with borrowed capital, deduction towards interest payable thereon shall not exceed Rs. 30,000. Therefore, only Rs. 30,000 would be allowed as deduction on account of interest on loan borrowed for repair and reconstruction of self-occupied house property.

The higher limit of Rs. 2,00,000 in respect of interest on loan borrowed on or after 1.4.1999 would be available only where such loan is borrowed for acquisition or construction of self-occupied property and not for repair of such property.

Illustration 6

Anirudh has a property whose municipal valuation is Rs. 1,30,000 p.a. The fair rent is Rs. 1,10,000 p.a. and the standard rent fixed by the Rent Control Act is Rs. 1,20,000 p.a. The property was let out for a rent of Rs. 11,000 p.m. throughout the previous year. Unrealised rent was Rs. 11,000 and all conditions prescribed by Rule 4 are satisfied. He paid municipal taxes @10% of municipal valuation. Interest on borrowed capital was Rs. 40,000 for the year. Compute the income from house property of Anirudh for A.Y. 2020-21.
### Solution

**Computation of Income from house property of Mr. Anirudh for A.Y. 2020-21**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Amount in Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Computation of GAV</strong></td>
<td></td>
</tr>
<tr>
<td>Step 1 Compute ER</td>
<td></td>
</tr>
<tr>
<td>ER = Higher of MV of Rs. 1,30,000 p.a. and FR of Rs. 1,10,000 p.a., but restricted to SR of Rs. 1,20,000 p.a.</td>
<td>1,20,000</td>
</tr>
<tr>
<td>Step 2 Compute actual rent received/receivable</td>
<td></td>
</tr>
<tr>
<td>Actual rent received/receivable less unrealized rent as per Rule 4 = Rs. 1,32,000 - Rs. 11,000</td>
<td>1,21,000</td>
</tr>
<tr>
<td>Step 3 Compare ER of Rs. 1,20,000 and Actual rent received/receivable of Rs. 1,21,000.</td>
<td></td>
</tr>
<tr>
<td>GAV is the higher of ER and Actual rent received/receivable</td>
<td>1,21,000</td>
</tr>
<tr>
<td><strong>Gross Annual Value (GAV)</strong></td>
<td><strong>1,21,000</strong></td>
</tr>
<tr>
<td>Less: Municipal taxes (paid by the owner during the previous year) = 10% of Rs. 1,30,000</td>
<td><strong>13,000</strong></td>
</tr>
<tr>
<td><strong>Net Annual Value (NAV)</strong></td>
<td><strong>1,08,000</strong></td>
</tr>
<tr>
<td>Less: Deductions under section 24</td>
<td></td>
</tr>
<tr>
<td>(a) 30% of NAV</td>
<td><strong>32,400</strong></td>
</tr>
<tr>
<td>(b) Interest on borrowed capital (actual without any ceiling limit)</td>
<td><strong>72,400</strong></td>
</tr>
<tr>
<td><strong>Income from house property</strong> (C-F)</td>
<td><strong>35,600</strong></td>
</tr>
</tbody>
</table>

### (2) LET OUT PROPERTY VACANT FOR PART OF THE YEAR

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Computation of GAV</strong></td>
<td></td>
</tr>
<tr>
<td>Step 1 Compute ER</td>
<td></td>
</tr>
<tr>
<td>ER = Higher of MV and FR, but restricted to SR</td>
<td></td>
</tr>
<tr>
<td>Step 2 Compute Actual rent received/receivable</td>
<td></td>
</tr>
<tr>
<td>Actual rent received/receivable for let out period less unrealized rent as per Rule 4</td>
<td></td>
</tr>
<tr>
<td>Step 3 Compare ER and Actual rent received/receivable computed for the let-out period</td>
<td></td>
</tr>
<tr>
<td>Step 4 If Actual rent is lower than ER owing to vacancy, then Actual rent is the GAV. If Actual rent is lower than ER due to other reasons, then ER is the GAV. However, in spite of vacancy, if the actual rent is higher than the ER, then Actual rent is the GAV.</td>
<td></td>
</tr>
<tr>
<td><strong>Gross Annual Value (GAV)</strong></td>
<td>A</td>
</tr>
<tr>
<td>Less: Municipal taxes (paid by the owner during the previous year)</td>
<td>B</td>
</tr>
<tr>
<td><strong>Net Annual Value (NAV) = (A-B)</strong></td>
<td>C</td>
</tr>
<tr>
<td>Less: Deductions under section 24</td>
<td></td>
</tr>
<tr>
<td>(a) 30% of NAV</td>
<td>D</td>
</tr>
<tr>
<td>(b) Interest on borrowed capital (actual without any ceiling limit)</td>
<td>E F</td>
</tr>
<tr>
<td><strong>Income from house property</strong> (C-F)</td>
<td>G</td>
</tr>
</tbody>
</table>
Illustration 7

Ganesh has a property whose municipal valuation is Rs. 2,50,000 p.a. The fair rent is Rs. 2,00,000 p.a. and the standard rent fixed by the Rent Control Act is Rs. 2,10,000 p.a. The property was let out for a rent of Rs. 20,000 p.m. However, the tenant vacated the property on 31.1.2020. Unrealised rent was Rs. 20,000 and all conditions prescribed by Rule 4 are satisfied. He paid municipal taxes @8% of municipal valuation. Interest on borrowed capital was Rs. 65,000 for the year. Compute the income from house property of Ganesh for A.Y.2020-21.

Solution

Computation of income from house property of Ganesh for A.Y. 2020-21

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Amount in Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Computation of GAV</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Step 1</strong> Compute ER</td>
<td></td>
</tr>
<tr>
<td>ER = Higher of MV of Rs. 2,50,000 p.a. and FR of Rs. 2,00,000 p.a., but restricted to SR of Rs. 2,10,000 p.a.</td>
<td>2,10,000</td>
</tr>
<tr>
<td><strong>Step 2</strong> Compute Actual rent received/receivable</td>
<td></td>
</tr>
<tr>
<td>Actual rent received/receivable for let out period less unrealized rent as per Rule 4 = Rs. 2,00,000 - Rs. 20,000</td>
<td>1,80,000</td>
</tr>
<tr>
<td><strong>Step 3</strong> Compare ER and Actual rent received/receivable</td>
<td></td>
</tr>
<tr>
<td>In this case the actual rent of Rs. 1,80,000 is lower than ER of Rs. 2,10,000 owing to vacancy, since, had the property not been vacant the actual rent would have been Rs. 2,20,000 (Rs. 1,80,000 + Rs. 40,000). Therefore, actual rent is the GAV.</td>
<td>1,80,000</td>
</tr>
<tr>
<td><strong>Gross Annual Value (GAV)</strong></td>
<td>1,80,000</td>
</tr>
<tr>
<td>Less: Municipal taxes (paid by the owner during the previous year) = 8% of Rs. 2,50,000</td>
<td>20,000</td>
</tr>
<tr>
<td><strong>Net Annual Value (NAV)</strong></td>
<td>1,60,000</td>
</tr>
<tr>
<td>Less: Deductions under section 24</td>
<td></td>
</tr>
<tr>
<td>(a) 30% of NAV = 30% of Rs. 1,60,000</td>
<td>48,000</td>
</tr>
<tr>
<td>(b) Interest on borrowed capital (actual without any ceiling limit)</td>
<td>65,000</td>
</tr>
<tr>
<td><strong>Income from house property</strong></td>
<td>47,000</td>
</tr>
</tbody>
</table>

Illustration 8

Poorna has one house property at Indira Nagar in Bangalore. She stays with her family in the house. The rent of similar property in the neighbourhood is Rs. 25,000 p.m. The municipal valuation is Rs. 23,000 p.m. Municipal taxes paid is Rs. 8,000. The house construction began in April, 2013 with a loan of Rs. 20,00,000 taken from SBI Housing Finance Ltd on 1.4.2013. The construction was completed on 30.11.2015. The accumulated interest up to 31.3.2015 is Rs. 3,60,000. On 31.3.2020, Poorna paid Rs. 2,40,000 which included Rs. 1,80,000 as interest. There was no principal repayment prior to that date. Compute Poorna’s income from house property for A.Y. 2020-21.
Solution

Computation of income from house property of Smt. Poorna for A.Y.2020-21

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Amount Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Annual Value of one house used for self-occupation under section 23(2)</td>
<td>Nil</td>
</tr>
<tr>
<td>Less: Deduction under section 24</td>
<td></td>
</tr>
<tr>
<td>Interest on borrowed capital</td>
<td></td>
</tr>
<tr>
<td>Interest on loan was taken for construction of house on or after 1.4.99 and same was completed within the prescribed time - interest paid or payable subject to a maximum of Rs. 2,00,000 (including apportioned pre-construction interest) will be allowed as deduction.</td>
<td></td>
</tr>
<tr>
<td>In this case the total interest is Rs. 1,80,000 + Rs. 72,000 (Being 1/5th of Rs. 3,60,000) = Rs. 2,52,000. However, the interest deduction is restricted to Rs. 2,00,000.</td>
<td>2,00,000</td>
</tr>
<tr>
<td>Loss from house property</td>
<td>(2,00,000)</td>
</tr>
</tbody>
</table>

Illustration 9

Smt. Rajalakshmi owns a house property at Adyar in Chennai. The municipal value of the property is Rs. 5,00,000, fair rent is Rs. 4,20,000 and standard rent is Rs. 4,80,000. The property was let-out for Rs. 50,000 p.m. up to December 2019. Thereafter, the tenant vacated the property and Smt. Rajalakshmi used the house for self-occupation. Rent for the months of November and December 2019 could not be realised in spite of the owner’s efforts. All the conditions prescribed under Rule 4 are satisfied. She paid municipal taxes @12% during the year. She had paid interest of Rs. 25,000 during the year for amount borrowed for repairs for the house property. Compute her income from house property for the A.Y. 2020-21.

Solution

Computation of income from house property of Smt. Rajalakshmi for the A.Y.2020-21

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Amount in Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Computation of GAV</td>
<td></td>
</tr>
<tr>
<td>Step 1 Compute ER for the whole year</td>
<td></td>
</tr>
<tr>
<td>ER = Higher of MV of Rs. 5,00,000 and FR of Rs. 4,20,000, but restricted to SR of Rs. 4,80,000</td>
<td>4,80,000</td>
</tr>
<tr>
<td>Step 2 Compute Actual rent received/receivable</td>
<td></td>
</tr>
<tr>
<td>Actual rent received/receivable for the period let out less unrealized rent as per Rule 4 = (Rs. 50,000 × 9) - (Rs. 50,000 × 2) = Rs. 4,50,000 - Rs. 1,00,000 =</td>
<td>3,50,000</td>
</tr>
<tr>
<td>Step 3 Compare ER for the whole year with the actual rent received/receivable for the let-out period i.e. Rs. 4,80,000 and Rs. 3,50,000</td>
<td></td>
</tr>
<tr>
<td>Step 4 GAV is the higher of ER computed for the whole year and Actual rent received/receivable computed for the let-out period.</td>
<td>4,80,000</td>
</tr>
<tr>
<td>Gross Annual Value (GAV)</td>
<td>4,80,000</td>
</tr>
<tr>
<td>Less: Municipal taxes (paid by the owner during the previous year) = 12% of Rs. 5,00,000</td>
<td>60,000</td>
</tr>
<tr>
<td>Net Annual Value (NAV)</td>
<td>4,20,000</td>
</tr>
</tbody>
</table>
Illustration 10

Prem owns a house in Madras. During the previous year 2019-20, 2/3rd portion of the house was self-occupied and 1/3rd portion was let out for residential purposes at a rent of Rs. 8,000 p.m. Municipal value of the property is Rs. 3,00,000 p.a., fair rent is Rs. 2,70,000 p.a. and standard rent is Rs. 3,30,000 p.a. He paid municipal taxes @10% of municipal value during the year. A loan of Rs. 25,00,000 was taken by him during the year 2015 for acquiring the property. Interest on loan paid during the previous year 2019-20 was Rs. 1,20,000. Compute Prem’s income from house property for the A.Y. 2020-21

Solution

There are two units of the house. Unit I with 2/3rd area is used by Prem for self-occupation throughout the year and no benefit is derived from that unit, hence it will be treated as self-occupied and its annual value will be Nil. Unit 2 with 1/3rd area is let-out throughout the previous year and its annual value has to be determined as per section 23(1).

### Computation of income from house property of Mr. Prem for A.Y.2020-21

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Amount in Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Unit I (2/3rd area – self-occupied)</strong></td>
<td></td>
</tr>
<tr>
<td>Annual Value</td>
<td>Nil</td>
</tr>
<tr>
<td>Less: Deduction under section 24(b)</td>
<td></td>
</tr>
<tr>
<td>2/3rd of Rs. 1,20,000</td>
<td>80,000</td>
</tr>
<tr>
<td><strong>Income from Unit I (self-occupied)</strong></td>
<td>(80,000)</td>
</tr>
<tr>
<td><strong>Unit II (1/3rd area – let out)</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Computation of GAV</strong></td>
<td></td>
</tr>
<tr>
<td>Step 1 Compute ER</td>
<td></td>
</tr>
<tr>
<td>ER = Higher of MV and FR, restricted to SR</td>
<td></td>
</tr>
<tr>
<td>However, in this case, SR of Rs. 1,10,000 (1/3rd of Rs. 3,30,000) is more than the higher of MV of Rs. 1,00,000 (1/3rd of Rs. 3,00,000) and FR of Rs. 90,000 (1/3rd of Rs. 2,70,000). Hence the higher of MV and FR is the ER. In this case, it is the MV.</td>
<td>1,00,000</td>
</tr>
<tr>
<td>Step 2 Compute actual rent received/receivable</td>
<td></td>
</tr>
<tr>
<td>Rs.8,000×12 = Rs.96,000</td>
<td>96,000</td>
</tr>
<tr>
<td>Step 3 Compare ER and Actual rent received/receivable</td>
<td></td>
</tr>
<tr>
<td>Step 4 GAV is the higher of ER and actual rent received/receivable i.e. higher of Rs. 1,00,000 and Rs. 96,000</td>
<td>1,00,000</td>
</tr>
<tr>
<td><strong>Gross Annual Value (GAV)</strong></td>
<td>1,00,000</td>
</tr>
<tr>
<td>Less: Municipal taxes paid by the owner during the previous year relating to let-out portion</td>
<td></td>
</tr>
<tr>
<td>1/3rd of (10% of Rs. 3,00,000) = Rs. 30,000/3 = Rs. 10,000</td>
<td>10,000</td>
</tr>
<tr>
<td><strong>Net Annual Value (NAV)</strong></td>
<td>90,000</td>
</tr>
<tr>
<td>Less: Deductions under section 24</td>
<td></td>
</tr>
</tbody>
</table>
 Illustration 11

Mr. Anand sold his residential house property in March, 2019. In June, 2019, he recovered rent of Rs. 10,000 from Mr. Gaurav, to whom he had let out his house for two years from April 2013 to March 2015. He could not realise two month rent of Rs. 20,000 from him and to that extent his actual rent was reduced while computing income from house property for A.Y.2015-16. Further, he had let out his property from April, 2015 to February, 2019 to Mr. Satish. In April, 2017, he had increased the rent from Rs. 12,000 to Rs. 15,000 per month and the same was a subject matter of dispute. In September, 2019, the matter was finally settled and Mr. Anand received Rs. 69,000 as arrears of rent for the period April 2017 to February, 2019. Would the recovery of unrealised rent and arrears of rent be taxable in the hands of Mr. Anand, and if so in which year?

Solution

Since the unrealised rent was recovered in the P.Y.2019-20, the same would be taxable in the A.Y.2020-21 under section 25A, irrespective of the fact that Mr. Anand was not the owner of the house in that year. Further, the arrears of rent was also received in the P.Y.2019-20, and hence the same would be taxable in the A.Y.2020-21 under section 25A, even though Mr. Anand was not the owner of the house in that year. A deduction of 30% of unrealised rent recovered and arrears of rent would be allowed while computing income from house property of Mr. Anand for A.Y.2020-21.

| Computation of income from house property of Mr. Anand for A.Y.2020-21 |
|-----------------|-----------------|
| Particulars     | Rs.             |
| (i) Unrealised rent recovered | 10,000          |
| (ii) arrears of rent received  | 69,000          |
|Less: Deduction@30%              | 23,700          |
|Income from house property        | 55,300          |

Illustration 12

Ms. Aparna co-owns a residential house property in Calcutta along with her sister Ms. Dimple, where her sister’s family resides. Both of them have equal share in the property and the same is used by them for self-occupation. Interest is payable in respect of loan of Rs. 50,00,000@10% taken on 1.4.2018 for acquisition of such property. In addition, Ms. Aparna owns a flat in Pune in which she and her parents reside. She has taken a loan of Rs. 3,00,000@12% on 1.10.2018 for repairs of this flat. Compute the deduction which would be available to Ms. Aparna and Ms. Dimple under section 24(b) for A.Y.2020-21.
Solution

**Computation of deduction u/s 24(b) available to Ms. Aparna for A.Y.2020-21**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>I Interest on loan taken for acquisition of residential house property at Calcutta</td>
<td></td>
</tr>
<tr>
<td>( \text{Rs. } 50,00,000 \times 10% = \text{Rs. } 5,00,000 )</td>
<td></td>
</tr>
<tr>
<td>Ms. Aparna’s share = 50% of ₹ 5,00,000 = ₹ 2,50,000</td>
<td></td>
</tr>
<tr>
<td>Restricted to ₹ 2,00,000</td>
<td>2,00,000</td>
</tr>
<tr>
<td>II Interest on loan taken for repair of flat at Pune</td>
<td></td>
</tr>
<tr>
<td>( \text{Rs. } 3,00,000 \times 12% = \text{Rs. } 36,000 )</td>
<td></td>
</tr>
<tr>
<td>Restricted to ₹ 30,000</td>
<td>30,000</td>
</tr>
<tr>
<td>Total interest</td>
<td>2,30,000</td>
</tr>
<tr>
<td>Deduction under section 24(b) in respect of (I) and (II) above to be restricted to</td>
<td>2,00,000</td>
</tr>
</tbody>
</table>

**Computation of deduction u/s 24(b) available to Ms. Dimple for A.Y.2020-21**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest on loan taken for acquisition of residential house property at Calcutta</td>
<td></td>
</tr>
<tr>
<td>( \text{Rs. } 50,00,000 \times 10% = \text{Rs. } 5,00,000 )</td>
<td></td>
</tr>
<tr>
<td>Ms. Dimple’s share = 50% of ₹ 5,00,000 = ₹ 2,50,000</td>
<td></td>
</tr>
<tr>
<td>Restricted to ₹ 2,00,000</td>
<td>2,00,000</td>
</tr>
<tr>
<td>Deduction under section 24(b)</td>
<td>2,00,000</td>
</tr>
</tbody>
</table>
CHAPTER 6 - PROFITS & GAINS OF BUSINESS OR PROFESSION

EXERCISE

Question 1
Examine critically the following cases in the context of provisions contained in the Income-tax Act, 1961 relevant for Assessment Year 2020-21. Support the answers with relevant case laws and workings.

(a) Mr. Janak is proprietor of M/s. Yash Texnit which is engaged in garment manufacturing business. The entire block of Plant & Machinery chargeable to depreciation @ 15%, has 20 different machinery items as at 31-03-2020. One of the machineries used for packing had become obsolete and was discarded by Mr. Janak in July’ 19.

Assessee filed its return for A.Y. 2020-21 claiming total depreciation of Rs. 40 lacs which includes Rs. 4 lacs being the depreciation claimed on the machinery item discarded by Mr. Janak. The A.O. disallowed the claim of depreciation of Rs. 4 lacs during the course of scrutiny assessment.

Comment on the validity of action taken by A.O.

(b) X. Ltd. issued debentures in the previous year 2019-20, which were to be matured at the end of 5 years. The debenture holder was given an option of one time upfront payment of Rs. 60 per debenture on account of interest which was to be immediately paid by the company. As per the option exercised by the debenture holders, company paid interest upfront to them in the first year itself and the same was claimed as deduction in the return of the company. But in the accounts, the interest expenditure was shown as deferred expenditure to be written off over a period of 5 years. During the course of assessment, the Assessing Officer spread the upfront interest paid over a period of five year term of debentures and allowed only one-fifth of the amount in the previous year 2019-20. Examine the correctness of the action of Assessing Officer.

Answer

(a) The issue under consideration is whether disallowance of depreciation made by the Assessing Officer with regard to the discarded asset, in arriving at the written down value of the block of assets, is justified.

One of the conditions for claim of depreciation under section 32 is that the eligible asset must have been put to use for the purpose of business or profession.

The other aspect to considered is whether merely discarding an obsolete machinery, which is physically available, will attract the expression “moneys payable” appearing in section 43(6), so as to deduct its value from the written down value of the block.

The facts in the present case are similar to facts in the case of CIT v. Yamaha Motor India Pvt. Ltd. (2010) 328 ITR 297, wherein the Delhi High Court observed that the expression "used for the purposes of the business" in section 32 when used with respect to discarded machinery would mean the use in the business, not only in the relevant financial year/previous year, but also in the earlier financial years.

The discarded machinery may not be actually used in the relevant previous year but depreciation can be claimed as long as it was used for the purposes of business in the earlier years provided the block continues to exist in the relevant previous year.
Therefore, the condition for claiming depreciation in respect of the discarded machine would be satisfied if it was used in the earlier previous years for the business.

For the purpose of section 43(6), “moneys payable” means the sale price, in case of sale, or the insurance, salvage or compensation moneys payable in respect of the asset. In this case, the machinery has not been sold as machinery or scrap or disposed off, and it continues to exist. Hence, there is no “moneys payable” in this case, which alone is deductible while computing the WDV of the block to which it belongs.

Applying the rationale of the above case, the action of the Assessing Officer in disallowing Rs. 4 lakhs, being the depreciation claim attributable to discarded machinery, on the ground that the same was not put to use in the relevant previous year, is invalid, since the said machinery was put to use in the earlier previous years.

The issue under consideration is whether, in a case where debentures are issued with maturity at the end of five years, and the debenture holders are given an option of upfront payment of interest in the first year itself, can the entire upfront interest paid, be claimed as deduction by the company in the first year or should the same be deferred over a period of five years; and would the treatment of such interest as deferred revenue expenditure in the books of account have any impact on the tax treatment.

The moment the option for upfront payment was exercised by the subscriber, the liability of X Ltd. to make the payment in that year had arisen. Not only had the liability arisen in the previous year in question, it was even quantified and discharged as well in that very year.

As per the rationale of the Supreme Court ruling in Taparia Tools Ltd.’s case, when the deduction of entire upfront payment of interest is allowable as per the Income-tax Act, 1961, the fact that a different treatment was given in the books of account could not be a factor which would bar the company from claiming the entire expenditure as a deduction.

Accordingly, the action of the Assessing Officer in spreading the upfront interest paid over the five year term of debentures and restricting the deduction in the P.Y.2018-19 to one-fifth of the upfront interest paid is not correct. The company is eligible to claim the entire amount of interest paid upfront as deduction under section 36(1)(iii) in the P.Y.2019-20.

**Question 2**

Compute the quantum of depreciation available under section 32 of the Income-tax Act, 1961 in respect of the following items of Plant and Machinery purchased by PQR Textile Ltd., by paying through account payee cheque, which is engaged in the manufacture of textile fabrics, for the year ended 31-3-2020:

<table>
<thead>
<tr>
<th>Description</th>
<th>(Rs. In crores)</th>
</tr>
</thead>
<tbody>
<tr>
<td>New machinery installed on 1-5-2019</td>
<td>84</td>
</tr>
<tr>
<td>New Windmill purchased and installed on 18-6-2019</td>
<td>22</td>
</tr>
</tbody>
</table>
Items purchased after 30th November 2019:

<table>
<thead>
<tr>
<th>Description</th>
<th>Quantity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lorries for transporting goods to sales depots</td>
<td>3</td>
</tr>
<tr>
<td>Fork-lift-trucks, used inside factory</td>
<td>4</td>
</tr>
<tr>
<td>Computers installed in office premises</td>
<td>1</td>
</tr>
<tr>
<td>Computers installed in factory</td>
<td>2</td>
</tr>
<tr>
<td>New imported machinery</td>
<td>12</td>
</tr>
</tbody>
</table>

The new imported machinery arrived at Chennai port on 30-03-2020 and was installed on 3-4-2020. All other items were installed during the year ended 31-3-2020.

The company was newly started during the year.

Also, compute the WDV of the various blocks of assets as on 1.4.2020.

**Answer**

**Computation of depreciation allowance under section 32 for the A.Y. 2020-21**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Normal Depreciation [u/s 32 (1) (ii)]</th>
<th>Additional Depreciation [u/s 32 (1) (iia)]</th>
</tr>
</thead>
<tbody>
<tr>
<td>(A) Plant and Machinery (15% block) (Put to use for 180 days or more)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>- New machinery installed on 01.05.2019</td>
<td>84.00</td>
<td>84.00</td>
</tr>
<tr>
<td>- Lorries for transporting goods to depots</td>
<td>3.00</td>
<td>-</td>
</tr>
<tr>
<td>Normal Depreciation  @15% &amp; additional depreciation @20%</td>
<td>13.05</td>
<td>16.80</td>
</tr>
<tr>
<td>(B) Plant and Machinery (15% block) (Put to use for less than 180 days – hence, depreciation is restricted to 7.5%, being 50% of 15%)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Fork-lift trucks, used inside a factory</td>
<td>4.00</td>
<td>4.00</td>
</tr>
<tr>
<td>Normal Depreciation  @ 7.5% &amp; additional depreciation @10%</td>
<td>0.30</td>
<td>0.40</td>
</tr>
<tr>
<td>(C) Plant and Machinery (40% block) (Put to use for less than 180 days, hence depreciation restricted to 30%, i.e., 50% of 40%)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Computers installed in office premises</td>
<td>1.00</td>
<td>-</td>
</tr>
<tr>
<td>- Computers installed in factory</td>
<td>2.00</td>
<td>2.00</td>
</tr>
<tr>
<td>Normal depreciation  @20% &amp; additional depreciation @10%</td>
<td>0.60</td>
<td>0.20</td>
</tr>
<tr>
<td>(D) Plant and Machinery (40% block) (Put to use for 180 days or more) (See Note 1)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>- New windmill purchased and installed on 18.06.2019</td>
<td>22.00</td>
<td>22.00</td>
</tr>
<tr>
<td>Normal Depreciation  @ 40% &amp; additional depreciation @ 20%</td>
<td>8.80</td>
<td>4.40</td>
</tr>
</tbody>
</table>

**Total depreciation and additional depreciation**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount (Rs. in crores)</th>
</tr>
</thead>
<tbody>
<tr>
<td>- Plant and Machinery (15% block) (A +B)</td>
<td>13.13 17.20</td>
</tr>
<tr>
<td>- Plant and Machinery (40% block) (C + D)</td>
<td>9.40 4.60</td>
</tr>
</tbody>
</table>

Depreciation available under section 32 = Rs.44.55 crores
# Computation of Written Down Value (WDV) as on 01.04.2020

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Plant &amp; Machinery</th>
</tr>
</thead>
<tbody>
<tr>
<td>WDV as on 01.04.2019 (The company was started during the year – as given in question)</td>
<td>Nil</td>
</tr>
<tr>
<td><strong>Add:</strong> Plant and Machinery acquired during the year</td>
<td></td>
</tr>
<tr>
<td>- New Machinery installed on 01.05.2019</td>
<td>Rs. 84.00</td>
</tr>
<tr>
<td>- Lorries for transporting goods to sales depot</td>
<td>Rs. 3.00</td>
</tr>
<tr>
<td>- Fork-lift trucks, used inside factory</td>
<td>Rs. 4.00</td>
</tr>
<tr>
<td>- New imported machinery</td>
<td>Rs. 12.00</td>
</tr>
<tr>
<td>- New Windmill purchased and installed on 18.6.2019</td>
<td>Rs. 22.00</td>
</tr>
<tr>
<td>- Computers installed in office premises</td>
<td>Rs. 1.00</td>
</tr>
<tr>
<td>- Computers installed in factory</td>
<td>Rs. 2.00</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>Rs. 103.00</td>
</tr>
<tr>
<td><strong>Less:</strong> Asset sold during the year</td>
<td>Nil</td>
</tr>
<tr>
<td>WDV as on 31.3.2020 (before charging depreciation)</td>
<td>Rs. 103.00</td>
</tr>
<tr>
<td><strong>Less:</strong> Depreciation for the P.Y.2019-20</td>
<td></td>
</tr>
<tr>
<td>- Normal depreciation</td>
<td>Rs. 13.35</td>
</tr>
<tr>
<td>- Additional depreciation</td>
<td>Rs. 17.20</td>
</tr>
<tr>
<td><strong>WDV as on 1.4.2020</strong></td>
<td>Rs. 72.45</td>
</tr>
</tbody>
</table>

**Notes:**

1. Windmills and any specially designed devices which run on windmills installed on or after 1.4.2014 would be eligible for depreciation @ 40%.
2. New imported machinery was not installed during the previous year 2019-20. Hence, it would not be eligible for additional depreciation for A.Y. 2020-21. It would also not be eligible for normal depreciation for A.Y 2020-21, since it was not put to use in the P.Y.2019-20 being the year of acquisition.
3. It may be noted that investment in the following plant and machinery would not be eligible for additional depreciation under section 32(1)(iia):
   - Lorries for transporting goods to sales depots, being vehicles/road transport vehicles; and
   - Computers installed in office premises.
4. As per section 2(28) of the Motor Vehicles Act, 1988, the definition of a “vehicle” excludes, *inter alia*, a vehicle of special type adopted for use only in a factory or in any enclosed premises. Therefore, fork-lift trucks used inside the factory would not fall within the definition of “vehicle”. Hence, it is eligible for additional depreciation under section 32(1)(iia).

**Question 3**

(A) Examine the taxability and/or allowability of the following receipts or expenditures under the provisions of the Income-tax Act, 1961, for the assessment year 2020-21:

(i) *S Ltd. receives a sum of Rs. 10 lakhs from K Ltd. on 3rd January, 2020 for agreeing not to carry on any business relating to computer software in India for the next three years.*

(ii) *Secret commission was paid during the previous year 2019-20.*
(iii) P Ltd. paid dollars equivalent to Rs. 50 lakhs as sales commission for the year ended 31.03.2020, without deducting tax at source, to Mr. Rodrigues, a citizen of UK and non-resident who acted as agent for booking orders, from various customers who are outside India.

(B) Can the following transactions be covered under section 43B for disallowance?

(i) A bank guarantee given by a company towards disputed tax liabilities.

(ii) Interest payable to Goods and Services Tax Department but not paid before the due date specified in section 139(1).

Answer

(A) (i) As per section 28(va), any sum received under an agreement for not carrying out any activity in relation to any business / profession (i.e., non-compete fee) is chargeable to income-tax under the head “Profits and gains of business or profession”.

Accordingly, Rs. 10 lakhs received by S Ltd. from K Ltd. for agreeing not to carry on any business relating to computer software in India for the next three years is chargeable to income-tax under the head “Profits and gains of business or profession”.

The amount shall be allowed as deduction in the hands of K Ltd. provided tax has been deducted at source under section 194J on the payment so made to S Ltd. If tax is not deducted at source, 30% of the expenditure shall be disallowed under section 40(a)(ia).

(ii) Secret commission is one of the forms of commission payment generally made by business organizations. Secret commission is a payment for obtaining business orders or contracts from parties and / or customers and paid to employees and / or officials of those parties and / or customers or companies from whom business orders are obtained by the assessees.

Explanation 1 below section 37(1) of Income-tax Act, 1961 provides that any expenditure incurred by an assessees for any purpose which is an offence or which is prohibited by law, shall not be deemed to have been incurred for the purpose of business and no deduction or allowance shall be made in respect of such expenditure. In view of the Explanation, any expenditure incurred for a purpose which is an offence and prohibited by law cannot be allowed as expenditure. Therefore, if secret commission payment could be established as a payment for an offence prohibited by law, the same cannot be allowed as deduction.

(iii) A foreign agent of an Indian exporter operates in his own country and no part of his income accrues or arises in India. His commission is usually remitted directly to him and is, therefore, not received by him or on his behalf in India. The commission paid to the non-resident agent for services rendered outside India is, thus, not chargeable to tax in India.

Since commission income for booking orders by non-resident who remains outside India is not subject to tax in India, disallowance under section 40(a)(i) is not attracted in respect of payment of commission to such non-resident outside India even though tax has not been deducted at source. Thus, the amount of Rs. 50 lakhs remitted to Mr. Rodrigues outside India in foreign currency towards commission would not attract disallowance under section 40(a)(i) for non-deduction of tax at source.
(B) (i) For claiming deduction of any expense enumerated under section 43B, the requirement is, the actual payment and not deemed payment. Furnishing of bank guarantee cannot be equated with actual payment. Actual payment requires that money must flow from the assessee to the public exchequer as specified in section 43B. Therefore, deduction of an expense covered under section 43B cannot be claimed by merely furnishing a bank guarantee [CIT v. McDowell & Co Ltd (2009) 314 ITR 167 (SC)]

(ii) Interest payable to Goods and Services Tax department is part of Goods and Services Tax. Therefore, interest payable to Goods and Services Tax department, which is not paid before the “due date” of filing of return of income, would attract disallowance under section 43B [Mewar Motors v. CIT (2003) 260 ITR 218 (Raj)]

Question 4
ILT Limited is engaged in manufacturing pipes and tubes. The profit and loss account of the company for the year ended 31st March, 2020 shows a net profit of Rs. 405 lacs. The following information and particulars are furnished to you. You are required to compute total income of the company for Assessment Year 2020-21 indicating reasons for treatment of each item.

(i) A group free air ticket was provided by a supplier for reaching a certain volume of purchase during the financial year 2019-20. The same is encashed by the company for Rs. 10 lacs in April 2019 and credited to General Reserve Account.

(ii) A regular supplier of raw materials agreed for settlement of Rs. 8 lacs instead of Rs. 10 lacs for poor quality of material supplied during the previous year which was not given effect in the running account of the supplier.

(iii) Andhra Bank sanctioned and disbursed a term loan in the financial year 2016-17 for a sum of Rs. 50 lacs. Interest of Rs. 8 lacs was in arrear. The bank has converted the arrear interest into a new loan repayable in 10 equal instalments. During the year, the company has paid 2 instalments and the amount so paid has been reduced from Funded Interest in the Balance Sheet.

(iv) The company remitted Rs. 5 lacs as interest to a company incorporated in USA on a loan taken 2 years ago. Tax deducted under section 195 from such interest has been deposited by the company on 15th July, 2020. The said interest was debited to profit and loss account.

(v) Sandeep, a sales executive stationed at HO at Delhi, was on official tour in Bangalore from 31st May, 2019 to 18th June, 2019 and 28th September, 2019 to 15th October, 2019 for the business development. The company has paid Sandeep's salary in cash, from its local office at Bangalore for the month of May, 2018 (payable on 1st June) and September 2018 (payable on 1st October), amounting to Rs. 45,000 and Rs. 47,000 respectively (net of TDS and other deduction), as Sandeep has no bank account at Bangalore. These were included in the amount of “salary” debited to Profit and Loss Account.

(vi) The company has contributed Rs. 50,000 by cheque to an electoral trust and the same stands included under the head "General Expenses".
### Answer

**Computation of total income of ILT Ltd. for the A.Y.2020-21**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs. (in lacs)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Profits and gains from business or profession</strong></td>
<td>405.00</td>
</tr>
<tr>
<td>Net profit as per profit and loss account</td>
<td></td>
</tr>
<tr>
<td><strong>Add : Items debited to profit and loss account, but to be disallowed and items not considered in accounts but to be taxed</strong></td>
<td></td>
</tr>
<tr>
<td>Value of group free air ticket provided by a supplier is taxable as business income under section 28(iv), as the value of any benefit, whether convertible into money or not, arising from business is taxable as business income.</td>
<td>10</td>
</tr>
<tr>
<td>Amount waived by the supplier of raw materials is a deemed income under section 41(1), as the expenditure was allowed as deduction in the last year and there is a benefit by way of remission or cessation of a trading liability. The fact that effect was not given in the running account of supplier is not relevant.</td>
<td>2</td>
</tr>
<tr>
<td>Interest payable outside India to a foreign company is allowable (See Note 1 below)</td>
<td>-</td>
</tr>
<tr>
<td>Contribution to electoral trust is not an allowable expenditure while computing business income. Hence, the same has to be added back, since it is included in general expenses.</td>
<td>0.50</td>
</tr>
<tr>
<td>Salary paid to employee Sandeep is eligible for deduction. Disallowance under section 40A(3) will not apply [See Note 2 below]</td>
<td>NIL 12.50</td>
</tr>
<tr>
<td><strong>Less: Amount of deduction allowable</strong></td>
<td></td>
</tr>
<tr>
<td>Under section 43B, interest on loan due to any scheduled bank, etc. is allowed as deduction, if such interest is actually paid irrespective of the method of accounting followed by the assessee. Conversion of arrear interest into a fresh loan by a bank cannot be considered as actual payment of interest. However, the amount of funded interest (i.e., converted loan) actually paid is allowable as deduction. Hence, Rs. 1,60,000, being two installments of Rs. 80,000 each, actually paid is deductible.</td>
<td>1.60</td>
</tr>
<tr>
<td><strong>Business Income</strong></td>
<td>415.90</td>
</tr>
<tr>
<td><strong>Gross total income</strong></td>
<td>415.90</td>
</tr>
<tr>
<td><strong>Less: Deduction under Chapter VI-A</strong></td>
<td></td>
</tr>
<tr>
<td>Deduction under section 80GGB in respect of contribution by the assessee company to an electoral trust.</td>
<td>0.50</td>
</tr>
<tr>
<td><strong>Total Income</strong></td>
<td>415.40</td>
</tr>
</tbody>
</table>

**Notes:**

1. Since tax has been deducted on interest payable outside India to a foreign company during the previous year 2019-20 and the same has been deposited before the due date of filing return of income under section 139(1), disallowance under section 40(a)(i) is not attracted. Since the interest has already been debited to profit and loss account, no further adjustment is required.

2. In respect of payment of salary to sales executive in cash, no disallowance under section 40A(3) is to be made as the payments fall within the scope of Rule 6DD(i). Salary paid to him in cash is allowable as the executive was temporarily posted for a continuous period of more than 15 days in Bangalore which is not the place of his
normal duty. Further tax was deducted from such salary under section 192 and he does not maintain any bank account in Bangalore. No disallowance under section 40A(3) is attracted in respect of such salary.

Question 5

G Ltd. is engaged in the business of growing and manufacturing tea in India. For the previous year ended 31.03.2019, its composite business profits before allowing deduction u/s 33AB is Rs. 60,00,000. On 01.09.2019, it deposited a sum of Rs. 11,00,000 in the Tea Development Account. During the previous year 2017-18, G Ltd. had incurred a business loss of Rs. 14,00,000 which has been carried forward. On 25.01.2020, it withdrew Rs. 10 lakhs, from deposit account which is utilized as under:

- Rs. 6,00,000 for purchase on non-depreciable asset as per the scheme specified.
- Rs. 3,00,000 for purchase of machinery to be installed in the office premises.
- Rs. 1,00,000 was spent for the purpose of scheme on 5.4.2020.

(i) You are required to determine business income of G Ltd. and the tax consequences that may arise from the above transactions in the relevant assessment year.

(ii) What will be the consequence if the asset which was purchased for Rs. 6,00,000 is sold for Rs. 8,00,000 in April, 2020.

Answer

(i) Computation of Business Income of G Ltd. for the A.Y. 2020-21

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rs. 10,00,000 being the amount withdrawn from Tea Development Account has to be utilized in the prescribed manner, otherwise, the withdrawn amount would be chargeable to tax as business income. In the given case, the taxability of withdrawal amount based on their utilization is as follows:</td>
<td></td>
</tr>
<tr>
<td>- Rs. 6,00,000, out of the amount withdrawn from the deposit account, utilised for purchase of non-depreciable asset as per the specified scheme. [As per section 33AB(6), no deduction would be allowed under section 33AB since amount is spent out of Rs. 11 lakh deposited in Tea Development Account, which has already been allowed as deduction in A.Y.2019-20 (See Working Note below)].</td>
<td>Not taxable</td>
</tr>
<tr>
<td>- Rs. 3,00,000, being the amount utilized for purchase of machinery to be installed in the office premises is not a permissible utilization. Hence, the amount would be deemed as profits and gains of business of the previous year 2019-20 as per section 33AB(4).</td>
<td>3,00,000</td>
</tr>
<tr>
<td>- Rs. 1,00,000 was spent for the purpose of scheme on 05.04.2020. As per section 33AB(7), this amount would be taxable since the same is not utilized during the same previous year (i.e., P.Y. 2019-20) in which the amount is withdrawn from the deposit account.</td>
<td>1,00,000</td>
</tr>
</tbody>
</table>

When any part of withdrawal amount becomes taxable, the agricultural and non-agricultural portions of income must be segregated. Accordingly, Rs. 1,60,000, being 40% of Rs. 4,00,000 (Rs. 3,00,000 + Rs. 1,00,000) would be chargeable to tax as business income and the balance Rs. 2,40,000, being 60% of Rs. 4,00,000 would be agricultural income exempt from tax.
Working Note:

Computation of Business Income of G Ltd. for the A.Y. 2019-20

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Composite business profits before allowing deduction under section 33AB</td>
<td>60,00,000</td>
</tr>
<tr>
<td>Less: Deduction under section 33AB(1) would be the lower of:</td>
<td></td>
</tr>
<tr>
<td>- Amount deposited in Tea Development Account on or before 30.9.2019 [i.e., Rs. 11,00,000]</td>
<td>11,00,000</td>
</tr>
<tr>
<td>- 40% of profits of such business [i.e., Rs. 24,00,000, being 40% of Rs. 60,00,000]</td>
<td></td>
</tr>
<tr>
<td>Less: 60% of Rs. 49,00,000, being agricultural income [as per Rule 8]</td>
<td>29,40,000</td>
</tr>
<tr>
<td>Business income</td>
<td>19,60,000</td>
</tr>
<tr>
<td>Less: Brought forward business loss of A.Y.2018-19 set-off as per section 72</td>
<td>14,00,000</td>
</tr>
<tr>
<td>Business income chargeable to tax</td>
<td>5,60,000</td>
</tr>
</tbody>
</table>

(ii) Consequences, if asset purchased out of deposit account is sold during the previous year 2020-21

As per section 33AB(8), if the asset is sold before the expiry of eight years from the end of the previous year in which it was acquired, then, the cost of such asset shall be deemed to be the profits and gains from business or profession of the previous year in which asset is sold.

Therefore, Rs. 6,00,000 would be deemed to be the business income (composite) for the A.Y.2021-22. However, since the full cost of the asset was deducted in the assessment year 2019-20 (being part of Rs. 11 lakh deposited in Tea Development Account) before segregation of agricultural income and non-agricultural income, the agricultural and non-agricultural portions of income should be segregated in the year in which such amount becomes taxable on account of sale of asset before the expiry of eight years. Therefore, Rs. 3,60,000, being 60% of Rs. 6,00,000 would represent agricultural income. The balance Rs. 2,40,000 being 40% of Rs. 6,00,000 would be chargeable to tax as business income.

Moreover, the difference between the sale consideration and purchase price of the asset would be chargeable to tax as “Short term capital gains”, which is computed as follows:

Sales consideration 8,00,000
Less: Cost of acquisition 6,00,000
Short term capital gain 2,00,000

Question 6

The trading and profit and loss account of Pingu Trading Pvt. Ltd. having business of agricultural produce, consumer items and other products for the year ended 31.03.2020 is as under:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Opening Stock</td>
<td>3,75,000</td>
<td>Sales</td>
<td>1,55,50,000</td>
</tr>
<tr>
<td>Purchases</td>
<td>1,25,75,000</td>
<td>Closing Stock</td>
<td>4,50,000</td>
</tr>
<tr>
<td>Freight &amp; Cartage</td>
<td>1,26,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Gross profit</td>
<td>29,24,000</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
## Profit and Loss Account

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bonus to staff</td>
<td>47,500</td>
<td>Gross profit</td>
<td>29,24,000</td>
</tr>
<tr>
<td>Rent of premises</td>
<td>53,500</td>
<td>Income-tax refund</td>
<td>20,000</td>
</tr>
<tr>
<td>Advertisement</td>
<td>5,000</td>
<td>Warehousing charges</td>
<td>15,000,000</td>
</tr>
<tr>
<td>Bad Debts</td>
<td>75,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interest on loans</td>
<td>1,67,500</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Depreciation</td>
<td>71,500</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Goods and Services tax demand paid</td>
<td>1,08,350</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Miscellaneous expenses</td>
<td>5,25,650</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net profit of the year</td>
<td>33,90,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>44,44,000</td>
<td></td>
<td>44,44,000</td>
</tr>
</tbody>
</table>

On scrutiny of records, the following further information and details were extracted/gathered:

(i) There was a survey under section 133A on the business premises on 31.3.2020 in which it was revealed that the value of closing stocks of 31.3.2019 was Rs. 8,75,000 and a sale of Rs. 75,000 made on 13.3.2020 was not recorded in the books. The value of closing stocks after considering these facts and on the basis of inventory prepared by the department as on 31.3.2020 worked out at Rs. 12,50,000, which was accepted to be correct and not disputed.

(ii) Income-tax refund includes amount of Rs. 4,570 of interest allowed thereon.

(iii) Bonus to staff includes an amount of Rs. 7,500 paid in the month of December 2019, which was provided in the books on 31.03.2019.

(iv) Rent of premises includes an amount of Rs. 5,500 incurred on repairs. The assessee was under no obligation to incur such expenses as per rent agreement.

(v) Advertisement expenses include an amount of Rs. 2,500 paid for advertisement published in the souvenir issued by a political party. The payment is made by way of an account payee cheque.

(vi) Miscellaneous expenses include:

   (a) amount of Rs. 15,000 paid towards penalty for non-fulfillment of delivery conditions of a contract of sale for the reasons beyond control,

   (b) amount of Rs. 1,00,000 paid to the wife of a director, who is working as junior lawyer for taking an opinion on a disputed matter. The junior advocate of High Courts normally charge only Rs. 25,000 for the same opinion,

   (c) amount of Rs. 1,00,000 paid to an Electoral Trust by cheque.

(vii) Goods and Services Tax demand paid includes an amount of Rs. 5,300 charged as penalty for delayed filing of returns and Rs. 12,750 towards interest for delay in deposit of tax.

(viii) The company had made an investment of Rs. 25 lacs on the construction of a warehouse in rural area for the purpose of storage of agricultural produce. This was made available for use from 15.09.2019 and the income from this activity is credited in the Profit and Loss account under the head “Warehousing charges”.

(ix) Depreciation under the Income-tax Act, 1961 works out at Rs. 65,000.

(x) Interest on loans includes an amount of Rs. 80,000 on which tax was not deducted.
Compute the income chargeable to tax for assessment year 2020-21 of Pingu Trading Pvt. Ltd, ignoring MAT. Support your answer with working notes.

**Answer**

**Computation of Income of Pingu Trading Pvt. Ltd. chargeable to tax for the A.Y. 2020-21**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net profit as per profit and loss account</td>
<td>33,90,000</td>
</tr>
<tr>
<td><strong>Add:</strong> Difference in the value of stocks detected on survey under section 133A on 31.03.2020 chargeable as income (See Note 1)</td>
<td>3,75,000</td>
</tr>
<tr>
<td><strong>Less:</strong> Income-tax refund credited in the profit and loss account, out of which interest is to be considered separately under the head “Income from other sources”</td>
<td>20,000</td>
</tr>
<tr>
<td><strong>Add:</strong> Expenses either not allowable or to be considered separately but charged in the profit &amp; loss account</td>
<td></td>
</tr>
<tr>
<td>Repair expenses on rented premises where assessee is under no obligation to incur such expenses are not allowable as per section 30(a)(i). However, if such expenses are required for carrying on the business efficiently, the same are allowable under section 37. In this case, assuming that such expenses are required for carrying on business efficiently, the same are allowable under section 37. Advertisement in the souvenir of political party not allowable as per section 37(2B) (See Note 3)</td>
<td>2,500</td>
</tr>
<tr>
<td>Payment made to the wife of a director examined as per section 40A(2) and the excess payment made to be disallowed (See Note 5)</td>
<td>75,000</td>
</tr>
<tr>
<td>Payment made to electoral trust by cheque (See Note 6)</td>
<td>1,00,000</td>
</tr>
<tr>
<td>Penalty levied by the Goods and Services tax department for delayed filing of returns not allowable as being paid for infraction of law (See Note 7)</td>
<td>5,300</td>
</tr>
<tr>
<td>Depreciation as per books</td>
<td>71,500</td>
</tr>
<tr>
<td>30% of interest paid on loan without deduction of tax at source not allowable as per section 40(a)(ia)</td>
<td>24,000</td>
</tr>
<tr>
<td><strong>Less:</strong> Depreciation allowable as per Income-tax Act, 1961</td>
<td>65,000</td>
</tr>
<tr>
<td><strong>Less:</strong> Income from specified business (warehousing charges) credited to profit and loss account, to be considered separately (See Note 8)</td>
<td>15,00,000</td>
</tr>
<tr>
<td><strong>Income from business (other than specified business)</strong></td>
<td>24,58,300</td>
</tr>
<tr>
<td><strong>Computation of income / loss from specified business (See Note 8)</strong></td>
<td></td>
</tr>
<tr>
<td>Income from specified business</td>
<td>Rs. 15,00,000</td>
</tr>
<tr>
<td>Less: Deduction under section 35AD @ 100% of Rs. 25 lakhs</td>
<td>Rs. 25,00,000</td>
</tr>
<tr>
<td><strong>Loss from specified business to be carried forward as per (10,00,000)</strong> section 73A</td>
<td></td>
</tr>
<tr>
<td><strong>Income from Other Sources</strong></td>
<td></td>
</tr>
<tr>
<td>Interest on income-tax refund</td>
<td>4,570</td>
</tr>
<tr>
<td><strong>Gross Total Income</strong></td>
<td>24,62,870</td>
</tr>
<tr>
<td><strong>Less: Deduction under section 80GGB</strong></td>
<td></td>
</tr>
<tr>
<td>Contribution to political party (See Note 3)</td>
<td>Rs. 2,500</td>
</tr>
</tbody>
</table>
Contribution to an Electoral trust (See Note 7)  Rs. 1,00,000  1,02,500
Total Income  23,60,370

Notes:

1. The business premises were surveyed and differences in the figures of opening and closing stocks and sales were found which have not been disputed and accepted by the assessee. Therefore, the trading account for the year is to be re-cast to arrive at the correct amount of the gross profit/net profit for the purpose of return of income to be filed for the previous year ended on 31.3.2020.

2. Bonus for the previous year 2018-19 paid after the due date for filing return for that year would have been disallowed under section 43B for the P.Y.2018-19. However, when the same has been paid in December 2019, it should be allowed as deduction in the P.Y.2019-20(A.Y. 2020-21). Since it is already included in the figure of bonus to staff debited to profit and loss account of this year, no further adjustment is required.

3. The amount of Rs. 2,500 paid for advertisement in the souvenir issued by a political party attracts disallowance under section 37(2B). However, such expenditure falls within the meaning assigned to “contribute” under section 293A of the Companies Act, 1956, and is hence, eligible for deduction under section 80GGB. Any contribution to the political party or electoral trust made by way of cash is not allowed as deduction under section 80GGB. Since in the present case, the payment to the political party is made by way of an account payee cheque, it is allowed as deduction under section 80GGB.

4. The penalty of Rs. 15,000 paid for non-fulfilment of delivery conditions of a contract for reasons beyond control is not for the breach of law but was paid for breach of contractual obligations and therefore, is an allowable expense.

5. It has been assumed that Rs. 25,000 is the reasonable payment for the wife of Director, working as a junior lawyer, since junior advocates of High Courts normally charge only Rs. 25,000 for the same opinion and therefore, the balance Rs. 75,000 has been disallowed.

6. Payment to an electoral trust qualifies for deduction under section 80GGB since the payment is made by way of a cheque. However, since the amount has been debited to profit and loss account, the same has to be added back for computing business income.

7. The interest of Rs. 12,750 paid on the delayed deposit of goods and services tax is for breach of contract and hence, is allowable as deduction. However, penalty of Rs. 5,300 for delay in filing of returns is not allowable since it is for breach of law.

Revised Trading Account

<table>
<thead>
<tr>
<th>Particular</th>
<th>Rs.</th>
<th>Particular</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Opening Stock</td>
<td>8,75,000</td>
<td>Sales</td>
<td>1,56,25,000</td>
</tr>
<tr>
<td>Purchases</td>
<td>1,25,75,000</td>
<td>(Rs. 1,55,50,000+Rs. 75,000)</td>
<td>12,50,000</td>
</tr>
<tr>
<td>Freight and Cartage</td>
<td>1,26,000</td>
<td>Closing Stock</td>
<td></td>
</tr>
<tr>
<td>Gross Profit</td>
<td>32,99,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>1,68,75,000</td>
<td></td>
<td>1,68,75,000</td>
</tr>
</tbody>
</table>

The difference of gross profit of Rs. 32,99,000 - Rs. 29,24,000 = Rs. 3,75,000 is to be added as income of the business for the year.
(8) Deduction @ 100% of the capital expenditure is available under section 35AD in respect of specified business of setting up and operating a warehouse facility for storage of agricultural produce which commences operation on or after 1.04.2012. It is presumed that Rs. 25 lacs does not include expenditure on acquisition of any land.

The loss from specified business under section 35AD (warehousing) should be segregated from the income from other businesses, since, as per section 73A(1), any loss computed in respect of any specified business referred to in section 35AD shall not be set off except against profits and gains, if any, of any other specified business.

In view of the provisions of section 73A(1), the loss of Rs. 10 lacs from the specified business cannot be set-off against income from other businesses. Such loss has to be carried forward to be set-off against profit from specified business in the next assessment year. The return should be filed on or before the due date under section 139(1) for carry forward of such losses.

Question 7
(a) A Ltd. paid IDBI (a public financial institution) a lump sum pre-payment premium of Rs. 1.2 lacs on 7.4.2019 for restructuring its debts and reducing its rate of interest. It claimed the entire sum as business expenditure for the P.Y. 2019-20. The Assessing Officer, however, held that the pre-payment premium should be amortised over a period of 10 years (being the tenure of the restructured loan), and thus, allowed only 10% of the pre-payment premium in the P.Y. 2019-20. Discuss, with reasons, whether the contention of A Ltd. is correct or that of the Assessing Officer.

Answer
(a) This issue came up before the Delhi High Court in CIT v. Gujarat Guardian Ltd (2009) 177 Taxman 434. The Court observed that the assessee company’s claim for deduction has to be allowed in one lump sum keeping in view the provisions of section 43B(d), which provide that any sum payable by the assessee as interest on any loan or borrowing from any financial institution shall be allowed to the assessee in the year in which the payment has actually been made, irrespective of the periods, in which the liability to pay such sum is incurred by the assessee according to the method of accounting regularly followed by the assessee. The High Court concurred with the Tribunal’s view supporting the assessee that in terms of section 36(1)(iii) read with section 2(28A), the deduction for pre-payment premium was allowable. Since there was no dispute that the pre-payment premium was nothing but interest and that it was paid to a public financial institution i.e. IDBI, the Court held that, in terms of section 43B(d), the assessee’s claim for deduction has to be allowed in the year in which the payment has actually been made.

Therefore, applying the ratio of the above case, the contention of A Ltd. is correct and not that of the Assessing Officer.

Note – Section 36(1)(iii) provides for deduction of interest paid in respect of capital borrowed for the purposes of business or profession. Section 2(28A)
defines interest to include, inter alia, any other charge in respect of the moneys borrowed or debt incurred. Section 43B provides for certain deductions to be allowed only on actual payment. From a combined reading of these three sections, it can be inferred that –

(i) pre-payment premium represents interest as per section 2(28A);
(ii) such interest is deductible as business expenditure as per section 36(1)(iii);
(iii) such interest is deductible in one lump-sum on actual payment as per section 43B(d).

(b) As per ICDS V on Tangible Fixed Assets, machinery spares shall be charged to the revenue as and when consumed. When such spares can be used only in connection with an item of tangible fixed asset and their use is expected to be irregular, they shall be capitalised. Where the spares are capitalised as per the above requirement, the issue as to provision of depreciation arises — whether depreciation can be provided where such spares are kept ready for use or is it necessary that they are actually put to use. This issue was dealt with by the Delhi High Court in CIT v. Insilco Ltd (2010) 320ITR 322. The Court observed that the expression “used for the purposes of business” appearing in section 32 also takes into account emergency spares, which, even though ready for use, yet are not consumed or used during the relevant period. This is because these spares are specific to a fixed asset, namely plant and machinery, and form an integral part of the fixed asset. These spares will, in all probability, be useless once the asset is discarded and will also have to be disposed of. In this sense, the concept of passive use which applies to standby machinery will also apply to emergency spares. Therefore, once the spares are considered as emergency spares required for plant and machinery, the assessee would be entitled to capitalize the entire cost of such spares and claim depreciation thereon.

Note – One of the conditions for claim of depreciation is that the asset must be “used for the purpose of business or profession”. In the past, courts have held that, in certain circumstances, an asset can be said to be in use even when it is “kept ready for use”. For example, depreciation can be claimed by a transport company on spare engines kept in store in case of need, though they have not actually been used by the company. Hence, in such cases, the term “use” embraces both active use and passive use for business purposes.

Question 8

“Easy Call Ltd.”, to provide telecom services in Mumbai, obtained a licence on 1.4.2017 for a period of 10 years ending on 31.3.2027 against a fee of Rs. 27 lacs to be paid in 3 installments of Rs. 9 lacs each by April, 2017, April, 2018 and April, 2019, respectively. The company has commenced business on 1.5.2018.

Explain, how the payment made for licence fee shall be dealt with under the Income-tax Act, 1961 and the amount, if any, deductible for A.Y. 2020-21.

Answer

The payment made for acquiring the licence to operate telecom services in Mumbai shall be subject to deduction as per the scheme in section 35ABB. As per section 35ABB, any amount actually paid for obtaining licence to operate telecommunication services shall be allowed as deduction in equal instalments during the number of years for which the license is in force.
If the payment is made before the commencement of business: The deduction shall be allowed beginning with the year of commencement of business.

In any other case: It will be allowed commencing from the year of payment. Deduction shall be allowed up to the year in which the license shall cease to be in force.

The amount of deduction available for A.Y. 2020-21 is worked out below:

<table>
<thead>
<tr>
<th>(1) Previous year of payment</th>
<th>(2) Unexpired period of license</th>
<th>(3) Instalment paid (Rs.)</th>
<th>(4) Deduction in respect of each instalment (Rs.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2017-18</td>
<td>9 years</td>
<td>9,00,000</td>
<td>1,00,000</td>
</tr>
<tr>
<td>2018-19</td>
<td>9 years</td>
<td>9,00,000</td>
<td>1,00,000</td>
</tr>
<tr>
<td>2019-20</td>
<td>8 years</td>
<td>9,00,000</td>
<td>1,12,500</td>
</tr>
<tr>
<td></td>
<td></td>
<td>27,00,000</td>
<td>3,12,500</td>
</tr>
</tbody>
</table>

The deduction under section 35ABB from assessment year 2020-21 shall be Rs. 3,12,500.

Question 9
Alpha Ltd., a manufacturing company, has disclosed a net profit of Rs. 12.50 lacs for the year ended 31st March, 2020. You are required to compute the taxable income of the company for the Assessment year 2020-21, after considering the following information, duly explaining the reasons for each item of adjustment:

(i) Advertisement expenditure debited to profit and loss account includes the sum of Rs. 60,000 paid in cash to the sister concern of a director, the market value of which is Rs. 52,000.

(ii) Repairs of plant and machinery debited to profit and loss account includes Rs. 1.80 lacs towards replacement of worn out parts of machineries. Such expenditure does not increase the future benefit from the asset beyond its previously assessed standard of performance.

(iii) A sum of Rs. 6,000 on account of liability foregone by a creditor has been taken to general reserve. The original purchases was debited to the Profit & Loss Account in the A.Y. 2015-16.

(iv) Sale proceeds of import entitlements amounting to Rs. 1 lac has been credited to Profit & Loss Account, which the company claims as capital receipt not chargeable to income-tax.

(v) Being also engaged in the biotechnology business, the company incurred the following expenditure on in-house research and development as approved by the prescribed authority:

(a) Research equipments purchased Rs. 1,50,000.

(b) Remuneration paid to scientists Rs. 50,000.

The total amount of Rs. 2,00,000 is debited to the profit and loss account.

Answer

Computation of taxable income of Alpha Ltd. for the A.Y. 2020-21

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net profit as per profit and loss account</td>
<td>12,50,000</td>
</tr>
<tr>
<td>Add: Items debited to profit and loss A/c but not deductible or income to be taxed</td>
<td></td>
</tr>
<tr>
<td>1. Payment of advertisement expenditure of Rs. 60,000</td>
<td></td>
</tr>
</tbody>
</table>

6.15
(i) **Rs. 8,000**, being the excess payment to a relative disallowed under section 40A(2) 

(ii) As the payment is made in cash and since the remaining amount of **Rs. 52,000** exceeds **Rs. 10,000**, 100% shall be disallowed under section 40A(3) 

2. Under section 31, expenditure relatable to current repairs regarding plant, machinery or furniture is allowed as deduction.

   The test to determine whether replacement of parts of machinery amounts to repair or renewal is whether the replacement is one which is in substance replacement of defective parts or replacement of the entire machinery or substantial part of the entire machinery 

   

   [CIT v. Darbhanga Sugar Co. Ltd. [1956] 29 ITR 21 (Pat)].

   Here expenditure on repairs does not bring in any new asset into existence. Such replacement can only be considered as current repairs. Hence, no adjustment is required.

   Further, as per ICDS V on Tangible Fixed Assets, only an expenditure that increases the future benefits from the existing asset beyond its previously assessed standard of performance has to be added to the actual cost.

3. Liability foregone by creditor chargeable as business income but not credited to profit and loss account [taxable under section 41(1)] 

4. Sale proceeds of import entitlements. The sale of the rights gives rise to profits or gains taxable under section 28(iiiia). As the amount has already been credited to profit and loss account, no further adjustment is necessary.

**Less: Amount not debited to profit and loss account but allowable as deduction**

5. Expenditure on in-house research and development is entitled to a weighted deduction of 150% of the expenditure (both capital and revenue) so incurred under section 35(2AB)(1) = **Rs. 2 lacs × 150% = Rs. 3 lacs**

   Expenditure of **Rs. 2,00,000** has already been debited to Profit & Loss Account, therefore only additional deduction of **Rs. 1 lacs** further to be allowed 

**Taxable Income**  

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>(i) Rs. 8,000</strong>, being the excess payment to a relative disallowed under section 40A(2)</td>
<td>8,000</td>
</tr>
<tr>
<td><strong>(ii) As the payment is made in cash and since the remaining amount of Rs. 52,000 exceeds Rs. 10,000, 100% shall be disallowed under section 40A(3)</strong></td>
<td>52,000</td>
</tr>
<tr>
<td>Under section 31, expenditure relatable to current repairs regarding plant, machinery or furniture is allowed as deduction.</td>
<td></td>
</tr>
<tr>
<td>The test to determine whether replacement of parts of machinery amounts to repair or renewal is whether the replacement is one which is in substance replacement of defective parts or replacement of the entire machinery or substantial part of the entire machinery [CIT v. Darbhanga Sugar Co. Ltd. [1956] 29 ITR 21 (Pat)].</td>
<td></td>
</tr>
<tr>
<td>Here expenditure on repairs does not bring in any new asset into existence. Such replacement can only be considered as current repairs. Hence, no adjustment is required.</td>
<td></td>
</tr>
<tr>
<td>Further, as per ICDS V on Tangible Fixed Assets, only an expenditure that increases the future benefits from the existing asset beyond its previously assessed standard of performance has to be added to the actual cost.</td>
<td></td>
</tr>
<tr>
<td>Liability foregone by creditor chargeable as business income but not credited to profit and loss account [taxable under section 41(1)]</td>
<td>6,000</td>
</tr>
<tr>
<td>Sale proceeds of import entitlements. The sale of the rights gives rise to profits or gains taxable under section 28(iiiia). As the amount has already been credited to profit and loss account, no further adjustment is necessary.</td>
<td>-</td>
</tr>
<tr>
<td>Expenditure on in-house research and development is entitled to a weighted deduction of 150% of the expenditure (both capital and revenue) so incurred under section 35(2AB)(1) = Rs. 2 lacs × 150% = Rs. 3 lacs</td>
<td></td>
</tr>
<tr>
<td>Expenditure of Rs. 2,00,000 has already been debited to Profit &amp; Loss Account, therefore only additional deduction of Rs. 1 lacs further to be allowed</td>
<td>1,00,000</td>
</tr>
<tr>
<td><strong>Taxable Income</strong></td>
<td>12,16,000</td>
</tr>
</tbody>
</table>

**Question 10**

(i) A corporation was set up by the State Government transferring all the buses owned by it for a consideration of Rs. 75 lacs, which was discharged by the Corporation by issue of equity shares. The Corporation in its assessment claimed depreciation. Can the depreciation be denied in the Corporation’s hands on the ground that there was no registration of the buses in favour of the Corporation?

(ii) Ravi succeeded to his father’s business in the year 2017. In the previous year ended 31.3.2020, Ravi has written off the balance in the name of ‘Y’ which relates to supply made by his father, when he carried on business. Ravi desires to know whether the write off could be eligible for deduction.
Answer

(i) The decision of the Supreme Court in *Mysore Minerals Ltd v. CIT* (1999) 239 ITR 775 is relevant in the context of the facts stated. The term “asset used” in section 32 must be assigned a wider meaning and anyone in possession of property in his own title, exercising dominion over the property, to the exclusion of others and having the right to use and enjoy it, must be taken to be the owner. Registration of the buses is only a formality to perfect the title and does not bar enjoyment. The Corporation cannot, therefore, be denied depreciation on the buses. A similar decision was also taken in *CIT v. J & K Tourism Development Corporation* (2001) 114 Taxman 734 (J&K).

(ii) The deduction of bad debt is allowed if it is written off in the books of account of the assessee. In this case, Ravi has succeeded to the business carried on by his father. Under clause (vii) of section 36(1) the amount has been written off in the books of account as irrecoverable is eligible for deduction provided the debt has been taken into account in computing the income of the business in an earlier previous year [vide section 36(2)].

Therefore, Ravi is eligible for deduction in respect of the amount due in the name of Y which is written off in the books of account as bad debt, even though the debt represents the amount due for the supplies made by previous owner viz. deceased father of Ravi.[*CIT v. T. Veerabhadra Rao, K. Koteswara Rao and Co* (1985) 155 ITR 152 (SC)].

Question 11

*B..."
### Illustration 1

Mr. X, a proprietor engaged in manufacturing business, furnishes the following particulars:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1) Opening WDV of plant and machinery as on 1.4.2019</td>
<td>30,00,000</td>
</tr>
<tr>
<td>(2) New plant and machinery purchased and put to use on 08.06.2019</td>
<td>20,00,000</td>
</tr>
<tr>
<td>(3) New plant and machinery acquired and put to use on 15.12.2019</td>
<td>8,00,000</td>
</tr>
<tr>
<td>(4) Computer acquired and installed in the office premises on 2.1.2020</td>
<td>3,00,000</td>
</tr>
</tbody>
</table>

Compute the amount of depreciation and additional depreciation as per the Income-tax Act, 1961 for the A.Y. 2020-21. Assume that all the assets were purchased by way of account payee cheque.

### Solution

#### Computation of depreciation and additional depreciation for A.Y. 2020-21

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Plant &amp; Machinery (15%) (Rs.)</th>
<th>Computer (40%) (Rs.)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Normal depreciation</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• @ 15% on Rs. 50,00,000</td>
<td>7,50,000</td>
<td>-</td>
</tr>
<tr>
<td>• @ 7.5% (50% of 15%, since put to use for less than 180 days) on Rs. 8,00,000</td>
<td>60,000</td>
<td>-</td>
</tr>
<tr>
<td>• @ 20% (50% of 40%, since put to use for less than 180 days) on Rs. 3,00,000</td>
<td>-</td>
<td>60,000</td>
</tr>
<tr>
<td><strong>Additional Depreciation</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• @ 20% on Rs. 20,00,000 (new plant and machinery put to use for more than 180 days)</td>
<td>4,00,000</td>
<td>-</td>
</tr>
<tr>
<td>• @ 10% (50% of 20%, since put to use for less than 180 days) on Rs. 8,00,000</td>
<td>80,000</td>
<td>-</td>
</tr>
<tr>
<td><strong>Total depreciation</strong></td>
<td>12,90,000</td>
<td>60,000</td>
</tr>
</tbody>
</table>

#### Working Notes:

1. **Computation of written down value of Plant & Machinery as on 31.03.2020**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Plant &amp; Machinery (Rs.)</th>
<th>Computer (Rs.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Written down value as on 1.4.2019</td>
<td>30,00,000</td>
<td>-</td>
</tr>
<tr>
<td>Add: Plant &amp; Machinery purchased on 08.6.2019</td>
<td>20,00,000</td>
<td>-</td>
</tr>
<tr>
<td>Add: Plant &amp; Machinery acquired on 15.12.2019</td>
<td>8,000,000</td>
<td>-</td>
</tr>
<tr>
<td>Computer acquired and installed in the office premises</td>
<td>-</td>
<td>3,000,000</td>
</tr>
<tr>
<td><strong>Written down value as on 31.03.2020</strong></td>
<td>58,00,000</td>
<td>3,000,000</td>
</tr>
</tbody>
</table>

2. **Composition of plant and machinery included in the WDV as on 31.3.2020**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Plant &amp; Machinery (Rs.)</th>
<th>Computer (Rs.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Plant and machinery put to use for 180 days or more</td>
<td>50,00,000</td>
<td>-</td>
</tr>
</tbody>
</table>
[Rs. 30,00,000 (Opening WDV) + Rs. 20,00,000 (purchased on 8.6.2019)]

Plant and machinery put to use for less than 180 days | 8,00,000
---|---
Computers put to use for less than 180 days | 3,00,000

58,00,000 3,00,000

Notes:

1. As per the second proviso to section 32(1)(ii), where an asset acquired during the previous year is put to use for less than 180 days in that previous year, the amount of deduction allowable as normal depreciation and additional depreciation would be restricted to 50% of amount computed in accordance with the prescribed percentage.

Therefore, normal depreciation on plant and machinery acquired and put to use on 15.12.2019 and computer acquired and installed on 02.01.2020, is restricted to 50% of 15% and 40%, respectively. The additional depreciation on the said plant and machinery is restricted to Rs. 80,000, being 10% (i.e., 50% of 20%) of Rs. 8 lakh.

2. As per third proviso to section 32(1)(ii), the balance additional depreciation of Rs. 80,000 being 50% of Rs. 1,60,000 (20% of Rs. 8,00,000) would be allowed as deduction in the A.Y.2021-22.

3. As per section 32(1)(iia), additional depreciation is allowable in the case of any new machinery or plant acquired and installed after 31.3.2005 by an assessee engaged, inter alia, in the business of manufacture or production of any article or thing, @20% of the actual cost of such machinery or plant.

However, additional depreciation shall not be allowed in respect of, inter alia, any machinery or plant installed in office premises, residential accommodation or in any guest house.

Accordingly, additional depreciation is not allowable on computer installed in the office premises.

Illustration 2

A newly qualified Chartered Accountant Mr. Dhaval commenced practice and has acquired the following assets in his office during F.Y. 2019-20 at the cost shown against each item. Calculate the amount of depreciation that can be claimed from his professional income for A.Y.2020-21: Assume that all the assets were purchased by way of account payee cheque.

<table>
<thead>
<tr>
<th>SL. No.</th>
<th>Description</th>
<th>Date of acquisition</th>
<th>Date when put to use</th>
<th>Amount Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Computer including computer software</td>
<td>27 Sept., 19</td>
<td>1 Oct., 19</td>
<td>35,000</td>
</tr>
<tr>
<td>2.</td>
<td>Computer UPS</td>
<td>2 Oct., 19</td>
<td>8 Oct., 19</td>
<td>8,500</td>
</tr>
<tr>
<td>3.</td>
<td>Computer printer</td>
<td>1 Oct., 19</td>
<td>1 Oct., 19</td>
<td>12,500</td>
</tr>
<tr>
<td>4.</td>
<td>Books (of which books being annual publications are of Rs. 12,000)</td>
<td>1 Apr., 19</td>
<td>1 Apr., 19</td>
<td>13,000</td>
</tr>
<tr>
<td>5.</td>
<td>Office furniture (Acquired from a practising C.A.)</td>
<td>1 Apr., 19</td>
<td>1 Apr., 19</td>
<td>3,00,000</td>
</tr>
<tr>
<td>6.</td>
<td>Laptop</td>
<td>26 Sep., 19</td>
<td>8 Oct., 19</td>
<td>43,000</td>
</tr>
</tbody>
</table>
### Solution

**Computation of depreciation allowable for A.Y.2020-21**

<table>
<thead>
<tr>
<th>Asset</th>
<th>Rate</th>
<th>Depreciation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Block 1 Furniture [See working note below]</td>
<td>10%</td>
<td>30,000</td>
</tr>
<tr>
<td>Block 2 Plant (Computer including computer software, computer UPS, laptop, printers &amp; books)</td>
<td>40%</td>
<td>34,500</td>
</tr>
<tr>
<td><strong>Total depreciation allowable</strong></td>
<td></td>
<td><strong>64,500</strong></td>
</tr>
</tbody>
</table>

**Working Notes:**

**Computation of depreciation**

<table>
<thead>
<tr>
<th>Block of Assets</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Block 1: Furniture – [Rate of depreciation - 10%]</strong></td>
<td></td>
</tr>
<tr>
<td>Put to use for more than 180 days [Rs. 3,00,000@10%]</td>
<td>30,000</td>
</tr>
<tr>
<td><strong>Block 2: Plant [Rate of depreciation - 40%]</strong></td>
<td></td>
</tr>
<tr>
<td>(a) Computer including computer software (put to use for more than 180 days) [Rs. 35,000 @ 40%]</td>
<td>14,000</td>
</tr>
<tr>
<td>(b) Computer UPS (put to use for less than 180 days) [Rs. 8,500 @ 20%] [See note below]</td>
<td>1,700</td>
</tr>
<tr>
<td>(c) Computer Printer (put to use for more than 180 days) [Rs. 12,500 @ 40%]</td>
<td>5,000</td>
</tr>
<tr>
<td>(d) Laptop (put to use for less than 180 days) [Rs. 43,000 @ 20%] [See note below]</td>
<td>8,600</td>
</tr>
<tr>
<td>(e) Books (other than annual publications) (Put to use for more than 180 days) [Rs. 13,000 @ 40%]</td>
<td>5,200</td>
</tr>
<tr>
<td><strong>Total depreciation allowable</strong></td>
<td><strong>34,500</strong></td>
</tr>
</tbody>
</table>

**Note** - Where an asset is acquired by the assessee during the previous year and is put to use for the purposes of business or profession for a period of less than 180 days, the deduction on account of depreciation would be restricted to 50% of the prescribed rate. In this case, since Mr. Dhaval commenced his practice in the P.Y.2019-20 and acquired the assets during the same year, the restriction of depreciation to 50% of the prescribed rate would apply to those assets which have been put to use for less than 180 days in that year, namely, laptop and computer UPS.

**Illustration 3**

*Sai Ltd. has a block of assets carrying 15% rate of depreciation, whose written down value on 01.04.2019 was Rs. 40 lacs. It purchased another asset (second-hand plant and machinery) of the same block on 01.11.2019 for Rs. 14.40 lacs and put to use on the same day. Sai Ltd. was amalgamated with Shirdi Ltd. with effect from 01.01.2020.

You are required to compute the depreciation allowable to Sai Ltd. & Shirdi Ltd. for the previous year ended on 31.03.2020 assuming that the assets were transferred to Shirdi Ltd. at Rs. 60 lacs. Also assume that the plant and machinery were purchased by way of account payee cheque.*

**Solution**

**Statement showing computation of depreciation allowable to Sai Ltd. & Shirdi Ltd. for A.Y. 2020-21**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Written down value (WDV) as on 1.4.2019</td>
<td>40,00,000</td>
</tr>
<tr>
<td>Addition during the year (used for less than 180 days)</td>
<td>14,40,000</td>
</tr>
</tbody>
</table>
**Total** | 54,40,000
---|---
Depreciation on Rs. 40,00,000 @ 15% | 6,00,000
Depreciation on Rs. 14,40,000 @ 7.5% | 1,08,000
**Total depreciation for the year** | 7,08,000

**Apportionment between two companies:**
(a) Amalgamating company, Sai Ltd.

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Rs. 6,00,000 × 275/366</td>
<td>4,50,820</td>
</tr>
<tr>
<td>Rs. 1,08,000 × 61/152</td>
<td>43,342</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>4,94,162</strong></td>
</tr>
</tbody>
</table>

(b) Amalgamated company, Shirdi Ltd.

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Rs. 6,00,000 × 90/366</td>
<td>1,49,180</td>
</tr>
<tr>
<td>Rs. 1,08,000 × 90/152</td>
<td>64,658</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>2,13,838</strong></td>
</tr>
</tbody>
</table>

**Notes:**
(i) The aggregate deduction, in respect of depreciation allowable to the amalgamating company and amalgamated company in the case of amalgamation shall not exceed in any case, the deduction calculated at the prescribed rates as if the amalgamation had not taken place. Such deduction shall be apportioned between the amalgamating company and the amalgamated company in the ratio of the number of days for which the assets were used by them.
(ii) The price at which the assets were transferred, i.e., Rs. 60 lacs, has no implication in computing eligible depreciation.

**Illustration 4**

*Lights and Power Ltd.* engaged in the business of generation of power, furnishes the following particulars pertaining to P.Y. 2019-20. Compute the depreciation allowable under section 32 for A.Y. 2020-21, while computing his income under the head “Profits and gains of business or profession”. The company has opted for the depreciation allowance on the basis of written down value. Assume that all the assets were purchased by way of account payee cheque.

<table>
<thead>
<tr>
<th><strong>Particulars</strong></th>
<th><strong>(Rs.)</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>1.</strong> Opening Written down value of Plant and Machinery (15% block) as on 01.04.2019 (Purchase value Rs. 8,00,000)</td>
<td>5,78,000</td>
</tr>
<tr>
<td><strong>2.</strong> Purchase of second hand machinery (15% block) on 29.12.2019 for business purpose</td>
<td>2,00,000</td>
</tr>
<tr>
<td><strong>3.</strong> Machinery Y (15% block) purchased and installed on 12.07.2019 for the purpose of power generation</td>
<td>8,00,000</td>
</tr>
<tr>
<td><strong>4.</strong> Acquired and installed for use a new air pollution control equipment on 31.7.2019</td>
<td>2,50,000</td>
</tr>
<tr>
<td><strong>5.</strong> New air conditioner purchased and installed in office premises on 8.9.2019</td>
<td>3,00,000</td>
</tr>
<tr>
<td><strong>6.</strong> New machinery Z (15% block) acquired and installed on 23.11.2019 for the purpose of generation of power</td>
<td>3,25,000</td>
</tr>
<tr>
<td><strong>7.</strong> Sale value of an old machinery X, sold during the year (Purchase value Rs. 4,80,000, WDV as on 01.04.2019 Rs. 3,46,800)</td>
<td>3,10,000</td>
</tr>
</tbody>
</table>
Solution

Computation of depreciation allowance under section 32 for the A.Y. 2020-21

<table>
<thead>
<tr>
<th>Particulars</th>
<th>(Rs.)</th>
<th>Plant and Machinery (15%) (Rs.)</th>
<th>Plant and Machinery (40%) (Rs.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Opening WDV as on 01.04.2019</td>
<td></td>
<td>5,78,000</td>
<td></td>
</tr>
<tr>
<td>Add: Plant and Machinery acquired during the year</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Second hand machinery</td>
<td>2,00,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Machinery Y</td>
<td>8,00,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Air conditioner for office</td>
<td>3,00,000</td>
<td>16,25,000</td>
<td>2,50,000</td>
</tr>
<tr>
<td>- Machinery Z</td>
<td>3,25,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Air pollution control equipment</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Less: Asset sold during the year</td>
<td></td>
<td>22,03,000</td>
<td>2,50,000</td>
</tr>
<tr>
<td>Written down value before charging depreciation</td>
<td>3,10,000</td>
<td></td>
<td>Nil</td>
</tr>
<tr>
<td>Normal depreciation</td>
<td></td>
<td>18,93,000</td>
<td>2,50,000</td>
</tr>
<tr>
<td>40% on air pollution control equipment (Rs. 2,50,000 × 40%)</td>
<td></td>
<td></td>
<td>1,00,000</td>
</tr>
<tr>
<td>Depreciation on plant and machinery put to use for less than 180 days@ 7.5% (i.e., 50% of 15%)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Second hand machinery (Rs. 2,00,000 × 7.5%)</td>
<td>15,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Machinery Z (Rs. 3,25,000 × 7.5%)</td>
<td>24,375</td>
<td>39,375</td>
<td></td>
</tr>
<tr>
<td>15% on the balance WDV being put to use for more than 180 days (Rs. 13,68,000 × 15%)</td>
<td></td>
<td>2,05,200</td>
<td></td>
</tr>
<tr>
<td>Additional depreciation</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Machinery Y (Rs. 8,00,000 × 20%)</td>
<td>1,60,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Machinery Z (Rs. 3,25,000 × 10%, being 50% of 20%)</td>
<td>32,500</td>
<td>1,92,500</td>
<td></td>
</tr>
<tr>
<td>- Air pollution control equipment (Rs. 2,50,000 × 20%)</td>
<td></td>
<td></td>
<td>50,000</td>
</tr>
<tr>
<td>Total depreciation</td>
<td></td>
<td>4,37,075</td>
<td>1,50,000</td>
</tr>
</tbody>
</table>

Notes:
(i) Power generation equipments qualify for claiming additional depreciation in respect of new plant and machinery.
(ii) Additional depreciation is not allowed in respect of second hand machinery.
(iii) No additional depreciation is allowed in respect of office appliances. Hence, no depreciation is allowed in respect of air conditioner installed in office premises.
(iv) The balance 50% additional depreciation in respect of Machinery Z of Rs. 32,500 (10% × Rs. 3,25000) can be claimed as deduction in subsequent financial year i.e., F.Y. 2020-21.

Illustration 5

X Ltd. set up a manufacturing unit in Warangal in the state of Telangana on 01.06.2019. It invested Rs. 30 crore in new plant and machinery on 1.6.2019. Further, it invested Rs. 25 crore in the plant and machinery on 01.11.2019, out of which Rs. 5 crore was second hand plant and machinery. Compute the depreciation allowable under section 32. Is X
Ltd. entitled for any other benefit in respect of such investment? If so, what is the benefit available?

Solution

(i) Computation of depreciation under section 32 for X Ltd. for A.Y. 2020-21

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs. (in crores)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Plant and machinery acquired on 01.06.2019</td>
<td>30.000</td>
</tr>
<tr>
<td>Plant and machinery acquired on 01.11.2019</td>
<td>25.000</td>
</tr>
<tr>
<td><strong>WDV as on 31.03.2020</strong></td>
<td><strong>55.000</strong></td>
</tr>
<tr>
<td><strong>Less:</strong> Depreciation @ 15% on Rs. 30 crore</td>
<td>4.500</td>
</tr>
<tr>
<td>Depreciation @ 7.5% (50% of 15%) on Rs. 25 crore</td>
<td>1.875</td>
</tr>
<tr>
<td>Additional Depreciation@35% on Rs. 30 crore</td>
<td>10.500</td>
</tr>
<tr>
<td>Additional Depreciation@17.5% (50% of 35%) on Rs. 20 crore</td>
<td>3.500</td>
</tr>
<tr>
<td><strong>WDV as on 01.04.2020</strong></td>
<td><strong>34.625</strong></td>
</tr>
</tbody>
</table>

(ii) Computation of deduction under section 32AD for X Ltd. for A.Y. 2020-21

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs. (in crores)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Deduction under section 32AD @ 15% on Rs. 50 crore</td>
<td>7.50</td>
</tr>
<tr>
<td><strong>Total benefit</strong></td>
<td><strong>7.50</strong></td>
</tr>
</tbody>
</table>

Notes:

1. As per the second proviso to section 32(1)(ii), where an asset acquired during the previous year is put to use for less than 180 days in that previous year, the amount deduction allowable as normal depreciation and additional depreciation would be restricted to 50% of amount computed in accordance with the prescribed percentage.

Therefore, normal depreciation on plant and machinery acquired and put to use on 1.11.2019 is restricted to 7.5% (being 50% of 15%) and additional depreciation is restricted to 17.5% (being 50% of 35%).

2. The balance additional depreciation of Rs. 3.5 crore, being 50% of Rs. 7 crore (35% of Rs. 20 crore) would be allowed as deduction in the A.Y. 2021-22.

3. As per section 32(1)(iiia), additional depreciation is allowable in the case of any new machinery or plant acquired and installed after 31.3.2005 by an assessee engaged, inter alia, in the business of manufacture or production of any article or thing. In this case, since new plant and machinery acquired was installed by a manufacturing unit set up in a notified backward area in the State of Telengana, the rate of additional depreciation is 35% of actual cost of new plant and machinery. Since plant and machinery of Rs. 20 crore was put to use for less than 180 days, additional depreciation@17.5% (50% of 35%) is allowable as deduction. However, additional depreciation shall not be allowed in respect of second hand plant and machinery of Rs. 5 crore.

Likewise, the benefit available under sections 32AD would not be allowed in respect of second hand plant and machinery.

Accordingly, additional depreciation and investment allowance under section 32AD have not been provided on Rs. 5 crore, being the actual cost of second hand plant and machinery acquired and installed in the previous year.
Illustration 6

A Ltd., engaged in the business of manufacturing, furnishes the following particulars for the P.Y.2019-20. Compute the deduction allowable under section 35 for A.Y.2020-21, while computing its income under the head “Profits and gains of business or profession”.

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Amount paid to Indian Institute of Science, Bangalore, for scientific research</td>
<td>1,00,000</td>
</tr>
<tr>
<td>2. Amount paid to IIT, Delhi for an approved scientific research programme</td>
<td>2,50,000</td>
</tr>
<tr>
<td>3. Amount paid to X Ltd., a company registered in India which has as its main object scientific research and development, as is approved by the prescribed authority</td>
<td>4,00,000</td>
</tr>
<tr>
<td>4. Expenditure incurred on in-house research and development facility as approved by the prescribed authority</td>
<td></td>
</tr>
<tr>
<td>(a) Revenue expenditure on scientific research</td>
<td>3,00,000</td>
</tr>
<tr>
<td>(b) Capital expenditure (including cost of acquisition of land Rs. 5,00,000) on scientific research</td>
<td>7,50,000</td>
</tr>
</tbody>
</table>

Solution

**Computation of deduction under section 35 for the A.Y.2020-21**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
<th>Section</th>
<th>% of weighted deduction</th>
<th>Amount of deduction (Rs.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Payment for scientific research</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Indian Institute of Science</td>
<td>1,00,000</td>
<td>35(1)(ii)</td>
<td>150%</td>
<td>1,50,000</td>
</tr>
<tr>
<td>IIT, Delhi</td>
<td>2,50,000</td>
<td>35(2AA)</td>
<td>150%</td>
<td>3,75,000</td>
</tr>
<tr>
<td>X Ltd.</td>
<td>4,00,000</td>
<td>35(1)(iii)</td>
<td>100%</td>
<td>4,00,000</td>
</tr>
<tr>
<td>Expenditure incurred on in-house research and development facility</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Revenue expenditure</td>
<td>3,00,000</td>
<td>35(2AB)</td>
<td>150%</td>
<td>4,50,000</td>
</tr>
<tr>
<td>Capital expenditure (excluding cost of acquisition of land Rs. 5,00,000)</td>
<td>2,50,000</td>
<td>35(2AB)</td>
<td>150%</td>
<td>3,75,000</td>
</tr>
</tbody>
</table>

**Deduction allowable under section 35**

17,50,000

Illustration 7

Mr. A commenced operations of the businesses of setting up a warehousing facility for storage of food grains, sugar and edible oil on 1.4.2019. He incurred capital expenditure of Rs. 80 lakh, Rs. 60 lakh and Rs. 50 lakh, respectively, on purchase of land and building during the period January, 2019 to March, 2019 exclusively for the above businesses, and capitalized the same in its books of account as on 1st April, 2019. The cost of land included in the above figures are Rs. 50 lakh, Rs. 40 lakh and Rs. 30 lakh, respectively. Further, during the P.Y.2019-20, he incurred capital expenditure of Rs. 20 lakh, Rs. 15 lakh & Rs. 10 lakh, respectively, for extension/ reconstruction of the building purchased and used exclusively for the above businesses.

The profits from the business of setting up a warehousing facility for storage of food grains, sugar and edible oil (before claiming deduction under section 35AD and section 32) for the A.Y. 2020-21 is Rs. 16 lakhs, Rs. 14 lakhs and Rs. 31 lakhs, respectively.

Compute the income under the head "Profits and gains of business or profession" for the A.Y.2020-21 and the loss to be carried forward, assuming that Mr. A has fulfilled all the
conditions specified for claim of deduction under section 35AD and has not claimed any deduction under Chapter VI-A under the heading “C. – Deductions in respect of certain incomes”. Assume in respect of expenditure incurred, the payments are made by account payee cheque or use of ECS through bank account.

Solution

Computation of profits and gains of business or profession for A.Y. 2020-21

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs. (in lakhs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profit from business of setting up of warehouse for storage of edible oil</td>
<td>31</td>
</tr>
<tr>
<td>(before providing for depreciation under section 32)</td>
<td></td>
</tr>
<tr>
<td>Less: Depreciation under section 32</td>
<td></td>
</tr>
<tr>
<td>10% of Rs. 30 lakh, being (Rs. 50 lakh – Rs. 30 lakh + Rs. 10 lakh)</td>
<td>3</td>
</tr>
<tr>
<td>Income chargeable under “Profits and gains from business or profession”</td>
<td>28</td>
</tr>
</tbody>
</table>

Computation of income/loss from specified business under section 35AD

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Food</th>
<th>Sugar</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>(A) Profits from the specified business of setting up a warehousing facility (before providing deduction under section 35AD)</td>
<td>16</td>
<td>14</td>
<td>30</td>
</tr>
<tr>
<td>(B) Capital expenditure incurred prior to 1.4.2017 (i.e., prior to commencement of business) and capitalized in the books of account as on 1.4.2017 (excluding the expenditure incurred on acquisition of land) = Rs. 30 lakh (Rs. 80 lakh – Rs. 50 lakh) and Rs. 20 lakh (Rs. 60 lakh – Rs. 40 lakh)</td>
<td>30</td>
<td>20</td>
<td>50</td>
</tr>
<tr>
<td>(C) Capital expenditure incurred during the P.Y. 2018-19</td>
<td>20</td>
<td>15</td>
<td>35</td>
</tr>
<tr>
<td>(D) Total capital expenditure (B + C)</td>
<td>50</td>
<td>35</td>
<td>85</td>
</tr>
<tr>
<td>(E) Deduction under section 35AD</td>
<td>50</td>
<td>35</td>
<td>85</td>
</tr>
<tr>
<td>100% of capital expenditure</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total deduction u/s 35AD for A.Y. 2020-21</td>
<td>50</td>
<td>35</td>
<td>85</td>
</tr>
<tr>
<td>(F) Loss from the specified business of setting up and operating a warehousing facility (after providing for deduction under section 35AD) to be carried forward as per section 73A (A-E)</td>
<td>(34)</td>
<td>(21)</td>
<td>(55)</td>
</tr>
</tbody>
</table>

Notes:

(i) Deduction of 100% of the capital expenditure is available under section 35AD for A.Y.2020-21 in respect of specified business of setting up and operating a warehousing facility for storage of sugar and setting up and operating a warehousing facility for storage of agricultural produce where operations are commenced on or after 01.04.2012 or on or after 01.04.2009, respectively.

(ii) However, since setting up and operating a warehousing facility for storage of edible oils is not a specified business, Mr. A is not eligible for deduction under section 35AD in respect of capital expenditure incurred in respect of such business.
(iii) Mr. A can, however, claim depreciation@10% under section 32 in respect of the capital expenditure incurred on buildings. It is presumed that the buildings were put to use for more than 180 days during the P.Y. 2019-20.

(iv) Loss from a specified business can be set-off only against profits from another specified business. Therefore, the loss of Rs. 55 lakh from the specified businesses of setting up and operating a warehousing facility for storage of food grains and sugar cannot be set-off against the profits of Rs. 28 lakh from the business of setting and operating a warehousing facility for storage of edible oils, since the same is not a specified business. Such loss can, however, be carried forward indefinitely for set-off against profits of the same or any other specified business.

Illustration 8
XYZ Ltd. commenced operations of the business of a new three-star hotel in Madurai, Tamil Nadu on 1.4.2019. The company incurred capital expenditure of Rs. 50 lakh during the period January, 2019 to March, 2019 exclusively for the above business, and capitalized the same in his books of account as on 1st April, 2019. Further, during the P.Y. 2019-20, it incurred capital expenditure of Rs. 2 crore (out of which Rs. 1.50 crore was for acquisition of land) exclusively for the above business.

Compute the income under the head “Profits and gains of business or profession” for the A.Y.2020-21, assuming that XYZ Ltd. has fulfilled all the conditions specified for claim of deduction under section 35AD and has not claimed any deduction under Chapter VI-A under the heading “C. – Deductions in respect of certain incomes”.

The profits from the business of running this hotel (before claiming deduction under section 35AD) for the A.Y.2020-21 is Rs. 25 lakhs. Assume that the company also have another existing business of running a four-star hotel in Coimbatore, which commenced operations ten years back, the profits from which are Rs. 120 lakhs for the A.Y.2020-21. Also, assume that expenditure incurred during the previous year 2019-20 were paid by account payee cheque or use of ECS through bank account.

Solution

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profits from the specified business of new hotel in Madurai (before providing deduction under section 35AD)</td>
<td>25 lakh</td>
</tr>
<tr>
<td><strong>Less: Deduction under section 35AD</strong></td>
<td></td>
</tr>
<tr>
<td>Capital expenditure incurred during the P.Y.2019-20 (excluding the 50 lakh expenditure incurred on acquisition of land) = Rs. 200 lakh – Rs. 150 lakh</td>
<td></td>
</tr>
<tr>
<td>Total deduction under section 35AD for A.Y.2020-21</td>
<td>100 lakh</td>
</tr>
<tr>
<td><strong>Loss from the specified business of new hotel in Madurai</strong></td>
<td>(75 lakh)</td>
</tr>
<tr>
<td>Profit from the existing business of running a hotel in Coimbatore</td>
<td>120 lakh</td>
</tr>
<tr>
<td>Net profit from business after set-off of loss of specified business against profits of another specified business under section 73A</td>
<td>45 lakh</td>
</tr>
</tbody>
</table>
Illustration 9

ABC Ltd. is a company having two units – Unit A carries on specified business of setting up and operating a warehousing facility for storage of sugar; Unit B carries on non-specified business of operating a warehousing facility for storage of edible oil.

Unit A commenced operations on 1.4.2018 and it claimed deduction of Rs. 100 lacs incurred on purchase of two buildings for Rs. 50 lacs each (for operating a warehousing facility for storage of sugar) under section 35AD for A.Y. 2019-20. However, in February, 2020, Unit A transferred one of its buildings to Unit B.

Examine the tax implications of such transfer in the hands of ABC Ltd.

Solution

Since the capital asset, in respect of which deduction of Rs. 50 lacs was claimed under section 35AD, has been transferred by Unit A carrying on specified business to Unit B carrying on non-specified business in the P.Y.2019-20, the deeming provision under section 35AD(7B) is attracted during the A.Y. 2020-21.

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Deduction allowed under section 35AD for A.Y.2019-20</td>
<td>5,00,000</td>
</tr>
<tr>
<td>Less: Depreciation allowable u/s 32 for A.Y.2019-20 [10% of Rs. 50 lacs]</td>
<td>5,00,000</td>
</tr>
<tr>
<td><strong>Deemed income under section 35AD(7B)</strong></td>
<td><strong>45,00,000</strong></td>
</tr>
</tbody>
</table>

ABC Ltd., however, by virtue of proviso to Explanation 13 to section 43(1), can claim depreciation under section 32 on the building in Unit B for A.Y. 2020-21. For the purpose of claiming depreciation on building in Unit B, the actual cost of the building would be:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Actual cost to the assessee</td>
<td>50,00,000</td>
</tr>
<tr>
<td>Less: Depreciation allowable u/s 32 for A.Y.2019-20 [10% of Rs. 50 lacs]</td>
<td>5,00,000</td>
</tr>
<tr>
<td><strong>Actual cost in the hands of ABC Ltd. in respect of building in its Unit B</strong></td>
<td><strong>45,00,000</strong></td>
</tr>
</tbody>
</table>

Illustration 10

X Ltd. contributes 20% of basic salary to the account of each employee under a pension scheme referred to in section 80CCD. Dearness Allowance is 40% of basic salary and it forms part of pay of the employees.

Compute the amount of deduction allowable under section 36(1)(iva), if the basic salary of the employees aggregate to Rs. 10 lakh. Would disallowance under section 40A(9) be attracted, and if so, to what extent?

Solution

**Computation of deduction u/s 36(1)(iva) and disallowance u/s 40A(9)**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Basic Salary</td>
<td>10,00,000</td>
</tr>
<tr>
<td>Dearness Allowance@40% of basic salary [DA forms part of pay]</td>
<td>4,00,000</td>
</tr>
<tr>
<td><strong>Salary for the purpose of section 36(1)(iva) (Basic Salary + DA)</strong></td>
<td><strong>14,00,000</strong></td>
</tr>
<tr>
<td>Actual contribution (20% of basic salary i.e., 20% of Rs. 10 lakh)</td>
<td>2,00,000</td>
</tr>
<tr>
<td><strong>Less: Permissible deduction under section 36(1)(iva) (10% of basic salary plus dearness pay = 10% of Rs. 14,00,000 = Rs.1,40,000)</strong></td>
<td><strong>1,40,000</strong></td>
</tr>
<tr>
<td>Excess contribution disallowed under section 40A(9)</td>
<td>60,000</td>
</tr>
</tbody>
</table>
Illustration 11

The following are the particulars in respect of a scheduled bank incorporated in India -

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs. in lakh</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i) Provision for bad and doubtful debts under section 36(1)(viia) upto A.Y.2019-20</td>
<td>100</td>
</tr>
<tr>
<td>(ii) Gross Total Income of A.Y.2020-21 [before deduction under section 36(1)(viia)]</td>
<td>800</td>
</tr>
<tr>
<td>(iii) Aggregate average advances made by rural branches of the bank</td>
<td>300</td>
</tr>
<tr>
<td>(iv) Bad debts written off (for the first time) in the books of account (in respect of urban advances only) during the previous year 2019-20</td>
<td>210</td>
</tr>
</tbody>
</table>

Compute the deduction allowable under section 36(1)(vii) for the A.Y.2020-21.

Solution

Compute the deduction allowable under section 36(1)(vii) for the A.Y.2020-21.

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs. in lakh</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bad debts written off (for the first time) in the books of account Less: Credit balance in the “Provision for bad and doubtful debts” under section 36(1)(viia) as on 31.3.2020</td>
<td>210</td>
</tr>
<tr>
<td>(i) Provision for bad and doubtful debts u/s 36(1)(viia) upto A.Y.2019-20</td>
<td>100</td>
</tr>
<tr>
<td>(ii) Current year provision for bad and doubtful debts u/s 36(1)(viia) [8.5% of Rs. 800 lakhs + 10% of Rs. 300 lakhs]</td>
<td>98 198</td>
</tr>
<tr>
<td>Deduction under section 36(1)(vii) in respect of bad debts written off for A.Y.2020-21</td>
<td>12</td>
</tr>
</tbody>
</table>

Illustration 12

Isac limited is a company engaged in the business of biotechnology. The net profit of the company for the financial year ended 31.03.2020 is Rs. 35,25,890 after debiting the following items:

<table>
<thead>
<tr>
<th>S. No</th>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Purchase price of raw material used for the purpose of in-house research and development</td>
<td>11,80,000</td>
</tr>
<tr>
<td>2.</td>
<td>Purchase price of asset used for in-house research and development wrongly debited to profit and loss account:</td>
<td>5,00,000, 3,00,000</td>
</tr>
<tr>
<td></td>
<td>(1) Land</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(2) Building</td>
<td></td>
</tr>
<tr>
<td>3.</td>
<td>Expenditure incurred on notified agricultural extension project</td>
<td>25,50,000</td>
</tr>
<tr>
<td>4.</td>
<td>Expenditure on notified skill development project:</td>
<td>40,00,000</td>
</tr>
<tr>
<td></td>
<td>(1) Purchase of land</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(2) Expenditure on training for skill development</td>
<td>32,50,000</td>
</tr>
<tr>
<td>5.</td>
<td>Expenditure incurred on advertisement in the souvenir published by a political party</td>
<td>75,000</td>
</tr>
</tbody>
</table>

Compute the income under the head “Profits and gains of business or profession” for the A.Y.2020-21 of Isac Ltd.
Solution

Computation of income under the head “Profits and gains of business or profession” for the A.Y.2020-21

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net profit as per profit and loss account</td>
<td>35,25,890</td>
<td></td>
</tr>
<tr>
<td>Add: Items debited to profit and loss account, but to be disallowed</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Purchase price of Land used in in-house research and development - being capital expenditure not allowable as deduction under section 35</td>
<td>5,00,000</td>
<td></td>
</tr>
<tr>
<td>Purchase price of building used in in-house research and development - being capital expenditure, 100% of which is allowable as deduction u/s 35(1)(iv) read with section 35(2)</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>Expenditure incurred on notified agricultural extension project (to be treated separately)</td>
<td>25,50,000</td>
<td></td>
</tr>
<tr>
<td>Expenditure incurred on notified skill development project - Purchase of land - being capital expenditure not qualifying for deduction under section 35CCD</td>
<td>40,00,000</td>
<td></td>
</tr>
<tr>
<td>Expenditure incurred on notified skill development project - Expenditure on training for skill development (to be treated separately)</td>
<td>32,50,000</td>
<td></td>
</tr>
<tr>
<td>Expenditure incurred on advertisement in the souvenir published by a political party not allowed as deduction as per section 37(2B)</td>
<td>75,000</td>
<td>1,03,75,000</td>
</tr>
<tr>
<td>Less: Purchase price of raw material used for in-house research and development qualifies for 150% deduction under section 35(2AB). Since, it is already debited to profit and loss account balance 50% is allowed.</td>
<td>5,90,000</td>
<td></td>
</tr>
<tr>
<td>Less: Expenditure incurred on notified agricultural extension project qualifies for 150% deduction under section 35CCC.</td>
<td>38,25,000</td>
<td></td>
</tr>
<tr>
<td>Less: Expenditure incurred on training for skill development in a notified skill development project qualifies for 150% deduction under section 35CCD.</td>
<td>48,75,000</td>
<td>92,90,000</td>
</tr>
<tr>
<td>Profit and gains from business</td>
<td>46,10,890</td>
<td></td>
</tr>
</tbody>
</table>

Note: The expenditure incurred on advertisement in the souvenir published by a political party is disallowed as per section 37(2B) while computing income under the head “Profit and Gains of Business or Profession” but the same would be allowed as deduction under section 80GGB from the gross total income of the company.

Illustration 13

Delta Ltd. credited the following amounts to the account of resident payees in the month of March, 2020 without deduction of tax at source. What would be the consequence of non-deduction of tax at source by Delta Ltd. on these amounts during the financial year
2019-20, assuming that the resident payees in all the cases mentioned below, have not paid the tax, if any, which was required to be deducted by Delta Ltd?

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Amount (Rs.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1) Salary to its employees (credited and paid in March, 2019)</td>
<td>12,00,000</td>
</tr>
<tr>
<td>(2) Directors’ remuneration (credited in March, 2019 and paid in April, 2019)</td>
<td>28,000</td>
</tr>
</tbody>
</table>

Would your answer change if Delta Ltd. has deducted tax on directors’ remuneration in April, 2020 at the time of payment and remitted the same in July, 2020?

Solution

Non-deduction of tax at source on any sum payable to a resident on which tax is deductible at source as per the provisions of Chapter XVII-B would attract disallowance under section 40(a)(ia).

Therefore, non-deduction of tax at source on any sum paid by way of salary on which tax is deductible under section 192 or any sum credited or paid by way of directors’ remuneration on which tax is deductible under section 194J, would attract disallowance(30%) under section 40(a)(ia). Whereas in case of salary, tax has to be deducted under section 192 at the time of payment, in case of directors’ remuneration, tax has to be deducted at the time of credit of such sum to the account of the payee or at the time of payment, whichever is earlier. Therefore, in both the cases i.e., salary and directors’ remuneration, tax is deductible in the P.Y.2019-20, since salary was paid in that year and directors’ remuneration was credited in that year. Therefore, the amount to be disallowed under section 40(a)(ia) while computing business income for A.Y.2020-21 is as follows –

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Amount paid in Rs.</th>
<th>Disallowance u/s 40(a)(ia) @ 30% in Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1) Salary [tax is deductible under section 192]</td>
<td>12,00,000</td>
<td>3,60,000</td>
</tr>
<tr>
<td>(2) Directors’ remuneration [tax is deductible under section 194J without any threshold limit]</td>
<td>28,000</td>
<td>8,400</td>
</tr>
</tbody>
</table>

**Disallowance under section 40(a)(ia)**

3,68,400

If the tax is deducted on directors’ remuneration in the next year i.e., P.Y.2020-21 at the time of payment and remitted to the Government, the amount of Rs. 8,400 would be allowed as deduction while computing the business income of A.Y.2021-22.

In case, assessee fails to deduct the whole or any part of tax on any such sum but is not deemed as assessee in default under the first proviso to section 201(1) by reason that such payee –

(i) has furnished his return of income under section 139;
(ii) has taken into account such sum for computing income in such return of income; and
(iii) has paid the tax due on the income declared by him in such return of income, and the payer furnishes a certificate to this effect from an accountant in such form as may be prescribed.

it would be deemed that the assessee has deducted and paid the tax on such sum.

The date of deduction and payment of taxes by the payer shall be deemed to be the date on which return of income has been furnished by the payee.
Since the date of furnishing the return of income by the resident payee is taken to be the date on which the payer has deducted tax at source and paid the same, 30% of such expenditure/payment in respect of which the payer has failed to deduct tax at source shall be disallowed under section 40(a)(ia) in the year in which the said expenditure is incurred. However, 30% of such expenditure will be allowed as deduction in the subsequent year in which the return of income is furnished by the resident payee, since tax is deemed to have been deducted and paid by the payer in that year.

Illustration 14

During the financial year 2019-20, the following payments/expenditure were made/incurred by Mr. Yuvan Raja, a resident individual (whose turnover during the year ended 31.3.2019 was Rs. 99 lacs):

(i) Interest of Rs. 45,000 was paid to Rehman & Co., a resident partnership firm, without deduction of tax at source;

(ii) Rs. 3,00,000 was paid as salary to a resident individual without deduction of tax at source;

(iii) Commission of Rs. 16,000 was paid to Mr. Vidyasagar on 2.7.2019 without deduction of tax at source.

Briefly discuss whether any disallowance arises under the provisions of section 40(a)(ia) of the Income-tax Act, 1961 assuming that the payees in all the cases mentioned above, have not paid the tax, if any, which was required to be deducted by Mr. Raja?

Solution

Disallowance under section 40(a)(ia) of the Income-tax Act, 1961 is attracted where the assessee fails to deduct tax at source as is required under the Act, or having deducted tax at source, fails to remit the same to the credit of the Central Government within the stipulated time limit.

(i) The obligation to deduct tax at source from interest paid to a resident arises under section 194A in the case of an individual, whose total turnover in the immediately preceding previous year, i.e., P.Y.2018-19 exceeds Rs. 100 lakhs. Thus, in present case, since the turnover of the assessee is less than Rs. 100 lakhs, he is not liable to deduct tax at source. Hence, disallowance under section 40(a)(ia) is not attracted in this case.

(ii) The disallowance of 30% of the sums payable under section 40(a)(ia) would be attracted in respect of all sums on which tax is deductible under Chapter XVII-B. Section 192, which requires deduction of tax at source from salary paid, is covered under Chapter XVII-B. The obligation to deduct tax at source under section 192 arises, in the hands all assessee - employer even if the turnover amount does not exceed Rs. 100 lacs in the immediately preceding previous year. Therefore, in the present case, the disallowance under section 40(a)(ia) is attracted for failure to deduct tax at source under section 192 from salary payment. However, only 30% of the amount of salary paid without deduction of tax at source would be disallowed.

(iii) The obligation to deduct tax at source under section 194-H from commission paid in excess of Rs. 15,000 to a resident arises in the case of an individual, whose total turnover in the immediately preceding previous year, i.e., P.Y.2018-19 exceeds Rs. 100 lakhs. Thus, in present case, since the turnover of the assessee is less than Rs.
100 lakhs, he is not liable to deduct tax at source. Therefore, disallowance under section 40(a)(ia) is not attracted in this case.

Illustration 15

A firm has paid Rs. 7,50,000 as remuneration to its partners for the P.Y. 2019-20, in accordance with its partnership deed, and it has a book profit of Rs. 10 lakh. What is the remuneration allowable as deduction?

Solution

The allowable remuneration calculated as per the limits specified in section 40(b)(v) would be –

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>On first Rs. 3 lakh of book profit [Rs. 3,00,000 × 90%]</td>
<td>2,70,000</td>
</tr>
<tr>
<td>On balance Rs. 7 lakh of book profit [Rs. 7,00,000 × 60%]</td>
<td>4,20,000</td>
</tr>
<tr>
<td></td>
<td><strong>6,90,000</strong></td>
</tr>
</tbody>
</table>

The excess amount of Rs. 60,000 (i.e., Rs. 7,50,000 – Rs. 6,90,000) would be disallowed as per section 40(b)(v).

Illustration 16

Rao & Jain, a partnership firm consisting of two partners, reports a net profit of Rs. 7,00,000 before deduction of the following items:

1. Salary of Rs. 20,000 each per month payable to two working partners of the firm (as authorized by the deed of partnership).
2. Depreciation on plant and machinery under section 32 (computed) Rs. 1,50,000.
3. Interest on capital at 15% per annum (as per the deed of partnership). The amount of capital eligible for interest Rs. 5,00,000.

Compute:

(i) Book-profit of the firm under section 40(b) of the Income-tax Act, 1961.
(ii) Allowable working partner salary for the assessment year 2019-20 as per section 40(b).

Solution

(i) As per Explanation 3 to section 40(b), “book profit” shall mean the net profit as per the profit and loss account for the relevant previous year computed in the manner laid down in Chapter IV-D as increased by the aggregate amount of the remuneration paid or payable to the partners of the firm if the same has been already deducted while computing the net profit.

In the present case, the net profit given is before deduction of depreciation on plant and machinery, interest on capital of partners and salary to the working partners. Therefore, the book profit shall be as follows:

**Computation of Book Profit of the firm under section 40(b)**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net Profit (before deduction of depreciation, salary and interest)</td>
<td></td>
<td>7,00,000</td>
</tr>
<tr>
<td>Less: Depreciation under section 32</td>
<td>1,50,000</td>
<td>0</td>
</tr>
<tr>
<td>Interest @ 12% p.a. [being the maximum allowable as per section 40(b)] (Rs. 5,00,000 × 12%)</td>
<td>60,000</td>
<td>2,10,000</td>
</tr>
</tbody>
</table>
(ii) Salary actually paid to working partners = Rs. 20,000 × 2 × 12 = Rs. 4,80,000.

As per the provisions of section 40(b)(v), the salary paid to the working partners is allowed subject to the following limits -

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>On the first Rs. 3,00,000 of book profit or in case of loss</td>
<td>Rs. 1,50,000 or 90% of book profit, whichever is more</td>
</tr>
<tr>
<td>On the balance of book profit</td>
<td>60% of the balance book profit</td>
</tr>
</tbody>
</table>

Therefore, the maximum allowable working partners’ salary for the A.Y. 2020-21 in this case would be:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>On the first Rs. 3,00,000 of book profit [((Rs. 1,50,000 or 90% of Rs. 3,00,000)) whichever is more]</td>
<td>2,70,000</td>
</tr>
<tr>
<td>On the balance of book profit [60% of ((Rs. 4,90,000 - Rs. 3,00,000))]</td>
<td>1,14,000</td>
</tr>
<tr>
<td><strong>Maximum allowable partners’ salary</strong></td>
<td><strong>3,84,000</strong></td>
</tr>
</tbody>
</table>

Hence, allowable working partners’ salary for the A.Y. 2020-21 as per the provisions of section 40(b)(v) is Rs. 3,84,000.

**Illustration 17**

Hari, an individual, carried on the business of purchase and sale of agricultural commodities like paddy, wheat, etc. He borrowed loans from Andhra Pradesh State Financial Corporation (APSFC) and Indian Bank and has not paid interest as detailed hereunder:

<table>
<thead>
<tr>
<th></th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i)</td>
<td>Andhra Pradesh State Financial Corporation (P.Y. 2018-19 &amp; 2019-20)</td>
</tr>
<tr>
<td>(ii)</td>
<td>Indian Bank (P.Y. 2019-20)</td>
</tr>
<tr>
<td></td>
<td><strong>45,00,000</strong></td>
</tr>
</tbody>
</table>

Both APSFC and Indian Bank, while restructuring the loan facilities of Hari during the year 2019-20, converted the above interest payable by Hari to them as a loan repayable in 60 equal installments. During the year ended 31.3.2020, Hari paid 5 installments to APSFC and 3 installments to Indian Bank.

Hari claimed the entire interest of Rs. 45,00,000 as an expenditure while computing the income from business of purchase and sale of agricultural commodities. Discuss whether his claim is valid and if not what is the amount of interest, if any, allowable.

**Solution**

According to section 43B, any interest payable on the term loans to specified financial institutions and any interest payable on any loans and advances to scheduled banks shall be allowed only in the year of payment of such interest irrespective of the method of accounting followed by the assessee. Where there is default in the payment of interest by the assessee, such unpaid interest may be converted into loan. Such conversion of unpaid interest into loan shall not be construed as payment of interest for the purpose of section 43B. The amount of unpaid interest so converted as loan shall be allowed as deduction only in the year in which the converted loan is actually paid.

In the given case of Hari, the unpaid interest of Rs. 15,00,000 due to APSFC and of Rs. 30,00,000 due to Indian Bank was converted into loan. Such conversion would not amount to payment of interest and would not, therefore, be eligible for deduction in the year of such conversion. Hence, claim of Hari that the entire interest of Rs. 45,00,000 is to be
allowed as deduction in the year of conversion is not tenable. The deduction shall be allowed only to the extent of repayment made during the financial year. Accordingly, the amount of interest eligible for deduction for the A.Y.2020-21 shall be calculated as follows:

<table>
<thead>
<tr>
<th>Bank</th>
<th>Interest outstanding (Rs.)</th>
<th>Number of Installments</th>
<th>Amount per installment (Rs.)</th>
<th>Installments paid</th>
<th>Interest allowable (Rs.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>APSFC</td>
<td>15 lakh</td>
<td>60</td>
<td>25,000</td>
<td>5</td>
<td>1,25,000</td>
</tr>
<tr>
<td>Indian Bank</td>
<td>30 lakh</td>
<td>60</td>
<td>50,000</td>
<td>3</td>
<td>1,50,000</td>
</tr>
<tr>
<td><strong>Total amount eligible for deduction</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td><strong>2,75,000</strong></td>
</tr>
</tbody>
</table>

**Illustration 18**

Vinod is a person carrying on profession as film artist. His gross receipts from profession are as under:

<table>
<thead>
<tr>
<th>Financial year</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>2016-17</td>
<td>1,15,000</td>
</tr>
<tr>
<td>2017-18</td>
<td>1,80,000</td>
</tr>
<tr>
<td>2018-19</td>
<td>2,10,000</td>
</tr>
</tbody>
</table>

What is his obligation regarding maintenance of books of accounts for Assessment Year 2020-21 under section 44AA of Income-tax Act, 1961?

**Solution**

Section 44AA(1) requires every person carrying on any profession, notified by the Board in the Official Gazette (in addition to the professions already specified therein), to maintain such books of account and other documents as may enable the Assessing Officer to compute his total income in accordance with the provisions of the Income-tax Act, 1961.

A person carrying on a notified profession shall be required to maintain **specified books of accounts**, only if:

(i) his gross receipts in all the three years immediately preceding the relevant previous year has exceeded Rs. 1,50,000; or

(ii) it is a new profession which is setup in the relevant previous year, it is likely to exceed Rs. 1,50,000 in that previous year.

In the present case, Vinod is a person carrying on profession as film artist, which is a notified profession. Since his gross receipts have not exceeded Rs. 1,50,000 in financial year 2016-17, the requirement under section 44AA to compulsorily maintain the prescribed books of account is not applicable to him for A.Y. 2020-21.

Mr. Vinod, however, required to maintain such books of accounts as would enable the Assessing Officer to compute his total income.

**Illustration 19**

Mr. Praveen engaged in retail trade, reports a turnover of Rs. 1,98,50,000 for the financial year 2019-20. His income from the said business as per books of account is Rs. 11,20,000 computed as per the provisions of Chapter IV-D “Profits and gains from business or Profession” of the Income-tax Act, 1961. All transactions are carried out by way of A/c payee cheque/ECS through bank A/c. Retail trade is the only source of income for Mr. Praveen. A.Y. 2019-20 was the first year for which he declared his business income in accordance with the provisions of presumptive taxation under section 44AD.
(i) Is Mr. Praveen eligible to opt for presumptive taxation scheme in respect of his income from retail trade for the assessment year 2020-21?

(ii) If so, determine his income from retail trade as per the applicable presumptive provision.

(iii) In case Mr. Praveen does not opt for presumptive taxation of income from retail trade, what are his obligations under the Income-tax Act, 1961?

(iv) What is the due date for filing his return of income under both the options?

Solution:

(i) Yes. Since his total turnover for the F.Y 2019-20 is below Rs. 200 lakhs, he is eligible to opt for presumptive taxation scheme under section 44AD in respect of his retail trade business.

(ii) His income from retail trade, applying the presumptive tax provisions under section 44AD, would be Rs. 15,88,000, being 8% of Rs. 1,98,50,000.

(iii) Mr. Praveen had declared profit for the previous year 2018-19 in accordance with the presumptive provisions and if he does not opt for presumptive provisions for any of the five consecutive assessment years i.e., A.Y. 2020-21 to A.Y. 2024-25, he would not be eligible to claim the benefit of presumptive taxation for five assessment years subsequent to the assessment year relevant to the previous year in which the profit has not been declared in accordance the presumptive provisions i.e., if he does not opt for presumptive taxation in say P.Y. 2019-20, then he would not be eligible to claim the benefit of presumptive taxation for A.Y. 2021-22 to A.Y. 2025-26.

Consequently, Mr. Praveen is required to maintain the books of accounts and get them audited under section 44AB, since his income exceeds the basic exemption limit.

(iv) In case he opts for the presumptive taxation scheme under section 44AD, the due date would be 31st July, 2020.

In case he does not opt for the presumptive taxation scheme, he is required to get his books of account audited, in which case the due date for filing of return would be 30th September, 2020.

Illustration 20

Mr. X commenced the business of operating goods vehicles on 1.4.2019. He purchased the following vehicles during the P.Y.2019-20. Compute his income under section 44AE for A.Y. 2020-21.

<table>
<thead>
<tr>
<th>Gross Vehicle Weight (in kilograms)</th>
<th>Number</th>
<th>Date of purchase</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1) 7,000</td>
<td>2</td>
<td>10.04.2019</td>
</tr>
<tr>
<td>(2) 6,500</td>
<td>1</td>
<td>15.03.2020</td>
</tr>
<tr>
<td>(3) 10,000</td>
<td>3</td>
<td>16.07.2019</td>
</tr>
<tr>
<td>(4) 11,000</td>
<td>1</td>
<td>02.01.2020</td>
</tr>
<tr>
<td>(5) 15,000</td>
<td>2</td>
<td>29.08.2019</td>
</tr>
<tr>
<td>(6) 15,000</td>
<td>1</td>
<td>23.02.2020</td>
</tr>
</tbody>
</table>

Would your answer change if the two goods vehicles purchased in April, 2019 were put to use only in July, 2019?
Solution

Since Mr. X does not own more than 10 vehicles at any time during the previous year 2019-20, he is eligible to opt for presumptive taxation scheme under section 44AE. Rs. 1,000 per ton of gross vehicle weight or unladen weight per month or part of the month for each heavy goods vehicle and Rs. 7,500 per month or part of month for each goods carriage other than heavy goods vehicle, owned by him would be deemed as his profits and gains from such goods carriage.

Heavy goods vehicle means any goods carriage, the gross vehicle weight of which exceeds 12,000 kg.

<table>
<thead>
<tr>
<th>(1)</th>
<th>(2)</th>
<th>(3)</th>
<th>(4)</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Number of Vehicles</td>
<td>Date of purchase</td>
<td>No. of months for which vehicle is owned</td>
<td>No. of months × No. of vehicles [(1) × (3)]</td>
</tr>
<tr>
<td></td>
<td>Heavy goods vehicle</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>29.08.2019</td>
<td>8</td>
<td>16</td>
<td></td>
</tr>
<tr>
<td>1</td>
<td>23.02.2020</td>
<td>2</td>
<td>2</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Goods vehicle other than heavy goods vehicle</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>10.4.2019</td>
<td>12</td>
<td>24</td>
<td></td>
</tr>
<tr>
<td>1</td>
<td>15.3.2020</td>
<td>1</td>
<td>1</td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>16.7.2019</td>
<td>9</td>
<td>27</td>
<td></td>
</tr>
<tr>
<td>1</td>
<td>2.1.2020</td>
<td>3</td>
<td>3</td>
<td></td>
</tr>
</tbody>
</table>

The presumptive income of Mr. X under section 44AE for A.Y.2020-21 would be -

Rs. 6,82,500, i.e., 55 × Rs. 7,500, being for other than heavy goods vehicle + 18 × Rs. 1,000 × 15 ton being for heavy goods vehicle.

The answer would remain the same even if the two vehicles purchased in April, 2019 were put to use only in July, 2019, since the presumptive income has to be calculated per month or part of the month for which the vehicle is owned by Mr. X.

Illustration 21

Alpha Co-operative Bank amalgamated with Beta Co-operative Bank on 1.12.2019. The depreciation for the year ended 31.3.2020 calculated as per Income-tax Rules, 1962, allowable to Alpha Co-operative Bank had the amalgamation had not taken place amounts to Rs. 2,40,000. Compute the deduction on account of depreciation allowable in the hands of Alpha Co-operative Bank and Beta Co-operative Bank for A.Y. 2020-21.

Solution

(i) The amount of deduction allowable to the amalgamating co-operative bank (i.e. Alpha Co-operative bank, in this case) under section 32 has to be determined in accordance with the following formula -

\[ A \times \frac{B}{C} \]

A = the amount of deduction allowable to the predecessor co-operative bank (i.e. Alpha Co-operative bank, in this case) if the business reorganisation had not taken place. In this case, the amount of deduction is Rs. 2,40,000.
B = the number of days comprised in the period beginning with the 1st day of the financial year (i.e., 1.4.2018, in this case) and ending on the day immediately preceding the date of business reorganization (i.e., 30.11.2019, in this case); and

C = the total number of days in the financial year in which the business reorganisation has taken place (i.e., 365 days).

(ii) The amount of deduction allowable to the amalgamated co-operative bank (i.e. Beta Co-operative bank, in this case) under section 32 has to be determined in accordance with the formula -

\[
A \times \frac{B}{C}
\]

A = the amount of deduction allowable to the predecessor co-operative bank (i.e. Alpha Co-operative bank, in this case) if the business reorganisation had not taken place. In this case, the amount of deduction is \textbf{Rs. 2,40,000}.

B = the number of days comprised in the period beginning with the date of business reorganisation (i.e. 1.12.2019, in this case) and ending on the last day of the financial year (i.e. 31.3.2020); and

C = the total number of days in the financial year in which the business reorganisation has taken place (i.e. 365 days).

(iii) In this case, the deduction that would have been allowable under section 32 to Alpha co-operative bank had the business reorganization not taken place is \textbf{Rs. 2,40,000} and the business re-organisation took place on 1.12.2019. Therefore, the deduction allowable to Alpha co-operative bank under section 32 would be \textbf{Rs.1,60,000} i.e., \textbf{Rs. 2,40,000} x 244/366. The deduction allowable to Beta co-operative bank would be \textbf{Rs. 80,000} i.e., \textbf{Rs. 2,40,000} x 122/366.

Illustration 22

\textit{Miss Vivitha, a resident and ordinarily resident in India, has derived the following income from various operations (relating to plantations and estates owned by her) during the year ended 31-3-2020:}

<table>
<thead>
<tr>
<th>S. No.</th>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i)</td>
<td>Income from sale of centrifuged latex processed from rubber plants grown in Darjeeling.</td>
<td>3,00,000</td>
</tr>
<tr>
<td>(ii)</td>
<td>Income from sale of coffee grown and cured in Yercaud, Tamil Nadu.</td>
<td>1,00,000</td>
</tr>
<tr>
<td>(iii)</td>
<td>Income from sale of coffee grown, cured, roasted and grounded, in Colombo. Sale consideration was received at Chennai.</td>
<td>2,50,000</td>
</tr>
<tr>
<td>(iv)</td>
<td>Income from sale of tea grown and manufactured in Shimla.</td>
<td>4,00,000</td>
</tr>
<tr>
<td>(v)</td>
<td>Income from sapling and seedling grown in a nursery at Cochin. Basic operations were not carried out by her on land.</td>
<td>80,000</td>
</tr>
</tbody>
</table>

You are required to compute the business income and agricultural income of Miss Vivitha for the assessment year 2020-21.
Solution

Computation of business income and agricultural income of Ms. Vivitha for the A.Y. 2020-21

<table>
<thead>
<tr>
<th>Sr. No.</th>
<th>Source of income</th>
<th>Gross (Rs.)</th>
<th>Business income</th>
<th>Agricultural income</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i)</td>
<td>Sale of centrifuged latex from rubber plants grown in India.</td>
<td>3,00,000</td>
<td>35% 1,05,000</td>
<td>1,95,000</td>
</tr>
<tr>
<td>(ii)</td>
<td>Sale of coffee grown and cured in India.</td>
<td>1,00,000</td>
<td>25% 25,000</td>
<td>75,000</td>
</tr>
<tr>
<td>(iii)</td>
<td>Sale of coffee grown, cured, roasted and grounded outside India. (See Note 1 below)</td>
<td>2,50,000</td>
<td>100% 2,50,000</td>
<td>-</td>
</tr>
<tr>
<td>(iv)</td>
<td>Sale of tea grown and manufactured in India</td>
<td>4,00,000</td>
<td>40% 1,60,000</td>
<td>2,40,000</td>
</tr>
<tr>
<td>(v)</td>
<td>Saplings and seedlings grown in nursery in India (See Note 2 below)</td>
<td>80,000</td>
<td>Nil</td>
<td>80,000</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td></td>
<td></td>
<td>5,40,000</td>
</tr>
</tbody>
</table>

Notes:
1. Where income is derived from sale of coffee grown, cured, roasted and grounded by the seller in India, 40% of such income is taken as business income and the balance as agricultural income. However, in this question, these operations are done in Colombo, Sri Lanka. Hence, there is no question of such apportionment and the whole income is taxable as business income. Receipt of sale proceeds in India does not make this agricultural income. In the case of an assessee, being a resident and ordinarily resident, the income arising outside India is also chargeable to tax.
2. Explanation 3 to section 2(1A) provides that the income derived from saplings or seedlings grown in a nursery would be deemed to be agricultural income whether or not the basic operations were carried out on land.
EXERCISE

Question 1

Hari has acquired a residential house property in Delhi on 15th April, 2002 for Rs. 9,00,000 and decided to sell the same on 3rd May, 2005 to Ms. Pari and an advance of Rs. 25,000 was taken from her. The balance money was not paid by Ms. Pari and Hari has forfeited the entire advance sum. On 3rd June, 2019, he has sold this house to Mr. Suri for Rs. 40,00,000. In the meantime, on 4th April, 2019, he had purchased a residential house in Delhi for Rs. 8,00,000, where he was staying with his family on rent for the last 5 years and paid the full amount as per the purchase agreement. However, Hari does not possess any legal title till 31st March, 2020, as such transfer was not registered with the registration authority.

Hari has purchased another old house in Chennai on 14th October, 2019 from Mr. X, an Indian resident, by paying Rs. 5,00,000 and the purchase was registered with the appropriate authority.

Determine the taxable capital gain arising from above transactions in the hands of Hari for Assessment Year 2020-21.


Answer

Computation of taxable capital gain of Mr. Hari for the A.Y.2020-21

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sale proceeds</td>
<td>40,00,000</td>
</tr>
<tr>
<td>Less: Indexed cost of acquisition (See Note 1)</td>
<td>24,08,333</td>
</tr>
<tr>
<td>Long Term Capital Gain</td>
<td>15,91,667</td>
</tr>
<tr>
<td>Less: Exemption under section 54 in respect of investment in house at Delhi (See Note 2)</td>
<td>8,00,000</td>
</tr>
<tr>
<td>Exemption under section 54 in respect of investment in house at Chennai (See Note 3)</td>
<td>5,00,000</td>
</tr>
<tr>
<td>Taxable long-term capital gain</td>
<td>2,91,667</td>
</tr>
</tbody>
</table>

Notes:

1. **Computation of indexed cost of acquisition**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost of acquisition</td>
<td>9,00,000</td>
</tr>
<tr>
<td>Less: Advance taken and forfeited</td>
<td>25,000</td>
</tr>
<tr>
<td>Cost for the purpose of Indexation</td>
<td>8,75,000</td>
</tr>
<tr>
<td>Indexed cost of acquisition (Rs. 8,75,000 × 289/105)</td>
<td>24,08,333</td>
</tr>
</tbody>
</table>

**Note:** Advance received and forfeited on or after 01.04.2014 is taxable under section 56(2)(ix). Such amount would not be reduced to compute indexed cost of acquisition while determining capital gains on sale of such property.

However, in this case, since the advance was received and forfeited in the year 2004, such advance has to be reduced for calculating indexed cost of acquisition for the purpose of arriving at capital gains.

2. In order to avail exemption of capital gains under section 54, a residential house should be purchased within 1 year before or 2 years after the date of transfer or constructed within a period of 3 years after the date of transfer. In this case, Hari
has purchased the residential house in Delhi within one year before the date of transfer and paid the full amount as per the purchase agreement, though he does not possess any legal title till 31.3.2020 since the transfer was not registered with the registration authority. However, for the purpose of claiming exemption under section 54, holding of legal title is not necessary. If the taxpayer pays the full consideration in terms of the purchase agreement within the stipulated period, the exemption under section 54 would be available. It was so held in Balraj v. CIT(2002) 254 ITR 22 (Del.) and CIT v. Shahzada Begum (1988) 173 ITR 397 (A.P.).

3. As per section 54, since the amount of capital gain does not exceed Rs. 2 crore, Mr. Hari can claim exemption thereunder in respect of investment made in two residential houses situated in India. However, if Mr. Hari exercises the option to claim exemption in respect of two residential houses in Delhi and Chennai in P.Y. 2019-20, he shall not be subsequently entitled to exercise the option for the same or any other assessment year.

Question 2

The proprietary firm of "Mr. Amolak" a practicing Chartered Accountant, was converted into partnership on 01.09.2019 when his son joined him in the firm for 50% share. All the assets and liabilities of the erstwhile proprietary firm were transferred into the newly constituted partnership firm.

"Mr. Amolak" was credited and paid an amount of Rs. 5 lacs in his account from the firm. Explain as to chargeability of this amount of Rs. 5 lacs in the hands of "Mr. Amolak" when it stands paid for:

(i) transfer of business into partnership;
(ii) goodwill by the incoming partner.

Answer

(i) If the amount was paid for transfer of business / profession to partnership

As per section 45(3), the profits and gains arising from the transfer of a capital asset by a person to the firm in which he becomes a partner shall be chargeable to tax as the income of the previous year which such transfer takes place. The amount recorded in the books of account of the firm would be deemed to be the full value of consideration received or accruing as a result of transfer of the capital asset. Since in this case, consideration of Rs. 5 lacs is received for such transfer, profit or gain accruing to the transferor for the purposes of section 45. The amount of Rs. 5 lacs would be the full value of consideration received as a result of transfer and the capital gains resulting from this transfer would be chargeable to tax.

(ii) If the amount is paid by the incoming partner for Goodwill

The Supreme Court, in CIT v. B.C. Srinivasa Setty (1981) 128 ITR 294, observed that the income chargeable to capital gains tax is to be computed by deducting from the full value of consideration “the cost of acquisition of the capital asset”. If it is not possible to ascertain the cost of acquisition, then, transfer of such asset is not chargeable to tax. Section 55(2)(a) provides that the cost of acquisition of certain self-generated assets, including goodwill of a business, is Nil. Therefore, in respect of these self-generated assets covered under section 55(2)(a), the decision of the Supreme Court in B.C. Srinivasa Setty’s case would not apply. However, in respect of other self-generated
assets, including goodwill of profession, the decision of the Supreme Court in B.C. Srinivasa Setty’s case, would continue to be applicable.

In effect, in case of self-generated assets not covered under section 55(2)(a), since the cost is not ascertainable, there would be no capital gains tax liability. Therefore, in this case, since the consideration of Rs. 5 lakhs is paid towards goodwill of a profession, whose cost is NOT to be taken as ‘Nil’ since it is not covered under section 55(2)(a), the liability to capital gains tax will not arise.

Question 3

Mr. Ganesh sold his residential house in Mumbai and purchased two residential flats adjacent to each other on the same day vide two separate registered sale deeds from two different persons. The builder had certified that he had effected necessary modification to make it one residential apartment. Mr. Ganesh sought exemption under section 54 in respect of the investment made in purchase of the two residential flats. The Assessing Officer, however, gave exemption under section 54 to the extent of purchase of one residential flat only contending that sub-section (1) of section 54 clearly restricts the benefit of exemption to purchase one residential house only and the two flats cannot be treated as one residential unit since—

(i) the flats were purchased through different sale deeds; and
(ii) it was found by the Inspector that, before its sale to the assessee, the residential flats were in occupation of two different tenants.

Examine the correctness of the contention of the Assessing Officer.

Answer

This issue came up before the Karnataka High Court in CIT v. D. Ananda Basappa (2009) 309 ITR 329. The Court observed that the assessee had shown that the flats were situated side by side and the builder had also certified that he had effected modification of the flats to make them one unit by opening the door between the apartments. Therefore, it was immaterial that the flats were occupied by two different tenants prior to sale or that it was purchased through different sale deeds. The Court observed that these were not the grounds to hold that the assessee did not have the intention to purchase the two flats as one unit. The Court held that the assessee was entitled to exemption under section 54 in respect of purchase of both the flats to form one residential house.

Applying the ratio of the above decision to the case on hand, Mr. Ganesh is entitled to exemption under section 54 in respect of purchase of two flats to form one residential house. Therefore, the contention of the Assessing Officer is not correct.

Question 4

Vijay, an individual, owned three residential houses which were let out. Besides, he and his four brothers co-owned a residential house in equal shares. He sold one residential house owned by him during the previous year relevant to the assessment year 2020-21. Within a month from the date of such sale, the four brothers executed a release deed in respect of their shares in the co-owned residential house in favour of Vijay for a monetary consideration.

Vijay utilised the entire long-term capital gain arising out of the sale of the residential house for payment of the said consideration to his four brothers. Vijay is not using the
house, in respect of which his brothers executed a release deed, for his own residential purposes, but has let it out to another person, who is using it for his residential purposes.

Is Vijay eligible for exemption under section 54 of the Income-tax Act, 1961 for the assessment year 2020-21 in respect of the long-term capital gain arising from the sale of his residential house, which he utilised for acquiring the shares of his brothers in the co-owned residential house? Will the non-use of the new house for his own residential purposes disentitle him to exemption?

**Answer**
The long-term capital gain arising on sale of residential house would be exempt under section 54 if it is utilized, *inter alia*, for purchase of one residential house situated in India within one year before or two years after the date of transfer. Release by the other co-owners of their share in co-owned property in favour of Vijay would amount to “purchase” by Vijay for the purpose of claiming exemption under section 54 *[CIT v. T.N. Arvinda Reddy (1979) 120 ITR 46 (SC)]*. Since such purchase is within the stipulated time of two years from the date of transfer of asset, Vijay is eligible for exemption under section 54. As Vijay has utilised the entire long-term capital gain arising out of the sale of the residential house for payment of consideration to the other co-owners who have released their share in his favour, he can claim full exemption under section 54.

There is no requirement in section 54 that the new house should be used by the assessee for his own residence. The condition stipulated is that the new house should be utilised for residential purposes and its income is chargeable under the head “Income from house property”. This requirement would be satisfied even when the new house is let out for residential purposes.

**Question 5**
*Aries Tubes Private Ltd. went into liquidation on 01.06.2019. The company was seized and possessed of the following funds prior to the distribution of assets to the shareholders:*

| **Rs.** |
|-----------------|------------------|
| Share Capital (issued on 01.04.2013) | 5,00,000 |
| Reserves prior to 1.6.2019 | 3,00,000 |
| Excess realization in the course of liquidation | 5,00,000 |
| **Total** | **13,00,000** |

There are 5 shareholders, each of whom received **Rs. 2,60,000** from the liquidator in full settlement. The shareholders desire to invest the resultant element of capital gains in long-term specified assets as defined in section 54EC. You are required to examine the various issues and advice the shareholders about their liability to income tax.

**Answer**
Under section 46(1), where the assets of a company are distributed to its shareholders on its liquidation, such distribution shall not be regarded as transfer in the hands of the company for the purpose of section 45.

However, under section 46(2), where the shareholder, on liquidation of a company, receives any money or other assets from the company, he shall be chargeable to income-tax under the head “capital gains”, in respect of the money so received or the market value of the other assets on the date of distribution as reduced by the amount of dividend deemed under section 2(22)(c) and the sum so arrived at shall be deemed to be the full value of the consideration for the purposes of section 48.
As per section 2(22)(c), dividend includes any distribution made to the shareholders of a company on its liquidation, to the extent to which the distribution is attributable to the accumulated profits of the company immediately before its liquidation, whether capitalized or not.

In this case, the accumulated profits immediately before liquidation is Rs. 3,00,000. The share of each shareholder is Rs. 60,000 (being one-fifth of Rs. 3,00,000). An amount of Rs. 60,000 is the deemed dividend under section 2(22)(c). The same is exempt under section 10(34) in the hands of the shareholder, since the company is liable to dividend distribution tax in respect of the same.

Therefore, Rs. 2,00,000 [i.e. Rs. 2,60,000 minus Rs. 60,000, being the deemed dividend under section 2(22)(c)] is the full value of consideration in the hands of each shareholder as per section 46(2). Against this, the investment of Rs. 1,00,000 by each shareholder is to be deducted to arrive at the capital gains of Rs. 1,00,000 of each shareholder. The benefit of indexation is available to the shareholders (since the shares are held for more than 24 months and hence long-term capital asset), but could not be computed in the absence of required information. Since the equity shares are not listed, it would not be liable for securities transaction tax and hence, the capital gain (long term) is not exempt under section 10(38). The benefit of concessional rate of tax @10% without indexation would also not be available. Hence, such long term capital gain would be taxable @20% with indexation benefit.

Exemption under section 54EC is available only where there is an actual transfer of capital assets and not in the case of deemed capital gain as per the decision rendered in the case of CIT v. Ruby Trading Co (P) Ltd (2003) 259 ITR 54 (Raj). Therefore, exemption under section 54EC will not be available in this case since it is deemed transfer and not actual transfer. Furthermore, with effect from A.Y. 2019-20, exemption under section 54EC is available only on transfer of long-term capital asset, being land or building or both.

**Question 6**

Xavier had taken a loan under registered mortgage deed against the house, which was purchased by him on 26.05.2002 for Rs. 5 lacs. The said property was inherited by his son Abraham in financial year 2009-10 as per Will.

For obtaining a clear title thereof, Abraham paid the outstanding amount of loan on 12.02.2010 of Rs. 15 lacs. The said house property was sold by Abraham on 16.03.2020 for Rs. 50 lacs. Examine with reasons the amount chargeable to capital gains for A.Y. 2020-21. (Cost Inflation Index 2002-03: 105, 2009-10: 148 and 2019-20: 289).

**Answer**

The cost of inherited property to Mr. Abraham shall be the cost to the previous owner as per provisions of section 49(1)(iiiia) and therefore, Rs. 5 lacs, being the cost to his father (amount paid by his father on 26.5.2001 for acquiring the property) shall be the cost to Mr. Abraham, who is the new owner. Payment of outstanding loan of the predecessor by the successor for obtaining a clear title of the property by release of Mortgage Deed shall be the cost of acquisition of the successor under section 48 read with section 55(2) of the Act as held by the Apex Court in case of RM. Arunachalam v. CIT [1997] 227 ITR 222.

7.5
Computation of Taxable Capital Gain for the A.Y. 2020-21

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sale consideration of house property</td>
<td>50,00,000</td>
</tr>
</tbody>
</table>

Less: **Indexed cost of acquisition (See Note below)**

<table>
<thead>
<tr>
<th>(i) Cost to previous owner (Rs. 5,00,000 × 289 / 148)</th>
<th>9,76,351</th>
</tr>
</thead>
<tbody>
<tr>
<td>(ii) Loan amount paid by Mr. Abraham</td>
<td></td>
</tr>
<tr>
<td>(Benefit of CII is available since the loan amount was paid in the financial year 2009-10) (Rs. 15,00,000 × 289/148)</td>
<td>39,05,405</td>
</tr>
</tbody>
</table>

Capital gains                                      | 10,94,595 |

**Note:** Since the property was acquired by Mr. Abraham through inheritance, the cost of acquisition will be cost to the previous owner.

As per the definition of indexation cost of acquisition under clause (iii) of *Explanation* below section 48, indexation benefit will be available only from the previous year in which Abraham first held the asset i.e. P.Y. 2009-10.

However, as per the view expressed by Bombay High Court, in the case of *CIT v. Manjula J. Shah* (2013) 355 ITR 474, in case the cost of acquisition of the capital asset in the hands of the assessee is taken to be cost of such asset in the hands of the previous owner, the indexation benefit would be available from the year in which the capital asset is acquired by the previous owner. If this view is considered, the indexed cost of acquisition would be Rs. 43,05,244 (Rs. 13,76,190 + Rs. 29,29,054) and long term capital gain would be Rs. 6,94,756.

**Question 7**

*Gama Ltd, located within the corporation limits decided in December, 2019 decided to shift its industrial undertaking to non-urban area. The company sold some of the assets and acquired new assets in the process of shifting. The relevant details are as follows:*

<table>
<thead>
<tr>
<th>(Rs. in lacs)</th>
<th>Particulars</th>
<th>Land</th>
<th>Building</th>
<th>Plant &amp; Machinery</th>
<th>Furniture</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i)</td>
<td>Sale proceeds (sale effected in March, 2019)</td>
<td>8</td>
<td>18</td>
<td>16</td>
<td>3</td>
</tr>
<tr>
<td>(ii)</td>
<td>Indexed cost of acquisition</td>
<td>4</td>
<td>10</td>
<td>12</td>
<td>2</td>
</tr>
<tr>
<td>(iii)</td>
<td>Cost of acquisition in terms of section 50</td>
<td>--</td>
<td>4</td>
<td>5</td>
<td>2</td>
</tr>
<tr>
<td>(iv)</td>
<td>Cost of new assets purchased in July, 2020 for the purpose of business in the new place</td>
<td>4</td>
<td>7</td>
<td>17</td>
<td>2</td>
</tr>
</tbody>
</table>

*Compute the capital gains of Gama Ltd for the assessment year 2020-21.*

**Answer**

Section 54G deals with deduction in respect of any capital gain that may arise from the transfer of an industrial undertaking situated in an urban area in the course of or in consequence of shifting to a non-urban area.

If the assessee purchases new machinery or plant or acquires a building or land or constructs a new building or shifts the original asset and transfers the establishment to the new area,
within 1 year before or 3 years after the date on which the transfer takes place, then, instead of the capital gain being charged to tax, it shall be dealt with as under:

1. If the capital gain is greater than the cost of the new asset, the difference between the capital gain and the cost of the new asset shall be chargeable as income ‘under section 45’.

2. If the total gain is equal to or less than the cost of the new asset, section 45 is not to be applied.

The capital assets referred to in section 54G are machinery or plant or land or building or any rights in building or land. Capital gain arising on transfer of furniture does not qualify for exemption under section 54G. No exemption is therefore available under section 54G in respect of investment of Rs. 2 lacs in acquiring furniture.

The first step therefore is to determine the capital gain arising out of the transfer and thereafter apply the provisions of section 54G.

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) Land – Sale proceeds (Non-depreciable asset)</td>
<td>8,00,000</td>
</tr>
<tr>
<td>Less: Indexed cost of acquisition</td>
<td>4,00,000</td>
</tr>
<tr>
<td>Long term capital gain</td>
<td>4,00,000</td>
</tr>
<tr>
<td>Less: Cost of new assets purchased within three year after the date of transfer (under section 54G)</td>
<td>3,00,000</td>
</tr>
<tr>
<td><strong>Taxable Long term capital gain</strong></td>
<td>1,00,000</td>
</tr>
<tr>
<td>(b) Building – sale proceeds (depreciable assets)</td>
<td>18,00,000</td>
</tr>
<tr>
<td>Less: W.D.V. is deemed as cost of acquisition under section 50</td>
<td>4,00,000</td>
</tr>
<tr>
<td><strong>Short term capital gain</strong></td>
<td>14,00,000</td>
</tr>
<tr>
<td>(c) Plant &amp; machinery- sale proceeds (depreciable asset)</td>
<td>16,00,000</td>
</tr>
<tr>
<td>Less: WDV is deemed cost under section 50</td>
<td>5,00,000</td>
</tr>
<tr>
<td><strong>Short term capital gain</strong></td>
<td>11,00,000</td>
</tr>
<tr>
<td>(d) Furniture - sale proceeds (depreciable asset)</td>
<td>3,00,000</td>
</tr>
<tr>
<td>Less: WDV is deemed cost under section 50</td>
<td>2,00,000</td>
</tr>
<tr>
<td><strong>Short term capital gain (A)</strong></td>
<td>1,00,000</td>
</tr>
</tbody>
</table>

**Summary**

<table>
<thead>
<tr>
<th></th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Short term capital gain : Building</td>
<td>14,00,000</td>
</tr>
<tr>
<td>Short term capital gain : Plant &amp; machinery</td>
<td>11,00,000</td>
</tr>
<tr>
<td><strong>Less: Section 54G [New assets purchased]</strong> (See Note below)</td>
<td>25,00,000</td>
</tr>
<tr>
<td>Net short term capital gain (B)</td>
<td>25,00,000</td>
</tr>
<tr>
<td><strong>Total short term capital gain (A)+(B) = Rs. 1 lac</strong></td>
<td>Nil</td>
</tr>
</tbody>
</table>

**Note** – Total exemption available under section 54G is Rs. 28 lacs (Rs. 4 lacs + Rs. 7 lacs + Rs. 17 lacs). The exemption should first be exhausted against short term capital gain as the incidence of tax in case of short-term capital gain is more than in case of long term capital gain. Therefore, Rs. 25 lacs is exhausted against short term capital gain and the balance of Rs. 3 lacs against long term capital gain.

The taxable capital gains would be:

- Long term capital gains: Rs. 1,00,000 (taxable @ 20% under section 112)
- Short term capital gains (furniture): Rs. 1,00,000 (taxable @ 30%/25%, as the case may be)
- Rs. 2,00,000
Question 8

The assessee was a company carrying on business of manufacture and sale of art-silk cloth. It purchased machinery worth Rs. 4 lacs on 1.5.2008 and insured it with United India Assurance Ltd against fire, flood, earthquake etc. The written down value of the asset as on 01.04.2019 was Rs. 2,08,800. The insurance policy contained a reinstatement clause requiring the insurance company to pay the value of the machinery, as on the date of fire etc., in case of destruction of loss. A fire broke out in August, 2019 causing extensive damage to the machinery of the assessee rendering them totally useless. The assessee company received a sum of Rs. 6 lacs from the insurance company on 15th March, 2020. Discuss the issues arising on account on the transactions and their tax treatment.

(Cost inflation index for financial year 2008-09 and 2019-20 are 137 and 289 respectively)

Answer

As per section 45(1A), where any person receives any money or other assets under an insurance from an insurer on account of damage to or destruction of capital asset, then, any profits and gains arising from the receipt of such money or other assets, shall be chargeable to income tax under the head “Capital Gains” and shall be deemed to be the income of such person of the previous year in which such money or asset was received.

For the purpose of section 48, the money received or the market value of the asset shall be deemed to be the full value of the consideration accruing as a result of the transfer of such capital asset. Since the asset was destroyed and the money from the insurance company was received in the previous year, there will be a liability to capital gains in respect of the insurance moneys received by the assessee.

Under section 45(1A) any profits and gains arising from receipt of insurance moneys is chargeable under the head “Capital gains”. For the purpose of section 48, the moneys received shall be deemed to be the full value of the consideration accruing or arising. Under section 50 the capital gains in respect of depreciable assets had to be computed in the following manner (assuming it was the only asset in the block).

The computation of capital gain and tax implication is given below:

<table>
<thead>
<tr>
<th>Full value of the consideration</th>
<th>Rs. 6,00,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less: Written down value as on April 1st, 2018</td>
<td>Rs. 2,08,800</td>
</tr>
<tr>
<td>Short term capital gains</td>
<td>Rs. 3,91,200</td>
</tr>
</tbody>
</table>

Question 9

Tani purchased a land at a cost of Rs. 35 lakhs in the financial year 2004-05 and held the same as her capital asset till 31st May, 2018. Tani started her real estate business on 1st June, 2018 and converted the said land into stock-in-trade of her business on the said date, when the fair market value of the land was Rs. 210 lakhs.

She constructed 15 flats of equal size, quality and dimension. Cost of construction of each flat is Rs. 10 lakhs. Construction was completed in January, 2020. She sold 10 flats at Rs. 30 lakhs per flat between January, 2020 and March, 2020. The remaining 5 flats were held in stock as on 31st March, 2020.

She invested Rs. 50 lakhs in bonds issued by National Highway Authority of India on 31st March, 2020 and another Rs. 50 lakhs in bonds of Rural Electrification Corporation Ltd. in April, 2020.
Compute the amount of chargeable capital gain and business income in the hands of Tani arising from the above transactions for Assessment Year 2020-21 indicating clearly the reasons for treatment for each item.


**Answer**

**Computation of capital gains and business income of Tani for A.Y. 2020-21**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Capital Gains</strong></td>
<td></td>
</tr>
<tr>
<td>Fair market value of land on the date of conversion deemed as the full value of consideration for the purposes of section 45(2)</td>
<td>2,10,00,000</td>
</tr>
<tr>
<td>Less: Indexed cost of acquisition [Rs. 35,00,000 × 280/113]</td>
<td>86,72,566</td>
</tr>
<tr>
<td></td>
<td>1,23,27,434</td>
</tr>
<tr>
<td>Proportionate capital gains arising during A.Y.2019-20 [Rs. 1,23,27,434 × 2/3]</td>
<td>82,18,289</td>
</tr>
<tr>
<td>Less: Exemption under section 54EC</td>
<td>50,00,000</td>
</tr>
<tr>
<td><strong>Capital gains chargeable to tax for A.Y.2020-21</strong></td>
<td>32,18,289</td>
</tr>
<tr>
<td><strong>Business Income</strong></td>
<td></td>
</tr>
<tr>
<td>Sale price of flats [10 × Rs. 30 lakhs]</td>
<td>3,00,00,000</td>
</tr>
<tr>
<td>Less: Cost of flats</td>
<td></td>
</tr>
<tr>
<td>Fair market value of land on the date of conversion [Rs. 210 lacs × 2/3]</td>
<td>1,40,00,000</td>
</tr>
<tr>
<td>Cost of construction of flats [10 × Rs. 10 lakhs]</td>
<td>1,00,00,000</td>
</tr>
<tr>
<td><strong>Business income chargeable to tax for A.Y.2020-21</strong></td>
<td>60,00,000</td>
</tr>
</tbody>
</table>

**Notes:**

1. The conversion of a capital asset into stock-in-trade is treated as a transfer under section 2(47). It would be treated as a transfer in the year in which the capital asset is converted into stock-in-trade.
2. However, as per section 45(2), the capital gains arising from the transfer by way of conversion of capital assets into stock-in-trade will be chargeable to tax only in the year in which the stock-in-trade is sold.
3. The indexation benefit for computing indexed cost of acquisition would, however, be available only up to the year of conversion of capital asset to stock-in-trade and not up to the year of sale of stock-in-trade.
4. For the purpose of computing capital gains in such cases, the fair market value of the capital asset on the date on which it was converted into stock-in-trade shall be deemed to be the full value of consideration received or accruing as a result of the transfer of the capital asset.
   In this case, since only 2/3rd of the stock-in-trade (10 flats out of 15 flats) is sold in the P.Y.2019-20, only proportionate capital gains (i.e., 2/3rd) would be chargeable in the A.Y.2020-21.
5. On sale of such stock-in-trade, business income would arise. The business income chargeable to tax would be computed after deducting the fair market value on the date of conversion of the capital asset into stock-in-trade and cost of construction of flats from the price at which the stock-in-trade is sold.
6. In case of conversion of capital asset into stock-in-trade and subsequent sale of stock-in-trade, the period of 6 months is to be reckoned from the date of sale of stock-in-trade for the purpose of exemption under section 54EC [CBDT Circular No.791 dated 2.6.2000]. In this case, since the investment in bonds of NHAI has been made within
6 months of sale of flats, the same qualifies for exemption under section 54EC. With respect to long-term capital gains arising in any financial year, the maximum deduction under section 54EC would be Rs. 50 lakhs, whether the investment in bonds of NHAI or RECL are made in the same financial year or next financial year or partly in the same financial year and partly in the next financial year.

Therefore, even though investment of Rs. 50 lakhs has been made in bonds of NHAI during the P.Y.2019-20 and investment of Rs. 50 lakhs has been made in bonds of RECL during the P.Y.2020-21, both within the stipulated six month period, the maximum deduction allowable for A.Y.2020-21, in respect of long-term capital gain arising on sale of long-term capital asset(s) during the P.Y.2019-20, is only Rs. 50 lakhs.

**Question 10**

*X. Limited has transferred its Unit N to Y. Limited by way of slump sale on November 30, 2019. The summarised Balance Sheet of X. Limited as on that date is given below:*

<table>
<thead>
<tr>
<th>Liabilities</th>
<th>Rs.(in lakhs)</th>
<th>Assets</th>
<th>Rs.(in lakhs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Paid up capital</td>
<td>1,700</td>
<td>Fixed Assets:</td>
<td></td>
</tr>
<tr>
<td>Reserve &amp; surplus</td>
<td>620</td>
<td>Unit L</td>
<td>150</td>
</tr>
<tr>
<td>Liabilities:</td>
<td></td>
<td>Unit M</td>
<td>150</td>
</tr>
<tr>
<td>Unit L</td>
<td>40</td>
<td>Unit N</td>
<td>550</td>
</tr>
<tr>
<td>Unit M</td>
<td>110</td>
<td>Other Assets:</td>
<td></td>
</tr>
<tr>
<td>Unit N</td>
<td>90</td>
<td>Unit L</td>
<td>520</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Unit M</td>
<td>800</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Unit N</td>
<td>390</td>
</tr>
</tbody>
</table>

**Total** 2,560 **Total** 2,560

*Using the further information given below, compute the capital gain arising from slump sale of Unit N and tax on such capital gain.*

(i) **Lump sum consideration on transfer of Unit N is Rs.880 lakhs.**

(ii) **Fixed assets of Unit N includes land which was purchased at Rs. 60 lakhs in August 2007 and revalued at Rs.90 lakhs as on March 31, 2019.**

(iii) **Other fixed assets are reflected at Rs. 460 lakhs (i.e. Rs. 550 lakhs less value of land) which represents written down value of those assets as per books. The written down value of these assets under section 43(6) of the Income-tax Act, 1961 is Rs. 410 lakhs.**

(iv) **Unit N was set up by X. Limited in July, 2007.**

(v) **Cost inflation index for financial year 2006-07 and financial year 2019-20 are 129 and 289, respectively.**

**Answer**

**Computation of capital gain on slump sale of Unit N under section 50B**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.(in lacs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sale consideration for the slump sale of Unit N</td>
<td>880</td>
</tr>
<tr>
<td>Less: Net worth of Unit N (Refer Note 1 below)</td>
<td>770</td>
</tr>
<tr>
<td>Long term capital gain arising on slump sale</td>
<td>110</td>
</tr>
</tbody>
</table>

**Computation of tax liability of X Ltd. on slump sale of Unit N**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.(in lacs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax on capital gains@20%</td>
<td>22.00</td>
</tr>
</tbody>
</table>
Add: Surcharge@7%  
\[ \text{Add: Education cess@4%} \]
\[ \text{Total tax liability on capital gain arising on slump sale of Unit N} \]
\[ \begin{array}{l}
\text{Add: Surcharge@7%} \\
\text{Add: Education cess@4%} \\
\hline
\text{Total tax liability on capital gain arising on slump sale of Unit N} \\
\hline
1.54 \\
23.54 \\
0.94 \\
\hline
24.48
\end{array} \]

Notes:
1. The net worth of an undertaking transferred by way of slump sale shall be deemed to the cost of acquisition and cost of improvement for the purposes of section 48 and 49 [Section 50B(2)].

**Computation of net worth of Unit N**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs. (in lacs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>(A) Book value of non-depreciable assets:</td>
<td></td>
</tr>
<tr>
<td>(i) Land (Revaluation is to be ignored for computing net worth)</td>
<td>60</td>
</tr>
<tr>
<td>(ii) Other assets</td>
<td>390</td>
</tr>
<tr>
<td>(B) Written down value of depreciable assets under section 43(6)</td>
<td>410</td>
</tr>
<tr>
<td>Aggregate value of total assets</td>
<td>860</td>
</tr>
<tr>
<td>Less: Value of liabilities of Unit N</td>
<td>90</td>
</tr>
<tr>
<td><strong>Net worth of Unit N</strong></td>
<td><strong>770</strong></td>
</tr>
</tbody>
</table>

2. Since Unit N is held for more than 36 months, the capital gains of **Rs. 110 lacs** arising on transfer of such unit would be a long term capital gain taxable under section 112. However, indexation benefit is not available in the case of a slump sale.

**Question 11**

Following are the details of income provided by Mr. Singh, the assessee for the financial year ended 31st March, 2020:

(i) Rental income from property at Bangalore - **Rs. 3 lakhs**, Standard Rent - **Rs. 2,50,000**, Fair Rent - **Rs. 2,80,000**.

(ii) Municipal and water tax paid during 2018-19: Current year **Rs. 35,000**, Arrears - **Rs. 1,50,000**.

(iii) Interest on loan borrowed towards major repairs to the property: **Rs. 1,50,000**.

(iv) Arrears of rent of **Rs. 30,000** received during the year, which was not charged to tax in earlier years.

Further, the assessee furnished following additional information regarding sale of property at Chennai:

(i) Mr. Singh's father acquired a residential house in April 2006 for **Rs. 1,25,000** and thereafter gifted this property to the assessee, Mr. Singh on 1st March, 2007.

(ii) The property, so gifted, was sold by Mr. Singh on 10th June 2019. The consideration received was **Rs. 25,00,000**.

(iii) Stamp duty charges paid by the purchaser at the time of registration @ 13% (as per statutory guidelines) was **Rs. 3,90,000**.

(iv) Out of the sale consideration received:
   
   (a) On 02/01/2020, the assessee had purchased two adjacent flats, in the same building, and made suitable modification to make it as one unit. The investment was made by separate sale deeds, amount being **Rs. 8,00,000** and **Rs. 7,00,000**, respectively.

   (b) On 10/10/2019, **Rs. 10 lakhs** was invested in bonds issued by National Highways Authority of India, but the allotment of the bonds was made on 1.2.2020.
Compute Mr. Singh's taxable income for assessment year 2020-21.

Answer

### Computation of taxable income of Mr. Singh for A.Y.2020-21

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Income from house property</strong></td>
<td></td>
</tr>
<tr>
<td>Gross Annual Value [Higher of Expected Rent &amp; Actual Rent]</td>
<td>3,00,000</td>
</tr>
<tr>
<td>Expected Rent (lower of Fair Rent and Standard Rent)</td>
<td>2,50,000</td>
</tr>
<tr>
<td>Actual Rent</td>
<td>3,00,000</td>
</tr>
<tr>
<td><strong>Less:</strong> Municipal taxes paid by Mr. Singh during the year (including arrears) [Rs. 35,000 + Rs.1,50,000]</td>
<td>1,85,000</td>
</tr>
<tr>
<td><strong>Net Annual Value (NAV)</strong></td>
<td>1,15,000</td>
</tr>
<tr>
<td><strong>Less:</strong> Deductions under section 24</td>
<td></td>
</tr>
<tr>
<td>(a) 30% of NAV</td>
<td>34,500</td>
</tr>
<tr>
<td>(b) Interest on loan borrowed for major repairs</td>
<td>1,50,000</td>
</tr>
<tr>
<td><strong>Net Amount Deductions (69,500)</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Arrears of rent taxable under section 25A</strong></td>
<td>30,000</td>
</tr>
<tr>
<td><strong>Less:</strong> Deduction@30%</td>
<td>9,000</td>
</tr>
<tr>
<td><strong>Net Amount Deductions (48,500)</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Capital Gains</strong></td>
<td></td>
</tr>
<tr>
<td>Full value of consideration</td>
<td>30,00,000</td>
</tr>
<tr>
<td>As per section 50C, the full value of consideration would be the higher of -</td>
<td></td>
</tr>
<tr>
<td>Actual Consideration</td>
<td>25,00,000</td>
</tr>
<tr>
<td><strong>Stamp Duty Value [Rs. 3,90,000/13%]</strong></td>
<td>30,00,000</td>
</tr>
<tr>
<td>Since stamp duty value &gt; 105% of actual consideration</td>
<td></td>
</tr>
<tr>
<td><strong>Less:</strong> Indexed cost of acquisition [Rs. 1,25,000 × 289/122]</td>
<td>2,99,107</td>
</tr>
<tr>
<td><strong>Capital Gains</strong></td>
<td></td>
</tr>
<tr>
<td>Purchase of residential house within the stipulated time (within one year before or two years after the date of sale) [Where the flats are situated side by side and the builder had effected the necessary modification to make it as one house, the assessee would be entitled to exemption under section 54 in respect of investment in both the flats, despite the fact that they were purchased by separate sale deeds]</td>
<td>15,00,000</td>
</tr>
<tr>
<td><strong>Note:</strong> Since two adjacent flats are treated as one residential house, Mr. Singh can defer availing exemption under section 54 in respect of two residential houses (where capital gains does not exceed Rs. 2 crores) to a later assessment year.</td>
<td></td>
</tr>
<tr>
<td><strong>Exemption under section 54EC</strong></td>
<td></td>
</tr>
<tr>
<td>Investment in bonds of NHAI within six months from the date of transfer. Where the payment for bonds has been made within the six month period, exemption under section 54EC</td>
<td></td>
</tr>
</tbody>
</table>
Question 12

SS(P) Ltd., an Indian company having two undertakings engaged in manufacture of cement and steel, decided to hive off cement division to RV(P) Ltd., an Indian company, by way of demerger. The net worth of SS(P) Ltd. immediately before demerger was Rs. 40 crores. The net book value of assets transferred to RV(P) Ltd. was Rs. 10 crores. The demerger was made in January 2020. In the scheme of demerger, it was fixed that for each equity share of Rs. 10 each (fully paid up) of SS(P) Ltd., two equity shares of Rs. 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 2004-05 for Rs. 6,00,000. Mr. N.K. received 50,000 equity shares from RV(P) Ltd. consequent to demerger in January 2020. He sold all the shares of RV(P) Ltd. for Rs. 8,00,000 in March, 2020. In this background you are requested to answer the following:

(i) Does the transaction of demerger attract any income tax liability in the hands of SS(P) Ltd. and RV(P) Ltd.?
(ii) Compute the capital gain that could arise in the hands of Mr. N.K. on receipt of shares of RV(P) Ltd.
(iii) Compute the capital gain that could arise in the hands of Mr. N.K. on sale of shares of RV(P) Ltd.
(iv) Will the sale of shares by Mr. N.K. affect the tax benefits availed by SS(P) Ltd. and/or RV(P) Ltd.?
(v) 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, mention in brief.

Note:

<table>
<thead>
<tr>
<th>Financial Year</th>
<th>Cost inflation index</th>
</tr>
</thead>
<tbody>
<tr>
<td>2004-05</td>
<td>113</td>
</tr>
<tr>
<td>2019-20</td>
<td>289</td>
</tr>
</tbody>
</table>

Answer

(i) No, the transaction of demerger would not attract any income-tax liability in the hands of SS(P) or RV(P) Ltd.

As per section 47(vib), any transfer in a demerger, of a capital asset, by the demerged company to the resulting company would not be regarded as “transfer” for levy of capital gains tax if the resulting company is an Indian company.

Hence, capital gains tax liability would not be attracted in the hands of SS(P) Ltd., the demerged company, in this case, since RV(P) Ltd. is an Indian company.

(ii) There would be no capital gains liability in the hands of Mr. N.K. on receipt of shares of RV (P) Ltd., since as per section 47(vid), any issue of shares by the resulting company in a scheme of demerger to the shareholders of the demerged company will not be regarded as “transfer” for levy of capital gains tax, if the issue is made in consideration of demerger of the undertaking.

(iii) Yes, capital gains would arise in the hands of Mr. N.K. on sale of shares of RV (P) Ltd.

Sale consideration 8,00,000
Less: Indexed cost of acquisition of shares of RV (P) Ltd.
Cost of acquisition of shares of RV(P) Ltd. as per section 49(2C):
Cost of acquisition of shares of SS(P) Ltd. × Net book value of assets transferred in a demerger
Net worth of the demerged company immediately before demerger

Rs.6,00,000 × \frac{10}{40} \text{ crore} = \text{Rs.}1,50,000

Indexed cost of acquisition of shares of RV (P) Ltd. [\text{Rs.}1,50,000 × 289/113] \text{ Rs.}3,83,628

Long-term capital gain (since period of holding of shares in demerged company is also to be considered) \text{ Rs.}4,16,372

(iv) No, sale of shares by Mr. N.K. would not affect the tax benefits availed by SS(P) Ltd. or RV (P) Ltd.

One of the conditions to be satisfied is that the shareholders holding not less than three-fourths in value of the shares in the demerged company become shareholders of the resulting company by virtue of the demerger. It is presumed that the condition is satisfied in this case.

There is no stipulation that they continue to remain shareholders for any period of time thereafter.

(v) Since the resultant capital gain on sale of shares of RV(P) Ltd. is a long-term capital gain (on account of the period of holding of shares in demerged company being considered by virtue of section 2(42A)(g)), Mr. N.K. can avail exemption –

(1) under section 54EE, by investing the long-term capital gain units of specified fund, within a period of 6 months from the date of transfer.

(2) under section 54F by investing the entire net consideration in purchase (within one year before and two years after the date of transfer) or construction (within three years after the date of transfer) of one residential house in India. If part of the net consideration is invested, only proportionate exemption would be available.

Question 13

The Balance sheet of JB Opticals Limited as on 31-03-2020 reads as under:

Paid up capital \quad \text{Rs.} 2,52,00,000

<table>
<thead>
<tr>
<th>Description</th>
<th>Unit A (Rs.)</th>
<th>Unit B (Rs.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fixed assets</td>
<td>1,00,00,000</td>
<td>1,50,00,000</td>
</tr>
<tr>
<td>Debtors</td>
<td>1,00,00,000</td>
<td>75,00,000</td>
</tr>
<tr>
<td>Liabilities</td>
<td>28,00,000</td>
<td>50,00,000</td>
</tr>
<tr>
<td>Stock in trade</td>
<td>50,00,000</td>
<td>25,00,000</td>
</tr>
<tr>
<td>Reserves</td>
<td>1,48,00,000</td>
<td></td>
</tr>
<tr>
<td>Share premium</td>
<td>22,00,000</td>
<td></td>
</tr>
</tbody>
</table>

The company acquired Unit B on 1.04.2017. They made certain capital additions in the form of Generator set and additional building etc., for \text{Rs.} 25 lacs during the year 2017-18. The members of the company have authorized the Board in their meeting held on 28.01.2020 to dispose of Unit ‘B’. The company decides to sell Unit ‘B’ by way of slump sale for \text{Rs.} 225 lacs as consideration. JB Opticals Ltd. has offered 1% discount if the buyer closes the sale and makes payment before 31.03.2020. However, this discount would not be available if the sale is completed (and payment is made) after 31.03.2020. You are required to advise the company as a measure of tax planning to determine the date of sale keeping in view the capital gains tax. Assume that the written down value of the fixed assets as per section 43(6) is \text{Rs.} 120 lacs.
Would your answer change if the buyer is ready to accept discount of 3%, other facts remaining the same?

**Note:** Total turnover for the P.Y. 2017-18 was Rs. 450 crore.

**Solution**

**Determination of net worth of Unit B of M/s. J.B. Opticals Ltd.**

<table>
<thead>
<tr>
<th></th>
<th>Rs. (in lacs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Written down value of fixed assets</td>
<td>120</td>
</tr>
<tr>
<td>Debtors</td>
<td>75</td>
</tr>
<tr>
<td>Stock-in-trade</td>
<td>25</td>
</tr>
<tr>
<td><strong>Less : Liabilities</strong></td>
<td>220</td>
</tr>
<tr>
<td><strong>Net worth</strong></td>
<td>170</td>
</tr>
</tbody>
</table>

**Comparative calculation of chargeable capital gains**

<table>
<thead>
<tr>
<th></th>
<th>Sale before 31.3.2020</th>
<th>Sale after 31.03.2020</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sale consideration</td>
<td>2,25,00,000</td>
<td>2,25,00,000</td>
</tr>
<tr>
<td>Less: Discount</td>
<td>Nil</td>
<td>9,00,000</td>
</tr>
<tr>
<td>Net sale consideration</td>
<td>2,25,00,000</td>
<td>2,16,00,000</td>
</tr>
<tr>
<td>Less: Net worth</td>
<td>1,70,00,000</td>
<td>1,70,00,000</td>
</tr>
<tr>
<td>Short term capital gain</td>
<td>55,00,000</td>
<td>N.A.</td>
</tr>
<tr>
<td>Long term capital gain</td>
<td>N.A.</td>
<td>46,00,000</td>
</tr>
<tr>
<td>Tax rate</td>
<td>31.2%</td>
<td>20.8%</td>
</tr>
<tr>
<td><strong>Tax thereon</strong></td>
<td>17,16,000</td>
<td>9,56,800</td>
</tr>
</tbody>
</table>

**Computation of Net Cash flow**

<table>
<thead>
<tr>
<th></th>
<th>Sale before 31.3.2020</th>
<th>Sale after 31.03.2020</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net sale consideration</td>
<td>2,25,00,000</td>
<td>2,16,00,000</td>
</tr>
<tr>
<td>Less: Income-tax</td>
<td>17,16,000</td>
<td>9,56,800</td>
</tr>
<tr>
<td><strong>Net Cash flow</strong></td>
<td>2,07,84,000</td>
<td>2,06,43,200</td>
</tr>
</tbody>
</table>

**Note:** The assessee is advised to effect slump sale before 31.03.2020 as the net cash flow arising from sale effected before 31.03.2020 is higher than the net cash flow arising from sale effected after 31.03.2020, inspite of the higher rate of tax on short-term capital gains.

**Alternate Situation:** If the buyer is ready to accept discount of 3% offered by J.B. Opticals Ltd.

In this case, the capital gain tax and net cash flow would be as under:

**Comparative calculation of chargeable capital gains**

<table>
<thead>
<tr>
<th></th>
<th>Sale before 31.3.2020</th>
<th>Sale after 31.03.2020</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sale consideration</td>
<td>2,25,00,000</td>
<td>2,25,00,000</td>
</tr>
<tr>
<td>Less: Discount</td>
<td>Nil</td>
<td>6,75,000</td>
</tr>
<tr>
<td>Net sale consideration</td>
<td>2,25,00,000</td>
<td>2,18,25,000</td>
</tr>
<tr>
<td>Less: Net worth</td>
<td>1,70,00,000</td>
<td>1,70,00,000</td>
</tr>
<tr>
<td>Short term capital gain</td>
<td>55,00,000</td>
<td>N.A.</td>
</tr>
<tr>
<td>Long term capital gain</td>
<td>N.A.</td>
<td>48,25,000</td>
</tr>
<tr>
<td>Tax rate</td>
<td>31.2%</td>
<td>20.8%</td>
</tr>
<tr>
<td><strong>Tax thereon</strong></td>
<td>17,16,000</td>
<td>10,03,600</td>
</tr>
</tbody>
</table>
Computation of Net Cash flow

<table>
<thead>
<tr>
<th></th>
<th>Sale before 31.3.2020</th>
<th>Sale after 31.03.2020</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net sale consideration</td>
<td>2,25,00,000</td>
<td>2,18,25,000</td>
</tr>
<tr>
<td>Less: Income-tax</td>
<td>17,16,000</td>
<td>10,03,600</td>
</tr>
<tr>
<td><strong>Net Cash flow</strong></td>
<td><strong>2,07,84,000</strong></td>
<td><strong>2,08,21,400</strong></td>
</tr>
</tbody>
</table>

**Note:** In case the buyer is ready to accept discount of 3%, the assessee can effect slump sale after 31.03.2020 as the net cash flow arising from sale effected after 31.03.2020 is higher than the net cash flow arising from sale effected before 31.03.2020.

**Question 14**

*PQR Limited has two units - one engaged in manufacture of computer hardware and the other involved in developing software. As a restructuring drive, the company has decided to sell its software unit as a going concern by way of slump sale for Rs. 385 lacs to a new company called S Limited, in which it holds 74% equity shares.*

The balance sheet of PQR limited as on 31st March 2020, being the date on which software unit has been transferred, is given hereunder –

**Balance Sheet as on 31.3.2020**

<table>
<thead>
<tr>
<th>Liabilities</th>
<th>Rs. (in lacs)</th>
<th>Assets</th>
<th>Rs. (in lacs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Paid up Share Capital</td>
<td>300</td>
<td>Fixed Assets</td>
<td></td>
</tr>
<tr>
<td>General Reserve</td>
<td>150</td>
<td>Hardware unit</td>
<td>170</td>
</tr>
<tr>
<td>Share Premium</td>
<td>50</td>
<td>Software unit</td>
<td>200</td>
</tr>
<tr>
<td>Revaluation Reserve</td>
<td>120</td>
<td>Debtors</td>
<td></td>
</tr>
<tr>
<td>Current Liabilities</td>
<td></td>
<td>Hardware unit</td>
<td>140</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Hardware unit</td>
<td>40</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Software unit</td>
<td>90</td>
</tr>
<tr>
<td>Hardware unit</td>
<td></td>
<td></td>
<td>110</td>
</tr>
<tr>
<td>Software unit</td>
<td>90</td>
<td>Inventories</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Hardware unit</td>
<td>95</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Software unit</td>
<td>35</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>750</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>750</td>
</tr>
</tbody>
</table>

Following additional information are furnished by the management:

(i) The Software unit is in existence since May, 2015.
(ii) Fixed assets of software unit includes land which was purchased at Rs. 40 lacs in the year 2008 and revalued at Rs. 60 lacs as on March 31, 2020.
(iii) Fixed assets of software unit mirrored at Rs. 140 lacs (Rs. 200 lacs minus land value Rs. 60 lacs) is written down value of depreciable assets as per books of account. However, the written down value of these assets under section 43(6) of the Income-tax Act, 1961 is Rs. 90 lacs.

(a) Ascertain the tax liability, which would arise from slump sale to PQR Limited.
(b) What would be your advice as a tax-consultant to make the restructuring plan of the company more tax-savvy, without changing the amount of sale consideration?

**Answer**

(a) As per section 50B, any profits and gains arising from the slump sale effected in the previous year shall be chargeable to income-tax as capital gains arising from the transfer of capital assets and shall be deemed to be the income of the previous year in which the transfer took place.
If the assessee owned and held the undertaking transferred under slump sale for more than 36 months before slump sale, the capital gain shall be deemed to be long-term capital gain. Indexation benefit is not available in case of slump sale as per section 50B(2).

**Ascertainment of tax liability of PQR Limited from slump sale of software unit**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs. (in lacs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sale consideration for slump sale of Software Unit</td>
<td>385</td>
</tr>
<tr>
<td>Less: Cost of acquisition being the net worth of Software Unit</td>
<td>185</td>
</tr>
<tr>
<td><strong>Long term capital gains arising on slump sale</strong></td>
<td><strong>200</strong></td>
</tr>
</tbody>
</table>

(The capital gains is long-term as the Software Unit is held for more than 36 months)

**Tax liability on LTCG**

Under section 112 @ 20% on Rs. 200 lacs

Add: Surcharge @ 7% 2.80

Add: Health and Education cess @ 4% 1.712

**44.512**

**Working Note:**

**Computation of net worth of Software Unit**

<table>
<thead>
<tr>
<th></th>
<th>Rs. (in lacs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1) Book value of non-depreciable assets</td>
<td></td>
</tr>
<tr>
<td>(i) Land (Revaluation not to be considered)</td>
<td>40</td>
</tr>
<tr>
<td>(ii) Debtors</td>
<td>110</td>
</tr>
<tr>
<td>(iii) Inventories</td>
<td>35</td>
</tr>
<tr>
<td>(2) Written down value of depreciable assets under section 43(6)</td>
<td>90</td>
</tr>
<tr>
<td><strong>Aggregate value of total assets</strong></td>
<td>275</td>
</tr>
<tr>
<td><strong>Less: Current liabilities of software unit</strong></td>
<td>90</td>
</tr>
<tr>
<td><strong>Net worth of software unit</strong></td>
<td><strong>185</strong></td>
</tr>
</tbody>
</table>

**Note:** For computing net worth, the aggregate value of total assets in the case of depreciable assets shall be the written down value of the block of assets as per section 43(6).

**Tax advice**

(i) Transfer of any capital asset by a holding company to its 100% Indian subsidiary company is exempt from capital gains under section 47(iv). Hence, PQR Limited should try to acquire the remaining 26% equity shares in S Limited then make the slump sale in the above said manner, in which case the slump sale shall be exempt from tax. For this exemption, PQR Limited will have to keep such 100% holding in S Limited for a period of 8 years from the date of slump sale, otherwise the amount exempt would be deemed to be income chargeable under the head “Capital Gains” of the previous year in which such transfer took place.

(ii) Alternatively, if acquisition of 26% share is not feasible, PQR Limited may think about demerger plan of Software Unit to get benefit of section 47(vib) of the Income-tax Act, 1961.
ADDITIONAL ILLUSTRATIONS FOR PRACTICE:

Illustration 1

X converts his capital asset (acquired on June 10, 2003 for Rs. 60,000) into stock-in-trade on March 10, 2019. The fair market value on the date of the above conversion was Rs. 5,50,000. He subsequently sells the stock-in-trade so converted for Rs. 6,00,000 on June 10, 2019. Examine the tax implication.


Solution

Since the capital asset is converted into stock-in-trade during the previous year relevant to the A.Y. 2019-20, it will be a transfer under section 2(47) during the P.Y.2018-19. However, the profits or gains arising from the above conversion will be chargeable to tax during the A.Y. 2020-21, since the stock-in-trade has been sold only on June 10, 2019. For this purpose, the fair market value on the date of such conversion (i.e. 10th March, 2019) will be the full value of consideration.

The capital gains will be computed after deducting the indexed cost of acquisition from the full value of consideration. The cost inflation index for 2003-04 i.e., the year of acquisition is 109 and the index for the year of transfer i.e., 2018-19 is 280. The indexed cost of acquisition is $60,000 \times \frac{280}{109} = \text{Rs. 1,54,128}$. Hence, Rs. 3,95,872 (i.e. Rs. 5,50,000 – Rs. 1,54,128) will be treated as long-term capital gains chargeable to tax during the A.Y.2020-21. During the same assessment year, Rs. 50,000 (Rs. 6,00,000 - Rs. 5,50,000) will be chargeable to tax as business profits.

Illustration 2

M held 2000 shares in a company ABC Ltd. This company amalgamated with another company during the previous year ending 31-3-2020. Under the scheme of amalgamation, M was allotted 1000 shares in the new company. The market value of shares allotted is higher by Rs. 50,000 than the value of holding in ABC Ltd.

The Assessing Officer proposes to treat the transaction as an exchange and to tax Rs. 50,000 as capital gain. Is he justified?

Solution

In the above example, assuming that the amalgamated company is an Indian company, the transaction is squarely covered by the exemption explained above and the proposal of the Assessing Officer to treat the transaction as an exchange is not justified.

Illustration 3

In which of the following situations capital gains tax liability does not arise?

(i) Mr. A purchased gold in 1970 for Rs. 25,000. In the P.Y. 2019-20, he gifted it to his son at the time of marriage. Fair market value (FMV) of the gold on the day the gift was made was Rs. 1,00,000.

(ii) A house property is purchased by a Hindu undivided family in 1945 for Rs. 20,000. It is given to one of the family members in the P.Y. 2018-19 at the time of partition of the family. FMV on the day of partition was Rs. 12,00,000.
(iii) Mr. B purchased 50 convertible debentures for Rs. 40,000 in 1995 which are converted into 500 shares worth Rs. 85,000 in November 2019 by the company.

Solution

We know that capital gains arise only when we transfer a capital asset. The liability of capital gains tax in the situations given above is discussed as follows:

(i) As per the provisions of section 47(iii), transfer of a capital asset under a gift is not regarded as transfer for the purpose of capital gains. Therefore, capital gains tax liability does not arise in the given situation.

(ii) As per the provisions of section 47(i), transfer of a capital asset (being in kind) on the total or partial partition of Hindu undivided family is not regarded as transfer for the purpose of capital gains. Therefore, capital gains tax liability does not arise in the given situation.

(iii) As per the provisions of section 47(x), transfer by way of conversion of bonds or debentures, debenture stock or deposit certificates in any form of a company into shares or debentures of that company is not regarded as transfer for the purpose of capital gains. Therefore, capital gains tax liability does not arise in the given situation.

Illustration 4

Mr. Abhishek, a senior citizen, mortgaged his residential house with a bank, under a notified reverse mortgage scheme. He was getting loan from the bank in monthly installments. Mr. Abhishek did not repay the loan on maturity and hence gave possession of the house to the bank, to discharge his loan. How will the treatment of long-term capital gain be on such reverse mortgage transaction?

Solution:

Section 47(xvi) provides that any transfer of a capital asset in a transaction of reverse mortgage under a scheme made and notified by the Central Government shall not be considered as a transfer for the purpose of capital gain.

Accordingly, the mortgaging of residential house with the bank by Mr. Abhishek will not be regarded as a transfer. Therefore, no capital gain will be charged on such transaction.

Further, section 10(43) provides that the amount received by the senior citizen as a loan, either in lump sum or in installment, in a transaction of reverse mortgage would be exempt from income-tax. Therefore, the monthly installment amounts received by Mr. Abhishek would not be taxable.

However, capital gains tax liability would be attracted at the stage of alienation of the mortgaged property by the bank for the purposes of recovering the loan.

Illustration 5

Neerja was carrying on the textile business under a proprietorship concern, Neerja Textiles. On 21.07.2019 the business of Neerja Textiles was succeeded by New Look Textile Private Limited and all the assets and liabilities of Neerja Textiles on that date became the assets and liabilities of New Look Textile Private Limited and Neerja was given 52% share in the share capital of the company. No other consideration was given to Neerja on account of this succession.

7.19
The assets and liabilities of Neerja Textiles transferred to the company included an urban land which was acquired by Neerja on 19.7.2013 for Rs. 9,80,000. The company sold the same on 30.03.2020 for Rs. 15,00,000.

Examine the tax implication of the above-mentioned transaction and compute the income chargeable to tax in such case(s).


Solution

**Taxability in case of succession of Neerja Textiles by New Look Textile Private Limited**

As per provisions of section 47(xiv), in case a proprietorship concern is succeeded by a company in the business carried by it and as a result of which any capital asset is transferred to the company, then the same shall not be treated as transfer and will not be chargeable to capital gain tax in case the following conditions are satisfied:

(1) all the assets and liabilities of sole proprietary concern becomes the assets and liabilities of the company.

(2) the shareholding of the sole proprietor in the company is not less than 50% of the total voting power of the company and continues to remain as such for a period of 5 years from the date of succession.

(3) the sole proprietor does not receive any consideration or benefit in any form from the company other than by way of allotment of shares in the company.

In the present case, all the conditions mentioned above are satisfied therefore, the transfer of capital asset by Neerja Textiles to New Look Textiles Private Limited shall not attract capital gain tax provided Neerja continues to hold 50% or more of voting power of New Look Textiles Private Limited for a minimum period of 5 years.

**Taxability in case of transfer of land by New Look Textiles Private Limited**

As per the provisions of section 49(1) and Explanation 1 to section 2(42A), in case a capital asset is transferred in the circumstances mentioned in section 47(xiv), the cost of the asset in the hands of the company shall be the cost of the asset in the hands of the sole proprietor. Consequently, for the determining the period of holding of the asset, the period for which the asset is held by the sole proprietor shall also be considered.

Therefore, in the present case, the urban land shall be a long-term capital asset since it is held for more than 24 months by New Look Textile Private Limited and Neerja Textiles taken together. Cost of acquisition of land in the hands of the company shall be Rs. 9,80,000 i.e., the purchase cost of the land in the hands of Neerja.

**Computation of capital gain chargeable to tax in the hands of New Look Textile Private Ltd.**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net Sale Consideration</td>
<td>15,00,000</td>
</tr>
<tr>
<td>Less: Indexed cost of acquisition 9,80,000 × 289/289</td>
<td>9,80,000</td>
</tr>
<tr>
<td>Long-term capital gain</td>
<td>5,20,000</td>
</tr>
</tbody>
</table>

**Note:** The year of transfer and the year in which the company first held the asset are the same in this case, which is the reason why the numerator and the denominator for calculating the indexed cost of acquisition would remain the same. Therefore, in effect, there is no benefit of indexation in this case. However, as per the view expressed by Bombay High Court in CIT v. Manjula J. Shah 16 Taxman 42, in case the cost of acquisition of the capital asset in the hands of the assessee is taken to be cost of such asset in the hands of the previous owner, the indexation benefit would be available from the year in which the capital asset is acquired by the previous owner. If this view is considered, the indexed cost of acquisition would have to be calculated by taking the CII
of F.Y.2013-14 i.e., 220, being the year in which the capital asset was acquired by the previous owner, Neerja, as the denominator, in which case, the capital gains chargeable to tax would undergo a change. The long-term capital gains in such a case would be Rs. 2,12,636 [Rs. 15,00,000 - Rs. 12,87,364 (9,80,000 x Rs. 289/220)].

Illustration 6

ABC Ltd., converts its capital asset acquired for an amount of Rs. 50,000 in June, 2003 into stock-in-trade in the month of November, 2017. The fair market value of the asset on the date of conversion is Rs. 4,50,000. The stock-in-trade was sold for an amount of Rs. 6,50,000 in the month of September, 2019. What will be the tax treatment?

<table>
<thead>
<tr>
<th>Financial year</th>
<th>Cost Inflation Index</th>
</tr>
</thead>
<tbody>
<tr>
<td>2003-04</td>
<td>109</td>
</tr>
<tr>
<td>2017-18</td>
<td>272</td>
</tr>
<tr>
<td>2019-20</td>
<td>289</td>
</tr>
</tbody>
</table>

Solution

The capital gains on the sale of the capital asset converted to stock-in-trade is taxable in the given case. It arises in the year of conversion (i.e. P.Y. 2017-18) but will be taxable only in the year in which the stock-in-trade is sold (i.e. P.Y. 2019-20). Profits from business will also be taxable in the year of sale of the stock-in-trade (P.Y. 2019-20).

The long-term capital gains and business income for the A.Y.2019-20 are calculated as under:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Profits and Gains from Business or Profession</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sale proceeds of the stock-in-trade</td>
<td>6,50,000</td>
<td></td>
</tr>
<tr>
<td>Less: Cost of the stock-in-trade (FMV on the date of conversion)</td>
<td>4,50,000</td>
<td>2,00,000</td>
</tr>
<tr>
<td><strong>Long Term Capital Gains</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Full value of the consideration (FMV on the date of the conversion)</td>
<td>4,50,000</td>
<td></td>
</tr>
<tr>
<td>Less: Indexed cost of acquisition (Rs. 50,000 × 272/109)</td>
<td>1,24,771</td>
<td>3,25,229</td>
</tr>
</tbody>
</table>

Note: For the purpose of indexation, the cost inflation index of the year in which the asset is converted into stock-in-trade should be considered.

Illustration 7

Ms. Usha purchases 1,000 equity shares in X Ltd., at a cost of Rs. 30 per share (brokerage 1%) in January 1996. She gets 100 bonus shares in August 2000. She again gets 1100 bonus shares by virtue of her holding on February 2006. Fair market value of the shares of X Ltd. on April 1, 2001 is Rs. 80.

In January 2020, she transfers all her shares @ Rs. 200 per share (brokerage 2%).

Compute the capital gains taxable in the hands of Ms. Usha for the A.Y. 2020-21


Solution

<table>
<thead>
<tr>
<th>Computation of capital gains for the A.Y. 2020-21</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>1000 Original shares</strong></td>
<td></td>
</tr>
<tr>
<td>Sale proceeds (1000 × Rs. 200)</td>
<td>2,00,000</td>
</tr>
<tr>
<td>Less : Brokerage paid (2% of Rs. 2,00,000)</td>
<td>4,000</td>
</tr>
</tbody>
</table>
Illustration 8

On January 31, 2020, Mr. A has transferred self-generated goodwill of his profession for a sale consideration of Rs. 70,000 and incurred expenses of Rs. 5,000 for such transfer. You are required to compute the capital gains chargeable to tax in the hands of Mr. A for the A.Y. 2020-21.

Solution

The transfer of self-generated goodwill of profession is not chargeable to tax. It is based upon the Supreme Court’s ruling in CIT vs. B.C. Srinivasa Shetty.

Illustration 9

Mr. R holds 1000 shares in Star Minus Ltd., an unlisted company, acquired in the year 2001-02 at a cost of Rs. 75,000. He has been offered right shares by the company in the month of August, 2019 at Rs. 160 per share, in the ratio of 2 for every 5 held. He retains 50% of the rights and renounces the balance right shares in favour of Mr. Q for Rs. 30 per share in September 2019. All the shares are sold by Mr. R for Rs. 300 per share in January 2020 and Mr. Q sells his shares in December 2019 at Rs. 280 per share. What are the capital gains taxable in the hands of Mr. R and Mr. Q?

<table>
<thead>
<tr>
<th>Financial year</th>
<th>Cost Inflation Index</th>
</tr>
</thead>
<tbody>
<tr>
<td>2001-02</td>
<td>100</td>
</tr>
<tr>
<td>2019-20</td>
<td>289</td>
</tr>
</tbody>
</table>

Solution

Computation of capital gains in the hands of Mr. R for the A.Y. 2020-21

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1000 Original shares</td>
<td></td>
</tr>
<tr>
<td>Sale proceeds (1000 × Rs.300)</td>
<td>3,00,000</td>
</tr>
<tr>
<td>Less : Indexed cost of acquisition [Rs.75,000 × 289/100]</td>
<td>2,16,750</td>
</tr>
<tr>
<td>Long-term capital gain (A)</td>
<td>90,000</td>
</tr>
</tbody>
</table>
200 Right shares
Sale proceeds (200 × Rs.300) 60,000
Less : Cost of acquisition [Rs.160 × 200] [Note 1] 32,000
Short-term capital gain (B) 28,000

Sale of Right Entitlement
Sale proceeds (200 × Rs.30) 6,000
Less : Cost of acquisition [Note 2] NIL
Short-term capital gain (C) 6,000
Capital Gains (A+B+C) 1,17,250

Note 1: Since the holding period of these shares is less than 24 months, they are short term capital assets and hence cost of acquisition will not be indexed.

Note 2: The cost of the rights renounced in favour of another person for a consideration is taken to be nil. The consideration so received is taxed as short-term capital gains in full. The period of holding is taken from the date of the rights offer to the date of the renouncement.

Computation of capital gains in the hands of Mr. Q for the A.Y.2020-21

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sale proceeds (200 shares × Rs.280)</td>
<td>56,000</td>
</tr>
<tr>
<td>Less: Cost of acquisition [200 shares × (Rs. 30 + Rs. 160)] [See Note below]</td>
<td>38,000</td>
</tr>
<tr>
<td>Short-term capital gain</td>
<td>18,000</td>
</tr>
</tbody>
</table>

Note: The cost of the rights is the amount paid to Mr. R as well as the amount paid to the company. Since the holding period of these shares is less than 24 months, they are short term capital assets.

Illustration 10

X & sons, HUF, purchased a land for Rs. 1,20,000 in the P.Y. 2002-03. In the P.Y. 2006-07, a partition takes place when Mr. A, a coparcener, is allotted this plot valued at Rs. 1,50,000. In P.Y. 2007-08, he had incurred expenses of Rs. 2,35,000 towards fencing of the plot. Mr. A sells this plot of land for Rs. 15,00,000 in P.Y. 2019-20 after incurring expenses to the extent of Rs. 20,000. You are required to compute the capital gain for the A.Y.2020-21.

<table>
<thead>
<tr>
<th>Financial year</th>
<th>Cost Inflation Index</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002-03</td>
<td>105</td>
</tr>
<tr>
<td>2006-07</td>
<td>122</td>
</tr>
<tr>
<td>2007-08</td>
<td>129</td>
</tr>
<tr>
<td>2019-20</td>
<td>289</td>
</tr>
</tbody>
</table>

Solution

Computation of taxable capital gains for the A.Y.2020-21

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sale consideration</td>
<td>15,00,000</td>
<td></td>
</tr>
<tr>
<td>Less: Expenses incurred for transfer</td>
<td>20,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>14,80,000</td>
<td></td>
</tr>
<tr>
<td>Less: (i) Indexed cost of acquisition (Rs. 1,20,000 × 289/122)</td>
<td>2,84,262</td>
<td></td>
</tr>
<tr>
<td>(ii) Indexed cost of improvement (Rs.2,35,000 × 289/129)</td>
<td>5,26,473</td>
<td></td>
</tr>
<tr>
<td>Long term capital gains</td>
<td>6,69,265</td>
<td></td>
</tr>
</tbody>
</table>

Note - As per the view expressed by Bombay High Court in CIT v. Manjula J. Shah 16 Taxman 42, in case the cost of acquisition of the capital asset in the hands of the assessee
is taken to be cost of such asset in the hands of the previous owner, the indexation benefit would be available from the year in which the capital asset is acquired by the previous owner. If this view is considered, the indexed cost of acquisition would have to be calculated by considering the Cost Inflation Index of F.Y.2002-03.

Illustration 11
Mr. C purchases a house property for Rs. 1,06,000 on May 15, 1975. The following expenses are incurred by him for making addition/alternation to the house property:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>a. Cost of construction of first floor in 1982-83</td>
<td>3,10,000</td>
</tr>
<tr>
<td>b. Cost of construction of the second floor in 2002-03</td>
<td>7,35,000</td>
</tr>
<tr>
<td>c. Reconstruction of the property in 2012-13</td>
<td>5,50,000</td>
</tr>
</tbody>
</table>

Fair market value of the property on April 1, 2001 is Rs. 8,50,000. The house property is sold by Mr. C on August 10, 2019 for Rs. 68,00,000 (expenses incurred on transfer: Rs. 50,000). Compute the capital gain for the assessment year 2020-21.


Solution

**Computation of Capital Gains of Mr. B for the A.Y.2020-21**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sale consideration</td>
<td>68,00,000</td>
</tr>
<tr>
<td>Less: Expenses on transfer</td>
<td>50,000</td>
</tr>
<tr>
<td>Net consideration</td>
<td>67,50,000</td>
</tr>
<tr>
<td>Less: Indexed cost of acquisition (Note 1)</td>
<td>24,56,500</td>
</tr>
<tr>
<td>Less: Indexed cost of improvement (Note 2)</td>
<td>28,17,750</td>
</tr>
<tr>
<td>Long term capital gain</td>
<td>14,75,750</td>
</tr>
</tbody>
</table>

Notes:
Indexed cost of acquisition: Rs. 8,50,000 × 289/100 = Rs. 24,56,500
Fair market value on April 1, 2001 (actual cost of acquisition is ignored as it is lower than market value on April 1, 2001.)

Indexed cost of improvement is determined as under:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Construction of first floor in 1982-83</td>
<td>Nil</td>
</tr>
<tr>
<td>(expenses incurred prior to April 1, 2001 are not considered)</td>
<td></td>
</tr>
<tr>
<td>Construction of second floor in 2002-03 (i.e., Rs.7,35,000 × 289/105)</td>
<td>20,23,000</td>
</tr>
<tr>
<td>Alternation/reconstruction in 2012-13 (i.e., Rs.5,50,000 × 289/200)</td>
<td>7,94,750</td>
</tr>
<tr>
<td><strong>Indexed cost of improvement</strong></td>
<td>28,17,750</td>
</tr>
</tbody>
</table>

Illustration 12
Singhania & Co., a sole proprietorship own six machines, put in use for business in March, 2019. The depreciation on these machines is charged @ 15%. The written down value of these machines as on 1st April, 2019 was Rs. 8,50,000. Three of the old machines were sold on 10th June, 2019 for Rs. 11,00,000. A new plant was bought for Rs. 8,50,000 on 30th November, 2019.
You are required to:

(i) determine the claim of depreciation for Assessment Year 2020-21.
(ii) compute the capital gains liable to tax for Assessment Year 2020-21.
(iii) If Singhania & Co. had sold the three machines in June, 2019 for Rs. 21,00,000, will there be any difference in your above workings? Examine.

Solution

(i) Computation of depreciation for A.Y.2020-21

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>W.D.V. of the block as on 1.4.2019</td>
<td>8,50,000</td>
</tr>
<tr>
<td>Add: Purchase of new plant during the year</td>
<td>8,50,000</td>
</tr>
<tr>
<td>Add: Purchase of new plant during the year</td>
<td>17,00,000</td>
</tr>
<tr>
<td>Less: Sale consideration of old machinery during the year</td>
<td>11,00,000</td>
</tr>
<tr>
<td>W.D.V of the block as on 31.03.2020</td>
<td>6,00,000</td>
</tr>
</tbody>
</table>

Since the value of the block as on 31.3.2020 comprises of a new asset which has been put to use for less than 180 days, depreciation is restricted to 50% of the prescribed percentage of 15% i.e. depreciation is restricted to 7½%. Therefore, the depreciation allowable for the year is Rs. 45,000, being 7½% of Rs. 6,00,000.

(ii) The provisions under section 50 for computation of capital gains in the case of depreciable assets can be invoked only under the following circumstances:

(a) When one or some of the assets in the block are sold for consideration more than the value of the block.
(b) When all the assets are transferred for a consideration more than the value of the block.
(c) When all the assets are transferred for a consideration less than the value of the block.

Since in the first two cases, the sale consideration is more than the written down value of the block, the computation would result in short term capital gains.

In the third case, since the written down value exceeds the sale consideration, the resultant figure would be a short-term capital loss.

In the given case, capital gains will not arise as the block of asset continues to exist, and some of the assets are sold for a price which is lesser than the written down value of the block.

(iii) If the three machines are sold in June, 2019 for Rs. 21,00,000, then short term capital gains would arise, since the sale consideration is more than the aggregate of the written down value of the block at the beginning of the year and the additions made during the year.
Particulars | Rs. | Rs.
--- | --- | ---
Sale consideration | 21,00,000 | 
Less: W.D.V. of the machines as on 1.4.2019 | 8,50,000 | 
Purchase of new plant during the year | 8,50,000 | 
Short term capital gains | 4,00,000 | 

Illustration 13

Mr. A is a proprietor of Akash Enterprises having 2 units. He transferred on 1.4.2019 his Unit 1 by way of slump sale for a total consideration of Rs. 25 lacs. Unit 1 was started in the year 2005-06. The expenses incurred for this transfer were Rs. 28,000. His Balance Sheet as on 31.3.2019 is as under:

<table>
<thead>
<tr>
<th>Liabilities</th>
<th>Total (Rs.)</th>
<th>Assets</th>
<th>Unit 1(Rs.)</th>
<th>Unit 2 (Rs.)</th>
<th>Total (Rs.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Own Capital</td>
<td>15,00,000</td>
<td>Building</td>
<td>12,00,000</td>
<td>2,00,000</td>
<td>14,00,000</td>
</tr>
<tr>
<td>Revaluation Reserve (for building of unit 1)</td>
<td>3,00,000</td>
<td>Machinery</td>
<td>3,00,000</td>
<td>1,00,000</td>
<td>4,00,000</td>
</tr>
<tr>
<td>Bank loan (70% for unit 1)</td>
<td>2,00,000</td>
<td>Debtors</td>
<td>1,00,000</td>
<td>40,000</td>
<td>1,40,000</td>
</tr>
<tr>
<td>Trade creditors (25% for unit 1)</td>
<td>1,50,000</td>
<td>Other assets</td>
<td>1,50,000</td>
<td>60,000</td>
<td>2,10,000</td>
</tr>
<tr>
<td>Total</td>
<td>21,50,000</td>
<td>Total</td>
<td>17,50,000</td>
<td>4,00,000</td>
<td>21,50,000</td>
</tr>
</tbody>
</table>

Other information:
(i) Revaluation reserve is created by revising upward the value of the building of Unit 1.
(ii) No individual value of any asset is considered in the transfer deed.
(iii) Other assets of Unit 1 include patents acquired on 1.7.2017 for Rs. 50,000 on which no depreciation has been charged.

Compute the capital gain for the assessment year 2020-21.

Solution:

Computation of capital gains on slump sale of Unit 1

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sale value</td>
<td>25,00,000</td>
</tr>
<tr>
<td>Less: Expenses on sale</td>
<td>28,000</td>
</tr>
<tr>
<td>Net sale consideration</td>
<td>24,72,000</td>
</tr>
<tr>
<td>Less: Net worth (See Note 1 below)</td>
<td>12,50,625</td>
</tr>
<tr>
<td>Long-term capital gain</td>
<td>12,21,375</td>
</tr>
</tbody>
</table>

Notes:
1. Computation of net worth of Unit 1 of Akash Enterprises

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Building (excluding Rs. 3 lakhs on account of revaluation)</td>
<td>9,00,000</td>
<td></td>
</tr>
<tr>
<td>Machinery</td>
<td>3,00,000</td>
<td></td>
</tr>
<tr>
<td>Debtors</td>
<td>1,00,000</td>
<td></td>
</tr>
<tr>
<td>Patents (See Note 2 below)</td>
<td>28,125</td>
<td></td>
</tr>
<tr>
<td>Other assets(Rs. 1,50,000 – Rs.50,000)</td>
<td>1,00,000</td>
<td></td>
</tr>
<tr>
<td>Total assets</td>
<td>14,28,125</td>
<td></td>
</tr>
</tbody>
</table>
2. Written down value of patents as on 1.4.2019

<table>
<thead>
<tr>
<th>Value of patents:</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost as on 1.7.2017</td>
<td>50,000</td>
</tr>
<tr>
<td>Less: Depreciation @ 25% for FY 2017-18</td>
<td>12,500</td>
</tr>
<tr>
<td>WDV as on 1.4.2018</td>
<td>37,500</td>
</tr>
<tr>
<td>Less: Depreciation for FY 2018-19</td>
<td>9,375</td>
</tr>
<tr>
<td>WDV as on 1.4.2019</td>
<td>28,125</td>
</tr>
</tbody>
</table>

For the purposes of computation of net worth, the written down value determined as per section 43(6) has to be considered in the case of depreciable assets. The problem has been solved assuming that the Balance Sheet values of Rs. 3 lakh and Rs. 9 lakh (Rs. 12 lakh – Rs. 3 lakh) represent the written down value of machinery and building, respectively, of Unit 1.

3. Since the Unit is held for more than 36 months, capital gain arising would be long term capital gain. However, indexation benefit is not available in case of slump sale.

### Illustration 14

Mr. Kay purchases a house property on April 10, 1992 for Rs. 65,000. The fair market value of the house property on April 1, 2001 was Rs. 2,70,000. On August 31, 2004, Mr. Kay enters into an agreement with Mr. Jay for sale of such property for Rs. 3,70,000 and received an amount of Rs. 60,000 as advance. However, as Mr. Jay did not pay the balance amount, Mr. Kay forfeited the advance. In May 2008, Mr. Kay constructed the first floor by incurring a cost of Rs. 2,35,000. Subsequently, in January 2009, Mr. Kay gifted the house to his friend Mr. Dee. On February 10, 2020, Mr. Dee sold the house for Rs. 12,00,000.


Compute the capital gains in the hands of Mr. Dee for A.Y.2020-21.

### Solution

**Computation of taxable capital gains of Mr. Dee for A.Y.2020-21**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sale consideration</td>
<td>12,00,000</td>
<td></td>
</tr>
<tr>
<td>Less: Indexed cost of acquisition (See Note below)</td>
<td>5,69,562</td>
<td></td>
</tr>
<tr>
<td>Indexed cost of improvement (See Note below)</td>
<td>4,95,730</td>
<td></td>
</tr>
<tr>
<td><strong>Long-term capital gain</strong></td>
<td><strong>1,34,708</strong></td>
<td></td>
</tr>
</tbody>
</table>

**Note:** For the purpose of capital gains, holding period is considered from the date on which the house was purchased by Mr. Kay, till the date of sale. However, indexation of cost of acquisition is considered from the date on which the house was gifted by Mr. Kay to Mr. Dee, till the date of sale, i.e. from January 2009 (P.Y. 2008-09) to February, 2020 (P.Y. 2019-20).

Indexed cost of acquisition = (Rs. 2,70,000 × 289/137) = Rs. 5,69,562

Indexed cost of improvement = (Rs. 2,35,000 × 289/137) = Rs. 4,95,730
Amount forfeited by previous owner, Mr. Kay, shall not be deducted from cost of acquisition.

**Alternative view** - As per the view expressed by Bombay High Court in *CIT v. Manjula J. Shah* 16 Taxman 42, in case the cost of acquisition of the capital asset in the hands of the assessee is taken to be cost of such asset in the hands of the previous owner, the indexation benefit would be available from the year in which the capital asset is acquired by the previous owner. If this view is considered, the indexed cost of acquisition would have to be calculated by taking the CII of F.Y.2001-02, since the Fair Market Value as on 1.4.2001 has been taken as the cost of acquisition.

**Note** – In case Mr. Kay had gifted the house to his friend Mr. Dee on or after 1.10.2009, the stamp duty value of the property which was subject to tax in the hands of Mr. Dee under section 56(2) would be deemed to be the cost of acquisition for computation of capital gains.

**Illustration 15**

Mr. X purchases a house property in December 1993 for Rs. 5,25,000 and an amount of Rs. 1,75,000 was spent on the improvement and repairs of the property in March, 1997. The property was proposed to be sold to Mr. Z in the month of May, 2007 and an advance of Rs. 40,000 was taken from him. As the entire money was not paid in time, Mr. X forfeited the advance and subsequently sold the property to Mr. Y in the month of March, 2020 for Rs. 52,00,000. The fair value of the property on April 1, 2001 was Rs. 11,90,000. What is the capital gain chargeable in the hands of Mr. X for the A.Y. 2020-21?

<table>
<thead>
<tr>
<th>Financial year</th>
<th>Cost Inflation Index</th>
</tr>
</thead>
<tbody>
<tr>
<td>2001-02</td>
<td>100</td>
</tr>
<tr>
<td>2007-08</td>
<td>129</td>
</tr>
<tr>
<td>2019-20</td>
<td>289</td>
</tr>
</tbody>
</table>

**Solution**

Capital gains in the hands of Mr. X for the A.Y.2020-21 is computed as under:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sale proceeds</td>
<td>52,00,000</td>
</tr>
<tr>
<td>Less : Indexed cost of acquisition</td>
<td></td>
</tr>
<tr>
<td>Indexed cost of improvement [Note 2]</td>
<td>33,23,500</td>
</tr>
<tr>
<td><strong>Long term capital gains</strong></td>
<td><strong>18,76,500</strong></td>
</tr>
</tbody>
</table>

**Note 1:** Computation of indexed cost of acquisition

| Cost of acquisition (higher of fair market value as on April 1, 2001 and the actual cost of acquisition) | 11,90,000 |
| Less : Advance taken and forfeited                                                          | 40,000    |
| Cost for the purposes of indexation                                                         | 11,50,000 |
| Indexed cost of acquisition (Rs.11,50,000 × 289/100)                                        | 33,23,500 |

**Note 2:** Any improvement cost incurred prior to 1.4.2001 is to be ignored when fair market value as on 1.4.2001 is taken into consideration.
Illustration 16

Mr. Kumar has an agricultural land costing Rs. 6 lakh in Lucknow on 1.4.2003 and has been using it for agricultural purposes till 1.8.2012 when the Government took over compulsory acquisition of this land. A compensation of Rs. 10 lakh was settled. The compensation was received by Mr. Kumar on 1.7.2019. Compute the amount of capital gains taxable in the hands of Mr. Kumar.


Solution

In the given problem, compulsory acquisition of an urban agricultural land has taken place and the compensation is received after 1.4.2004. This land had also been used for at least 2 years by the assessee himself for agricultural purposes. Thus, as per section 10(37), entire capital gains arising on such compulsory acquisition will be fully exempt and nothing is taxable in the hands of Mr. Kumar in the year of receipt of compensation i.e. A.Y. 2020-21.

Illustration 17

Will your answer be any different if Mr. Kumar had by his own will sold this land to his friend Mr. Sharma? Examine.

Solution

As per section 10(37), exemption is available if compulsory acquisition of urban agricultural land takes place. Since the sale is out of own will and desire, the provisions of this section are not attracted and the capital gains arising on such sale will be taxable in the hands of Mr. Kumar.

Illustration 18

Will your answer be different if Mr. Kumar had not used this land for agricultural activities? Examine and compute the amount of capital gains taxable in the hands of Mr. Kumar, if any.

Solution

As per section 10(37), exemption is available only when such land has been used for agricultural purposes during the preceding two years by such individual or a parent of his or by such HUF. Since the assessee has not used it for agricultural activities, the provisions of this section are not attracted and the capital gains arising on such compulsory acquisition will be taxable in the hands of Mr. Kumar in the year of receipt of compensation i.e., A.Y. 2020-21.

Computation of capital gains

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Amount (Rs.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales consideration</td>
<td>12,00,000</td>
</tr>
<tr>
<td>Less: Cost of acquisition (Rs. 6,00,000 × 200/109)</td>
<td>11,00,917</td>
</tr>
<tr>
<td>Long term capital Gains</td>
<td>99,083</td>
</tr>
</tbody>
</table>
Illustration 19

Will your answer be different if the land belonged to ABC Ltd. and not Mr. Kumar and compensation on compulsory acquisition was received by the company? Examine.

Solution

Section 10(37) exempts capital gains arising to an individual or a HUF from transfer of agricultural land by way of compulsory acquisition. If the land belongs to ABC Ltd., a company, the provisions of this section are not attracted and the capital gains arising on such compulsory acquisition will be taxable in the hands of ABC Ltd.

Illustration 20

Mr. Cee purchased a residential house on July 20, 2017 for Rs. 10,00,000 and made some additions to the house incurring Rs. 2,00,000 in August 2017. He sold the house property in April 2019 for Rs. 20,00,000. Out of the sale proceeds, he spent Rs. 5,00,000 to purchase another house property in September 2019.

What is the amount of capital gains taxable in the hands of Mr. Cee for the A.Y. 2020-21?

Solution

The house is sold before 24 months from the date of purchase. Hence, the house is a short-term capital asset and no benefit of indexation would be available.

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sale consideration</td>
<td>20,00,000</td>
</tr>
<tr>
<td>Less: Cost of acquisition</td>
<td>10,00,000</td>
</tr>
<tr>
<td></td>
<td>2,00,000</td>
</tr>
<tr>
<td>Short-term capital gains</td>
<td>8,00,000</td>
</tr>
</tbody>
</table>

Note: The exemption of capital gains under section 54 is available only in case of long-term capital asset. As the house is short-term capital asset, Mr. Cee cannot claim exemption under section 54. Thus, the amount of taxable short-term capital gains is Rs. 8,00,000.

Illustration 21

PQR Ltd., purchased a land for industrial undertaking in May 2004, at a cost of Rs. 3,50,000. The above property was compulsorily acquired by the State Government at a compensation of Rs. 12,00,000 in the month of January, 2020. The compensation was received in March, 2019. The company purchased another land for its industrial undertaking at a cost of Rs. 2,00,000 in the month of March, 2020. What is the amount of the capital gains chargeable to tax in the hands of the company for the A.Y. 2020-21?

Solution

Computation of capital gains in the hands of PQR Ltd. for the A.Y. 2020-21

<table>
<thead>
<tr>
<th>Financial year</th>
<th>Cost Inflation Index</th>
</tr>
</thead>
<tbody>
<tr>
<td>2004-05</td>
<td>113</td>
</tr>
<tr>
<td>2019-20</td>
<td>289</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sale proceeds (Compensation received)</td>
<td>12,00,000</td>
</tr>
<tr>
<td>Less: Indexed cost of acquisition [Rs. 3,50,000 × 289/113]</td>
<td>8,95,132</td>
</tr>
<tr>
<td></td>
<td>3,04,867</td>
</tr>
<tr>
<td>Less: Exemption under section 54D (Cost of acquisition of new undertaking)</td>
<td>2,00,000</td>
</tr>
<tr>
<td>Taxable long term capital gain</td>
<td>1,04,867</td>
</tr>
</tbody>
</table>
Illustration 22

Capital gain of **Rs.** 75 lakh arising from transfer of long term capital assets on 1.5.2019 will be exempt from tax if such capital gain is invested in the bonds redeemable after three years, issued by NHAI under section 54EC. Examine with reasons whether the given statement is true or false having regard to the provisions of the Income-tax Act, 1961.

**Solution**

**False:** The exemption under section 54EC has been restricted, by limiting the maximum investment in long term specified assets (i.e. bonds of NHAI or RECL or any other bond notified by Central Government in this behalf, redeemable after 5 years) to **Rs.** 50 lakh, whether such investment is made during the relevant previous year or the subsequent previous year, or both. Therefore, in this case, the exemption under section 54EC can be availed only to the extent of **Rs.** 50 lakh, provided the investment is made before 1.11.2019 (i.e., within six months from the date of transfer).

Illustration 23

From the following particulars, compute the taxable capital gains of Mr. D for A.Y.2020-21-

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Amount (Rs.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost of jewellery [Purchased in F.Y.2005-06]</td>
<td>4,52,000</td>
</tr>
<tr>
<td>Sale price of jewellery sold in January 2020</td>
<td>11,50,000</td>
</tr>
<tr>
<td>Expenses on transfer</td>
<td>7,000</td>
</tr>
<tr>
<td>Residential house purchased in March 2020</td>
<td>5,00,000</td>
</tr>
</tbody>
</table>

*The cost inflation Index are as follows:

<table>
<thead>
<tr>
<th>Financial Year</th>
<th>Cost Inflation Index</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005-06</td>
<td>117</td>
</tr>
<tr>
<td>2019-20</td>
<td>289</td>
</tr>
</tbody>
</table>

**Solution**

**Computation of taxable capital gains for A.Y.2020-21**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross consideration</td>
<td>11,50,000</td>
</tr>
<tr>
<td>Less: Expenses on transfer</td>
<td>7,000</td>
</tr>
<tr>
<td>Net consideration</td>
<td>11,43,000</td>
</tr>
<tr>
<td>Less: Indexed cost of acquisition (Rs. 4,52,000 × 289/117)</td>
<td>11,16,479</td>
</tr>
<tr>
<td>Less: Exemption under section 54F (Rs. 23,000 × Rs. 5,00,000/Rs. 11,43,000)</td>
<td>26,521</td>
</tr>
<tr>
<td><strong>Taxable capital gains</strong></td>
<td><strong>14,920</strong></td>
</tr>
</tbody>
</table>

Illustration 24

Mr. Akash sold his residential property on 2nd February, 2020 for **Rs.** 90 lakh and paid brokerage@1% of sale price. He had purchased the said property in May 2002 for **Rs.** 24,36,000. In June, 2020, he invested **Rs.** 75 lakh in equity of A (P) Ltd., an eligible start-up company, which constituted 27% of share capital of the said company. A (P) Ltd. utilized the said sum for the following purposes –

(a) Purchase of new plant and machinery during July 2020 – **Rs.** 65 lakh
(b) Included in (a) above is **Rs.** 8 lakh for purchase of cars.
(c) Air-conditioners purchased for **Rs.** 1 lakh, included in the (a) above, were installed at the residence of Mr. Akash.
Compute the chargeable capital gain for the A.Y.2020-21. Assume that Mr. Akash is liable to file his return of income on or before 30th September, 2020 and he files his return on 29.09.2020.


Solution

Computation of taxable capital gains for A.Y.2020-21

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross consideration</td>
<td>90,00,000</td>
</tr>
<tr>
<td>Less: Expenses on transfer (1% of the gross consideration)</td>
<td>90,000</td>
</tr>
<tr>
<td>Net consideration</td>
<td>89,10,000</td>
</tr>
<tr>
<td>Less: Indexed cost of acquisition (Rs. 24,36,000 × 289/105)</td>
<td>67,04,800</td>
</tr>
<tr>
<td></td>
<td>22,05,200</td>
</tr>
<tr>
<td>Less: Exemption under section 54GB</td>
<td></td>
</tr>
<tr>
<td>(Rs.22,05,200 × Rs.66,00,000/Rs.89,10,000)</td>
<td>16,33,481</td>
</tr>
<tr>
<td>Taxable capital gains</td>
<td>5,71,719</td>
</tr>
</tbody>
</table>

Deemed cost of new plant and machinery for exemption under section 54GB

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1) Purchase cost of new plant and machinery acquired in July, 2020</td>
<td>65,00,000</td>
<td></td>
</tr>
<tr>
<td>Less: Cost of vehicles, i.e., cars</td>
<td>8,00,000</td>
<td></td>
</tr>
<tr>
<td>Cost of air-conditioners installed at the residence of Mr. Akash</td>
<td>9,00,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>56,00,000</td>
<td></td>
</tr>
<tr>
<td>(2) Amount deposited in the specified bank before the due date of filing of return</td>
<td>10,00,000</td>
<td></td>
</tr>
<tr>
<td>Deemed cost of new plant and machinery for exemption under section 54GB</td>
<td>66,00,000</td>
<td></td>
</tr>
</tbody>
</table>

Illustration 25

Calculate the income-tax liability for the assessment year 2020-21 in the following cases:

<table>
<thead>
<tr>
<th>Status</th>
<th>Mr. A (age 45)</th>
<th>Mrs. B (age 62)</th>
<th>Mr. C (age 81)</th>
<th>Mr. D (age 82)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Status</td>
<td>Resident</td>
<td>Non-resident</td>
<td>Resident</td>
<td>Non-resident</td>
</tr>
<tr>
<td>Total income other than long-term capital gain</td>
<td>2,40,000</td>
<td>2,80,000</td>
<td>5,90,000</td>
<td>4,80,000</td>
</tr>
<tr>
<td>Long-term capital gain</td>
<td>15,000 from sale of vacant site</td>
<td>10,000 from sale of listed shares (STT paid on sale and purchase of shares)</td>
<td>60,000 from sale of agricultura land in rural area</td>
<td>Nil</td>
</tr>
</tbody>
</table>
Solution

### Computation of income-tax liability for the A.Y.2020-21

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Mr. A (age 45)</th>
<th>Mrs. B (age 62)</th>
<th>Mr. C (age 81)</th>
<th>Mr. D (age 82)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Residential Status</strong></td>
<td>Resident</td>
<td>Non-resident</td>
<td>Resident</td>
<td>Non-resident</td>
</tr>
<tr>
<td>Applicable basic exemption limit</td>
<td>Rs. 2,50,000</td>
<td>Rs. 2,50,000</td>
<td>Rs. 5,00,000</td>
<td>Rs. 2,50,000</td>
</tr>
<tr>
<td>Asset sold</td>
<td>Vacant site</td>
<td>Listed shares</td>
<td>Rural</td>
<td>-</td>
</tr>
<tr>
<td>(STT paid at both sale and purchase of shares)</td>
<td></td>
<td></td>
<td>agricultural land</td>
<td></td>
</tr>
<tr>
<td>Long-term capital gain (on sale of above asset)</td>
<td>Rs. 15,000</td>
<td>[Exempt u/s 112A since it is less than Rs. 1,00,000]</td>
<td>Rs. 60,000</td>
<td>-</td>
</tr>
<tr>
<td>Other income</td>
<td>Rs. 2,40,000</td>
<td>Rs. 2,80,000</td>
<td>Rs. 5,90,000</td>
<td>Rs. 4,80,000</td>
</tr>
<tr>
<td><strong>Tax liability</strong></td>
<td>Rs. 1,000</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>On LTCG (after adjusting unexhausted basic limit of Rs. 10,000) i.e., 20% x Rs. 5,000</td>
<td>Nil</td>
<td>Rs. 1,500</td>
<td>Rs. 18,000</td>
<td>Rs. 11,500</td>
</tr>
<tr>
<td>On Other income</td>
<td>Rs. 1,000</td>
<td>Rs. 1,500</td>
<td>Rs. 18,000</td>
<td>Rs. 11,500</td>
</tr>
<tr>
<td><strong>Less: Rebate u/s 87A</strong></td>
<td>Rs. 1,000</td>
<td>Rs. 1,500</td>
<td>Rs. 18,000</td>
<td>Rs. 11,500</td>
</tr>
<tr>
<td>Add: Health and education cess @4%</td>
<td>Nil</td>
<td>Rs. 60</td>
<td>Rs. 720</td>
<td>Rs. 460</td>
</tr>
<tr>
<td><strong>Total tax liability</strong></td>
<td>Nil</td>
<td>Rs. 1,560</td>
<td>Rs. 18,720</td>
<td>Rs. 11,960</td>
</tr>
</tbody>
</table>

**Notes:**

1. Since Mrs. B and Mr. D are non-residents, they cannot avail the higher basic exemption limit of Rs. 3,00,000 and Rs. 5,00,000 for persons over the age of 60 years and 80 years, respectively.

2. Since Mr. A is a resident whose total income does not exceed Rs. 5 lakhs, he is eligible for rebate of Rs. 12,500 or the actual tax payable, whichever is lower, under section 87A.
CHAPTER 8 - INCOME FROM OTHER SOURCES

EXERCISE

Question 1
Parimal, Managing Director of Heavens Engg. Pvt. Ltd. holds 70% of its paid up capital of Rs. 20 Lacs. The balance as at 31.03.2019 in General Reserve was Rs. 6 Lacs. The company on 1.04.2019 gave an interest-free loan of Rs. 5 lacs to its Supervisor having salary of Rs. 4,000 p.m., who in turn on 15.4.2019 advanced the said amount of loan so taken from the company to Shri Parimal. The Assessing Officer had treated the amount of advance as deemed dividend. Is the action of Assessing Officer correct?

Answer
The company had advanced a loan to an employee who in turn had advanced the same to the Managing Director of the company holding 70% of its capital. By virtue of the provisions of section 2(22)(e), the same shall be treated as the payment by a company in which public are not substantially interested, on behalf of, or for individual benefit of any such share holder (who holds not less than 10% of the voting power), to the extent to which the company possesses accumulated profits.

In this case, the company has reserves of Rs. 6 Lacs on 31st March of the preceding year and the amount of loan advanced on 1st April is Rs. 5 Lacs. Therefore, the payment is to be treated as deemed dividend. The amount of interest-free loan of Rs. 5 Lacs given by the company to the supervisor who in turn had given the same to Mr. Parimal, shall be construed as the amount given for the benefit of Mr. Parimal and would be treated as deemed dividend. On such amount the Heavens Engg. Pvt. Ltd. is liable to pay dividend distribution tax @30% plus surcharge @12% plus Health and education cess @4%. This has been held by the Supreme Court in the case of L. Alagusundaram Chettiar v. CIT (2001) 252 ITR 893.

Question 2
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 Rs. 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 Rs. 50 lakhs. The Assessing Officer proposes to tax the amount of Rs. 10 lakhs by invoking the provision of section 2(22)(e).

Is the proposition of the Assessing Officer correct in law?

Answer
The issue under consideration is whether loan or advance given to a shareholder by the company, in return of an advantage or benefit conferred on the company by the shareholder, can be deemed as dividend under section 2(22)(e) of the Income-tax Act, 1961 in the hands of the shareholder.

The facts of the case are similar to the facts in Pradip Kumar Malhotra v. CIT (2011) 338 ITR 538, wherein the above issue came up before the Calcutta High Court.
The High Court observed that the phrase "by way of advance or loan" appearing in section 2(22)(e) must be construed to mean those advances or loans which a shareholder enjoys simply on account of being a person who is the beneficial owner of shares (not being shares entitled to a fixed rate of dividend whether with or without a right to participate in profits) holding not less than 10% of the voting power.

In case such loan or advance is given to such shareholder as a consequence of any further consideration received from such a shareholder which is beneficial to the company, such advance or loan cannot be a deemed dividend within the meaning of the Act.

Thus, gratuitous loan or advance given by a company to a shareholder, who is the beneficial owner of shares holding not less than 10% of the voting power, would come within the purview of section 2(22)(e) to the extent of accumulated profits of the company but not the cases where the loan or advance is given in return for an advantage conferred upon the company by such shareholder.

In this case, advance of Rs. 10 lakhs was given by VKS Manufacturing (P) Ltd. to Mr. Santhanam holding 25% of voting power in lieu of non-release of his personal property from mortgage thereby enabling the company to retain the benefit of loan obtained from bank. Therefore, applying the rationale of the Calcutta High Court ruling in Pradip Kumar Malhotra’s case, such advance cannot be brought within the purview of section 2(22)(e), since it was not in the nature of gratuitous advance but was given to protect the interest of the company.

The proposition of the Assessing Officer to tax the amount of Rs. 10 lakhs by invoking the provisions of section 2(22)(e) in this case is, therefore, not correct.

**Question 3**
An enterprise engaged in manufacturing of steel balls discontinued its activities and decided to lease out its factory building, plant and machinery and furniture from 1.4.2019 on a consolidated lease rent of Rs. 50,000 per month. Compute the income for Assessment Year 2020-21 of the assessee from following information:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount (Rs.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i) Interest received on deposits</td>
<td>1,00,000</td>
</tr>
<tr>
<td>(ii) Brokerage paid on hundi loan taken</td>
<td>2,000</td>
</tr>
<tr>
<td>(iii) Interest paid on hundi and other loans which were given as deposits</td>
<td></td>
</tr>
<tr>
<td>on interest to others</td>
<td>75,000</td>
</tr>
<tr>
<td>(iv) Expenses incurred on repairs of building, plant and machinery</td>
<td>15,000</td>
</tr>
<tr>
<td>(v) Fire insurance premium of plant and machinery and furniture</td>
<td>12,000</td>
</tr>
<tr>
<td>(vi) Depreciation for the year</td>
<td>1,47,500</td>
</tr>
<tr>
<td>(vii) Legal fees paid to an advocate for drafting and registering the lease</td>
<td>1,500</td>
</tr>
<tr>
<td>agreement</td>
<td></td>
</tr>
<tr>
<td>(viii) Factory licence fees paid for the year</td>
<td>1,000</td>
</tr>
<tr>
<td>(ix) There is unabsorbed depreciation of Rs. 2,75,000 of the Assessment</td>
<td></td>
</tr>
<tr>
<td>(x) Interest paid includes an amount of Rs. 25,000 remitted to a non-resident</td>
<td></td>
</tr>
<tr>
<td>outside India on which tax was not deducted at source.</td>
<td></td>
</tr>
</tbody>
</table>
Answer

The income derived from leased assets shall be chargeable to tax as 'Income from other sources' under section 56(2)(iii) but the computation thereof shall be made after allowing deductions specified under sections 30, 31 and 32 subject to section 38. This is as per the provisions of section 57(ii) and 57(iii).

**Computation of income under the head “Income from other sources”**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>(A) Lease Rent for 12 months @ Rs.50,000 p.m. Less: Expenses and deductions allowable under section 57(ii) &amp; 57(iii):</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Repairs</td>
<td>15,000</td>
<td></td>
</tr>
<tr>
<td>Fire Insurance Premium</td>
<td>12,000</td>
<td></td>
</tr>
<tr>
<td>Legal expenses for drafting of lease agreement</td>
<td>1,500</td>
<td></td>
</tr>
<tr>
<td>Factory Licence fee</td>
<td>1,000</td>
<td></td>
</tr>
<tr>
<td>Depreciation for the year</td>
<td>1,47,500</td>
<td></td>
</tr>
<tr>
<td>Unabsorbed depreciation of earlier assessment years – eligible for deduction (Note 1)</td>
<td>2,75,000</td>
<td>4,52,000</td>
</tr>
<tr>
<td>(B) Interest on Deposits Less: Expenses allowable under section 57(i)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Brokerage</td>
<td>Rs. 2,000</td>
<td></td>
</tr>
<tr>
<td>Interest on hundi loans (Note 2)</td>
<td>Rs. 50,000</td>
<td></td>
</tr>
</tbody>
</table>

**Total Income** 1,96,000

Note:
1. Unabsorbed depreciation of Rs. 2,75,000 pertains to earlier assessment years. The unabsorbed depreciation shall form part of the current year depreciation and can be set off against any other head of income. Accordingly, the amount of Rs. 2,75,000 is adjustable / allowed to be set off against 'Income from other sources'.
2. Since deposits are made by investing amount received on hundi and other loans, the interest on hundi and other loans would be eligible for deduction from the income arising on such deposits. However, interest paid to non-resident is not eligible for deduction as the tax has not been deducted at source.

**Question 4**

In July 2019, Mr. Pervez employed as Marketing Manager in a Pharma company, received a Maruti car as gift from a distributor of the company. The value of the gifted car is estimated at Rs. 2,60,000. Is the value of car taxable as income? If so, under what head it is taxable?

**Answer**

Mr. Pervez, an employee of a Pharma company, has received a car as a gift from a distributor of the company. Since there is no employer-employee relationship in this case between the distributor and Mr. Pervez, the value of gift is not a perquisite chargeable to tax under the head “Salaries”.

Section 56(2)(x), brings within its scope the value of any property received by any person. For this purpose, “property” means immovable property being land or building or both, shares and securities, jewellery, archaeological collections, drawings, paintings, sculptures, any work of art or bullion.
Therefore, for the purpose of attracting the provisions of section 56(2)(x) for chargeability under the head “Income from Other Sources”, an individual should be in receipt of property as defined therein. Since, car is not included in the definition of “property”, the provisions of section 56(2)(x) would not be attracted in the hands of Mr. Pervez.

**ADDITIONAL ILLUSTRATIONS FOR PRACTICE:**

**Illustration 1**
A Ltd., a domestic company, declared dividend of Rs. 170 lakh for the year F.Y.2018-19 and distributed the same on 10.7.2019. Mr. X, holding 10% shares in A Ltd., receives dividend of Rs. 17 lakh in July, 2019. Mr. Y, holding 5% shares in A Ltd., receives dividend of Rs. 8.50 lakh. Discuss the tax implications in the hands of A Ltd., Mr. X and Mr. Y, assuming that Mr. X and Mr. Y have not received dividend from any other domestic company during the year.

**Solution**
1. The dividend of Rs. 170 lakh declared and distributed in the P.Y.2019-20 is subject to dividend distribution tax under section 115-O in the hands of A Ltd. First of all, the dividend received has to be grossed up by applying the rate of 15%. The gross dividend is Rs. 200 lakhs [Rs. 170 lakhs x 100/85]. Dividend distribution tax @ 17.472% is Rs. 34.944 lakhs.

2. In the hands of Mr. X, dividend received up to Rs. 10 lakh would be exempt under section 10(34). Rs. 7 lakh, being dividend received in excess of Rs. 10 lakh, would be taxable @ 10% as per section 115BBDA. Such dividend would not be exempt under section 10(34). Therefore, tax payable by Mr. X on dividend of Rs. 7 lakh under section 115BBDA would be Rs. 72,800 [i.e., 10% of Rs. 7 lakh + health and education cess @ 4%].

(iii) In the hands of Mr. Y, the entire dividend of Rs. 8.50 lakh received would be exempt under section 10(34), since only dividend received in excess of Rs. 10 lakh would be taxable under section 115BBDA.

**Illustration 2**
Dhaval is in business of manufacturing customized kitchen equipments. He is also the Managing Director and held nearly 65% of the paid-up share capital of Aarav (P) Ltd. A substantial part of the business of Dhaval is obtained through Aarav (P) Ltd. For this purpose, Aarav (P) Ltd. passed on the advance received from its customers to Dhaval to execute the job work entrusted to him.

The Assessing Officer held that the advance money received by Dhaval is in the nature of loan given by Aarav (P) Ltd. to him and accordingly is deemed dividend within the meaning of provisions of section 2(22)(e) of the Income-tax Act, 1961. The Assessing Officer, therefore made the addition by treating advance money as deemed dividend. Examine whether the action of the Assessing Officer is tenable in law.

**Solution**
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.
In the present case, Dhaval is holding 65% of the paid-up capital of Aarav (P) Ltd. Aarav (P) Ltd. has passed on advance received from its customers to Dhaval for execution of job work entrusted to Dhaval.

Since Aarav (P) Ltd. is not a company in which public are substantially interested, the applicability of the provisions of section 2(22)(e) in respect of such transaction has to be examined. In CIT v. Rajkumar (2009) 318 ITR 462 (Del.), it was held that trade advance given to the shareholder which is in the nature of money transacted to give effect to a commercial transaction, would not be deemed to be dividend in the hands of the shareholder under section 2(22)(e). The Delhi High Court ruling in CIT v. Ambassador Travels (P) Ltd. (2009) 318 ITR 376 also supports the above view.

In the present case, the payment is made to Dhaval by Aarav (P) Ltd. for execution of work is in the course of commercial business transaction and therefore, it shall not be deemed as dividend in the hands of Dhaval under section 2(22)(e). Hence, the action of the Assessing Officer is not tenable in law.

Note – This can also be answered on the basis of Circular No. 19/2017, dated 12.06.2017. The CBDT has, in its circular clarified that it is a settled position that trade advances, which are in the nature of commercial transactions, would not fall within the ambit of the word 'advance' in section 2(22)(e) and therefore, the same would not to be treated as deemed dividend. Since, the payment is made to Dhaval by Aarav (P) Ltd. for execution of work is in the course of commercial business transaction and therefore, the advance cannot be treated as deemed dividend under section 2(22)(e). Hence, the action of the Assessing Officer is not tenable in law.

Illustration 3

MNO Ltd. is a company in which the public are not substantially interested. K is a shareholder of the company holding 15% of the equity shares. The accumulated profits of the company as on 1.10.2019 amounted to Rs. 10,00,000. The company lent Rs. 1,00,000 to K by an account payee bank draft on 1.10.2019. The loan was not connected with the business of the company. K repaid the loan to the company by an account payee bank draft on 30.3.2020. Examine the effect of the borrowal and repayment of the loan by K on the computation of his total income for the assessment year 2020-21.

Solution

As per section 2(22)(e), any payment by a company, in which the public are not substantially interested, by way of advance or loan to a shareholder, being a person who is the beneficial owner of shares holding not less than 10% of the voting power, shall be treated as dividend to the extent to which the company possesses accumulated profits.

In the instant case, MNO (P) Ltd. is a company in which the public are not substantially interested. The company has accumulated profits of Rs. 10,00,000 on 1.10.2019. The loan given by the company to K was not in the course of its business. K holds more than 10% of the equity shares in the company. Therefore, assuming that K has voting power equivalent to his shareholding, section 2(22)(e) comes into play and MNO (P) Ltd. has to pay dividend distribution tax under section 115- O @ 34.944% (30% plus surcharge @12% plus health and education cess @4%) on Rs. 1,00,000, representing the amount lent by the company to K. Deemed dividend of Rs. 1,00,000 under section 2(22)(e) would be exempt under section 10(34) in the hands of Mr. K.

Under section 2(22)(e), the liability arises the moment the loan is borrowed by the shareholder and it is immaterial whether the loan is repaid before the end of the accounting
year or not. Therefore, the repayment of loan by K to the company on 30.3.2020 will not affect the taxability of the sum of Rs. 1,00,000 as deemed dividend.

Illustration 4
Mr. A, a dealer in shares, received the following without consideration during the P.Y.2019-20 from his friend Mr. B, -

(1) Cash gift of Rs. 75,000 on his anniversary, 15th April, 2019.
(2) Bullion, the fair market value of which was Rs. 60,000, on his birthday, 19th June, 2019.
(3) A plot of land at Faridabad on 1st July, 2019, the stamp value of which is Rs. 5 lakh on that date. Mr. B had purchased the land in April, 2009.

Mr. A purchased from his friend Mr. C, who is also a dealer in shares, 1000 shares of X Ltd. @ Rs. 400 each on 19th June, 2019, the fair market value of which was Rs. 600 each on that date. Mr. A sold these shares in the course of his business on 23rd June, 2019.

Further, on 1st November, 2019, Mr. A took possession of property (building) booked by him two years back at Rs. 20 lakh. The stamp duty value of the property as on 1st November, 2019 was Rs. 32 lakh and on the date of booking was Rs. 23 lakh. He had paid Rs. 1 lakh by account payee cheque as down payment on the date of booking.

On 1st March, 2020, he sold the plot of land at Faridabad for Rs. 7 lakh.

Compute the income of Mr. A chargeable under the head "Income from other sources" and "Capital Gains" for A.Y.2020-21.

Solution

Computation of “Income from other sources” of Mr. A for the A.Y.2020-21

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1) Cash gift is taxable under section 56(2)(x), since it exceeds Rs. 50,000</td>
<td>75,000</td>
</tr>
<tr>
<td>(2) Since bullion is included in the definition of property, therefore, when bullion is received without consideration, the same is taxable, since the aggregate fair market value exceeds Rs. 50,000</td>
<td>60,000</td>
</tr>
<tr>
<td>(3) Stamp value of plot of land at Faridabad, received without consideration, is taxable under section 56(2)(x)</td>
<td>5,00,000</td>
</tr>
<tr>
<td>(4) Difference of Rs. 2 lakh in the value of shares of X Ltd. purchased from Mr. C, a dealer in shares, is not taxable as it represents the stock-in-trade of Mr. A. Since Mr. A is a dealer in shares and it has been mentioned that the shares were subsequently sold in the course of his business, such shares represent the stock-in-trade of Mr. A.</td>
<td>-</td>
</tr>
<tr>
<td>(5) Difference between the stamp duty value of Rs. 23 lakh on the date of booking and the actual consideration of Rs. 20 lakh paid is taxable under section 56(2)(x) since the difference exceeds Rs. 1 lakh being, the higher of Rs. 50,000 and 5% of consideration.</td>
<td>3,00,000</td>
</tr>
</tbody>
</table>

Income from Other Sources

9,35,000

Computation of “Capital Gains” of Mr. A for the A.Y.2020-21

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sale Consideration</td>
<td>7,00,000</td>
</tr>
<tr>
<td>Less: Cost of acquisition [deemed to be the stamp value charged to tax under section 56(2)(x) as per section 49(4)]</td>
<td>5,00,000</td>
</tr>
<tr>
<td>Short-term capital gains</td>
<td>2,00,000</td>
</tr>
</tbody>
</table>

**Note** – The resultant capital gains will be short-term capital gains since for calculating the period of holding, the period of holding of previous owner is not to be considered.

**Illustration 5**

Discuss the taxability or otherwise of the following in the hands of the recipient under section 56(2)(x) the Income-tax Act, 1961 -

(i) Akhil HUF received Rs. 75,000 in cash from niece of Akhil (i.e., daughter of Akhil’s sister). Akhil is the Karta of the HUF.

(ii) Nitisha, a member of her father’s HUF, transferred a house property to the HUF without consideration. The stamp duty value of the house property is Rs. 9,00,000.

(iii) Mr. Akshat received 100 shares of A Ltd. from his friend as a gift on occasion of his 25th marriage anniversary. The fair market value on that date was Rs. 100 per share. He also received jewellery worth Rs. 45,000 (FMV) from his nephew on the same day.

(iv) Kishan HUF gifted a car to son of Karta for achieving good marks in XII board examination. The fair market value of the car is Rs. 5,25,000.

**Solution**

<table>
<thead>
<tr>
<th>Taxable/ Non-taxable</th>
<th>Amount liable to tax (Rs.)</th>
<th>Reason</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i) Taxable</td>
<td>75,000</td>
<td>Sum of money exceeding Rs. 50,000 received without consideration from a non-relative is taxable under section 56(2)(x). Daughter of Mr. Akhil’s sister is not a relative of Akhil HUF, since she is not a member of Akhil HUF.</td>
</tr>
<tr>
<td>(ii) Non-taxable</td>
<td>Nil</td>
<td>Immovable property received without consideration by a HUF from its relative is not taxable under section 56(2)(x). Since Nitisha is a member of the HUF, she is a relative of the HUF. However, income from such asset would be included in the hands of Nitisha under 64(2).</td>
</tr>
<tr>
<td>(iii) Taxable</td>
<td>55,000</td>
<td>As per provisions of section 56(2)(x), in case the aggregate fair market value of property, other than immovable property, received without consideration exceeds Rs. 50,000, the whole of the aggregate value shall be taxable. In this case, the aggregate fair market value of shares (Rs. 10,000) and jewellery (Rs. 45,000) exceeds Rs. 50,000. Hence, the entire amount of Rs. 55,000 shall be taxable.</td>
</tr>
<tr>
<td>(iv) Non-taxable</td>
<td>Nil</td>
<td>Car is not included in the definition of property for the purpose of section 56(2)(x), therefore, the same shall not be taxable.</td>
</tr>
</tbody>
</table>
Illustration 6

Mr. Hari, a property dealer, sold a building in the course of his business to his friend Mr. Rajesh, who is a dealer in automobile spare parts, for Rs. 90 lakh on 1.1.2020, when the stamp duty value was Rs. 150 lakh. The agreement was, however, entered into on 1.9.2019 when the stamp duty value was Rs. 140 lakh. Mr. Hari had received a down payment of Rs. 15 lakh by a crossed cheque from Mr. Rajesh on the date of agreement. Discuss the tax implications in the hands of Mr. Hari and Mr. Rajesh, assuming that Mr. Hari has purchased the building for Rs. 75 lakh on 12th July, 2018.

Would your answer be different if Hari was a share broker instead of a property dealer?

Solution

Case 1: Tax implications if Mr. Hari is a property dealer

<table>
<thead>
<tr>
<th>In the hands of Mr. Hari</th>
<th>In the hands of Mr. Rajesh</th>
</tr>
</thead>
<tbody>
<tr>
<td>In the hands of Hari, the provisions of section 43CA would be attracted, since the building represents his stock-in-trade and he has transferred the same for a consideration less than the stamp duty value and the stamp duty value exceeds 105% of consideration.</td>
<td>Since Mr. Rajesh is a dealer in automobile spare parts, the building purchased would be a capital asset in his hands. The provisions of section 56(2)(x) would be attracted in the hands of Mr. Rajesh who has received immovable property, being a capital asset, for inadequate consideration and the difference between the consideration and stamp duty value exceeds Rs. 4,50,000, being the higher of Rs. 50,000 and 5% of consideration.</td>
</tr>
<tr>
<td>Under section 43CA, the option to adopt the stamp duty value on the date of agreement can be exercised only if whole or part of the consideration has been received on or before the date of agreement by way of account payee cheque or draft or by use of ECS through a bank account on or before the date of agreement. In this case, since the payment is made by crossed cheque, the option cannot be exercised.</td>
<td>Therefore, Rs. 60 lakh, being the difference between the stamp duty value of the property on the date of registration (i.e., Rs. 150 lakh) and the actual consideration (i.e., Rs. 90 lakh) would be taxable under section 56(2)(x) in the hands of Mr. Rajesh, since the payment is made by crossed cheque and not account payee cheque/draft or ECS. or through such other prescribed electronic mode.</td>
</tr>
<tr>
<td>Therefore, Rs. 75 lakh, being the difference between the stamp duty value on the date of registration (i.e., Rs. 150 lakh) and the purchase price (i.e., Rs. 75 lakh), would be chargeable as business income in the hands of Mr. Hari, since stamp duty value exceeds 105% of the consideration.</td>
<td></td>
</tr>
<tr>
<td>There would be no difference in the taxability in the hands of Mr. Rajesh, whether Mr. Hari is a property dealer or a stock broker.</td>
<td></td>
</tr>
</tbody>
</table>

Case 2: Tax implications if Mr. Hari is a stock broker

<table>
<thead>
<tr>
<th>In the hands of Mr. Hari</th>
<th>In the hands of Mr. Rajesh</th>
</tr>
</thead>
<tbody>
<tr>
<td>In case Mr. Hari is a stock broker and not a property dealer, the building would represent his capital asset and not stock-in-trade. In such a case, the provisions of section 50C would be attracted in the hands of Mr. Hari since building is transferred for a consideration less than the stamp duty value and the stamp duty value exceeds 105% of consideration. Thus Rs. 75 lakh, being the difference</td>
<td>There would be no difference in the taxability in the hands of Mr. Rajesh, whether Mr. Hari is a property dealer or a stock broker. Therefore, the provisions of section 56(2)(x) would be attracted in the hands of Mr. Rajesh who has received immovable property, being a capital asset, for inadequate consideration and the difference between the consideration and</td>
</tr>
</tbody>
</table>

8.8
between the stamp duty value on the date of registration (i.e., Rs. 150 lakh) and the purchase price (i.e., Rs. 75 lakh) would be chargeable as short-term capital gains.

It may be noted that under section 50C, the option to adopt the stamp duty value on the date of agreement can be exercised only if whole or part of the consideration has been received on or before the date of agreement by way of account payee cheque or draft or by use of ECS through a bank account on or before the date of agreement. In this case, since the payment is made by crossed cheque, the option cannot be exercised.

stamp duty value exceeds Rs. 4,50,000, being the higher of Rs. 50,000 and 5% of consideration. Therefore, Rs. 60 lakh, being the difference between the stamp duty value of the property on the date of registration (i.e., Rs. 150 lakh) and the actual consideration (i.e., Rs. 90 lakh) would be taxable under section 56(2)(x) in the hands of Mr. Rajesh since the payment on the date of agreement is made by crossed cheque and not account payee cheque/draft or ECS or through such other prescribed electronic mode.

Illustration 7
Interest on enhanced compensation received by Mr. G during the previous year 2019-20 is Rs. 5,00,000. Out of this interest, Rs. 1,50,000 relates to the previous year 2016-17, Rs. 1,65,000 relates to previous year 2017-18 and Rs. 1,85,000 relates to previous year 2018-19. Discuss the tax implication, if any, of such interest income for A.Y.2020-21.

Solution
The entire interest of Rs. 5,00,000 would be taxable in the year of receipt, namely, P.Y.2019-20.

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest on enhanced compensation taxable u/s 56(2)(viii)</td>
<td>5,00,000</td>
</tr>
<tr>
<td>Less: Deduction under section 57(iv) @50%</td>
<td>2,50,000</td>
</tr>
<tr>
<td><strong>Interest chargeable under the head “Income from other sources”</strong></td>
<td>2,50,000</td>
</tr>
</tbody>
</table>
CHAPTER 9 - CLUBBING

EXERCISE

Question 1
Mrs. E, wife of Mr. F, is a partner in a firm. Her capital contribution to the firm as on 01-04-2019 was Rs. 5 lacs, out of which Rs. 3 lacs was contributed out of her own sources and Rs. 2 lacs was contributed out of gift from her husband.

As further capital was needed by the firm, she further invested Rs. 2 lacs on 01.05.2019 out of the funds gifted by her husband. The firm paid interest on capital of Rs. 80,000 and share of profit of Rs. 60,000 for the financial year 2019-20.

Advise Mr. F as to the applicability of the provisions of section 64(1)(iv) and the manner thereof in respect of the above referred transactions.

Answer

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, subject to the provisions of section 27(i), to the spouse of such individual from assets transferred directly or indirectly to the spouse by such individual otherwise than for adequate consideration or in connection with an agreement to live apart.

In this instant case, Mr. F has gifted money to his wife, Mrs. E. Mrs. E, in turn, invested such gifted money in the capital of a partnership firm, of which she is a partner. Mrs. E has also contributed a sum of Rs. 3 lacs out of her own resources to the capital of the firm.

As per Explanation 3 to section 64(1), for the purpose of clubbing under section 64(1)(iv), where the assets transferred, directly or indirectly, by an individual to his spouse are invested by the transferee in the nature of contribution of capital as a partner in a firm, proportionate interest on capital will be clubbed with the income of the transferor. Such proportion has to be computed by taking into account the value of the aforesaid investment as on the first day of the previous year to the total investment by way of capital contribution as a partner in the firm as on that day.

In view of the above provision, interest received by Mrs. E from the firm shall be included in total income of Mr. F to the extent of Rs. 32,000 i.e., Rs. 80,000 × Rs. 2,00,000/ Rs. 5,00,000.

Share of profit amounting to Rs. 60,000 is exempt from income-tax under the provisions of section 10(2A). The provisions of section 64 will not apply, if the income from the transferred asset itself is exempt from tax.

Note: It is assumed that rate of interest on capital contributed by Mrs. E does not exceed 12% p.a.

Question 2
Mr. A has gifted a house property valued at Rs. 50 lakhs to his wife, Mrs. B, who in turn has gifted the same to Mrs. C, their daughter-in-law. The house was let out at Rs. 25,000 per month throughout the year. Compute the total income of Mr. A and Mrs. C.

Will your answer be different if the said property was gifted to his son, husband of Mrs. C?
Answer
As per section 27(i), an individual who transfers otherwise than for adequate consideration any house property to his spouse, not being a transfer in connection with an agreement to live apart, shall be deemed to be the owner of the house property so transferred.

Therefore, in this case, Mr. A would be the deemed owner of the house property transferred to his wife Mrs. B without consideration.

As per section 64(1)(vi), income arising to the son’s wife from assets transferred, directly or indirectly, to her by an individual otherwise than for adequate consideration would be included in the total income of such individual.

Income from let-out property is Rs. 2,10,000 [i.e., Rs. 3,00,000, being the actual rent calculated at Rs.25,000 per month less Rs.90,000, being deduction under section 24 @30% of Rs.3,00,000]

In this case, income of Rs. 2,10,000 from let-out property arising to Mrs. C, being Mr. A’s son’s wife, would be included in the income of Mr. A, applying the provisions of section 27(i) and section 64(1)(vi). Such income would, therefore, not be taxable in the hands of Mrs. C.

In case the property was gifted to Mr. A’s son, the clubbing provisions under section 64 would not apply, since the son is not a minor child. Therefore, the income of Rs. 2,10,000 from letting out of property gifted to the son would be taxable in the hands of the son.

It may be noted that the provisions of section 56(2)(x) would not be attracted in the hands of the recipient of house property, since the receipt of property in each case was from a “relative” of such individual. Therefore, the stamp duty value of house property would not be chargeable to tax in the hands of the recipient of immovable property, even though the house property was received by her or him without consideration.

Note - The first part of the question can also be answered by applying the provisions of section 64(1)(vi) directly to include the income of Rs. 2,10,000 arising to Mrs. C in the hands of Mr. A [without first applying the provisions of section 27(i) to deem Mr. A as the owner of the house property transferred to his wife Mrs. B without consideration], since section 64(1)(vi) speaks of clubbing of income arising to son’s wife from indirect transfer of assets to her by her husband’s parent, without consideration. Gift of house property by Mr. A to Mrs. C, via Mrs. B, can be viewed as an indirect transfer by Mr. A to Mrs. C.

Question 3
Mr. Korani transferred 2,000 debentures of Rs. 100 each of Wild Fox Ltd. to his wife Mrs. Rekha Korani on 3.10.2018 without consideration. The company paid interest of Rs. 30,000 in September, 2019 which was deposited by Mrs. Korani with Kartar Finance Co. in October, 2019 Kartar Finance Co. paid interest of Rs. 3,000 upto March, 2020. How would both the interest income be charged to tax in A.Y. 2020-21?

Answer
As per section 64(1)(iv), income arising from assets transferred without adequate consideration by an individual to his spouse is liable to be clubbed in the hands of the individual. It may be noted that income on the asset transferred has to be clubbed but if there is accretion to the asset, any further income derived on such accretion should not be clubbed.
Therefore, applying the provisions of section 64(1)(iv), Rs. 30,000, being the interest on debentures received by Mrs. Rekha Korani in September, 2018 will be clubbed with the income of Mr. Korani, since he had transferred the debentures of the company without consideration to her in October, 2018.

However, the interest of Rs. 3,000 upto March, 2020 earned by Mrs. Rekha Korani on the interest on the debentures deposited by her with Kartar Finance Company shall be taxable in her individual capacity and will not be clubbed with the income of Mr. Korani.

**Question 4**

Mr. Rose, out of his own funds, had taken an FDR for Rs. 10,00,000 bearing interest @10% p.a. payable half-yearly in the name of his wife Lilly. The interest earned during the financial year 2019-20 of Rs. 1,00,000 was invested by Mrs. Lilly in the business of packed spices which resulted in a net profit of Rs. 55,000 for the year ended 31.03.2020. How shall the interest on FDR and income from business be taxed for the Assessment Year 2020-21?

**Answer**

Section 64(1)(iv) specifies that the income derived by the spouse of an assessee from the assets transferred directly or indirectly without adequate consideration or intention to live apart shall be clubbed with the income of the transferor. Therefore, the interest income of Rs. 1 lac on the FDR of Rs. 10 lacs for the F.Y.2019-20 shall be clubbed with the income of Mr. Rose.

When Mrs. Lilly invested the interest income in a business and earned profits therefrom, such profits shall not be clubbed with the income of her husband but shall be taxable in her individual capacity. This is so because the income from the accretion of the transferred assets is not to be clubbed with the income of the transferor [CIT v. M. S. S. Rajan (2001) 252 ITR 126 (Mad)].

**Question 5**

Naresh is a fashion designer having lucrative business. His wife is a model. Naresh pays her monthly salary of Rs. 10,000. The Assessing Officer while admitting that the salary is an admissible deduction, in computing the total income of Naresh had applied the provisions of section 64(1), and had clubbed the income (salary) of his wife in Naresh hands. Discuss the correctness of the action of the Assessing Officer.

**Answer**

This question is based on the principles laid down by Madras High Court in the case of CIT v. Smt. R. Bharati (1999) 240 ITR 697 where the interpretation of the terms “professional qualifications” and “knowledge” came up for consideration as per proviso to section 64(1).

These words do not necessarily connote a qualification conferred by a recognized university after examining the candidate who has undergone a course of study in a technical subject or course of study preparing him for a profession of law, accountancy etc. Accordingly, the term “qualification” must be given a wide meaning as referring to the qualities which are required to be possessed by a person performing the work that he does, so long as that work is capable of being regarded as technical or professional.

The word “professional” is a term capable of very broad meaning and would encompass a variety of occupations. A large number of occupations are being practiced which form a
source of livelihood and are capable of being regarded, as professions as long as they require certain degree of skill. A person having skill, experience and competence in a line of work can be regarded as professionally qualified for the purpose of section 64(1)(ii).

Applying the rationale of the Madras High Court ruling, a model, having skill, competence and experience in her line can be considered as a professional. Hence, the action of the Assessing Officer is not correct.

**ADDITIONAL ILLUSTRATIONS FOR PRACTICE:**

**Illustration 1**
Mr. A holds shares carrying 25% voting power in X Ltd. Mrs. A is working as a computer software programmer in X Ltd. at a salary of Rs. 30,000 p.m. She is, however, not qualified for the job. The other income of Mr. A & Mrs. A are Rs. 7,00,000 & Rs. 4,00,000, respectively. Compute the gross total income of Mr. A and Mrs. A for the A.Y.2020-21.

**Solution**
Mr. A holds shares carrying 25% voting power in X Ltd i.e. a substantial interest in the company. His wife is working in the same company without any professional qualifications for the same. Thus, by virtue of the clubbing provisions of the Act, the salary received by Mrs. A from X Ltd. will be clubbed in the hands of Mr. A.

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Salary received by Mr. A (Rs. 30,000 × 12)</td>
<td>3,60,000</td>
</tr>
<tr>
<td>Less: Standard deduction under section 16(ia)</td>
<td>40,000</td>
</tr>
<tr>
<td>Other Income</td>
<td>7,00,000</td>
</tr>
<tr>
<td><strong>Gross total income</strong></td>
<td><strong>10,10,000</strong></td>
</tr>
</tbody>
</table>

The gross total income of Mrs. A is Rs. 4,00,000.

**Illustration 2**
*Will your answer be different if Mrs. A was qualified for the job?*

**Solution**
If Mrs. A possesses professional qualifications for the job, then the clubbing provisions shall not be applicable.

Gross total income of Mr. A = Rs. 7,00,000 (other income)

Gross total income of Mr. A = Salary received by Mr. A [Rs. 30,000 × 12] less Rs. 50,000, being the standard deduction under section 16(ia) plus other income [Rs. 4,00,000] = Rs. 7,10,000.

**Illustration 3**
Mr. B holds shares carrying 30% voting power in Y Ltd. Mrs. B is working as accountant in Y Ltd. getting income from salary (computed) of Rs. 3,44,000 without any qualification in accountancy. Mr. B also receives Rs. 30,000 as interest on securities. Mrs. B owns a house property which she has let out. Rent received from tenants is Rs. 6,000 p.m. Compute the gross total income of Mr. B and Mrs. B for the A.Y. 2020-21.
Solution
Since Mrs. B is not professionally qualified for the job, the clubbing provisions shall be applicable.

Computation of Gross total income of Mr. B

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income from Salary of Mrs. B (Computed)</td>
<td>3,44,000</td>
</tr>
<tr>
<td>Income from other sources</td>
<td></td>
</tr>
<tr>
<td>- Interest on securities</td>
<td>30,000</td>
</tr>
<tr>
<td></td>
<td>3,74,000</td>
</tr>
</tbody>
</table>

Computation of Gross total income of Mrs. B

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income from Salary [clapped in the hands of Mr. B]</td>
<td></td>
<td>Nil</td>
</tr>
<tr>
<td>Income from house property</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Gross Annual Value [Rs. 6,000 × 12]</td>
<td>72,000</td>
<td></td>
</tr>
<tr>
<td>Less: Municipal taxes paid</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>Net Annual Value (NAV)</td>
<td>72,000</td>
<td></td>
</tr>
<tr>
<td>Less: Deductions under section 24</td>
<td></td>
<td></td>
</tr>
<tr>
<td>- 30% of NAV i.e., 30% of Rs. 72,000</td>
<td>21,600</td>
<td>50,400</td>
</tr>
<tr>
<td>- Interest on loan</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>Gross total income</td>
<td>50,400</td>
<td></td>
</tr>
</tbody>
</table>

Illustration 4
Mr. Vaibhav started a proprietary business on 01.04.2018 with a capital of Rs. 5,00,000. He incurred a loss of Rs. 2,00,000 during the year 2018-19. To overcome the financial position, his wife Mrs. Vaishaly, a software Engineer, gave a gift of Rs. 5,00,000 on 01.04.2019, which was immediately invested in the business by Mr. Vaibhav. He earned a profit of Rs. 4,00,000 during the year 2019-20. Compute the amount to be clubbed in the hands of Mrs. Vaishaly for the Assessment Year 2020-21. If Mrs. Vaishaly gave the said amount as loan, what would be the amount to be clubbed?

Solution
Section 64(1)(iv) of the Income-tax Act, 1961 provides for the clubbing of income in the hands of the individual, if the income earned is from the assets (other than house property) transferred directly or indirectly to the spouse of the individual, otherwise than for adequate consideration or in connection with an agreement to live apart.

In this case, Mr. Vaibhav received a gift of Rs. 5,00,000 on 1.4.2019 from his wife Mrs. Vaishaly, which he invested in his business immediately. The income to be clubbed in the hands of Mrs. Vaishaly for the A.Y. 2020-21 is computed as under:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Mr. Vaibhav’s capital contribution (Rs.)</th>
<th>Capital contribution out of gift from Mrs. Vaishaly (Rs.)</th>
<th>Total (Rs.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital as on 1.4.2019</td>
<td>3,00,000 (5,00,000 – 2,00,000)</td>
<td>5,00,000</td>
<td>8,00,000</td>
</tr>
</tbody>
</table>
Profit for P.Y.2019-20 to be apportioned on the basis of capital employed on the first day of the previous year i.e. as on 1.4.2019 (3:5)

<table>
<thead>
<tr>
<th>Amount (in Rs.)</th>
<th>Calculation</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1,50,000</td>
<td>( 4,00,000 \times \frac{3}{8} )</td>
<td></td>
</tr>
<tr>
<td>2,50,000</td>
<td>( 4,00,000 \times \frac{5}{8} )</td>
<td></td>
</tr>
<tr>
<td>4,00,000</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Therefore, the income to be clubbed in the hands of Mrs. Vaishaly for the A.Y.2020-21 is Rs. 2,50,000.

In case Mrs. Vaishaly gave the said amount of Rs. 5,00,000 as a *bona fide* loan, then, clubbing provisions would not be attracted.

**Note:** The provisions of section 56(2)(x) would not be attracted in the hands of Mr. Vaibhav, since he has received a sum of money exceeding Rs. 50,000 without consideration from a relative i.e., his wife.

**Illustration 5**

Mrs. Kasturi transferred her immovable property to ABC Co. Ltd. subject to a condition that out of the rental income, a sum of Rs. 36,000 per annum shall be utilized for the benefit of her son’s wife.

Mrs. Kasturi claims that the amount of Rs. 36,000 (utilized by her son’s wife) should not be included in her total income as she no longer owned the property.

Examine with reasons whether the contention of Mrs. Kasturi is valid in law.

**Solution**

The clubbing provisions under section 64(1)(viii) are attracted in case of transfer of any asset, directly or indirectly, otherwise than for adequate consideration, to any person to the extent to which the income from such asset is for the immediate or deferred benefit of son’s wife. Such income shall be included in computing the total income of the transferor-individual.

Therefore, income of Rs. 36,000 meant for the benefit of daughter-in-law is chargeable to tax in the hands of transferor i.e., Mrs. Kasturi in this case.

The contention of Mrs. Kasturi is, hence, not valid in law.

**Note** - In order to attract the clubbing provisions under section 64(1)(viii), the transfer should be otherwise than for adequate consideration. In this case, it is presumed that the transfer is otherwise than for adequate consideration and therefore, the clubbing provisions are attracted. In such case, the provisions of section 56(2)(x) will also get attracted in the hands of ABC Co Ltd., if stamp duty value exceeds Rs. 50,000 and the other conditions specified thereunder are satisfied.

If it is presumed that the transfer was for adequate consideration, the provisions of section 64(1)(viii) would not be attracted.

**Illustration 6**

Mr. A has three minor children – two twin daughters and one son. Income of the twin daughters is Rs. 2,000 p.a. each and that of the son is Rs. 1,200 p.a. Compute the income, in respect of minor children, to be clubbed in the hands of Mr. A.
Solution

Taxable income, in respect of minor children, in the hands of Mr. A is

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Twin minor daughters [Rs. 2,000 × 2]</td>
<td>4,000</td>
<td></td>
</tr>
<tr>
<td>Less: Exempt under section 10(32) [Rs. 1,500 × 2]</td>
<td>3,000</td>
<td>1,000</td>
</tr>
<tr>
<td>Minor son</td>
<td>1,200</td>
<td></td>
</tr>
<tr>
<td>Less: Exempt under section 10(32)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Income to be clubbed in the hands of Mr. A</td>
<td></td>
<td>1,000</td>
</tr>
</tbody>
</table>

Illustration 7

Mr. Vasudevan gifted a sum of Rs. 6 lakhs to his brother's wife on 14-6-2019. On 12-7-2019, his brother gifted a sum of Rs. 5 lakhs to Mr. Vasudevan's wife. The gifted amounts were invested as fixed deposits in banks by Mrs. Vasudevan and wife of Mr. Vasudevan's brother on 01-8-2019 at 9% interest. Discuss the consequences of the above under the provisions of the Income-tax Act, 1961 in the hands of Mr. Vasudevan and his brother.

Solution

In the given case, Mr. Vasudevan gifted a sum of Rs. 6 lakhs to his brother’s wife on 14.06.2019 and simultaneously, his brother gifted a sum of Rs. 5 lakhs to Mr. Vasudevan’s wife on 12.07.2019. The gifted amounts were invested as fixed deposits in banks by Mrs. Vasudevan and his brother’s wife. These transfers are in the nature of cross transfers. Accordingly, the income from the assets transferred would be assessed in the hands of the deemed transferor because the transfers are so intimately connected to form part of a single transaction and each transfer constitutes consideration for the other by being mutual or otherwise.

If two transactions are inter-connected and are part of the same transaction in such a way that it can be said that the circuitous method was adopted as a device to evade tax, the implication of clubbing provisions would be attracted. It was so held by the Apex Court in CIT vs. Keshavji Morarji (1967) 66 ITR 142.

Accordingly, the interest income arising to Mrs. Vasudevan in the form of interest on fixed deposits would be included in the total income of Mr. Vasudevan and interest income arising in the hands of his brother’s wife would be taxable in the hands of Mr. Vasudevan’s brother as per section 64(1), to the extent of amount of cross transfers i.e., Rs. 5 lakhs.

This is because both Mr. Vasudevan and his brother are the indirect transferors of the income to their respective spouses with an intention to reduce their burden of taxation.

However, the interest income earned by his spouse on fixed deposit of Rs. 5 lakhs alone would be included in the hands of Mr. Vasudevan’s brother and not the interest income on the entire fixed deposit of Rs. 6 lakhs, since the cross transfer is only to the extent of Rs. 5 lakhs.
Illustration 8

Mr. Ravi has gifted his only house property to his wife, Mrs. Ravi, and his married daughter, Mrs. Divya. The Assessing Officer has served a notice of demand on Mr. Ravi for payment of tax for the income derived from the said house property. Examine the validity of the Assessing Officer's action.

Answer

As per section 27(i), an individual who transfers otherwise than for adequate consideration any house property to his spouse, not being a transfer in connection with an agreement to live apart, or to a minor child not being a married daughter shall be deemed to be the owner of the house property so transferred.

Mr. Ravi, in this case, would be the deemed owner only in respect of the share of house property transferred to his wife Mrs. Ravi without consideration and not for the share of the house property transferred to his married daughter Mrs. Divya.

Since Mr. Ravi is the deemed owner of the share of house property transferred to his wife without consideration, the income derived from the house property, to the extent attributable to the share of property transferred to his wife without consideration, would be taxable in his hands under the head “Income from house property”.

As per section 65, the notice of demand can, however, be served on Mrs. Ravi for payment of that portion of tax levied on Mr. Ravi attributable to the income derived [by virtue of section 27(i)], from the share of house property transferred to Mrs. Ravi, and standing in her name.

However, the income derived from house property, attributable to the share of property transferred to his married daughter without consideration, would be taxable in the hands of his daughter. Such income would not be taxable in the hands of Mr. Ravi. Mr. Ravi will not be responsible for the payment of tax attributable to aforesaid share of income of daughter from house property.

Thus, the action of the Assessing Officer in serving notice of demand on Mr. Ravi for payment of tax for the entire income derived from the said house property is not valid.

********************************************************************************
EXERCISE

Question 1

X carrying on a business as sole proprietor, died on 31st March, 2019. On his death, the same business was continued by his legal heirs, by forming a firm. As on 31st March 2019, a determined business loss of Rs. 5 lacs is to be carried forward under the Income-tax Act, 1961.

Does the firm consisting of all legal heirs of Mr. X, get a right to have this loss adjusted against its current income?

Answer

Section 78(2) provides that where a person carrying on any business or profession has been succeeded in such capacity by another person, otherwise than by inheritance, then, the successor is not entitled to carry forward and set-off the loss of the predecessor against his income. This implies that generally, set-off of business losses should be claimed by the same person who suffered the loss and the only exception to this provision is when the business passes on to another person by inheritance.

The facts of case given in the question are similar to the case CIT v. Madhukant M. Mehta (2001) 247 ITR 805, where the Supreme Court has held that if the business is succeeded by inheritance, the legal heirs are entitled to the benefit of carry forward of the loss of the predecessor. Even if the legal heirs constitute themselves as a partnership firm, the benefit of carry forward and set off of the loss of the predecessor would be available to the firm.

In this case, the business of X was continued by his legal heirs after his death by constituting a firm. Hence, the exception contained in section 78(2) along with the decision of the Apex Court discussed above, would apply in this case. Therefore, the firm is entitled to carry forward the business loss of Rs. 5 lacs of X.

Question 2

ABC Limited was amalgamated with XYZ Limited on 01.04.2019. All the conditions of section 2(1B) were satisfied.

ABC Limited has the following carried forward losses as assessed till the Assessment Year 2019-20:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs. (in lacs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i) Speculative Loss</td>
<td>4</td>
</tr>
<tr>
<td>(ii) Unabsorbed Depreciation</td>
<td>18</td>
</tr>
<tr>
<td>(iii) Unabsorbed expenditure of capital nature on scientific research</td>
<td>2</td>
</tr>
<tr>
<td>(iv) Business Loss</td>
<td>120</td>
</tr>
</tbody>
</table>

XYZ Limited has computed a profit of Rs. 140 lacs for the financial year 2019-20 before setting off the eligible losses of ABC Limited but after providing depreciation at 15% per annum on Rs. 150 lacs, being the consideration at which plant and machinery were
transferred to XYZ Limited. The written down value as per income-tax record of ABC Limited as on 31st March, 2019 was Rs. 100 lacs.

The above profit of XYZ Limited includes speculative profit of Rs. 10 lacs.

Compute the total income of XYZ Limited for Assessment Year 2020-21 and indicate the losses/other allowances to be carried forward by it.

Answer

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

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

Notes:
1. It is presumed that the amalgamation is within the meaning of section 72A of the Income-tax Act, 1961.
2. In the case of amalgamation of companies, the unabsorbed losses and unabsorbed depreciation of the amalgamating company shall be deemed to be the loss or unabsorbed depreciation of the amalgamated company for the previous year in which the amalgamation was effected and such business loss and unabsorbed depreciation shall be carried forward and set-off by the amalgamated company for a period of 8 years and indefinitely, respectively.
3. As per section 72A(7), the accumulated loss to be carried forward specifically excludes loss sustained in a speculative business. Therefore, speculative loss of Rs. 4 lacs of ABC Ltd. cannot be carried forward by XYZ Ltd.
4. Section 72(2) provides that where any allowance or part thereof unabsorbed under section 32(2) (i.e., unabsorbed depreciation) or section 35(4) (i.e., unabsorbed scientific research capital expenditure) is to be carried forward, effect has to be first given to brought forward business losses under section 72.
5. Section 35(4) provides that the provisions of section 32(2) relating to unabsorbed depreciation shall apply in relation to deduction allowable under section 35(1)(iv) in respect of capital expenditure on scientific research related to the business carried on by the assessee. Therefore, unabsorbed capital expenditure on scientific research can be set-off and carried forward in the same manner as unabsorbed depreciation.
6. The restriction contained in section 73 is only regarding set-off of loss computed in respect of speculative business. Such a loss can be set-off only against profits of another speculation business and not non-speculation business. However, there is no restriction under the Income-tax Act, 1961 regarding set-off of normal business losses against speculative income. Therefore, normal business losses can be set-off against profits of a speculative business.

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

Question 3
Examine in brief about the treatment to be given in the following case under the Income-tax Act, 1961, for A.Y.2020-21:
A loss of Rs. 85,000 was sustained by Simran in the activity of owning and maintaining camels for races.

Answer
Sec 74A(3) lays down the provisions for set-off and carry forward of loss from the activity of owning and maintaining race horses. According to provisions of section 74A(3), the losses incurred by an assessee from the activity of owning and maintaining race horses cannot be set-off against the income from any other source other than the activity of owning and maintaining race horses. Since the scope of this section is confined to the activity of owning and maintaining race horses only, therefore, set-off and carry forward of loss from the activity of owning and maintaining camels is not covered under section 74A(3).

It is possible to take a view that the loss from the activity of owning and maintaining camels for races may be governed by section 72 provided such activity amounts to business. Accordingly, the loss from the activity of owning and maintaining of camels for races can be set-off against any income (other than income from salary) of current year and unadjusted amount shall be carried forward for set off against any business income for a maximum period of 8 assessment years immediately succeeding the assessment year in which the loss was incurred.

Question 4
M/s. JKLM, a firm, consists of four partners namely, J, K, L and M. They shared profits and losses equally during the year ended 31.3.2019. The assessed business loss of the firm for the assessment year 2018-19 which it is entitled to carry forward amounts to Rs. 3,60,000. A new deed of partnership was executed among J, K, L and M on 1.4.2019 in terms of which they agreed to share profits and losses in the ratio of 15:15:20:50 respectively.

Compute the amount of business loss relating to the assessment year 2019-20, which the firm is entitled to set off against its business income for the assessment year 2020-21. The business income of the firm for the assessment year 2020-21 is Rs. 3,30,000. Your answer should be supported by reasons.
Answer

The firm is entitled to set off its brought forward business loss amounting to Rs. 3,60,000 relating to the assessment year 2019-20 to the extent of Rs. 3,30,000 against its business income of Rs. 3,30,000 for the assessment year 2019-20, as per the provisions of section 72(1).

The balance unabsorbed business loss of Rs. 30,000 relating to the assessment year 2019-20 will be carried forward to assessment year 2021-22.

Section 78(1) which deals with carry forward and set-off of losses in the case of change in constitution of firm is applicable only where there is retirement or death of a partner. It is not applicable to a case where there is a change in the ratio of sharing profits and losses amongst the existing partners. Therefore, section 78(1) is not applicable to the case of M/s. JKLM.

Question 5

An assessee sustained a loss under the head “Income from house property” in the previous year relevant to the assessment year 2019-20, which could not be set off against income from any other head in that assessment year. The assessee did not furnish the return of loss within the time allowed under section 139(1) in respect of the relevant assessment year. However, the assessee filed the return within the time allowed under section 139(4). Can the assessee carry forward such loss for set off against income from house property of the assessment year 2020-21?

Answer

Section 139(3) stipulates that an assessee claiming carry forward of loss under the heads “Profits and gains of business or profession” or “Capital gains” should furnish the return of loss within the time stipulated under section 139(1). There is no reference to loss under the head “Income from house property” in section 139(3). The assessee, in the instant case, has filed the return showing loss from property within the time prescribed under section 139(4). The assessee is, therefore, entitled to carry forward such loss for set off against the income from house property of the subsequent assessment year.

ADDITIONAL ILLUSTRATIONS FOR PRACTICE:

Illustration 1

Mr. A submits the following particulars pertaining to the A.Y.2020-21:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income from salary</td>
<td>4,00,000</td>
</tr>
<tr>
<td>Loss from self-occupied property</td>
<td>(-70,000)</td>
</tr>
<tr>
<td>Loss from let-out property</td>
<td>(-1,50,000)</td>
</tr>
<tr>
<td>Business loss</td>
<td>(-1,00,000)</td>
</tr>
<tr>
<td>Bank interest (FD) received</td>
<td>80,000</td>
</tr>
</tbody>
</table>

Compute the total income of Mr. A for the A.Y.2020-21.
Solution

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

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Amount (Rs.)</th>
<th>Amount (Rs.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income from salary</td>
<td>4,00,000</td>
<td></td>
</tr>
<tr>
<td>Loss from house property of Rs. 2,20,000 to be restricted to Rs. 2 lakhs by virtue of section 71(3A)</td>
<td>(-) 2,00,000</td>
<td>2,00,000</td>
</tr>
<tr>
<td>Balance loss of Rs. 20,000 from house property to be carry forward to next assessment year</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Income from other sources (interest on fixed deposit with bank)</td>
<td>80,000</td>
<td></td>
</tr>
<tr>
<td>Business loss set-off Business loss of Rs. 20,000 to be carried forward against business income of the next assessment year</td>
<td>(-) 1,00,000</td>
<td>-</td>
</tr>
<tr>
<td><strong>Gross total income [See Note below]</strong></td>
<td>2,00,000</td>
<td></td>
</tr>
<tr>
<td>Less: Deduction under Chapter VI-A</td>
<td>Nil</td>
<td></td>
</tr>
<tr>
<td><strong>Total income</strong></td>
<td>2,00,000</td>
<td></td>
</tr>
</tbody>
</table>

**Note:** Gross Total Income includes salary income of Rs. 2,00,000 after adjusting loss of Rs. 2,00,000 from house property. The balance loss of Rs. 20,000 from house property will be carried forward. Business loss of Rs. 1,00,000 is set off against bank interest of Rs. 80,000 and remaining business loss of Rs. 20,000 will be carried forward as it cannot be set off against salary income.

Illustration 2

Mr. B, a resident individual, furnishes the following particulars for the P.Y.2019-20:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income from salary (Net)</td>
<td>45,000</td>
</tr>
<tr>
<td>Income from house property</td>
<td>(24,000)</td>
</tr>
<tr>
<td>Income from business – non-speculative</td>
<td>(22,000)</td>
</tr>
<tr>
<td>Income from speculative business</td>
<td>(4,000)</td>
</tr>
<tr>
<td>Short-term capital losses</td>
<td>(25,000)</td>
</tr>
<tr>
<td>Long-term capital gains u/s 112</td>
<td>19,000</td>
</tr>
</tbody>
</table>

What is the total income chargeable to tax for the A.Y.2020-21?

Solution

Total income of Mr. B for the A.Y. 2020-21

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Amount (Rs.)</th>
<th>Amount (Rs.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income from salaries</td>
<td>45,000</td>
<td></td>
</tr>
<tr>
<td>Income from house property</td>
<td>(24,000)</td>
<td>21,000</td>
</tr>
<tr>
<td><strong>Profits and gains of business and profession</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Business loss to be carried forward [Note 1]</td>
<td>(22,000)</td>
<td></td>
</tr>
<tr>
<td>Speculative loss to be carried forward [Note 2]</td>
<td>(4,000)</td>
<td></td>
</tr>
<tr>
<td><strong>Capital Gains</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Long term capital gain</td>
<td>19,000</td>
<td></td>
</tr>
<tr>
<td>Short term capital loss</td>
<td>(25,000)</td>
<td></td>
</tr>
<tr>
<td>Short term capital loss to be carried forward [Note 3]</td>
<td>(6,000)</td>
<td>-</td>
</tr>
<tr>
<td><strong>Taxable income</strong></td>
<td>21,000</td>
<td></td>
</tr>
</tbody>
</table>
Note 1: Business loss cannot be set-off against salary income. Therefore, loss of Rs. 22,000 from the non-speculative business cannot be set off against the income from salaries. Hence, such loss has to be carried forward to the next year for set-off against business profits, if any.

Note 2: Loss of Rs. 4,000 from the speculative business can be set off only against the income from the speculative business. Hence, such loss has to be carried forward.

Note 3: Short term capital loss can be set off against both short term capital gain and long term capital gain. Therefore, short term capital loss of Rs. 25,000 can be set-off against long- term capital gains to the extent of Rs. 19,000. The balance short term capital loss of Rs. 6,000 cannot be set-off against any other income and has to be carried forward to the next year for set-off against capital gains, if any.

Illustration 3

During the P.Y. 2019-20, Mr. C has the following income and the brought forward losses:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Short term capital gains on sale of shares</td>
<td>1,50,000</td>
</tr>
<tr>
<td>Long term capital loss of A.Y.2018-19</td>
<td>(96,000)</td>
</tr>
<tr>
<td>Short term capital loss of A.Y.2019-20</td>
<td>(37,000)</td>
</tr>
<tr>
<td>Long term capital gain</td>
<td>75,000</td>
</tr>
</tbody>
</table>

What is the capital gain taxable in the hands of Mr. C for the A.Y.2020-21?

Solution

Taxable capital gains of Mr. C for the A.Y. 2020-21

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Short term capital gains on sale of shares</td>
<td>1,50,000</td>
<td></td>
</tr>
<tr>
<td>Less: Brought forward short term capital loss of the A.Y.2019-20</td>
<td>(37,000)</td>
<td>1,13,000</td>
</tr>
<tr>
<td>Long term capital gain</td>
<td>75,000</td>
<td></td>
</tr>
<tr>
<td>Less: Brought forward long term capital loss of A.Y.2018-19</td>
<td></td>
<td>Nil</td>
</tr>
<tr>
<td>[See Note below]</td>
<td>(75,000)</td>
<td></td>
</tr>
<tr>
<td>Taxable short-term capital gains</td>
<td></td>
<td>1,13,000</td>
</tr>
</tbody>
</table>

Note: Long-term capital loss cannot be set off against short-term capital gain. Hence, the unadjusted long term capital loss of A.Y.2018-19 of Rs. 21,000 (i.e. Rs. 96,000 – Rs. 75,000) has to be carried forward to the next year to be set-off against long-term capital gains of that year.

Illustration 4

Mr. D has the following income for the P.Y.2019-20-

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income from the activity of owning and maintaining the race horses</td>
<td>75,000</td>
</tr>
<tr>
<td>Income from textile business</td>
<td>85,000</td>
</tr>
<tr>
<td>Brought forward textile business loss</td>
<td>50,000</td>
</tr>
<tr>
<td>Brought forward loss from the activity of owning and maintaining the race horses (relating to A.Y.2017-18)</td>
<td>96,000</td>
</tr>
</tbody>
</table>

What is the total income in the hands of Mr. D for the A.Y. 2020-21?
Solution

**Total income of Mr. D for the A.Y. 2020-21**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income from the activity of owning and maintaining race horses</td>
<td>75,000</td>
<td></td>
</tr>
<tr>
<td>Less: Brought forward loss from the activity of owning and maintaining race horses</td>
<td>96,000</td>
<td></td>
</tr>
<tr>
<td>Loss from the activity of owning and maintaining race horses to be carried forward to A.Y.2021-22</td>
<td>(21,000)</td>
<td></td>
</tr>
<tr>
<td>Income from textile business</td>
<td>85,000</td>
<td></td>
</tr>
<tr>
<td>Less: Brought forward business loss from textile business</td>
<td>50,000</td>
<td>35,000</td>
</tr>
<tr>
<td><strong>Total income</strong></td>
<td></td>
<td>35,000</td>
</tr>
</tbody>
</table>

**Note:** Loss from the activity of owning and maintaining race horses cannot be set-off against any other source/head of income.

**Illustration 5**

*Mr. E has furnished his details for the A.Y.2020-21 as under:*

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income from salaries</td>
<td>1,50,000</td>
</tr>
<tr>
<td>Income from speculation business</td>
<td>60,000</td>
</tr>
<tr>
<td>Loss from non-speculation business</td>
<td>(40,000)</td>
</tr>
<tr>
<td>Short term capital gain</td>
<td>80,000</td>
</tr>
<tr>
<td>Long term capital loss of A.Y.2018-19</td>
<td>(30,000)</td>
</tr>
<tr>
<td>Winning from lotteries</td>
<td>20,000</td>
</tr>
</tbody>
</table>

*What is the taxable income of Mr. E for the A.Y.2019-20?*

**Solution**

**Computation of taxable income of Mr. E for the A.Y.2020-21**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income from salaries</td>
<td></td>
<td>1,50,000</td>
</tr>
<tr>
<td>Income from speculation business</td>
<td>60,000</td>
<td></td>
</tr>
<tr>
<td>Less: Loss from non-speculation business</td>
<td>(40,000)</td>
<td>20,000</td>
</tr>
<tr>
<td>Short-term capital gain</td>
<td>80,000</td>
<td></td>
</tr>
<tr>
<td>Winnings from lotteries</td>
<td>20,000</td>
<td></td>
</tr>
<tr>
<td><strong>Taxable income</strong></td>
<td></td>
<td>2,70,000</td>
</tr>
</tbody>
</table>

**Note:** Long term capital loss can be set off only against long term capital gain. Therefore, long term capital loss of Rs. 30,000 has to be carried forward to the next assessment year.

**Illustration 6**

*Compute the gross total income of Mr. F for the A.Y.2020-21 from the information given below –*

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net income from house property</td>
<td>1,25,000</td>
</tr>
<tr>
<td>Income from business (before providing for depreciation)</td>
<td>1,35,000</td>
</tr>
<tr>
<td>Short term capital gains on sale of shares</td>
<td>56,000</td>
</tr>
<tr>
<td>Long term capital loss from sale of property (brought forward from A.Y.2017-18)</td>
<td>(90,000)</td>
</tr>
<tr>
<td>Income from tea business</td>
<td>1,20,000</td>
</tr>
</tbody>
</table>

10.7
Dividends from Indian companies carrying on agricultural operations 80,000
Current year depreciation 26,000
Brought forward business loss (loss incurred six years ago) (45,000)

Solution

Gross Total Income of Mr. F for the A.Y. 2020-21

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income from house property</td>
<td></td>
<td>1,25,000</td>
</tr>
<tr>
<td>Income from business</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Profits before depreciation</td>
<td></td>
<td>1,35,000</td>
</tr>
<tr>
<td>Less: Current year depreciation</td>
<td></td>
<td>26,000</td>
</tr>
<tr>
<td>Less: Brought forward business loss</td>
<td></td>
<td>45,000</td>
</tr>
<tr>
<td>Income from tea business (40% is business income)</td>
<td></td>
<td>48,000</td>
</tr>
<tr>
<td>Income from the capital gains</td>
<td></td>
<td>1,12,000</td>
</tr>
<tr>
<td>Short term capital gains</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Gross Total Income</td>
<td></td>
<td>2,93,000</td>
</tr>
</tbody>
</table>

Notes:

(1) Dividend from Indian companies of Rs. 80,000 is exempt from tax under section 10(34).
(2) 60% of the income from tea business is treated as agricultural income and therefore, exempt from tax;
(3) Long-term capital loss can be set-off only against long-term capital gains. Therefore, long- term capital loss of Rs. 90,000 brought forward from A.Y.2017-18 cannot be set-off in the A.Y.2020-21. It has to be carried forward for set-off against long-term capital gains, if any, during A.Y.2021-22.
CHAPTER 11 - DEDUCTIONS UNDER CH VIA

EXERCISE

Question 1

Mr. Srinivasan, aged 61 years, furnishes the following particulars for the year ending 31.03.2020:

(a) Life Insurance Premium paid – Rs. 15,000, actual capital sum of the policy assured for Rs. 1,40,000. The insurance policy was taken on 31.03.2012;

(b) Contribution to Public Provident Fund – Rs. 40,000 in the name of father;

(c) Tuition fee payment – Rs. 8,000 each for 2 sons pursuing full time graduation course in Calcutta; Tuition fee for daughter pursuing PHD in Kellogg University, USA – Rs. 2.50 Lacs;

(d) Housing loan principal repayment – Rs. 32,000 to Axis Bank. This property is under construction at Calcutta as on 31.03.2020;

(e) Principal repayment of housing loan taken from a relative – Rs. 70,000. The property is self-occupied situated at Pune;

(f) Deposit under Senior Citizens Savings Scheme – Rs. 15,000;

(g) Five-year deposits in an account under Post Office Time Deposit Scheme – Rs. 50,000;

(h) Investment in National Savings Certificate – Rs. 70,000;

Compute the deduction eligible under appropriate provisions of section 80C for A.Y. 2020-21.

Answer

Computation of eligible deduction under section 80C for A.Y. 2020-21

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Life Insurance Premium (See Note 1)</td>
<td>15,000</td>
</tr>
<tr>
<td>Contribution to Public Provident Fund (See Note 2)</td>
<td>Nil</td>
</tr>
<tr>
<td>Tuition fee of 2 sons for graduation course (See Note 3)</td>
<td>16,000</td>
</tr>
<tr>
<td>Housing loan principal repayment (See Notes 4 &amp; 5)</td>
<td>Nil</td>
</tr>
<tr>
<td>Senior Citizen Savings Scheme deposit (See Note 6)</td>
<td>15,000</td>
</tr>
<tr>
<td>Post Office Time Deposit Scheme (See Note 6)</td>
<td>50,000</td>
</tr>
<tr>
<td>Investment in National Savings Certificate</td>
<td>70,000</td>
</tr>
<tr>
<td><strong>Total Investment</strong></td>
<td><strong>1,66,000</strong></td>
</tr>
<tr>
<td>Eligible deduction under section 80C restricted to</td>
<td>1,50,000</td>
</tr>
</tbody>
</table>

Notes:

1. Any amount of life insurance premium paid in excess of the specified percentage of actual capital sum assured shall be ignored for the purpose of deduction under section 80C. In the given case, since the insurance policy has been issued before 1.04.2012, therefore, premium paid upto 20% of actual capital sum assured i.e., Rs. 28,000 shall be allowed as deduction. Hence, the premium of Rs. 15,000 paid during the year is allowable as deduction under section 80C.

2. In the case of an individual, contribution to PPF can be made in his name or in the name of his spouse or children to qualify for deduction under section 80C. As the contribution was made in the name of his father, deduction is not allowable.
3. Tuition fee paid is eligible for deduction under section 80C for a maximum of two children. Therefore, Rs. 16,000 shall be allowed as deduction. **Tuition fee paid to an educational institution situated outside India is not eligible for deduction.**

4. In order to claim the principal repayment on loan borrowed for house property as deduction, the construction of such property should have been completed and should be chargeable to tax under the head "Income from house property". In the given case, since the property is under construction, principal repayment does not qualify for deduction.

5. Repayment of principal on housing loan is not allowed as deduction in case the loan is borrowed from friends, relatives etc. In order to qualify for deduction, the loan should have been obtained from Central Government / State Government / bank / specified employer / institution.

6. The following investments are also eligible for deduction under section 80C:-
   - (1) five year time deposit in an account under Post Office Time Deposit Rules, 1981; and
   - (2) deposit in an account under the Senior Citizens Savings Scheme Rules, 2004.

Question 2

**X Ltd. has two units, unit 'N' and unit 'Y'. Unit 'N' engaged in the business of power generation installed a windmill in March, 2018 and had a profit of Rs. 100 lakhs in Assessment Year 2020-21. X Ltd. claimed depreciation of Rs. 120 lakhs on windmill against the profit of Rs. 100 lakhs from power generation business which was eligible for deduction under section 80-IA. Unit 'Y', engaged in manufacturing of wires, non-eligible business, had a profit of Rs. 70 lakhs for Assessment Year 2020-21.**

The loss of Rs. 20 lakhs, i.e., balance depreciation not set off pertaining to unit 'N' was set-off against the profits of unit 'Y' carrying on non-eligible business, by the assessee, X Ltd. The Assessing Officer was of the view that depreciation relating to a business eligible for deduction under section 80-IA cannot be set-off against non-eligible business income. Hence, unabsorbed depreciation should be carried forward to the subsequent year to be set off against eligible business income of the assessee of that year.

**Examine the correctness of the action of the Assessing Officer.**

**Answer**

In **CIT v. Swarnagiri Wire Insulations Pvt. Ltd. (2012) 349 ITR 245**, the Karnataka High Court observed that it is a generally accepted principle that the deeming provision of a particular section cannot be breathed into another section. Therefore, the deeming provision contained in section 80-IA(5) cannot override the provisions of section 70(1).

In this case, X Ltd. had incurred loss in eligible business (power generation) on account of claiming depreciation of Rs. 120 lakhs. Hence, section 80-IA becomes insignificant, since there is no profit from which this deduction can be claimed.

It is, thereafter, that section 70(1) comes into play, whereby an assessee is entitled to set off the losses from one source against income from another source under the same head of income. Accordingly, X Ltd. is entitled to the benefit of set off of loss of Rs. 20 lakhs (representing balance depreciation not set-off) pertaining to Unit N engaged in eligible business of power generation against profit of Rs. 70 lakhs of Unit Y carrying on non-eligible business. Therefore, the net profit of Rs. 50 lakhs would be taxable in the A.Y.2020-21.
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 any subsequent assessment year i.e., the loss (arising on account of balance depreciation of eligible business) so set-off under section 70(1) has to be first deducted while computing profits eligible for deduction under section 80-IA in the subsequent year. Accordingly, in the A.Y.2021-22, the net profits of Unit N has to be reduced by Rs. 20 lacs for computing the profits eligible for deduction under section 80-IA in that year.

The action of the Assessing Officer in not permitting set-off of loss of eligible business against profits of non-eligible business in this case is, therefore, not correct.

Question 3

From the following details, compute the total income of Mr. A, Mr. B and Mr. C for A.Y.2020-21 –

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Mr. A</th>
<th>Mr. B</th>
<th>Mr. C</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i) Salary (computed)</td>
<td>9,25,000</td>
<td>10,45,000</td>
<td>11,15,000</td>
</tr>
<tr>
<td>(ii) Interest income (on fixed deposits)</td>
<td>75,000</td>
<td>85,000</td>
<td>95,000</td>
</tr>
</tbody>
</table>

The particulars of their other investments/ payments made during the P.Y.2019-20 are given hereunder –

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1) Deposit in Public Provident Fund (PPF) by Mr. A</td>
<td>1,50,000</td>
</tr>
<tr>
<td>(2) Life insurance premium paid by Mr. C, the details of which are as follows—</td>
<td></td>
</tr>
<tr>
<td><strong>Date of issue of policy</strong></td>
<td><strong>Person insured</strong></td>
</tr>
<tr>
<td>31/3/2012</td>
<td>Self</td>
</tr>
<tr>
<td>11/6/2016</td>
<td>Spouse</td>
</tr>
<tr>
<td>31/7/2017</td>
<td>Handicapped son (Section 80U disability)</td>
</tr>
<tr>
<td>(3) Payment of medical insurance premium by the following persons to insure their health:</td>
<td></td>
</tr>
<tr>
<td><strong>Payer</strong></td>
<td><strong>Amount in Rs.</strong></td>
</tr>
<tr>
<td>Mr. A (aged 55 years)</td>
<td>30,000</td>
</tr>
<tr>
<td>Mr. B (aged 52 years)</td>
<td>15,000</td>
</tr>
<tr>
<td>Mr. C (aged 48 years)</td>
<td>20,000</td>
</tr>
<tr>
<td>(4) Mr. B paid interest on loan taken for the purchase of house in which he currently resides. He is claiming benefit of self-occupation under section 23(2) in respect of this house. He does not own any other house.</td>
<td>2,20,000</td>
</tr>
<tr>
<td>Repayment of principal amount of loan taken for purchase of the said house</td>
<td>1,70,000</td>
</tr>
<tr>
<td>(5) Contribution by Mr. A by cheque to National Children’s Fund during the year.</td>
<td>30,000</td>
</tr>
<tr>
<td>(6) Mr. B makes the following donations during the P.Y. 2019-20 -</td>
<td></td>
</tr>
<tr>
<td>Donation to BJP by crossed cheque</td>
<td>50,000</td>
</tr>
<tr>
<td>Donation to Electoral trust by cash</td>
<td>50,000</td>
</tr>
</tbody>
</table>
Answer

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

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Mr. A</th>
<th>Mr. B</th>
<th>Mr. C</th>
</tr>
</thead>
<tbody>
<tr>
<td>Salary</td>
<td>9,25,000</td>
<td>10,45,000</td>
<td>11,15,000</td>
</tr>
<tr>
<td>Income from house property [See Note 4]</td>
<td></td>
<td>(2,00,000)</td>
<td></td>
</tr>
<tr>
<td>Income from other sources (Interest)</td>
<td>75,000</td>
<td>85,000</td>
<td>95,000</td>
</tr>
<tr>
<td><strong>Gross total income</strong></td>
<td><strong>10,00,000</strong></td>
<td><strong>9,30,000</strong></td>
<td><strong>12,10,000</strong></td>
</tr>
</tbody>
</table>

**Less: Deductions under Chapter VIA**

**Under section 80C**
- Deposit in PPF (See Note 3) 1,50,000
- LIC premium paid [See Note 1]
- Principal repayment of housing loan (restricted to Rs. 1,50,000) [See Note 4]

**Under section 80D**
- Medical insurance premium [See Note 2]
- Contribution to National Children’s Fund [See Note 5]
- Donation to BJP by crossed cheque
- Cash donation to Electoral Trust

**Under section 80GGC [See Note 6]**

**Total deduction under Chapter VIA** 2,05,000 2,00,000 77,500

**Total Income (A) – (B)** 7,95,000 7,30,000 11,32,500

Notes:

1. **Deduction u/s 80C in respect of life insurance premium paid by Mr. C**

<table>
<thead>
<tr>
<th>Date of issue of policy</th>
<th>Person insured</th>
<th>Actual capital sum assured</th>
<th>Insurance premium paid during 2019-20</th>
<th>Restricted to % of sum assured</th>
<th>Deduction u/s 80C</th>
</tr>
</thead>
<tbody>
<tr>
<td>31/3/2012</td>
<td>Self</td>
<td>1,48,000</td>
<td>15,000</td>
<td>20%</td>
<td>15,000</td>
</tr>
<tr>
<td>11/6/2016</td>
<td>Spouse</td>
<td>1,25,000</td>
<td>15,000</td>
<td>10%</td>
<td>12,500</td>
</tr>
<tr>
<td>31/7/2017</td>
<td>Handicapped Son (section 80U disability)</td>
<td>2,00,000</td>
<td>32,000</td>
<td>15%</td>
<td>30,000</td>
</tr>
</tbody>
</table>

**Total** 57,500

2. **Medical Insurance Premium**
   - (i) Medical insurance premium of Rs. 30,000 paid by account payee cheque by Mr. A is allowed as a deduction under section 80D, subject to a maximum of Rs. 25,000.
   - (ii) Medical insurance premium paid by cash is not allowable as deduction. Hence, Mr. B is not eligible for deduction under section 80D in respect of medical insurance premium of Rs. 15,000 paid in cash.
   - (iii) Mr. C is eligible for deduction of Rs. 20,000 under section 80D in respect of medical insurance premium paid by crossed cheque.

3. The maximum amount eligible for deduction under section 80C shall not exceed Rs. 1,50,000. Further, the investment limit in PPF also increased to Rs. 1,50,000. Since
Mr. A has no other investment under section 80C during the P.Y. 2018-19, Mr. A would be eligible for deduction of Rs. 1,50,000 in respect of PPF.

(4) **Deduction in respect of interest and principal repayment of housing loan**

Mr. B is eligible for a maximum deduction of Rs. 2,00,000 under section 24 in respect of interest on housing loan taken in respect of a self-occupied property, for which he is claiming benefit of “Nil” annual value. Therefore, Rs. 2,00,000 would represent his loss from house property.

Further, the maximum amount eligible for deduction under section 80C should not exceed Rs. 1,50,000. Since, Mr. B has no other investment under section 80C during the previous year 2018-19, he would be eligible for deduction of Rs. 1,50,000 in respect of principal repayment of housing loan.

(5) Contribution to National Children’s Fund qualifies for 100% deduction under section 80G. Therefore, Mr. A is entitled to 100% deduction of the sum of Rs. 30,000 contributed by him by way of cheque to National Children’s Fund.

(6) Mr. B is eligible for deduction under section 80GGC in respect of donation to a political party made otherwise than by way of cash. However, cash donations to electoral trust do not qualify for deduction under section 80GGC.

**Question 4**

Following issues have been raised by Navi Limited in connection with its eligibility for claiming deduction under section 80-IB for your consideration and advice for the assessment year 2020-21:

(i) It operates two separate industrial units. One unit is eligible for deduction under section 80-IB, while the other unit is not eligible for such deduction. If the eligible unit has profit and the other unit has loss, should it claim deduction after setting off the loss of the other unit against profit of the eligible unit?

(ii) Its profit from one unit includes sale of import entitlement, duty drawback and interest from customers for delayed payment. Is it permissible to claim deduction on these items of income?

**Answer**

(i) Section 80-IB(13) provides that the provisions contained in section 80-IA(5) shall, so far as may be, apply to the eligible business under section 80-IB. Accordingly, for the purpose of computing the deduction under section 80-IB, the profits and gains of an eligible business shall be computed as if such eligible business was the only source of income of the assessee.

Therefore, Navi Limited should claim deduction under section 80-IB on profit from the eligible unit without setting off loss suffered in the other unit. It may be noted that the aggregate deduction under Chapter VI-A, however, cannot exceed the gross total income of the assessee.

(ii) Under section 80-IB, where the gross total income of an assessee includes any profits and gains derived from an industrial undertaking referred to in the section, there shall be allowed, in computing the total income of the assessee, a deduction from such profits and gains at the specified percentage and for such number of years as specified in the section. In *CIT vs. Sterling Foods* (1999) 237 ITR 579 (SC) and *Liberty India vs. CIT* (2009) 317 ITR 218 (SC), it was held that sale of import entitlement and duty drawback cannot be construed as income derived from industrial undertaking. Therefore, such income cannot be included in computing income for the purpose of deduction under section 80-IB.
Interest income derived by an undertaking on delayed collection of sale proceeds shall be treated as income derived from the industrial undertaking, and therefore, the same would be eligible for deduction under section 80-IB. [Phatela Cotgin Industries Private Limited vs CIT (2008) 303 ITR 411 (P & H)].

Question 5

PQR Co-operative Bank, a co-operative society, having its area of operation confined to Gubbi Taluk and the principal object of which is to provide for long-term credit for agricultural and rural development activities, has received the following amounts during the year ending 31.3.2020:

(i) Interest amounting to Rs. 1,00,000 from its members on loans advanced to them.
(ii) Interest amounting to Rs. 1,50,000 on deposits with other co-operative societies.
(iii) Rent amounting to Rs. 2,00,000 from letting out its godowns for storage of commodities.

PQR Co-operative Bank seeks your advice in the matter of taxability of the above amounts and the eligibility for deduction, if any, in respect thereof for the assessment year 2020-21.

Answer

Sub-clause (viia) to section 2(24) includes within the scope of definition of income, the profits and gains of any business of banking (including providing credit facilities) carried on by a co-operative society with its members. Hence, the interest of Rs. 1,00,000 received by PQR Co-operative Bank on loans advanced to its members constitutes its income.

Further, interest received amounting to Rs. 1,50,000 on deposits with other co-operative societies and rent amounting to Rs. 2,00,000 received from letting out its godowns for storage of commodities also constitute the income of the co-operative bank.

Sub-section (4) of section 80P provides that section 80P shall not apply to any co-operative bank other than a primary agricultural credit society or a primary co-operative agricultural and rural development bank.

Explanation to section 80P(4) defines a primary co-operative agricultural and rural development bank to mean a society having its area of operation confined to a taluk and the principal object of which is to provide for long-term credit for agricultural and rural development activities.

PQR Co-operative Bank is a primary co-operative agricultural and rural development bank as defined in the said Explanation since it is a co-operative society having its area of operation confined to Gubbi Taluk and its principal object is to provide long-term credit for agricultural and rural development activities. Therefore, it is eligible for deduction under section 80P.

Interest of Rs. 1,00,000 received by the bank on loans advanced to its members is eligible for deduction in full under section 80P(2)(a)(i).

Interest of Rs. 1,50,000 received by the bank from deposits with other co-operative societies qualifies for deduction in full under section 80P(2)(d).

Rent of Rs. 2,00,000 received by the bank from letting out its godowns for storage of commodities is eligible for deduction in full under section 80P(2)(e).
ADDITIONAL ILLUSTRATIONS FOR PRACTICE:

Illustration 1
Examine the following statements with regard to the provisions of the Income-tax Act, 1961:
(a) For grant of deduction under section 80-IB, filing of audit report in prescribed form is must for a corporate assessee; filing of return within the due date laid down in section 139(1) is not required.
(b) Filing of belated return under section 139(4) of the Income-tax Act, 1961 will debar an assessee from claiming deduction under section 80-IE.

Solution
(a) The statement is not correct. Section 80AC stipulates compulsory filing of return of income on or before the due date specified under section 139(1), as a pre-condition for availing the benefit of deduction, *inter alia*, under section 80-IB.
(b) The statement is correct. As per section 80AC, the assessee has to furnish his return of income on or before the due date specified under section 139(1), to be eligible to claim deduction under, *inter alia*, section 80-IE.

Illustration 2
Compute the eligible deduction under section 80C for A.Y.2020-21 in respect of life insurance premium paid by Mr. Ganesh during the P.Y.2019-20, the details of which are given hereunder -

<table>
<thead>
<tr>
<th>Date of issue of policy</th>
<th>Person insured</th>
<th>Actual capita sum assured (Rs.)</th>
<th>Insurance premium paid during 2019-20 (Rs.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i) 30/3/2012</td>
<td>Self</td>
<td>5,00,000</td>
<td>51,000</td>
</tr>
<tr>
<td>(ii) 1/5/2015</td>
<td>Spouse</td>
<td>1,50,000</td>
<td>20,000</td>
</tr>
<tr>
<td>(iii) 1/6/2017</td>
<td>Handicapped Son (section 80U disability)</td>
<td>4,00,000</td>
<td>80,000</td>
</tr>
</tbody>
</table>

Solution

<table>
<thead>
<tr>
<th>Date of issue of policy</th>
<th>Person insured</th>
<th>Actual capita sum assured (Rs.)</th>
<th>Insurance premium paid during 2019-20 (Rs.)</th>
<th>Deduction u/s 80C for A.Y. 2020-21 (Rs.)</th>
<th>Remark (restricted to % of sum assured)</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i) 30/3/2012</td>
<td>Self</td>
<td>5,00,000</td>
<td>51,000</td>
<td>51,000</td>
<td>20%</td>
</tr>
<tr>
<td>(ii) 1/5/2015</td>
<td>Spouse</td>
<td>1,50,000</td>
<td>20,000</td>
<td>15,000</td>
<td>10%</td>
</tr>
<tr>
<td>(iii) 1/6/2017</td>
<td>Handicapped Son (section 80U disability)</td>
<td>4,00,000</td>
<td>80,000</td>
<td>60,000</td>
<td>15%</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>1,26,000</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Illustration 3
An individual assessee, resident in India, has made the following deposit/payment during the previous year 2019-20:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Contribution to the public provident fund</td>
<td>1,50,000</td>
</tr>
<tr>
<td>Insurance premium paid on the life of the spouse (policy taken on 1.4.2015) (Assured value Rs. 2,00,000)</td>
<td>25,000</td>
</tr>
</tbody>
</table>

What is the deduction allowable under section 80C for A.Y.2020-21?

Solution

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Deposit in public provident fund</td>
<td>1,50,000</td>
</tr>
<tr>
<td>Insurance premium paid on the life of the spouse</td>
<td>20,000</td>
</tr>
<tr>
<td>Maximum 10% of the assured value Rs. 2,00,000, as the policy is taken after 31.3.2012</td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>1,70,000</td>
</tr>
</tbody>
</table>

However, the maximum permissible deduction u/s 80C is restricted to 1,50,000.

Illustration 4
Mr. A, aged about 40 years, has earned a lottery income of Rs. 1,20,000 (gross) during the P.Y. 2019-20. He also has interest on Fixed Deposit of Rs. 30,000. He invested an amount of Rs. 10,000 in Public Provident Fund account and Rs. 24,000 in National Savings Certificate. What is the total income of Mr. A for the A.Y.2020-21?

Solution

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income from other sources</td>
<td></td>
</tr>
<tr>
<td>- Interest on Fixed Deposit</td>
<td>30,000</td>
</tr>
<tr>
<td>- Lottery income</td>
<td>1,20,000</td>
</tr>
<tr>
<td>Gross Total Income</td>
<td>1,50,000</td>
</tr>
<tr>
<td>Less: Deductions under Chapter VIA [See Note below]</td>
<td></td>
</tr>
<tr>
<td>Under section 80C</td>
<td></td>
</tr>
<tr>
<td>- Deposit in Public Provident Fund</td>
<td>10,000</td>
</tr>
<tr>
<td>- Investment in National Savings Certificate</td>
<td>24,000</td>
</tr>
<tr>
<td>Restricted to</td>
<td>34,000</td>
</tr>
<tr>
<td>Total Income</td>
<td>1,20,000</td>
</tr>
</tbody>
</table>

Note: Though the value of eligible investments is Rs. 34,000, however, deduction under Chapter VIA cannot exceed the gross total income exclusive of long term capital gains, short-term capital gains covered under section 111A, winnings of lotteries etc. of the assessee. Therefore, the maximum permissible deduction u/s 80C = Rs. 1,50,000 – Rs. 1,20,000 = Rs. 30,000.
Illustration 5

The basic salary of Mr. A is Rs. 1,00,000 p.m. He is entitled to dearness allowance, which is 40% of basic salary. 50% of dearness allowance forms part of pay for retirement benefits. Both Mr. A and his employer contribute 15% of basic salary to the pension scheme referred to in section 80CCD. Examine the tax treatment in respect of such contribution in the hands of Mr. A.

Solution

Tax treatment in the hands of Mr. A in respect of employer’s and own contribution to pension scheme referred to in section 80CCD

(a) Employer’s contribution to such pension scheme would be treated as salary since it is specifically included in the definition of “salary” under section 17(1)(viii). Therefore, Rs. 1,80,000, being 15% of basic salary of Rs. 12,00,000, will be included in Mr. A’s salary.

(b) Mr. A’s contribution to pension scheme is allowable as deduction under section 80CCD(1). However, the deduction is restricted to 10% of salary. Salary, for this purpose, means basic pay plus dearness allowance, if it forms part of pay.

Therefore, “salary” for the purpose of deduction under section 80CCD for Mr. A would be –

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Basic salary = Rs. 1,00,000 × 12 =</td>
<td>12,00,000</td>
</tr>
<tr>
<td>Dearness allowance = 40% of Rs. 12,00,000 = Rs. 4,80,000</td>
<td></td>
</tr>
<tr>
<td>50% of Dearness Allowance forms part of pay = 50% of Rs. 4,80,000</td>
<td>2,40,000</td>
</tr>
<tr>
<td>Salary for the purpose of deduction under section 80CCD</td>
<td>14,40,000</td>
</tr>
<tr>
<td>Deduction under section 80CCD(1) is restricted to 10% of Rs. 14,40,000</td>
<td>1,44,000</td>
</tr>
<tr>
<td>(as against actual contribution of Rs. 1,80,000, being 15% of basic salary</td>
<td></td>
</tr>
<tr>
<td>of Rs. 12,00,000)</td>
<td></td>
</tr>
<tr>
<td>As per section 80CCD(1B), a further deduction of up to Rs. 50,000 is</td>
<td>36,000</td>
</tr>
<tr>
<td>allowable. Therefore, deduction under section 80CCD(1B) is Rs. 36,000</td>
<td></td>
</tr>
<tr>
<td>(Rs. 1,80,000 - Rs. 1,44,000).</td>
<td></td>
</tr>
</tbody>
</table>

Rs. 1,44,000 is allowable as deduction under section 80CCD(1). This would be taken into consideration and be subject to the overall limit of Rs. 1,50,000 under section 80CCE. Rs. 36,000 allowable as deduction under section 80CCD(1B) is outside the overall limit of Rs. 1,50,000 under section 80CCE.

In the alternative, Rs. 50,000 can be claimed as deduction under section 80CCD(1B). The balance Rs. 1,30,000 (Rs. 1,80,000 - Rs. 50,000) can be claimed as deduction under section 80CCD(1).

(c) Employer’s contribution to pension scheme would be allowable as deduction under section 80CCD(2), subject to a maximum of 10% of salary. Therefore, deduction under section 80CCD(2), would also be restricted to Rs. 1,44,000, even though the entire employer’s contribution of Rs. 1,80,000 is included in salary under section 17(1)(viii). However, this deduction of employer’s contribution of Rs. 1,44,000 to pension scheme would be outside the overall limit of Rs. 1,50,000 under section 80CCE i.e., this deduction would be over and above the other deductions which are subject to the limit of Rs. 1,50,000.
Illustration 6
The gross total income of Mr. X for the A.Y.2020-21 is Rs. 8,00,000. He has made the following investments/payments during the F.Y.2019-20 –

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1) Contribution to PPF</td>
<td>1,10,000</td>
</tr>
<tr>
<td>(2) Payment of tuition fees to Apeejay School, New Delhi, for education of his son studying in Class XI</td>
<td>45,000</td>
</tr>
<tr>
<td>(3) Repayment of housing loan taken from Standard Chartered Bank</td>
<td>25,000</td>
</tr>
<tr>
<td>(4) Contribution to approved pension fund of LIC</td>
<td>1,05,000</td>
</tr>
</tbody>
</table>

Compute the eligible deduction under Chapter VI-A for the A.Y.2020-21.

Solution

Computation of deduction under Chapter VI-A for the A.Y.2020-21

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Deduction under section 80C</td>
<td></td>
</tr>
<tr>
<td>- Contribution to PPF</td>
<td>1,10,000</td>
</tr>
<tr>
<td>- Payment of tuition fees to Apeejay School, New Delhi, for education of his son studying in Class XI</td>
<td>45,000</td>
</tr>
<tr>
<td>- Repayment of housing loan</td>
<td>25,000</td>
</tr>
<tr>
<td>Restricted to Rs. 1,50,000, being the maximum permissible deduction u/s 80C</td>
<td>1,50,000</td>
</tr>
<tr>
<td>Deduction under section 80CCC</td>
<td></td>
</tr>
<tr>
<td>- Contribution to approved pension fund of LIC</td>
<td>1,05,000</td>
</tr>
<tr>
<td>As per section 80CCE, the aggregate deduction under section 80C, 80CCC and 80CCD(1) has to be restricted to Rs. 1,50,000</td>
<td>2,55,000</td>
</tr>
</tbody>
</table>

Deduction allowable under Chapter VIA for the A.Y.2020-21

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
</table>

Illustration 7
Mr. A, aged 40 years, paid medical insurance premium of Rs. 20,000 during the P.Y.2019-20 to insure his health as well as the health of his spouse. He also paid medical insurance premium of Rs. 47,000 during the year to insure the health of his father, aged 63 years, who is not dependant on him. He contributed Rs. 3,600 to Central Government Health Scheme during the year. He has incurred Rs. 3,000 in cash on preventive health check-up of himself and his spouse and Rs. 4,000 by cheque on preventive health check-up of his father. Compute the deduction allowable under section 80D for the A.Y.2020-21.

Solution

Deduction allowable under section 80D for the A.Y.2020-21

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Actual Payment Rs.</th>
<th>Maximum deduction allowable Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>A. Premium paid and medical expenditure incurred for self and spouse</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(i) Medical insurance premium paid for self and spouse</td>
<td>20,000</td>
<td>20,000</td>
</tr>
<tr>
<td>(ii) Contribution to CGHS</td>
<td>3,600</td>
<td>3,600</td>
</tr>
<tr>
<td>(iii) Exp. on preventive health check-up of self &amp; spouse</td>
<td>3,000</td>
<td>1,400</td>
</tr>
<tr>
<td></td>
<td>26,600</td>
<td>25,000</td>
</tr>
</tbody>
</table>

11.10
B. Premium paid and medical expenditure incurred for father, who is a senior citizen

<table>
<thead>
<tr>
<th>Description</th>
<th>Rs.</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i) Mediclaim premium paid for father, who is over 60 years of age</td>
<td>47,000</td>
<td>47,000</td>
</tr>
<tr>
<td>(ii) Expenditure on preventive health check-up of father</td>
<td>4,000</td>
<td>3,000</td>
</tr>
<tr>
<td><strong>Total deduction under section 80D (Rs. 25,000 + Rs. 50,000)</strong></td>
<td><strong>51,000</strong></td>
<td><strong>50,000</strong></td>
</tr>
</tbody>
</table>

Notes:

1. The total deduction under A.(i), (ii) and (iii) above should not exceed Rs. 25,000. Therefore, the expenditure on preventive health check-up for self and spouse would be restricted to Rs. 1,400, being (Rs. 25,000 – Rs. 20,000 – Rs. 3,600).

2. The total deduction under B. (i) and (ii) above should not exceed Rs. 50,000. Therefore, the expenditure on preventive health check-up for father would be restricted to Rs. 3,000, being (Rs. 50,000 – Rs. 47,000).

3. In this case, the total deduction allowed on account of expenditure on preventive health check-up of self, spouse and father is Rs. 4,400 (i.e., Rs. 1,400 + Rs. 3,000), which is less than the maximum permissible limit of Rs. 5,000.

Illustration 8

Mr. Y, aged 40 years, paid medical insurance premium of Rs. 22,000 during the P.Y.2019-20 to insure his health as well as the health of his spouse and dependant children. He also paid medical insurance premium of Rs. 33,000 during the year to insure the health of his mother, aged 67 years, who is not dependant on him. He incurred medical expenditure of Rs. 20,000 on his father, aged 71 years, who is not covered under mediclaim policy. His father is also not dependent upon him. He contributed Rs. 6,000 to Central Government Health Scheme during the year. Compute the deduction allowable under section 80D for the A.Y.2020-21.

Solution

<table>
<thead>
<tr>
<th>Deduction allowable under section 80D for the A.Y.2020-21</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Particulars</strong></td>
</tr>
<tr>
<td>(i) Medical insurance premium paid for self, spouse and dependant children</td>
</tr>
<tr>
<td>(ii) Contribution to CGHS restricted to</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>(iii) Mediclaim premium paid for mother, who is over 60 years of age</td>
</tr>
<tr>
<td>(iv) Medical expenditure incurred for father, who is over 60 years of age and not covered by any insurance</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td></td>
</tr>
</tbody>
</table>

Illustration 9

Mr. X is a resident individual. He deposits a sum of Rs. 50,000 with Life Insurance Corporation every year for the maintenance of his handicapped grandfather who is wholly dependant upon him. The disability is one which comes under the Persons with Disabilities (Equal Opportunities, Protection of Rights and Full Participation) Act, 1995.
A copy of the certificate from the medical authority is submitted. Compute the amount of deduction available under section 80DD for the A.Y. 2020-21.

**Solution**

Since the amount deposited by Mr. X was for his grandfather, he will not be allowed any deduction under section 80DD. The deduction is available if the individual assessee incurs any expense for a dependant disabled relative. Grandfather does not come within the definition of dependant.

**Illustration 10**

*What will be the deduction if Mr. X had made this deposit for his dependant father?*

**Solution**

Since the expense was incurred for a dependant disabled relative, Mr. X will be entitled to claim a deduction of Rs. 75,000 under section 80DD, irrespective of the amount deposited. In case his father has severe disability, the deduction would be Rs. 1,25,000.

**Illustration 11**

*Mr. B has taken three education loans on April 1, 2019, the details of which are given below:*

<table>
<thead>
<tr>
<th>Loan 1</th>
<th>Loan 2</th>
<th>Loan 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>For whose education loan was taken</td>
<td>B</td>
<td>Son of B</td>
</tr>
<tr>
<td>Purpose of loan</td>
<td>MBA</td>
<td>B. Sc.</td>
</tr>
<tr>
<td>Amount of loan (Rs.)</td>
<td>5,00,000</td>
<td>2,00,000</td>
</tr>
<tr>
<td>Annual repayment of loan (Rs.)</td>
<td>1,00,000</td>
<td>40,000</td>
</tr>
<tr>
<td>Annual repayment of interest (Rs.)</td>
<td>20,000</td>
<td>10,000</td>
</tr>
</tbody>
</table>

Compute the amount deductible under section 80E for the A.Y.2020-21.

**Solution**

Deduction under section 80E is available to an individual assessee in respect of any interest paid by him in the previous year in respect of loan taken for pursuing his higher education or higher education of his spouse or children. Higher education means any course of study pursued after senior secondary examination. Therefore, interest repayment in respect of all the above loans would be eligible for deduction.

Deduction under section 80E = Rs. 20,000 + Rs. 10,000 + Rs. 18,000 = Rs. 48,000.

**Illustration 12**

*Mr. A purchased a residential house property for self-occupation at a cost of Rs. 45 lakh on 1.4.2017, in respect of which he took a housing loan of Rs. 35 lakh from Bank of India@11% p.a. on the same date. The loan was sanctioned on 28th March, 2017. Compute the eligible deduction in respect of interest on housing loan for A.Y.2020-21 under the provisions of the Income-tax Act, 1961, assuming that the entire loan was outstanding as on 31.3.2020 and he does not own any other house property.*

**Solution**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest deduction for A.Y.2020-21</td>
<td></td>
</tr>
<tr>
<td>(i) Deduction allowable while computing income under the head</td>
<td></td>
</tr>
</tbody>
</table>
(ii) Deduction under Chapter VI-A from Gross Total Income

Deduction under section 80EE Rs.1,85,000 (Rs. 3,85,000 – Rs. 2,00,000)
Restricted to Rs. 50,000

Illustration 13

The following are the particulars relating to Mr. A, Mr. B, Mr. C and Mr. D, salaried individuals, for A.Y.2020-21 –

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Mr. A</th>
<th>Mr. B</th>
<th>Mr. C</th>
<th>Mr. D</th>
</tr>
</thead>
<tbody>
<tr>
<td>Amount of loan taken</td>
<td>Rs. 43 lakhs</td>
<td>Rs. 45 lakhs</td>
<td>Rs. 20 lakhs</td>
<td>Rs. 15 lakhs</td>
</tr>
<tr>
<td>Loan taken from</td>
<td>HFC</td>
<td>Deposit taking NBFC</td>
<td>Deposit taking NBFC</td>
<td>Public sector bank</td>
</tr>
<tr>
<td>Date of sanction of loan</td>
<td>1.4.2019</td>
<td>1.4.2019</td>
<td>1.4.2019</td>
<td>30.3.2019</td>
</tr>
<tr>
<td>Date of disbursement of loan</td>
<td>1.5.2019</td>
<td>1.5.2019</td>
<td>1.5.2019</td>
<td>1.5.2019</td>
</tr>
<tr>
<td>Purpose of loan</td>
<td>Acquisition of residential house property for self-occupation</td>
<td>Acquisition of residential house property for self-occupation</td>
<td>Purchase of electric vehicle for personal use</td>
<td>Purchase of electric vehicle for personal use</td>
</tr>
<tr>
<td>Stamp duty value of house property</td>
<td>Rs. 45 lakhs</td>
<td>Rs. 48 lakhs</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Cost of electric vehicle</td>
<td>-</td>
<td>-</td>
<td>Rs. 22 lakhs</td>
<td>Rs. 18 lakhs</td>
</tr>
<tr>
<td>Rate of interest</td>
<td>9% p.a.</td>
<td>9% p.a.</td>
<td>10% p.a.</td>
<td>10% p.a.</td>
</tr>
</tbody>
</table>

Compute the amount of deduction, if any, allowable under the provisions of the Income-tax Act, 1961 for A.Y.2020-21 in the hands of Mr. A, Mr. B, Mr. C and Mr. D. Assume that there has been no principal repayment during the P.Y.2019-20.

Solution

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>Mr. A</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest deduction for A.Y.2020-21</td>
<td></td>
</tr>
<tr>
<td>(i) Deduction allowable while computing income under the head “Income from house property”</td>
<td></td>
</tr>
<tr>
<td>Deduction u/s 24(b) Rs. 3,54,750 [Rs. 43,00,000 × 9% x 11/12]</td>
<td></td>
</tr>
<tr>
<td>Restricted to</td>
<td></td>
</tr>
<tr>
<td>2,00,000</td>
<td></td>
</tr>
<tr>
<td>(ii) Deduction under Chapter VI-A from Gross Total Income</td>
<td></td>
</tr>
<tr>
<td>Deduction u/s 80EEA Rs. 1,54,750 (Rs. 3,54,750 – Rs. 2,00,000)</td>
<td></td>
</tr>
<tr>
<td>Restricted to</td>
<td></td>
</tr>
<tr>
<td>1,50,000</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Mr. B</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest deduction for A.Y.2020-21</td>
<td></td>
</tr>
<tr>
<td>(i) Deduction allowable while computing income under the head “Income from house property”</td>
<td></td>
</tr>
<tr>
<td>Deduction u/s 24(b) Rs. 3,71,250 [Rs. 45,00,000 × 9% x 11/12]</td>
<td></td>
</tr>
</tbody>
</table>
Deductions under Section 80EEA is not permissible since:

- (i) loan is taken from NBFC
- (ii) stamp duty value exceeds Rs. 45 lakh.

Deduction under section 80EEA would not be permissible due to either violation listed above.

Mr. C

Deduction under Section 80EEB for interest payable on loan taken for purchase of an electric vehicle [Rs. 20 lakhs × 10% × 11/12 = Rs. 1,83,333, restricted to Rs. 1,50,000, being the maximum permissible deduction]

Mr. D

Deduction under Section 80EEB is not permissible since loan was not sanctioned in the P.Y. 2019-20.

Illustration 14

Mr. Shiva aged 58 years, has gross total income of Rs. 7,75,000 comprising of income from salary and house property. He has made the following payments and investments:

- (i) Premium paid to insure the life of her major daughter (policy taken on 1.4.2017) (Assured value Rs. 1,80,000) – Rs. 20,000.
- (ii) Medical Insurance premium for self – Rs. 12,000; Spouse – Rs. 14,000.
- (iii) Donation to a public charitable institution registered under 80G Rs. 50,000 by way of cheque.
- (iv) LIC Pension Fund – Rs. 60,000.
- (v) Donation to National Children’s Fund - Rs. 25,000 by way of cheque
- (vi) Donation to Jawaharlal Nehru Memorial Fund - Rs. 25,000 by way of cheque
- (vii) Donation to approved institution for promotion of family planning - Rs. 40,000 by way of cheque
- (viii) Deposit in PPF – Rs. 1,00,000

Compute the total income of Mr. Shiva for A.Y. 2020-21.

Solution

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross Total Income</td>
<td>7,75,000</td>
<td></td>
</tr>
<tr>
<td>Less: Deduction under section 80C</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Deposit in PPF</td>
<td>1,00,000</td>
<td></td>
</tr>
<tr>
<td>Life insurance premium paid for insurance of major daughter (Maximum 10% of the assured value Rs. 1,80,000, as the policy is taken after 31.3.2012)</td>
<td>18,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>1,18,000</td>
<td></td>
</tr>
<tr>
<td>Deduction under section 80CCC in respect of LIC pension fund</td>
<td>60,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>1,78,000</td>
<td></td>
</tr>
<tr>
<td>As per section 80CCE, deduction under section 80C &amp; 80CCC is</td>
<td>1,15,000</td>
<td></td>
</tr>
</tbody>
</table>
Deductions under CH VIA AJ Education NeXt

11.15
restricted to

Deduction under section 80D
Medical Insurance premium in respect of self and spouse  26,000
Restricted to  25,000

Deduction under section 80G (See Working Note below)  87,500

Total income  5,12,500

Working Note: Computation of deduction under section 80G

<table>
<thead>
<tr>
<th>Particulars of donation</th>
<th>Amount donated (Rs.)</th>
<th>% of deduction</th>
<th>Deduction u/s 80G (Rs.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i) National Children’s Fund</td>
<td>25,000</td>
<td>100%</td>
<td>25,000</td>
</tr>
<tr>
<td>(ii) Jawaharlal Nehru Memorial Fund</td>
<td>25,000</td>
<td>50%</td>
<td>12,500</td>
</tr>
<tr>
<td>(iii) Approved institution for promotion of family planning</td>
<td>40,000</td>
<td>100%, subject to qualifying limit</td>
<td>40,000</td>
</tr>
<tr>
<td>(iv) Public Charitable Trust</td>
<td>1,50,000</td>
<td>50% subject to qualifying limit (See Note below)</td>
<td>10,000</td>
</tr>
</tbody>
</table>

87,500

Note - Adjusted total income = Gross Total Income – Amount of deductions under section 80C to 80U except section 80G i.e., Rs. 6,00,000, in this case.

Rs. 60,000, being 10% of adjusted total income is the qualifying limit, in this case.

Firstly, donation of Rs. 40,000 to approved institution for family planning qualifying for 100% deduction subject to qualifying limit, has to be adjusted against this amount. Thereafter, donation to public charitable trust qualifying for 50% deduction, subject to qualifying limit is adjusted. Hence, the contribution of Rs. 50,000 to public charitable trust is restricted to Rs. 20,000 (being, Rs. 60,000 - Rs. 40,000), 50% of which would be the deduction under section 80G. Therefore, the deduction under section 80G in respect of donation to public charitable trust would be Rs.10,000, which is 50% of Rs. 20,000.

Illustration 15

Mr. Ganesh, a businessman, whose total income (before allowing deduction under section 80GG) for A.Y.202-21 is Rs. 4,60,000, paid house rent at Rs. 12,000 p.m. in respect of residential accommodation occupied by him at Mumbai. Compute the deduction allowable to him under section 80GG for A.Y.2020-21.

Solution

The deduction under section 80GG will be computed as follows:

(i) Actual rent paid less 10% of total income

\[
\text{Rs. } 1,44,000 \left( - \frac{10 \times 4,60,000}{100} \right) = \text{Rs. } 98,000 \text{ (A)}
\]

(ii) 25% of total income

\[
\frac{25 \times 4,60,000}{100} = \text{Rs. } 1,15,000 \text{ (B)}
\]

(iii) Amount calculated at Rs. 5,000 p.m. = Rs. 60,000 (C)

Deduction allowable (least of A, B and C) = Rs. 60,000

11.15
**Illustration 16**

*During the P.Y.2019-20, ABC Ltd., an Indian company,*

1. contributed a sum of Rs. 2 lakh to an electoral trust; and
2. incurred expenditure of Rs. 25,000 on advertisement in a brochure of a political party.

*Is the company eligible for deduction in respect of such contribution/expenditure, assuming that the contribution was made by cheque? If so, what is the quantum of deduction?*

**Solution**

An Indian company is eligible for deduction under section 80GGB in respect of any sum contributed by it in the previous year to any political party or an electoral trust. Further, the word “contribute” in section 80GGB has the meaning assigned to it in section 293A of the Companies Act, 1956, and accordingly, it includes the amount of expenditure incurred on advertisement in a brochure of a political party.

Therefore, ABC Ltd. is eligible for a deduction of Rs. 2,25,000 under section 80GGB in respect of sum of Rs. 2 lakh contributed to an electoral trust and Rs. 25,000 incurred by it on advertisement in a brochure of a political party.

It may be noted that there is a specific disallowance under section 37(2B) in respect of expenditure incurred on advertisement in a brochure of a political party. Therefore, the expenditure of Rs. 25,000 would be disallowed while computing business income/gross total income. However, the said expenditure incurred by an Indian company is allowable as a deduction from gross total income under section 80GGB.

**Illustration 17**

*A (P) Ltd. was incorporated on 1.4.2017 and it holds a certificate of eligible business from the notified IMBC. It is engaged in innovation of new products.*

*Its total turnover and profits and gains from such business for the P.Y.2017-18 to P.Y.2023-24 are as follows:*

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Total turnover</td>
<td>15.42</td>
<td>18.36</td>
<td>20.21</td>
<td>22.72</td>
<td>24.95</td>
<td>23.52</td>
<td>24.68</td>
</tr>
<tr>
<td>Profits/Losses</td>
<td>(2.52)</td>
<td>(1.37)</td>
<td>6.52</td>
<td>8.13</td>
<td>9.87</td>
<td>7.59</td>
<td>9.42</td>
</tr>
</tbody>
</table>

*Is A (P) Ltd. eligible for any tax benefit under the provisions of the Income-tax Act, 1961 for A.Y. 2020-21? If yes, what is the benefit available?*

**Solution**

A (P) Ltd. is an eligible start-up, since –
1. it is a company engaged in eligible business of innovation of new products.
2. it is incorporated during the period 1.4.2016 to 31.3.2021.
3. its total turnover does not exceed Rs. 25 crores in the relevant previous years for which deduction is claimed (i.e., P.Y.2019-20 to P.Y.2021-22 (or) P.Y.2020-21 to P.Y.2022-23 (or) P.Y.2021-22 to P.Y.2023-24)
4. it holds a certificate of eligible business from the notified IMBC
Therefore, A (P) Ltd., being an eligible start-up, is eligible for deduction under section 80-IAC of 100% of the profits and gains derived by it from an eligible business for any three consecutive assessment years out of seven years beginning from the year in which the eligible start up is incorporated i.e., P.Y.2017-18.

In the first and second year i.e., P.Y.2017-18 and P.Y.2018-19, A (P) Ltd. has incurred a loss. In the current previous year i.e., P.Y.2019-20, A (P) Ltd. has earned profits from eligible business and can hence, claim 100% of its profits as deduction for any three consecutive assessment years under section 80-IAC from the P.Y.2019-20 to P.Y.2023-24. However, for P.Y.2019-20, the profits eligible for deduction would be the profits after set-off of brought forward losses of P.Y.2017-18 and P.Y. 2018-19.

Illustration 18

Mr. A has commenced the business of manufacture of computers on 1.4.2019. He employed 350 new employees during the P.Y.2019-20, the details of whom are as follows –

<table>
<thead>
<tr>
<th>No. of employees</th>
<th>Date of employment</th>
<th>Regular/Casual</th>
<th>Total monthly emoluments per employee (Rs.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i) 75</td>
<td>1.4.2019</td>
<td>Regular</td>
<td>24,000</td>
</tr>
<tr>
<td>(ii) 125</td>
<td>1.5.2019</td>
<td>Regular</td>
<td>26,000</td>
</tr>
<tr>
<td>(iii) 50</td>
<td>1.8.2019</td>
<td>Casual</td>
<td>25,500</td>
</tr>
<tr>
<td>(iv) 100</td>
<td>1.9.2019</td>
<td>Regular</td>
<td>24,000</td>
</tr>
</tbody>
</table>

The regular employees participate in recognized provident fund while the casual employees do not. Compute the deduction, if any, available to Mr. A for A.Y.2019-20, if the profits and gains derived from manufacture of computers that year is Rs. 75 lakhs and his total turnover is Rs. 2.16 crores.

What would be your answer if Mr. A has commenced the business of manufacture of apparel on 1.4.2019?

Solution

Mr. A is eligible for deduction under section 80JJAA since he is subject to tax audit under section 44AB for A.Y.2020-21, as his total turnover from business exceeds Rs. 1 crore and he has employed “additional employees” during the P.Y.2019-20.

I If Mr. A is engaged in the business of manufacture of computers

Additional employee cost = Rs. 24,000 × 12 × 75 [See Working Note below] = Rs. 2,16,00,000

Deduction under section 80JJAA = 30% of Rs.2,16,00,000 = Rs. 64,80,000.

Working Note:

Number of additional employees

<table>
<thead>
<tr>
<th>Particulars</th>
<th>No. of workmen</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total number of employees employed during the year</td>
<td>350</td>
</tr>
<tr>
<td>Less: Casual employees employed on 1.8.2018 who do not participate in recognized provident fund</td>
<td>50</td>
</tr>
<tr>
<td>Regular employees employed on 1.5.2018, since their total monthly emoluments exceed Rs.25,000</td>
<td>125</td>
</tr>
<tr>
<td>Regular employees employed on 1.9.2018 since they have been employed for less than 240 days in the P.Y.2018-19.</td>
<td>100</td>
</tr>
<tr>
<td>Number of “additional employees”</td>
<td>75</td>
</tr>
</tbody>
</table>
Note –
(i) Since casual employees do not participate in recognized provident fund, they do not qualify as additional employees. Further, 125 regular employees employed on 1.5.2019 also do not qualify as additional employees since their monthly emoluments exceed Rs. 25,000. Also, 100 regular employees employed on 1.9.2019 do not qualify as additional employees for the P.Y.2019-20, since they are employed for less than 240 days in that year. Therefore, only 75 employees employed on 1.4.2019 qualify as additional employees, and the total emoluments paid or payable to them during the P.Y.2019-20 is deemed to be the additional employee cost.
(ii) As regards 100 regular employees employed on 1.9.2019, they would be treated as additional employees for previous year 2020-21, if they continue to be employees in that year for a minimum period of 240 days. Accordingly, 30% of additional employee cost in respect of such employees would be allowable as deduction under section 80JJAA in the hands of Mr. A for the A.Y. 2021-22.

II If Mr. A is engaged in the business of manufacture of apparel

If Mr. A is engaged in the business of manufacture of apparel, then, he would be entitled to deduction under section 80JJAA in respect of employee cost of regular employees employed on 1.9.2019, since they have been employed for more than 150 days in the previous year 2019-20.

Additional employee cost = Rs. 2,16,00,000 + Rs. 24,000 × 7 × 100 = Rs. 3,84,00,000
Deduction under section 80JJAA = 30% of Rs. 3,84,00,000 = Rs. 1,15,20,000

Illustration 19

Mr. A, a resident individual aged about 61 years, has earned business income (computed) of Rs. 1,35,000, lottery income of Rs. 1,20,000 (gross) during the P.Y. 2019-20. He also has interest on Fixed Deposit of Rs. 30,000 with banks. He invested an amount of Rs. 1,50,000 in Public Provident Fund account. What is the total income of Mr. A for the A.Y.2020-21?

Solution

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

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profits and gains of business or profession</td>
<td>1,35,000</td>
<td></td>
</tr>
<tr>
<td>Income from other sources</td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Interest on Fixed Deposit with banks</td>
<td>30,000</td>
<td></td>
</tr>
<tr>
<td>- lottery income</td>
<td>1,20,000</td>
<td></td>
</tr>
<tr>
<td>Gross Total Income</td>
<td>2,85,000</td>
<td></td>
</tr>
<tr>
<td>Less: Deductions under Chapter VIA [See Note below]</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Under section 80C</td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Deposit in Public Provident Fund</td>
<td>1,50,000</td>
<td></td>
</tr>
<tr>
<td>Under section 80TTB</td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Interest on fixed deposits with banks</td>
<td>30,000</td>
<td></td>
</tr>
<tr>
<td>Restricted to</td>
<td>1,80,000</td>
<td>1,65,000</td>
</tr>
</tbody>
</table>

11.18
Total Income  |  1,20,000

Note: In case of resident individuals of the age of 60 years or more, interest on bank fixed deposits qualifies for deduction upto Rs. 50,000 under section 80TTB.

Though the value of eligible deductions is Rs. 1,80,000, however, deduction under Chapter VI-A cannot exceed the gross total income exclusive of long term capital gains taxable under section 112 and section 112A, short-term capital gains covered under section 111A and winnings of lotteries of the assessee.

Therefore, the maximum permissible deduction under Chapter VI-A = Rs. 2,85,000 – Rs. 1,20,000 = Rs. 1,65,000.

Illustration 20

Mr. Gurnam, aged 42 years, has salary income (computed) of Rs. 5,50,000 for the previous year ended 31.03.2020. He has earned interest of Rs. 14,500 on the saving bank account with State Bank of India during the year. Compute the total income of Mr. Gurnam for the assessment year 2020-21 from the following particulars:

(i) Life insurance premium paid to Birla Sunlife Insurance in cash amounting to Rs. 25,000 for insurance of life of his dependant parents. The insurance policy was taken on 15.07.2017 and the sum assured on life of his dependant parents is Rs. 2,00,000.

(ii) Life insurance premium of Rs. 25,500 paid for the insurance of life of his major son who is not dependant on him. The sum assured on life of his son is Rs. 2,50,000 and the life insurance policy was taken on 30.3.2012.

(iii) Life insurance premium paid by cheque of Rs. 22,500 for insurance of his life. The insurance policy was taken on 08.09.2016 and the sum assured is Rs. 2,00,000.

(iv) Premium of Rs. 26,000 paid by cheque for health insurance of self and his wife.

(v) Rs. 1,500 paid in cash for his health check-up and Rs. 4,500 paid in cheque for health check-up for his parents, who are senior citizens.

(vi) Paid interest of Rs. 6,500 on loan taken from bank for MBA course pursued by his daughter.

(vii) A sum of Rs. 15,000 donated in cash to an institution approved for purpose of section 80G for promoting family planning.

Solution

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
<th>Rs.</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income from salary</td>
<td>5,50,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interest on saving bank deposit</td>
<td>14,500</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Gross Total Income</strong></td>
<td>5,64,500</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Less: Deduction under Chapter VI-A</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Under section 80C (See Note 1)</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Life insurance premium paid for life insurance of:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- major son</td>
<td>25,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>- self Rs. 22,500 restricted to 10% of Rs. 2,00,000</td>
<td>20,000</td>
<td>45,000</td>
<td></td>
</tr>
<tr>
<td><strong>Under section 80D (See Note 2)</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Premium paid for health insurance of self and wife by cheque</td>
<td>25,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Payment made for health check-up for parents:</td>
<td>4,500</td>
<td>29,500</td>
<td></td>
</tr>
</tbody>
</table>
Deductions under CH VIA AJ Education NeXt

Under section 80E
For payment of interest on loan taken from bank for MBA course of his daughter

Under section 80TTA (See Note 4)
Interest on savings bank account Rs. 14,500 restricted to

Total Income

Notes:

(1) As per section 80C, no deduction is allowed in respect of premium paid for life insurance of parents whether they are dependant or not. Therefore, no deduction is allowable in respect of Rs. 25,000 paid as premium for life insurance of dependant parents of Mr. Gurnam.

In respect of insurance policy issued after 01.04.2012, deduction shall be allowed for life insurance premium paid only to the extent of 10% of sum assured. In case the insurance policy is issued before 01.04.2012, deduction of premium paid on life insurance policy shall be allowed up to 20% of sum assured.

Therefore, in the present case, deduction of Rs. 25,500 is allowable in respect of life insurance of Mr. Gurnam’s son since the insurance policy was issued before 01.04.2012 and the premium amount is less than 20% of Rs. 2,50,000. However, in respect of premium paid for life insurance policy of Mr. Gurnam himself, deduction is allowable only up to 10% of Rs. 2,00,000 since the policy was issued after 01.04.2012 and the premium amount exceeds 10% of sum assured.

(2) As per section 80D, in case the premium is paid in respect of health of a person specified therein and for health check-up of such person, deduction shall be allowed up to Rs. 25,000. Further, deduction up to Rs. 5,000 in aggregate shall be allowed in respect of health check-up of self, spouse, children and parents. In order to claim deduction under section 80D, the payment for health check-up can be made in any mode including cash. However, the payment for health insurance premium has to be paid in any mode other than cash.

Therefore, in the present case, in respect of premium of Rs. 26,000 paid for health insurance of self and wife, deduction would be restricted to Rs. 25,000. Since the limit of Rs. 25,000 has been exhausted against medical insurance premium, no deduction is allowable for preventive health check-up for self and wife. However, deduction of Rs. 4,500 is allowable in respect of health check-up of his parents, since it falls within the limit of Rs. 5,000.

(3) No deduction shall be allowed under section 80G in case the donation is made in cash of a sum exceeding Rs. 2,000. Therefore, no deduction is allowed under section 80G in respect of donation made to institution approved therein.

(4) As per section 80TTA, deduction shall be allowed from the gross total income of an individual or Hindu Undivided Family in respect of income by way of interest on deposit in the savings account included in the assessee’s gross total income, subject to a maximum of Rs. 10,000. Therefore, a deduction of Rs. 10,000 is allowable from the gross total income of Mr. Gurnam, though the interest from savings bank account is Rs. 14,500.

**********************************************************************
Deductions under CH VIA AJ Education NeXt

<table>
<thead>
<tr>
<th>Under section 80E</th>
</tr>
</thead>
<tbody>
<tr>
<td>For payment of interest on loan taken from bank for MBA course of his daughter</td>
</tr>
<tr>
<td>6,500</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Under section 80TTA (See Note 4)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest on savings bank account Rs. 14,500 restricted to</td>
</tr>
<tr>
<td>10,000</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Total Income</th>
</tr>
</thead>
<tbody>
<tr>
<td>4,37,500</td>
</tr>
</tbody>
</table>
Question 1

XYZ Ltd. is engaged in the manufacture of textiles since 01-04-2009. Its Statement of Profit & Loss shows a profit of Rs. 700 lakhs after debit/credit of the following items:

1. Depreciation calculated on the basis of useful life of assets as per provisions of the Companies Act, 2013 is Rs. 50 lakhs.
2. Employer's contribution to EPF of Rs. 2 lakhs and Employees' contribution of Rs. 2 lakhs for the month of March, 2020 were remitted on 8th May 2020.
3. The company appended a note to its Income Statement that industrial power tariff concession of Rs. 2.5 lakhs was received from the State Government and credited the same to Statement of P & L.
4. The company had provided an amount of Rs. 25 lakhs being sum estimated as payable to workers based on agreement to be entered with the workers union towards periodical wage revision once in 3 years. The provision is based on a fair estimation on wage and reasonable certainty of revision once in 3 years.
5. The company had made a provision of 10% of its debtors towards bad and doubtful debts. Total sundry debtors of the company as on 31-03-2020 was Rs. 200 lakhs.
6. A debtor who owed the company an amount of Rs. 40 lakhs was declared insolvent and hence, was written off by debit to Statement of Profit and loss.
7. Sundry creditors include an amount of Rs. 50 lakhs payable to A & Co, towards supply of raw materials, which remained unpaid due to quality issues. An agreement has been made on 31-03-2020, to settle the amount at a discount of 75% of the outstanding. The amount waived is credited to Statement of Profit and Loss.
8. The opening and closing stock for the year were Rs. 200 lakhs and Rs. 255 lakhs, respectively. They were overvalued by 10%.
9. Provision for gratuity based on actuarial valuation was Rs. 500 lakhs. Actual gratuity paid debited to gratuity provision account was Rs. 300 lakhs.
10. Commission of Rs. 1 lakhs paid to a recovery agent for realization of a debt. Tax has been deducted and remitted as per Chapter XVIIIB of the Act.
11. The company has purchased 500 tons of industrial paper as packing material at a price of Rs. 30,000/ton from PQR, a firm in which majority of the directors are partners. PQR's normal selling price in the market for the same material is Rs. 28,000/ton.

Additional Information:

1. There was an addition to Plant & Machinery amounting to Rs. 50 lakhs on 10-06-2019, which was used for more than 180 days during the year. Additional depreciation has not been adjusted in the books.
2. Normal depreciation calculated as per income-tax rules is Rs. 80 lakhs.
3. The company had credited a sub-contractor an amount of Rs. 10 lakhs on 31-03-2019 towards repairing a machinery component. The tax so deducted was remitted on 31-12-2019.
4. The company has collected Rs. 7 lakhs as sales tax from its customers and paid the same on the due dates. However, on an appeal made, the High Court directed the Sales Tax Department to refund Rs. 3 lakhs to the company. The company in turn refunded
Rs. 2 lakhs to the customers from whom the amount was collected and the balance of Rs. 1 lakh is still lying under the head “Current Liabilities”.

Compute total income and tax payable for A.Y. 2020-21. Ignore MAT provisions.

Note - The turnover of XYZ Ltd. for the P.Y.2017-18 was Rs. 405 crore.

Answer

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

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Amount (Rs.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profits and Gains from Business and Profession</td>
<td></td>
</tr>
<tr>
<td>Profit as per Statement of profit and loss account</td>
<td>7,00,00,000</td>
</tr>
<tr>
<td><strong>Add: Items debited but to be considered separately or to be disallowed</strong></td>
<td></td>
</tr>
<tr>
<td>(a) Depreciation as per Companies Act, 2013</td>
<td>50,00,000</td>
</tr>
<tr>
<td>(b) Employees’ contribution to EPF [See Note 1 below]</td>
<td>2,00,000</td>
</tr>
<tr>
<td>[(Since employees’ contribution to EPF has not been deposited on or before the due date under the PF Act, the same is not allowable as deduction as per section 36(1)(va). Since the same has been debited to profit and loss account, it has to be added back for computing business income).]</td>
<td></td>
</tr>
<tr>
<td>(c) Employers contribution to EPF</td>
<td>Nil</td>
</tr>
<tr>
<td>[(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)]</td>
<td></td>
</tr>
<tr>
<td>(d) Provision for wages payable to workers</td>
<td>Nil</td>
</tr>
<tr>
<td>[(The provision is based on fair estimate of wages and reasonable certainty of revision, the provision is allowable as deduction, since ICDS X requires ‘reasonable certainty for recognition of a provision, which is present in this case. As the provision has been debited to profit and loss account, no adjustment is required while computing business income)]</td>
<td></td>
</tr>
<tr>
<td>(e) Provision for doubtful debts [10% of Rs. 200 lakhs]</td>
<td>20,00,000</td>
</tr>
<tr>
<td>[(Provision for doubtful debts is allowable as deduction under section 36(1)(viia) only in case of banks, public financial institutions, state financial corporations, state industrial investment corporations and non-banking financial corporations. Such provision is not allowable as deduction in the case of a manufacturing company. Since the same has been debited to profit and loss account, it has to be added back for computing business income)]</td>
<td></td>
</tr>
<tr>
<td>(f) Bad debts written off</td>
<td>Nil</td>
</tr>
<tr>
<td>[(Bad debts write off in the book of account is allowable as deduction under section 36(1)(vii). Since the same has already been debited to profit and loss account, no further adjustment is required)]</td>
<td></td>
</tr>
<tr>
<td>(g) Provision for gratuity</td>
<td>2,00,00,000</td>
</tr>
<tr>
<td>[(Provision of Rs. 500 lakhs for gratuity based on actuarial valuation is not allowable as deduction as per)]</td>
<td></td>
</tr>
</tbody>
</table>
section 40A(7). However, actual gratuity of Rs. 300 lakhs paid is allowable as deduction. Hence, the difference has to be added back]

(h) Commission paid to recovery agent for realization of a debt.
[Commission of Rs. 1 lakh paid to a recovery agent for realisation of a debt is an allowable expense under section 37 as per DCIT v. Super Tannery (India) Ltd. (2005) 274 ITR 338 (All). Since the same has been debited to profit and loss account, no further adjustment is required]

(i) Purchase of paper at a price higher than the fair market value
[As per section 40A(2), the difference between the purchase price (Rs. 30,000 per ton) and the fair market value (Rs. 28,000 per ton) multiplied by the quantity purchased (500 tons) has to be added back since the purchase is from a related party, a firm in which majority of the directors are partners, at a price higher than the fair market value]

(j) Sales tax not refunded to customers out of sales tax refund
[The amount of sales tax refunded to the company by the Government is a revenue receipt chargeable to tax under section 41(1). Deduction can be claimed of amount refunded to customers [CIT v. Thirumalaiswamy Naidu & Sons (1998) 230 ITR 534 (SC)]. Hence, the net amount of Rs. 1,00,000 (i.e., Rs. 3,00,000 minus Rs. 2,00,000) would be chargeable to tax]

(k) Industrial power tariff concession received from State Government
[Any assistance in the form of, inter alia, concession received from the Central or State Government would be treated as income as per section 2(24)(xviii). Since the same has been credited to Statement of profit and loss, no adjustment is required.

(l) Discount given by Sundry Creditors for supply of raw materials
[Discount of 75% given by Sundry Creditors for supply of raw materials is taxable under section 41(1). Since the same has already been credited to Statement of profit and loss, no further adjustment is required]

(m) Depreciation as per Income-tax Act, 1961

(n) Over-valuation of stock [Rs. 55 lakhs × 10/110]
[The amount by which stock is over-valued has to be reduced for computing business income. Rs. 50 lakhs, being the difference between closing and opening stock, has to be adjusted to remove the effect of over-valuation]

(o) Additional Depreciation[See Note 2 below]

Less: Items credited but to be considered separately/ permissible expenditure and allowances

(k) Nil

(l) Nil

(m) 80,00,000

(n) 5,00,000

(o) 10,00,000

Total: 9,83,00,000
[Additional depreciation@20% is allowable on Rs. 50 lakhs, being actual cost of new plant & machinery acquired on 10.06.2019, as the same was put to use for more than 180 days in the P.Y.2019-20.]

Payment to a sub-contractor where tax deducted last year was remitted after the due date of filing of return [See Note 3 below]

[30% of Rs. 10 lakhs, being payment to a sub-contractor, would have been disallowed under section 40(a)(ia) while computing the business income of A.Y.2019-20, since tax deducted was remitted after the due date of filing of return. However, the same is allowable in A.Y.2020-21, since the remittance has been made on 31.12.2019]

Total Income

Computation of tax liability of XYZ Ltd. for A.Y.2020-21

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax @30% on the above total income (since the turnover exceeded Rs. 400 crore in the P.Y. 2017-18)</td>
<td>2,65,50,000</td>
</tr>
<tr>
<td><strong>Add:</strong> Surcharge@7% (since total income exceeds Rs. 1 crore but less than Rs. 10 crore)</td>
<td>18,58,500</td>
</tr>
<tr>
<td><strong>Add:</strong> Health and Education cess@4%</td>
<td>11,36,340</td>
</tr>
<tr>
<td><strong>Total tax liability</strong></td>
<td><strong>2,95,44,840</strong></td>
</tr>
</tbody>
</table>

Notes:

(1) 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.

The CBDT has, vide Circular No. 22/2015, dated 17.12.2015, clarified that the employer contribution to provident fund remitted on or before due date of filing of return under section 139(1), is allowable as deduction while computing Business Income. Further, it has also clarified that the circular does not apply to claim of deduction relating to employee’s contribution welfare funds which are governed by section 36(1)(va) of the Act.

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 Polysfabriks 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.
(2) Rs. 50 lakhs, being the addition to plant and machinery on 10.6.2019 qualifies for additional depreciation@20% under section 32(1)(iia). Since only the normal depreciation as per Income- tax Rules, 1962, has been debited to profit and loss account, additional depreciation of Rs. 10 lakhs (being 20% of Rs. 50 lakhs) has to be deducted while computing business income.

(3) Since the tax deducted during the P.Y.2018-19 was remitted only on 31.12.2019, i.e., after the due date of filing of return for A.Y.2019-20, Rs. 3,00,000, being 30% of Rs. 10 lakh would have been disallowed while computing the business income of that year. Since the tax deducted has been remitted on 31.12.2019, Rs. 3,00,000 would be allowed as deduction while computing the business income of the A.Y.2020-21.

Question 2

Parik Hospitality Limited is engaged in the business of running hotels of 3-star category. The company's Statement of Profit and Loss for the previous year ended 31 March, 2020 shows a profit of Rs. 152 lakhs after debiting or crediting the following items:

(a) Payment of Rs. 0.25 lakh and Rs. 0.30 lakh in cash on 3rd December, 2019 and 10th December, 2019 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 80CCD for a sum of Rs. 3 lakhs calculated at 12% of basic salary and Dearness Allowance payable to the employees.

(c) Payment of Rs. 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 opts for presumptive taxation under section 44AE and has furnished a declaration to this effect. It also furnished its Permanent Account Number in the tender document.

(d) Profit of Rs. 12 lakhs on sale of a 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, 2018.

(e) Contribution of Rs. 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 Rs. 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 Rs. 1 lakh paid to independent directors for attending Board meeting without deduction of tax at source under section 194J.

(h) Depreciation charged Rs. 10 lakhs.

(i) Rs. 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 2015-16.

(j) Dividend received from a foreign company Rs. 5 lakhs.

Additional information:

(i) As a corporate debt restructuring, the bank has converted unpaid interest of Rs. 10 lakhs upto 31st March, 2019 into a new loan account repayable in five equal annual...
installments. The first installment of Rs. 2 lakhs was paid in March, 2020 by debiting new loan account.

(ii) Depreciation as per Income-tax Act, 1961 Rs. 15 lakhs.

(iii) The company received a bill for Rs. 2 lakhs on 31st March 2020 from a supplier of vegetables for supply made in March, 2020. The bill was omitted to be recorded in the books in March, 2020. The bill was paid in April, 2020 and the necessary entry was made in the books then.

Compute total income of Parik Hospitality Limited for the Assessment Year 2020-21 indicating the reason for treatment of each item. Ignore the provisions relating to minimum alternate tax.

**Answer**

**Computation of Total Income of Parik Hospitality Ltd. for the A.Y.202-21**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Amount (Rs.)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Profits and Gains from Business and Profession</strong></td>
<td></td>
</tr>
<tr>
<td>Profit as per Statement of profit and loss</td>
<td>1,52,00,000</td>
</tr>
<tr>
<td>Add: Items debited but to be considered separately or to be disallowed</td>
<td></td>
</tr>
<tr>
<td>(a) Payment to middleman for purchase of crab etc. in an amount exceeding</td>
<td>30,000</td>
</tr>
<tr>
<td>Rs. 10,000 [Under section 40A(3), disallowance is attracted in respect of</td>
<td></td>
</tr>
<tr>
<td>expenditure for which cash payment exceeding Rs. 10,000 is made on a day</td>
<td></td>
</tr>
<tr>
<td>to a person. Payment of Rs. 25,000 to fishermen for purchase of crab etc.</td>
<td></td>
</tr>
<tr>
<td>is covered by exception under Rule 6DD. However, payment of Rs. 30,000 to</td>
<td></td>
</tr>
<tr>
<td>middlemen for purchase of crab etc. is not covered under the exception -</td>
<td></td>
</tr>
<tr>
<td>CBDT Circular 10/2008 dated 5/12/2008].</td>
<td></td>
</tr>
<tr>
<td>(b) Contribution towards employees’ pension scheme in excess of 10% of</td>
<td>50,000</td>
</tr>
<tr>
<td>salary disallowed under section 40A(9) [Contribution to the extent of 10%</td>
<td></td>
</tr>
<tr>
<td>of salary (basic salary + dearness allowance, if it forms part of pay for</td>
<td></td>
</tr>
<tr>
<td>retirement benefits) is allowable as deduction under section 36(1)(iva).</td>
<td></td>
</tr>
<tr>
<td>In this case, it is presumed that dearness allowance forms part of pay for</td>
<td></td>
</tr>
<tr>
<td>retirement benefits]</td>
<td></td>
</tr>
<tr>
<td>(c) Payment to transport contractor without deduction of tax at source</td>
<td>-</td>
</tr>
<tr>
<td>[Since the contractor opts for presumptive taxation under section 44AE and</td>
<td></td>
</tr>
<tr>
<td>furnished a declaration to this effect, tax is not required to be deducted</td>
<td></td>
</tr>
<tr>
<td>at source under section 194C in respect of payment to transport contractor].</td>
<td></td>
</tr>
<tr>
<td>(f) Expenses on foreign travel of two directors for a collaboration</td>
<td>10,00,000</td>
</tr>
<tr>
<td>agreement which failed to materialize [Where expenditure is incurred for</td>
<td></td>
</tr>
<tr>
<td>a project not related the existing business and the project was abandoned</td>
<td></td>
</tr>
<tr>
<td>without creating a new asset, the expenses are capital in nature as per</td>
<td></td>
</tr>
<tr>
<td>Mc Gaw-Ravindra Laboratories (India) Ltd. v. CIT (1994) 210 ITR 1002 (Guj.).</td>
<td></td>
</tr>
<tr>
<td>Brewery project is not related to the existing business of running three</td>
<td></td>
</tr>
<tr>
<td>star</td>
<td></td>
</tr>
</tbody>
</table>
(g) Fees paid to directors without deducting tax at source [30% of Rs. 1 lakh]
[Disallowance@30% would be attracted under section 40(a)(i) for non-deduction of tax at source from director’s remuneration on which tax is deductible under section 194J]

<table>
<thead>
<tr>
<th>Item</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>(g) Fees paid to directors without deducting tax at source [30% of Rs. 1 lakh]</td>
<td>30,000</td>
</tr>
</tbody>
</table>

Less: Items credited but to be considered separately / Expenditure to be allowed

(d) Profit on sale of plot of land to 100% subsidiary
[Short-term capital gains arises on sale of plot of land held for less than 24 months. However, in this case, since the transfer is to a 100% subsidiary company and the subsidiary company is an Indian company, the same would not constitute a transfer for levy of capital gains tax as per section 47(iv). Since this amount has been credited to the statement of profit and loss, the same has to be deducted for computing business income].

<table>
<thead>
<tr>
<th>Item</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>(d) Profit on sale of plot of land to 100% subsidiary</td>
<td>12,00,000</td>
</tr>
</tbody>
</table>

(e) Contribution to IIT for scientific research
[Contribution to IIT for scientific research programme approved by the prescribed authority qualifies for weighted deduction@150% under section 35(2AA). Since 100% of contribution has already been debited to the statement of profit and loss, the balance 50% has to be deducted while computing business income].

<table>
<thead>
<tr>
<th>Item</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>(e) Contribution to IIT for scientific research</td>
<td>1,25,000</td>
</tr>
</tbody>
</table>

(h) Depreciation
[Depreciation allowable under the Income-tax Act, 1961 is Rs.15 lakhs whereas the depreciation as per books of account debited to the statement of profit and loss is Rs. 10 lakhs. Hence, the additional amount of Rs. 5 lakhs has to be deducted while computing business income].

<table>
<thead>
<tr>
<th>Item</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>(h) Depreciation</td>
<td>5,00,000</td>
</tr>
</tbody>
</table>

(i) Additional compensation received from State Government
[Since the additional compensation has been received pursuant to an interim order of the Court, the same would be deemed as income chargeable to tax under the head “Capital Gains” in the year of final order as per section 45(5). Since the compensation has been credited to the statement of profit and loss, the same has to be deducted while computing business income].

<table>
<thead>
<tr>
<th>Item</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i) Additional compensation received from State Government</td>
<td>10,00,000</td>
</tr>
</tbody>
</table>

(j) Dividend received from foreign company
[Dividend received from foreign company is taxable under the head “Income from other sources”. Since the said dividend has been credited to the statement of profit and loss, the same has to be deducted while computing business income].

<table>
<thead>
<tr>
<th>Item</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>(j) Dividend received from foreign company</td>
<td>5,00,000</td>
</tr>
</tbody>
</table>

(i) Interest paid during the year
[Conversion of unpaid interest into loan shall not be construed as payment of interest for the purpose section 43B. The amount of unpaid interest converted into a new...]

<table>
<thead>
<tr>
<th>Item</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i) Interest paid during the year</td>
<td>2,00,000</td>
</tr>
</tbody>
</table>
loan will be allowable as deduction only in the year in which such converted loan is actually paid. Since Rs. 2 lakhs has been paid in the P.Y.2019-20, the same is allowable as deduction.

(iii) Purchases omitted to be recorded in the books
[Since the purchase is made in March, 2020 (i.e., P.Y.2019 - 20), in respect of which bill of Rs. 2 lakhs received on 31.3.2020 has been omitted to be recorded in the books in that year, it has to be deducted to compute the business income [Kedarnath Jute Manufacturing Company Ltd. v. CIT (1971) 82 ITR 363 (SC)]. It is logical to assume that the company is following mercantile system of accounting].

### Income under the head “Profits and Gains of Business or Profession”

### Income from Other Sources

Dividend received from foreign company
[Dividend received from a foreign company is chargeable to tax under the head “Income from other sources”].

### Gross Total Income

1,25,85,000

Less: Deduction under Chapter VI-A
Nil

### Total Income

1,25,85,000

---

**Question 3**

**Hyper Ltd.,** engaged in diversified activities, earned a profit of Rs. 14,25,000 after debit/credit of the following items to its statement of profit and loss account for the year ended on 31.3.2020:

(a) Items debited to Statement of Profit and Loss Account

<table>
<thead>
<tr>
<th>Item</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Provision for loss of subsidiary</td>
<td>70,000</td>
</tr>
<tr>
<td>Provision for income-tax demand</td>
<td>1,05,000</td>
</tr>
<tr>
<td>Expenses on purchase/sale of equity shares</td>
<td>15,000</td>
</tr>
<tr>
<td>Depreciation</td>
<td>3,60,000</td>
</tr>
<tr>
<td>Interest on deposit credited to buyers on 31.3.2020 for advance received from them, on which TDS was deducted in April 2020 and was deposited on 31.7.2020</td>
<td>1,00,000</td>
</tr>
</tbody>
</table>

(b) Items credited to Statement of Profit and Loss Account

<table>
<thead>
<tr>
<th>Item</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Long term capital gain on sale of equity shares on which securities transaction tax was paid at the time of acquisition and sale of units of UTI</td>
<td>3,60,000</td>
</tr>
<tr>
<td>Income from units of UTI</td>
<td>75,000</td>
</tr>
</tbody>
</table>

The company provides the following additional information:

(i) Depreciation includes Rs. 1,50,000 on account of revaluation of fixed assets.

(ii) Depreciation allowable as per Income-tax Rules is Rs. 2,80,000.

(iii) Brought forward Business Loss/Unabsorbed Depreciation:

<table>
<thead>
<tr>
<th>F.Y.</th>
<th>Amount as per books</th>
<th>Amount as per Income-tax</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Loss Rs.</td>
<td>Depreciation Rs.</td>
</tr>
<tr>
<td>2015-2016</td>
<td>2,50,000</td>
<td>3,00,000</td>
</tr>
<tr>
<td>2016-2017</td>
<td>Nil</td>
<td>2,70,000</td>
</tr>
</tbody>
</table>
You are required to:

(i) compute the total income of the company for the assessment year 2020-21 giving the reasons for treatment of items and

(ii) examine the applicability of section 115JB of the Income-tax Act, 1961, and compute book profit and the tax credit to be carried forward.

Assume the tax rate applicable to Hyder Ltd for the P.Y. 2019-20 is 30%. Ignore the provisions of section 115BAA.

Answer

**Computation of total income of M/s Hyper Ltd. for the A.Y. 2020-21**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profit as per Statement of Profit &amp; Loss Account</td>
<td>14,25,000</td>
<td></td>
</tr>
<tr>
<td><strong>Add: Items disallowed /considered separately</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Provision for loss of subsidiary [since it is not wholly and exclusively for the purpose of business of the assessee]</td>
<td>70,000</td>
<td></td>
</tr>
<tr>
<td>Provision for income-tax [disallowed under section 40(a)(ii)]</td>
<td>1,05,000</td>
<td></td>
</tr>
<tr>
<td>Expenses on transfer of shares [not deductible from business income. It is to be deducted from gross sale consideration while computing capital gains]</td>
<td>15,000</td>
<td></td>
</tr>
<tr>
<td>Interest on deposit credited on 31.3.2020 and tax deducted in April 2020 which was deposited on 31.7.2020 [not allowed under section 40(a)(ia) @ 30%].</td>
<td>30,000</td>
<td></td>
</tr>
<tr>
<td>Depreciation debited to statement of profit and loss account [only depreciation calculated as per the Income-tax Rules, 1962 is allowable as deduction]</td>
<td>3,60,000</td>
<td></td>
</tr>
<tr>
<td><strong>Less: Items credited but not includible under business income or are exempt under the provisions of the Act</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Long-term capital gain on sale of equity shares on which securities transaction tax was paid, since it is not a business income.</td>
<td>3,60,000</td>
<td></td>
</tr>
<tr>
<td>Income from UTI, since it is not a business income.</td>
<td>75,000</td>
<td></td>
</tr>
<tr>
<td><strong>Less: Depreciation (allowable as per the Income-tax Rules, 1962)</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Less: Set-off of brought forward business loss and unabsorbed depreciation</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Brought forward business loss under section 72</td>
<td>4,20,000</td>
<td></td>
</tr>
<tr>
<td>Brought forward depreciation under section 32</td>
<td>6,40,000</td>
<td></td>
</tr>
<tr>
<td><strong>Income from business</strong></td>
<td>2,30,000</td>
<td></td>
</tr>
<tr>
<td><strong>Capital Gains</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Long term capital gain on sale of equity shares on which securities transaction tax was paid at the time of acquisition and sale</td>
<td>3,60,000</td>
<td></td>
</tr>
<tr>
<td><strong>Income from Other Sources</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Income from units of UTI</td>
<td>75,000</td>
<td></td>
</tr>
<tr>
<td><strong>Less: Exempt under section 10(35)</strong></td>
<td>75,000</td>
<td></td>
</tr>
<tr>
<td>Nil</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Assessment of Various Entities

<table>
<thead>
<tr>
<th>Total Income</th>
<th>5,90,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax on LTCG exceeding Rs. 1 lakh @10%</td>
<td>26,000</td>
</tr>
<tr>
<td>Tax on other income of Rs. 2,30,000 @30%</td>
<td>69,000</td>
</tr>
<tr>
<td>Add: Health and Education cess @4%</td>
<td>95,000</td>
</tr>
<tr>
<td>Tax Payable as per the Income-tax Act, 1961</td>
<td>3,800</td>
</tr>
</tbody>
</table>

**Total**: 98,800

### Computation of Book Profit under section 115JB

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profit as per Statement of Profit &amp; Loss Account</td>
<td>14,25,000</td>
<td></td>
</tr>
<tr>
<td><strong>Add: Net Profit to be increased by the following amounts as per Explanation 1 to section 115JB</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Provision for loss of subsidiary</td>
<td>70,000</td>
<td></td>
</tr>
<tr>
<td>Provision for income-tax</td>
<td>1,05,000</td>
<td></td>
</tr>
<tr>
<td>Depreciation debited to profit and loss account</td>
<td>3,60,000</td>
<td></td>
</tr>
<tr>
<td><strong>Less: Net Profit to be reduced by the following amounts as per Explanation 1 to section 115JB</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Depreciation debited to profit and loss account (excluding depreciation on account of revaluation of fixed assets) (i.e., Rs. 3,60,000 – Rs. 1,50,000)</td>
<td>2,10,000</td>
<td></td>
</tr>
<tr>
<td>Income from UTI [since it is an income exempt u/s 10(35)]</td>
<td>75,000</td>
<td></td>
</tr>
<tr>
<td>Brought forward business loss or unabsorbed depreciation as per books of account, whichever is less, taken on cumulative basis</td>
<td>6,00,000</td>
<td></td>
</tr>
<tr>
<td><strong>Book Profit</strong></td>
<td><strong>10,75,000</strong></td>
<td></td>
</tr>
<tr>
<td>15% of book profit</td>
<td>1,61,250</td>
<td></td>
</tr>
<tr>
<td>Add: Health and Education cess @ 4%</td>
<td>6,450</td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>1,67,700</strong></td>
<td></td>
</tr>
</tbody>
</table>

In case of a company, it has been provided that where income-tax payable on total income computed as per the provisions of the Act is less than 15% of book profit, the book profit shall be deemed as the total income and the tax payable on such total income shall be 15% thereof plus health and education cess @4%.

Accordingly, in this case, since income-tax payable on total income computed as per the provisions of the Act is less than 15% of book profit, the book profit of Rs. 10,75,000 is deemed to be the total income and income-tax is payable @ 15% thereof plus health and education cess @4%. The tax liability, therefore, works out to be Rs. 1,67,700.

Section 115JAA provides that where tax is paid in any assessment year in relation to the deemed income under section 115JB(1), the excess of tax so paid, over and above the tax payable under the other provisions of the Income-tax Act, 1961, will be allowed as tax credit in the subsequent years.

The tax credit is, therefore, the difference between the tax paid under section 115JB(1) and the tax payable on the total income computed in accordance with the other provisions of the Act. This tax credit is allowed to be carried forward for 15 assessment years succeeding the assessment year in which the credit became allowable.

Such credit is allowed to be set off against the tax payable on the total income in an assessment year in which the tax is computed in accordance with the provisions of the Act,
other than section 115JB, to the extent of excess of such tax payable over the tax payable on book profits in that year.

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax on book profit under section 115JB</td>
<td>1,67,700</td>
</tr>
<tr>
<td>Less: Tax on total income computed as per the other provisions of the Act</td>
<td>98,800</td>
</tr>
<tr>
<td>Tax credit to be carried forward under section 115JAA</td>
<td>68,900</td>
</tr>
</tbody>
</table>

**Question 4**

The profit as per the statement of profit and loss account of XYZ Ltd., a resident company, for the year ended 31.3.2020 is Rs. 190 lacs arrived at after making the following adjustments:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs. (in lacs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i) Depreciation on assets</td>
<td>100</td>
</tr>
<tr>
<td>(ii) Reserve for currency exchange fluctuation</td>
<td>50</td>
</tr>
<tr>
<td>(iii) Provision for tax</td>
<td>40</td>
</tr>
<tr>
<td>(iv) Proposed dividend</td>
<td>120</td>
</tr>
</tbody>
</table>

Following further information are also provided by company:

(a) Profit includes Rs. 10 lacs, being dividend received from an Indian subsidiary company.

(b) Provision for tax includes Rs. 16 lacs of tax payable on distribution of profit and of Rs. 2 lacs of interest payable on income-tax.

(c) Depreciation includes Rs. 40 lacs towards revaluation of assets.

(d) Amount of Rs. 50 lacs credited to statement of P & L account was drawn from revaluation reserve.

(e) Balance of statement of profit and loss account shown in balance sheet at the asset side as at 31.3.2019 was Rs. 30 lacs which includes unabsorbed depreciation of Rs. 10 lakhs.

**Compute the book profit for the year ended 31.3.2020.**

**Answer**

**Computation of book profit of XYZ Ltd. for the year ended 31.3.2020**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profit as per Statement of Profit &amp; Loss</td>
<td></td>
<td>1,90,00,000</td>
</tr>
<tr>
<td><em>Add: Net profit to be increased by the following amounts as per Explanation 1 to section 115JB(2)</em></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Depreciation on assets debited to P&amp;L</td>
<td>1,00,00,000</td>
<td></td>
</tr>
<tr>
<td>Reserve for currency exchange fluctuation, since the amount carried to any reserve, by whatever name called, is to be added back</td>
<td>50,00,000</td>
<td></td>
</tr>
<tr>
<td>Provision for tax <em>(See Note below)</em></td>
<td>40,00,000</td>
<td></td>
</tr>
<tr>
<td>Proposed dividend</td>
<td>1,20,00,000</td>
<td>3,10,00,000</td>
</tr>
<tr>
<td><em>Less: Net profit to be decreased by the following amounts as per Explanation 1 to section 115JB(2)</em></td>
<td></td>
<td>5,00,00,000</td>
</tr>
<tr>
<td>Depreciation other than depreciation on revaluation of assets <em>(Rs. 100 lacs - Rs. 40 lacs)</em></td>
<td>60,00,000</td>
<td></td>
</tr>
<tr>
<td>Withdrawal from revaluation reserve restricted to the extent of depreciation on account of revaluation of assets <em>(Rs. 50 lacs or Rs. 40 lacs, whichever is less)</em></td>
<td>40,00,000</td>
<td></td>
</tr>
<tr>
<td>Unabsorbed depreciation or brought forward business loss,</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
whichever is less, as per the books of account. Unabsorbed depreciation Rs. 10 lakhs and brought forward business loss Rs. 20 lakhs – whichever is less
Dividend income [since the same is exempt under section 10(34)] 10,00,000

| Book profit | 3,80,00,000 |

Note – For the purpose of section 115JB, book profit means the profit as per the statement of profit and loss account prepared in accordance with Schedule III to the Companies Act, 2013, as adjusted by certain additions/deductions as specified. One of the adjustments is to add back income-tax paid or payable, and the provisions therefor. Explanation 2 after subsection (2) of section 115JB clarifies that income-tax includes, inter alia, dividend distribution tax / tax on distributed income and interest. Therefore, the entire provision of Rs. 40 lacs for income-tax is added back for computing book profit for levy.

**Question 5**

Mr. Harish, aged 66, running business as a proprietor furnishes the particulars of his income for the year ended 31.03.2020 as under:

(a) Net Profit of Rs. 3,65,500 from the wholesale business of textiles and fabrics arrived at after charge of following expenses in the Profit & Loss Account:
   (i) Personal travelling expenses of Rs.12,750.
   (ii) Purchase of furniture items for shop on 13.6.2019 of Rs. 25,000 but charged in shop expenses.

(b) He owns a house with two floors constructed with the financial assistance of HDFC, out of which ground floor is used by him for self use and first floor was let out on rent for Rs. 8,500 p.m. from April, 2019. The municipal tax paid for the whole house was of Rs. 2,500 and interest paid on housing loan for the construction was Rs. 52,000. Both the floors of the house are identical.

(c) He deposited insurance premium on the life of self of Rs.12,500, wife Rs. 13,500, son and daughter of Rs. 28,000, repaid housing loan of Rs. 50,000 and paid Rs. 35,000 by credit card for health insurance of himself and his family.

Compute taxable income and the amount of tax payable by Mr. Harsh on such income for the Assessment Year 2020-21.

**Answer**

**Computation of total income of Mr. Harsh for the A.Y.2020-21**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income from house property</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Self-occupied portion (50%)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Annual Value under section 23(2)</td>
<td>Nil</td>
<td></td>
</tr>
<tr>
<td>Less: Deduction under section 24(b)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interest on housing loan [Rs. 52,000 × 50%]</td>
<td>26,000</td>
<td>(26,000)</td>
</tr>
<tr>
<td>Let-out portion (50%)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Income of let out portion being rent of Rs. 8,500 p.m. received for 12 months (Rent received has been taken as the GAV in the absence of other information).</td>
<td>1,02,000</td>
<td></td>
</tr>
<tr>
<td>Gross Annual Value under section 23(1) (Rs. 8,500 × 12)</td>
<td>1,02,000</td>
<td></td>
</tr>
<tr>
<td>Less: 50% of municipal taxes paid allowable in respect of rented out portion (i.e., 50% of Rs. 2,500)</td>
<td>1,250</td>
<td></td>
</tr>
<tr>
<td>Net Annual Value (NAV)</td>
<td>1,00,750</td>
<td></td>
</tr>
</tbody>
</table>
Less: Deduction under section 24
- 30% of NAV under section 24(a) 30,225
- Interest on housing loan under section 24(b) 26,000

Profits and gains of business or profession
Net profit as per profit and loss account of wholesale business of textiles and fabrics 3,65,500
Add: Expenses charged in profit and loss account either not allowable or to be considered separately -
- Personal travelling expenses of proprietor 12,750
- Purchase of furniture wrongly debited to shop expenses 25,000

Less: Depreciation on furniture @ 10% on Rs. 25,000 2,500
Gross Total Income 4,03,750

Less: Deduction under Chapter VI-A
Under section 80C
- Life insurance premium
  Self 12,500
  Wife 13,500
  Son and daughter 28,000
- Housing loan repaid 50,000

Under section 80D [Medical insurance premium]
Mediclaim insurance premium of Rs. 55,000 [maximum deductible is Rs. 50,000 where it covers a resident senior citizen] 50,000

Total Income 2,65,275
Total Income (rounded off) 2,65,280
Tax on total income of Rs. 2,65,280 Nil
(The basic exemption limit for senior citizen is Rs. 3,00,000 for A.Y. 2020-21)

Question 6
X, Y and HUF of Z (represented by Z) are partners with equal shares in profits and losses of a firm, M/s Popular Cine Vision, which is engaged in the production of TV serials and telefilms. In the previous year 2018-19, one partner ‘A’ retired, but his dues have been settled in the previous year 2019-20.
The earlier partnership deed did not authorise payment of remuneration or interest to partners. The partnership deed was revised by the partners on 1st June, 2019 to authorise payment of remuneration of Rs. 1 lac per month to each working partner and simple interest at 15% per annum on partners’ capital. X, Y and Z are actively associated with the affairs of the firm.
The Profit & Loss Account of the firm for the year ended 31st March, 2020 shows a net profit of Rs. 10 lacs after debiting/crediting the following:
(a) Interest amounting to Rs. 5 lacs each was paid to partners on the balances standing to their capital accounts from 1st June, 2019 to 31st March, 2020.
(b) Remuneration to the partners including partner in representative capacity Rs. 30 lacs.
(c) Interest amounting to Rs. 2 lacs paid to Z on loan provided by him in his individual capacity at 16% interest.
(d) Royalty of Rs. 5 lacs paid to partner X, who is a professional script writer, for use of his scripts as per agreement between the firm and X. The same is authorized by partnership deed.

(e) Two separate payments of Rs. 18,000 and Rs. 15,000 made in cash on 1st February, 2020 to Altaf, a hairdresser, against his bill for services rendered in January, 2019 and two payments of Rs. 19,000 and Rs. 10,000 made in cash on 1st February and 2nd February, 2020, respectively, to Priyam, an assistant cameraman, against her bill for services provided in January, 2020.

(f) Amount of Rs. 5 lacs provided in the books on 31st March 2020 as liability for remuneration to Shreya, a film artist and a non-resident. Tax deducted at source under section 195 from the amount so credited was paid on 3rd June, 2020.

(g) Amount of Rs. 6 lacs provided as gratuity for the year on the basis of actuarial valuation. Gratuity actually paid to one retired employee during the year is Rs. 1.50 lacs.

(h) Interest of Rs. 1.20 lacs received on income-tax refund under section 244(1A) in respect of A.Y. 2017-18.

The firm has also provided the following additional information:

The amount due to A, an ex-partner, was Rs. 15 lacs which was settled on 30th September, 2019 by transferring a plot of land purchased one years back having book value of Rs. 10 lacs. The difference of Rs. 5 lacs was credited to partners' capital accounts in their profit sharing ratio. The value of plot for stamp duty valuation on the date of transfer was Rs. 16 lacs.

Compute the total income of the firm for the assessment year 2020-21 stating the reasons for treatment of each item.

**Answer**

<table>
<thead>
<tr>
<th>Computation of Total Income of M/s. Popular Cine Vision for the A.Y.2020-21</th>
<th>Rs.</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Profits and Gains from Business or Profession</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net Profit as per Profit &amp; Loss A/c</td>
<td>10,00,000</td>
<td></td>
</tr>
<tr>
<td>Add: Expenses disallowed or considered separately:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interest to partners in excess of 12% <strong>(Note 1)</strong></td>
<td>3,00,000</td>
<td></td>
</tr>
<tr>
<td>Disallowance under section 40A(3A) for aggregate cash payment exceeding Rs. 10,000 in a single day <strong>(Note 5)</strong></td>
<td>52,000</td>
<td></td>
</tr>
<tr>
<td>Provision for gratuity <strong>(Note 8)</strong></td>
<td>4,50,000</td>
<td></td>
</tr>
<tr>
<td>Partners’ Remuneration</td>
<td>30,00,000</td>
<td></td>
</tr>
<tr>
<td>Royalty paid to Partner X <strong>(Note 4)</strong></td>
<td>5,00,000</td>
<td>43,02,000</td>
</tr>
<tr>
<td>**Less: Interest on income-tax refund <strong>(Note 9)</strong></td>
<td></td>
<td>53,02,000</td>
</tr>
<tr>
<td><strong>Book Profit</strong></td>
<td></td>
<td>51,82,000</td>
</tr>
<tr>
<td>Less: Partners’ remuneration allowable under section 40(b)(v)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(i) As per limit prescribed in section 40(b)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>On first Rs. 3,00,000</td>
<td>90%</td>
<td>2,70,000</td>
</tr>
<tr>
<td>On the balance Rs. 48,82,000</td>
<td>60%</td>
<td>29,92,000</td>
</tr>
<tr>
<td><strong>(ii) Remuneration actually paid or payable</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(Rs. 1,00,000 × 10 months × 3 partners) + (Royalty Rs. 5 Lacs)</td>
<td></td>
<td>31,99,200</td>
</tr>
<tr>
<td>(i) or (ii) whichever is less, is deductible</td>
<td></td>
<td>19,82,800</td>
</tr>
<tr>
<td>Capital Gain</td>
<td></td>
<td></td>
</tr>
<tr>
<td>-------------</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Short-term capital gain on transfer of land (Note 9)</td>
<td>6,00,000</td>
<td></td>
</tr>
<tr>
<td>Income from other sources</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interest on income-tax refund</td>
<td>1,20,000</td>
<td></td>
</tr>
<tr>
<td>Gross Total Income</td>
<td>27,02,800</td>
<td></td>
</tr>
<tr>
<td>Deductions under Chapter VI-A</td>
<td>Nil</td>
<td></td>
</tr>
<tr>
<td>Total Income</td>
<td>27,02,800</td>
<td></td>
</tr>
</tbody>
</table>

Notes:

1. As per section 40(b), simple interest at 12% p.a. to partners relating to the period after the date of partnership deed is allowable. Excess interest @ 3% paid from 1st June, 2019 to 31st March, 2020 is to be disallowed. Excess interest of 3% being Rs. 15,00,000 \times 3/15 = Rs. 3,00,000.

2. Even though Z is a partner in a representative capacity, he is still a partner. Therefore, remuneration to Z should also be subject to the limits prescribed in section 40(b). This view finds support from the decision of the Supreme Court in the case of Rashik Lal & Co. vs CIT (1998) 229 ITR 458 (SC).

3. As per Explanation 1 to section 40(b), where an individual is a partner in a firm in representative capacity, the provisions of section 40(b) shall not apply to any interest payable by the firm to such individual in his personal capacity. Z represents his HUF in the firm. However, Z gave the loan in his individual capacity. Hence, assuming that the provisions of section 40A(2) do not get attracted in this case, such interest shall be allowed as deduction in full even though the interest rate is more than 12% p.a.

4. It may be noted that the limits specified under section 40(b)(v) are applicable in case of payment of salary, bonus, commission, or remuneration, by whatever name called, to a working partner. From a plain reading of the section, it is clear that any remuneration, by whatever name called, paid to a working partner, is subject to the limits laid down in section 40(b)(v). Therefore, the royalty of Rs. 5 Lacs paid to partner X would also be subject to the limits laid down in section 40(b)(v). Hence, the same has to be added back for computing book profits.

5. Section 40A(3A) provides for disallowance of any expenditure which was allowed in the earlier year and the actual payment was made subsequently and where the aggregate payment so made is otherwise than by an account payee cheque, account payee bank draft or use of ECS through bank account or through such other electronic mode as may be prescribed in a single day to a person exceeding a sum of Rs. 10,000. Hence, the payments of Rs. 18,000 and Rs. 15,000 in cash on 1.2.2019 to Altaf, a hairdresser, shall be disallowed, since the aggregate payment of Rs. 33,000 exceeds the limit of Rs. 10,000.

The payment of bill of the assistant cameraman of Rs. 19,000 on 1st February is liable for disallowance under section 40A(3) since the aggregate payment in cash on a single day has exceeded Rs. 10,000.

6. As per section 40(a)(i), any sum payable to a non-resident shall not be allowed as deduction, if tax has not been deducted at source or after deduction, has not been paid on or before the due date specified under section 139(1). Tax deducted from the amount of remuneration credited to payee's account on 31st March 2020 has to be deposited latest by 31st July 2020/ 30th September, 2019 (as the case may be). The firm has paid the tax on 3rd June, 2020 and hence, the remuneration shall be allowed.
Since the same is already debited to profit and loss account, no further adjustment is made.

7. As per section 40A(7), any provision made for payment of gratuity to employees on their retirement or on termination of employment for any reason is disallowed. However, gratuity of Rs. 1.50 lacs paid to retired employees is allowable as deduction. Hence, the balance provision of Rs. 4.50 lacs (i.e., Rs. 6 lacs – Rs. 1.50 lacs) is to be disallowed.

8. Interest on income-tax refund is assessable under the head "Income from other sources".

9. Distribution of a capital asset by a firm to its partner on dissolution or otherwise attracts capital gains tax liability as per the provisions of section 45(4) and the fair market value of the asset on the date of transfer is deemed to be the full value of consideration received or accruing as a result of the transfer. The words "or otherwise" includes within its scope, cases of distribution of capital assets on retirement of a partner also. [CIT vs. A. N. Naik Associates (2004) 265 ITR 346 (Bom.)]. Therefore, distribution of a plot of land on retirement of a partner would attract section 45(4).

Rs. 16 lacs, being the fair market value of the plot on the date of transfer, is deemed to be the full value of consideration. Therefore, the capital gain would be Rs. 6 lacs (i.e., Rs. 16 lacs – Rs. 10 lacs).

**Question 7**

PQR LLP, a limited liability partnership set up a unit in Special Economic Zone (SEZ) in the financial year 2015-16 for production of washing machines. The unit fulfills all the conditions of section 10AA of the Income-tax Act, 1961. During the financial year 2018-19, 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 Rs. 75 lakhs (including cost of land Rs. 10 lakhs). The warehouse became operational with effect from 1st April, 2019 and the expenditure of Rs. 75 lakhs was capitalized in the books on that date.

Relevant details for the financial year 2019-20 are as follows:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profit of unit located in SEZ</td>
<td>40,00,000</td>
</tr>
<tr>
<td>Export sales of above unit</td>
<td>80,00,000</td>
</tr>
<tr>
<td>Domestic sales of above unit</td>
<td>20,00,000</td>
</tr>
<tr>
<td>Profit from operation of warehousing facility (before considering deduction under Section 35AD)</td>
<td>1,05,00,000</td>
</tr>
</tbody>
</table>

**Computation of total income and tax liability of PQR LLP for A.Y.2020-21**

(under the regular provisions of the Income-tax Act, 1961)

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profits and gains of business or profession</td>
<td></td>
</tr>
<tr>
<td>Unit in SEZ</td>
<td>40,00,000</td>
</tr>
<tr>
<td>Less: Deduction under section 10AA [See Note (1) below]</td>
<td>32,00,000</td>
</tr>
<tr>
<td>Business income of SEZ unit chargeable to tax</td>
<td>8,00,000</td>
</tr>
</tbody>
</table>

**Answer**

Compute income tax (including AMT under Section 115JC) payable by PQR LLP for Assessment Year 2020-21.
### Assessment of Various Entities

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profit from operation of warehousing facility</td>
<td>1,05,00,000</td>
<td>65,00,000</td>
</tr>
<tr>
<td>Less: Deduction under section 35AD [See Note (2) below]</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Business income of warehousing facility chargeable to tax</td>
<td>40,00,000</td>
<td></td>
</tr>
<tr>
<td><strong>Total Income</strong></td>
<td>48,00,000</td>
<td></td>
</tr>
<tr>
<td><strong>Computation of tax liability (under the normal/regular provisions)</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tax@30% on Rs. 48,00,000</td>
<td>14,40,000</td>
<td></td>
</tr>
<tr>
<td><strong>Add</strong>: Education cess@4%</td>
<td>57,600</td>
<td></td>
</tr>
<tr>
<td><strong>Total tax liability</strong></td>
<td>14,97,600</td>
<td></td>
</tr>
</tbody>
</table>

**Computation of adjusted total income of PQR LLP for levy of Alternate Minimum Tax**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total Income (as computed above)</strong></td>
<td>48,00,000</td>
<td></td>
</tr>
<tr>
<td><strong>Add</strong>: Deduction under section 10AA</td>
<td>32,00,000</td>
<td>80,00,000</td>
</tr>
<tr>
<td><strong>Add</strong>: Deduction under section 35AD</td>
<td>65,00,000</td>
<td></td>
</tr>
<tr>
<td><strong>Less</strong>: Depreciation under section 32</td>
<td>6,50,000</td>
<td>58,50,000</td>
</tr>
<tr>
<td><strong>On building @10% of Rs. 65 lakhs</strong></td>
<td>6,50,000</td>
<td>58,50,000</td>
</tr>
<tr>
<td><strong>Adjusted Total Income</strong></td>
<td>1,38,50,000</td>
<td></td>
</tr>
<tr>
<td><strong>Alternate Minimum Tax@18.5%</strong></td>
<td>25,62,250</td>
<td>3,07,470</td>
</tr>
<tr>
<td><strong>Add</strong>: Surcharge@12% (since adjusted total income &gt; Rs. 1 crore)</td>
<td>28,69,720</td>
<td></td>
</tr>
<tr>
<td><strong>Add</strong>: Health and Education cess @ 4%</td>
<td>1,14,789</td>
<td>29,84,509</td>
</tr>
<tr>
<td><strong>Tax liability under section 115JC (rounded off)</strong></td>
<td>29,84,510</td>
<td></td>
</tr>
</tbody>
</table>

Since the regular income-tax payable is less than the alternate minimum tax payable, the adjusted total income shall be deemed to be the total income and tax is leviable @18.5% thereof plus surcharge@12% and cess@4%. Therefore, the tax liability is Rs. 29,84,510.

<table>
<thead>
<tr>
<th>AMT Credit to be carried forward under section 115JEE</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax liability under section 115JC</td>
<td>29,84,510</td>
</tr>
<tr>
<td><strong>Less</strong>: Tax liability under the regular provisions of the Income-tax Act, 1961</td>
<td>14,97,600</td>
</tr>
<tr>
<td><strong>AMT Credit to be carried forward</strong></td>
<td>14,86,910</td>
</tr>
</tbody>
</table>

**Notes:**

1. **Deduction under section 10AA in respect of Unit in SEZ =**
   
   \[
   \text{Profit of the Unit in SEZ} \times \frac{\text{Export turnover of the Unit in SEZ}}{\text{Total turnover of the Unit in SEZ}} = \text{Rs. 32,00,000}
   \]

2. **Deduction @ 100% of the capital expenditure is available under section 35AD for A.Y.2020-21 in respect of specified business of setting up and operating a warehousing facility for storage of agricultural produce which commences operation on or after 01.04.2012.**

   Further, the expenditure incurred, wholly and exclusively, for the purposes of such specified business, shall be allowed as deduction during the previous year in which he commences operations of his specified business if the expenditure is incurred
prior to the commencement of its operations and the amount is capitalized in the books of account of the assessee on the date of commencement of its operations.

Deduction under section 35AD would, however, not be available on expenditure incurred on acquisition of land.

In this case, since the capital expenditure of Rs. 65 lakhs (i.e., Rs. 75 lakhs – Rs. 10 lakhs, being expenditure on acquisition of land) has been incurred in the F.Y.2018-19 and capitalized in the books of account on 1.4.2019, being the date when the warehouse became operational, Rs. 65,00,000, being 100% of Rs. 65 lakhs would qualify for deduction under section 35AD.

**Question 8**

Victory Polyfibres, a partnership firm, has earned a gross total income of Rs. 300 lacs for the year ended 31-3-2020. The firm has not undertaken any international transaction or specified domestic transaction during the said year.

The above includes a profit of Rs. 220 lacs from an undertaking having a turnover of Rs. 80 crores. This is the fifth year and deduction under section 80-IA of the Income-tax Act, 1961 is available to the extent of Rs. 200 lacs.

There are some grey areas in the taxation workings and hence, the assessee is contemplating to file the return of income on 7.12.2020, after seeking clarifications from tax experts.

Advise the assessee-firm by working out the total income and tax payable, where the return is filed on 30-09-2020 or when the same is filed on 7-12-2020.

What is the practical solution as regards obtaining clarifications, which might or might not have an impact on the total income? You may ignore interest under section 234A, 234B, 234C and 234F while making the computation in support of your advice.

**Answer**

As per section 80AC, while computing the total income of an assessee of a previous year (P.Y.2019-20, in this case) relevant to any assessment year (A.Y.2020-21, in this case), any deduction is admissible, inter alia, under section 80-IA, such deduction shall not be allowed unless it furnishes a return of income for such assessment year on or before the ‘due date’ specified in section 139(1).

Since the turnover of the partnership firm has exceeded Rs. 200 lacs in the previous year 2018-19, it would be subject to audit under section 44AB, in which case the ‘due date’ of filing its return of income for A.Y.2020-21 would be 30th September, 2020 as per section 139(1).

**Computation of total income and tax liability of M/s. Victory Polyfibres for A.Y.2020-21**

1. **Where the firm files its return of income on 30th September 2020:**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs. in lacs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross Total Income</td>
<td>300.00</td>
</tr>
<tr>
<td>Less: Deduction under section 80-IA</td>
<td>200.00</td>
</tr>
<tr>
<td><strong>Total Income</strong></td>
<td><strong>100.00</strong></td>
</tr>
<tr>
<td>Tax liability@ 30%</td>
<td>30.00</td>
</tr>
<tr>
<td>Add: Education cess@2% and secondary and higher education cess@1%</td>
<td>1.20</td>
</tr>
<tr>
<td><strong>Regular income-tax payable</strong></td>
<td><strong>31.20</strong></td>
</tr>
</tbody>
</table>
Computation of Alternate Minimum Tax payable [Section 115JC]

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs. in lacs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Income</td>
<td>100.00</td>
</tr>
<tr>
<td>Add: Deduction under section 80-IA</td>
<td>200.00</td>
</tr>
<tr>
<td>Adjusted Total Income</td>
<td><strong>300.00</strong></td>
</tr>
<tr>
<td>Alternate Minimum Tax (AMT) @ 18.5% on Rs. 300 lacs</td>
<td>55.50</td>
</tr>
<tr>
<td>Add: Surcharge@12% (Since adjusted total income &gt; Rs. 1 crore)</td>
<td>6.66</td>
</tr>
<tr>
<td>Add: Health and Education cess @ 4%</td>
<td>2.49</td>
</tr>
<tr>
<td>Total tax payable (AMT)</td>
<td><strong>64.65</strong></td>
</tr>
</tbody>
</table>

Since the regular income-tax payable by the firm is less than the alternate minimum tax payable, the adjusted total income shall be deemed to be the total income of the firm for P.Y.2019-20 and it shall be liable to pay income-tax on such total income @18.5% [Section 115JC(1)]. Therefore, the tax payable for the A.Y.2020-21 would be Rs. 64.65 lacs.

<table>
<thead>
<tr>
<th>Tax credit for Alternate Minimum Tax [Section 115JD]</th>
<th>Rs. in lacs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total tax payable for A.Y.2020-21 (Alternate Minimum Tax)</td>
<td>64.65</td>
</tr>
<tr>
<td>Less: Regular income-tax payable</td>
<td>31.20</td>
</tr>
<tr>
<td>To be carried forward for set-off against regular income-tax payable (upto a maximum of fifteen assessment years)</td>
<td><strong>33.45</strong></td>
</tr>
</tbody>
</table>

II. Where the firm files its return of income on 7th December 2020:

Where the firm files its return on 7-12-2020, it would be a belated return under section 139(4). Consequently, as per section 80AC, deduction under section 80-IA would not be available. In such circumstances, the gross total income of Rs. 300 lacs would be the total income of the firm.

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs. in lacs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income-tax@30% of Rs. 300 lacs</td>
<td>90.000</td>
</tr>
<tr>
<td>Add: Surcharge@12% (since total income exceeds Rs. 100 lacs)</td>
<td>10.800</td>
</tr>
<tr>
<td>Income-tax (plus surcharge)</td>
<td>100.800</td>
</tr>
<tr>
<td>Add: Health and Education cess @ 4%</td>
<td>4.032</td>
</tr>
<tr>
<td>Total tax liability</td>
<td><strong>104.832</strong></td>
</tr>
</tbody>
</table>

Practical solution regarding obtaining clarifications

The practical solution regarding obtaining clarifications would be to file the return of income under section 139(1) on or before the ‘due date’, i.e., 30.9.2020, and claim deduction under section 80-IA. In such a case, the firm can claim deduction of Rs. 200 lacs under section 80-IA. Thereafter, consequent to the clarifications obtained, if any change is required, it can file a revised return under section 139(5) within 31.3.2021 (i.e., within the end of A.Y.2020-21) which would replace the original return filed under section 139(1).

If the firm files the return of income under section 139(1) on or before 30.9.2020, its tax liability would stand reduced to Rs. 64.65 lacs, as against Rs. 104.832 lacs to be paid if return is furnished after due date. Further, it would also be eligible for tax credit for alternate minimum tax under section 115JD to the extent of Rs. 33.45 lacs. Therefore, the firm is advised to file its return of income on or before 30.9.2020.
Question 9

Prakash, a member in two AOPs, namely, “AOP & Co.” and “Prakash & Akash”, provides the following details of his income for the year ended on 31.3.2020:

(a) “AOP & Co.”, assessed at normal rates of tax, had credited in his account, amount of Rs. 96,000 as interest on capital, Rs. 4,96,000 as salary and Rs. 20,000 as share of profit.

(b) A house property located at Jaipur was purchased on 1.7.2010 with the borrowed capital in “Prakash & Akash” jointly shared equally and occupied by both of them for self residential purposes. Total interest paid for the year 2019-20 on the borrowed capital was Rs. 4,10,000.

Compute the income and the tax liability thereon for the A.Y. 2020-21 and support your answer with brief reasons and the provisions of the Act.

Answer

Mr. Prakash is a member in two AOPs, namely, AOP & Co. and Prakash & Akash. Though Prakash & Akash is an AOP, the income from the house property will not be assessed as income of the AOP, but will be included in the hands of the individual members as per section 26, since the share of each member is definite and ascertainable. Hence, Prakash’s share of income from house property would be assessed in his individual hands.

Since AOP & Co., has been taxed at normal rates of tax, Mr. Prakash’s share income from the AOP (i.e. salary, interest on capital and his share of profit) would be included in his total income. Mr. Prakash, however, would be entitled to a relief under section 86 in respect of this income which has been included in his total income but on which tax has already been paid by the AOP. As per section 110, the relief shall be allowed at the average rate of tax calculated on the total income inclusive of such income.

Hence, the tax liability in the hands of Mr. Prakash would be as under:-

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Annual Value (½ share in house property used for own residence);</td>
<td>Nil</td>
<td></td>
</tr>
<tr>
<td>Less: Interest on loan [½ share in Rs. 4,10,000] – Since the loan is borrowed on or after 1.4.1999 and is used for acquiring property within 5 years, deduction would be available upto a maximum of Rs. 2,00,000. This limit of Rs. 2,00,000 applies for each member separately.</td>
<td>2,00,000</td>
<td>(-) 2,00,000</td>
</tr>
<tr>
<td>Loss from house property</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Share income from AOP &amp; Co.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Interest on capital</td>
<td>2,10,000</td>
<td></td>
</tr>
<tr>
<td>- Salary</td>
<td>4,96,000</td>
<td></td>
</tr>
<tr>
<td>- Share of profit</td>
<td>20,000</td>
<td>7,26,000</td>
</tr>
<tr>
<td>Total Income</td>
<td></td>
<td>5,26,000</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax on Rs. 5,26,000</td>
<td>17,700</td>
</tr>
<tr>
<td>Add: Health and Education Cess @ 4%</td>
<td>708</td>
</tr>
<tr>
<td>Tax Liability</td>
<td>18,408</td>
</tr>
<tr>
<td>Less: Rebate under section 86 read with section 110 = Rs. 18,408 x 3.5% = Rs. 25,410</td>
<td></td>
</tr>
</tbody>
</table>

12.20
Question 10

T and Q are individuals, who constitute an Association of Persons, sharing profit and losses in the ratio of 2:1. For the accounting year ended 31st March, 2020, the Profit and Loss account of the business was as under:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs. 1000s</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost of goods sold</td>
<td>4,250</td>
</tr>
<tr>
<td>Sales</td>
<td>4,900</td>
</tr>
<tr>
<td>Remuneration to:</td>
<td></td>
</tr>
<tr>
<td>T</td>
<td>130</td>
</tr>
<tr>
<td>Q</td>
<td>170</td>
</tr>
<tr>
<td>Employees</td>
<td>256</td>
</tr>
<tr>
<td>Interest to:</td>
<td></td>
</tr>
<tr>
<td>T</td>
<td>48.3</td>
</tr>
<tr>
<td>Q</td>
<td>35.7</td>
</tr>
<tr>
<td>Other expenses</td>
<td>111.7</td>
</tr>
<tr>
<td>Sales-tax penalty due</td>
<td>39</td>
</tr>
<tr>
<td>Net profit</td>
<td>5,565</td>
</tr>
</tbody>
</table>

Additional information furnished:
(i) Other expenses included:
   (a) Wrist watches costing Rs. 2,500 each were given to 12 dealers, who had exceeded the sales quota prescribed under a sales promotion scheme;
   (b) Employer’s contribution of Rs. 6,000 to the Provident Fund was paid on 14th January, 2020.
   (c) Rs. 30,000 was paid in cash to an advertising agency for publicity.
(ii) Outstanding sales tax penalty was paid on 15th October, 2020. The penalty was imposed by the Sales-tax Officer for non-filing of returns and statements by the due dates.

T and Q had, for this year, income from other sources of Rs. 3,60,000 and Rs. 2,32,000 respectively.

Required to:
(i) Compute the total income of the AOP for the assessment year 2020-21; and
(ii) Discuss the tax implication for that year in the hands of the individual members.

Answer

(i) Computation of total income of the AOP for A.Y. 2020-21

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profit &amp; gains of business</td>
<td>3,12,300</td>
</tr>
<tr>
<td>Long term capital gain</td>
<td>6,40,000</td>
</tr>
<tr>
<td>Income from other sources [Dividend is exempt under section 10(34)]</td>
<td>-</td>
</tr>
<tr>
<td><strong>Total income</strong></td>
<td><strong>9,52,300</strong></td>
</tr>
</tbody>
</table>

Working Note - Computation of profits and gains of business

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net profit as per profit &amp; loss account</td>
<td></td>
<td>5,24,300</td>
</tr>
<tr>
<td><strong>Add: Inadmissible payments</strong></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

12.21
### Question 11

The assessee, Pandey Co-operative Housing Society, is a registered co-operative housing society, formed with the objective of maintaining the property owned by it, to effect repairs and maintenance of the common property of the members, and to confer to the members, the usual rights and privileges. For the assessment year 2020-21, the assessee has received Rs. 3 lacs as transfer fees from the transferor members and like amount from the transferees, who at the time of transfer, were not members of the society. Discuss the exigibility to tax the aforesaid receipts in the hands of the assessee.

### Answer

Transfer fees received by a co-operative housing society, whether from outgoing or from incoming members, is not liable to tax on the ground of principle of mutualty where the predominant activity of such co-operative society is maintenance of property of the society. It was so held by the Bombay High Court in Sind Co-op Housing Society v. ITO (2009) 317 ITR 47.

Further, section 28(iii), which provides that income derived by a trade, professional or similar association from specific services performed for its members shall be treated as business income, can have no application since the co-operative housing society is not a trade or professional association.

Therefore, Rs. 3 lacs received as transfer fees by Pandey Co-operative Housing Society from its transferor members and its transferees, is not chargeable to tax.
Illustration 1

A domestic company, ABC Ltd., furnishes the following particulars in respect of Assessment Year 2020-21 and seeks your opinion on the application of section 115JB. You are also required to compute the total income and tax payable.

(1) Profits as per Statement of profit and loss account as per the Companies Act, 2013 Rs.215 Lacs
(2) Statement of Profit and Loss A/c includes:
   (a) Credits: Dividend income from Indian companies Rs. 20 Lacs
       Excess realized on sale of land held as investment Rs. 30 Lacs
   (b) Debits: Depreciation on straight line method basis Rs. 100 Lacs
       Provision for loss of subsidiary company Rs. 60 Lacs
(3) Depreciation allowable as per the Income-tax Rules, 1962 Rs. 150 Lacs
(4) Short term Capital gains on sale of land mentioned above as computed under Income-tax Act, 1961 Rs. 40 Lacs
(5) Losses brought forward as per books of account and as per Income-tax Act, 1961:
       Business loss Rs.50 Lacs
       Unabsorbed depreciation Rs. 60 Lacs

The company has represented to you that the excess realized on sale of land cannot form part of the book profit for purposes of section 115JB. You will have to deal with this issue assuming that ABC Ltd. is not required to comply with the Indian Accounting Standards. Ignore the provisions of section 115BAA.

Note - The turnover of ABC Ltd. for the P.Y.2017-18 was Rs. 390 crore.

Solution

In the case of a company, it has been provided that where tax on 18.50% of book profit exceeds tax on total income computed as per normal provisions, the book profit shall be deemed to be the total income for tax purposes.

It is therefore necessary to compute total income as per Income-tax Act, 1961 as well as book profits.

I. Computation of Total income as per the Income-tax Act, 1961

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.(in Lacs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net profit as per statement of profit and loss account</td>
<td>215</td>
</tr>
<tr>
<td>Add: Depreciation debited to profit and loss account</td>
<td></td>
</tr>
<tr>
<td>Provision for losses of subsidiary company</td>
<td>100</td>
</tr>
<tr>
<td></td>
<td>60</td>
</tr>
<tr>
<td>Less: Dividend income – exempt under section 10(34)</td>
<td>375</td>
</tr>
<tr>
<td>Excess realized on sale of land (considered separately)</td>
<td></td>
</tr>
<tr>
<td>Depreciation allowable as per Income-tax Rules, 1962</td>
<td>150</td>
</tr>
<tr>
<td></td>
<td>200</td>
</tr>
<tr>
<td>Business Income</td>
<td>175</td>
</tr>
<tr>
<td>Less: Set-off of brought forward business loss</td>
<td></td>
</tr>
<tr>
<td>Capital gains</td>
<td>50</td>
</tr>
<tr>
<td></td>
<td>125</td>
</tr>
<tr>
<td></td>
<td>40</td>
</tr>
<tr>
<td>Less: Set-off of unabsorbed depreciation</td>
<td></td>
</tr>
<tr>
<td>Total Income as per Income-tax Act, 1961</td>
<td>105</td>
</tr>
</tbody>
</table>
II. Computation of book profit under section 115JB

<table>
<thead>
<tr>
<th>Particulars</th>
<th>(Rs. in Lacs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net profit as per profit and loss account</td>
<td>215</td>
</tr>
<tr>
<td>Add: Provision for loss of subsidiary</td>
<td></td>
</tr>
<tr>
<td>Depreciation</td>
<td>60</td>
</tr>
<tr>
<td></td>
<td>100</td>
</tr>
<tr>
<td>Less: Dividend income exempt under section 10(34)</td>
<td></td>
</tr>
<tr>
<td>Depreciation</td>
<td></td>
</tr>
<tr>
<td>Business loss which is less than unabsorbed depreciation</td>
<td>50</td>
</tr>
<tr>
<td></td>
<td>170</td>
</tr>
<tr>
<td>“Book Profit”</td>
<td>205</td>
</tr>
</tbody>
</table>

III. Computation of Tax liability under the normal provisions of the Income-tax Act, 1961

Total income as per the Income-tax Act, 1961 is Rs. 105 Lacs,

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax payable Rs. 105 Lacs @ 25%, since the turnover of the company for the previous year 2016-17 does not exceed Rs. 20 crore.</td>
<td>26,25,000</td>
</tr>
<tr>
<td>Add: Surcharge @ 7%</td>
<td>1,83,750</td>
</tr>
<tr>
<td></td>
<td>28,08,750</td>
</tr>
<tr>
<td>Add: Education cess &amp; SHEC@ 4%</td>
<td>1,12,350</td>
</tr>
<tr>
<td>Total Tax payable</td>
<td>29,21,100</td>
</tr>
</tbody>
</table>

IV. Computation of Minimum Alternate Tax

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax @150% of book profit of Rs. 205 lacs</td>
<td>30,75,500</td>
</tr>
<tr>
<td>Add: Surcharge @ 7%</td>
<td>2,15,250</td>
</tr>
<tr>
<td></td>
<td>32,90,250</td>
</tr>
<tr>
<td>Add: Education cess &amp; SHEC@ 4%</td>
<td>1,31,610</td>
</tr>
<tr>
<td>Minimum Alternate Tax payable</td>
<td>34,21,860</td>
</tr>
</tbody>
</table>

Since 15% of book profit exceeds the tax payable as per the Income-tax Act, 1961, the book profit of Rs. 205 lacs would be deemed to be the total income and the tax payable on such total income shall be 15% thereof i.e. 30,75,000 plus surcharge @7% being Rs. 2,15,250 plus education cess and SHEC @4% (of tax and surcharge) being Rs. 1,31,610. Total tax liability would be Rs. 34,21,860.

Note: With regard to the company’s representation, in respect of capital gain whether liable for book profit tax under section 115JB, it may be noted that since the excess realized on sale of land has been included in net profit computed under Schedule III of the Companies Act, 2013, it will form part of book profit [Bombay High Court judgment in CIT v. Veekay Lal Investment Co. Pvt. Ltd. (2001) 249 ITR 597].

Illustration 2

Maitri Jeans (P) Ltd. is in the business of manufacturing jeans. For the assessment year 2020-21, it paid tax @ 15% on its book profit computed under section 115JB. The Assessing Officer though satisfied that it is liable to pay book profit tax U/s. 115JB, wants to charge interest under sections 234B and 234C as no advance tax was paid during the financial year 2019-20. The company seeks your opinion on the proposed levy of interest. Advice.
Solution

The issue under consideration is whether interest under sections 234B and 234C can be levied where a company is assessed on the basis of its book profit under section 115JB.

The Supreme Court, in *Joint CIT v. Rolta India Ltd. (2011) 330 ITR 470*, observed that there is a specific provision in section 115JB(5) providing that all other provisions of the Income-tax Act, 1961 shall apply to every assessee, being a company, mentioned in that section. Section 115JB is a self-contained code pertaining to MAT, and by virtue of subsection (5) thereof, the liability for payment of advance tax would be attracted.

According to section 207, tax shall be payable in advance during any financial year, in accordance with the provisions of sections 208 to 219 (both inclusive), in respect of the total income of the assessee which would be chargeable to tax for the assessment year immediately following that financial year.

Under section 115JB(1), where the tax payable on total income is less than 15% of “book profit” of a company, the “book profit” would be deemed to be the total income and tax would be payable at the rate of 15%.

Since in such cases, the book profit is deemed to be the total income, therefore, as per the provisions of section 207, tax shall be payable in advance in respect of such book profit (which is deemed to be the total income) also.

Therefore, if a company defaults in payment of advance tax in respect of tax payable under section 115JB, it would be liable to pay interest under sections 234B and 234C.

Therefore, even though Maitri Jeans (P) Ltd. is assessed on the basis of its book profit under section 115JB for A.Y.2020-21, it is liable to pay advance tax. Since Maitri Jeans (P) Ltd. has not paid any advance tax during the financial year 2019-20, the levy of interest under section 234B and 234C is valid.

Illustration 3

*Sona Ltd.*, a resident company, earned a profit of Rs. 15 lakhs after debit/credit of the following items to its Statement of Profit and Loss for the year ended on 31/03/2020.

(i) Items debited to Statement of Profit and Loss:

<table>
<thead>
<tr>
<th>No.</th>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Provision for the loss of subsidiary</td>
<td>70,000</td>
</tr>
<tr>
<td>2.</td>
<td>Provision for doubtful debts</td>
<td>75,000</td>
</tr>
<tr>
<td>3.</td>
<td>Provision for income-tax</td>
<td>1,05,000</td>
</tr>
<tr>
<td>4.</td>
<td>Provision for gratuity based on actuarial valuation</td>
<td>2,00,000</td>
</tr>
<tr>
<td>5.</td>
<td>Depreciation</td>
<td>3,60,000</td>
</tr>
<tr>
<td>6.</td>
<td>Interest to financial institution (unpaid before filing of return)</td>
<td>1,00,000</td>
</tr>
<tr>
<td>7.</td>
<td>Penalty for infraction of law</td>
<td>50,000</td>
</tr>
</tbody>
</table>

(ii) Items credited to Statement of Profit and Loss:

<table>
<thead>
<tr>
<th>No.</th>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Profit from unit established in special economic zone</td>
<td>5,00,000</td>
</tr>
<tr>
<td>2.</td>
<td>Share in income of an AOP as a member</td>
<td>1,00,000</td>
</tr>
<tr>
<td>3.</td>
<td>Income from units of UTI</td>
<td>75,000</td>
</tr>
<tr>
<td>4.</td>
<td>Long term capital gains</td>
<td>3,00,000</td>
</tr>
</tbody>
</table>

*Other Information:*

(i) Depreciation includes Rs. 1,50,000 on account of revaluation of fixed assets.

(ii) Depreciation as per Income-tax Rules is Rs. 2,80,000.
(iii) Brought forward loss of Rs. 10 lakhs which includes unabsorbed depreciation of Rs. 4 lakhs.

(iv) The capital gain has been invested in specified assets under section 54EC.

(v) The AOP, of which the company is a member, has paid tax at maximum marginal rate.

(vi) Provision for income-tax includes Rs. 45,000 of interest payable on income-tax.

Compute minimum alternate tax under section 115JB of the Income-tax Act, 1961, for A.Y. 2020-21, assuming that Sona Ltd. is not required to comply with the Indian Accounting Standards.

Solution

Computation of “Book Profit” for levy of MAT under section 115JB for A.Y.2020-21

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net Profit as per Statement of Profit and Loss</td>
<td>15,00,000</td>
<td></td>
</tr>
<tr>
<td>Add: Net profit to be increased by the following amounts as per Explanation 1 to section 115JB:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Provision for the loss of subsidiary</td>
<td>70,000</td>
<td></td>
</tr>
<tr>
<td>- Provision for doubtful debts, being the amount set aside as provision for diminution in the value of any asset</td>
<td>75,000</td>
<td></td>
</tr>
<tr>
<td>- Provision for income-tax [As per Explanation 2 to section 115JB, income-tax shall include, inter alia, any interest charged under the Act, therefore, whole of the amount of provision for income-tax including Rs. 45,000 towards interest payable has to be added]</td>
<td>1,05,000</td>
<td></td>
</tr>
<tr>
<td>- Depreciation</td>
<td>3,60,000</td>
<td>6,10,000</td>
</tr>
<tr>
<td>Less: Net profit to be decreased by the following amounts as per Explanation 1 to section 115JB:</td>
<td></td>
<td>21,10,000</td>
</tr>
<tr>
<td>- Share in income of an AOP as a member [In a case, where AOP has paid tax on its total income at maximum marginal rate, no income-tax is payable by the company, being a member of AOP, in accordance with the provisions of section 86. Therefore, share in income of an AOP on which no income-tax is payable in accordance with the provisions of section 86, would be reduced while computing book profit, since the same has been credited to profit and loss account]</td>
<td>1,00,000</td>
<td></td>
</tr>
<tr>
<td>- Income from units in UTI [Income from units in UTI shall be reduced while computing the book profits, since the same is exempt under section 10(35)]</td>
<td>75,000</td>
<td></td>
</tr>
<tr>
<td>- Depreciation other than depreciation on revaluation of assets (Rs. 3,60,000 – Rs. 1,50,000)</td>
<td>2,10,000</td>
<td></td>
</tr>
<tr>
<td>- Unabsorbed depreciation or brought forward business loss, whichever is less, as per the books of account. Lower of unabsorbed depreciation Rs. 4,00,000 and brought forward business loss Rs. 6,00,000 as per books of accounts has to be reduced while computing</td>
<td>4,00,000</td>
<td>7,85,000</td>
</tr>
</tbody>
</table>
the book profit]

| Book Profit | 13,25,000 |

Computation of MAT liability under section 115JB

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>15% of book profit</td>
<td>1,98,750</td>
</tr>
<tr>
<td>Add: Held and Education cess@4%</td>
<td>7,950</td>
</tr>
<tr>
<td>Minimum Alternate Tax liability</td>
<td>2,06,700</td>
</tr>
</tbody>
</table>

Notes:

1. It is only the specific items mentioned under Explanation 1 to section 115JB, which can be adjusted from 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 thereunder, the same cannot be adjusted for computing book profit:
   - Interest to financial institution (unpaid before filing of return) and
   - Penalty for infraction of law

2. Provision for gratuity based on actuarial valuation is an ascertained liability [CIT v. Echjay Forgings (P) Ltd. (2001) 251 ITR 15 (Bom.)]. Hence, the same should not be added back to compute book profit.

3. As per proviso to section 115JB(6), the profits from unit established in special economic zone cannot be excluded while computing the book profit, and hence, such income would be liable for MAT.

4. 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 to section 115JB 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.)]

Illustration 4

X Ltd., a domestic company, has distributed on 1/11/2019, dividend of Rs. 230 lakh to its shareholders. On 1/10/2019, X Ltd. has received dividend of Rs. 60 lakh from its domestic subsidiary company Y Ltd., on which Y Ltd. has paid dividend distribution tax under section 115-O. Compute the additional income-tax payable by X Ltd. under section 115-O.

Solution

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs. in lakh</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dividend distributed by X Ltd.</td>
<td>230</td>
</tr>
<tr>
<td>Less: Dividend received from subsidiary Y Ltd.</td>
<td>60</td>
</tr>
<tr>
<td>Net distributed profits</td>
<td>170</td>
</tr>
<tr>
<td>Add: Increase for the purpose of grossing up of dividend $\left{ \frac{15}{(100-15)} \times 170 \right}$</td>
<td>30</td>
</tr>
<tr>
<td>Gross dividend</td>
<td>200</td>
</tr>
<tr>
<td>Additional income-tax payable by X Ltd. u/s 115-O [15% of Rs. 200 lakh]</td>
<td>30.00</td>
</tr>
</tbody>
</table>
Illustration 5

Yaman Limited is a company in which 60% of the shares are held by Piloo Limited. Yaman Limited declared a dividend amounting to Rs. 35 lacs to its shareholders for the financial year 2018-19 in its Annual General Meeting held on 10th July, 2019. Dividend distribution tax was paid by Yaman Limited on 21st July, 2019. Piloo Limited declared an interim dividend amounting to Rs. 50 lacs on 15th October, 2019.

Compute the amount of tax on dividend payable by Piloo Limited.

What would be your answer, if 58% shares of Piloo Limited are held by Kafi Limited, an Indian company?

Solution

As per section 115-O, dividend distribution tax at the rate of 17.472% (i.e., 15% plus surcharge@12% and health and education cess@4%) is leviable on dividend declared, distributed or paid by a domestic company. As per section 115-O(1A), a holding company receiving dividend from its domestic subsidiary company can reduce the same from dividend declared, distributed or paid by it. The dividend from its domestic subsidiary company should be received in the same financial year in which the holding company declares, distributes or pays the dividend. Further, the dividend shall not be considered for reduction more than once.

The conditions to be fulfilled for this purpose are as follows:

1) The domestic subsidiary company should have paid the dividend distribution tax which is payable on such dividend;

2) The recipient holding company should be a domestic company;

For this purpose, a holding company is a company which holds more than 50% of the nominal value of equity shares of another company.

Section 115-O (1B) provides that for the purposes of determining the tax on distributed profits payable in accordance with section 115-O, any amount by way of dividends referred to in section 115-O(1), as reduced by the amount referred to in section 115-O(1A) [referred to as net distributed profits], shall be increased to such amount as would, after reduction of the tax on such increased amount at the rate specified in section 115-O(1), be equal to the net distributed profits.

On the basis of the aforesaid provision, dividend distribution tax payable by Piloo Limited shall be computed as follows:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.in lakh</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dividend distributed by Piloo Ltd.</td>
<td>50.00</td>
</tr>
<tr>
<td>Less: Dividend received from subsidiary Yaman Ltd. (60% of Rs. 35 lacs)</td>
<td>21.00</td>
</tr>
<tr>
<td>Net distributed profits</td>
<td>29.00</td>
</tr>
<tr>
<td>Add: Increase for the purpose of grossing up of dividend</td>
<td>5.12</td>
</tr>
<tr>
<td>Rs. $29 \times 100/85 = Rs. 34.12 minus Rs. 29.00</td>
<td></td>
</tr>
<tr>
<td>Gross dividend</td>
<td>34.12</td>
</tr>
<tr>
<td>Additional income-tax payable by Piloo Ltd. u/s 115-O [15% of Rs. 34.12]</td>
<td>5.12</td>
</tr>
</tbody>
</table>
In order to remove the cascading effect of DDT in a multi-tier corporate structure, section 115-O provides that, in case any domestic company (Piloo Ltd., in this case) receives any dividend during the year from any subsidiary company (Yaman Ltd., in this case) and such subsidiary company (Yaman Ltd.) has paid the DDT as payable on such dividend, then, dividend distributed by the holding company (Piloo Ltd.,) in the same year to the extent of dividend received from the subsidiary (Yaman Ltd.), shall not be subject to DDT under section 115-O, irrespective of whether the holding company (Piloo Ltd.) is a subsidiary of any other company (Kafi Ltd., in this case).

Therefore, in spite of the fact that Piloo Ltd. is a subsidiary of Kafi Ltd., it can reduce the amount of dividend received from Yaman Ltd. for computation of dividend distribution tax. Therefore, dividend distribution tax payable by Piloo Ltd. shall be 17.472% of Rs. 34.12 lacs (grossed up amount) i.e. Rs. 5.96 lacs.

**Illustration 6**

*XYZ Ltd., a domestic company, purchases its own unlisted shares on 4th July, 2019. The consideration for buyback amounted to Rs. 21 lakh, which was paid on the same day. The amount received by the company two years back for issue of such shares determined in the manner specified in Rule 40BB was Rs. 13 lakh. Compute the additional income-tax payable by XYZ Ltd. Compute the interest, if any, payable if such tax is paid to the credit of the Central Government on 29th September, 2019.*

*What would be your answer if the shares purchased were listed shares, other facts remaining the same?*

**Solution**

XYZ Ltd is liable to pay Rs. 1,86,368 as additional income-tax, which is the amount calculated @23.296% (20% plus surcharge@12% plus health and education cess@4%) on Rs. 8 lakh, being its distributed income (i.e., Rs. 21 lakh – Rs. 13 lakh).

The additional income-tax was payable on or before 18th July, 2019. However, the same was paid only on 29th September 2019.

Period for which interest@1% per month or part of a month is leviable -

<table>
<thead>
<tr>
<th>Period</th>
<th>No. of months/part of month</th>
</tr>
</thead>
<tbody>
<tr>
<td>19th July – 18th August, 2019 (whole of first month)</td>
<td>1</td>
</tr>
<tr>
<td>19th August – 18th September, 2019 (whole of second month)</td>
<td>1</td>
</tr>
<tr>
<td>19th September – 29th September, 2019 (part of third month)</td>
<td>1</td>
</tr>
<tr>
<td><strong>Total number of months</strong></td>
<td><strong>3</strong></td>
</tr>
</tbody>
</table>

Interest under section 115QB is payable @1% per month for 3 months on the amount of additional tax payable i.e., Rs. 1,86,300 (rounded off as per Rule 119A). Therefore, interest payable under section 115QB is Rs. 5,589.

If the shares purchased were listed shares, additional income-tax would not be attracted in the hands of XYZ Ltd., since the purchase was made before 5.7.2019.
Illustration 7

A business trust, registered under SEBI (Real Estate Investment Trusts) Regulations, 2014, gives particulars of its income for the P.Y.2019-20:

1. Interest income from Beta Ltd. – Rs. 4 crore;
2. Dividend income from Beta Ltd. – Rs. 2 crore;
3. Short-term capital gains on sale of listed shares of Beta Ltd. – Rs. 1.5 crore;
4. Short-term capital gains on sale of developmental properties – Rs. 1 crore;
5. Interest received from investments in unlisted debentures of real estate companies – Rs. 10 lakh;
6. Rental income from directly owned real estate assets – Rs. 2.50 crore

Beta Ltd. is an Indian company in which the business trust holds controlling interest. The business trust holds 100% of the shareholding of Beta Ltd.

Discuss the tax consequences of the above income earned by the business trust in the hands of the business trust and the unit holders, assuming that the business trust has distributed Rs. 10 crore to the unit holders in the P.Y.2019-20.

Solution

Tax consequences in the hands of the business trust and its unit holders

1. Interest income of Rs. 4 crore from Beta Ltd.: There would be no tax liability in the hands of the business trust due to pass-through status enjoyed by it under sub-clause (a) of section 10(23FC) in respect of interest income from Beta Ltd., being the special purpose vehicle. Therefore, Beta Ltd. is not required to deduct tax at source on interest payment to the business trust.

   The distributed income or any part thereof, received by a unit holder from the REIT, which is in the nature of interest income received or receivable from a SPV is deemed income of the unit holder as per section 115UA(3).

   The business trust has to deduct tax at source under section 194LBA –
   - @ 10%, on interest component of income distributed to resident unit holders;
   - @ 5%, on interest component of income distributed to non-corporate non-resident and foreign companies unit holders.

   Interest component of income distributed to unit holders is taxable in the hands of the unit holders – @ 5%, in case of unit holders, being non-corporate non-residents or foreign companies; and at normal rates of tax, in case of resident unit holders.

   The interest component of income received from the business trust in the hands of each unit holder would be determined in the proportion of 4/11.1, by virtue of section 115UA(1).

2. Dividend income of Rs. 2 crore from Beta Ltd.: The dividend distributed by the SPV to the business trust is exempt by virtue of section 115-O(7), since the SPV is a specified domestic company in which the business trust has become the holder of whole of the nominal value of equity share capital of the company. Further, there would be no tax liability in the hands of the business trust, due to specific exemption provided under sub-clause (b) of section 10(23FC).

   Any distributed income referred to in section 115UA, to the extent it does not comprise of interest [referred to in sub-clause (a) of section 10(23FC)] and rental income from real estate assets owned directly by the business trust [referred to in section 10(23FCA)] received by unit holders, is exempt in their hands under section 115UA(1).
10(23FD). Therefore, by virtue of section 10(23FD), there would be no tax liability on the dividend component [referred to in sub-clause (b) of section 10(23FC)] of income distributed to unit holders in their hands.

(3) **Short-term capital gains of Rs. 1.50 crore on sale of listed shares of Beta Ltd.:** As per section 115UA(2), the business trust is liable to pay tax@15% under section 111A in respect of short-term capital gains on sale of listed shares of special purpose vehicle. There would, however, be no tax liability on the capital gain component of income distributed to unit holders, by virtue of the exemption contained in section 10(23FD).

(4) **Short-term capital gains of Rs. 1 crore on sale of developmental properties:** It is taxable at maximum marginal rate of 42.744% in the hands of the business trust as per section 115UA(2). There would be no tax liability in the hands of the unit holders on the capital gain component of income distributed to them, by virtue of the exemption contained in section 10(23FD).

(5) **Interest of Rs. 10 lakh received in respect of investment in unlisted debentures of real estate companies:** Such interest is taxable @ 42.744%, being the maximum marginal rate, in the hands of the business trust, as per section 115UA(2). However, there would be no tax liability in the hands of the unit holders on the interest component of income distributed to them, by virtue of section 10(23FD).

(6) **Rental income of Rs. 2.50 crore from directly owned real estate assets:** Any income of a business trust, being a REIT, by way of renting or leasing or letting out any real estate asset owned directly by such business trust is exempt in the hands of the trust as per section 10(23FCA).

Where the income by way of rent is credited or paid to a business trust, being a REIT, in respect of any real estate asset held directly by such REIT, no tax is deductible at source under section 194-I.

The distributed income or any part thereof, received by a unit holder from the REIT, which is in the nature of income by way of renting or leasing or letting out any real estate asset owned directly by such REIT is deemed income of the unit holder as per section 115UA(3). The business trust has to deduct tax at source@10% under section 194LBA in case of distribution to a resident unit holder and at rates in force in case of distribution to a non-resident unit holder.

The rental income component received from the business trust in the hands of each unit holder would be determined in the proportion of 2.5/11.1, by virtue of section 115UA(1).

**Illustration 8**

*The following are the particulars of income of three investment funds for P.Y.2020-21:*

<table>
<thead>
<tr>
<th>Particulars</th>
<th>A</th>
<th>B</th>
<th>C</th>
<th>Rs. in lakh</th>
</tr>
</thead>
<tbody>
<tr>
<td>Business Income</td>
<td></td>
<td>2</td>
<td>(2)</td>
<td></td>
</tr>
<tr>
<td>Capital Gains</td>
<td>16</td>
<td>14</td>
<td>(6)</td>
<td></td>
</tr>
<tr>
<td>Income from other sources</td>
<td>4</td>
<td>4</td>
<td>8</td>
<td></td>
</tr>
</tbody>
</table>

Compute the total income of the investment funds and unit-holders for A.Y.2020-21, assuming that:

(i) each investment fund has 20 unit holders each having one unit; and
(ii) income from investment in the investment fund is the only income of the unit-holder.
If Investment Fund C has the following income components for A.Y.2021-22, what would be the total income of the fund and the unit holder for that year?

**Business Income Rs. 2 lakh**

**Capital Gains Rs. 9 lakh**

**Income from other source Rs. 8 lakh**

**Solution**

**Computation of total income of the investment fund for A.Y.2019-20**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>A</th>
<th>B</th>
<th>C</th>
</tr>
</thead>
<tbody>
<tr>
<td>Business Income</td>
<td>Nil</td>
<td>2,00,000</td>
<td>Nil</td>
</tr>
<tr>
<td>Total Income</td>
<td>Nil</td>
<td>2,00,000</td>
<td>Nil</td>
</tr>
</tbody>
</table>

**Computation of total income of a unit holder of the following Investment funds for A.Y. 2019-20**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>A</th>
<th>B</th>
<th>C</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital Gains</td>
<td>80,000</td>
<td>70,000</td>
<td>-</td>
</tr>
<tr>
<td>Income from other sources</td>
<td>20,000</td>
<td>20,000</td>
<td>30,000</td>
</tr>
<tr>
<td>Total Income</td>
<td>1,00,000</td>
<td>90,000</td>
<td>30,000</td>
</tr>
</tbody>
</table>

**Notes:**

(i) The total income of Investment Fund B would be chargeable to tax@30% if the fund is a firm and @30%/25%, as the case may, if the fund is a company and at the maximum marginal rate, in any other case.

(ii) In case of Investment Fund C, the business loss of Rs. 2 lakh is set-off against income from other sources of Rs. 8 lakh. Loss of Rs. 6 lakh under the head capital gains cannot be set-off. The same has to be carried forward by the Investment Fund for set-off in the subsequent years.

(iii) For A.Y.2020-21, the brought forward capital loss of Rs. 6 lakh can be set-off against capital gains of Rs. 9 lakh. Business income of Rs. 2 lakh would be taxable in the hands of the Investment Fund. Capital gains of Rs. 3 lakh (Rs. 9 lakh – Rs. 6 lakh) and Income from other sources of Rs. 8 lakh would be taxable in the hands of the unit-holders. The total income of each unit holder for A.Y.2020-21 would be Rs. 55,000, comprising of –

- Capital gains = Rs. 15,000 [i.e., Rs. 3 lakh/20]
- Income from other sources = Rs. 40,000 [i.e., Rs. 8 lakh / 20]

**Illustration 9**

Mr. Rajesh has income of Rs. 45 lakhs under the head “Profits and gains of business or profession”. One of his businesses is eligible for deduction@100% of profits under section 80-IB for A.Y. 2020-21. The profit from such business included in the business income is Rs. 20 lakhs. Compute the tax payable by Mr. Rajesh, assuming that he has no other income during the P.Y.2019-20.
Solution

Computation of regular income-tax payable under the provisions of the Act

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profits and gains of business or profession</td>
<td>45,00,000</td>
</tr>
<tr>
<td>Less: Deduction under section 80-IB</td>
<td>20,00,000</td>
</tr>
<tr>
<td><strong>Total Income</strong></td>
<td><strong>25,00,000</strong></td>
</tr>
</tbody>
</table>

Tax payable

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Upto Rs.2,50,000</td>
<td>Nil</td>
</tr>
<tr>
<td>5% on next Rs.2,50,000</td>
<td>12,500</td>
</tr>
<tr>
<td>20% on next Rs.5,00,000</td>
<td>1,00,000</td>
</tr>
<tr>
<td>30% on balance Rs. 15,00,000</td>
<td>4,50,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>5,62,500</strong></td>
</tr>
</tbody>
</table>

Computation of Alternate Minimum Tax (AMT)

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Income as per the Income-tax Act, 1961</td>
<td>25,00,000</td>
</tr>
<tr>
<td>Add: Deduction under section 80-IB</td>
<td>20,00,000</td>
</tr>
<tr>
<td><strong>Adjusted Total Income</strong></td>
<td><strong>45,00,000</strong></td>
</tr>
<tr>
<td>AMT = 18.5% × 45,00,000 =</td>
<td>8,32,500</td>
</tr>
</tbody>
</table>

Since the regular income-tax payable as per the provisions of the Act is less than the AMT, the adjusted total income of Rs. 45 lakhs would be deemed to be the total income of Mr. Rajesh and he would be liable to pay tax@18.5% thereof. The tax payable by Mr. Rajesh for the A.Y.2020-21 would, therefore, be Rs. 8,32,500 plus education cess@4% and secondary and higher education cess@1%, totaling Rs. 8,65,80.

Mr. Rajesh would be eligible for credit to the extent of Rs. 2,80,800 [Rs. 8,65,800 – Rs. 5,85,000 (i.e., Rs. 5,62,500 + 4% cess)] to be set-off in the year in which tax on total income computed under the regular provisions of the Act exceeds the AMT. Such credit can be carried forward for succeeding 15 assessment years.

Illustration 10

Mr. Ram (aged 56) is Karta of his HUF. The HUF consists of himself, his wife and two sons viz. Mr. C (aged 28) and Minor D (aged 16). The HUF is assessed to income tax and has business income from the year 2010-11 onwards. The business income of HUF for the year ended 31.3.2020 is Rs. 5,00,000 (computed). Mr. Ram is employed in a private company and his salary income for the same period is Rs. 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 Rs. 1,00,000 to the HUF of Mr. Ram. What would be the total income of HUF?

(ii) The HUF has one house property fetching rent of Rs. 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 Rs. 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 Rs. 10,000 from 1-10-2019. How would this income be taxed?
Solution

(i) Cash gift of Rs. 1 lakh by Mr. C, Ram’s major son, to the HUF of Mr. Ram would not be taxable in the hands of the HUF, since gifts from a relative of the HUF does not fall within the scope of income taxable under section 56(2)(x). Since Mr. C, being Mr. Ram’s son, is a member of Ram’s HUF, he is a relative of the HUF. Hence the total income of HUF would be Rs. 5 lakhs, being the business income computed.

Note - Salary income of Mr. Ram, the Karta of the HUF, who is employed in a private company would be taxed in his individual hands, since the remuneration earned by the Karta on account of the personal qualifications and exertions and not on account of the investment of the family funds cannot be treated as income of the HUF.

(ii) Partial partition (after 31.12.1978) is not recognized and the HUF, which has been hitherto assessed to tax, shall continue to be liable to be assessed as if no such partial partition has taken place [Section 171(9)].

The rental income in this case would continue to be assessed in the hands of the HUF, even after partial partition. Therefore, it is not advisable to do a partial partition.

(iii) Income of Rs. 70,000 earned by Minor D by use of his special skill and talent would be taxable in his individual hands. It will not be included in the hands of his parent by virtue of the exception to section 64(1A) contained in the proviso to section 64(1A).

(iv) As per section 64(2), where a member of the HUF blends his self-acquired property for inadequate consideration with the HUF, income derived therefrom is deemed to arise to the transferor-member and not to the HUF. In this case, Mr. Ram has blended his personal property (i.e., car) with the HUF.

Since there is no consideration in case of blending, the income from car computed in the prescribed manner, [which can be as per the presumptive provisions or lease rental of Rs. 60,000 (Rs. 10,000 × 6 months) less depreciation] would be deemed as the income of Mr. Ram.

Illustration 11

M/s. HIG, a firm, consisting of three partners namely, H, I and G, carried on the business of purchase and sale of television sets in wholesale and manufacture and sale of pens under a deed of partnership executed on 1.4.2010. H, I and G were partners in their individual capacity.

The deed of partnership provided for payment of salary amounting to Rs. 1,25,000 each to H and G, who were the working partners. A new deed of partnership was executed on 1.10.2019 which, apart from providing for payment of salary to the two working partners as mentioned in the deed of partnership executed on 1.4.2010, for the first time provided for payment of simple interest @ 12% per annum on the balances standing to the credit of the Capital accounts of partners from 1.4.2019.

The firm was dissolved on 31.3.2020 and the capital assets of the firm were distributed among the partners on 20.4.2020. The net profit of the firm for the year ended 31.3.2020 after payment of salary to the working partners and debit/credit of the following items to the Profit and Loss Account was Rs. 1,50,000:

(i) Interest amounting to Rs. 1,00,000 paid to the partners on the balances standing to the credit of their capital accounts from 1.4.2019 to 31.3.2020.

(ii) Interest amounting to Rs. 50,000 paid to the partners on the balances standing to the credit of their Current accounts from 1.4.2019 to 31.3.2020.
(iii) Interest amounting to Rs. 20,000 paid to the Hindu undivided family of partner H @ 18% per annum.
(iv) Payment of Rs. 25,000 towards purchase of television sets (stock in trade) made by crossed cheque on 1.11.2019.
(v) Rs. 30,000 being the value of gold jewellery received as gift from a manufacturer for achieving sales target.
(vi) Depreciation amounting to Rs. 15,000 on motor car bought and used exclusively for business purposes, but registered in the name of partner ‘H’.
(vii) Depreciation under section 32(1)(ii) amounting to Rs. 37,500 of new machinery bought and installed for manufacture of pens on 1.11.2019 at a cost of Rs. 5,00,000.
(viii) Interest amounting to Rs. 25,000 received from bank on fixed deposits made out of surplus funds.

The firm furnishes the following information relating to it:
(a) Closing stock-in-trade was valued at Rs. 60,000 as per the method of lower of cost or net realizable value consistently followed by it. The net realizable value of the closing stock - in-trade was Rs. 65,000.
(b) Brought forward business loss relating to the assessment year 2019-20 was Rs. 50,000.
(c) The fair market value of the capital assets as on 31.3.2020 was Rs. 20,00,000 and the cost of their acquisition was Rs. 15,00,000.

Compute the total income of M/s. HIG for the assessment year 2020-21.
You are required to furnish explanations for the treatment of the various items given above.

Solution

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net profit as per profit &amp; loss account</td>
<td>1,50,000</td>
</tr>
<tr>
<td>Add: Interest to partners on capital accounts for the period from 1.4.2018 to 30.9.2019 disallowed (total interest Rs. 1,00,000 but deduction limited to 6 months only hence 50% thereof is deductible and the balance is added) [Note (i)]</td>
<td>50,000</td>
</tr>
<tr>
<td>Interest to partners on current accounts from 1.4.2019 to 31.3.2020 – not authorized by the deed, hence disallowed [Note (ii)].</td>
<td>50,000</td>
</tr>
<tr>
<td>100% of Rs. 25,000 paid towards purchase of television sets otherwise than by an account payee cheque drawn on a bank or an account payee bank draft or use of electronic clearing system through a bank account or through such other electronic mode as may be prescribed (being stock in trade, hence disallowed) [Note (iv)].</td>
<td>25,000</td>
</tr>
<tr>
<td>Difference on account of valuation of closing stock-in-trade at market value (Rs. 65,000 less Rs. 60,000) [Note (ix)]</td>
<td>5,000</td>
</tr>
<tr>
<td>Salary paid to working partners considered separately.</td>
<td>2,50,000</td>
</tr>
<tr>
<td>3,80,000</td>
<td></td>
</tr>
<tr>
<td>5,30,000</td>
<td></td>
</tr>
<tr>
<td>Less: Additional depreciation on new machinery (Rs. 5,00,000 x 20%) = Rs. 1,00,000. Only 50% is allowable as deduction. [Note (vii)]</td>
<td>50,000</td>
</tr>
<tr>
<td>4,80,000</td>
<td></td>
</tr>
<tr>
<td>Less: Interest received from bank on fixed deposits considered separately</td>
<td>25,000</td>
</tr>
<tr>
<td>4,55,000</td>
<td></td>
</tr>
</tbody>
</table>
Less: Salary to working partners -
(i) As per limit in section 40(b)
   - On first Rs. 3,00,000 @ 90%: 2,70,000
   - On the balance of Rs. 1,55,000 @ 60%: 93,000
   - Total deduction allowed: 2,50,000
(ii) Salary actually paid
   - Deduction allowed being (i) or (ii) whichever is less: 2,05,000

Less: Business loss relating to assessment year 2019-20 set off: 50,000
Income from business: 1,55,000
Income from other sources:
   - Interest received from bank on fixed deposits: 25,000
Total Income: 1,80,000

Notes:
(i) Interest to partners authorised by the partnership deed will be allowed as deduction only for the period beginning with the date of the partnership deed and not for any earlier period as per section 40(b)(iv). Therefore, interest paid to the partners on the balances standing to the credit of their capital accounts from 1.10.2019 alone is eligible for deduction, since the partnership deed was executed only on 1.10.2019. Interest for the period prior to 1.10.2019 is not allowed.
(ii) The partnership deed of 1.10.2019 provides for payment of interest on balances in capital accounts of partners only. As such, the interest paid on the balances standing to the credit of the current accounts of partners is not allowable under section 40(b). The Kerala High Court has, in Novel Distributing Enterprises v. DCIT (2001) 251 ITR 704 (Ker), on identical facts, held that interest paid to the partners on their current account balances is not allowable.
(iii) Since H is a partner in his individual capacity, interest paid to the Hindu Undivided Family of partner H does not attract disallowance under section 40(b)(iv).
(iv) Section 40A(3) provides for disallowances @ 100% of the expenditure incurred otherwise than by an account payee cheque drawn on a bank or an account payee bank draft or use of electronic clearing system through a bank account or through such other electronic mode as may be prescribed. Since the firm has made payment of Rs. 25,000 towards purchase of television sets by a crossed cheque and not by an account payee cheque, 100% of such expenditure would be disallowed.
(v) Gold jewellery valued at Rs. 30,000 received as gift from a manufacturer for achieving sales target is taxable under section 28(iv), being a benefit arising from business.
(vi) Depreciation on motor car bought and used exclusively for the purposes of business is allowable though not registered in the name of the firm in view of the ratio of the decision of the Supreme Court in Mysore Minerals Ltd. v. CIT (1999) 239 ITR 775.
(vii) The firm is entitled to additional depreciation @ 20% under section 32(1)(iiia) in respect of the new machinery installed for manufacture of pens. Since the new machinery is put to use for less than 180 days during the relevant previous year, the additional depreciation is restricted to 50% of the prescribed rate of 20% i.e. it is restricted to 10%. The balance additional depreciation can be claimed in the immediately succeeding financial year.
(viii) Interest received from bank on fixed deposits made out of surplus funds is assessable under the head 'Income from other sources'. Hence, it is not taken into account for the purpose of computing book-profit.

(ix) As per para 24 of ICDS II: Valuation of Inventories, closing stock has to be valued at net realizable value in the case of a dissolved firm. As such, the closing stock-in-trade of the firm has to be valued at the net realizable value.

(x) Net profit shown in the profit and loss account computed in the manner laid down in Chapter IV-D as increased by the aggregate amount of the remuneration paid or payable to all the partners constitutes book profit as per Explanation 3 to section 40(b). Carry forward and set off of business loss is covered under Chapter VI. Hence, brought forward business loss relating to the assessment year 2019-20 is not considered for calculation of book-profit.

(xi) Section 45(4) is not applicable to the firm for the assessment year 2020-21, though the dissolution of the firm took place on 31.3.2020, as there was no transfer by way of distribution of capital assets during the relevant previous year. The distribution of the capital assets took place on 20.4.2020. The capital gains will, therefore, be assessable in the assessment year 2021-22.

Illustration 12

Vijay Agencies, a partnership firm constituted by three partners with equal shares was dissolved on 1-04-2019 after a search. The tax liability of the firm outstanding to be paid was determined at Rs. 15 Lacs. Out of three partners, one was declared insolvent on 18-03-2020 by the Court. The Assessing Officer, for recovering the demand, attached the Bank Accounts of other two partners and could recover an amount of Rs. 6 Lacs from the Account of one such partner. You are asked by the partners of the dissolved firm the following questions:

(i) About the liability of each of them to pay outstanding demand.

(ii) Whether the action of Assessing Officer to attach the Bank Account of partners to recover the tax demand of the dissolved firm is justified?

Solution

(i) As per section 189(3), every person who was at the time of dissolution, a partner of the firm, shall be jointly and severally liable for the amount of tax, penalty or other sum payable and all the provisions of the Act relating to assessment of such tax or imposition of such penalty or other sum, shall apply. Therefore, the three partners (till one was declared as insolvent by the Court) are jointly and severally liable for making the payment of outstanding dues of Rs. 15 Lacs. After insolvency of one partner, the other two partners are jointly and severally liable to pay such demand.

(ii) Accordingly, the action of the Assessing Officer to attach the bank accounts of the partners for recovery of outstanding demand is correct and the amount of Rs. 6 Lacs recovered by attachment of the bank account of one of the partners is also in order.

Illustration 13

JK Associates is an Association of Persons (AOP) consisting of two members, J and K. Shares of the members are: 60%(J) and 40%(K). Income of the AOP for the previous year 2019-20 is Rs. 6 lacs.

Compute tax liability of the AOP and the members in the following situations:
(i) J and K have their income, other than income from AOPs, amounting to Rs. 1 lac and Rs. 2.7 lacs, respectively.
(ii) J and K’s income, other than income from AOPs, amount to Rs. 1.50 lac and Rs. 2.30 lacs, respectively.

**Solution**

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

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

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

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

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

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

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

**Tax Liability of J K Associates, AOP**

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

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

**Tax Liability of J and K**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>J Rs.</th>
<th>K Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i) Share of profit from AOP</td>
<td>Exempt</td>
<td>Exempt</td>
</tr>
<tr>
<td>Income from other sources</td>
<td>1,00,000</td>
<td>2,70,000</td>
</tr>
<tr>
<td>Total Income</td>
<td>1,00,000</td>
<td>2,70,000</td>
</tr>
<tr>
<td>Tax liability</td>
<td>NIL</td>
<td>1,000</td>
</tr>
<tr>
<td>Less: Rebate under section 87A</td>
<td>–</td>
<td>1,000</td>
</tr>
<tr>
<td>Total tax payable</td>
<td>NIL</td>
<td>NIL</td>
</tr>
<tr>
<td>(ii) Share of profit from AOP</td>
<td>4,20,000</td>
<td>2,80,000</td>
</tr>
<tr>
<td>Income from other sources</td>
<td>1,50,000</td>
<td>2,30,000</td>
</tr>
<tr>
<td>(A)</td>
<td>5,70,000</td>
<td>5,10,000</td>
</tr>
<tr>
<td>Tax liability</td>
<td>26,500</td>
<td>14,500</td>
</tr>
<tr>
<td>Add: Health and Education cess @ 4%</td>
<td>1,060</td>
<td>580</td>
</tr>
<tr>
<td>Total tax payable</td>
<td><strong>27,560</strong></td>
<td><strong>15,080</strong></td>
</tr>
<tr>
<td>Average rate of tax [B/A × 100]</td>
<td>4.835%</td>
<td>2.957%</td>
</tr>
<tr>
<td>Total tax liability</td>
<td>27,560</td>
<td>15,080</td>
</tr>
</tbody>
</table>
Illustration 14

Transfer fees are received by a cooperative housing society from its incoming and outgoing members. Are such transfer fees liable to tax in the hands of the cooperative society?

Solution

The issue under consideration is whether the transfer fees received by a co-operative housing society from its incoming and outgoing members is taxable or exempt on the principle of mutuality.

On this issue, the High Court, in *Sind Co-operative Housing Society v. ITO* (2009) 317 ITR 47, observed that under the bye-laws of the society, charging of transfer fees had no element of trading or commerciality. Both the incoming and outgoing members have to contribute to the common fund of the assessee. The amount paid was to be exclusively used for the benefit of the members as a class.

The High Court, therefore, held that transfer fees received by a co-operative housing society, whether from outgoing or from incoming members, is not liable to tax on account of the principle of mutuality, since the predominant activity of such co-operative society is maintenance of property of the society and there is no taint of commerciality, trade or business.

Further, section 28(iii), which provides that income derived by a trade, professional or similar association from specific services performed for its members shall be treated as business income, can have no application since the co-operative housing society is not a trade or professional association.

Applying the rationale of the above ruling, transfer fees received by a co-operative housing society from its incoming and outgoing members would not be liable to tax in the hands of the co-operative society.
EXERCISE

Question 1
A trust, unless created for "charitable purpose", does not qualify to claim exemption under Chapter III of the Act. In this context, explain the meaning of "charitable purpose" and examine whether the following objects constitute part of it:

(i) Rural reconstruction and upliftment of the masses through Cottage Industry.
(ii) Welfare of industrial workers with a stipulation that the workers of settlor of trust have got preference over others.

Answer
Section 2(15) defines “charitable purpose” to include relief of the poor, education, medical relief, yoga, preservation of environment (including watersheds, forests and wildlife) and preservation of monuments or places or objects of artistic or historic interest and the advancement of any other object of general public utility. However, “advancement of any other object of general public utility” would not be a charitable purpose, if it involves carrying on of any activity in the nature of trade, commerce or business or, any activity of rendering of any service in relation to any trade, commerce or business, for a fee or cess or any other consideration, irrespective of the nature of use or application of the income from such activity or the retention of such income, by the concerned entity.

“Advancement of any other object of general public utility” would continue to be a “charitable purpose”, if the total receipt from any activity in the nature of trade, commerce or business, or any activity of rendering any service in relation to any trade, commerce or business does not exceed 20% of the total receipts of the trust in the previous year, and such activity is undertaken in the course of actual carrying out of such advancement of any other object of general public utility.

(i) The Supreme Court has, in 

Thiagarajar Charities vs. Addl. CIT (1997) 225 ITR 1010, observed that “cottage industry” is associated with the idea of a small, simple enterprise or industry in which employees work in their own houses or in a small place, gathered together for the purpose, using their own equipments and is usually found in rural areas or so carried on, by the poorer section of the society. In substance, the activity of rural reconstruction and upliftment of masses through cottage industry is to afford relief to the poor and consequently, it is for charitable purpose.

(ii) The welfare of industrial workers with a stipulation that the workers of settlor of trust have preference over others would also constitute “charitable purpose” within the meaning of section 2(15). The Patna High Court has, in 

CIT v. Tata Steel Charitable Trust (1993) 203 ITR 764, observed that exemption under section 11(1) can be availed only if the following conditions are satisfied –

(1) the trust is created for a charitable purpose; and
(2) no part of the income of such trust enures or has been used or applied directly or indirectly for the benefit of any person referred to in section 13(3).

The list of persons contained in section 13(3) does not include employees of the settlor of the trust. Section 13(3)(d), which includes any relative of the author, can have no application because “relative” means a person connected by birth or marriage with another person. A person having relationship pursuant to a contract like that of an employer and an employee cannot be said to be a relative. The
High Court concluded that it was immaterial that any employee of the settler of the trust had acquired any benefit out of the income of the trust as an ordinary member of the community. Therefore, the application of part of the income of the trust for the benefit of the employees of the settler cannot disentitle the trust from claiming exemption under section 11.

Question 2
How do you deal with the following situation? Give reasons for your answer.
Ramji Charitable Trust has filed return of income for the Assessment Year 2020-21 within the stipulated time under section 139(1) and applied only 50% of its income to specified purposes. It intends to accumulate the balance 35% of income to be spent in future years. While completing the assessment, the Assessing Officer disallowed the accumulated income of 35% and taxed the same on the ground that the trust has not made any application under section 11(2) along with return of income. Discuss the validity of the action of the Assessing Officer in this case.

Answer
Section 11(2) provides that a charitable trust has to apply 85% of its income to charitable purposes and where 85% of its income is not applied for such purposes, the trust may accumulate or set apart either the whole or part of its income for future application for such purposes in India. The requirement of the Act is that the trust has to make an application/intimation in the prescribed form, for accumulation of income, specifying the purpose and the period (not exceeding 5 years). The application should be filed or furnished before the assessing authority on or before the due date specified under section 139(1). Further, the money so set apart or accumulated should be invested/deposited in any one or more of these modes or forms specified under section 11(5).

Thus, this requirement of filing application is mandatory and without those particulars, the assessing authority cannot entertain the claim of the assessee under section 11. In case the statement in Form 10 is not submitted on or before the due date of filing return of income under section 139(1), then, the benefit of accumulation would not be available and such income would be taxable at the applicable rate. Further, the benefit of accumulation would also not be available if return of income is not furnished on or before the due date of filing of return of income under section 139(1). Therefore, the action of the Assessing Officer in this case is valid.

Question 3
An institution operating for promotion of education claiming exemption under section 11 since 1994 furnishes the following data for the assessment year 2020-21:

<table>
<thead>
<tr>
<th>S. No.</th>
<th>Particulars</th>
<th>Rs.in crores</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i)</td>
<td>Fees collected from students</td>
<td>14</td>
</tr>
<tr>
<td>(ii)</td>
<td>Construction of a new computer science laboratory</td>
<td>0.50</td>
</tr>
<tr>
<td>(iii)</td>
<td>Land acquired to be used as a cricket field for the students</td>
<td>2</td>
</tr>
<tr>
<td>(iv)</td>
<td>Amount earmarked and set apart for construction of an arts block within the next 4 years.</td>
<td>4</td>
</tr>
</tbody>
</table>

Compute the total income of the institution for the A.Y.2020-21.
**Question 4**

A public charitable trust registered under Section 12AA, for the previous year ending 31.3.2020, derived gross income of Rs. 21 Lacs, which consists of the following:

<table>
<thead>
<tr>
<th></th>
<th>(Rs. in Lacs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a)</td>
<td>Income from properties held by trust (net)</td>
</tr>
<tr>
<td>(b)</td>
<td>Income (net) from business (incidental to main objects)</td>
</tr>
<tr>
<td>(c)</td>
<td>Voluntary contributions from public</td>
</tr>
</tbody>
</table>

The trust applied a sum of Rs. 11.60 lacs towards charitable purposes during the year which includes repayment of loan taken for construction of orphanage Rs. 3.60 lacs.

Determine the taxable income of the trust for the assessment year 2020-21.

**Answer**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i) Income from property held under trust (net)</td>
<td>10,00,000</td>
</tr>
<tr>
<td>(ii) Income (net) from business (incidental to main objects)</td>
<td>4,00,000</td>
</tr>
<tr>
<td>(iii) Voluntary contributions from public</td>
<td>7,00,000</td>
</tr>
</tbody>
</table>

Voluntary contribution made with a specific direction towards corpus are alone to be excluded under section 11(1)(d). In this case, there is no such direction and hence, included.
Question 5
A charitable trust registered under section 12AA of the Income-tax Act, 1961 has, out of its income of Rs. 3,90,000 for the year ending 31.3.2020 and sale proceeds of a capital asset, held by it for less than 24 months, amounting to Rs. 9,60,000, purchased a building during the year ending 31.3.2020 for Rs. 13,50,000. The capital asset was sold during the year ending 31.3.2020. The building is held only for charitable purposes. The trust claims that the purchase of the building amounts to application of its income for charitable purposes and that the capital gain arising on the sale of the capital asset is deemed to have been applied to charitable purposes. Is the claim made by the charitable trust valid in law?

Answer
Section 11(1)(a) stipulates that in order to avail exemption of income derived from property held under trust wholly for charitable or religious purposes, the trust is required to apply for charitable or religious purposes, 85% of its income from such property. In this case, the trust has earned income of Rs. 3,90,000 for the year ended 31.3.2020. It has also earned short term capital gain from sale of capital asset for Rs. 9,60,000. The trust had utilized the entire amount of Rs. 13,50,000 for the purchase of a building meant for charitable purposes.

The Supreme Court, in S.R.M. M. CT. M. Tiruppani Trust v. CIT (1998) 230 ITR 636, ruled that the assessee-trust, which applied its income for charitable purposes by purchasing a building for use as a hospital, was entitled to exemption under section 11(1) in respect of such income.

The ratio of the decision squarely applies to the case of the charitable trust in question. Therefore, the charitable trust is justified in claiming that the purchase of the building amounted to application of its income for charitable purposes.

Under section 11(1A), where the whole of the sale proceeds of a capital asset held by a charitable trust is utilised by it for acquiring another capital asset, the capital gain arising therefrom is deemed to have been applied to charitable purposes and would be exempt. Section 11(1A) does not make any distinction between a long-term capital asset and a short-term capital asset. The claim of the charitable trust to the effect that the capital gain is deemed to have been applied to charitable purposes is tenable in law.

Question 6
Work out, from the following particulars, the amount of capital gain which shall be deemed to have been applied for charitable or religious purpose arising out of sale of a capital asset utilized for the purposes of trust to the extent of 60%:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost of transferred asset</td>
<td>2,40,000</td>
</tr>
<tr>
<td>Sale consideration</td>
<td>3,60,000</td>
</tr>
</tbody>
</table>
### Question 7

*An electoral trust approved by the CBDT is not liable to income-tax in respect of voluntary contribution received and other income - Examine the correctness of the statement.*

**Answer**

Section 13B provides exemption in respect of voluntary contribution received by an electoral trust approved by the CBDT in accordance with the scheme to be made by the Central Government.

Voluntary contribution received by an electoral trust would be treated as its income under section 2(24), but shall be exempt under section 13B if the trust distributes to a registered political party during the year, 95% of the aggregate donations received by it during the year along with surplus brought forward from any earlier years. Another condition for availing the benefit under this section is that the electoral trust should function in accordance with the rules framed by the Central Government.

It may be noted that the exemption under section 13B will be available only in respect of voluntary contribution received by an electoral trust. The exemption cannot be claimed in respect of any other income of the electoral trust.

Therefore, the given statement is not correct.

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**ADDITIONAL ILLUSTRATIONS FOR PRACTICE:**

**Illustration 1**

*An educational institution having annual receipts of Rs. 1.20 crore during the P.Y. 2019-20, has to make an application to the prescribed authority before 31.3.2020 for claiming tax exemption under section 10(23C). Discuss the correctness or otherwise of this statement.*

**Solution**

This statement is not correct.

According to the first proviso to section 10(23C), an educational institution having aggregate annual receipts exceeding Rs. 1 crore, is required to make an application to the prescribed authority for grant of exemption under section 10(23C)(vi). Further, it is
provided that such application can be made on or before 30th September of the relevant assessment year from which the exemption is sought.

Therefore, in the given case, the educational institution (having annual receipts of **Rs. 1.20 crore** during the P.Y. 2019-20 can make an application for grant of exemption in the prescribed form to the prescribed authority on or before 30th September, 2020, for claiming exemption under section 10(23C)(vi) for previous year 2019-20.

**Illustration 2**

An institution having its main object as “advancement of general public utility” received **Rs. 30 lakhs** in aggregate during the P.Y.2019-20 from an activity in the nature of trade. The total receipts of the institution, including donations, was **Rs. 140 lakhs**. It applied 85% of its total receipts from such activity during the same year for its main object i.e. advancement of general public utility.

(i) What would be the tax consequence of such receipt and application thereof by the institution?

(ii) Would your answer be different if the institution’s total receipts had been **Rs. 150 lakhs** (instead of **Rs. 140 lakhs**) in aggregate during the P.Y.2019-20?

(iii) What would be your answer if the main object of the institution is “relief of the poor” and the institution receives **Rs. 30 lakhs** from a trading activity, when its total receipts are **Rs. 140 lakhs** and applies 85% of the said receipts for its main object?

**Solution**

(i) As the main object of the institution is “advancement of object of general public utility”, the institution will lose its “charitable” status for the P.Y.2019-20, since it has received **Rs. 30 lakhs** from an activity in the nature of trade, which exceeds **Rs. 28 lakhs**, being 20% of the total receipts of the institution undertaking that activity for the previous year. The application of 85% of such receipt for its main object during the year would not help in retaining its “charitable” status for that year. The institution will lose its charitable status and consequently, the benefit of exemption of income for the P.Y.2019-20, irrespective of the fact that its approval is not withdrawn or its registration is not cancelled.

(ii) If the total receipts of the institution is **Rs. 150 lakhs**, and the institution receives **Rs. 30 lakhs** in aggregate from an activity in the nature of trade during the P.Y.2019-20, then it will not lose its “charitable” status since receipt of upto 20% of the total receipts of the institution in a year from such activity is permissible. The institution can claim exemption subject to fulfilment of other conditions under sections 11 to 13. Further, such activity should also be undertaken in the course of actual carrying out of such advancement of any other object of general public utility.

(iii) The restriction regarding carrying on of a trading activity for a cess, fee or other consideration will not apply if the main object of the institution is “relief of the poor”. Therefore, receipt of **Rs. 30 lakhs** from a trading activity by such an institution will not affect its “charitable” status, even if it exceeds 20% of the total receipts of the institution. The institution can claim exemption subject to fulfilment of other conditions under sections 11 to 13.
Illustration 3

(a) “Save Wild Life” an institution having its main object as ‘preservation of wildlife’, used the entire income derived from an activity in the nature of trade for its main object during the previous year ended on 31.03.2020. The institution seeks your opinion to know whether such utilization of its income be treated for “charitable purpose”? Would your answer be different, if the main object of the institution is “advancement of object of general public utility”?

(b) A charitable trust derives its income from the business of providing mineral water to various companies situated in Software Technology Park in Hyderabad. A sum of Rs. 30 lacs has been derived as net income from such business activity, which has been applied for the object of general public utility. The total receipts of the trust during the P.Y. 2019-20 was Rs. 140 lacs. Examine the taxability of application of the income, if the income so derived relates to the previous year 2019-20. Would your answer be different, if the trust runs a school in a backward district and applies the profits from the business for such school’s activity?

Solution

(a) Section 2(15) defines “charitable purpose” to include relief of the poor, education, yoga, medical relief, preservation of environment (including watersheds, forests and wildlife) and preservation of monuments or places or objects of artistic or historic interest and the advancement of any other object of general public utility. However, the “advancement of any other object of general public utility” shall not be a charitable purpose, if the institution is carrying on any activity in the nature of trade, commerce or business, or any activity of rendering any service in relation to any trade, commerce or business, for a cess or fee or any other consideration, irrespective of the nature of use or application, or retention, of the income derived from such activity.

Therefore, preservation of wildlife is included in the definition of “charitable purpose” under section 2(15). Further, an institution having the preservation of wildlife as its main object would not be subject to the restrictions which are applicable to the “advancement of any other object of general public utility”. Such institution would continue to retain its “charitable” status, even if it derives income from an activity in the nature of trade.

However, if an institution having its main object as “advancement of any other object of general public utility”, derives income from an activity in the nature of trade during a financial year, it would lose its “charitable” status for that year, even if it applies such income for its main objects.

It may be noted that if the receipts from such activity does not exceed 20% of the total receipts in that year, then, the institution would not lose its “charitable” status, even its main object is “advancement of any other object of general public utility”, if such activity is undertaken in the course of actual carrying out of such advancement of any other object of general public utility.

(b) In the first case, net income from the business of supplying mineral water to various companies i.e., Rs. 30 lacs is not eligible for exemption under section 11, since the receipt from such activity exceeds 20% of total receipts (i.e., 20% of Rs. 140 lakhs) during the year. This is because “advancement of any object of general public utility” would not be a charitable purpose if it involves carrying on of any activity in the nature of trade, commerce or business, for example, supply of...
mineral water for a consideration, as in this case. It is immaterial that the net income from such business is applied for the object of general public utility.

On the other hand, where the trust runs a school in a backward district, this restriction is not applicable. The reason is that the restriction contained in section 2(15) is applicable only to the last limb of the definition of “charitable purpose” i.e. advancement of object of general public utility. It does not affect the other limbs of the definition viz. “relief of the poor”, “education”, “medical relief” etc.

Section 11(4) clarifies that “property held under trust” includes a business undertaking so held. As per section 11(4A), exemption can be availed in respect of profits and gains of business, if such business is incidental to the attainment of the objectives of the trust and separate books of account are maintained in respect of such business. Therefore, in the second case, the profit from the business shall be eligible for exemption under section 11, assuming that the said business is incidental to the attainment of the objects of the trust (i.e., education) and books of account for such business activity is maintained separately.

Illustration 4

A charitable institution registered under section 12AA of the Income-tax Act, 1961 filled in Form No.10 for seeking permission to accumulate unapplied income under Section 11(2) of the Act for the objects of the institution and submitted it to the Assessing Officer along with the resolution for accumulation. The Assessing Officer found that the objects for which accumulation was sought were not particularised in as much as they covered the entire range of objects of the institution. Can the Assessing Officer deny the benefit of accumulation in such a case?

Solution

Section 11(2) permits a charitable trust or institution to accumulate its unspent income where 85% of the income is not applied or is not deemed to have been applied to charitable or religious purposes in India during the previous year. The institution or trust has to specify, by notice in writing given to the Assessing Officer, the purpose for which the income is being accumulated or set apart and the period for which such income is to be accumulated or set apart.

In the given case, the assessee institution sought the permission of the Assessing Officer to accumulate unapplied income for the objects of the institution. The institution had not stated any objects in particular for which the unspent income was sought to be accumulated or set apart. In Bharat Krishak Samaj vs. Deputy Director of Income-tax (Exemption) (2008) 306 ITR 153 (Del.), it was held that it is not necessary for a charitable trust to particularize each and every object for which accumulation is sought. It is enough if the assessee seeks permission for accumulation for the objects of the trust. Therefore, the Assessing Officer cannot deny the benefit of accumulation in such a case.

Illustration 5

MSO Foundation, a charitable institution set up on 1st April, 2019 and registered under section 12AA with effect from that date, is engaged in providing education in hotel management. The organisation acquires a building for using the same for holding classes and office activities. It has approached you for your opinion on its eligibility to claim the
cost of the building and also depreciation thereon in the current year and the subsequent year. Advise the institution indicating the reasons.

Solution

(i) 15% of income from property held for charitable purposes is exempt from tax under section 11. The remaining 85% of such “income” would be exempt if it is “applied” for charitable purposes in India.
(ii) Application of the amount can be for revenue or capital purposes. As long as the expenditure is incurred out of income earned by the trust and for the purposes of carrying on the objects of the trust, it would be treated as application of income even if such expenditure is for capital purposes. Therefore, since the building is acquired by the organization for holding classes and office activities, which is for the purposes of carrying on the objects of the charitable institution i.e., for providing education in hotel management, the cost of the building would be treated as application of income.

However, section 11 provides that where the cost of building is claimed as application, no other deduction for depreciation or otherwise would be allowed as an application of income in respect of such asset for the same or any other previous year.

Illustration 6

Hundi (charitable box) superscribing “contributions in this hundi form part of corpus of trust fund” kept at Lord Venkateshwara Temple, Tirumala, was opened on 30.3.2020. Cash of Rs. 100 lacs and valuable articles worth Rs. 250 lacs were found to have been contributed by the devotees. Discuss the tax implications.

Solution

As per section 11(1)(d), income in the form of voluntary contributions made with a specific direction that they shall form part of the corpus of the trust or institution shall not be included in the total income of the recipient. In the given case, there is a specific declaration by the temple authorities that the contributions being put in the hundi (charity box) would form part of the corpus of the trust fund. Therefore, it is possible to take a view that those who put the contributions in the hundi give a tacit declaration that the contributions would form part of the corpus. Hence, a view can be taken that such contributions shall not be included in the total income of the recipient trust.

Further, it may be noted that the provision relating to taxability of anonymous donations under section 115BBC does not apply to voluntary contributions received by a trust or institution created or established wholly for religious purposes.

Illustration 7

Can a trust created for charitable purposes in April 2019, having filed application for registration as per section 12A on 11.4.2020, claim benefits of sections 11 and 12 from Assessment Year 2020-21?

Solution

In respect of applications filed on or after 1st June, 2007, the provisions of sections 11 and 12 shall apply from the assessment year relevant to the financial year in which the application is made i.e., the exemption would be available only with effect from the assessment year relevant to the previous year in which the application is filed. It would not be available in respect of any earlier assessment year.
Therefore, since the trust has filed application for registration only on 11.4.2020, it cannot claim benefit of sections 11 and 12 from A.Y.2020-21. Assuming that the registration has been granted under section 12AA, the exemption would be available only from the A.Y. 2021-22, being the assessment year relevant to the previous year in which application is filed [i.e., P.Y. 2020-21].

However, where a trust has been granted registration under section 12AA in the P.Y. 2020-21, the benefit of sections 11 and 12 shall be available in respect of any income derived from property held under trust for assessment year 2020-21, being the assessment year preceding the assessment year in which application is filed i.e., A.Y.2021-22, if assessment proceedings in respect of that year is pending before the Assessing Officer as on the date of such registration.

It may be noted that exemption in respect of an earlier assessment year can be claimed only if the objects and activities of such trust or institution in the relevant earlier assessment year are the same as those on the basis of which such registration has been granted.

**Illustration 8**

*Help All, a trust created on 1\textsuperscript{st} January, 2020 for providing relief to the poor, applied for registration under section 12A on 1\textsuperscript{st} March, 2020. On that date, its corpus fund comprised only of the initial contribution made by the trustees. The Commissioner denied registration solely on the ground that the trust had not commenced any charitable activity, due to which he could not satisfy himself about the genuineness of the trust. Is the ground for denial of registration by the Commissioner justified in this case? Discuss.*

**Solution**

The Karnataka High Court, in *DIT (Exemptions) v. Meenakshi Amma Endowment Trust* (2013) 354 ITR 219, opined that an application under section 12A for registration of the trust can be sought even within a week of its formation. The activities carried on by the trust are to be seen in a case where the registration is sought much later after formation of the trust.

The High Court further observed that the corpus fund included contribution made by the trustees only, which indicated that the trustees were contributing the funds by themselves in a humble way and were intending to commence charitable activities. The assessee-trust had not also collected any donation for the activities of the trust, by the time its application came up for consideration before them. When the application for registration was made, the trust, therefore, did not have sufficient funds for commencement of its activities.

The High Court observed that, with the money available with the trust, it cannot be expected to carry out activity of charity immediately. Consequently, in such a case, it cannot be concluded that the trust has not intended to do any activity of charity. In such a situation, where application is made shortly after formation of the trust, the objects of the trust as mentioned in the trust deed have to be taken into consideration by the authorities for satisfying themselves about the genuineness of the trust and not the activities carried on by it. Later on, if it is found from the subsequent returns filed by the trust, that it is not carrying on any charitable activity, it would be open to the concerned authorities to withdraw the registration granted or cancel the registration as per the provisions of section 12AA(3).
Applying the rationale of the above ruling, the Commissioner cannot deny registration solely on the ground that the trust had not commenced any charitable activity in this case, since the trust has applied for registration under section 12A within two months after its formation and the corpus fund comprised only of contribution made by the trustees. The Commissioner has to take into consideration the objects of the trust as mentioned in the trust deed to satisfy itself about the genuineness of the trust.

Illustration 9

Educare, a trust created with the objective of promoting primary education in rural areas, filed an application for registration under section 12A on 30th April, 2019. Since the application was not disposed of by the Commissioner on or before 31st October, 2019 as required under section 12AA(2), the trust contended that it was deemed to be registered as per the provisions of section 12AA(1). Examine the correctness of contention of the trust.

Solution

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 under section 12A(1)(a) or section 12A(1)(aa).

The Supreme Court, in CIT v. Society for Promotion of Education (2017) 382 ITR 6, held that once an application under section 12AA was made and the same was not responded to within six months, the trust would be deemed as registered with effect from the date following the expiry of the six month period.

Applying the rationale of the above Supreme Court ruling in this case, the trust would be deemed as registered with effect from 1.11.2019. 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.

Note: The benefit of exemption under section 11 and 12 would be available from the A.Y. 2020-21, being the assessment year relevant to the financial year in which such application is made.

Illustration 10

A charitable trust, whose income can be exempt under section 11 of the Income-tax Act, 1961, was formed on 1st March, 2017. For the accounting year ended 31st March, 2020, it earned an income of Rs. 3,60,000.

It filed with the Commissioner of Income-tax its application for registration on 31st August, 2019 explaining that for good and sufficient reasons, it was prevented from filing the application for so long.

Examine

(i) by which date the application for registration should have been filed;
(ii) whether such an application could have been filed before the formation of the trust;
(iii) in the absence of an order of registration from the Commissioner, can the trust be deemed to be registered;
(iv) the steps to be taken by the trust to secure exemption from income-tax;
(v) whether a certificate of registration once granted can be cancelled and if so, the conditions there for.

Solution

(i) The requirement of filing an application for registration under section 12A within one year of creation of the trust has been removed. The application can be filed at any time now. Accordingly, the provisions of sections 11 and 12 would apply from the assessment year relevant to the financial year in which the application is made i.e. the exemption would be available only with effect from the assessment year relevant to the previous year in which the application was filed.

However, where registration has been granted to the trust under section 12AA and on the said date, assessment proceedings relating to earlier assessment years are pending, then, the benefit of sections 11 and 12 shall be available in respect of income derived from property held under trust in those years, provided the objects and activities of the trust remain unchanged.

(ii) No. The application for registration under section 12A cannot be filed before the formation of the trust.

(iii) As per section 12AA(2), every order granting or refusing registration should be passed before the expiry of 6 months from the end of the month in which the application was received under section 12A. The Supreme Court, in CIT v. Society for Promotion of Education (2017) 382 ITR 6, held that the trust would be deemed as registered if the application under section 12AA is not disposed of within the stipulated period of six months. Therefore, in this case, the trust would be deemed as registered with effect from 1st March, 2020. The benefit of exemption under section 11 and 12 would be available from A.Y. 2020-21, being the assessment year relevant to the financial year in which the application is made.

(iv) The following are the steps to be taken by the trust to secure exemption from income - tax:

1. The trust should be registered with the Principal Commissioner or Commissioner of Income-tax under section 12AA.

2. The accounts of the trust for the previous year must be audited by a Chartered Accountant if its total income without giving effect to the provisions of section 11 and section 12 exceeds the maximum amount which is not chargeable to tax. The audit report in the prescribed form, duly signed and verified by the Chartered Accountant, should be furnished along with the return of income of the trust for the relevant assessment year.

3. At least 85% of the income is required to be applied for the approved purposes.

4. The unapplied income and the money accumulated or set apart should be invested or deposited in the specified forms or modes, after filing statement in Form 10 on or before the due date of filing return of income specified under section 139(1).

(v) Yes, the certificate of registration can be cancelled by the Commissioner. According to section 12AA, if the Commissioner is satisfied that the activities of the trust are not genuine or are not being carried out in accordance with the objects of the trust, he shall, after giving the trust a reasonable opportunity of being heard, pass an order in writing cancelling the registration of the trust.

Further, section 12AA(4) provides that where a trust or an institution has been granted registration, and subsequently it is noticed that its activities are being carried out in such a manner that,—
(i) its income does not enure for the benefit of general public;
(ii) it is for benefit of any particular religious community or caste;
(iii) any income or property of the trust is applied for benefit of specified persons like author of trust, trustees etc.; or
(iv) its funds are invested in prohibited modes,

then, the Commissioner may cancel the registration of such trust or institution. The Commissioner may also cancel the registration of such trust or institution, if it has not complied with the requirement of any other law and the order, direction or decree, by whatever name called, holding that such non-compliance has occurred, has either not been disputed or has attained finality. However, if the trust or institution proves that there was a reasonable cause for the activities to be carried out in the above manner, the registration shall not be cancelled.

Illustration 11
The following trusts claim that anonymous donations received by them during the financial year 2019-20 are not liable to tax under section 115BBC:

(i) A charitable trust referred to in section 11 which applied the entire amount of anonymous donations for purposes of the trust during the relevant financial year.

(ii) A trust established wholly for religious purposes which applied 85% of the amount of anonymous donations for the purposes of the objects of the trust during the relevant financial year.

Examine the validity of the claim made by the trusts.

Solution
(i) Section 115BBC provides for levy of tax @ 30% on anonymous donation received by, inter alia, charitable trusts or institutions referred to in section 11 in the following manner:

(a) the amount of income-tax calculated @30% on the aggregate of anonymous donations received in excess of 5% of the total donations received by the assessee or one lakh rupees, whichever is higher; and

(b) the amount of income-tax with which the assessee would have been chargeable had his total income been reduced by the aggregate of the anonymous donations received in excess of 5% of the total donations received by the assessee or Rs. 1 lakh, as the case may be.

Further, section 13(7) provides that the exemption provisions contained in sections 11 and 12 shall not be applicable in respect of any anonymous donation liable to tax under section 115BBC. As such, application of the anonymous donations received by the charitable trust for charitable purposes does not confer any exemption from tax. Therefore, the claim for non-taxability under section 115BBC of anonymous donations received by the charitable trust is not valid in law.

However, a view may be taken that anonymous donation upto higher of 5% of total donations or Rs. 1 lakh, which is taxable at normal rates would be eligible for application of income and thereby, the benefit of exemption under section 11 would apply.

(ii) Section 115BBC(2) provides that the provisions contained in section 115BBC(1) relating to the taxability of anonymous donations are not applicable to any trust or institution created or established wholly for religious purposes. As such, the trust established wholly for religious purposes is not liable to be taxed in respect of the
anonymous donations received by it. Therefore, the claim made by the trust is valid in law. The application or non-application of such anonymous donation for the purposes of trust during the relevant financial year is not germane to the issue of taxability under section 115BBC.

Illustration 12

Explain in the context of provisions of the Act, whether the income derived during the year ended on 31.03.2020 in following case shall be subject to tax in the A.Y. 2020-21:

A political party, duly registered under section 29A of the Representation of the People Act, 1951, received rent of Rs. 1,25,000 per month of one of its building let out to a bank from 01.06.2019.

Solution

Rent received by the political party from the bank is an income chargeable under the head "Income from house property". However, according to the provisions of section 13A, income from, inter alia, house property shall not be included in total income of a political party registered under section 29A of the Representation of the People Act, 1951, provided the political party fulfills the conditions as specified therein including furnishing a return of income for the previous year in accordance with the provisions of sub-section (4B) of section 139 on or before the due date under section 139. Therefore, if the stipulated conditions are fulfilled by the political party, rent of Rs. 1,25,000 per month received by the registered political party from letting out of its building to a bank would not be included in its total income.

Illustration 13

The books of account maintained by a National Political Party registered with Election Commission for the year ended on 31.3.2020 discloses the following receipts:

<table>
<thead>
<tr>
<th>Description</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) Rent of property let out to a departmental store at Chennai</td>
<td>6,00,000</td>
</tr>
<tr>
<td>(b) Interest on deposits other than banks</td>
<td>5,00,000</td>
</tr>
<tr>
<td>(c) Cash contributions from 100 persons (who have secreted their names) of Rs. 21,000 each</td>
<td>21,00,000</td>
</tr>
<tr>
<td>(d) Contribution from 10 persons by way of electoral bonds of Rs. 25,000 each</td>
<td>2,50,000</td>
</tr>
<tr>
<td>(e) Cash contribution @ Rs. 2,100 each from 1,000 members (recorded in books of account)</td>
<td>21,00,000</td>
</tr>
<tr>
<td>(f) Net profit of cafeteria run in the premises at Delhi</td>
<td>3,00,000</td>
</tr>
</tbody>
</table>

Compute the total income of the political party for the assessment year 2020-21, with reasons for inclusion or otherwise.

Solution

The total income of a political party registered with the Election Commission is to be computed as per section 13A under which the income derived from house property, income from other sources and income by way of voluntary contributions received from any person, on fulfilling of the conditions as mentioned thereunder, are exempt from tax. However, in this case, since cash contribution in excess of Rs. 2,000 is received from 1000 persons, the political party has violated the condition of receipt of donation through account payee cheque/draft or prescribed electronic modes. Further, the political party has also violated the condition of maintenance of records in case of donations exceeding Rs. 20,000 received otherwise than by way of electoral bonds. Hence, its total
income has to be computed as under without providing for exemption available under section 13A:

**Computation of total income of National Political Party**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) The rent of the property of Rs. 6 lacs located at Chennai [assuming the same to be the Gross Annual Value] less 30% of Rs.6 lacs, being deduction u/s 24</td>
<td>4,20,000</td>
</tr>
<tr>
<td>(b) Interest received on deposits</td>
<td>5,00,000</td>
</tr>
<tr>
<td>(c) Contribution from 100 persons (who have secreted their names) of Rs. 21,000 each</td>
<td>21,00,000</td>
</tr>
<tr>
<td>(d) Contribution from 10 persons by way of electoral bonds of Rs. 25,000 each</td>
<td>2,50,000</td>
</tr>
<tr>
<td>(e) Cash contribution @ Rs. 2,100 each from 1,000 members (recorded in books of account)</td>
<td>21,00,000</td>
</tr>
<tr>
<td>(f) Net profit of cafeteria at Delhi</td>
<td>3,00,000</td>
</tr>
<tr>
<td><strong>Total Income</strong></td>
<td><strong>56,70,000</strong></td>
</tr>
</tbody>
</table>

**Note** – Alternatively, the political party can contend that only Rs. 45 lakh is taxable on account of non-maintenance of records and receipt of cash donations, in which the case the total income would be computed as under:

**Computation of total income of National Political Party**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) Rent of the property of Rs. 6 lacs located at Chennai</td>
<td>Exempt</td>
</tr>
<tr>
<td>(b) Interest received on deposits</td>
<td>Exempt</td>
</tr>
<tr>
<td>(c) Contribution from 100 persons (who have secreted their names) of Rs. 21,000 each</td>
<td>21,00,000</td>
</tr>
<tr>
<td>(d) Contribution from 10 persons by way of electoral bonds of Rs. 25,000 each</td>
<td>Exempt</td>
</tr>
<tr>
<td>(e) Cash contribution @ Rs. 2,100 each from 1,000 members (recorded in books of account)</td>
<td>21,00,000</td>
</tr>
<tr>
<td>(f) Net profit of cafeteria at Delhi</td>
<td>3,00,000</td>
</tr>
<tr>
<td><strong>Total Income</strong></td>
<td><strong>45,00,000</strong></td>
</tr>
</tbody>
</table>

**Note:** It is presumed that the conditions regarding maintenance of books of account, audit, submission of report under section 29C of the Representation of the People Act, 1951 and filing of return of income under section 139(4B) are fulfilled by the political party, and hence it is eligible for exemption of income under section 13A.
EXERCISE

Question 1

Distinguish between Tax planning and Tax Evasion

Answer

Tax planning is carried out within the framework of law by availing the deductions and exemptions permitted by law and thereby minimizing tax liability. Tax planning is an arrangement by which full advantage is taken of the concessions and benefits conferred by the statute, without violation of legal provisions. Tax evasion on the other hand is an attempt to reduce tax liability by dubious or artificial methods or downright fraud. It is illegal and denies the State its legitimate share of tax.

Question 2

Specify with reason, whether the following acts can be considered as (i) Tax planning; or (ii) Tax management; or (iii) Tax evasion.

(i) Mr. P deposits Rs. 1,00,000 in PPF account so as to reduce his total income from Rs. 5,90,000 to Rs. 4,90,000.

(ii) SQL Ltd. maintains register of tax deduction at source effected by it to enable timely compliance.

(iii) An individual tax payer making tax saver deposit of Rs. 1,00,000 in a nationalized bank.

(iv) A partnership firm obtaining declaration from lenders/depositors in Form No. 15G/15H and forwarding the same to income-tax authorities.

(v) A company installed an air-conditioner costing Rs. 75,000 at the residence of a director as per terms of his appointment but treats it as fitted in quality control section in the factory. This is with the objective to treat it as plant for the purpose of computing depreciation.

(vi) RR Ltd. issued a credit note for Rs. 80,000 as brokerage payable to Mr. Ramana who is the son of the managing director of the company. The purpose is to increase the total income of Mr. Ramana from Rs. 4,20,000 to Rs. 5,00,000 and reduce the income of RR Ltd. correspondingly.

(vii) A company remitted provident fund contribution of both its own contribution and employees' contribution on monthly basis before due date.

Answer

<table>
<thead>
<tr>
<th>Answer</th>
<th>Reason</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Tax planning</td>
<td>Depositing money in PPF and claiming deduction under section 80C is as per the provisions of law.</td>
</tr>
<tr>
<td>2. Tax management</td>
<td>Maintaining register of payments subject to TDS helps in complying with the obligations under the Income-tax Act, 1961.</td>
</tr>
<tr>
<td>3. Tax planning</td>
<td>Making a tax saver deposit of Rs. 1,00,000 in a nationalized bank for claiming deduction under section 80C by an individual is a permitted tax planning measure under the provisions of income-tax law.</td>
</tr>
<tr>
<td>4. Tax</td>
<td>Obtaining declaration from lenders/depositors in Form No.</td>
</tr>
</tbody>
</table>
management 15G/15H by a partnership firm and forwarding the same to Income-tax authorities is in the nature of compliance of statutory obligation under the Income-tax Act, 1961.

5. Tax evasion
An air conditioner fitted at the residence of a director 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 director as a plant fitted at the factory would tantamount to furnishing of false particulars with an attempt to evade tax.

6. Tax evasion
Issuance of a credit note for Rs. 80,000 by RR Ltd. as brokerage payable to Mr. Ramana, the son of the Managing Director, to increase his total income from Rs. 4.2 lakh to Rs. 5.00 lakh and to correspondingly reduce the company’s total income is a method of reducing the tax liability of the company by recording a fictitious transaction.

The company is liable to tax at a flat rate of 30%/25%, as the case may be, whereas Mr. Ramana would not be liable to pay any tax, since his total income does not exceed Rs. 5,00,000, consequent to which he would be eligible for tax rebate of Rs. 12,500 under section 87A. Reducing tax liability by recording a fictitious transaction would tantamount to tax evasion.

7. Tax management
Remitting of own contribution to provident fund and employees contribution to provident fund on a monthly basis before due date is proper compliance of the statutory obligations.

Question 3
Examine the doctrine of form and substance in the context of tax planning.

Answer
The following are certain principles enunciated by the Courts on the question as to whether it is the form or substance of a transaction, which will prevail in income-tax matters:

(i) **Form of transaction is to be considered in case of genuine transactions** - It is well settled that when a transaction is arranged in one form known to law, it will attract tax liability whereas, if it is entered into in another form which is equally lawful, it may not. Therefore, in considering whether a transaction attracts tax or not, the form of the transaction put through is to be considered and not the substance. **However, this rule applies only to genuine transactions.** [CIT v. Motor and General Stores (P Ltd.) v. CIT (1967) 66 ITR 692(AP). Moreover, with General Anti-Avoidance Rules coming into force with effect from A.Y.2017-18,

(ii) **True legal relation is the crucial element for taxability** - It is open for the authorities to pierce the corporate veil and look behind the legal facade at the reality of the transaction. The taxing authority is entitled as well as bound to determine the true legal relation resulting from a transaction. The true legal relation arising from a transaction alone determines the taxability of a receipt arising from the transaction [CIT v. B.M. Kharwar (1969) 72 ITR 603 (SC)]

(iii) **Substance (i.e. actual nature of expense) is relevant and not the form** –
(a) In the case of an expenditure, the mere fact that the payment is made under an agreement does not preclude the department from enquiring into the actual nature of the payment [Swadeshi Cotton Mills Co. Ltd. v. CIT (1967) 63 ITR 57 (SC)].

(b) In order to determine whether a particular item of expenditure is of revenue or capital nature, the substance and not merely the form should be looked into. [Assam Bengal Cement Co. Ltd. v. CIT (1955) 27 ITR 34 (SC)].

**Question 4**

(a) The merger of a loss making company with a profit making one results in losses setting off profits, a lower net profit and lower tax liability for the merged company. Would the losses be disallowed by applying GAAR?

(b) In the above facts, let us presume, the profit making company merges with a loss making one. This results in losses setting off profits, a lower net profit and lower tax liability for both companies taken together. Can this be examined under GAAR?

**Answer**

(a) As regards setting off of losses, the provisions relating to merger and amalgamation already contain specific anti-avoidance safeguards. Therefore, GAAR need not be invoked when SAAR is applicable, though as per CBDT Circular No. 7/2017 dated 27.01.2017, GAAR and SAAR can co-exist.

(b) In case of merger of a profit-making company with loss making company, there is no specific anti-avoidance safeguards. However, since such merger would be under the order of High Court, GAAR would not be invoked if the High Court has explicitly and adequately considered the tax implication while sanctioning the merger scheme.

**Question 5**

A choice is made by a company by acquiring an asset on lease over outright purchase. The company claims deduction for lease rentals in case of acquisition through lease rather than depreciation as in the case of purchase of the asset. Would the lease rent payment, being higher than the depreciation, be disallowed as expense under GAAR?

**Answer**

GAAR provisions would not apply in this case as the taxpayer merely makes a selection out of the options available to him.

**Question 6**

M/s Global Architects Inc is a company incorporated in country F1. It is engaged in the business of providing architectural design services all over the world. It receives an offer from Lovely Resorts Pvt Ltd, an Indian company, for design and development of resorts all over India.

India-F1 tax treaty provides that architectural services are technical services and payment for the same to a company may be taxed in India. However, if such professional services are provided by a firm or individual, then payment for such services are taxable only if the firm has a fixed base in India or stay of partners/employees in India exceed 180 days.
M/s Global Architects Inc forms a partnership firm with a third party (director of the company) having only a nominal share in the F1. The firm enters into an agreement to carry out the services in India. The company seconded its trained manpower to the firm.

Thus, the partnership firm claimed the treaty benefit and no tax was paid in India. Can such an arrangement be examined under GAAR?

Answer

It is obvious that there was no commercial necessity to create a separate firm except to obtain the tax benefit. The firm was only on paper as the manpower was drawn from the company. The firm did not have any commercial substance. Moreover, it is a case of treaty abuse. Hence, GAAR may be invoked to disregard the firm and tax payment for architectural services as fee for technical services. However, the rate of tax on such payment shall be as applicable under the treaty, if more beneficial.

Question 7

An Indian holding company Holdco borrows Rs. 10 crore for acquisition of shares of Subco which then became subsidiary of Holdco. Holdco and Subco amalgamate so that the interest payable on the monies borrowed to acquire the shares can be deducted in computing the income from the business of the amalgamated company.

Answer

The borrowing by Holdco followed by the amalgamation by Subco is not abusive and GAAR would not apply in the case of merger which is carried out under the orders of High Court.

Question 8

Mr. Gavaskar sought voluntary retirement from a Government of India Undertaking and received compensation of Rs. 40 lacs on 31st January, 2019. He is planning to use the money as capital for a business dealership in electronic goods. The manufacturer of the product requires a security deposit of Rs. 15 lacs, which would carry interest at 8% p.a. Gavaskar’s wife is a graduate and has worked as marketing manager in a multinational company for 15 years. She now looks for a change in employment. She is willing to join her husband in running the business. She expects an annual income of Rs. 5 lacs. Mr. Gavaskar would like to draw a monthly remuneration of Rs. 40,000 and also interest @10% p.a. on his capital in the business. Mr. Gavaskar has approached you for a tax efficient structure of the business.

Discuss the various issues, which are required to be considered for formulating your advice. Computation of income or tax liability is not required.

Answer

The selection of the form of organisation to carry on any business activity is essential in view of the differential tax rates prescribed under the Income-tax Act, 1961 and specific concessions and deductions available under the Act in respect of different entities. For the purpose of formulating advice as to the tax efficient structure of the business, it is necessary for the tax consultant to consider the following issues:

(i) In the case of sole proprietary concern, interest on capital and remuneration paid to the proprietor is not allowable as deduction under section 37(1) as the expenditure is of personal nature. On the other hand, in the case of partnership firm, both interest on capital and remuneration payable to partners are allowable.
under section 37(1) subject to the conditions and limits laid down in section 40(b). Remuneration and interest should however, be authorised by the instrument of partnership and paid in accordance with such instrument. Such interest and salary shall be taxable in the hands of partners to the extent the same is allowed as deduction in the hands of the firm under section 40(b). Interest to partners can be allowed upto 12% on simple interest basis, while the limit for allowability for partners' remuneration is based on book profit under section 40(b). As per section 40(b)(v), partners’ remuneration shall be allowed to the extent of aggregate of –

(a) On the first Rs. 3,00,000 of book profit or in case of loss – Rs. 1,50,000 or at the rate of 90% of book profits, whichever is more

(b) On the balance of book profit – at the rate of 60%

Note – However, if the firm is eligible to opt for presumptive taxation under section 44AD, 8% of gross receipts or 6% of gross receipts, as the case may be, would be deemed as its income. All deductions under section 30 to 37 are deemed to be allowed. No deduction is allowable, including deduction for partner’s remuneration and interest on capital.

(ii) Partner's share in the profits of firm is not taxed in the hands of the partners by virtue of section 10(2A).

(iii) If a proprietary concern is formed, the salary of Mrs. Gavaskar shall be allowed as deduction under section 37(1).

(iv) The possibility of invoking section 40A(2) cannot be ruled out as salary is payable to a relative, who is an interested person within the meaning of section 40A(2). However, it can be argued successfully that salary of Rs. 5 lacs is justified in view of her long experience as marketing manager of a multinational company and the fair market value of services to be rendered by her to the concern.

(v) An issue arises as to whether remuneration of Mrs. Gavaskar would be includible in the total income of Mr. Gavaskar. Under section 64(1)(ii), remuneration of the spouse of an individual working in a concern in which the individual is having a substantial interest shall be included in the total income of the individual. However, the clubbing provision does not apply if the spouse possesses technical or professional qualification and the income is solely attributable to the application of his or her technical or professional knowledge and experience. Further, technical or professional qualification would not necessarily mean the qualifications obtained by degree or diploma of any recognized body [Batta Kalyani vs. CIT (1985) 154 ITR 0059 (AP)]. The experience of Mrs. Gavaskar as a marketing manager in a multinational company for 15 years may reasonably be considered as a professional qualification for this purpose.

(vi) If Mrs. Gavaskar joins the proprietary concern or partnership concern of her husband as employee, remuneration of Rs. 5 lacs shall be taxed in her hands under the head "salary".

(vii) If she joins as partner in the business, remuneration shall be taxed in her hand as business income under section 28 to the extent such remuneration is allowed in the hands of the firm under section 40(b).

(viii) The tax rate applicable to an individual depends on the level of his/her income, whereas for partnership firms it is flat rate at 30%. Surcharge @ 12% would be attracted only if total income exceeds Rs. 1 crore. For individuals, the rate of tax is 5% on income exceeding Rs. 2.50 lakhs but not exceeding Rs. 5 lakhs; 20% for total income exceeding Rs. 5 lakhs but not exceeding Rs. 10 lakhs and @ 30% in respect of income exceeding Rs. 10 lakhs for the assessment year 2020-21. The
surcharge for total income exceeding Rs. 50 lakhs but not exceeding Rs. 1 crore is 10% of tax payable; for total income exceeding Rs. 1 crore but not exceeding Rs. 2 crore is 15% of tax payable; for total income exceeding Rs. 2 crore but not exceeding Rs. 5 crore is 25% of tax payable and for total income exceeding Rs. 5 crore is 37% of tax payable. Health and Education cess @ 4% on income-tax plus surcharge, if applicable, is attracted in all the cases.
CHAPTER 15 – TDS TCS ADVANCE TAX

EXERCISE

Question 1
Mr. Madhusudan is regular in deducting tax at source and depositing the same. In respect of the quarter ended 31st December, 2019 a sum of Rs. 80,000 was deducted at source from the contractors. The statement of tax deducted at source under section 200 was filed on 23rd March 2020 for the quarter ended 31.12.2019.

(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 234E?
(iii) Is there any remedy available to him for reduction/waiver of the levy?

Answer
(i) Yes, there has been a delay on the part of Mr. Madhusudan in filing the statement of TDS.

As per section 200(3) read with Rule 31A, the statement of tax deducted at source for the quarter ended 31st December, 2019 has to be filed on or before 31st January, 2020. However, the same has been filed only on 23rd March, 2020. Hence, there has been a 52 days delay on the part of Mr. Madhusudan in filing the statement of TDS.

(ii) As per section 234E of the Income-tax Act, 1961, where a person fails to file deliver or cause to be delivered the statement of tax deducted at source within the prescribed time, then, he shall be liable to pay, by way of fee, a sum of Rs. 200 for every day during which the failure continues.

The amount of fee shall not, however, exceed the amount of tax deductible.

In this case, since Mr. Madhusudhan has delayed filing the statement of TDS by 52 days, he would be liable to pay a fee of Rs. 10,400 (Rs. 200 × 52 days) under section 234E. The said fee does not exceed the tax deductible (Rs. 80,000, in this case).

(iii) The CBDT is empowered to issue general or special orders, whether by way of relaxation of any of the provisions of sections 139, 143, 144, 147 etc. or otherwise, in respect of any class of incomes or class of cases. The CBDT may issue such order(s) from time to time if it considers expedient so to do, for the purpose of proper and efficient management of the work of assessment and collection of revenue. Section 234E is included in the list of sections in respect of which the CBDT is empowered to issue order for relaxation of the provisions of the Act.

Hence, the remedy available to Mr. Madhusudhan is that he can file an application to the CBDT under section 119 and seek waiver/reduction of the penalty levied/leviable under section 234E.

Question 2
Smt. Vijaya, proprietor of Lakshmi Enterprises, made turnover of Rs. 210 lakhs during the previous year 2017-18. Her turnover for the year ended 31-3-2020 was Rs. 90 lakhs.
Decide whether provisions relating to deduction of tax at source are attracted for the following payments made during the financial year 2019-20:

(i) Purchase commission paid to one agent Rs. 25,000 on 13.6.2019 towards purchases made during the year.

(ii) Payments to Civil engineer of Rs. 5,00,000 for construction of residential house for self use.

**Answer**

Since Smt. Vijaya’s turnover was Rs. 210 lakhs in the immediately preceding financial year (i.e., F.Y.2018-19), she is liable to deduct tax at source in the P.Y.2019-20, irrespective of her turnover being only Rs. 90 lakhs in the F.Y.2019-20.

(i) Tax@5% has to be deducted under section 194H in respect of purchase commission of Rs. 25,000 to an agent for purchases made during the year, since the same exceeds the threshold limit of Rs. 15,000 for non-deduction of tax at source thereunder.

(ii) Tax has to be deducted under section 194C in case of payment to resident contractors. The rate of tax is 1% if the payee is an individual or HUF and 2% in case of payees, other than individuals and HUFs.

However, as per section 194C(4), no individual or Hindu undivided family shall be liable to deduct income tax on the sum credited or paid to the account of the contractor where such sum is credited or paid exclusively for personal purposes of such individual or any member of the Hindu undivided family.

In this case, since Smt. Vijaya, an individual, makes payment of Rs. 5 lakh to a civil engineer for construction of residential house for self use, she is not liable to deduct tax at source under section 194C from such sum.

**Question 3**

What is the rate at which the tax is either to be deducted or collected under the provisions of the Act in the following cases?

(i) A partnership firm making sales of timber which was procured and obtained under a forest lease.

(ii) Payment of income of Rs.25 lakh on investments in the securities to the Foreign Institutional Investor.

(iii) A nationalized bank receiving professional services from a registered society made provision on 31-03-2020 of an amount of ` 25 lakh against the service charges bills to be received.

(iv) Payment of Rs. 5 lacs made to Mr. Phelps who is an athlete by a manufacturer of a swim wear for brand ambassador.

**Answer**

<table>
<thead>
<tr>
<th>Applicable Rate of TDS/TCS</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Situation</strong></td>
</tr>
<tr>
<td>Partnership firm selling timber obtained under forest lease</td>
</tr>
<tr>
<td>Payment of income on investments in the securities to the Foreign Institutional Investors</td>
</tr>
<tr>
<td>In case the securities are Government securities</td>
</tr>
</tbody>
</table>

15.2
<table>
<thead>
<tr>
<th>(iii)</th>
<th>Professional services rendered by a registered society to a nationalised bank</th>
<th>TDS</th>
<th>10%</th>
<th>3</th>
</tr>
</thead>
<tbody>
<tr>
<td>(iv)</td>
<td>Payment by a manufacturer of swim wear to its brand ambassador Mr. Phelps, an athlete</td>
<td>TDS</td>
<td>10%</td>
<td>4</td>
</tr>
<tr>
<td></td>
<td>If Mr. Phelps is a resident</td>
<td></td>
<td>20.8%</td>
<td></td>
</tr>
<tr>
<td></td>
<td>If Mr. Phelps is a non-resident</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Notes:**

1. As per section 206C(1), tax has to be collected at source @ 2½% by the partnership firm, being a seller, at the time of debiting of the amount payable by the buyer to the account of the buyer or at the time of receipt of such amount, whichever is earlier.

2. As per section 196D, tax has to be deducted at source @ 20.8% (20% plus cess @ 4%) by any person who is responsible for paying to a Foreign Institutional Investor, any income by way of interest on securities at the time of credit of such income to the account of the payee or at the time of payment of such income, whichever is earlier.

   Alternatively, if the said securities are assumed to be government securities, tax is deductible @ 5.20% (i.e., 5% plus cess @ 4%) under section 194LD.

3. Tax has to be deducted at source @ 10% under section 194J, by the nationalized bank at the time of credit of fees for professional services to the account of the registered society (i.e., on 31.3.2020), even though payment is to be made after that date.

4. Tax has to be deducted at source @ 10% under section 194J in respect of income of Rs. 5 lacs paid to Mr. Phelps, athlete, for advertisement, on the inherent presumption that Mr. Phelps is a resident.

   Alternatively, if Mr. Phelps is assumed to be a non-resident, who is not a citizen of India, tax has to be deducted at source @ 20.8% (20% plus cess 3%) under section 194E in respect of income of Rs. 5 lacs paid to Mr. Phelps, an athlete, for advertisement referred under section 115BBA.

**Question 4**

Examine the liability for tax deduction at source in the following cases for the assessment year 2020-21:

(i) Wings Ltd. has paid amount of Rs. 15 lacs during the year ended 31-3-2020 to Airports Authority of India towards landing and parking charges.

(ii) Omega Ltd., an event management company, organized a concert of international artists in India. In this connection, it engaged the services of an overseas agent Mr. John from UK to bring artists to India. He contacted the artists and negotiated with them for performance in India in terms of the authority given by the company. He did not take part in event organized in India. The company made the payment of commission equivalent to Rs. 1 lac to the overseas agent.

(iii) Ramesh gave a building on sub-lease to Mac Ltd. with effect from 1-7-2019 on a rent of Rs. 20,000 per month. The company also took on hire machinery from Ramesh with effect from 1-11-2019 on hire charges of Rs. 15,000 per month. The rent of building and hire charges of machinery for the year 2019-20 were credited by the company to the account of Ramesh in its books of account on 31-3-2020.
(iv) Rs. 2,45,000 paid to Mr. X on 01-02-2020 by Karnataka State Government on compulsory acquisition of his urban land. What would be your answer if the land is agricultural land?

Answer

(i) TDS on landing and parking charges: The landing and parking charges which are fixed by the Airports Authority of India are not merely for the "use of the land". These charges are also for services and facilities offered in connection with the aircraft operation at the airport which include providing of air traffic services, ground safety services, aeronautical communication facilities, installation and maintenance of navigational aids and meteorological services at the airport [Japan Airlines Co. Ltd. v. CIT / CIT v. Singapore Airlines Ltd. (2015) 377 ITR 372 (SC)]. Thus, tax is not deductible under section 194I which provides deduction of tax for payment in the nature of rent.

Hence, tax is deductible @2% under section 194C by the airline company, Wings Ltd., on payment of Rs. 15 lacs made towards landing and parking charges to the Airports Authority of India for the previous year 2019-20.

(ii) TDS on services of overseas agent outside India: An overseas agent of an Indian company operates in his own country and no part of his income accrues or arises in India. His commission is usually remitted directly to him and is, therefore, not received by him or on his behalf in India. The commission paid to the non-resident agent for services rendered outside India is, thus, not chargeable to tax in India. Since commission income for contacting and negotiating with artists by Mr. John, a non-resident, who remains outside India is not subject to tax in India, consequently, there is no liability for deduction of tax at source. It is assumed that the commission equivalent to Rs. 1 lakh was remitted to Mr. John outside India.

(iii) TDS on rent for building and machinery: Tax is deductible on rent under section 194-I, if the aggregate amount of rental income paid or credited to a person exceeds Rs. 2,40,000. Rent includes payment for use of, inter alia, building and machinery.

The aggregate payment made by Mac Ltd. to Ramesh towards rent in P.Y.2019-20 is Rs. 2,55,000 (i.e., Rs. 1,80,000 for building and Rs. 75,000 for machinery). Hence, Mac Ltd. has to deduct tax@10% on rent paid for building and tax@2% on rent paid for machinery.

(iv) TDS on compensation for compulsory acquisition: Tax is deductible at source @10% under section 194LA, where payment is made to a resident as compensation or enhanced compensation on compulsory acquisition of any immovable property (other than agricultural land).

However, no tax deduction is required if the aggregate payments in a year does not exceed Rs. 2,50,000.

Therefore, no tax is required to be deducted at source on payment of Rs. 2,45,000 to Mr. X, since the aggregate payment does not exceed Rs.2,50,000.

Since the definition of immovable property specifically excludes agricultural land, no tax is deductible at source on compensation paid for compulsory acquisition of agricultural land.
Question 5
Examine whether tax has to be deducted at source under the provisions of the Income-tax Act, 1961 in the following situations, which have taken place during the year ended 31-3-2020:

(i) M/s. Jiva & Co., a partnership firm, pays a sum of Rs. 43,000 as interest on loan borrowed from an Indian branch of a foreign bank.

(ii) Above firm has paid Rs. 42,000 as interest on capital to partner Mr. A, a resident in India, and Rs. 44,000 as interest on capital to partner Mr. B, a non-resident.

(iii) The above firm paid Rs. 50,000 being share of profit of partner Mr. B, a non-resident.

Answer

(i) Section 194A requires deduction of tax on any income by way of interest, other than interest on securities, credited or paid to a resident, at the rates in force. However, it specifically excludes from its scope, income credited or paid to any banking company to which the Banking Regulation Act, 1949 applies. An Indian branch of a foreign bank, transacting the business of banking in India, is a banking company to which the Banking Regulation Act, 1949 applies. Therefore, interest payment to such bank will not attract tax deduction under section 194A. Consequently, no tax is required to be deducted at source under section 194A on interest of Rs. 43,000 paid by M/s. Jiva & Co., a partnership firm, on loan borrowed from an Indian branch of a foreign bank.

(ii) Section 194A requiring deduction of tax at source on any income by way of interest, other than interest on securities, credited or paid to a resident, excludes from its scope, income credited or paid by a firm to its partner. Therefore, no tax is required to be deducted at source under section 194A on interest on capital of Rs. 42,000 paid to partner Mr. A, a resident partner. Section 195, which requires tax deduction at source on payments to non-residents, does not provide for any exclusion in respect of payment of interest by a firm to its non-resident partner. Therefore, tax has to be deducted under section 195 at the rates in force in respect of interest on capital of Rs. 44,000 paid to partner Mr. B, a non-resident.

(iii) As per section 10(2A), share of profit received by a partner from the total income of the firm is exempt from tax. Therefore, the share of profit paid to non-resident partner is not liable for tax deduction at source. However, section 195(6) provides that the person responsible for paying any sum, whether or not chargeable to tax, to a non-corporate non-resident or to a foreign company, shall be required to furnish the information relating to payment of such sum in the prescribed form and manner.

Question 6
"Come Air Ltd." has paid a sum of Rs. 12 lakhs during the year ended 31-3-2020 to Airports Authority of India towards landing and parking charges. The company has deducted tax at source@2% under section 194C on the said payment and remitted the tax deducted within the prescribed time. The Assessing Officer contended that landing and parking charges were levied for use of the land of the airport and hence, the payment
was in the nature of rent attracting TDS@10% under section 194-I. Discuss the correctness or otherwise of the contention of the Assessing Officer.

**Answer**

The issue as to whether the charges fixed by the Airport Authority of India (AAI) for landing and take-off facilities and parking facility for the aircraft are for the “use of the land” by the airline company came up before the Supreme Court in Japan Airlines Co. Ltd. v. CIT / CIT v. Singapore Airlines Ltd. (2015) 377 ITR 372.

The Supreme Court observed that the charges which are fixed by the AAI for landing and take-off services as well as for parking of aircrafts are not for the "use of the land". These charges are for services and facilities offered in connection with the aircraft operation at the airport which include providing of air traffic services, ground safety services, aeronautical communication facilities, installation and maintenance of navigational aids and meteorological services at the airport.

There are various international protocols which mandate all authorities manning and managing these airports to construct the airport of desired standards which are stipulated in the protocols. The services which are required to be provided by these authorities, like AAI, are aimed at passengers' safety as well as for safe landing and parking of the aircrafts. Therefore, the services are not restricted to merely permitting "use of the land" of airport. On the contrary, it encompasses all the facilities that are to be compulsorily offered by the AAI in tune with the requirements of the protocol.

The Supreme Court observed that the charges levied on air-traffic includes landing charges, lighting charges, approach and aerodrome control charges, aircraft parking charges, aerobridge charges, hangar charges, passenger service charges, cargo charges, etc. Thus, when the airlines pay for these charges, treating such charges as charges for "use of the land" would tantamount to adopting a totally simplistic approach which is far away from reality.

The Supreme Court opined that the substance behind such charges has to be considered and when the issue is viewed from this angle, keeping the larger picture in mind, it becomes very clear that the charges are not for use of the land per se and, therefore, it cannot be treated as "rent" within the meaning of section 194-I. The Supreme Court, thus, concurred with the view taken by the Madras High Court in Singapore Airlines case and overruled the view taken by the Delhi High Court in United Airlines/Japan Airlines case.

Applying the rationale of the Supreme Court ruling to the facts of this case, the contention of the Assessing Officer that landing and parking charges are levied for use of the land of airport and hence, the charges are in the nature of rent to attract the provisions of tax deduction at source under section 194-I is not correct.

**Question 7**

Mr. Harish, Vice President of ABC Bank, sold his house property in Chennai as well as his rural agricultural land for a consideration of Rs. 60 lakh and Rs. 15 lakh, respectively, to Mr. Suresh, a retail trader of garments, on 10.10.2019. Mr. Harish had purchased the house property and rural agricultural land in December 2017 for Rs. 40 lakh and Rs. 10 lakh, respectively. The stamp duty value on the date of transfer, i.e., 10.10.2019, is Rs. 85 lakh and Rs. 20 lakh for the house property and rural agricultural land, respectively.

(a) Determine the tax implications in the hands of Mr. Harish and Mr. Suresh, if the date of agreement for sale of house property and rural agricultural land is
1.7.2019 and the stamp duty value on the said date was Rs. 75 lakh and Rs. 15 lakh, respectively. On the said date, Mr. Suresh made payment of Rs. 5 lakh by way of account payee cheque to Mr. Harish for purchase of house property. Also, discuss the TDS implications, if any, in the hands of Mr. Suresh, assuming that both Mr. Harish and Mr. Suresh are resident Indians.

(b) Would your answer be different if Mr. Harish is a property dealer and sold the house property in the course of his business?

Answer

(a) Tax implications on sale of rural agricultural land and house property representing a capital asset in the hands of Mr. Harish, a salaried employee

<table>
<thead>
<tr>
<th>(i)</th>
<th>Tax implications in the hands of Mr. Harish, a salaried employee</th>
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<tbody>
<tr>
<td></td>
<td>Since rural agricultural land is not a capital asset, the gains arising on sale of such land is not taxable in the hands of Mr. Harish. However, capital gains would arise on sale of house property, being a capital asset. As per section 50C(1), the stamp duty value of house property on the date of agreement (i.e., Rs. 75 lakh) would be deemed to be the full value of consideration arising on transfer of property. Therefore, Rs. 35 lakh (i.e., Rs. 75 lakh – Rs. 40 lakh, being the purchase price) would be taxable as short-term capital gains in the A.Y.202-21. It may be noted that under first and second proviso to section 50C(1), the stamp duty value on the date of agreement can be adopted as the advance was received on the date of agreement through account payee cheque. As the date of agreement is different from the date of registration and part of the consideration was received on or before the date of agreement by way of account payee cheque, the stamp duty value on the date of agreement is to be adopted as the deemed sale consideration.</td>
</tr>
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</table>

(ii) Tax implications in the hands of the buyer – Mr. Suresh, a retail trader

The house property purchased would be a capital asset in the hands of Mr. Suresh, who is a retail trader of garments. The provisions of section 56(2)(x) is attracted in the hands of Mr. Suresh who has acquired the immovable property, being a capital asset, for inadequate consideration. For the purpose of section 56(2)(x), Mr. Suresh can take the stamp duty value on the date of agreement instead of the date of registration since he has paid a part of the consideration by account payee cheque on the date of agreement. Therefore, Rs. **15 lakh**, being the difference between the stamp duty value of the property on the date of agreement (i.e., Rs. 75 lakh) and the actual consideration (i.e., Rs. 60 lakh) would be taxable as per section 56(2)(x) under the head “Income from other sources” in the hands of Mr. Suresh, since such difference exceeds the higher of Rs. 50,000 or 5% of consideration.

As rural agricultural land is not a capital asset, the provisions of section 56(2)(x) are not attracted in respect of acquisition of agricultural land for inadequate

(iii) TDS implications in the hands of the buyer, Mr. Suresh

Since the sale consideration of house property exceeded Rs. 50 lakh, Mr.
Suresh is required to deduct tax at source under section 194-IA. The tax deduction under section 194-IA would be Rs. 60,000, being 1% of Rs. 60 lakh.

TDS provisions under section 194-IA are not attracted in respect of transfer of rural agricultural land.

Tax implications on sale of house property representing stock-in-trade in the hands of Mr. Harish, a property dealer:

(i) Tax implications in the hands of Mr. Harish for A.Y.2020-21

If Mr. Harish is a property dealer who has sold the house property in the course of his business, the provisions of section 43CA would be attracted, since the house property represents his stock-in-trade and he has transferred the same for a consideration less than the stamp duty value.

For the purpose of section 43CA, Mr. Harish can take the stamp duty value on the date of agreement instead of the date of registration, since he has received part of the sale consideration by a mode other than cash on the date of agreement. Therefore, Rs. 35 lakh, being the difference between the stamp duty value on the date of agreement (i.e., Rs. 75 lakh) and the purchase price (i.e., Rs. 40 lakh), would be chargeable as business income in the hands of Mr. Harish.

(ii) TDS implications and taxability in the hands of Mr. Suresh for A.Y.2020-21

There would be no difference in the TDS implications or taxability in the hands of Mr. Suresh, whether Mr. Harish is a property dealer or a salaried employee.

Therefore, the provisions of section 56(2)(x) would be attracted in the hands of Mr. Suresh who has received house property, being a capital asset, for inadequate consideration. The TDS provisions under section 194-IA would also be attracted since the actual consideration for house property exceeds Rs. 50 lakh.

Question 8

Siddharth Hospitals Pvt. Ltd. has recently been accorded recognition by several insurance companies to admit and treat patients on cashless hospitalization basis. Payment to the assessee hospital will be made by Third Party Administrators (TPA) who will process the claims of the patients admitted and make payments to the various hospitals including the assessee. All TPAs are corporate entities. The assessee wants to know whether the TPAs are bound to deduct tax at source under section 194J or under section 194C?

Answer

This issue has been clarified by the CBDT Circular No.8/2009 dated 24.11.2009. As per provisions of section 194J(1), any person, who is responsible for paying to a resident any sum by way of fees for professional services, shall, at the time of credit of such sum to the account of the payee or at the time of payment thereof in cash or by issue of a cheque or draft or by any other mode, whichever is earlier, deduct an amount equal to 10% of such sum as TDS.
Further, as per clause (a) of Explanation to section 194J “professional services” includes services rendered by a person in the course of carrying on medical profession.

The services rendered by hospitals to various patients are primarily medical services and, therefore, the provisions of section 194J are applicable on payments made by TPAs to hospitals etc. Further, for invoking provisions of section 194J, there is no stipulation that the professional services have to be necessarily rendered to the person who makes payment to hospital. Therefore, TPAs who are making payment on behalf of insurance companies to hospitals for settlement of medical/insurance claims etc. under various schemes including Cashless Schemes are liable to deduct tax at source under section 194J on all such payments to hospitals etc.

In view of the above, all such transactions between TPAs and hospitals would fall within the ambit of provisions of section 194J.

Question 9
Examine in the context of provisions contained in Chapter XVII of the Act and also work out the amount of tax to be deducted by the payer of income in the following cases:

(i) Payment of Rs. 5 lacs made by JCP & Co. to Pingu Events Co. Ltd. for organizing a debate competition on the subject "Preservation of Rural Heritage of Rajasthan".

(ii) "Profit Commission" of Rs. 1 lac paid on 10.6.2018 by a re-insurance company to the insurer company after the expiry of the term of insurance and where there was no claim during the treaty.

(iii) KD, a part time director of DAF Pvt. Ltd. was paid an amount of Rs. 2,25,000 as fees which was actually in the nature of commission on sales for the period 1.4.2019 to 30.6.2019.

Answer

(i) The services of Event Managers in relation to sports activities alone have been notified by the CBDT as “professional services” for the purpose of section 194J. In this case, payment of Rs. 5 lacs was made to an event management company for organization of a debate competition. Hence, the provisions of section 194J are not attracted.

However, TDS provisions under section 194C relating to contract payments would be attracted and consequently, tax has to be deducted @ 2% under section 194C. The tax deductible under section 194C would be Rs. 10,000, being 2% of Rs. 5 lacs.

(ii) Section 194D requires deduction of tax at source@5% from insurance commission, where the commission exceeds Rs. 15,000.

Reinsurance is different from insurance since there is no direct contractual relationship between the person insured and the re-insurer.

In order to attract section 194D, the commission or any other payment covered under the section should be a remuneration or reward for soliciting or procuring the insurance business. The insurance companies do not procure business for the reinsurance company nor does the reinsurer pay commission or other payment for soliciting the business from the insurance companies. Therefore, section 194D has no application.

Hence, when profit commission is paid by a reinsurance company to an insurance company, after the expiry of the term of insurance, in respect of cases where there
is no claim during the operation of the reinsurance treaty, tax deduction under section 194D is not attracted.

(iii) Section 194J provides for deduction of tax at source @10% on any remuneration or fees or commission, by whatever name called, paid to a director, which is not in the nature of salary in respect of which tax is deductible at source under section 192.

Hence, tax is to be deducted at source under section 194J @10% by DAF Pvt. Ltd. on the commission of Rs. 2,25,000 paid to KD, a part-time director. The tax deductible under section 194J would be Rs. 22,500, being 10% of Rs. 2,25,000.

Question 10
Examine the applicability of the provisions relating to deduction of tax at source in the following transactions:

(i) Max Limited pays Rs. 1,02,000 to Mini Limited, a resident contractor who, under the contract dated 15th October, 2019, manufactures a product according to specification of Max Limited by using materials purchased from Max Limited.

(ii) A company operating a television channel makes payment of Rs. 5 lacs to a former cricketer for making running commentary of a one-day cricket match.

(iii) EL Ltd., a foreign company, pays outside India, salary to its employee, Mr. Raghavan, a foreign national and a non-resident, for services rendered in India.

Answer

(i) 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, Mini Limited manufactures the product as per the specification given by Max Limited by using the raw materials purchased from Max Limited. Therefore, it falls within the definition of “work” under section 194C. Consequently, tax is to be deducted 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.

(ii) Provisions for deduction of tax at source under section 194J are attracted in respect of payment of fees for professional services, if the amount of such fees exceeds Rs. 30,000 in the relevant financial year. The service rendered by a commentator in relation to sports activities has been notified by the CBDT as a professional service for the purposes of section 194J vide its Notification No. 88 dated 21st August, 2008. Therefore, tax is required to be deducted @10% from the fee of Rs. 5 lacs payable to the former cricketer.

(iii) Section 195 requires deduction of tax at source by any person responsible for making payment to a non-resident, any interest or any other sum chargeable under the provisions of the Income-tax Act, 1961 (other than income chargeable under the head “Salaries”).

Section 192(1) requires “any person” responsible for paying income under the head “Salaries” to deduct tax at source. Therefore, even if the payer is a foreign company, section 192 would be applicable.
TDS provisions under section 192 are attracted, if the salary payable to a non-resident is chargeable to tax in India. Under section 9(1)(ii), income which falls under the head "Salaries" shall be deemed to accrue or arise in India, if it is earned in India. Salary payable for service rendered in India shall be regarded as income earned in India. Therefore, salary paid to Mr. Raghavan, a non-resident, attracts tax liability in India, as he has rendered services in India and the salary is attributable to such services.

Therefore, the foreign company, EL Limited, is liable to deduct tax at source under section 192 from the salary of Mr. Raghavan.

**Question 11**

Examine in the following cases the obligation of the person paying the income in respect of tax deduction at source and indicate the due date for payment of such tax, wherever applicable:

(i) MNO Ltd., the employer, credited salary due for the financial year 2019-20 amounting to Rs. 3,40,000 to the account of Q, an employee, in its books of account on 31.3.2020. Q has not furnished any information about his income/loss from any other head or proof of investments/payments qualifying for deduction under section 80C.

(ii) T, an individual whose total sales in business during the year ended 31.3.2019 was Rs. 2.20 crores, paid Rs. 9 lacs by cheque on 1.1.2020 to a contractor (an individual), for construction of his factory building. No amount was credited earlier to the account of the contractor in the books of T.

(iii) BCD Ltd. credited Rs. 28,000 towards fees for professional services and Rs. 27,000 towards fees for technical services to the account of HG in its books of account on 6.10.2019. The total sum of Rs. 55,000 was paid by cheque to HG on 18.12.2019.

**Answer**

(i) Section 192 requires deduction of tax from salary at the time of payment. Thus, the employer is not required to deduct tax at source when salary has not been paid but is merely credited to the account of the employee in its books of account. MNO Ltd. therefore, is not required to deduct tax at source in respect of the salary merely credited to the account of employee Q which is not paid.

If salary has been paid during the year to Q, then, MNO Ltd has to obtain from Q, the evidence/proof/particulars of prescribed claims (including claim for set-off of loss) under the provisions of the Act in such form and manner as may be prescribed.

If Q has not furnished any information about his income/loss under any other head or proof of investments/expenditure qualifying for deduction under section 80C, then, the employer has to deduct tax without considering any claim for any expenditure or set-off of losses or deduction under section 80C.

(ii) An individual who is liable for tax audit under section 44AB in the immediately preceding financial year is liable to deduct tax at source under section 194C for the financial year 2018-19 in respect of the payment made to contractor exceeding Rs. 30,000 in a single contract and Rs. 1,00,000 in aggregate of contracts during the financial year. Turnover of the individual T is Rs. 2.20 crores in the financial year 2017-18. Therefore, T is liable to get his accounts for that year audited under...
section 44AB. As the payment during financial year 2018-19 to the contractor has exceeded the limits prescribed in section 194C, tax has to be deducted under section 194C.

The rate of tax deduction is 1% as the contractor is an individual.

(iii) The limit of Rs. 30,000 for non-deduction of tax under section 194J would apply separately for fees for professional services and fees for technical services. This means that if a person has rendered services falling under both the categories, tax need not be deducted if the fee for each category does not exceed Rs. 30,000 even though the aggregate of the amounts credited to the account of such person or paid to him for both the categories of services exceed Rs. 30,000. Therefore, BCD Ltd. is not required to deduct tax at source in respect of the fees either at the time of credit or at the time of payment.

Question 12
Examine the liability for tax deduction at source in the following cases for the assessment year 2020-21:

(i) Mr. Anand has been running a sole proprietary business whose accounts are audited under section 44AB with turnover of Rs. 202 lakhs for the A.Y. 2019-20. He pays a monthly rent of Rs. 10,000 for the office premises to Mr. R, the owner of building and an individual. Besides, he also pays service charges of Rs. 6,000 per month to Mr. R towards the use of furniture, fixtures and vacant land appurtenant thereto.

(ii) By virtue of an agreement with a nationalised bank, a catering organisation receives a sum of Rs. 50,000 per month towards supply of food, water, snacks etc. during office hours to the employees of the bank.

(iii) An Indian company pays gross salary including allowances and monetary perquisites amounting to Rs. 7,30,000 to its General Manager. Besides, the company provides non-monetary perquisites to him whose value is estimated at Rs. 1,20,000.

(iv) A notified infrastructure debt fund eligible for exemption under section 10(47) of the Income-tax Act, 1961 pays interest of Rs. 5 lakhs to a company incorporated in USA. The US Company incurred expenditure of Rs. 12,000 for earning such interest. The fund also pays interest of Rs. 3 lakhs to Mr. X, who is a resident of a notified jurisdictional area.

Answer

(i) Where the payer is an individual or HUF whose turnover exceeds the monetary limits specified in clause (a) of section 44AB, he has to deduct tax at source. Since the turnover of Mr. Anand was Rs. 202 lakhs for the A.Y.2018-19, he is liable to deduct tax at source under section 194-I in respect of rental payments during the financial year 2019-20.

Accordingly, Mr. Anand is liable to deduct tax at source under section 194-I on the rental payments made. Section 194-I provides that rent includes any payment, by whatever name called, for the use of land or building together with furniture, fittings etc. Therefore, in the given case, apart from monthly rent of Rs. 15,000 p.m., service charge of Rs. 6,000 p.m. for use of furniture and fixtures would also attract TDS under section 194-I. Since the aggregate rental payments to Mr. R
during the financial year 2019-20 exceeds Rs. 2,40,000, Mr. Anand is liable to deduct tax at source @10% under section 194-I from rent paid to Mr. R.

(ii) The definition of “work” under Explanation to section 194-C includes catering services and therefore, TDS provisions under section 194C are attracted in respect of payments to a caterer. As the payment exceeds Rs. 30,000, the nationalised bank is required to deduct tax at source at 2% on the payments made to catering organisation under 194-C. If the catering organization is an individual or HUF, then the tax deduction shall be @1%.

(iii) | Description | Amount (Rs) |
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<tbody>
<tr>
<td>Gross salary, allowances and monetary perquisites</td>
<td>7,20,000</td>
</tr>
<tr>
<td>Non-Monetary perquisites</td>
<td>1,20,000</td>
</tr>
<tr>
<td>Less: Standard deduction under section 16(ia)</td>
<td>50,000</td>
</tr>
<tr>
<td><strong>Tax Liability</strong></td>
<td><strong>8,00,000</strong></td>
</tr>
<tr>
<td>Average rate of tax (Rs. 75,400 / Rs. 8,00,000 × 100)</td>
<td>9.425%</td>
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</table>

The company can deduct Rs. 75,400 at source from the salary of the General Manager. Alternatively, the company can pay tax on non-monetary perquisites as under –

Tax on non-monetary perquisites = 9.425% of Rs. 1,20,000 = Rs. 11,310

Balance to be deducted from salary = Rs. 64,090

If the company pays tax of Rs. 11,310 on non-monetary perquisites, the same is not a deductible expenditure as per section 40(a). The amount of tax paid towards non-monetary perquisite by the employer, however, is not chargeable to tax in the hands of the employee as per section 10(10CC).

(iv) 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 the first case, since the payment is to a foreign company, health and education cess @4% has to be added to the applicable rate of TDS. Therefore, the tax deductible under section 194LB would be Rs. 26,000 (i.e., 5.20% of Rs. 5 lakhs).

However, in case the notified infrastructure debt fund pays interest to a person who is a resident of a notified jurisdictional area, section 94A will apply. Accordingly, tax would be deductible @30% (plus health and education cess@4%) under section 94A, even though section 194LB provides for deduction of tax at a concessional rate of 5%. Therefore, the tax deductible in respect of payment of Rs. 3 lakh to Mr. X, who is a resident of a notified jurisdictional area, would be Rs. 93,600, being 31.2% of Rs. 3,00,000.

**Question 13**

The following issues arise in connection with the deduction of tax at source under Chapter XVII-B. Examine the liability for tax deduction in these cases:

(a) An employee of the Central Government receives arrears of salary for the earlier 3 years. He enquires whether he is liable for deduction of tax on the entire amount during the current year.
(b) A T.V. channel pays Rs. 10 lakh on 1.9.2019 as prize money to the winner of a quiz programme, “Who will be a Millionaire”? 

(c) State Bank of India pays Rs. 50,000 per month as rent to the Central Government for a building in which one of its branches is situated. 

(d) A television company pays Rs. 80,000 to a cameraman for shooting of a documentary film. 

(e) A State Government pays Rs. 22,000 on 2.7.2019 as commission to one of its agents on sale of lottery tickets. 

(f) A Turf Club awards a jack-pot of Rs. 5 lakh to the winner of one of its races on 1.2.2020. 

Answer 

(a) As per section 192, tax is deductible at source by any person who is responsible for paying any income chargeable under the head ‘Salaries’. However, as per subsection (2A) of that section, the employee will be entitled to relief under section 89 and consequently he will be required to furnish to the person responsible for making the payment, such particulars in the prescribed form (i.e., Form No.10E). The person responsible for making the payment shall compute the relief and take into account the same while deducting tax at source from salary. 

(b) Under section 194B, the person responsible for paying by way of winnings from any card game and other game in an amount exceeding Rs. 10,000 shall at the time of payment deduct income-tax at 30%. Therefore, tax of Rs.3 lakh has to be deducted at source from the prize money of Rs. 10 lakh payable to the winner. 

(c) Section 194-I, which governs the deduction of tax at source on payment of rent, exceeding Rs. 2,40,000 p.a., is applicable to all taxable entities except individuals and HUFs, whose turnover/gross receipts do not exceed the monetary limits specified under clause (a) of section 44AB. Section 196, however, provides exemption in respect of payments made to Government from application of the provisions of tax deduction at source. Therefore, no tax is required to be deducted at source by State Bank of India from rental payments to the Government. 

(d) If the cameraman is an employee of the T.V. Company, the provisions of section 192 will apply. However, if he is a professional, TDS provisions under section 194-J will apply. Tax at 10% will have to be deducted at the time of credit of Rs. 80,000 or on its payment, whichever is earlier. 

(e) Under section 194G, the person responsible for paying to any person stocking, distributing, purchasing or selling lottery tickets shall at the time of credit of the commission or payment thereof, whichever is earlier, amounting to more than Rs. 15,000, deduct income-tax at source @5%. Accordingly, tax@5% under section 194G amounting to Rs. 1,100 has to be deducted from commission payment of Rs. 22,000 to the agent of the State Government. 

(f) The payment by way of winnings from horse race is governed by section 194BB. Under this section, the person responsible for payment shall, at the time of payment, deduct tax at source @30%, if the payment exceeds Rs. 10,000. Accordingly, tax@30% amounting to Rs. 1,50,000 has to be deducted from the winnings of Rs. 5 lakh payable to the winner of the race.
### Question 14
Examine and compute the liability for deduction of tax at source, if any, in the cases stated hereunder, for the financial year ended 31st March, 2020

(i) Mr. X, a resident, acquired a house property at Mumbai from Mr. Y for a consideration of Rs. 90 lakhs, on 20.6.2019. On the same day, Mr. X made two separate transactions, thereby acquiring an urban plot in Kolkata from Mr. C for a sum of Rs. 49,50,000 and rural agricultural land from Mr. D for a consideration of Rs. 60 lakhs.

(ii) On 17.6.2019, a commission of Rs. 50,000 was retained by the consignee 'ABC Packaging Ltd.' and not remitted to the consignor 'XYZ Developers', while remitting the sale consideration. Examine the obligation of the consignor to deduct tax at source.

(iii) Raj is working with AB Ltd. He is entitled to a salary of Rs. 55,000 per month w.e.f. 1.4.2019. He has a house property which is self-occupied. He paid an interest of Rs. 80,000 on loan, during the previous year 2019-20. The loan was taken for construction of house. He has notified his employer AB Ltd. that there will be a loss of Rs. 80,000 in respect of this house property for financial year ended 31.3.2020.

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<tr>
<th>Answer</th>
<th>Amount of TDS (Rs.)</th>
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</tr>
<tr>
<td>Since the consideration for transfer of house property at Mumbai exceeds Rs. 50 lakhs, Mr. X, being the transferee, is required to deduct tax @1% under section 194-IA on Rs. 90 lakhs, being the amount of consideration for transfer of property.</td>
<td></td>
</tr>
<tr>
<td>Mr. X is not required to deduct tax as source under section 194-IA from the consideration of Rs. 49,50,000 paid to Mr. C for transfer of urban plot, since the consideration is less than Rs. 50 lakhs.</td>
<td></td>
</tr>
<tr>
<td>Mr. X is also not required to deduct tax at source under section 194-IA from the consideration of Rs. 60 lakhs paid to Mr. D for transfer of rural agricultural land, since the same is specifically excluded from the scope of immovable property for the purpose of tax deduction under section 194-IA.</td>
<td></td>
</tr>
<tr>
<td><strong>Note</strong> - Section 194-IA requires every transferee responsible for paying any sum as consideration for transfer of immovable property (land, other than agricultural land, or building or part of building) to deduct tax, at the rate of 1% of such sum, at the time of credit of such sum to the account of the resident transferor or at the time of payment of such sum to the resident transferor, whichever is earlier. However, no tax is required to be deducted where the consideration for transfer of an immovable property is less than Rs. 50 lakhs.</td>
<td></td>
</tr>
<tr>
<td>(ii)</td>
<td></td>
</tr>
<tr>
<td>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 Rs. 15,000.</td>
<td></td>
</tr>
<tr>
<td>In the given case, ‘ABC Packaging Ltd.’, the consignee, has not remitted the commission of Rs. 50,000 to the consignor ‘XYZ Developers’.</td>
<td></td>
</tr>
</tbody>
</table>

15.15
Developers’ while remitting the sales 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, XYZ Developers has to deduct tax at source on Rs. 50,000 at the rate of 5%.

(iii) Section 192 provides that tax is required to be deducted on the payment made as salaries. Tax is to be deducted on the estimated income at the average of income tax computed on the basis of the rates in force for the financial year in which payment is made.

The employee may declare details of his other incomes (including loss under the head “Income from house property” but not any other loss) to his employer. In this case, since Mr. Raj has notified his employer AB Ltd. of loss from self-occupied house property, the employer has to take the same into consideration for deduction of tax at source.

Therefore, AB Ltd. is required to deduct tax at source on the salary of Rs. 45,000 per month paid to Mr. Raj, in the following manner:

| Income under the head salaries (55,000 × 12) | 6,60,000 |
| Less: Standard deduction under section 16(ia) | 50,000 |
| Income under the head “house property” | 6,10,000 |
| Gross total income | (80,000) |
| Less: Deduction under Chapter VI-A | 5,30,000 |
| **Total Income** | Nil |
| **Tax@10% on Rs. 1,70,000, being the amount arrived at after reducing the basic exemption limit of Rs. 2,50,000 from Rs.4,20,000** | 18,500 |
| **Add: Health and Education cess @4%** | 740 |
| **Tax to be deducted at source** | 19,240 |

**Question 15**

A foreign company seconded some employees to the assessee, an Indian collaborator. These employees worked with the Indian collaborator throughout the P.Y.2019-20. The employees were in receipt of salary from the Indian collaborator. They were also in receipt of special allowance directly from the foreign company in foreign currency outside India. The Indian collaborator deducted tax under section 192, on the component of salary paid by it, without taking into account the special allowance paid abroad by the foreign company in foreign currency to these employees. For this reason, the Revenue authorities treated the Indian collaborator as an 'assessee-in-default' under section 201 for non-deduction of tax at source on the “special allowance” component of salary paid by the foreign company.

Is such treatment by the Revenue Authorities and the consequent levy of interest and penalty justified?
Answer

Section 9(1)(ii) provides that any income which falls under the head “salaries” is deemed to accrue or arise in India, if it is earned in India. The Explanation thereto further clarifies that income payable for services rendered in India shall be regarded as income earned in India.

Section 192(1) requires the person responsible for paying any income chargeable under the head “Salaries” to deduct income-tax, at the time of payment, at the average rate of income-tax computed on the basis of the rates in force for the financial year on the amount payable.

Since the TDS provisions relating to payment of income chargeable under the head “Salaries” form an integrated code along with the charging and computation provisions under the Act, section 192(1) has to be read with section 9(1)(ii) and the Explanation thereto. Therefore, if any payment under the head “Salaries” falls within section 9(1)(ii), then TDS provisions under section 192 gets attracted. Consequently, the Indian tax deductor assessee is duty bound to deduct, from the portion of salary paid by it, tax at source under section 192(1) on the entire salary paid to the employee, including special allowance paid abroad to the employee by the foreign company.

It was so held by the Apex Court in CIT, New Delhi v. Eli Lilly & Co. (India) P. Ltd. (2009) 312 ITR 225.

In this case, all the employees are resident in India, since they have worked with the Indian collaborator throughout the previous year 2018-19. If the tax due on special allowance received from the foreign company is paid by the recipient-employees, then, the Indian collaborator would not be treated as an assessee-in-default under section 201(1), if these resident-employees have furnished a return of income under section 139 on or before the due date of filing return of income, disclosing such income, and have also furnished a certificate to this effect from an accountant in the prescribed form. However, interest under section 201(1A)@1% per month or part of month shall be payable by the Indian collaborator from the date on which such tax was deductible to the date of furnishing of return by such resident employee.

In cases where the tax has not been paid by the recipient employee, the Assessing Officer can proceed under section 201(1) to recover the shortfall in payment of tax and interest thereon under section 201(1A).

However, no penalty under section 271C would be attracted, if the Indian collaborator was under the genuine and bona fide belief that it was not under any obligation to deduct tax at source from the special allowance paid by the foreign company. This is provided for under section 273B.

ADDITIONAL ILLUSTRATIONS FOR PRACTICE

Illustration 1

LL Limited paid leave travel facility to its employees and considered exemption under section 10(5), based on the self-declaration furnished by the employees. The Assessing Officer held that the company as an employer ought to have verified the genuineness of the claim of exemption by obtaining from them, the proof of actual expenditure incurred by availing leave travel facility. Accordingly, the Assessing Officer treated the assessee company as assessee in default. Decide the correctness of action.
Solution
Section 192 casts liability on the employer to deduct tax at source from the salary paid to its employees.

In this case, the employer has paid leave travel concession / facility to its employees and the said concession / facility would be eligible for exemption subject to the conditions laid down in section 10(5) read with Rule 2B of the Income-tax Rules, 1962.

Section 192(2D) casts responsibility on the person responsible for paying any income chargeable under the head ‘Salaries’ to obtain from the assessee, the evidence or proof or particulars of prescribed claims under the provisions of the Act in the prescribed form and manner for the purposes of –

(1) estimating income of the assesses; or
(2) computing tax deductible under section 192(1).

Rule 26C of the Income-tax Rules, 1962 mandates a salaried assessee claiming, inter alia, leave travel concession or assistance to furnish evidence of expenditure incurred in relation thereto to the person responsible for making such for payment under section 192(1), for the purpose of estimating his income for computing the tax deductible under section 192.

Thus, the action of the Assessing Officer is correct in law.

Illustration 2
Mr. Sharma, an employee of M/s. ABC Ltd. since 10-04-2016 resigned on 31-03-2020 and withdrew Rs. 60,000 being the balance in his EPF account. State with reasons whether the provisions of Chapter XVII-B are attracted and if so, what is the net amount receivable by the payee, Mr. Sharma?

Solution
As per section 192A, in a case where the accumulated balance due to an employee participating in a recognized provident fund is includible in his total income owing to the provisions of Rule 8 of Part A of the Fourth Schedule not being applicable, the trustees of the Employees Provident Fund Scheme, 1952 or any person authorised under the scheme to make payment of accumulated balance due to employees are required to deduct income-tax @10% at the time of payment of accumulated balance due to the employee. Tax deduction at source has to be made only if the amount of such payment or aggregate amount of such payment of the payee is Rs. 50,000 or more.

Rule 8 of Part A of the Fourth Schedule, inter alia, provides that only if an employee has rendered continuous service of five years or more with the employer, then accumulated balance in a recognized provident fund payable to an employee would be excluded from the total income of that employee.

In the present case, Mr. Sharma has withdrawn an amount exceeding Rs. 50,000 on his resignation after rendering a continuous service of four years with M/s. ABC Ltd. Therefore, tax has to be deducted at source @10% under section 192A on Rs. 60,000, being the amount withdrawn on his resignation without rendering continuous service of a period of five years with M/s. ABC Ltd.

The net amount receivable by Mr. Sharma is Rs. 54,000 [i.e., Rs. 60,000 – Rs. 6,000, being tax deducted at source].
Note – It is assumed that Mr. Sharma has furnished his permanent account number (PAN) to the person responsible for deducting tax at source. Otherwise, tax would be deductible at the maximum marginal rate. It may be noted that with effect from 1.6.2015 such employee can furnish declaration in Form No.15G for non-deduction of tax at source under section 192A by virtue of section 197A(1A).

Illustration 3
Examine the TDS implications under section 194A in the cases mentioned hereunder –

(i) On 1.10.2019, Mr. Harish, aged 40 years, made a six-month fixed deposit of Rs. 10 lakh @9% p.a. with ABC Co-operative Bank. The fixed deposit matures on 31.3.2020.

(ii) On 1.6.2019, Mr. Ganesh, aged 45 years, made three nine month fixed deposits of Rs. 3 lakh each carrying interest@9% with Dwarka Branch, Janakpuri Branch and Rohini Branch of XYZ Bank, a bank which has adopted CBS. The fixed deposits mature on 28.2.2020.

(iii) On 1.4.2019, Mr. Rajesh, aged 35 years, started a 1 year recurring deposit of Rs. 80,000 per month@8% p.a. with PQR Bank. The recurring deposit matures on 31.3.2020.

Solution

(i) ABC Co-operative Bank has to deduct tax at source@10% on the interest of Rs. 45,000 (9% × Rs. 10 lakh × ½) under section 194A. The tax deductible at source under section 194A from such interest is, therefore, Rs. 4,500.

(ii) XYZ Bank has to deduct tax at source@10% under section 194A, since the aggregate interest on fixed deposit with the three branches of the bank is Rs. 60,750 [3,00,000 × 3 × 9% × 9/12], which exceeds the threshold limit of Rs. 40,000. Since XYZ Bank has adopted CBS, the aggregate interest credited/paid by all branches has to be considered. Since the aggregate interest of Rs. 60,750 exceeds the threshold limit of Rs. 40,000, tax has to be deducted@10% under section 194A.

(iii) Tax has to be deducted under section 194A by PQR Bank on the interest of Rs. 41,600 falling due on recurring deposit on 31.3.2020 to Mr. Rajesh, since –

(1) “recurring deposit” is included in the definition of “time deposit”; and

(2) such interest exceeds the threshold limit of Rs. 40,000.

Illustration 4
Maya Bank credited Rs. 73,50,000 towards interest on the deposits in a separate account for macro-monitoring purposes by using Core-branch Banking Solutions (CBS) software. No tax was deducted at source in respect of interest on deposits so credited even where the interest in respect of some depositors exceeded the limit of Rs. 40,000.

The Assessing Officer disallowed 30% of interest expenditure, where the interest on time deposits credited exceeded the limit of Rs. 40,000 and also levied penalty under section 271C.

Decide the correctness of action of the Assessing Officer.

Solution
The Explanation below section 194A(1) provides that where any income by way of interest other than interest on securities is credited to any account, whether called

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‘interest payable account’ or ‘suspense account’ or by any other name, in the books of account of the person liable to pay such income, such crediting shall be deemed to be credit of such income to the account of the payee and provisions of section 194A, shall, thus, apply.

However, the CBDT has, vide Circular No.3/2010 dated 2.3.2010, clarified that Explanation to section 194A will not apply in cases of banks where credit is made to provisioning account on daily/monthly basis for the purpose of macro monitoring only by the use of CBS software.

Since no constructive credit to the depositor's / payee's account takes place while calculating interest on daily / monthly basis in the CBS software used by banks, tax need not be deducted at source on such provisioning of interest by banks for the purposes of macro monitoring only.

In such cases, tax shall be deducted at source on accrual of interest at the end of the financial year or at periodic intervals as per practice of the bank or as per the depositor's or payee’s requirement or on maturity or on encashment of time deposit, whichever event takes place earlier and wherever the aggregate amount of interest income credited or paid or likely to be credited or paid during the financial year by the bank exceeds the limits specified in section 194A i.e., Rs. 40,000.

In view of the above, the action of the Assessing Officer in disallowing the interest expenditure credited in a separate account for macro monitoring purpose is not valid and consequent initiation of penalty proceedings under section 271C is not tenable in law.

Illustration 5
Mr. Govind won the first prize in a lottery ticket and the prize was a Maruti car worth Rs. 5 lacs. What is the procedure to be adopted before handing over the Maruti Car to Mr. Govind?

Solution
Section 194B provides that the person responsible for paying to any person, any income by way of winnings from any lottery or crossword puzzle, card game or any other game of any sort and the amount of winning exceeds Rs.10,000, tax shall be deducted at source @ 30%.

However, in case where the winning is wholly in kind, the person responsible for paying the prize shall before releasing the winning, ensure that the tax has been paid in respect of such winning.

The Karnataka High Court in the case of CIT v. Hindustan Lever Ltd. (2014) 361 ITR 1 has held that where the winnings are wholly in kind, the responsibility cast under section 194B is to ensure that the tax is paid by the winner of the prize before the prize is released in his favour. In this regard, the CBDT Circular No.763 dated 18/2/1998 clarifies that the person responsible for paying the winnings shall, before releasing such winnings, ensure that the tax is paid by the winner. He can do so, for example, by collecting from the winner a sum equal to the tax deductible at source on the winnings in kind, before releasing the winnings. For this purpose, the value of the winnings in kind shall be taken as the cost incurred by the payer in acquiring the said winnings in kind.

Therefore, in this case since the entire winning is in kind, it must be ensured that the sum equal to the tax deductible at source (i.e., Rs. 1,50,000, being @ 30% of Rs. 5 lacs) is paid by Mr. Govind, before the car is released in his favour. This can be done by
collecting Rs. 1,50,000 from Mr. Govind before releasing the Maruti car to him and remitting the said sum to the Government account or verifying the tax payment by the winner and thereafter releasing the prize.

Illustration 6
ABC Ltd. makes the following payments to Mr. X, a contractor, for contract work during the P.Y.2019-20–

Rs. 20,000 on 1.5.2019
Rs. 25,000 on 1.8.2019
Rs. 28,000 on 1.12.2019

On 1.3.2020, a payment of Rs. 30,000 is due to Mr. X on account of a contract work.
Discuss whether ABC Ltd. is liable to deduct tax at source under section 194C from payments made to Mr. X.

Solution
In this case, the individual contract payments made to Mr. X does not exceed Rs. 30,000. However, since the aggregate amount paid to Mr. X during the P.Y.2019-20 exceeds Rs. 1,00,000 (on account of the last payment of Rs. 30,000, due on 1.3.2020, taking the total from Rs. 73,000 to Rs. 1,03,000), the TDS provisions under section 194C would get attracted. Tax has to be deducted@1% on the entire amount of Rs. 1,03,000 from the last payment of Rs. 30,000 and the balance of Rs. 28,970 (i.e., Rs. 30,000 – Rs. 1,030) has to be paid to Mr. X.

Illustration 7
Bharathi Cements Ltd. purchased jute bags from Raj Kumar & Co. The latter has to supply the jute bags with the logo and address of the assessee, printed on it. From 01.09.2019 to 20.03.2020, the value of jute bags supplied is Rs. 8,00,000, for which the invoice has been raised on 20.03.2020. While effecting the payment for the same, is the assessee bound to deduct tax at source, assuming that the value of the printing component involved is Rs. 1,10,000. You are informed that the assessee has not sold any material to Raj Kumar & Co. and that the latter has to manufacture the jute bags in its plant using raw materials purchased by it from outsiders.

Solution
As per the definition under section 194C, "work" shall not include manufacturing or supplying a product according to the requirement or specification of a customer by using raw material purchased from a person, other than such customer. This is regardless of the quantum of expenditure incurred towards printing or processing comprised in the bill amount.

The problem clearly states that Raj Kumar & Co. has to manufacture the jute bags using raw materials purchased from outsiders and that the assessee Bharathi Cements Ltd has not sold any material to them. Therefore, in this case, it is a contract of sale. Hence, the provisions of section 194C are not attracted and no liability to deduct tax at source would arise.
Illustration 8

Alap Ltd. has made following payments on various dates in financial year 2019-20 to Vilambit Ltd. towards work done under different contracts:

<table>
<thead>
<tr>
<th>Contract Number</th>
<th>Date of payment</th>
<th>Amount (Rs.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>5.5.2018</td>
<td>20,000</td>
</tr>
<tr>
<td>2.</td>
<td>6.6.2018</td>
<td>15,000</td>
</tr>
<tr>
<td>3.</td>
<td>8.8.2018</td>
<td>25,000</td>
</tr>
<tr>
<td>4.</td>
<td>10.12.2018</td>
<td>25,000</td>
</tr>
<tr>
<td>5.</td>
<td>29.01.2019</td>
<td>17,000</td>
</tr>
</tbody>
</table>

Alap Ltd. claims that it is not liable for deduction of tax at source under section 194C. Examine the correctness of the claim made by the company. What would be the position if the value of the contract no. 5 is Rs. 14,000 only and there was no further contract during the year?

Solution

As per section 194C(5), tax has to be deducted at source where the amount credited or paid or likely to be credited or paid to a contractor or sub-contractor exceeds Rs. 30,000 in a single payment or Rs. 1,00,000 in aggregate during the financial year.

Therefore, in the given case, even though the value of each individual contract does not exceed Rs. 30,000, the aggregate amount exceeds Rs. 1,00,000. Hence, Alap Ltd's contention is not correct and tax is required to be deducted at source on the whole amount of Rs. 1,02,000 from the last payment of Rs. 17,000 towards Contract No.5 on account of which the aggregate amount exceeded Rs. 1,00,000.

However, no tax deduction is to be made if the value of the last contract is Rs. 14,000 as the aggregate amount in such case would only be Rs. 99,000, which is below the aggregate monetary limit of Rs. 1,00,000.

Illustration 9

Examine the applicability of the provisions for tax deduction at source under section 194DA in the following cases -

(i) Mr. X, a resident, is due to receive Rs. 4.50 lakhs on 31.3.2020, towards maturity proceeds of LIC policy taken on 1.4.2017, for which the sum assured is Rs. 4 lakhs and the annual premium is Rs. 1,10,000.

(ii) Mr. Y, a resident, is due to receive Rs. 3.25 lakhs on 31.3.2020 on LIC policy taken on 31.3.2012, for which the sum assured is Rs. 3 lakhs and the annual premium is Rs. 35,000.

(iii) Mr. Z, a resident, is due to receive Rs. 95,000 on 1.8.2019 towards maturity proceeds of LIC policy taken on 1.8.2013 for which the sum assured is Rs. 90,000 and the annual premium was Rs. 12,000.

Solution

(i) Since the annual premium exceeds 10% of sum assured in respect of a policy taken after 31.3.2012, the maturity proceeds of Rs. 4.50 lakhs due on 31.3.2020 are not exempt under section 10(10D) in the hands of Mr. X. Therefore, tax is required to be deducted at 5% under section 194DA on the amount of income comprised therein i.e., on Rs. 1,20,000 (Rs. 4,50,000, being maturity proceeds - Rs. 3,30,000, being the entire amount of insurance premium paid).

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(ii) Since the annual premium is less than 20% of sum assured in respect of a policy taken before 1.4.2012, the sum of Rs. 3.25 lakhs due to Mr. Y would be exempt under section 10(10D) in his hands. Hence, no tax is required to be deducted at source under section 194DA on such sum payable to Mr. Y.

(iii) Even though the annual premium exceeds 10% of sum assured in respect of a policy taken after 31.3.2012, and consequently, the maturity proceeds of Rs. 95,000 due on 1.8.2019 would not be exempt under section 10(10D) in the hands of Mr. Z, the tax deduction provisions under section 194DA are not attracted since the maturity proceeds are less than Rs. 1 lakh.

Illustration 10

Calculate the amount of tax to be deducted at source (TDS) on payment made to Ricky Ponting, an Australian cricketer, by a newspaper for contribution of articles Rs. 25,000.

Solution

Under section 194E, the person responsible for payment of any amount to a non-resident sportsman for contribution of articles relating to any game or sport in India in a newspaper shall deduct tax @ 20%. Further, since Ricky Ponting is a non-resident, education cess@20% and secondary and higher education cess@4% on TDS would also be added.

Therefore, tax to be deducted = Rs. 25,000 × 20.80% = Rs. 5,200.

Illustration 11

B. Airways Ltd. sold tickets to the travel agents in India at a minimum fixed commercial price. The agents were permitted to sell the tickets at a higher price but not exceeding the maximum published price. Commission at the rate of 9% of minimum fixed commercial price was deducted under section 194H by the company. The Assessing Officer contended that the liability for tax deduction at source is attracted on the difference between the minimum fixed commercial price and the maximum published price by treating it as "additional special commission" in the hands of the agents.

Is the contention of Assessing Officer tenable in law?

Solution

As per the provisions of section 194H, a person is liable to deduct tax at source at the time of credit or payment of commission to any resident, whichever is earlier.

In the present case, B. Airways Ltd. correctly deducted tax at source under section 194H from the commission@9% of the minimum fixed commercial price paid to the travel agents, who were allowed to sell the air tickets at any price higher than the minimum fixed commercial price subject to a maximum published price. However, the Assessing Officer contended that the airline company was required to deduct tax at source on the difference between the minimum fixed commercial price and the maximum published price by treating it as “additional special commission” in the hands of the agents.

The facts of the case are similar to the case of CIT v. Qatar Airways (2011) 332 ITR 253, where the Bombay High Court held that the difference between the maximum published price and the minimum fixed commercial price cannot be taken as “additional special commission” in the hands of the agents. This is because the maximum published price is
the maximum price and the airline company has granted permission to the agents to sell the tickets at a price lower than the maximum published price. Further, the airline company would have no information about the exact rate at which the tickets were ultimately sold by its agents. In order to deduct tax at source on the difference between actual sale price and minimum fixed commercial price, the exact income in the hands of the agents must be ascertainable by the airline company. However, it is not so ascertainable in this case, since the agents are given discretion to sell the tickets at any rate between the minimum fixed commercial price and the maximum published price. It would be impracticable and unreasonable to expect the airline company to get a feedback from its numerous agents in respect of the price at which the tickets were sold by them.

Applying the rationale of the above case to the case on hand, B. Airways Ltd. is not liable to deduct tax at source under section 194H on the difference between the maximum published price and the minimum fixed commercial price, even though the amount earned by the agent over and above the minimum fixed commercial price is taxable as income in their hands.

Therefore, the contention of the Assessing Officer is not tenable in law.

Illustration 12
Moon TV, a television channel, made payment of Rs. 50 lakhs to a production house for production of programme for telecasting as per the specifications given by the channel. The copyright of the programme is also transferred to Moon TV. Would such payment be liable for tax deduction at source under section 194C? Discuss.

Also, examine whether the provisions of tax deduction at source under section 194C would be attracted if the payment was made by Moon TV for acquisition of telecasting rights of the content already produced by the production house.

Solution
In this case, since the programme is produced by the production house as per the specifications given by Moon TV, a television channel, and the copyright is also transferred to the television channel, the same falls within the scope of definition of the term ‘work’ under section 194C. Therefore, the payment of Rs. 50 lakhs made by Moon TV to the production house would be subject to tax deduction at source under section 194C.

If, however, the payment was made by Moon TV for acquisition of telecasting rights of the content already produced by the production house, there is no contract for “carrying out any work”, as required in section 194C(1). Therefore, such payment would not be liable for tax deduction at source under section 194C.

Illustration 13
ABC Ltd. took on sub-lease a building from J, an individual, with effect from 1.9.2019 on a rent of Rs. 25,000 per month. It also took on hire machinery from J with effect from 1.10.2019 on hire charges of Rs. 15,000 per month. ABC Ltd. entered into two separate agreements with J for sub-lease of building and hiring of machinery. The rent of building and hire charges of machinery for the financial year 2019-20 were Rs. 1,75,000 and Rs. 90,000, respectively, which were credited by ABC Ltd. to the account of J in
its books of account on 31.3.2020. Examine the obligation of ABC Ltd. with regard to
deduction of tax at source in respect of the rent and hire charges.

**Solution**

As per section 194-I dealing with deduction of tax at source from payment of rent, the
rate of TDS applicable is 2% for machinery hire charges and 10% for building lease
rent. The scope of the section includes within its ambit, rent for machinery, plant and
equipment. Tax is required to be deducted at source from payment of rent, by whatever
name called, under any lease, sub-lease, tenancy or any other agreement or
arrangement for the use of building and machinery, irrespective of whether such assets
are owned or not by the payee.

The limit of Rs. 2,40,000 for tax deduction at source will apply to the aggregate rent of all
the assets. Even if two separate agreements are entered into, one for sub-lease of
building and another for hiring of machinery, rent and hire charges under the two
agreements have to be aggregated for the purpose of application of the threshold limit of
Rs. 2,40,000. In this case, since the payment for rent and hire charges credited to the
account of J, the payee, aggregates to Rs. 2,65,000 (Rs. 1,75,000 + Rs. 90,000), tax is
deductible at source under section 194-I. Tax is deductible@10% on Rs. 1,75,000 (rent
of building) and @2% on Rs. 90,000 (hire charges of machinery).

**Illustration 14**

Mr. X sold his house property in Bangalore as well as his rural agricultural land for a
consideration of Rs. 60 lakh and Rs. 15 lakh, respectively, to Mr. Y on 1.8.2019. He has
purchased the house property and the land in the year 2018 for Rs. 40 lakh and Rs. 10
lakh, respectively. The stamp duty value on the date of transfer, i.e., 1.8.2019, is Rs. 85
lakh and Rs. 20 lakh for the house property and rural agricultural land, respectively.
Determine the tax implications in the hands of Mr. X and Mr. Y and the TDS
implications, if any, in the hands of Mr. Y, assuming that both Mr. X and Mr. Y are
resident Indians.

**Solution**

<table>
<thead>
<tr>
<th>(i) Tax implications in the hands of Mr. X</th>
</tr>
</thead>
<tbody>
<tr>
<td>As per section 50C, the stamp duty value of house property (i.e. Rs. 85 lakh) would be deemed to be the full value of consideration arising on transfer of property. Therefore, Rs. 45 lakh (i.e., Rs. 85 lakh – Rs. 40 lakh, being the purchase price) would be taxable as short-term capital gains in the A.Y.2020-21. Since rural agricultural land is not a capital asset, the gains arising on sale of such land is not taxable in the hands of Mr. X.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>(ii) Tax implications in the hands of Mr. Y</th>
</tr>
</thead>
<tbody>
<tr>
<td>In case immovable property is received for inadequate consideration, the difference between the stamp value and actual consideration would be taxable under section 56(2)(x), if such difference exceeds higher of Rs. 50,000 or 5% of the consideration. Therefore, in this case Rs. 25 lakh (Rs. 85 lakh – Rs. 60 lakh) would be taxable in the hands of Mr. Y under section 56(2)(x). Since agricultural land is not a capital asset, the provisions of section 56(2)(x) are not attracted in respect of receipt of agricultural land for inadequate consideration, since the definition of “property” under section 56(2)(x) includes only capital assets specified thereunder.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>(iii) TDS implications in the hands of Mr. Y</th>
</tr>
</thead>
</table>

15.25
Since the sale consideration of house property exceeds Rs. 50 lakh, Mr. Y is required to deduct tax at source under section 194-IA. The tax to be deducted under section 194-IA would be Rs. 60,000, being 1% of Rs. 60 lakh. TDS provisions under section 194-IA are not attracted in respect of transfer of rural agricultural land.

Illustration 15
Mr. X, a salaried individual, pays rent of Rs. 55,000 per month to Mr. Y from June, 2018. Is he required to deduct tax at source? If so, when is he required to deduct tax? Also, compute the amount of tax to be deducted at source.
Would your answer change if Mr. X vacated the premises on 31st December, 2019?
Also, what would be your answer if Mr. Y does not provide his PAN to Mr. X?

Solution
Since Mr. X pays rent exceeding Rs. 50,000 per month in the F.Y. 2019-20, he is liable to deduct tax at source @5% of such rent for F.Y. 2019-20 under section 194-IB. Thus, Rs. 27,500 [Rs. 55,000 × 5% × 10] has to be deducted from rent payable for March, 2020.
If Mr. X vacated the premises in December, 2019, then tax of Rs. 19,250 [Rs. 55,000 × 5% × 7] has to be deducted from rent payable for December, 2019.
In case Mr. Y does not provide his PAN to Mr. X, tax would be deductible @20%, instead of 5%.
In case 1 above, this would amount to Rs. 1,10,000 [Rs. 55,000 × 20% × 10] but the same has to be restricted to Rs. 55,000, being rent for March, 2020.
In case 2 above, this would amount to Rs. 77,000 [Rs. 55,000 × 20% × 7] but the same has to be restricted to Rs. 55,000, being rent for December, 2019.

Illustration 16
XYZ Ltd. makes a payment of Rs. 28,000 to Mr. Ganesh on 2.8.2019 towards fees for professional services and another payment of Rs. 25,000 to him on the same date towards fees for technical services. Discuss whether TDS provisions under section 194J are attracted.

Solution
TDS provisions under section 194J would not get attracted, since the limit of Rs. 30,000 is applicable for fees for professional services and fees for technical services, separately. It is assumed that there is no other payment to Mr. Ganesh towards fees for professional services and fees for technical services during the P.Y.2019-20.

Illustration 17
East Bengal Club, a renowned football club, has engaged Raghu, a resident in India, as its coach at a remuneration of Rs. 6 lacs per annum. The club wants to know from you whether it is liable to deduct tax at source from such remuneration.

Solution
Section 194J requires deduction of tax at source @10% from the amount credited or paid by way of fees for professional services, where such amount or aggregate of such amounts credited or paid to a person exceeds Rs. 30,000 in a financial year. As per
Explanation (a) to section 194J, professional services includes services rendered by a person in the course of carrying on such other profession as is notified by the CBDT for the purposes of section 194J.

Accordingly, the CBDT has, vide Notification No.88 dated 21.8.2008, in exercise of the powers conferred by clause (a) of the Explanation to section 194J notified the services rendered by coaches and trainers in relation to the sports activities as professional services for the purposes of section 194J.

Therefore, the club is liable to deduct tax at source under section 194J from the remuneration payable to the Coach, Raghu.

**Illustration 18**

Examine whether TDS provisions would be attracted in the following cases, and if so, under which section. Also, specify the rate of TDS applicable in each case. Assume that all payments are made to residents.

<table>
<thead>
<tr>
<th>Particulars of the payer</th>
<th>Nature of payment</th>
<th>Aggregate of payments made in the F.Y.2019-20</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Mr. Ganesh, an individual carrying on retail business with turnover of Rs. 2.5 crores in the P.Y.2018-19</td>
<td>Contract Payment for repair of residential house</td>
<td>Rs. 5 lakhs</td>
</tr>
<tr>
<td></td>
<td>Payment of commission to Mr. Vallish for business purposes</td>
<td>Rs.80,000</td>
</tr>
<tr>
<td>3. Mr. Satish, a salaried individual</td>
<td>Payment of brokerage for buying a residential house in March, 2020</td>
<td>Rs.51 lakhs</td>
</tr>
<tr>
<td>4. Mr. Dheeraj, a pensioner</td>
<td>Contract payment made during October-November 2019 for reconstruction of residential house</td>
<td>Rs.48 lakhs</td>
</tr>
</tbody>
</table>

**Solution**

<table>
<thead>
<tr>
<th>Particulars of the payer</th>
<th>Nature of payment</th>
<th>Aggregate of payments made in the F.Y.2019-20</th>
<th>Whether TDS provisions are attracted?</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Mr. Ganesh, an individual carrying on retail business with turnover of Rs. 2.5 crores in the P.Y.2018-19</td>
<td>Contract Payment for repair of residential house</td>
<td>Rs. 5 lakhs</td>
<td>No, TDS u/s 194C is not attracted since the payment is for personal purpose and TDS u/s 194M is not attracted as aggregate of contract payment to the payee in the P.Y.2019-20 does not exceed Rs. 50 lakhs.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Payment of commission to Mr. Vallish for business purposes</td>
<td>Rs. 80,000</td>
</tr>
<tr>
<td>---</td>
<td>---</td>
<td>---</td>
<td>---</td>
</tr>
<tr>
<td>2.</td>
<td>Mr. Rajesh, a wholesale trader who declares profits under section 44AD for P.Y.2018-19 and P.Y.2019-20.</td>
<td>Contract Payment for reconstruction of residential house</td>
<td>Rs. 55 lakhs</td>
</tr>
<tr>
<td>3.</td>
<td>Mr. Satish, a salaried individual</td>
<td>Payment of brokerage for buying a residential house</td>
<td>Rs. 51 lakhs</td>
</tr>
<tr>
<td>4.</td>
<td>Mr. Dheeraj, a pensioner</td>
<td>Contract payment for reconstruction of residential house</td>
<td>Rs. 48 lakhs</td>
</tr>
</tbody>
</table>

**Illustration 19**

'X' while making payment "net of tax" to a non-resident for providing technical services on a world bank aided project had deducted tax out of such payments as per rates prescribed but says that the payee is not entitled for the TDS certificate. Examine.

**Solution**

As per section 198, any sum deducted in accordance with the provisions of Chapter XVII-B of the Income-tax Act, 1961 is deemed to be income received while computing the income of the payee.

As per section 203, every person deducting tax at source shall furnish to the payee a certificate in the prescribed form within the prescribed time.
Even in a case where ‘X undertakes to pay the tax on the grossed up amount, the non-resident shall be entitled for issue of certificate for tax deducted at source in respect of payment made ‘net of tax’ in terms of section 195A. This has been clarified vide CBDT Circular No.785 dated 24.11.1999.

Therefore, X has a legal obligation to issue TDS certificate to the non-resident, even if he has made payment of income “net of tax” to him.

**Illustration 20**

An amount of Rs. 40,000 was paid to Mr. X on 1.7.2019 towards fees for professional services without deduction of tax at source. Subsequently, another payment of Rs. 50,000 was due to Mr. X on 28.2.2020, from which tax@10% (amounting to Rs. 9,000) on the entire amount of Rs. 90,000 was deducted. However, this tax of Rs. 9,000 was deposited only on 22.6.2020. Compute the interest chargeable under section 201(1A).

**Solution**

Interest under section 201(1A) would be computed as follows –

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1% on tax deductible but not deducted i.e., 1% on Rs. 4,000 for 8 months</td>
<td>320</td>
</tr>
<tr>
<td>1½% on tax deducted but not deposited i.e. 1½% on Rs. 9,000 for 4 months</td>
<td>540</td>
</tr>
<tr>
<td></td>
<td>860</td>
</tr>
</tbody>
</table>

(ii) Such interest should be paid before furnishing the statements in accordance with section 200(3).

(iii) Where the payer fails to deduct the whole or any part of the tax on the amount credited or payment made to a payee and is not deemed to be an assessee-in-default under section 201(1) on account of payment of taxes by such payee, interest under section 201(1A)(i) i.e., @1% p.m. or part of month, shall be payable by the payer from the date on which such tax was deductible to the date of furnishing of return of income by such payee. The date of deduction and payment of taxes by the payer shall be deemed to be the date on which return of income has been furnished by the payee.

(iv) Where the tax has not been paid after it is deducted, the amount of the tax together with the amount of simple interest thereon shall be a charge upon all the assets of the person or the company, as the case may be.

**Illustration 21**

The Assessing Officer issued a notice of demand under section 156 to Mr. X on 1.10.2019 for payment of Rs. 15 lakhs towards his income-tax liability for the A.Y.2018-19, requiring him to pay the said amount within 30 days.

(a) Is he required to issue fresh notice of demand and if so, for what amount, in the following two cases (each case has to be considered independently) –

   (i) If the tax demand is reduced to Rs. 12 lakhs by the Commissioner (Appeals) by issue of order under section 250;

   (ii) If the tax demand is increased to Rs. 20 lakhs by the Appellate Tribunal, by issue of an order under section 254.
(b) How would the interest liability under section 220(2) be calculated if the tax demand is reduced to Rs. 12 lakhs by the Commissioner (Appeals) by issue of order under section 250 and subsequently increased to Rs. 15 lakhs by the Appellate Tribunal by way of issue of order under section 254?

Solution

(a) (i) No fresh notice of demand is required to be served on Mr. X. The Assessing Officer is only required to give an intimation of the fact of reduction of demand to Rs. 12 lakhs to Mr. X. The proceedings initiated on the basis of the original notice of demand may be continued in relation to the reduced amount of Rs. 12 lakhs from the stage at which such proceedings stood immediately before disposal of appeal.

(ii) A fresh notice of demand has to be given only in respect of Rs. 5 lakhs, being the amount of enhancement. Any proceedings in relation to Rs. 15 lakhs covered by the original notice of demand served upon Mr. X may be continued from the stage at which such proceedings stood immediately before disposal of appeal.

(b) The interest under section 220(2) has to be paid on Rs. 15 lakhs @1% per month or part of the month comprised in the period commencing from 1.11.2019 and ending with the date on which the amount is paid, assuming that Mr. X has not paid any interest so far.
EXERCISE

Question 1

Rajesh regularly files his return of income electronically. While he was trying to upload his return of income for assessment year 2019-20 on 31st August, 2019 (extended due date), last date for filing the same, he found it extremely difficult to do the same due to network problems and ultimately he became successful in making e-filing of his return only at 1 a.m. on 1st September, 2019. The return contained a claim for carry forward of business loss of Rs. 51 lakh. This circumstance was recorded in a letter delivered to the office of the Deputy Commissioner of Income Tax on 1st September, 2019 during normal office hours. Rajesh made a request to the CBDT for condonation of delay in filing the return of income. Discuss whether the CBDT has the power to condone the delay in filing the return of income and permit carry forward of loss in the given circumstance.

Would your answer change, if the return contained a claim for carry forward of business loss of Rs. 48 lakh.

Answer

Section 119(2)(b) empowers the CBDT to authorise any income tax authority to admit an application or claim for any exemption, deduction, refund or any other relief under the Act after the expiry of the period specified under the Act, to avoid genuine hardship in any case or class of cases. The claim for carry forward of loss in case of late filing of a return is relatable to a claim arising under the category of “any other relief available under the Act”. Therefore, the CBDT has the power to condone delay in filing of such loss return due to genuine reasons.

The facts of the case are similar to the case of Lodhi Property Company Ltd. v. Under Secretary, (ITA-II), Department of Revenue (2010) 323 ITR 0441, where the Delhi High Court held that the Board has the power to condone the delay in case of a return which was filed late and where a claim for carry forward of losses was made. The delay was only one day and the assessee had shown justifiable reason for the delay of one day in filing the return of income. If the delay is not condoned, it would cause genuine hardship to the assessee. Therefore, the Court held that the delay of one day in filing of the return had to be condoned.

Further, the CBDT Circular No. 9/2015 dated 09.06.2015 has expressly clarified that CBDT can consider application for such claim where the amount exceeds Rs. 50 lakhs.

Applying the rationale of the above court ruling and the clarification given in CBDT Circular to the case on hand, the CBDT has the power to condone the delay in filing the return of income of Mr. Rajesh and permit carry forward of business loss of Rs. 51 lakhs, since the delay of one hour was due to a genuine and justifiable reason i.e., network problem while e-filing the return.

However, if the claim for carry forward of business loss is 48 lakhs, then, the Principal Chief Commissioner of Income-tax/Chief Commissioner of Income-tax has the power to condone the delay (since the amount is between 10 lakhs to 50 lakhs). It may be noted that if the claim is less than Rs.10 lakhs, the Principal Commissioner of Income-tax/Commissioner of Income-tax is empowered to condone the delay. This clarification is given in CBDT Circular No. 9/2015 dated 09.06.2015.
Question 2

Examine the correctness of the statement “the jurisdiction of an Assessing Officer cannot be objected by the assessee”.

Answer

According to section 124(3), the assessee can raise a question as to the jurisdiction of an Assessing Officer within the prescribed time limit as under:

(i) where a return has been filed under section 139(1) then, within one month from the date of service of notice under section 142(1) or section 143(2) or before the completion of assessment, whichever is earlier.

(ii) where no return has been filed, then, within the expiry of time allowed by the notice under section 142(1) or section 148 for filing the return or within the time allowed in show cause notice issued seeking as to why a best judgment assessment under section 144 should not be made, whichever is earlier.

(iii) where search is initiated under section 132 or books of accounts, other documents or any assets are requisitioned under section 132A, within one month from the date on which he was served with a notice under section 153A(1) or 153C(2) or before the completion of assessment, whichever is earlier.

Where the assessee calls in question the jurisdiction of an Assessing Officer and the Assessing Officer is not satisfied with such claim, he shall refer the matter for determination by the Principal Director General or Director General or Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner before the assessment is made.

Therefore, in view of the above provisions, the statement that “the jurisdiction of an Assessing Officer cannot be objected by the assessee” is not correct.

Question 3

The Director General of Income Tax after getting the information that Mr. Mogambo is in possession of unaccounted cash of Rs. 50 lacs, issued orders by invoking powers vested in him as per section 131(1A), for its seizure. Is the order for seizure of cash issued by the Director General of Income Tax correct? If not, does the Director General of Income Tax have any other power to seize such cash?

Answer

The powers under section 131(1A) deal with power of discovery and production of evidence. They do not confer the power of seizure of cash or any asset. The Director General, for the purposes of making an enquiry or investigation relating to any income concealed or likely to be concealed by any person or class of persons within his jurisdiction, shall be competent to exercise powers conferred under section 131(1), which confine to discovery and inspection, enforcing attendance, compelling the production of books of account and other documents and issuing commissions. Thus, the power of seizure of unaccounted cash is not one of the powers conferred on the Director General under section 131(1A).

However, under section 132(1), the Director General has the power to authorize any Additional Director or Additional Commissioner or Joint Director or Joint Commissioner etc. to seize money found as a result of search [Clause (iii) of section 132(1)], if he has reason to believe that any person is in possession of any money which represents wholly or partly
income which has not been disclosed [Clause (c) of section 132(1)]. Therefore, the proper course open to the Director General is to exercise his power under section 132(1) and authorize the Officers concerned to enter the premises where the cash is kept by Mr. Mogambo and seize such unaccounted cash.

Question 4
The premises of Ganesh were subjected to a search under section 132 of the Act. The search was authorized and the warrant was signed by the Joint Commissioner of Income-tax having jurisdiction over the assessee, consequent to information in his possession. The assessee challenged the validity of search on the ground that section 132(1) does not empower Joint Commissioner to authorise a search under the Act. Decide the correctness of the contention raised by the assessee.

Answer
Under section 132(1), the income-tax authorities listed therein are empowered to authorise other income-tax authorities to conduct search and seizure operations. The authorities empowered to issue authorization include such Additional Director, Additional Commissioner, Joint Director and Joint Commissioner as are empowered by the CBDT to do so.

However, a Joint Commissioner can issue warrant of authorization only if he has been specifically empowered to do so by the CBDT. Therefore, only if the Joint Commissioner has not been specifically empowered by the CBDT to do so, the contention of the assessee would hold good.

Question 5
Examine whether the information regarding possession of unexplained assets and income received from the Central Bureau of Investigation, a Government agency, can constitute “information” for action under section 132. Discuss.

Answer
As per section 132(1)(c), authorization for search and seizure can take place if the authority, in consequence of information in his possession, has reason to believe that any person is in possession of money, bullion, jewellery or other valuable article or thing and these assets represent, either wholly or partly, income or property which has not been, or would not be disclosed by such person for the purposes of this Act. In the absence of such information, a search cannot be validly authorized.

The Apex Court in *UOI v Ajit Jain* [2003] 260 ITR 80 has held that mere intimation by the CBI that money was found in the possession of the assessee, which according to the CBI was undisclosed, without something more, does not constitute “information” within the meaning of section 132, on the basis of which a search warrant could be issued. Consequently, the Supreme Court held that the search conducted on this basis and the assessment made pursuant to such search was not valid.

Question 6
In the course of search operations under section 132 in the month of July, 2019, a tax payer makes a declaration under section 132(4) on the earning of income not disclosed in respect of P.Y.2018-19. Can that statement save the tax payer from a levy of penalty, if he is yet to file his return of income for A.Y.2019-20?
Answer

Since the search is conducted on or after 15.12.2016, and return is yet to be filed for the P.Y. 2018-19, the penalty would be as follows

(1) penalty@30%, if undisclosed income is admitted during the course of search in the statement furnished under section 132(4), and the assessee explains the manner in which such income was derived, pays the tax, together with interest if any, in respect of the undisclosed income, and furnishes the return of income for the specified previous year declaring such undisclosed income on or before the specified date (i.e., the due date of filing return of income or the date on which the period specified in the notice issued under section 153A expires, as the case may be).

(2) penalty@60% in any other case.

Therefore, even if the tax payer furnishes the statement under section 132(4), penalty@30% of undisclosed income of the specified previous year would be attracted under section 271AAB.

Question 7

Cash of Rs. 25 lacs was seized on 12.9.2019 in a search conducted as per section 132 of the Act. The assessee moved an application on 27.10.2019 to release such cash after explaining the sources thereof, which was turned down by the department. The assessee seeks your opinion on, the following issues:

(i) Can the department withhold the explained money?
(ii) If yes, then to what extent and upto what period?

Answer

The proviso to section 132B(1)(i) provides that where the person concerned makes an application to the Assessing Officer, within 30 days from the end of the month in which the asset was seized, for release of the asset and the nature and source of acquisition of the asset is explained to the satisfaction of the Assessing Officer, then, the Assessing Officer may, with the prior approval of the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner, release the asset after recovering the existing liability under the Income-tax Act, 1961, etc. out of such asset. ‘Existing liability’, however, does not include advance tax payable. Such asset or portion thereof has to be released within 120 days from the date on which the last of the authorizations for search under section 132 was executed.

In this case, since the application was made to the Assessing Officer within the 30 day period the amount of existing liability may be recovered out of the asset and the balance may be released within 120 days from the date on which the last of the authorizations for search under section 132 was executed.

Note: It may be noted that one of the conditions mentioned above for release of an asset is that the nature and source of acquisition of the asset should be explained to the satisfaction of the Assessing Officer. However, in this case, it has been given that the assessee’s application for release of the asset, explaining the sources thereof, was turned down by the Department. If the application was turned down by the Department due to the reason that it was not satisfied with the explanation given by the assessee as to the nature and source of acquisition of the asset, then, the asset (in this case, cash) cannot be released, since the condition mentioned above is not satisfied.
Question 8

The business premises of Ram Bharose Ltd. and the residence of two of its directors at Delhi were searched under section 132 by the DDI, Delhi. The search was concluded on 9.8.2019 and following were also seized besides other papers and records:

(i) Papers found in the drawer of an accountant relating to Shri Krishna Ltd., Mumbai indicating details of various business transactions. However, Ram Bharose Ltd. is not having any direct or indirect connection of any nature with these transactions and Shri Krishna Ltd., Mumbai and its directors.

(ii) Jewellery worth Rs. 5 lacs from the bed room of one of the director, which was claimed by him to be of his married daughter.

(iii) Papers recording certain transactions of income and expenses having direct nexus with the business of the company for the period from 16.4.2015 to date of search. It was admitted by the director that the transactions recorded in such papers have not been incorporated in the books.

You are required to answer on the basis of aforesaid and the provisions of Act, following questions:

(a) What action the DDI shall be taking in respect of the seized papers relating to Shri Krishna Ltd., Mumbai?

(b) Whether the contention raised by the director as to jewellery found from his bed-room will be acceptable?

(c) What presumption shall be drawn in respect of the papers which indicate transactions not recorded in the books?

(d) Can the company move an application for settlement of case as per Chapter XIX-A of the Act?

Answer

(a) The authorised officer being DDI, Delhi is not having any jurisdiction over Shri Krishna Ltd., Mumbai, and therefore as per section 132(9A), the papers seized relating to this company shall be handed over by him to the Assessing Officer having jurisdiction over Shri Krishna Ltd., Mumbai within a period of 60 days from the date on which the last of the authorisations for search was executed for taking further necessary action thereon.

(b) The contention raised by the Director will not be acceptable because as per the provisions of sub-section (4A)(i) of section 132, where any books of account, other documents, money, bullion, jewellery or other valuables are found in the possession or control of any person in the course of search, then, in respect thereof, it may be presumed that the same belongs to that person.

(c) As per section 132(4A), the presumptions in respect of the papers, indicating transactions not recorded in the books but having direct nexus with the business of the company, are that the same belong to the company, contents of such papers are true and the handwriting in which the same are written is/are of the persons(s) whose premises have been searched.

(d) As per clause (iii) in the Explanation to section 245A, the assessee can approach the Settlement Commission at any time after the date of issue of notice under section 153A or section 153C initiating the assessment proceedings. Therefore, an application can be made to the Settlement Commission where search has been initiated under section 132 followed by assessment under section 153A or section 153C.
The proviso to section 245C(1) specifies the monetary limit for making application for settlement of cases, in respect of search cases. Accordingly, the additional amount of income-tax payable on the income disclosed in the application must exceed Rs. 50 lacs so that application for settlement of the case is eligible for admission.

Question 9

*In the course of search on 25.03.2019, assets were seized. Examine the procedure laid down to deal with such seized assets under the Act.*

**Answer**

Section 132B of the Income-tax Act, 1961 deals with the application of assets seized under section 132. Such assets will be first applied towards the existing liability under the Income-tax Act, 1961, etc. ‘Existing liability’, however, does not include advance tax payable. Further, the amount of liability determined on completion of search assessment (including any penalty levied or interest payable in connection with such assessment) and in respect of which the assessee is in default or deemed to be in default, may be recovered out of such assets.

Where the nature and source of acquisition of such seized assets is explained to the satisfaction of the Assessing Officer, the amount of any existing liability mentioned in para 1 above may be recovered out of such asset and the remaining portion, if any, of the asset may be released, with the prior approval of the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner, as the case may be. The release must be made within 120 days from the date on which the last of the authorisations for search under section 132 or for requisition under section 132A was executed. The assets would be released to the person from whose custody they were seized.

When the assets consist of solely of money, or partly of money and partly of other assets, the Assessing Officer may apply such money in the discharge of the liabilities referred to in para 1 above and the assessee shall be discharged of such liability to the extent of the money so applied. However, the assets other than money may also be applied for the discharge of such liabilities if the complete recovery could not be made from the money seized or the money seized was not sufficient.

***************************************************************************
EXERCISE

Question 1
Teachwell Education is a trust approved under section 10(23C)(vi) which runs various educational institutions. During the course of assessment under section 143(3), the Assessing Officer finds that the trust has carried out its activities in contravention of the section under which it was approved for exemption. Hence, the Assessing Officer wants to pass an order without giving exemption under section 10, which the assessee objects. You are required to examine the following with respect to the provisions of Income-tax Act, 1961.

(a) Whether the Assessing Officer can pass an order without giving exemption under section 10?

(b) Can the Assessing Officer get any additional time limit in completing this assessment?

Answer

(a) As per the first proviso to section 143(3), in the case of an institution approved under, inter alia, section 10(23C)(vi), which is required to furnish the return of income under section 139(4C), the Assessing Officer shall not pass an order of assessment under section 143(3) without giving effect to the provisions of section 10, unless he is of the view that the activities of the institution are being carried on in contravention to the provisions of that section and:

(1) he has intimated the Central Government or the prescribed authority, which had earlier approved the concerned institution, about the contravention of the relevant provisions by the institution; and

(2) the approval granted to such institution has been withdrawn or notification in that respect has been rescinded.

Therefore, in the aforesaid case, the Assessing Officer can pass an assessment order without giving exemption under section 10 to Teachwell Education, which is an educational institution approved under section 10(23C)(vi), only if he has intimated the contravention made by Teachwell Education to the Central Government or the prescribed authority, as the case may be, and its approval under section 10(23C)(vi) is withdrawn.

(b) As per Explanation 1 to section 153, in case the Assessing Officer intimates the contravention of provisions of section 10(23C)(vi) to the Central Government or the prescribed authority, the period commencing from the date of intimation of such contravention by the Assessing Officer and ending on the date on which the copy of the order of withdrawing the approval under section 10(23C)(vi) is received by the Assessing Officer, shall be excluded for computing the period of limitation for completing the assessment.

Further, in case the time limit available to the Assessing Officer for passing an assessment order, after such exclusion, is less than 60 days, such remaining period of assessment shall be deemed to have been extended to 60 days.

Therefore, the Assessing Officer will get the above mentioned additional time for completing the assessment of Teachwell Education.
**Question 2**
State with reasons whether return of income is to be filed in the following cases for the Assessment Year 2020-21:

(i) Mr. X, a resident individual, aged 80 years, has a total income of **Rs. 2,85,000**. He has claimed deduction of **Rs. 1,50,000** under section 80C. Long-term capital gains of **Rs. 80,000** is not taxable by virtue of the exemption available upto specified threshold under section 112A.

Would your answer change if Mr. X has incurred **Rs. 1,05,000** towards payment of electricity bills for F.Y.2019-20?

(ii) ABC, a partnership firm, has a loss of **Rs. 10,000** during the previous year 2019-20.

(iii) A registered association, eligible for exemption under section 10(23B), has income from house property of **Rs. 2,60,000**.

(iv) Mr. Y, aged 45 years, an employee of ABC (P) Ltd, draws a salary of **Rs. 4,90,000** and has income from fixed deposits with bank of **Rs. 10,000**.

**Answer**

<table>
<thead>
<tr>
<th>S. No.</th>
<th>Is filing of return required?</th>
<th>Reason</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i)</td>
<td>Yes</td>
<td>As per the provisions of section 139(1), every person, whose total income without giving effect to the provisions of Chapter VI-A exceeds the maximum amount not chargeable to tax, is required to furnish the return of income for the relevant assessment year on or before the due date. The gross total income of Mr. X before giving effect to deduction of <strong>Rs. 1,50,000</strong> under section 80C is <strong>Rs. 4,35,000</strong>, which is less than the basic exemption limit of <strong>Rs. 5,00,000</strong> applicable to an individual aged 80 years or more. Therefore, Mr. X need not furnish his return of income for the A.Y. 2020-21. <strong>Note</strong> – Yes, the answer would change, since Mr. X has incurred expenditure of an amount exceeding <strong>Rs. 1 lakh</strong> towards consumption of electricity. Hence, he would have to file his return for A.Y.2020-21 on or before the due date u/s 139(1)</td>
</tr>
<tr>
<td>(ii)</td>
<td>Yes</td>
<td>As per section 139(1), it is mandatory for a firm to furnish its return of income or loss on or before the specified due date. Therefore, M/s ABC has to furnish its return of loss for the A.Y. 2020-21 on or before the due date.</td>
</tr>
<tr>
<td>(iii)</td>
<td>Yes</td>
<td>As per section 139(4C), every institution referred to, inter alia, in section 10(23B), whose total income without giving effect to the provisions of section 10 exceeds the maximum amount not chargeable to tax, is required to furnish the return of income for the relevant assessment year on or before the due date. In the above case, the registered association has income from house property of <strong>Rs. 2,60,000</strong> before exemption under section 10, which exceeds the basic exemption limit of <strong>Rs. 2,50,000</strong>. Therefore, it is under an obligation to furnish its return of income for the A.Y. 2020-21.</td>
</tr>
</tbody>
</table>
**Assessment Procedure**

(iv) Yes

| As per the provisions of section 139(1), every person, whose gross total income exceeds the maximum amount not chargeable to tax, is required to furnish the return of income for the relevant assessment year on or before the due date. Mr. Y’s salary income is Rs. 4,40,000 (i.e., Rs. 4,90,000 less standard deduction of Rs. 50,000). The gross total income of Mr. Y is Rs. 4,50,000 (Rs. 4,40,000 + Rs. 10,000) which exceeds the basic exemption limit of Rs. 2,50,000 applicable to an individual. Therefore, Mr. Y has to furnish his return of income for the A.Y. 2020-21. |

| Question 3

The Assessing Officer issued a notice under section 142(1) on the assessee on 24th December, 2019 calling upon him to file return of income for Assessment Year 2019-20. In response to the said notice, the assessee furnished a return of loss and claimed carry forward of business loss and unabsorbed depreciation. State whether the assessee would be entitled to carry forward as claimed in the return.

**Answer**

As per the provisions of section 139(3), any person who has sustained loss under the head ‘Profit and gains of business or profession’ is allowed to carry forward such a loss under section 72(1) or section 73(2), only if he has filed the return of loss within the time allowed under section 139(1). Also, the provisions of section 80 specify that a loss which has not been determined as per the return filed under section 139(3) shall not be allowed to be carried forward and set-off under, inter alia, section 72(1) (relating to business loss) or section 73(2) (losses in speculation business) or section 74(1) (loss under the head “Capital gains”) or section 74A(3) (loss from the activity or owning and maintaining race horses) or section 73A (loss relating to a “specified business”). However, there is no such condition for carry forward of unabsorbed depreciation under section 32.

In the given case, the assessee has filed its return of loss in response to notice under section 142(1). As per the provisions stated above, the return filed by the assessee in response to notice under section 142(1) is a belated return and therefore, the benefit of carry forward of business loss under section 72(1) or section 73(2) or section 73A shall not be available. The assessee shall, however be entitled to carry forward the unabsorbed depreciation as per provisions of section 32(2).

| Question 4

The regular assessment of MNO Ltd. for the Assessment Year 2018-19 was completed under section 143(3) on 13th March, 2020. There was an audit objection by the Revenue Audit team that interest on loan should be disallowed partly as there was diversion of borrowed fund to sister concern without charge of interest.

Based on the above facts:

(i) State, with reasons, whether the Assessing Officer can issue notice under section 148 on the basis of audit objection of the Revenue Audit team.

(ii) If the action stated in (i) above is not permitted, what is the option open to the Revenue Department to deal with the said audit objection?

**Answer**

(i) Section 147 states that if the Assessing Officer has reason to believe that any income chargeable to tax has escaped assessment for any assessment year, he
may assess or reassess such income and also any other income chargeable to tax which has escaped assessment and which comes to his notice subsequently in the course of the proceedings under this section.

The Assessing Officer should, therefore, have reason to believe that income chargeable to tax has escaped assessment. The belief should be that of the Assessing Officer and not of the revenue audit team.

Further, the Income-tax Act, 1961 does not confer jurisdiction on the Assessing Officer to change its opinion on the interpretation of a particular provision earlier adopted by it. If the issue had already been considered earlier during the course of scrutiny assessment and the Assessing Officer had come to a conclusion that no disallowance of interest paid by the assessee is required, even though loans had been given to sister concern without any interest, the same issue cannot be the basis of reassessment, merely because the revenue audit team takes a different view.

The Supreme Court, in ACIT v. ICICI Securities Primary Dealership Ltd. (2012) 348 ITR 299, held that re-opening of the assessment by the Assessing Officer on the ground of change of opinion is not valid.

Therefore, the Assessing Officer cannot issue notice under section 148 on the basis of audit objection of the Revenue Audit team.

If the Assessing Officer has acted only under compulsion of the audit party and not independently, the action of reopening would be invalid.

(ii) The option open to the Revenue is initiation of proceedings under 263, by the jurisdictional Commissioner. He has the power to call for and examine the records, if he is of the opinion that the order passed by the Assessing Officer under section 143(3) is erroneous in so far as it is prejudicial to the interests of the Revenue.

However, where the Assessing Officer has considered the issue in the original assessment and come to a conclusion that no disallowance of interest is called for, the Commissioner cannot initiate revisionary proceedings, merely because he holds a different view. Only where the view taken by the Assessing Officer is unsustainable in law, the Commissioner will be justified in initiating the revisionary proceedings under section 263. It was so held in CIT vs. Sohana Woollen Mills (2008) 296 ITR 238 (P & H).

Mere audit objection and possibility of a different view are not sufficient to conclude that the order of the Assessing Officer is erroneous or prejudicial to the interest of revenue.

**Question 5**

State whether the following assessees have to file return of income and if so, the due date for the assessment year 2020-21:

(i) A registered trade union having income from let out property of Rs. 1,00,000.

(ii) A public trust hospital having an aggregate annual receipt of Rs. 200 lacs and availing exemption under section 10(23C)(via) with total income of Rs. 1,10,000.

**Answer**

(i) A registered trade union is having income from house property, which is exempt under section 10(24).

Section 139(4C) mandates filing of return only when the total income exceeds the maximum amount which is not chargeable to tax without giving effect to the
provisions of section 10. In this case, even without giving effect to section 10(24), the total income of the registered trade union is below basic exemption limit and therefore, there is no mandatory requirement to file the return of income.

(ii) Since the total income without giving effect to the exemption under section 10(23C)(via) is Rs. 3,30,000, which exceeds Rs. 2,50,000, the trust has to file its return of income by 30th September, 2020.

Question 6
Dishant received a notice under section 148 from the Assessing Officer for A.Y. 2016-17 on the ground that depreciation on certain assets was allowed in excess. The Assessing Officer recorded the reason for reopening. The original assessment was completed under section 143(3). In course of reassessment proceeding, the Assessing Officer also disallowed certain sum under section 14A in respect of expenses purported to be in relation to dividend from companies and tax-free interest. However, the Assessing Officer did not record the reason for applying the provisions of section 147 in respect of the issue of disallowance under section 14A and passed the order disallowing the excess depreciation and also certain sum under section 14A. Is there any infirmity in the order passed by the Assessing Officer?

Answer
Explanation 3 to section 147 permits the Assessing Officer to assess or reassess the income in respect of any issue (which has escaped assessment) which comes to his notice subsequently in the course of proceedings under section 147, even though the reason for such issue does not form part of the reasons recorded under section 148(2).

Therefore, in the instant case, the Assessing Officer has the power to disallow expenses under section 14A in addition to disallowing excess depreciation for which notice under section 148 was issued even though the reason for issue relating to disallowance under section 14A was not recorded under section 148(2).

Hence, there is no deficiency in the order passed by the Assessing Officer.

Question 7
In the proceedings initiated under section 153A, the assessment order passed in respect of Mr. Simbu pertaining to a particular assessment year was annulled by the Income-tax Appellate Tribunal in its order passed on 28.1.2019. The same was received on 28.2.2020 by the jurisdictional Commissioner of Income-tax. Does the Department have any power to complete the assessment subsequent to such annulment? If yes, within what time limit?

Answer
As per section 153A(2), if any proceedings initiated under section 153A or any order of assessment or reassessment made under section 153A(1) has been annulled in any appeal or other legal proceeding, the abated assessment or reassessment relating to any assessment year shall stand revived with effect from the date of receipt of the order of such annulment by the Principal Commissioner or Commissioner. If the order of annulment is set aside, such revival shall cease to have effect [Sub-section (2) of section 153A].

The time limit for completion of such assessment or reassessment shall be one year from the end of the month in which the abated assessment revives or within the period specified in section 153B(1) [i.e., 21 months from the end of the financial year in which the last of authorisations for search or requisition was executed], whichever is later.
Question 8
What will be the consequences when Mr. Raghav made payment of Rs. 75,000 in cash to a travel agent for his travel to Saudi Arabia to be undertaken for business purposes by quoting intentionally the wrong PAN? Would your answer be different if such cash payment was made for his travel to Nepal, instead of Saudi Arabia?

Answer
If a person who is required to quote his permanent account number in any document referred to in section 139A(5)(c), quotes a number which is false, and which he either knows or believes to be false or does not believe to be true, the Assessing Officer may direct that such a person shall pay by way of penalty a sum of Rs. 10,000 under section 272B(2).

In the given case, if Mr. Raghav travels to Saudi Arabia and pays his travel agent cash in excess of Rs. 50,000, such a transaction is covered by section 139A(5)(c) read with Rule 114B and therefore, Mr. Raghav has to quote his PAN. Since Mr. Raghav has misquoted his PAN, penalty under section 272B(2) is leviable. Mr. Raghav has to be given an opportunity of being heard in the matter. If Mr. Raghav is not able to prove that there was a reasonable cause for the said failure, penalty under section 272B(2) would be imposable.

The answer would remain the same even if such cash payment was made for his travel to Nepal.

Question 9
For facilitating expeditious resolution of disputes relating to international transactions involving transfer pricing and foreign companies, the Income-tax Act, 1961, has provided for "alternate dispute resolution mechanism". In this context, you are required to answer the following:

(i) What meanings have been assigned to "dispute resolution panel" and the "eligible assessee" under this mechanism?
(ii) When can a grievance for resolution be filed by an assessee?
(iii) What evidences are being considered by the panel to redress the grievance of the assessee?

Answer
(i) The term “Dispute Resolution Panel” has been defined to mean a collegium comprising of three Principal Commissioners or Commissioners of Income-tax constituted by the Board for this purpose.

The term “Eligible Assessee” means any person in whose case the variation referred to in section 144C(1) in the income or loss returned arises as a consequence of the order of the Transfer Pricing Officer passed under section 92CA(3) and any foreign company.

(ii) The Assessing Officer shall forward a draft of the proposed order of assessment to the eligible assessee and on receipt of such order, the eligible assessee shall, within thirty days of the receipt of the draft order, file his acceptance of the variations to the Assessing Officer or file his objections, if any, to such variation, with the Dispute Resolution Panel and the Assessing Officer.

(iii) The Dispute Resolution Panel shall, in a case where any objections are received, take into consideration:-

(a) the draft order
(b) the objections filed by the assessee
(c) the evidence furnished by the assessee
(d) the report, if any, of the Assessing Officer, Valuation Officer or Transfer Pricing Officer or any other authority
(e) the records relating to the draft order
(f) the evidence collected by, or caused to be collected by it
(g) the result of any enquiry made by or caused to be made by it,
and issue such directions, as it thinks fit, for the guidance of the Assessing Officer to enable him to complete the assessment.

**Question 10**
The Assessing Officer has the power to make an assessment to the best of his judgment, in certain situations. What are they?

**Answer**
Under section 144, the Assessing Officer, after taking into account all relevant material which he has gathered, is under an obligation to make an assessment of the total income or loss to the best of his judgment and determine the sum payable by the assessee in the following cases –

1. Where any person fails to make the return under section 139(1) and has not filed a belated return under section 139(4) or a revised return under section 139(5).
2. Where any person fails to comply with all the terms of a notice issued under section 142(1) or fails to comply with a direction issued under section 142(2A) for getting the accounts audited.
3. Where any person, having made a return, fails to comply with all the terms of a notice issued under section 143(2).

Further, section 145(3) of the Income-tax Act, 1961 permits the Assessing Officer to make an assessment in the manner provided in section 144:

(i) where the Assessing Officer is not satisfied about the correctness or completeness of the accounts of the assessee; or
(ii) where the method of accounting under section 145(1) has not been regularly followed by the assessee;
(iii) where the income has not been computed in accordance with “Income Computation and Disclosure Standards” notified by the Central Government under section 145(2).

**Question 11**
The assessment of CNK Associates, a partnership firm, for the assessment year 2017-18 was made under section 143(3) on 31st July, 2019. The Assessing Officer made two additions to the income of the assessee viz. (a) addition of Rs. 2 lacs under section 40(a)(ia) due to non-furnishing of evidence of payment of TDS and (ii) addition of Rs. 5 lacs on account of unexplained cash credit. The assessee contested addition on account of unexplained cash credit in appeal to the Commissioner (Appeals). The appeal was decided in January, 2020 against the assessee. The assessee approaches you for your suggestion as to whether it should apply for revision to the Commissioner under section 264 or rectification to the Assessing Officer under section 154 as regards disallowance under section 40(a)(ia). What should be your suggestion?
**Question 12**

Examine critically in the context of provisions of the Act “Can the Assessing Officer issue notice under section 148 to reopen the same assessment order on the same grounds for which the CIT had issued notice under section 263 of the Act”?

**Answer**

The Assessing Officer cannot issue notice under section 148 to reopen the same assessment order on the same grounds for which the Commissioner had issued notice under section 263 of the Income-tax Act, 1961, since the third proviso to section 147 specifically provides that the Assessing Officer may assess or reassess an income which is chargeable to tax and has escaped assessment, other than the income involving matters which are the subject matter of any appeal, reference or revision. Therefore, if the income relates to a matter which is the subject matter of revision under section 263, then the Assessing Officer cannot issue notice under section 148 to reopen the assessment order.

**Question 13**

Is the Assessing Officer empowered to assess or reassess an income which is chargeable to tax and has escaped assessment, in a case which is pending before the Appellate Tribunal? Discuss.

**Answer**

As per third proviso to section 147, the Assessing Officer may assess or reassess an income which is chargeable to tax and which has escaped assessment, other than the income involving matters which are the subject matter of any appeal, reference or revision. Therefore, in respect of the matters which are the subject matter of an appeal before the Appellate Tribunal, it is not possible for the Assessing Officer to initiate proceeding under section 147. However, in respect of other matters, which are not the subject matter of the appeal, the Assessing Officer can initiate proceeding under section 147.
Question 14

A search was conducted under section 132 in the business premises of Harish on 15th December, 2019. At that time, assessments under section 143(3) for A.Y. 2017-18 and A.Y. 2018-19 and reassessment proceeding under section 147 for A.Y. 2016-17 were pending before the Assessing Officer.

(i) What are the assessment years for which notice can be issued for making post-search assessment?

(ii) What would be the fate of pending assessments and reassessment?

(iii) What would be the effect, if the post-search assessment orders are annulled by the Income-tax Appellate Tribunal?

Answer

(i) The 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, the search is conducted in the previous year 2019-20, the relevant assessment year for which is A.Y.2020-21. Therefore, notice can be issued for the six preceding assessment years i.e. for assessment years 2014-15 to 2019-20.

Further, notice for assessment or reassessment can be issued by Assessing Officer for the relevant assessment year or years (i.e. for A.Y.2010-11 to A.Y.2013-14) if the following conditions are satisfied:

(a) The Assessing Officer has in his possession, books of account or other documents or evidence which reveal that the income, represented in the form of asset, which has escaped assessment amounts to or is likely to amount Rs.50 lakhs or more in the relevant assessment year or in aggregate in the relevant assessment years.

(b) The income so referred above has escaped assessment for such year or years; and

(c) The search under section 132 is initiated or requisition under section 132A is made on or after 01.04.2017 (This condition is satisfied since the search has taken place in December, 2019).

Note - The expression "relevant assessment year" shall mean an assessment year preceding the assessment year relevant to the previous year in which search is conducted or requisition is made which falls beyond six assessment years but not later than ten assessment years from the end of the assessment year relevant to the previous year in which search is conducted or requisition is made.

"Asset" shall include immovable property being land or building or both, shares and securities, loans and advances, deposits in bank account.

(ii) As per section 153A, the assessment or reassessment relating to any assessment year, falling within the above period of six assessment years and for the relevant assessment year or 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 2017-18 and 2018-19 and the reassessment proceeding under section 147 for assessment year 2016-17 shall abate.

(iii) Section 153A provides that 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 2017-18 and 2018-19 and the reassessment proceeding relating to assessment year 2016-17, which abated on initiation of search, shall
stand revived with effect from the date of receipt of the order of such annulment by the Principal Commissioner or Commissioner.

Question 15

A search was conducted under section 132 in the business premises of Sanskar on 30th March, 2019. The search was concluded by executing last of authorisation for search on 4th April, 2019. Since the search is concluded in the financial year 2018-19, and other conditions are also fulfilled, the Assessing Officer issued notice under section 153A on Sanskar for preceding ten Assessment Years prior to the Assessment Year relevant to the previous year 2018-19. Thus, he issued the notice from A.Y. 2009-10 to A.Y.2018-19. Discuss the correctness of the action taken by Assessing Officer.

Answer

As per section 153A, the Assessing Officer can issue the notice to file a return in respect of six assessment years and for the relevant assessment year or years immediately preceding the assessment year relevant to the previous year in which the search was conducted under section 132 or requisition was made under section 132A. However, no notice for assessment or reassessment shall be issued by Assessing Officer for the relevant assessment year or years unless:

(a) He has, in his possession, books of account or other documents or evidence which reveal that the income, represented in the form of assets, which has escaped assessment amounts to or is likely to amount Rs.50 lakhs or more in the relevant assessment year or in aggregate in the relevant assessment years.

(b) The income so referred above has escaped assessment for such year or years.

(c) The search under section 132 is initiated or requisition under section 132A is made on or after 01.04.2017

The expression "relevant assessment year" shall mean an assessment year preceding the assessment year relevant to the previous year in which search is conducted or requisition is made which falls beyond six assessment years but not later than ten assessment years from the end of the assessment year relevant to the previous year in which search is conducted or requisition is made.

Thus, it is clear that the Assessing Officer can issue the notice in respect of four assessment years which falls beyond six assessment years, subject to fulfillment of aforesaid conditions. As per condition (c) above, search must be initiated on or after 01.04.2017.

In the given case, Assessing Officer has initiated the search on 25.03.2019 and concluded on 31.03.2019. Therefore, the condition given in (c) is satisfied. Assuming that conditions given in (a) and (b) are also satisfied, the Assessing Officer could issue the notice for ten assessment years from the end of the assessment year relevant to the previous year in which search is conducted. i.e. from A.Y.2013-14 to A.Y. 2018-19 as well as the relevant assessment years, namely, A.Y. 2009-10 to A.Y. 2012-13

Hence, the action of Assessing Officer in issuing the notice under section 153A for A.Y.2009-10 to A.Y.2018-19, is correct.

Question 16

Examine whether the Assessing Officer has the power to make any adjustment to income disclosed by the assessee in the return of income in course of processing the return under section 143(1)?
Answer

The procedure to be followed for summary assessment is contained in section 143(1). As per section 143(1), the total income or loss of an assessee shall be computed after making the following adjustments to the returned income:

(i) any arithmetical error in the return; or
(ii) an incorrect claim, if such incorrect claim is apparent from any information in the return.
(iii) disallowance of loss claimed, if return is filed beyond due date u/s 139(1)
(iv) disallowance of expenditure indicated in the audit report but not taken into account in computing the total income in the return
(v) disallowance of deduction claimed under section u/s 10AA, 80-IA, 80-IAB, 80-IB, 80-IC, 80-ID or 80-IE, if return is filed beyond due date u/s 139(1)

No such adjustment shall be made unless as intimation is given to the assessee of such adjustment either in writing or electronic mode. Further, Assessing Officer shall make any adjustment after considering the response received from the assessee, if any. Where no response is received within 30 days of the issue of such notice, the above adjustment can be made.

For the purpose of section 143(1), “an incorrect claim apparent from any information in the return” means such claim on the basis of an entry, in the return of income:

(i) of an item, which is inconsistent with another entry of the same or some other item in such return;
(ii) in respect of which, the information required to be furnished under the Income-tax Act, 1961 to substantiate such entry, has not been so furnished;
(iii) in respect of a deduction, where such deduction exceeds specified statutory limit which may be expressed as monetary amount or percentage or ratio or fraction.

Question 17

Can the Assessing Officer complete the assessment of income from international transactions in disregard of the order passed by the Transfer Pricing Officer by accepting the contention of the assessee?

Answer

Section 92CA(4) provides that the order of the Transfer Pricing Officer determining the arm’s length price of an international transaction is binding on the Assessing Officer and the Assessing Officer shall proceed to compute the total income in conformity with the arm’s length price determined by the Transfer Pricing Officer.

Therefore, the Assessing Officer cannot complete the assessment of income from international transactions in disregard of the order of Transfer Pricing Officer and on the basis of contention raised by the assessee.

Question 18

Tai Ltd. filed its return of income for assessment year 2019-20 on 6th June, 2019. The return is selected for regular assessment under section 143(3) for which notice under section 143(2) is served on the company on 3rd October, 2020. The company responded to the notice under section 143(2). Examine whether the service of the notice is within time and if not, whether the assessment order can be challenged by the assessee.
Answer
The time limit for service of notice under section 143(2) is six months from the end of the financial year in which the return of income was furnished by the assessee. The return of income for assessment year 2019-20 was filed by the assessee on 6th June, 2019. Therefore, the notice under section 143(2) has to be served by 30th September, 2020. However, the notice was served on the assessee only on 3rd October, 2020. Hence, the notice issued under section 143(2) is time-barred.

However, as per section 292BB, where an assessee had appeared in any proceedings or co-operated in any enquiry relating to an assessment or reassessment, it shall be deemed that any notice required to be served upon him, has been duly served upon him in time in accordance with the provisions of the Act and such assessee shall be precluded from raising any objection in any proceeding or enquiry that the notice was (a) not served upon him or (b) not served upon him in time or (c) served upon him in an improper manner.

The above provision shall not be applicable where the assessee has raised such objection before the completion of such assessment or reassessment. Therefore, in the instant case, if the assessee, Tai Limited, had raised an objection to the proceeding, on the ground of non-service of the notice under section 143(2) upon it on time, then, the validity of the assessment order can be challenged. In absence of such objection, the assessment order cannot be challenged.

Question 19
In the case of Mr. Rajesh, a summary assessment was made under section 143(1) for assessment year 2016-17 without calling him. Thereafter, Mr. Rajesh has received a notice under section 148 on 6th April, 2019 for reopening of assessment. Can Mr. Rajesh challenge the legality of the notice on the ground of change of opinion?

Answer
Under the scheme of section 143(1), only the adjustments relating to any arithmetical error in the return, disallowance of losses claimed where the relevant return of income was filed beyond the due date under section 139(1), disallowance of expenditure indicated in the audit report but not taken into account in computing total income in the return, disallowance of deduction claimed under section 10AA, sections 80-IA to 80-IE, where return is furnished beyond due date and addition of income appearing in Form 26AS or Form 16 or Form 16A which has not been included in computing the total income in the return are permitted. In short, what is permissible is only correction of errors apparent on the basis of the return and tax audit report filed as well as Form 26AS, Form 16 or Form 16A. Therefore, the intimation given under section 143(1) is only a preliminary assessment, commonly referred to as a summary assessment without calling the assessee. The same cannot be treated as an order of assessment under section 143(3). Since there has been no assessment under section 143(3) in this case, the question of change of opinion does not arise.

Therefore, the assessee cannot challenge the legality of the notice issued under section 148 reopening the assessment on the ground of change of opinion in a case where no assessment is made under section 143(3). This inference is supported by the Supreme Court ruling in ACIT vs. Rajesh Jhaveri Stock Brokers P. Ltd. (2007) 291 ITR 500.
Question 20
Discuss the correctness or otherwise of the following proposition in the context of the Income-tax Act, 1961:
A fresh claim before the Assessing Officer can be made only by filing a revised return and not otherwise.

Answer
This proposition is correct. A return of income filed within the due date under section 139(1) or a belated return filed under section 139(4) may be revised by filing a revised return under section 139(5) where the assessee finds any omission or wrong statement in the original return subject to satisfying other conditions. There is no provision in the Income-tax Act, 1961, to make changes or modification in the return of income by filing a letter. The revised return can be filed at any time before the end of the relevant assessment year or before completion of assessment, whichever is earlier. In a case where a return of income has been filed within the due date under section 139(1) or after the due date under section 139(4), the only option available to the assessee to make an amendment to such return is by way of filing a revised return under section 139(5). Therefore, a fresh claim can be made before the Assessing Officer only by filing a revised return and not otherwise. The Supreme Court in Goetze (India) Ltd. vs. CIT (2006) 284 ITR 323 has held that there is no provision in the Income-tax Act, 1961 to allow an amendment in the return of income filed except by way of filing a revised return.

Question 21
The Assessing Officer within the powers vested in him under section 142(2A), while examining the accounts of PNF Ltd., had ordered to get the same audited. The company challenges this order on the ground “that the opportunity was not provided to them by the Assessing Officer prior to passing of such an order”. Decide the correctness of the action of the Assessing Officer.

Answer
As per the proviso to section 142(2A), the Assessing Officer shall not direct the assessee to get the accounts so audited unless the assessee has been given a reasonable opportunity of being heard.
Therefore, in this case, the order of the Assessing Officer is not valid, since the assessee was not given an opportunity of being heard prior to passing of such order.

Question 22
Smt. Kanti engaged in the business of growing, curing, roasting and grounding of coffee after mixing chicory had a total income of Rs. 6,00,000 from this business which was her only source of income during the year ended on 31.3.2020. She consults you to have an opinion whether she is required to file return of income for the A.Y. 2020-21 as per provisions of section 139(1).

Answer
The clarification regarding filing of return of income by the coffee growers being individuals covered by Rule 7B of the Income-tax Rules, 1962 is given in Circular No.10/2006 dated 16.10.2006. According to the Circular, an individual deriving income from growing, curing, roasting and grounding of coffee with or without mixing chicory, would not be required to file the return of income if the aggregate of 40% of his or her
income from growing, curing, roasting and grounding of coffee with or without mixing chicory and income from all other sources liable to tax in accordance with the provisions of this Act, is equal to or less than the basic exemption limit prescribed in the First Schedule of the Finance Act of the relevant year.

In this case, Smt. Kanti has a total income of Rs. 6,00,000 from this business, which was her only source of income for P.Y.2018-19. 40% of her total income works out to Rs. 2,40,000, which is less than the basic exemption limit of Rs. 2,50,000 in respect of an individual assessee. Therefore, Smt. Kanti is not required to file a return of income for the A.Y.2019-20 as per the provisions of section 139(1).

**Question 23**

Ram, an individual, filed his return of income for the assessment year 2020-21 on 15.6.2020. He later discovered that he had not claimed deduction under section 80C in the said return. He claimed the said deduction through a letter addressed to the Assessing Officer. The Assessing Officer completed the assessment without allowing the deduction claimed by Ram. Is the Assessing Officer justified in doing so?

**Answer**

The Supreme Court has, in Goetze (India) Ltd. v. CIT (2006) 284 ITR 323, ruled that the assessing authority has no power to entertain a claim for deduction made after filing of the return of income otherwise than by way of a revised return. In the instant case, Ram has claimed the deduction under section 80C, which he omitted to claim in the original return of income, through a letter addressed to the Assessing Officer and not by filing a revised return under section 139(5). In view of the decision of the Supreme Court cited above, the Assessing Officer was justified in completing the assessment without allowing the deduction under section 80C.

**Question 24**

Examine the correctness or otherwise of the following statements in the context of provisions contained in the Income-tax Act, 1961 and the decided case laws:

“The Assessing Officer is bound to allow the set-off of brought forward losses under section 72 even if the assessee has not claimed the same in the return filed”.

**Answer**

The statement is correct.

The Supreme Court has, in CIT v. Mahalakshmi Sugar Mills Co. Ltd. (1986) 160 ITR 920, held that it is the duty of the Assessing Officer to apply the relevant provisions of the Act for the purpose of determining the true figure of the assessee’s total income and consequential tax liability. Merely because the assessee has not claimed the set-off in the return filed, it cannot relieve the Assessing Officer of his duty to apply section 72 in the appropriate case.

As per CBDT Circular No.14 (XL-35) of 1955 dated 11.04.1955, it is the duty of the Assessing Officer to assist a taxpayer in every reasonable way, particularly in the matter of claiming and securing reliefs and in this regard, they should take the initiative in guiding a taxpayer where proceedings or other particulars before them indicate that some refund or relief is due to him.

Therefore, on the basis of the above Supreme Court ruling and the CBDT Circular, the Assessing Officer is bound to allow the set-off of brought forward losses under section 72,
even if the assessee has not claimed the same in the return filed, provided the loss was
determined in pursuance of a return filed under section 139(3) in any earlier previous year.
Moreover, the wording used in section 72 is “shall”, indicating that the provisions relating
to set off of brought forward business loss are mandatory.

Therefore, the Assessing Officer is bound to allow the claim for set off of brought forward
business losses even if the assessee has not claimed the same in the return filed.

**Question 25**

X, an individual, has got his books of account for the year ending 31.3.2020 audited under
section 44AB. His total income for the assessment year 2020-21 is Rs. 5,20,000. He desires
to know if he can furnish his return of income for the assessment year 2020-21 through a
Tax Return Preparer.

**Answer**

Section 139B provides for submission of return of income through Tax Return Preparers. It
empowers the Central Board of Direct Taxes (CBDT) to frame a scheme for the purpose of
enabling any specified class or classes of persons to prepare and furnish their returns of
income through Tax Return Preparers. Specified class or classes of persons have been
defined to mean any person, other than a company or a person whose accounts are
required to be audited under section 44AB or under any other existing law, who is
required to furnish a return of income under the Act. Thus, companies and persons whose
accounts are liable for tax audit under section 44AB do not fall within the definition of
'specified class or classes of persons' and consequently, cannot furnish their returns of
income through Tax Return Preparers. In the instant case, the books of account of X for the
year ending 31.3.2020 have been audited under section 44AB. As such, he cannot furnish
his return of income for the assessment year 2020-21 through a Tax Return Preparer.

**Question 26**

In April, 2019, the business premises of Priyanka Ravi were searched under section 132 by
the DDI, Delhi. The search was concluded on 30.04.2019 and following assets/documents
were found which were not recorded in her books of accounts:
- Jewellery of Rs. 25 Lacs pertaining to P.Y. 2014-15
- Agreement for purchase of land which contains the payment of advance of Rs. 35
  Lacs in cash in the P.Y.2013-14
- Shares purchased in the P.Y.2011-12 and in the P.Y.2012-13 totaling to Rs. 40 Lacs.
- Paper containing the payment of Rs. 15 Lacs in the P.Y.2009-10 and Rs. 10 Lacs in
  P.Y.2008-09 to a contractor for construction of residential house.

Accordingly, Assessing Officer has issued the notice for all the previous years from
P.Y.2008-09 to P.Y.2018-19 under section 153A.

However, Miss Priyanka Ravi contented that the Assessing Officer cannot issue the notice
under section 153A beyond six assessment years immediately preceding the assessment
year relevant to the previous year in which the search was conducted under section 132
i.e. notice can be issued upto A.Y.2014-15 (P.Y. 2013-14).

Discuss about the correctness of action of Assessing Officer and the contention of Miss
Priyanka Ravi.
Answer

As per section 153A(1), issuance of notice and assessment or reassessment under the said section can also be made for an assessment year preceding the assessment year relevant to the previous year in which search is conducted or requisition is made which falls beyond six assessment years but not beyond ten assessment years from the assessment year relevant to the previous year in which search is conducted or which is made, provided that -

(i) the Assessing Officer has in his possession books of account or other documents or evidence which reveal that the income which has escaped assessment amounts to or is likely to amount to fifty lakh rupees or more in one year or in aggregate in the relevant assessment years;

(ii) such income escaping assessment is represented in the form of asset which shall include immovable property being land or building or both, shares and securities, deposits in bank account, loans and advances;

(iii) the income escaping assessment or part thereof relates to such year or years; and

(iv) search under section 132 is initiated or requisition under section 132A is made on or after 1-4-2017.

In the light of the above amended provision, the Assessing Officer can issue the notice u/s 153A beyond six assessment years but not beyond ten assessment years from the assessment year relevant to the previous year in which search is conducted or requisition is made. Thus, in the given case, the Assessing Officer can issue notice under section 153A upto A.Y.2010-11 as she,

a. has in his possession, documents or evidence which reveals the escaped assessment amounts to Rs. 55 lacs in aggregate during the relevant four assessment years i.e. from A.Y. 2010-11 to A.Y. 2013-14

b. such income escaping assessment represents in the form of assets which includes Rs. 40 lacs being Shares purchased in P.Y. 2011-12 and P.Y. 2012-13 plus Rs. 15 lacs being payment to contractor for construction of residential house in P.Y. 2009-10 (payment of Rs. 10 lacs relevant to P.Y. 2008-09 cannot be included as it is beyond ten assessment years)

c. search was conducted after 01.04.2017.

Hence, the contention of Miss. Priyanka Ravi that the Assessing Officer cannot issue the notice under section 153A beyond six assessment years immediately preceding the assessment year relevant to the previous year in which the search was conducted under section 132 is incorrect.

The action of Assessing Officer is partly correct as it is possible to him to issue notice beyond six assessment years but not beyond ten assessment years from the assessment year relevant to the previous year in which search is conducted or requisition is made. Thus, he cannot issue the notice under section 153A for the A.Y.2009-10.

Question 27

The assessment of Mr. Hari for A.Y.2012-13 was made on 28.3.2014 making an addition of Rs. 3,25,000 for a certain income received during the P.Y.2011-12. The assessee contested the addition before Commissioner (Appeals) but lost the case. The Appellate Tribunal passed an order on 26.2.2019 holding that the said income was not taxable in the P.Y.2011-12 but the same was taxable in the year of accrual, being P.Y.2006-07 relevant to
A.Y.2007-08. The Assessing Officer issued notice under section 148 for A.Y.2007-08 in March 2019 bringing to tax the sum of Rs. 3,25,000. Is the notice valid?

Would your answer change if in the said case, the assessment order for A.Y.2012-13 was made on 4.4.2014 instead of 28.3.2014?

Solution

Section 149 requires issue of notice under section 148 within a period of 6 years from the end of the relevant assessment year, where income escaping assessment exceeds Rs. 1 lakh. Accordingly, in respect of A.Y.2012-13, notice can be issued upto 31.3.2019. Section 150(1) enables issue of notice at any time to give effect to a finding contained in an appellate order. However, this is subject to the provisions of section 150(2), which places a restriction that if on the date of passing of the order which was the subject-matter of appeal, no notice could have been issued, then, such notice cannot be issued by virtue of the enabling provision contained in section 150(1).

In this case, the income was taxable in the A.Y.2007-08 as per the order of the Appellate Tribunal. The six year time limit, in this case, expires on 31.3.2014. Since the original assessment in respect of such income was made on 28.3.2014, the notice issued under section 148 consequent to the Appellate Tribunal order is valid.

Had the assessment order for A.Y.2012-13 been made on 4.4.2014 (instead of 28.3.2014), then the same would have been outside the six year time limit from A.Y.2007-08. Hence, since notice could not have been issued at that point of time, it cannot be now issued invoking the provisions of section 150(1).

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Assessment Procedure AJ Education NeXt

17.17

A.Y.2007-08. The Assessing Officer issued notice under section 148 for A.Y.2007-08 in March 2019 bringing to tax the sum of Rs. 3,25,000. Is the notice valid?

Would your answer change if in the said case, the assessment order for A.Y.2012-13 was made on 4.4.2014 instead of 28.3.2014?

Solution

Section 149 requires issue of notice under section 148 within a period of 6 years from the end of the relevant assessment year, where income escaping assessment exceeds Rs. 1 lakh. Accordingly, in respect of A.Y.2012-13, notice can be issued upto 31.3.2019. Section 150(1) enables issue of notice at any time to give effect to a finding contained in an appellate order. However, this is subject to the provisions of section 150(2), which places a restriction that if on the date of passing of the order which was the subject-matter of appeal, no notice could have been issued, then, such notice cannot be issued by virtue of the enabling provision contained in section 150(1).

In this case, the income was taxable in the A.Y.2007-08 as per the order of the Appellate Tribunal. The six year time limit, in this case, expires on 31.3.2014. Since the original assessment in respect of such income was made on 28.3.2014, the notice issued under section 148 consequent to the Appellate Tribunal order is valid.

Had the assessment order for A.Y.2012-13 been made on 4.4.2014 (instead of 28.3.2014), then the same would have been outside the six year time limit from A.Y.2007-08. Hence, since notice could not have been issued at that point of time, it cannot be now issued invoking the provisions of section 150(1).

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EXERCISE

Question 1
"SVS Propcon" did not make a claim of Rs. 20 lacs in the return of income filed for A.Y. 2020-21 which was disallowed in the previous assessment year under section 43B. However, the said claim was also not considered by the Assessing Officer during assessment proceedings on the ground that no revised return was filed. Can the assessee now make such claim before the appellate authority?

Answer
Yes, the assessee is entitled to raise additional claims before the appellate authorities. The restriction that an additional claim has to be made by filing a revised return applies only in respect of a claim made before the Assessing Officer. An assessee cannot make a claim before the Assessing Officer otherwise than by filing a revised return. It was so held by the Supreme Court in Goetze (India) Ltd v. CIT (2006) 284 ITR 323.

However, this restriction does not apply to an additional claim made before an appellate authority. The appellate authorities have jurisdiction to permit additional claims before them, though, the exercise of such jurisdiction is entirely the authorities’ discretion. It was so held by the Bombay High Court in CIT v. Pruthvi Brokers & Shareholders (2012) 349 ITR 336.

Thus, an additional claim can be raised before the Appellate Authority even if no revised return is filed.

Question 2
Examine the correctness or otherwise of the following statements with reference to the provisions of the Income-tax Act, 1961:

(i) An appeal before Income-tax Appellate Tribunal cannot be decided in the event of difference of opinion between the Judicial Member and the Accountant Member on a particular ground.

(ii) A High Court does not have an inherent power to review an earlier order passed by it on merits.

Answer
(i) The statement given is not correct. As per the provisions of section 255, in the event of difference in opinion between the members of the Bench of the Income-tax Appellate Tribunal, the matter shall be decided on the basis of the opinion of the majority of the members. In case the members are equally divided, they shall state the point or points of difference and the case shall be referred by the President of the Tribunal for hearing on such points by one or more of the other members of the Tribunal. Such point or points shall be decided according to the opinion of majority of the members of the Tribunal who heard the case, including those who had first heard it.

(ii) The statement given is not correct. The Supreme Court, in CIT v. Meghalaya Steels Ltd. (2015) 377 ITR 112, observed that the power of review would inhere on High Courts, being courts of record under article 215 of the Constitution of India.
There is nothing in article 226 of the Constitution to preclude a High Court from exercising the power of review which inheres in every court of plenary jurisdiction to prevent miscarriage of justice or to correct grave and palpable errors committed by it. The Supreme Court further observed that section 260A(7) does not purport in any manner to curtail or restrict the application of the provisions of the Code of Civil Procedure. Section 260A(7) only states that all the provisions that would apply qua appeals in the Code of Civil Procedure would apply to appeals under section 260A. The Supreme Court opined that this does not in any manner suggest either that the other provisions of the Code of Civil Procedure are necessarily excluded or that the High Court’s inherent jurisdiction is in any manner affected.

Question 3

Does the Income-tax Appellate Tribunal have the following powers?

(i) Power to allow the assessee to urge any ground of appeal which was not raised by him before the Commissioner (Appeals);

(ii) Power to recall its own order.

Answer

(i) The Income-tax Appellate Tribunal has the power to entertain question raised for the first time. The Tribunal is not confined only to the issues arising out of the appeal before the Commissioner (Appeals). It has the power to allow the assessee to urge any ground not raised before the Commissioner (Appeals). However, the relevant facts in respect of such ground should be on record. The decision of the Supreme Court in the case of National Thermal Power Company Limited vs. CIT (1998) 229 ITR 383 (SC) supports this view.

(ii) The Delhi High Court, in Lachman Dass Bhatia Hingwala (P) Ltd. v. ACIT (2011) 330 ITR 243 (Delhi)(FB) observed that the justification of an order passed by the Tribunal recalling its own order is required to be tested on the basis of the law laid down by the Apex Court in Honda Siel Power Products Ltd. v. CIT (2007) 295 ITR 466, dealing with the Tribunal’s power under section 254(2) to recall its order where prejudice has resulted to a party due to an apparent omission, mistake or error committed by the Tribunal while passing the order. Such recalling of order for correcting an apparent mistake committed by the Tribunal has nothing to do with the doctrine or concept of inherent power of review. It is a well settled provision of law that the Tribunal has no inherent power to review its own judgment or order on merits or reappreciate the correctness of its earlier decision on merits. However, the power to recall has to be distinguished from the power to review. While the Tribunal does not have the inherent power to review its order on merits, it can recall its order for the purpose of correcting a mistake apparent from the record.

When prejudice results from an order attributable to the Tribunal’s mistake, error or omission, then it is the duty of the Tribunal to set it right. The Delhi High Court observed that the Tribunal, while exercising the power of rectification under section 254(2), can recall its order in entirety if it is satisfied that prejudice has resulted to the party which is attributable to the Tribunal’s mistake, error or omission and the error committed is apparent.
Question 4

Can a rectification order under section 254 of the Income-tax Act, 1961 be passed by the Income-tax Appellate Tribunal beyond 6 months from the end of the month in which the order sought to be rectified was passed?

Answer

The issue as to whether a rectification order can be passed by the Income-tax Appellate Tribunal under section 254 beyond six months from the end of the month in which order sought to be rectified was passed, has been addressed in Sree Ayyanar Spinning and Weaving Mills Ltd. v. CIT (2008) 301 ITR 434 (SC). Section 254(2), dealing with the power of the Appellate Tribunal to pass an order of rectification of mistakes, is in two parts. The first part refers to the suo moto exercise of the power of rectification by the Appellate Tribunal, whereas the second part refers to rectification on an application filed by the assessee or Assessing Officer bringing any mistake apparent from the record to the attention of the Appellate Tribunal.

If Income-tax Appellate Tribunal, suo moto, makes the rectification of its order, then the order has to be passed within 6 months from the end of the month in which the order sought to be rectified was passed. Where the application for rectification is made by the Assessing Officer or the assessee within 6 months from the end of the month in which the order sought to be rectified was passed, the Appellate Tribunal is bound to decide the application on merits and not on the ground of limitation i.e. order can be passed after expiry of 6 months from the end of the month in which the order sought to be rectified was passed. However, the application for rectification cannot be filed belatedly after 6 months from the end of the month in which the order sought to be rectified was passed. [Ajith Kumar Pitaliya vs ITO (2009) 318 ITR 182 (M.P.)]

Question 5

What do you mean by substantial question of law? Examine.

Answer

The expression “substantial question of law” has not been defined anywhere in the Act. However, it has acquired a definite meaning through various judicial pronouncements. The tests are:

1. whether directly or indirectly it affects substantial rights of the parties; or
2. the question is of general public importance; or
3. whether it is an open question in the sense that issue is not settled by the pronouncement of the Supreme Court or Privy Council or by the Federal Court; or
4. the issue is not free from difficulty; or
5. it calls for a discussion for alternative view.

Question 6

Examine the correctness of the following statement:

“The Appellate Tribunal is empowered to grant indefinite stay for the demand disputed in appeals before it.”
Section 254(2A) provides that the Appellate Tribunal, where it is possible, may hear and decide an appeal within a period of four years from the end of the financial year in which such appeal is filed.

The Appellate Tribunal may, on merit, pass an order of stay in any proceedings relating to an appeal. However, such period of stay cannot exceed 180 days from the date of such order. The Appellate Tribunal has to dispose off the appeal within this period of stay.

Where the appeal has not been disposed off within this period and the delay in disposing the appeal is not attributable to the assessee, the Appellate Tribunal can further extend the period of stay originally allowed. However, the aggregate of period originally allowed and the period so extended should not exceed 365 days even if the delay in disposing of the appeal is not attributable to the assessee. The Appellate Tribunal is required to dispose off the appeal within this extended period. If the appeal is not disposed of within such period or periods, the order of stay shall stand vacated after the expiry of such period or periods.

Therefore, the statement given in the question is not correct.

Question 7
Is Commissioner (Appeals) empowered to consider an appeal filed by an assessee challenging the order of assessment in respect of which the proceedings before the Settlement Commission abates? Examine.

Answer
Section 251(1) lists the powers of the Commissioner (Appeals) in disposing of an appeal. Clause (aa) of section 251(1) empowers the Commissioner (Appeals), in an appeal against the assessment order in respect of which the proceeding before the Settlement Commission abates under section 245HA, to confirm, reduce, enhance or annul the assessment after taking into consideration the following -

1. all the material and other information produced by the assessee before the Settlement Commission;
2. the results of the inquiry held by the Settlement Commission;
3. the evidence recorded by the Settlement Commission in the course of the proceeding before it; and
4. such other material as may be brought on his record.

Question 8
An Income-tax authority did not file an appeal to the Income-tax Appellate Tribunal against an order of the Commissioner (Appeals) decided against the Income-tax department on a particular issue in case of one assessee, Alpi for assessment year 2019-20 on the ground that the tax effect of such dispute was less than the monetary limit prescribed by CBDT. In assessment year 2020-21, similar issue arose in the assessments of Alpi and her sister Palki, which was decided by the Commissioner (Appeals) against the Department. Can the Income-tax department move an appeal to the Tribunal in respect of A.Y. 2020-21 against the orders of the Commissioner (Appeals) for Alpi and her sister Palki?

Answer
Under section 268A(1), the CBDT is empowered to issue orders, instructions or directions to the other income-tax authorities, fixing such monetary limits, as it may
deem fit, to regulate filing of appeal or application for reference by any income-tax authority.

Under section 268A(2), where an income-tax authority has not filed any appeal or application for reference on any issue in the case of an assessee for any assessment year, due to above-mentioned order/instruction/direction of the CBDT, such authority shall not be precluded from filing an appeal or application for reference on the same issue in the case of the same assessee for any other assessment year or any other assessee for the same or any other assessment year. Further, in such a case, it shall not be lawful for an assessee to contend that the income-tax authority has acquiesced in the decision on the disputed issue by not filing an appeal or application for reference in any case.

In view of above provision, it would be in order for the Income-tax Department to move an appeal to the Tribunal against the orders of the CIT(A) in respect of A.Y. 2020-21 both for Alpi and Palki.

Question 9

A petition for stay of demand was filed before ITAT by XYZ Ltd. in respect of a disputed demand for which appeal was pending before it, on which stay was granted by the ITAT vide order dated 1.1.2019. The bench could not function thereafter till 1.2.2020 and therefore, the disputed matter could not be disposed off. The Assessing Officer attached the bank account on 16.2.2020 and recovered the amount of Rs. 15 lacs against the arrear demand of Rs. 25 lacs. The assessee requested the Assessing Officer to refund back the amount as it holds stay over it. The Assessing Officer rejected the contention of the assessee. Now the assessee seeks your opinion.

Answer

The Appellate Tribunal may, on merit, pass an order of stay in any proceedings relating to an appeal. However, such period of stay cannot exceed 180 days from the date of such order. The Appellate Tribunal has to dispose off the appeal within this period of stay. Where the appeal has not been disposed off within this period and the delay in disposing the appeal is not attributable to the assessee, the Appellate Tribunal can further extend the period of stay originally allowed. Section 254(2A) provides that the aggregate of the period originally allowed and the period or periods so extended or allowed shall not, in any case, exceed 365 days, even if the delay in disposing of the appeal is not attributable to the assessee. If the appeal is not disposed of within such period or periods, the order of stay shall stand vacated after the expiry of such period or periods.

Accordingly, even if an appeal is not heard by the bench, say, due to the bench not functioning or due to the department seeking adjournment, the stay granted by the Appellate Tribunal shall stand vacated after the period of 365 days, inspite of the assessee having taken all steps to ensure speedy disposal of the appeal and having a good prima facie case.

In the present case, the period of 365 days has expired on 31.12.2019, after which date the order of stay stands vacated. Accordingly, the recovery of Rs. 15 lacs against the arrear demand of Rs. 25 lacs made by the Assessing Officer on 16.2.2020 is in order.
Question 10

An assessee who had been served with an order of assessment passed under section 143(3) on 1.1.2020 had filed an application against this order before the CIT as per section 264 on 11.1.2020. However, the CIT refused to entertain the application on the pretext of premature application. Assessee seeks your opinion.

Answer

An assessee, who is aggrieved by the order of the Assessing Officer under section 143(3) passed on 1.1.2020, had moved an application for revision of order under section 264 on 11.1.2020. The order passed by the Assessing Officer under section 143(3) is an order appealable before the Commissioner (Appeals). The time limit for filing an appeal is 30 days from the date of order i.e., upto 31.1.2020. This time limit had not expired on 11.1.2020 and the assessee had also not waived his right of appeal while filing the application for revision on 11.1.2020 before the Commissioner of Income-tax. The application filed before the Commissioner of Income-tax for revision under section 264 by the assessee will only be considered when the conditions specified under section 264(4) have been complied with. One of the conditions is that the Commissioner shall not revise any order where an appeal against the order lies to the Commissioner (Appeals) or Appellate Tribunal and the time within which such appeal may be made has not expired, unless the assessee has waived his right of appeal. In the present case, the time limit had not expired on 11.1.2020 and the assessee had also not waived the right of appeal while filing the application for revision before the Commissioner of Income-tax on 11.1.2020 under section 264. Therefore, the Commissioner’s refusal to entertain such application is correct.

Note : In practical situations, the Commissioner could have kept the proceedings in abeyance till the expiry of the time prescribed for filing appeal by the assessee and thereafter, could have assumed jurisdiction for making revision besides taking an undertaking from the assessee for waiving his right of appeal. In reality, taxpayers usually will not prefer revision in such short time period nor would the Commissioner reject the application, the moment it is received by him.

Question 11

(a) The Commissioner of Income-tax issued notice to revise the order passed by an Assessing Officer under section 143. During the pendency of proceedings before the Commissioner, on the basis of material gathered during survey under section 133A after issue of the first notice, the Commissioner of Income-tax issued a second notice, the contents of which were different from the contents of the first notice. Examine whether the action of the Commissioner is justified as to the second notice.

(b) Examine the circumstances where the appellant shall be entitled to produce additional evidence, oral or documentary, before the Commissioner of Income-tax (Appeals) other than the evidence produced during the proceedings before the Assessing Officer.

Answer

(a) The action of the Commissioner in issuing the second notice is not justified. The term “record” has been defined in clause (b) of Explanation to section 263(1). According to this definition “record” shall include and shall be deemed always to have included all records relating to any proceeding under the Act available at the time of examination by the Commissioner. In other words, the information, material, report etc. which were not in existence at the time the assessment was made and came into existence afterwards can be taken into consideration by the Commissioner for the
purpose of invoking his jurisdiction under section 263(1). However, at the same
time, in view of the express provisions contained in clause (b) of the Explanation to
section 263(1), such information, material, report etc. can be relied upon by the
Commissioner only if the same forms part of record when the action under section 263
is taken by the Commissioner,

Issuance of a notice under section 263 succeeds the examination of record by
Commissioner. In the present case, the Commissioner initially issued a notice under
section 263, after the examination of the record available before him. The
subsequent second notice was on the basis of material collected under section 133A,
which was totally unrelated and irrelevant to the issues sought to be revised in the
first notice. Accordingly, the material on the basis of which the second notice was
issued could not be said to be “record” available at the time of examination as
emphasized in Explanation (b) to section 263(1).

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

Further, no evidence shall be admitted unless the Commissioner (Appeals) records in
writing the reasons for its admission.

Question 12
Examine the correctness or otherwise of the following propositions in the context of the
Income-tax Act, 1961:

(a) The powers of the Commissioner of Income-tax (Appeals) to enhance the
assessment are plenary and quite wide.

(b) At the time of hearing of rectification application, the Income-tax Appellate
Tribunal can re-appreciate the evidence produced during the proceedings of the
appeal hearing.

(c) The High Court cannot interfere with the factual finding recorded by the lower
authorities and the Tribunal, without any valid reasons.

Answer
(a) The proposition is correct in law. The Supreme Court has, in CIT vs. McMilan & Co.
(1958) 33 ITR 182 and CIT vs. Kanpur Coal Syndicate (1964) 53 ITR 225, held that
in disposing of an appeal before him, the appellate authority can travel over a whole
range of the assessment order. The scope of his powers is co-terminus with that of the
Assessing Officer. He can do what the Assessing Officer can do and can also direct him
to do, what he has failed to do. He can assess income from sources which have been
considered by the Assessing Officer but not brought to tax. He can consider every
aspect of the assessment order and give appropriate relief.
The Allahabad High Court has, in CIT v. Kashi Nath Chandiwala (2006) 280 ITR 318, held that the appellate authority is empowered to consider and decide any matter arising out of the proceedings in which the order appealed against was passed notwithstanding the fact that such matter was not raised before him by the assessee. The Commissioner (Appeals) is entitled to direct additions in respect of items of income not considered by the Assessing Officer.

Further, the Apex Court has, in the case of Jute Corporation of India Ltd. vs. CIT (1991) 187 ITR 688, held that the appellate authority is vested with all the plenary powers which the subordinate authority may have in the matter.

Thus, the powers of the Commissioner of Income-tax (Appeals) in enhancing the assessment are very wide and plenary.

(b) The proposition is not correct as per law. This is because section 254(2) specifically empowers the Appellate Tribunal to amend any order passed by it, either suo-moto or on an application made by the assessee or Assessing Officer, with a view to rectify any mistake apparent from record, at any time within 6 months from the end of the month of the order sought to be amended.

The powers of the Tribunal under section 254(2) relating to rectification of its order are very limited. Such powers are confined to rectifying any mistake apparent from the record. The mistake has to be such that for which no elaborate reasons or inquiry is necessary. Accordingly, the re-appreciation of evidence placed before the Tribunal during the course of the appeal hearing is not permitted. It cannot re-adjudicate the issue afresh under the garb of rectification [CIT vs. Vardhman Spinning (1997) 226 ITR 296 (P & H), CIT v. Ballabh Prasad Agarwalla (1998) 233 ITR 354 (Cal.) & Niranjan & Co. Ltd. v. ITAT (1980) 122 ITR 519 (Cal.)]

(c) The proposition is correct in law. A finding of fact cannot be disturbed by the High Court in exercise of its powers under section 260A. The Income-tax Appellate Tribunal is the final fact finding authority and the findings of fact recorded by the Tribunal can be interfered with by the High Court under section 260A only on the ground that the same were without evidence or material, or if the finding is contrary to the evidence, or is perverse or there is no direct nexus between conclusion of fact and the primary fact upon which that conclusion is based.

In CIT vs. P. Mohanakala (2007) 291 ITR 278 and M. Janardhana Rao v. Joint CIT (2005) 273 ITR 50, the Apex Court observed that the High Court had set aside the factual findings of the lower authorities and the Tribunal without any valid reason. The Apex Court held that the findings of fact could not be interfered with by the High Court without carefully considering the facts on record, the surrounding circumstances and the material evidence. There is no scope for interference with the factual findings, unless the findings are per se without reason or basis, perverse and/or contrary to the material on record.

Hence, only if the issue gives rise to a substantial question of law, an appeal shall lie before the High Court.

Question 13
Answer the following in the context of provisions contained in the Income-tax Act, 1961:

The assessment for A.Y. 2016-17 was completed as per section 143(3) considering the various claims so made by the assessee on 23.12.2017. Subsequently, this was reopened under section 147 on certain issues, but excluding the claim of the assessee as to “Lease
Equalisation Fund”. The order of reassessment was passed on 18.11.2018. The Commissioner within the powers vested under section 263 passed an order on 11.4.2020 rejecting the claim of assessee as to “Lease Equalisation Fund”. The assessee challenges that the action of the CIT is not sustainable because the same was barred by limitation.

**Answer**

This issue was settled by the Supreme Court in CIT v. Alagendran Finance Ltd. (2007) 293 ITR 1. The Supreme Court observed that though there was no doubt that once an order of assessment is reopened, the previous assessment will be held to be set aside and the whole proceedings would start afresh, however, it would not mean that even when the subject-matter of reassessment is distinct and different, the entire proceeding would be deemed to have been reopened. The doctrine of merger would apply only in a case where the subject-matter of reassessment and the subject-matter of assessment are the same. However, in this case, the revision proceedings related to Lease Equalisation Fund, which was not the subject matter of reassessment. Therefore, the doctrine of merger does not apply in this case.

Section 263(2) provides no order shall be made under section 263(1) after the expiry of two years from the end of the financial year in which the order sought to be revised was passed. The period of limitation as referred to in section 263(2) relates to the assessment in which the claim of the assessee as to Lease Equalisation Fund was considered by the Assessing Officer. This issue was not the subject matter of reassessment proceedings. Accordingly, the period of limitation shall be reckoned with reference to the original assessment order and not from the date of the order of reassessment. Therefore, in this case, the revision proceedings are barred by limitation since the original assessment order was made on 23.12.2017 and the revision should have been made by 31.3.2020.

**Question 14**

An assessee, who is aggrieved by all or any of the following orders, is desirous to know the available remedial recourse and the time limit against each under the Income-tax Act, 1961:

(i) passed under section 143(3) by the Assessing Officer.
(ii) passed under section 263 by the Commissioner of Income-tax.
(iii) passed under section 272A by the Director General.
(iv) passed under section 254 by the ITAT.

**Answer**

(i) An assessee, aggrieved by the order passed under section 143(3) by the Assessing Officer, can file an appeal before the Commissioner of Income-tax (Appeals) under section 246A(1) within 30 days of the date of service of the notice of demand relating to the assessment. However, where the assessee does not want to prefer an appeal, then he can move a revision petition before the Principal Commissioner or Commissioner of Income-tax under section 264 within a period of one year from the date of on which the order was communicated to him or the date on which he otherwise came to know of it, whichever is earlier.

(ii) An assessee, aggrieved by the order passed under section 263 by the Commissioner of Income-tax, can file an appeal to Income-tax Appellate Tribunal under section 253(1)(c) within 60 days of the date on which the order sought to be appealed against is communicated to the assessee.
(iii) An assessee, aggrieved by the order passed under section 272A by the Director General, can file an appeal before the Income-tax Appellate Tribunal under section 253(1)(c) within 60 days of the date on which the order sought to be appealed against is communicated to the assessee.

(iv) An assessee, aggrieved by the order passed under section 254 by the Income-tax Appellate Tribunal, can file an appeal before the High Court under section 260A within 120 days from the date of receipt of order of Income-tax Appellate Tribunal, only where the order gives rise to a substantial question of law.

Question 15
Who can file memorandum of cross-objections before the Income-tax Appellate Tribunal? What is the time limit? What is the fee for filing memorandum of cross objections?

Answer
Section 253(4) of the Income-tax Act, 1961 gives the respondent (assessee or the Assessing Officer), in every appeal filed before the Income-tax Appellate Tribunal, a right to file a memorandum of cross-objections against any order of the Commissioner (Appeals). This right of filing a memorandum of cross-objections is an independent right given to the respondent in an appeal and is in addition to the right of appeal which may or may not be exercised by the assessee or the Assessing Officer under section 253(1) or section 253(2). The memorandum of cross-objections has to be in the prescribed form and verified in the prescribed manner and has to be filed within 30 days of the receipt of notice of the appeal. The Tribunal is empowered to permit filing of memorandum of cross-objections after the expiry of the prescribed period if sufficient cause is shown. Such memorandum of cross-objections will be disposed of by the Appellate Tribunal as if it were an appeal presented within the time specified in section 253(3). There is no fee for filing a memorandum of cross-objections.

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Appeals & Revision AJ Education NeXt

18.10
Question 1

X & Co Ltd. had made an application to the Settlement Commission. The issue in the said application related to cash credits in the books of account. The Commission passed an order making addition to the income on the basis of difference in gross profit rate adopted, which was neither an issue in the application nor in the report of the Commissioner of Income-tax. Discuss the validity of the order of the Settlement Commission.

Answer

The issue under consideration is whether the Settlement Commission can pass an order making addition to the income on the basis of difference in gross profit rate adopted, which was neither an issue in the application nor in the report of the Commissioner of Income-tax.

Section 245D(4) provides that the Settlement Commission, after examination of records and the report of the Commissioner and after examining such further evidence as may be placed before it or obtained by it, may, in accordance with the provisions of the Act, pass such order as it thinks fit.

Further, section 245D(5) provides that the materials brought on record before the Settlement Commission shall be considered by the Members of the concerned Bench before passing any order under section 245D(4).

“Consideration” means independent examination of the evidence and material brought on record before the Settlement Commission by the members and application of mind thereto with a view to independently assess the materials and evidence, whether adduced by the applicant or by the Commissioner, and come to a conclusion by themselves.

This view has been upheld in case of Supreme Agro Foods P Ltd. v. Income-tax Settlement Commission (2013) 353 ITR 385 (P&H)

The Settlement Commission, therefore, has to consider the material brought on record before it and “consideration” means independent examination of the evidence and material on record.

In this case, since the material was available before the Settlement Commission and such material has been taken into consideration for returning a finding which is relevant for determining the undisclosed income of the applicant, the addition made on the basis of difference in gross profit rate adopted is justified.

Therefore, the order of the Settlement Commission is valid.

Question 2

On an application made by Mr. Pandey, an order was passed by the Settlement Commission on 03-01-2020 under Section 245D(6B). The said order had a mistake apparent on record. The Settlement Commission suo-moto passed an amended order dated 30-07-2020 which resulted in modifying the liability of Mr. Pandey.
Mr. Pandey is of the view that order of the Settlement Commission is final and conclusive and it has no power to rectify the said mistake.

You are required to examine the following:

(i) Correctness of claim made by Mr. Pandey
(ii) Validity of the order amended by the Settlement Commission

Answer

(i) Under section 245F(1), the Settlement Commission has been conferred all the powers which are vested in an income-tax authority under the Act. Under section 154, an income-tax authority has the power to amend any order passed by it in order to rectify any mistake apparent from the record. Therefore, the Settlement Commission's power to amend an order to rectify any mistake apparent from the record is embedded in section 245F(1).

Further, in order to reflect the correct intention of the legislature, section 245D(6B) specifically provides that the Settlement Commission may, at any time within a period of six months from the end of the month in which the order was passed, amend any order passed by it under section 245D(4) to rectify any mistake apparent from the record. In this case, the rectification order was passed by the Settlement Commission within six months from the end of the month in which the order was passed (i.e. by 31.7.2020)

Therefore, Mr. Pandey’s view is not correct.

(ii) In this case, the rectification has the effect of modifying the liability of Mr. Pandey. Therefore, as per the second proviso to section 245D(6B), the Settlement Commission, before passing the amended order, should have –

(1) given a notice to the applicant and the Principal Commissioner/Commissioner of its intention to make such an amendment; and

(2) allowed the applicant and the Principal Commissioner/Commissioner an opportunity of being heard.

If these conditions are fulfilled, the order amended by the Settlement Commission would be a valid order, since the amended order is passed by the Settlement Commission within the permitted time limit i.e., within six months from the end of the month in which the original order was passed.

However, if the Settlement Commission has not given notice of its intention to make such an amendment or has not allowed the applicant and the Principal Commissioner/Commissioner an opportunity of being heard, then, the amended order passed by it will not be valid.

Question 3

Seizures were made from Mr. Sunder pursuant to a search conducted in his premises. He filed an application for settlement by claiming to have received the amount by way of loans from several persons. The Settlement Commission accepted his statement and made an order. The CBI, however, conducted enquiry at the instance of the Revenue regarding the claimed amount of loans and opined that the alleged lenders had no means or financial capacity to advance such huge loans to Mr. Sunder and were mere name lenders only. The Commissioner filed an application under section 245D(6) praying for the order to be declared void and for withdrawal of benefit granted. Mr. Sunder, however, contended that the order of the Settlement Commission was final and any fresh
analysis would amount to sitting in judgement over an earlier decision, for which the Settlement Commission was not empowered. Discuss the correctness of Mr. Sunder's contention.

Answer

The Apex Court, in CIT vs. Om Prakash Mittal (2005) 273 ITR 326, observed that a plain reading of section 245D(6) shows that every order passed under sub-section (4) has to provide for:

(i) the terms of settlement; and
(ii) that the settlement would become void, if it is subsequently found by the Settlement Commission that it has been obtained by fraud or misrepresentation of facts.

The decision that the order has been obtained by fraud or misrepresentation is that of the Settlement Commission. However, there is no requirement that the action be initiated by the Settlement Commission, suo moto. The Revenue can move the Settlement Commission for decision on an issue if it has material to show that the order was obtained by fraud or misrepresentation of facts.

The Supreme Court observed that the foundation for settlement is an application which an assessee can file at any stage of a case relating to him in such form and manner as may be prescribed. The fundamental requirement of the application under section 245C is that there must be full and true disclosure of the income along with the manner in which it has been derived. If an order is obtained by fraud or misrepresentation of facts, it cannot be said that there is a full and true disclosure and therefore, the Legislature has prescribed the condition relating to declaration of the order void when it is obtained by fraud or misrepresentation of facts.

The Supreme Court held that merely because section 245-I provides that the order of settlement is conclusive, it does not take away the power of the Settlement Commission to decide whether the settlement order has been obtained by fraud or misrepresentation of facts. If the Commissioner is able to establish that the earlier decision was void because of misrepresentation of facts, then it is open for the Settlement Commission to decide the issue. It cannot be called by any stretch of imagination to be a review of the earlier judgment or the subsequent Bench sitting in appeal over the earlier Bench’s decision.

Mr. Sunder's contention is, therefore, not correct.

Question 4

Does the Settlement Commission have the power to reduce or waive interest levied under sections 234A, 234B and 234C of the Income-tax Act? Discuss.

Answer

The matter concerning the power of the Settlement Commission to reduce or waive interest chargeable under section 234A, 234B or 234C has been settled by the Supreme Court in CIT v. Anjum M.H.Ghaswala (2001) 252 ITR 1.

According to the judgment, the provisions of section 245D(6) are only procedural in nature providing for fixing the term by which the amounts settled under sub-section (4) will have to be paid. It does not empower the Commission either to reduce or waive the interest. Any settlement made by the Commission must be in accordance with the provisions of the Act.

The Settlement Commission does not have the power to reduce or waive the interest levied under sections 234A, 234B and 234C. It does not authorize the waiver or deduction of
tax. The levy of interest under sections 234A, 234B or 234C is mandatory in nature and therefore any settlement made must include the interest under these sections. However, as per provisions of section 245F, the Settlement Commission shall have all the powers which are vested in an income-tax authority. Therefore, Settlement Commission can grant relief from the aforesaid interest to the extent of the powers given vide the circulars issued by CBDT under section 119.

**Question 5**

(a) Does the Settlement Commission have jurisdiction to entertain an application made under section 245C(1) in respect of a case covered by Chapter XIV-B (Search and seizure case).

(b) Discuss the power of the Settlement commission to grant immunity from prosecution and penalty.

**Answer**

(a) Section 245A(b) defines the term ‘case’ to mean any proceeding for assessment under the Act of any person in respect of any assessment year or years which is pending before the Assessing Officer on the date on which an application is made to the Settlement Commission.

Search cases are eligible for settlement through the Settlement Commission. Explanation to section 245A(b), provides that in case of a person referred to in section 153A or section 153C, a proceeding for assessment or reassessment shall be deemed to have been commenced on the date of issue of notice initiating such proceeding for assessment under section 153A or section 153C and concluded on the date on which the assessment is made. During this period, application for settlement of the case could be filed by the assessee.

Further, section 245C provides that an application before the Settlement Commission in cases falling under section 153A and 153C can be made, where the additional amount of income-tax payable on income disclosed in the application exceeds Rs. 50 lakh, in respect of the taxpayer who is the subject matter of search and Rs. 10 lakh, in respect of entities related to such a taxpayer, who are also the subject matter of search.

Moreover, such tax and interest thereon, which would have been payable had such income been disclosed in the return of income before the Assessing Officer on the date of application, should be paid on or before the date of making the application. Further, proof of such payment should be attached with the application.

(b) The power of Settlement Commission to grant immunity from prosecution and penalty is provided for in section 245H.

In respect of an application made on or after 1st June, 2007, the Settlement Commission’s power to grant immunity from prosecution is restricted to offences under the Income-tax Act, 1961. The Settlement Commission can also grant immunity from penalty imposed under the Income-tax Act, 1961. Such immunity from prosecution and penalty may be granted subject to conditions as it may think fit to impose.

However, the Settlement Commission may grant immunity only if the person who has made the application has co-operated with the Settlement Commission and made a full and true disclosure of his income and the manner in which it was derived. Further, the Settlement Commission while granting immunity to any person from prosecution shall record the reasons in writing in the order passed by it.
Also, the Settlement Commission cannot grant immunity if the prosecution proceeding for any such offence has been instituted before the date of receipt of application for settlement under section 245C.

Question 6

The business premises of Mr. Amit was subjected to a survey under section 133A of the Act. There were some incriminating materials found at the time of survey. The assessee apprehends reopening of assessments of the earlier years. He wants to know whether he can approach the Settlement Commission.

Explain briefly the basic conditions to be satisfied and the benefits that may accrue to Mr. Amit by approaching the Settlement Commission.

Answer

An assessee may, at any stage of a case relating to him, make an application in the prescribed form and manner to the Settlement Commission under section 245C. “Case” means any proceeding for assessment which may be pending before an Assessing Officer on the date on which such application is made. Thus, the basic condition for making an application before the Settlement Commission under section 245C is that there must be a proceeding for assessment pending before an Assessing Officer on the date on which the application is made.

A proceeding for assessment or reassessment or recomputation under section 147 shall be deemed to have commenced from the date on which a notice under section 148 is issued. In this case, Mr. Amit cannot approach the Settlement Commission merely due to his apprehension that assessment of earlier years may be reopened, since there is no case pending before an Assessing Officer.

Therefore, he has to wait for the Assessing Officer to issue notice under section 148. Thereafter, he can make an application to the Settlement Commission under section 245C, since there would be a “case pending” before the Assessing Officer on that date.

Another basic condition to be satisfied for making an application is that the additional amount of income-tax payable on the income disclosed in the application should exceed Rs. 10 lakh, and such tax and interest thereon which would have been paid had the income disclosed in the application been declared in the return of income should be paid on or before the date of making the application and proof of such payments should be attached with the application.

If the Settlement Commission is satisfied that Mr. Amit has co-operated in the proceedings and made true and full disclosure of his income and the manner in which it has been derived, it may, subject to such conditions as it may think fit to impose, grant to Mr. Amit -

(i) immunity from prosecution for any offence under the Income-tax Act, 1961 / Wealth-tax Act, 1957, where the proceedings for such prosecution have been instituted on or after the date of receipt of application under section 245C; and

(ii) immunity from imposition of penalty under the Income-tax Act, 1961, either wholly or in part, with respect to the case covered by the settlement.

This is the benefit that may accrue to Mr. Amit, if he approaches the Settlement Commission.

Note: Where a notice under section 148 is issued for any assessment year, a proceeding under section 147 shall be deemed to have commenced on the date of issue of such notice and the assessee can approach the Settlement Commission for other assessment years as well, even if notice under section 148 for such other assessment years has not
been issued but could have been issued on date. However, a return of income for such other assessment years should have been furnished under section 139 or the response to notice under section 142.

Question 7

Explain the powers of Settlement Commission to amend its order.

Answer

As per the section 245D(6B), the Settlement Commission may amend any order passed by it under section 245D(4) to rectify a mistake apparent from the record, within six months from the end of the month in which order was passed.

In case where an application for rectification is made by the Principal Commissioner or the Commissioner or the applicant within 6 months from the end of the month in which order under section 245D(4) was passed, the Settlement Commission may amend the order within six months from the end of the month in which an application for rectification has been made by the Principal Commissioner or Commissioner or the applicant.

However, an amendment which has the effect of modifying the liability of the applicant shall not be made unless the Settlement Commission –

1. has given notice to the applicant and the Principal Commissioner or Commissioner of its intention to do so; and
2. has allowed the applicant and the Principal Commissioner or Commissioner an opportunity of being heard.

Question 8

M/s. A Ltd. has received a notice under section 148 for the Assessment Year 2017-18 on 02-02-2020. They also anticipate similar notices for the Assessment Years 2015-16 and 2016-17 for which they have already furnished return of income. On examination of the books of account produced, you have noticed huge amounts of concealed income. As a consultant, what is your advice to A Ltd.?

Answer

As per section 245C, an assessee may, at any stage of a case relating to him, make an application in the prescribed form and manner to the Settlement Commission.

“Case” means any proceeding for assessment which may be pending before an Assessing Officer on the date on which such application is made.

A proceeding for assessment or reassessment or recomputation under section 147 is deemed to have commenced from the date of issue of notice under section 148. Where a notice under section 148 is issued for any assessment year, a proceeding under section 147 shall be deemed to have commenced on the date of issue of such notice and the assessee can approach the Settlement Commission for other assessment years as well, even if notice under section 148 for such other assessment years have not been issued but could have been issued on that date. However, a return of income for such other assessment years should have been furnished under section 139 or in response to notice under section 142.

In the case on hand, M/s A Ltd. has received a notice under section 148 for the A.Y.2017-18 and also anticipates similar notices for the A.Y.2015-16 and A.Y.2016-17, for which return of income has been furnished. Thus, a proceeding for assessment is pending before an Assessing Officer i.e., the basic condition for approaching Settlement Commission is satisfied.
Moreover, since after examination of the books of account, huge amount of concealed income is also noticed, it is presumed that the second condition that the additional amount of income-tax payable on the income disclosed in the application should exceed Rs. 10 lakhs has also been satisfied.

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

Question 1
A search under section 132 was initiated in the premises of Mr. X on 30.4.2019 and undisclosed money and jewellery belonging to Mr. X was found in his premises. Examine the penal provisions under the Income-tax Act which are attracted in this case, assuming that the undisclosed assets were acquired out of his undisclosed income of previous year 2019-20.

Answer
In order to deter the practice of non-disclosure of income, section 271AAB(1A) provides for levy of penalty on undisclosed income found during the course of a search, which relates to specified previous year, i.e.-

- the previous year which has ended before the date of search, but the due date of filing return of income for the same has not expired before the date of search and the return has not yet been furnished (P.Y. 2018-19);
- the previous year in which search is conducted (P.Y. 2019-20).

Accordingly, under section 271AAB(1A), in respect of searches initiated on or after 15.12.2016,

- penalty@30% would be attracted, if undisclosed income is admitted during the course of search in the statement furnished under section 132(4), and the assessee explains the manner in which such income was derived, pays the tax, together with interest if any, in respect of the undisclosed income, and furnishes the return of income for the specified previous year declaring such undisclosed income on or before the specified date (i.e., the due date of filing return of income or the date on which the period specified in the notice issued under section 153A expires, as the case may be).
- In all other cases, penalty @60% of undisclosed income would be attracted.

Question 2
What is the quantum of penalty that could be levied in each of the following cases -
(i) Failure to get books of accounts audited as required under section 44AB within the time prescribed under the Act.
(ii) Failure to comply with a direction issued under section 142(2A).
(iii) Failure to furnish report from an accountant as required under section 92E.

Answer
The penalty that could be levied in each case is:

(i) **Failure to get books of accounts audited as required under section 44AB of the Income-tax Act, 1961** - a sum equal to ½% of the total sales, turnover or gross receipts, as the case may be, in business, or of the gross receipts in profession, in such previous year or years, or a sum of Rs. 1,50,000, whichever is less [Section 271B].

(ii) **Failure to comply with a direction issued under section 142(2A)** – a sum of Rs. 10,000 [Section 272A(1)(d)].
(iii) Failure to furnish report from an accountant as required by section 92E - a sum of Rs. 1,00,000 [Section 271BA].

Question 3

X, an individual whose total sales in the business of food grains for the year ending 31.3.2020 was Rs. 205 lakhs, did not maintain books of account for P.Y.2019-20, even though his turnover exceeded Rs. 25 lakhs in the P.Y.2018-19. The Assessing Officer levied penalty of Rs. 25,000 under section 271A for non-maintenance of books of account and penalty of Rs. 1,02,500 under section 271B for not getting the books audited as required by section 44AB. Is the Assessing Officer justified in levying penalty under section 271B?

Answer

X is required to maintain books of account as per section 44AA for the P.Y.2019-20 since his turnover exceeded Rs. 25 lakhs in the P.Y.2018-19. He also has to get them audited under section 44AB, since his gross sales in the P.Y.2019-20 exceed Rs. 1 crore. He is liable to pay penalty under section 271A for not maintaining his books of account as per section 44AA. Accordingly, the action of the Assessing Officer in levying penalty of Rs. 25,000 under section 271A is correct. However, where books of account have not been maintained, there cannot be a question of getting them audited. Audit of books of account presupposes maintenance of books of account. When admittedly X has not maintained books, he cannot obviously get the audit done.

In Surajmal Parsuram Todi v. CIT (1996) 222 ITR 691, the Gauhati High Court has held that when a person commits an offence by not maintaining books of accounts as contemplated by section 44AA, the offence is complete and after that there can be no possibility of any offence as contemplated by section 44AB and, therefore, the imposition of penalty under section 271B is erroneous.

Therefore, in this case, the Assessing Officer is not justified in levying penalty under section 271B.

Question 4

State the conditions, if any, to be satisfied by an assessee in order to get relief under section 273A(4) regarding the waiver of penalty. Can the Commissioner refuse to grant relief, when the conditions laid down in the section was complied with, by the assessee?

Answer

There are two conditions to be satisfied by an assessee in order to get relief in the form of a waiver or reduction of penalty by the Commissioner of Income-tax under section 273A(4) of the Act. These conditions are:

(i) The payment of penalty would cause "genuine hardship" to the assessee and the Commissioner is satisfied about the existence of genuine hardship having regard to the circumstances of the case. The existence of genuine hardship would entitle the assessee to relief. The CBDT in its Circular No 784 dated 22-11-1999 has clarified that "genuine hardship" referred to in the provisions of section 273A(4) should exist both at the time at which the application under section 273A(4) is made by the assessee before the Commissioner and at the time of passing of order under section 273A(4) by the Commissioner.
(ii) The assessee has co-operated in any enquiry relating to the assessment or any proceeding for the recovery of any amount due from him.

As per the decision of Andhra Pradesh High Court in K.S.N. Murthy v. Chairman, CBDT (2001) 252 ITR 269, if the above conditions laid down for exercise of the discretion are satisfied, the Principal Commissioner or Commissioner cannot refuse to exercise the discretion. Though the power given to the Commissioner under section 273A is discretionary, the exercise of discretion cannot be either arbitrary or capricious and has to be judicious and objective, once the conditions required for exercise of discretion in any judicial or quasi-judicial proceedings are satisfied. Such discretion must be exercised taking into consideration all relevant facts. The satisfaction for exercise of discretionary power under the section must be based on objective consideration and not on subjective satisfaction.

Also, as per the proviso to section 273A(4), in case the quantum of penalty exceeds Rs. 1 lakh, the Principal Commissioner or Commissioner can grant relief only with the previous approval of the Principal Chief Commissioner or Chief Commissioner or the Principal Director General or Director General, as the case may be.

Note - The Principal Commissioner or Commissioner has to pass an order under section 273A(4), either accepting or rejecting the application in full or in part, within a period of 12 months from the end of the month in which the application is received. Further, no order rejecting the application, either in full or in part, shall be passed unless the assessee has been given an opportunity of being heard.

Question 5

An assessee had credited a sum of Rs. 50,000 in cash in the account of Madan, said to represent a loan obtained from him. The Assessing Officer, having gone into the genuineness of the transaction, disbelieved the story of loan and treated the sum of Rs. 50,000 as the income of the assessee from undisclosed sources. He also started proceedings under section 271D and levied a penalty of Rs. 60,000 on the assessee for having accepted the loan in contravention of section 269SS. Examine the correctness of the levy.

Answer

There are several flaws in the penalty levied by the Assessing Officer. Firstly, the penalty leviable under section 271D cannot exceed the sum equal to the loan taken. Hence, the maximum penalty leviable would be Rs. 50,000. Secondly, any penalty imposable under section 271D shall be imposed by the Joint Commissioner. Hence, unless the Assessing Officer happens to be a Joint Commissioner the levy of penalty will be invalid. Thirdly, the Assessing Officer cannot, on the one hand, treat the loan as undisclosed income of the assessee and on the other, treat it as a loan for the purpose of section 269SS read with section 271D. Such a treatment will be self-contradictory. The moment the amount of Rs. 50,000 is treated as undisclosed income, it ceases to bear the character of loan and therefore, the foundation for the levy of penalty under section 271D disappears. [Diwan Enterprises v. CIT and Others (2000) 246 ITR 571].
Question 6
Examine the following cases and state whether the same are liable for penalty as per the provisions of the Income-tax Act, 1961.

(i) Raman & Associates had made payment in excess of the limits prescribed to the contractors for carrying out labour job work at various sites, but had not deducted tax at source as per section 194C.

(ii) Hotels and Hotels were asked by Income-tax Officer (CIB) to furnish details of all such tourists who stayed in their hotels and had paid bill amount in excess of Rs. 10,000. They have not furnished the requisite information in spite of various reminders.

Answer

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

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

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

Question 7
Fox Limited failed to furnish information and documents sought by the Transfer Pricing Officer (TPO). Can TPO levy penalty for such failure? How much would be the quantum of penalty imposable for the said failure?

Answer

Under section 271G, if any person who has entered into an international transaction or specified domestic transaction fails to furnish any such information or document as required by section 92D(3) sought for by the Transfer Pricing Officer, then, such person shall be liable to a penalty which may be levied by the Assessing Officer or the Transfer Pricing Officer or the Commissioner (Appeals). Thus, the Transfer Pricing Officer is a competent authority to levy penalty.

Penalty would be a sum equal to 2% of the value of international transaction or specified domestic transaction for each such failure.
Question 8

What would be the penalty leviable under section 270A in case of the following assessees, 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?

<table>
<thead>
<tr>
<th>Particulars of total income of A.Y.2020-21</th>
<th>M/s. Alpha, a resident firm (Rs.)</th>
<th>Beta Ltd., an Indian company (Rs.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1) As per the return of income furnished u/s 139(1)</td>
<td>35,00,000</td>
<td>(12,00,000)</td>
</tr>
<tr>
<td>(2) Determined under section 143(1)(a)</td>
<td>45,00,000</td>
<td>(6,00,000)</td>
</tr>
<tr>
<td>(3) Assessed under section 143(3)</td>
<td>62,00,000</td>
<td>(2,00,000)</td>
</tr>
<tr>
<td>(4) Reassessed under section 147</td>
<td>81,00,000</td>
<td>6,00,000</td>
</tr>
</tbody>
</table>

Note – Beta Ltd. is a trading company. The total turnover of Beta Ltd. for the P.Y.2017-18 was Rs. 401 crore and the company has not exercised option under section 115BAA.

Answer

Penalty leviable under section 270A in case of M/s. Alpha, a resident firm

M/s. Alpha is deemed to have under-reported its income since:

1. its income assessed under 143(3) exceeds its income determined in a return processed under section 143(1)(a); and
2. the income reassessed under section 147 exceeds the income assessed under section 143(3).

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

Computation of penalty leviable under section 270A

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Assessment under section 143(3)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Under-reported income:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total income assessed under section 143(3)</td>
<td>62,00,000</td>
<td></td>
</tr>
<tr>
<td>(--) Total income determined u/s 143(1)(a)</td>
<td>45,00,000</td>
<td>17,00,000</td>
</tr>
<tr>
<td>Tax payable on under-reported income:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tax on under-reported income of Rs. 17 lakhs plus total income of Rs. 45 lakhs determined u/s 143(1)(a) [30% of Rs. 62 lakh + EC &amp; SHEC@4%]</td>
<td>19,34,400</td>
<td></td>
</tr>
<tr>
<td>Less: Tax on total income determined u/s 143(1)(a) [30% of Rs. 45 lakh + EC &amp; SHEC@4%]</td>
<td>14,04,000</td>
<td></td>
</tr>
<tr>
<td>Penalty leviable@50% of tax payable</td>
<td></td>
<td>2,62,200</td>
</tr>
<tr>
<td>Reassessment under section 147 Under-reported income:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total income reassessed under section 147</td>
<td>81,00,000</td>
<td></td>
</tr>
<tr>
<td>(--) Total income assessed under section 143(3)</td>
<td>62,00,000</td>
<td>19,00,000</td>
</tr>
<tr>
<td>Tax payable on under-reported income:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tax on under-reported income of Rs. 19 lakhs plus total income of Rs. 62 lakhs assessed u/s 143(3) [30% of Rs. 81 lakh + EC &amp; SHEC@4%]</td>
<td>25,27,200</td>
<td></td>
</tr>
<tr>
<td>Less: Tax on total income assessed u/s 143(3) [30% of Rs. 62 lakh + EC &amp; SHEC@4%]</td>
<td>19,34,400</td>
<td></td>
</tr>
</tbody>
</table>
Penalty leviable under section 270A in the case of Beta Ltd., an Indian company

Beta 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**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Assessment under section 143(3)</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Under-reported income:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Loss assessed u/s 143(3)</td>
<td>(2,00,000)</td>
<td></td>
</tr>
<tr>
<td>(-) Loss determined under section 143(1)(a)</td>
<td>(6,00,000)</td>
<td>4,00,000</td>
</tr>
<tr>
<td>Tax payable on under-reported income@30%</td>
<td>1,20,000</td>
<td>1,24,800</td>
</tr>
<tr>
<td>Add: EC &amp; SHEC@4%</td>
<td>4,800</td>
<td></td>
</tr>
<tr>
<td>Penalty leviable@50% of tax payable</td>
<td>62,400</td>
<td></td>
</tr>
<tr>
<td><strong>Reassessment under section 147</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Under-reported income:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total income reassessed under section 147</td>
<td>6,00,000</td>
<td>8,00,000</td>
</tr>
<tr>
<td>(-) Loss assessed under section 143(3)</td>
<td>(2,00,000)</td>
<td></td>
</tr>
<tr>
<td>Tax payable on under-reported income@30%</td>
<td>2,40,000</td>
<td>2,49,600</td>
</tr>
<tr>
<td>Add: EC &amp; SHEC@4%</td>
<td>9,600</td>
<td></td>
</tr>
<tr>
<td>Penalty leviable@50% of tax payable</td>
<td>1,24,800</td>
<td></td>
</tr>
</tbody>
</table>

**Note** – The applicable rate of tax for Beta Ltd. for A.Y.2020-21 is 30%, since its turnover for the P.Y.2017-18 exceeded Rs. 400 crore.

**ADDITIONAL ILLUSTRATION FOR PRACTICE:**

**Illustration 1**

M/s. XYZ is a firm liable to tax@30%. The following are the particulars furnished by the firm for A.Y.2020-21:

<table>
<thead>
<tr>
<th>Particulars of total income</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1) As per the return of income furnished u/s 139(1)</td>
<td>50,00,000</td>
</tr>
<tr>
<td>(2) Determined under section 143(1)(a)</td>
<td>60,00,000</td>
</tr>
<tr>
<td>(3) Assessed under section 143(3)</td>
<td>75,00,000</td>
</tr>
<tr>
<td>(4) Reassessed under section 147</td>
<td>95,00,000</td>
</tr>
</tbody>
</table>

Can penalty be levied under section 270A on M/s. XYZ? If the answer is in the affirmative, compute the penalty leviable under section 270A.
Solution

M/s. XYZ is deemed to have under-reported its income since:

1. its income assessed under 143(3) exceeds its income determined in a return processed under section 143(1)(a); and
2. the income reassessed under section 147 exceeds the income assessed under section 143(3).

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

**Computation of penalty leviable under section 270A**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Assessment under section 143(3)</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Under-reported income:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total income assessed under section 143(3)</td>
<td>75,00,000</td>
<td></td>
</tr>
<tr>
<td>(-) Total income determined u/s 143(1)(a)</td>
<td>60,00,000</td>
<td></td>
</tr>
<tr>
<td><strong>Tax payable on under-reported income:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tax on under-reported income of Rs. 15 lakhs plus tax on total income of Rs. 60 lakhs determined u/s 143(1)(a) [30% of Rs. 75 lakh + EC &amp; SHEC@4%]</td>
<td>23,40,000</td>
<td></td>
</tr>
<tr>
<td>Less: Tax on total income determined u/s 143(1)(a) [30% of Rs. 60 lakh + EC &amp; SHEC@4%]</td>
<td>18,72,000</td>
<td></td>
</tr>
<tr>
<td>Penalty leviable@50% of tax payable</td>
<td>4,68,000</td>
<td>2,34,000</td>
</tr>
<tr>
<td><strong>Reassessment under section 147</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Under-reported income:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total income reassessed under section 147</td>
<td>95,00,000</td>
<td></td>
</tr>
<tr>
<td>(-) Total income assessed under section 143(3)</td>
<td>75,00,000</td>
<td></td>
</tr>
<tr>
<td><strong>Tax payable on under-reported income:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tax on under-reported income of Rs. 20 lakhs plus tax on total income of Rs. 75 lakhs assessed u/s 143(3) [30% of Rs. 95 lakh + EC &amp; SHEC@4%]</td>
<td>29,64,000</td>
<td></td>
</tr>
<tr>
<td>Less: Tax on total income assessed u/s 143(3) [30% of Rs. 75 lakh + EC &amp; SHEC@4%]</td>
<td>23,40,000</td>
<td>6,24,000</td>
</tr>
<tr>
<td>Penalty leviable@50% of tax payable</td>
<td>3,12,000</td>
<td></td>
</tr>
</tbody>
</table>

**Note** – The following assumptions have been made -

1. None of the additions or disallowances made in assessment or reassessment qualifies under section 270A(6); and
2. The under-reported income is not on account of misreporting.

**Illustration 2**

Mr. Ram, a resident individual of the age of 55 years, has not furnished his return of income for A.Y.2020-21. However, the total income assessed in respect of such year under section 144 is Rs. 12 lakh. Is penalty under section 270A attracted in this case, and if so, what is the quantum of penalty leviable?
Solution
Mr. Ram is deemed to have under-reported his income since he has not filed his return of income and his assessed income exceeds the basic exemption limit of Rs. 2,50,000. Hence, penalty under section 270A is leviable in his case.

Computation of penalty leviable under section 270A

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Assessment under section 143(3)</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Under-reported income:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total income assessed under section 143(3)</td>
<td>12,00,000</td>
<td>12,00,000</td>
</tr>
<tr>
<td>(-) Basic exemption limit</td>
<td>2,50,000</td>
<td>9,50,000</td>
</tr>
<tr>
<td>Tax payable on under-reported income as increased by the basic exemption limit [30% of Rs. 2 lakhs + Rs. 1,12,500]</td>
<td>1,72,500</td>
<td></td>
</tr>
<tr>
<td>Add: EC &amp; SHEC@4%</td>
<td>6,900</td>
<td>1,79,400</td>
</tr>
<tr>
<td>Penalty leviable@50% of tax payable</td>
<td>89,700</td>
<td></td>
</tr>
</tbody>
</table>

Note – It is assumed that the under-reported income is not on account of misreporting.

Illustration 3
ABC Ltd. is a domestic company liable to tax@25%. The following are the particulars furnished by the company for A.Y. 2020-21:

<table>
<thead>
<tr>
<th>Particulars of total income</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1) As per the return of income furnished u/s 139(1)</td>
<td>15,00,000</td>
</tr>
<tr>
<td>(2) Determined under section 143(1)(a)</td>
<td>8,00,000</td>
</tr>
<tr>
<td>(3) Assessed under section 143(3)</td>
<td>5,00,000</td>
</tr>
<tr>
<td>(4) Reassessed under section 147</td>
<td>4,00,000</td>
</tr>
</tbody>
</table>

Is penalty leviable under section 270A on ABC Ltd., and if so, what is the quantum of penalty?

Solution
ABC 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

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Assessment under section 143(3)</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Under-reported income:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Loss assessed u/s 143(3)</td>
<td>(5,00,000)</td>
<td></td>
</tr>
<tr>
<td>(-) Loss determined under section 143(1)(a)</td>
<td>(8,00,000)</td>
<td></td>
</tr>
<tr>
<td>Tax payable on under-reported income@25%</td>
<td>75,000</td>
<td></td>
</tr>
<tr>
<td>Add: EC &amp; SHEC@4%</td>
<td>3,000</td>
<td>78,000</td>
</tr>
<tr>
<td>Penalty leviable@50% of tax payable</td>
<td></td>
<td>39,000</td>
</tr>
</tbody>
</table>
Reassessment under section 147 Under-reported income:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total income reassessed under section 147</td>
<td>4,00,000</td>
</tr>
<tr>
<td>(-) Loss assessed under section 143(3)</td>
<td>(5,00,000)</td>
</tr>
<tr>
<td>Tax payable on under-reported income @ 25%</td>
<td>2,25,000</td>
</tr>
<tr>
<td>Add: EC &amp; SHEC @ 4%</td>
<td>9,000</td>
</tr>
<tr>
<td>Penalty leviable @ 50% of tax payable</td>
<td>1,17,000</td>
</tr>
</tbody>
</table>

Note – The following assumptions have been made –
(1) None of the additions or disallowances made in assessment or reassessment qualifies under section 270A(6); and
(2) The under-reported income is not on account of misreporting.

Illustration 4

A private bank has not filed its statement of financial transaction or reportable account in relation to the specified financial transactions for the financial year 2019-20. A notice was issued by the prescribed income-tax authority on 1st October, 2020 requiring the bank to furnish the statement by 31st October, 2020. The bank, however, furnished the statement only on 15th November, 2020. What would be the penalty leviable under section 271FA?

Solution

<table>
<thead>
<tr>
<th>(1)</th>
<th>(2)</th>
<th>(3)</th>
<th>(4)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Non-compliance of section 271FA</td>
<td>Penalty under section 271FA</td>
<td>Period</td>
<td>Quantum of penalty under section 271FA (2) \times (3) (Rs.)</td>
</tr>
<tr>
<td>285BA(1)</td>
<td>Rs. 500 per day of continuing default</td>
<td>1.6.2019 to 31.10.2019</td>
<td>153 days \times Rs. 500</td>
</tr>
<tr>
<td>285BA(5)</td>
<td>Rs. 1,000 per day of continuing default</td>
<td>1.11.2019 to 15.11.2019</td>
<td>15 days \times Rs. 1,000</td>
</tr>
</tbody>
</table>

91,500

***************************************************************************
EXERCISE

Question 1

Can prosecution be launched for each of the following actions or defaults committed? If yes, then explain the relevant provisions of the Act and the quantum of prescribed punishment.

(i) The assessee had restrained and not allowed the officer authorized as per section 132(1)(iib) of the Act to inspect the documents maintained in the form of electronic record and the books of accounts.

(ii) The assessee deliberately has failed to comply with the requirement of section 142(1) and/or 142(2A).

(iii) The assessee deliberately has failed to make the payment of the tax collected under section 206C.

Answer

(i) Failure to afford facility to the officer authorized as per section 132(1)(iib) is a case for which prosecution can be launched under section 275B and such person shall be punishable with rigorous imprisonment for a term which may extend to two years and shall also be liable to fine.

(ii) Willful failure to produce books of account and documents as required under section 142(1) or willful failure to comply with a direction to get the accounts audited under section 142(2A) is a case for which prosecution can be launched under section 276D and such person shall be punishable with rigorous imprisonment for a term which may extend to one year and with fine.

(iii) Deliberate failure to deposit the tax collected under section 206C to the credit of the Central Government is a case for which prosecution can be launched under section 276BB and such person shall be punishable with rigorous imprisonment for a term which shall not be less than three months but which may extend to seven years and with fine.

Question 2

The Assessing Officer lodged a complaint against M/s. KLM, a firm, under section 276CC of the Income-tax Act, 1961 for failure to furnish its return of income for the A.Y.2018-19 within the due date under section 139(1). The tax payable on the assessed income, as reduced by the advance tax paid and tax deducted at source, was Rs. 60,000. The appeal filed by the firm against the order of assessment was allowed by the Commissioner (Appeals). The Assessing Officer passed an order giving effect to the order of the Commissioner (Appeals). The tax payable by the firm as per the said order of the Assessing Officer was Rs. 2,900. The Assessing Officer has accepted the order of the Commissioner (Appeals) and has not preferred an appeal against it to the Income Tax Appellate Tribunal. The firm desires to know of the maintainability of the prosecution proceedings in the facts and circumstances of the case.
Would your answer change if the person against whom complaint was lodged was KLM Ltd., a company, instead of a firm?

**Answer**

(i) Section 276CC provides for prosecution for wilful 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 Rs. 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 a person, other than a company, 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 Rs. 3,000.

In this case, even though the tax liability of the firm as per the original order of assessment exceeded Rs. 3,000, however, as a result of the order of the Commissioner (Appeals), it got reduced to Rs. 2,900, which is less than Rs. 3,000. Therefore, since the tax liability of the firm on final assessment was determined at Rs. 2,900, 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.

(ii) Yes, in case of a company, the answer would be different and prosecution proceedings would be maintainable.

**Question 3**

Explain section 278C applicable in respect of offences committed by Hindu undivided families.

**Answer**

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

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

**Question 4**

Can the Department launch prosecution in a case where they have accepted the revised return filed by the assessee, rectifying a mistake in the original return of income?

**Answer**
This question came up before the Karnataka High Court in K.E. Sunil Babu, Asst. CIT v. Steel Processors (2006) 286 ITR 315. The High Court observed that since the Department had accepted the revised returns filed under section 139(5), it was clear that there was a bona fide mistake in the original return and there was no element of mens rea. Therefore, the High Court held that the Department cannot launch prosecution under sections 276C, 277 and 278.
EXERCISE

Question 1

“NEPTUNE” is a shipliner, used in carrying passengers and cargo, owned by M/s Thomas & Thomas of U.K. The ship carried the passengers and cargo in June, 2019 from Singapore to Chennai and vice versa and collected charges thereof amounting to Rs. 200 lacs. It left Chennai port on 15.6.2019 for its journey to Korea. No other journey to India was undertaken by any of the vessels of the company during the year ended on 31.3.2020. The non-resident company had authorized its Indian agent to comply with the income tax provisions.

You are consulted by the company to explain about the procedure as to return of income to be filed and the period within which the assessment thereof will be completed by the Assessing Officer.

Answer

M/s. Thomas & Thomas of U.K shall be required to file the return of income in India for the journey of its ship before it leaves for onward journey to Korea.

However, as per the proviso to section 172(3), where the Assessing Officer is satisfied that it is not possible for the master of the ship to furnish the return before the departure of the ship from the port, and if satisfactory arrangements have been made for filing of return and payment of tax by the authorised agent in India, he may permit filing of return within 30 days of departure of the ship.

Section 172(4A) provides a time limit of 9 months for completion of assessment in such cases. The period of 9 months is reckoned from the end of the financial year in which the return under section 172(3) is furnished.

Question 2

The directors of a private company are personally liable to pay the income tax due from the company but their liability does not extend towards interest and penalty payable by the company. Discuss.

Answer

Section 179 contains the provisions relating to the liability of directors of a private company in liquidation in respect of tax due from the company. Where any tax due from a private company in respect of income of any previous year or from any other company in respect of any income of any previous year during which such other company was a private company cannot be recovered, then, every person who was a director of such company at any time during the relevant previous year shall be jointly and severally liable for the payment of such tax. However, the director shall not be so liable if he proves that the non-recovery cannot be attributed to any gross neglect, misfeasance or breach of duty on his part in relation to the affairs of the company.

Explanation to section 179 clarifies that the expression “tax due” includes penalty, interest or any other sum payable under the Act. Therefore, the directors liability is not
confined to tax alone but extends to penalty, interest or any other sum payable by the company.

**Question 3**

In respect of the taxes due from a private limited company, which could not be recovered from it, the Tax Recovery Officer attached the properties of an erstwhile director for recovery thereof. It was contended by the director that a notice under section 156 had not been served on him and therefore, the proceedings for recovery were not valid. What is the correct legal position?

**Answer**

The liability of a director of a private limited company for arrears due from the company is provided in section 179. There is no necessity to issue a notice to a director, because the position of a person on whom liability is fastened is equated to that of an ‘assessee’ in default. For the purpose of section 220(4), the person held liable under section 179 would be deemed to be an assessee-in-default. This may be contrasted with the arrears of a partnership firm which may be recovered from the erstwhile partners only after issue of a notice under section 156 and a default is committed by them.

Under section 179, every person who was a director of a private limited company at any time during the relevant previous year shall be jointly and severally liable for the payment of taxes which cannot be recovered from the company, unless he proves that the non-recovery cannot be attributed to any gross negligence, misfeasance or breach of duty on his part in relation to the affairs of the company.

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CHAPTER 23 - MISCELLANEOUS

EXERCISE

Question 1
How does the income of a person who is trying to alienate his assets with a view to avoid tax be dealt with under the Act?

Answer
The income of a person who is trying to alienate his assets with a view to avoid tax will be dealt with as per the provisions of section 175.

Accordingly, if it appears to the Assessing Officer during any current assessment year that any person is likely to charge, sell, transfer, dispose of or otherwise part with any of his assets with a view to avoiding payment of any liability under the Income-tax Act, 1961, the total income of such person for the period from the expiry of the previous year to the date when the Assessing Officer commences proceedings under this section is chargeable to tax in that assessment year.

The total income of each completed year or part of any previous year included in such period shall be chargeable to tax at the rates in force in that assessment year and separate assessments will be made for each completed previous year or part of any previous year.

The Assessing Officer may estimate the income of such individual for such period or any part thereof, where it cannot be readily determined in the manner provided in the Act.

The tax chargeable under this section shall be in addition to tax, if any, chargeable under any other provision of the Act.

Question 2
Fearless General Finance & Investment Limited, a residuary non-banking company, accepts public deposits, issues deposit certificate and repays the same after some period of time along with interest, under different schemes run by it. Following transactions were noted from their books of account:

(i) Mr. A, an individual, has deposited Rs. 15,000 on 1st May, 2016 for 48 months by bearer cheque and another Rs. 15,000 on 30th June, 2019 in cash to purchase a new certificate of 48 months tenure.

(ii) Mr. A has applied for premature withdrawal against both the certificates and the company has paid him Rs. 16,500, by a bearer cheque, against principal and interest on 23rd March, 2020, due against his first certificate (purchased in 2016) and Rs. 15,500 in cash on 25th March, 2020, against the second certificate.

Discuss the violation of income tax provision, if any, and consequential penalty for each transaction. Will it make any difference if the certificates were held by Mr. A with his wife Mrs. A, jointly, while repaying back in cash or bearer cheque?

Answer
(i) There is no violation of section 269SS at the time of acceptance of the first deposit of Rs. 15,000 by bearer cheque on 1.5.2016, since it is not in excess of the threshold limit of Rs. 20,000. However, violation under section 269SS is attracted at the time of acceptance of the second deposit in cash on 30th June, 2019, since as on that
date, there is already an outstanding deposit of Rs. 15,000 and another cash deposit of Rs. 15,000 would take the aggregate to Rs. 30,000, which exceeds the threshold limit of Rs. 20,000. Therefore, penalty under section 271D of a sum equal to the amount of deposit taken from Mr. A is attracted for failure to comply with the provisions of section 269SS.

(ii) In this case, there is a violation of the provisions of section 269T at the time of first repayment by bearer cheque on 23rd March, 2020, since on that date, the aggregate amount of deposits held by Mr. A with the non-banking company (together with interest payable on such deposits) is more than Rs. 20,000. Therefore, penalty under section 271E equal to the amount of deposit so repaid will be attracted for failure to comply with the provisions of section 269T.

However, the second repayment of Rs. 15,500 on 25th March, 2020 in cash cannot be considered as a violation of section 269T, since neither the amount of deposit with interest thereon nor the aggregate amount of deposits held by Mr. A on that date together with interest exceeds the threshold limit of Rs. 20,000.

The provisions of section 269T will be attracted at the time of first repayment of bearer cheque even if the certificate is being held by Mr. A in joint name with his wife.

Question 3
The proceedings before the Income-tax Authorities either can be attended by the assessee in person or through an authorized representative. Who can be treated as an authorized representative of the assessee?

Answer
As per section 288, the proceedings before the income-tax authorities can be attended by an assessee in person or through an authorised representative, i.e., a person authorized by the assessee in writing to appear on his behalf, being -

(i) a person who is a relative or a regular employee of the assessee; or
(ii) any officer of a Scheduled Bank in which the assessee maintains a current account or has other regular dealings; or
(iii) a legal practitioner who is entitled to practise in any civil court in India; or
(iv) a chartered accountant within the meaning of the Chartered Accountants Act, 1949 who hold a valid certificate of practice
(v) any person who has passed any accountancy examination recognized in this behalf by the CBDT for this purpose; or
(vi) any person who has acquired such educational qualifications as prescribed by the CBDT; or
(vii) any person who, before the coming into force of this Act in the Union territory of Dadra and Nagar Haveli, Goa, Daman and Diu, or Pondicherry, attended any proceedings before an income-tax authority in the said territory on behalf of any assessee otherwise than in the capacity of an employee or relative of that assessee
(viii) any person who was actually practising as an income-tax practitioner, immediately before commencement of the Income-tax Act, 1961.
Question 4
An order for A.Y. 2018-19 was passed by the Assessing Officer as per section 143(3), but the typist wrongly typed in the order, the assessment year as A.Y.2017-18 and the relevant previous year as ending on 31.3.2017. The assessee claimed in appeal that the same is an invalid order which was not accepted by the CIT (Appeals) on the ground of the error being of clerical nature. Discuss the correctness of the order of the CIT(Appeals).

Answer
Section 292B provides that no return of income, assessment, notice or summons furnished or made or issued or taken in pursuance of any of the provisions of the Income-tax Act, 1961 shall be invalid or deemed to be invalid merely by reason of any mistake, defect or omission in such return of income, assessment or notice etc., if such return of income, assessment, notice, summons etc. is in substance and effect in conformity with or according to the intent and purpose of the Act. Therefore, a clerical mistake cannot invalidate an otherwise valid assessment. Thus, the typographical error in the assessment order as to assessment year and previous year does not make the same invalid unless established otherwise. Accordingly, the action of the CIT(Appeals) in not accepting the claim of the assessee is valid.

Question 5
“Proceedings cannot be initiated under the Act, unless a proper notice to this effect has been served upon.” In this context answer:
(i) What are the prescribed modes of service of such notice?
(ii) On whom should the notice be addressed and served upon in the cases where the assessee is a dissolved firm, a deceased person and a partitioned HUF.

Answer
(i) As per section 282(1), the service of notice or summon or requisition or order or any other communication under this Act may be made by delivering or transmitting a copy thereof to the person named therein -

(1) by post or such courier services as approved by the CBDT; or
(2) in such manner as provided in the Code of Civil Procedure, 1908 for the purposes of service of summons; or
(3) in the form of any electronic record as provided in Chapter IV of the Information Technology Act, 2000; or
(4) by any other means of transmission of documents as may be provided by rules made by the CBDT in this behalf.

The CBDT is empowered to make rules providing for the addresses (including the address for electronic mail or electronic mail message) to which such communication may be delivered or transmitted to the person named therein.

(ii) The service of notice in the given cases should be on the persons mentioned hereunder:

<table>
<thead>
<tr>
<th>Person</th>
<th>Notice to be addressed and served on</th>
</tr>
</thead>
<tbody>
<tr>
<td>A dissolved firm</td>
<td>Any person who was a partner (not being a minor) immediately before dissolution.</td>
</tr>
<tr>
<td>A deceased person</td>
<td>The legal heirs of the deceased.</td>
</tr>
<tr>
<td>-------------------</td>
<td>---------------------------------</td>
</tr>
<tr>
<td>A partitioned HUF</td>
<td>Last Manager of the HUF, or, if he is dead, then, all adult members of the erstwhile HUF.</td>
</tr>
</tbody>
</table>

**Question 6**

"Tax Recovery Officer, can recover the arrear demands from the assessee in default out of sale proceeds of the property attached after making a proclamation". How can such proclamation be made under the Act?

**Answer**

**Manner of making a proclamation**

**Movable Property** [Rules 38 & 39 of Schedule II to the Income-tax Act, 1961]

Where the Tax Recovery Officer orders sale of movable property, he should issue a proclamation in the language of the district, of the intended sale, specifying the time and place of sale and whether the sale is subject to confirmation or not.

The proclamation should be made by beat of drum or other customary mode, -

(a) in the case of property attached by actual seizure –
   (i) in the village in which the property was seized, or, if the property was seized in a town or city, then, in the locality in which it was seized; and
   (ii) at such other places as the Tax Recovery Officer may direct;
(b) in the case of property attached otherwise than by actual seizure, in such places, if any, as the Tax Recovery Officer may direct.

A copy of the proclamation should also be affixed in a conspicuous part of the office of the Tax Recovery Officer.

**Immovable Property** [Rule 54 of Schedule II to the Income-tax Act, 1961]

The Tax Recovery Officer shall make a proclamation for sale of immovable property at some place on or near such property by beat of drum or other customary mode. A copy of the proclamation shall be affixed on a conspicuous part of the property and also upon a conspicuous part of the office of the Tax Recovery Officer.

Where the Tax Recovery Officer directs, such proclamation shall also be published in the Official Gazette or in a local newspaper or in both, and the cost of such publication shall be deemed to be the cost of the sale.

Where the property to be sold is divided into lots for the purpose of being sold separately, then it is not necessary to make a separate proclamation for each lot of property, unless in the opinion of the Tax Recovery Officer, proper notice of sale cannot otherwise be given.

**Time limit for sale of attached immovable property** [Rule 68B of Schedule II to the Income - tax Act, 1961]

The sale of immovable property attached has to be made on or before the expiry of 7 years from the end of the financial year in which the order giving rise to a demand of any tax, interest, fine, penalty or any other sum, for the recovery of which the immovable property has been attached,
- has become conclusive under the provisions of section 245-I (where order of settlement under section 245D(4) is deemed to be conclusive as to the matters stated therein) or
- has become final in terms of the provisions of Chapter XX (Appeals and Revision).

However, the CBDT may, for reasons to be recorded in writing, extend the aforesaid period for a further period not exceeding 3 years.

**Question 7**

Explain the circumstances under which the Assessing Officer can resort to provisional attachment of the property of the assessee. Also, state the period of time for which such attachment can take place.

When can the Assessing Officer revoke provisional assessment of property? Discuss.

**Answer**

As per the provisions of section 281B, there can be provisional attachment to protect the interest of Revenue in certain cases i.e.-

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

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

(iii) 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.

(iv) 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.

(v) 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 assessee 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.

**Question 8**

Mr. Biswas, a stock broker, has defaulted with regard to his income-tax payments and the Assessing Officer has attached his membership card of Stock Exchange under section 281B of the Income-tax Act, 1961. Mr. Biswas contends that the membership card is not
transferable and is not his personal asset. Discuss the validity of attachment of the card by the Assessing Officer in the context of Section 281B.

**Answer**

The right of membership is not a private asset and it is merely a personal privilege granted to the member. It is non-transferable and incapable of alienation by the member or his legal representative except to the limited extent provided in the rules and regulations of the stock exchange and subject to the fulfillment of conditions prescribed by the stock exchange. The nomination, even if permitted, is subject to the rules and is not automatic. The right of nomination is vested in the stock exchange absolutely in the case of death of or default of a member. Thus, the membership card is not the property of the assessee and therefore cannot be attached under section 281B. It has been so held by the Apex Court in the case of Stock Exchange Ahmedabad vs. ACIT (2001) 248 ITR 209.

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Miscellaneous AJ Education NeXt

23.6

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CHAPTER 24 - TRANSFER PRICING AND OTHER PROVISIONS TO CHECK AVOIDANCE OF TAX

EXERCISE

Question 1
Examine the consequences that would follow if the Assessing Officer makes adjustment to arm’s length price in international transactions of the assessee resulting in increase in taxable income. What are the remedies available to the assessee to dispute such adjustment?

Answer
In case the Assessing Officer makes adjustment to arm’s length price in an international transaction which results in increase in taxable income of the assessee, the following consequences shall follow:-

(1) No deduction under section 10AA or Chapter VI-A shall be allowed from the income so increased.

(2) No corresponding adjustment would be made to the total income of the other associated enterprise (in respect of payment made by the assessee from which tax has been deducted or is deductible at source) on account of increase in the total income of the assessee on the basis of the arm’s length price so recomputed.

The remedies available to the assessee to dispute such an adjustment are:-

(1) In case the assessee is an eligible assessee under section 144C, he can file his objections to the variation made in the income within 30 days [of the receipt of draft order by him] to the Dispute Resolution Panel and Assessing Officer. Appeal against the order of the Assessing Officer in pursuance of the directions of the Dispute Resolution Panel can be made to the Income-tax Appellate Tribunal.

(2) In any other case, he can file an appeal under section 246A to the Commissioner (Appeals) against the order of the Assessing Officer within 30 days of the date of service of notice of demand.

(3) The assessee can opt to file an application for revision of order of the Assessing Officer under section 264 within one year from the date on which the order sought to be revised is communicated, provided the time limit for appeal to the Commissioner (Appeals) or the Income-tax Appellate Tribunal has expired or the assessee has waived the right of such an appeal. The eligibility conditions stipulated in section 264 should be fulfilled.

Question 2
I. Limited, an Indian Company supplied billets to its holding company, U. Limited, UK during the previous year 2019-20. I. Limited also supplied the same product to another UK based company, V. Limited, an unrelated entity. The transactions with U. Limited are priced at Euro 500 per MT (FOB), whereas the transactions with V. Limited are priced at Euro 700 per MT (CIF). Insurance and Freight amounts to Euro 200 per MT. Compute the arm's length price for the transaction with U. Limited.
Answer

In this case, I. Limited, the Indian company, supplied billets to its foreign holding company, U. Limited. Since the foreign company, U. Limited, is the holding company of I. Limited, I. Limited and U. Limited are the associated enterprises within the meaning of section 92A.

As I. Limited supplies similar product to an unrelated entity, V. Limited, UK, the transactions between I. Limited and V. Limited can be considered as comparable uncontrolled transactions for the purpose of determining the arm’s length price of the transactions between I. Limited and U. Limited. Comparable Uncontrolled Price (CUP) method of determination of arm’s length price (ALP) would be applicable in this case.

Transactions with U. Limited are on FOB basis, whereas transactions with V. Limited are on CIF basis. This difference has to be adjusted before comparing the prices.

<table>
<thead>
<tr>
<th>Amount (in Euro)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Price per MT of billets to V. Limited</td>
</tr>
<tr>
<td>Less: Cost of insurance and freight per M.T.</td>
</tr>
<tr>
<td>Adjusted Price per M.T.</td>
</tr>
</tbody>
</table>

Since the adjusted price for V. Limited, UK and the price fixed for U. Limited are the same, the arm’s length price is Euro 500 per MT. Since the sale price to related party (i.e., U. Limited) and unrelated party (i.e., V. Limited) is the same, the transaction with related party U. Limited has also been carried out at arm’s length price.

Question 3

X Ltd., operating in India, is the dealer for the goods manufactured by Yen Ltd. of Japan. Yen Ltd. owns 55% shares of X Ltd. and out of 7 directors of the company, 4 were appointed by them. The Assessing Officer, after verification of transactions of Rs. 300 lacs of X Ltd. for the relevant year and by noticing that the company had failed to maintain the requisite records and had also not obtained the accountants report, adjusted its income by making an addition of Rs. 30,00,000 to the declared income and also issued a show cause notice to levy various penalties. X Ltd seeks your expert opinion.

Answer

The facts of the case indicate that X Ltd. and Yen Ltd. of Japan are associated enterprises since Yen Ltd. holds 55% shares of X Ltd. and has appointed more than half of the board of directors of X Ltd. Since Yen Ltd. is a non-resident, any transaction between X Ltd. and Yen Ltd. would fall within the meaning of “international transaction” under section 92B. Therefore, the income arising from such transactions have to be computed having regard to the arm’s length price.

The action of the Assessing Officer in making addition to the declared income and issuing show cause notice for levy of various penalties is correct since X Ltd. had committed defaults, as listed hereunder, in respect of which penalty, as briefed hereunder, is imposable -

(i) Failure to report any international transaction or any transaction, deemed to be an international transaction or any specified domestic transaction, to which the provisions of Chapter X applies, would attract penalty @ 200% of the amount of tax payable since it is a case of misreporting of income referred under section 270A(9) read with section 270A(8).
(ii) Failure to maintain the requisite records as required under section 92D in relation to international transaction makes it liable for penalty under section 271AA which will be 2% of the value of each international transaction.

(iii) Failure to furnish report from an accountant as required under section 92E makes it liable for penalty under section 271BA i.e., a fixed penalty of Rs. 1 Lac.

The Assessing Officer shall give an opportunity of hearing to the assessee with a notice as to why the arm’s length price should not be determined on the basis of material or information or document in the possession of the Assessing Officer.

Note: It is assumed that X Ltd. has not entered into an APA and has also not opted to be subject to Safe Harbour Rules.

Question 4
Anush Motors Ltd., an Indian company declared income of Rs. 300 crores computed in accordance with Chapter IV-D but before making any adjustments in respect of the following transactions for the year ended on 31.3.2020:

(i) 10,000 cars sold to Rida Ltd. which holds 30% shares in Anush Motors Ltd. at a price which is less by $ 200 each car than the price charged from Shingto Ltd.

(ii) Royalty of $ 1,20,00,000 was paid to Kyoto Ltd. for use of technical know-how in the manufacturing of car. However, Kyoto Ltd. had provided the same know-how to another Indian company for $ 90,00,000.

(iii) Loan of Euro 1000 crores carrying interest @ 10% p.a. advanced by Dorf Ltd., a German company, was outstanding on 31.3.2020. The total book value of assets of Anush Motors Ltd. on the date was Rs. 90,000 crores. The said German company had also advanced a loan of similar amount to another Indian company @ 9% p.a. Total interest paid for the year was EURO 100 crores.

Explain in brief the provisions of the Act affecting all these transactions and compute the income of the company chargeable to tax for A.Y.2020-21 keeping in mind that the value of 1 $ and of 1 EURO was Rs. 63 and Rs. 84, respectively, throughout the year.

Answer
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 (m) to the given facts, it is clear that “Anush Motors Ltd.” is associated with :-

(i) Rida Ltd. as per section 92A(2)(a), because this company holds shares carrying more than 26% of the voting power in Anush Motors Ltd.;

(ii) Kyoto Ltd. as per section 92A(2)(g), since this company is the sole owner of the technology used by Anush Motors Ltd. in its manufacturing process;

(iii) Dorf Ltd. as per section 92A(2)(c), since this company has financed an amount which is more than 51% of the book value of total assets of Anush Motors Ltd.

The transactions entered into by Anush Motors Ltd. with different companies are, therefore, to be adjusted accordingly to work out the income chargeable to tax for the A.Y. 2020-21.
<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs. (in crores)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income of Anush Motors Ltd. as computed under Chapter IV-D, prior to adjustments as per Chapter X</td>
<td>300.00</td>
</tr>
<tr>
<td>Add: Difference on account of adjustment in the value of international transactions:</td>
<td></td>
</tr>
<tr>
<td>(i) Difference in price of car @ $ 200 each for 10,000 cars ($ 200 × 10,000 × Rs. 63)</td>
<td>12.6</td>
</tr>
<tr>
<td>(ii) Difference for excess payment of royalty of $ 30,00,000 ($ 30,00,000 × Rs. 63) [See Note below]</td>
<td>18.90</td>
</tr>
<tr>
<td>(iii) Difference for excess interest paid on loan of EURO 1000 crores (Rs. 84<em>1000</em>1/100)</td>
<td>840.00</td>
</tr>
<tr>
<td><strong>Total Income</strong></td>
<td><strong>1,171.50</strong></td>
</tr>
</tbody>
</table>

The difference for excess payment of royalty has been added back presuming that the manufacture of cars by Anush Motors Ltd is wholly dependent on the use of know-how owned by Kyoto Ltd.

**Note:** It is presumed that Anush Motors Ltd. has not entered into an Advance Pricing Agreement or opted to be subject to Safe Harbour Rules.

**Question 5**

What is the legislative objective of bringing into existence the provisions relating to transfer pricing in relation to international transactions? Examine.

**Answer**

The presence of multinational enterprises in India and their ability to allocate profits in different jurisdictions by controlling prices in intra-group transactions prompted the Government to set up an Expert Group to examine the issues relating to transfer pricing.

There is a possibility that two or more entities belonging to the same multinational group can fix up their prices for goods and services and allocate profits among the enterprises within the group in such a way that there may be either no profit or negligible profit in the jurisdiction which taxes such profits and substantial profit in the jurisdiction which is tax haven or where the tax liability is minimum. This may adversely affect a country's share of due revenue. The increasing participation of multinational groups in economic activities in India has given rise to new and complex issues emerging from transactions entered into between two or more enterprises belonging to the same multinational group. The profits derived by such enterprises carrying on business in India can be controlled by the multinational group, by manipulating the prices charged and paid in such intra-group transactions, which may lead to erosion of tax revenue. Therefore, transfer pricing provisions have been brought in by the Finance Act, 2001 with a view to provide a statutory framework which can lead to computation of reasonable, fair and equitable profits and tax in India, in the case of such multinational enterprises.

**Question 6**

R, an individual resident in India, bought 1,000 equity shares of Rs. 10 each of A Ltd. at Rs. 50 per share on 30.5.2019. He sold 700 equity shares at Rs. 35 per share on 30.9.2019 and the remaining 300 shares at Rs. 25 per share on 20.12.2019. A Ltd. declared a
dividend of 50%, the record date being 10.8.2019. R sold on 1.2.2020, a house from which he derived a long-term capital gain of Rs.75,000. Compute the amount of capital gain arising to R for the assessment year 2020-21.

**Answer**

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

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

(b) such person sells or transfers -
   (i) such securities within a period of three months after such date; or
   (ii) such unit within a period of nine months after such date; and

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

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

For this purpose, “record date” means such date as may be fixed by a company for the purpose of entitlement of the holder of the securities to receive dividend; “securities” includes stocks and shares.

**Computation of capital gains of Mr. R for the assessment year 2020-21**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Long-term capital gain on sale of building</td>
<td></td>
<td>75,000</td>
</tr>
<tr>
<td>Less: Short-term capital loss on sale of shares</td>
<td></td>
<td></td>
</tr>
<tr>
<td>700 shares</td>
<td>7,000</td>
<td></td>
</tr>
<tr>
<td>300 shares</td>
<td>7,500</td>
<td>14,500</td>
</tr>
<tr>
<td><strong>Taxable long-term capital gains</strong></td>
<td></td>
<td><strong>60,500</strong></td>
</tr>
</tbody>
</table>

**Computation of capital gain on sale of shares of A Ltd. by Mr. R**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Date of purchase of shares</th>
<th>30.5.2018</th>
<th>Record date</th>
<th>10.8.2018</th>
<th>Date of sale of shares</th>
<th>30.9.2018</th>
<th>20.12.2018</th>
<th>Number of shares sold</th>
<th>700</th>
<th>300</th>
<th>Sale price per share</th>
<th>Rs.35</th>
<th>Rs.25</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sale consideraton</td>
<td>24,500</td>
<td>7,500</td>
<td></td>
<td></td>
<td></td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Less: Cost of acquisition</td>
<td>35,000</td>
<td>15,000</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Less: Dividend income as per section 94(7)[700×Rs.10×50%]</td>
<td>10,500</td>
<td>7,500</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>[See Note below]</td>
<td>3,500</td>
<td>-</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Short-term capital loss on sale of shares</td>
<td>7,000</td>
<td>7,500</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<td></td>
</tr>
</tbody>
</table>
Note:

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

(2) 300 shares having been sold after 3 months of record date, section 94(7) is not attracted. Therefore, the dividend income of Rs. 1,500 \[300 \times \text{Rs.10}\times50\%\] should not be deducted. Such dividend is exempt under section 10(34).

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

Question 7
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 2019-20.

(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 $ 7000 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 \$ = \text{Rs.64}
XE Ltd. is located in a Special Economic (SEZ) and its income before transfer pricing adjustments for the year ended 31\textsuperscript{st} March, 2020 was \text{Rs.} 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.

Answer
XE Ltd, the Indian company and Zilla Inc., the US company are deemed to be associated enterprises as per section 92A(2)(a), since Zilla Inc. holds shares carrying not less than 26% of the voting power in XE Ltd.

As per Explanation to section 92B, the transactions entered into between these two companies for sale of product, lending or guarantee and provision of services relating to market research are included within the meaning of “international transaction”.

Accordingly, transfer pricing provisions would be attracted and the income arising from such international transactions have to be computed having regard to the arm’s length price. In this case, from the information given, the arm’s length price has to be determined taking the comparable uncontrolled price method to be the most appropriate method.

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.in lakhs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Amount by which total income of XE Ltd. is enhanced on account of adjustment in the value of international transactions:</td>
<td></td>
</tr>
<tr>
<td>(i) Difference in price of T-Shirt @ $ 1 each for 1,00,000 pieces sold to Zilla Inc. ($ 1 \times 1,00,000 \times \text{Rs. 64})</td>
<td>64.00</td>
</tr>
</tbody>
</table>
(ii) Difference for excess payment of guarantee fee to Zilla Inc. for loan borrowed from foreign lender ($ 3,000 x Rs. 64) 1.92

(iii) Difference for excess payment for services to Zilla Inc. ($ 5,000 x Rs. 64) 3.20

| 69.12 |

XE Ltd. cannot claim deduction under section 10AA in respect of Rs. 69.12 lakhs, being the amount of income by which the total income is enhanced by virtue of the first proviso to section 92C(4)

Question 8

Examine the correctness or otherwise of the following with reference to the provisions of the Income-tax Act, 1961

(i) Transfer pricing rules shall have no implication where income is computed on the basis of book profits.

(ii) Assessing Officer can complete the assessment of income from international transaction in disregard of the order passed by the Transfer Pricing Officer by accepting the contention of assessee.

Answer

(i) The statement is correct.

For the purpose of computing book profit for levy of minimum alternate tax, the net profit shown in the profit and loss account prepared in accordance with the Companies Act can be increased/decreased only by the additions and deductions specified in Explanation 1 to section 115JB.

No other adjustments can be made to arrive at the book profit for levy of MAT, except where:

(a) it is discovered that the profit and loss account is not drawn up in accordance with the relevant Schedule of the Companies Act

(b) incorrect accounting policies and/or accounting standards have been adopted for preparing such accounts; and

(c) the method and rate of depreciation adopted is not correct.

Therefore, transfer pricing adjustments cannot be made while computing book profit for levy of MAT.

(ii) The statement is not correct.

Section 92CA(4) provides that on receipt of the order of the Transfer Pricing Officer determining the arm’s length price of an international transaction, the Assessing Officer shall proceed to compute the total income in conformity with the arm’s length price determined by the Transfer Pricing Officer.

The order of the Transfer Pricing Officer is binding on the Assessing Officer. Therefore, the Assessing Officer cannot complete the assessment of income from international transactions in disregard of the order of Transfer Pricing Officer by accepting the contention raised by the assessee.
Question 9
A Ltd., an Indian company, provides technical services to a company, XYZ Inc., located in a NJA for a consideration of Rs. 40 lakhs in October, 2019. It charges Rs. 42 lakhs for similar services rendered to PQR Inc., which is not located in a NJA. PQR Inc. is not an associated enterprise of A Ltd.

Discuss the tax implications under section 94A read with section 92C in respect of the above transaction of provision of technical services by A Ltd. to XYZ Inc.

Answer
Since XYZ Inc. is located in a NJA, the transaction of provision of technical services by the Indian company, A Ltd., would be deemed to be an international transaction and XYZ Inc. and A Ltd. would be deemed to be associated enterprises. Therefore, the provisions of transfer pricing would be attracted in this case.

The price of Rs. 42 lakhs charged for similar services from PQR Inc, being an independent entity located in a non-NJA country, can be taken into consideration for determining the arm’s length price (ALP) under Comparable Uncontrolled Price (CUP) Method.

Since the ALP is more than the transfer price, the ALP of Rs. 42 lakhs would be considered as the income arising from the international transaction between A Ltd. and XYZ Inc.

Question 10
Mr. X, a non-resident individual, is due to receive interest of Rs. 5 lakhs during March 2020 from a notified infrastructure debt fund eligible for exemption under section 10(47). He incurred expenditure amounting to Rs. 10,000 for earning such income. Assuming that Mr. X is a resident of a NJA, discuss the tax implications under section 94A, read with sections 115A and 194LB.

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

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

(a) at the rate or rates in force;
(b) at the rate specified in the relevant provision of the Act;
(c) at the rate of thirty per cent.”

Mr. X can, however, claim refund of excess tax deducted along with interest.

***************************************************************************
CHAPTER 25 - NON-RESIDENT TAXATION

EXERCISE

Question 1

Peeyush, returned to India on 12th June, 2019 for permanently residing in India after a stay of about 20 years in U.K., provides the sources of his various income and seeks your opinion to know about his liability to income tax thereon in India in assessment year 2020-21:

(i) Income of rent of the flat in London which was deposited in a bank there. The flat was given on rent by him after his return to India since July, 2019.

(ii) Dividends on the shares of three German Companies which are being collected in a bank account in London. He proposes to keep the dividend on shares in London with the permission of the Reserve Bank of India.

(iii) He has got two sons, one of whom is of 12 years and other 19 years. Both his sons are staying in London and not returning to India with him. Each of his sons is having income of Rs. 75,000 in U.K. in foreign currency (not received in India) and of Rs. 20,000 in India.

(iv) During the preceding accounting year when he was a non-resident, he had sold 1000 shares which were acquired by him in British Pound Sterling and the sale proceeds were repatriated. The profit in terms of British Pound Sterling on sale of these 1000 shares was 175% of the cost at Rs. 37,500 while in terms of Indian Rupee it was Rs. 50,000.

Answer

Peeyush returned to India on 12th June 2019 for permanently residing in India after staying in UK for 20 years. During the P.Y.2019-20, he stays in India for 293 days. Since he has stayed in India for a period of 182 days or more during the previous year 2019-20, he would be a resident in India for the A.Y.2020-21. However, he would be a resident but not ordinarily resident, assuming that he was a non-resident in nine out of ten previous years preceding P.Y.2019-20 and his stay in India during the seven previous years is less than 730 days. The residential status of Peeyush for A.Y.2020-21 is, therefore, **Resident but Not Ordinarily Resident.**

As per section 5(1), only income which is received/ deemed to be received/ accrued or arisen/ deemed to accrue or arise in India is taxable in case of a Resident but not Ordinarily Resident. Income which accrues or arises outside India shall not be included in his total income, unless it is derived from a business controlled in, or a profession set up in, India.

(i) Rental income from a flat in London which was deposited in a bank there shall not be taxable in the case of a resident but not ordinarily resident, since both the accrual and receipt of income are outside India.

(ii) Dividends from shares of three German Companies, collected in a bank account in London, would also not be taxable in the case of a resident but not ordinarily resident since both the accrual and receipt of income are outside India.
(iii) As per section 64(1A), all income accruing or arising to a minor child is includible in the hands of the parent, after providing for deduction of Rs. 1,500 per child under section 10(32).

Accordingly, income of Rs. 20,000 accruing to his minor son, aged 12 years, in India is includible in the income of Peeyush, after providing deduction of Rs. 1,500. Therefore, Rs. 18,500 is includible in the income of Peeyush. Income accruing to the minor child outside India (which is also received outside India) is not includible in the income of Peeyush.

Since the other son is major, his income is not includible in the income of Peeyush.

(iv) Repatriation of sale proceeds of 1000 shares sold in the preceding accounting year, when Peeyush was a non-resident, is not taxable in the A.Y.2020-21 since it is not the income of the P.Y.2019-20.

Consequently, only the income includible under section 64(1A) would form part of the total income of Mr. Peeyush for A.Y.2020-21. Since his total income (i.e., Rs. 18,500) is less than the basic exemption limit, there would be no liability to income-tax for A.Y.2020-21.

Question 2

Mr. David, a citizen of India, serving in the Ministry of External Affairs in India, was transferred to Indian Embassy in Canada on 31.03.2019. He did not visit India any time during the previous year 2019-20. He has received the following income for the Financial Year 2019-20:

<table>
<thead>
<tr>
<th>S. No.</th>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i)</td>
<td>Salary</td>
<td>5,00,000</td>
</tr>
<tr>
<td>(ii)</td>
<td>Foreign Allowance</td>
<td>4,00,000</td>
</tr>
<tr>
<td>(iii)</td>
<td>Interest on fixed deposit from bank in India</td>
<td>1,00,000</td>
</tr>
<tr>
<td>(iv)</td>
<td>Income from agriculture in Pakistan</td>
<td>2,00,000</td>
</tr>
<tr>
<td>(v)</td>
<td>Income from house property in Pakistan</td>
<td>2,50,000</td>
</tr>
</tbody>
</table>

Compute his gross total income for Assessment Year 2020-21.

**Answer**

As per section 6(1), Mr. David is a non-resident for the A.Y. 2020-21, since he was not present in India at any time during the previous year 2019-20.

As per section 5(2), a non-resident is chargeable to tax in India only in respect of following incomes:

(i) Income received or deemed to be received in India; and

(ii) Income accruing or arising or deemed to accrue or arise in India.

In view of the above provisions, income from agriculture in Pakistan and income from house property in Pakistan would not be chargeable to tax in the hands of David, assuming that the same were received in Pakistan.

Income from ‘Salaries’ payable by the Government to a citizen of India for services rendered outside India is deemed to accrue or arise in India as per section 9(1)(iii). Hence, such income is taxable in the hands of Mr. David, even though he is a non-resident.

However, allowances or perquisites paid or allowed as such outside India by the Government to a citizen of India for rendering service outside India is exempt under section 10(7). Hence, foreign allowance of Rs. 4,00,000 is exempt under section 10(7).
Question 3

Mr. A, a citizen of India, left for USA for the purposes of employment on 1.5.2019. He has not visited India thereafter. Mr. A borrows money from his friend Mr. B, who also left India for employment purpose one week before Mr. A's departure, to the extent of Rs. 10 lakhs and buys shares in X Ltd., an Indian company. Discuss the taxability of the interest charged at 10% in B's hands where the same has been received in New York.

Answer

An individual is said to be resident in India in any previous year, if he -
(i) has been in India during that year for a total period of 182 days or more, or
(ii) has been in India during the four years immediately preceding that year for a total period of 365 days or more and has been in India for at least 60 days in that year.

In the case of an Indian citizen leaving India for the purposes of employment outside India during the previous year, the period of stay during the previous year in condition (ii) above, to qualify as a resident, would be 182 days instead of 60 days.

In this case, Mr. A is an Indian citizen who left India for employment outside India on 01.05.2019. Mr. A has been in India only from 1.4.2019 to 01.05.2019 i.e. for 31 days. Since his stay in India during the previous year 2019-20 is only 31 days, he does not satisfy the minimum criterion of 182 days stay in India for being a resident. Hence, his residential status for A.Y. 2020-21 is Non-Resident. Mr. B, who left India one week before A’s departure, is also a non-resident for the same reasons.

Section 9(1)(v) provides that income by way of interest payable by a non-resident in respect of any debt incurred, or moneys borrowed and used, for the purposes of a business or profession carried on by such person in India shall be deemed to accrue or arise in India.

Therefore, interest payable by a non-resident in respect of any debt incurred, or moneys borrowed and used, for the purpose of making or earning any income from any source other than a business or profession carried on by him in India, shall not be deemed to accrue or arise in India. Therefore, interest payable by Mr. A on money borrowed from Mr. B to invest in shares of an Indian company shall not be deemed to accrue or arise in India and hence, is not taxable in India in the hands of Mr. B.

Question 4

JJ Limited, a company incorporated in Australia has entered into an agreement with KK Limited, an Indian company for rendering technical services to the latter for setting up a fertilizer plant in Orissa. As per the agreement, JJ Limited rendered both off-shore services and on-shore services to KK Limited at fee of Rs. 1 crore and Rs. 1.5 crore, respectively. JJ Limited is of the view that it is not liable to tax in India in respect of fee of Rs. 1 crore as it is for rendering services outside India. Discuss the correctness of the view of JJ Limited.
Answer

The Explanation below section 9(2) clarifies that income by way of, inter alia, fees for technical services from services utilized in India would be deemed to accrue or arise in India under section 9(1)(vii) in case of a non-resident and be included in his total income, whether or not such services were rendered in India.

In this case, the technical services rendered by the foreign company, JJ Ltd., were for setting up a fertilizer plant in Orissa. Therefore, the services were utilized in India. Consequently, as per the Explanation below section 9(2), the fee of Rs. 2.5 crore for technical services rendered by JJ Ltd. (both off-shore and on-shore services) to KK Ltd. is deemed to accrue or arise in India and includible in the total income of JJ Ltd.

Therefore, the view of JJ Ltd. that it is not liable to tax in India in respect of fee of Rs. 1 crore (as it is for rendering services outside India) is not correct.

Question 5

Examine with reasons whether the following transactions attract income-tax in India, in the hands of recipients under section 9 of Income-tax Act, 1961:

(i) A non-resident German company, which did not have a permanent establishment in India, entered into an agreement for execution of electrical work in India. Separate payments were made towards drawings & designs, which were described as 'Engineering Fee'. The assessee contended that such business profits should be taxable in Germany as there is no business connection within the meaning of section 9(1)(i) of the Income-tax Act, 1961.

(ii) A firm of solicitors in Mumbai engaged a barrister in UK for arguing a case before Supreme Court of India. A payment of 5000 pounds was made as per terms of professional engagement.

(iii) Amount paid by Government of India for use of a patent developed by Mr. A, who is a non-resident.

(iv) Sai Engineering, a non-resident foreign company entered into a collaboration agreement on 25/6/2019, with an Indian Company and was in receipt of interest on 8% debentures for Rs. 20 lakhs, issued by Indian Company, in consideration of providing technical know-how utilised in its business in Mumbai during previous year 2019-20.

Answer

(i) Fees for technical services is taxable under section 9(1)(vii). In this case, the separate payments made towards drawings and designs (described as “engineering fee”) are in the nature of fee for technical services and, therefore, it is taxable in India by virtue of section 9(1)(vii), since the services are utilized for execution of electrical work in India [Aeg Aktiengesellschaft v. CIT (2004) 267 ITR 209 (Kar.)].

As per Explanation to section 9, where income is deemed to accrue or arise in India under section 9(1)(vii), such income shall be included in the total income of the non-resident German company, regardless of whether it has a residence or place of business or business connection in India.

(ii) As per section 9(1)(i), all income accruing or arising, whether directly or indirectly, through or from any business connection in India is deemed to accrue or arise in India.
In this case, there was a professional connection between the firm of solicitors in Mumbai and the barrister in UK. The expression “business” includes not only trade and manufacture; it includes, within its scope, “profession” as well. Therefore, the existence of professional connection amounts to existence of “business connection” under section 9(1)(i). It was so held by the Supreme Court in Barendra Prasad Roy v. ITO (1981) 129 ITR 295.

Hence, the amount of 5,000 pounds paid to the barrister in UK as per the terms of the professional engagement constitutes income which is deemed to accrue or arise in India under section 9(1)(i). Hence, it is taxable in India.

(iii) As per section 9(1)(vi), income by way of royalty payable by the Government of India is deemed to accrue or arise in India. “Royalty” means consideration for, inter alia, use of patent. Therefore, the amount paid by Government of India for use of patent developed by Mr. A, a non-resident, is deemed to accrue or arise in India. Hence, it is taxable in India in the hands of Mr. A.

(iv) Rs. 20 lakhs, being the value of debentures issued by an Indian company in consideration of providing technical know-how for use in its business in India, is in the nature of fee for technical services, deemed to accrue or arise in India to Sai Engineering, a non-resident foreign company, under section 9(1)(vii). Hence, it is taxable in India.

Further, as per section 9(1)(v), income by way of interest payable by a person who is a resident of India is deemed to accrue or arise in India. Therefore, interest income from debentures of an Indian company is deemed to accrue or arise in India in the hands of Sai Engineering by virtue of section 9(1)(v). Hence, it is taxable in India.

Note – Since the question specifically requires the candidates to examine the taxability of the above transactions under section 9, the provisions of double taxation avoidance agreement, if any, applicable in the above cases, have not been taken into consideration.

**Question 6**

Z, an American tourist, comes to India for the first time on June 17, 2019. He leaves India on September 29, 2019. Determine his residential status for the assessment year 202-21. Does it make any difference if he comes to India on a business trip or if he is an Indian citizen?

Answer

<table>
<thead>
<tr>
<th>Previous year 2019-2:</th>
<th>105 [14+31+31+29]</th>
</tr>
</thead>
<tbody>
<tr>
<td>Previous year 2018-19:</td>
<td>Nil</td>
</tr>
<tr>
<td>Previous year 2017-18:</td>
<td>Nil</td>
</tr>
<tr>
<td>and so on ……</td>
<td></td>
</tr>
</tbody>
</table>

He is non-resident for the assessment year 2020-21 as he does not satisfy any of the basic conditions. It does not make any difference if he comes on a business trip to India.

Further, in this case, it does not make any difference if he is an Indian citizen as far as the answer of non-resident is concerned. However, there is a difference in application of basic conditions as an Indian citizen who comes on a visit to India during the previous has the option of only one basic condition of 182 days to become a resident.
Question 7
M/s. Global Airlines incorporated as a company in USA operated its flights to India and vice versa during the year 2019-20 (April, 2019 to March, 2020) and collected charges of Rs. 125 lakhs for carriage of passengers and cargo out of which Rs. 65 lakhs were received in New York in U.S Dollars for the passenger fare booked from New York to Mumbai. The total expenses for the year on operation of such flights were Rs. 195 lakhs. Compute the income chargeable to tax of the foreign airlines.

Answer
As per section 44BBA, in case of a non-resident engaged in the business of operation of aircraft, 5% of the following amounts would be deemed to be the profits and gains from such business:

(a) paid or payable, whether in or out of India, to the assessee or to any person on his behalf on account of the carriage of passengers, livestock, mail or goods from any place in India; and

(b) received or deemed to be received in India by or on behalf of the assessee on account of the carriage of passengers, livestock, mail or goods from any place outside India.

In the present case, the income chargeable to tax of M/s Global Airlines applying the provisions of section 44BBA are as follows:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Fare booked from India to outside India whether received in India or not (Rs.)</th>
<th>Fare booked from New York to Mumbai (Rs.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fare</td>
<td>60,00,000</td>
<td>65,00,000</td>
</tr>
<tr>
<td></td>
<td>(1,25,00,000 – 65,00,000)</td>
<td></td>
</tr>
<tr>
<td>Deemed income @5% u/s 44BBA</td>
<td>3,00,000</td>
<td>Nil (since the amount not received in India)</td>
</tr>
<tr>
<td></td>
<td>(60,00,000 × 5%)</td>
<td></td>
</tr>
</tbody>
</table>

Question 8
Atlant Italy, a company incorporated in France, was engaged in manufacture, trade and supply equipment and services for GSM Cellular Radio Telephones Systems. It supplied hardware and software to various entities in India. Software licensed by assessee embodied the process which is required to control and manage the specific set of activities involved in the business use of its customers, and also made available to its customers, who used it to carry out their business activities. The Assessing Officer contented that the consideration for supply of software embedded in hardware is 'royalty' under section 9(1)(vi).

Examine the correctness of the action of the Assessing Officer assuming that the software that was loaded on the hardware and embedded in the system does not have any independent existence.

Answer
The issue under consideration in this case is whether consideration for supply of software embedded in hardware would tantamount to ‘royalty’ for attracting deemed accrual of income under section 9(1)(vi).

As per section 9(1)(vi), income by way of royalty payable by a person who is a non-resident would be deemed to accrue or arise in India, where the royalty is payable in respect of any right, property or information used or services utilized for the purposes of a
business or profession carried on by such person in India or for the purposes of making or earning any income from any source in India.

For this purpose, ‘royalty’ includes transfer of all or any right for use or right to use a computer software irrespective of the medium through which such right is transferred.

The facts of the case are similar to the facts in CIT v. Alcatel Lucent Canada (2015) 372 ITR 476, wherein the above issue came up before the Delhi High Court. The Court observed that the software supply is an integral part of GSM mobile telephone system and is used by the cellular operators for providing cellular services to its customers. Where payment is made for hardware in which the software is embedded and the software does not have independent functional existence, no amount could be attributed as ‘royalty’ for software in terms of section 9(1)(vi).

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

**ADDITIONAL ILLUSTRATION FOR PRACTICE:**

**Illustration 1**

ABC Inc., a Swedish company headquartered at Stockholm, not having a permanent establishment in India, has set up a liaison office in Mumbai in April, 2019 in compliance with RBI guidelines to look after its day to day business operations in India, spread awareness about the company’s products and explore further opportunities. The liaison office takes decisions relating to day to day routine operations and performs support functions that are preparatory and auxiliary in nature. The significant management and commercial decisions are, however, in substance made by the Board of Directors at Sweden.

Determine the residential status of ABC Inc. for A.Y. 2020-21.

**Solution**

Section 6(3) provide that a company would be resident in India in any previous year, if-

(i) it is an Indian company; or

(ii) its place of effective management, in that year, is in India.

In this case, ABC Inc. is a foreign company. Therefore, it would be resident in India for P.Y.2019-20 only if its place of effective management, in that year, is in India.

Explanation to section 6(3) defines “place of effective management” to mean a place where key management and commercial decisions that are necessary for the conduct of the business of an entity as a whole are, in substance made. In the case of ABC Inc., its place of effective management for P.Y.2019-20 is not in India, since the significant management and commercial decisions are, in substance, made by the Board of Directors outside India in Sweden.

ABC Inc. has only a liaison office in India through which it looks after its routine day to day business operations in India. The place where decisions relating to day to day routine operations are taken and support functions that are preparatory or auxiliary in nature are performed are not relevant in determining the place of effective management.
Hence, ABC Inc., being a foreign company is a non-resident for A.Y.2020-21, since its place of effective management is outside India in the P.Y.2019-20.

Illustration 2
J, a citizen of India, employed in the Indian Embassy at Tokyo, Japan. He received salary and allowances at Tokyo from the Government of India for the year ended 31.3.2020 for services rendered by him in Tokyo. Besides, he was allowed perquisites by the Government. He is a non-resident for the assessment year 2020-21. Examine the taxability of salary, allowances and perquisites in the hands of J for the assessment year 2020-21.

Solution
As per section 9(1)(iii), salaries payable by the Government to a citizen of India for services rendered outside India shall be deemed to accrue or arise in India. As such, salary received by J is chargeable to tax, even though he was a non-resident for A.Y. 202-21.

As per section 10(7), all allowances or perquisites paid or allowed as such outside India by the Government to a citizen of India for rendering services outside India is exempt from tax. Therefore, the allowances and perquisites received by J are exempt as per section 10(7).

Illustration 3
Mr. Soham, an Indian Citizen, left India on 20-04-2017 for the first time to setup a software firm in Singapore. On 10-04-2019, he entered into an agreement with LK Limited, an Indian Company, for the transfer of technical documents and designs to setup an automobile factory in Faridabad. He reached India along with his team to render the requisite services on 15-05-2019 and was able to complete his assignment on 20-08-2019. He left for Singapore on 21-08-2019. He charged Rs. 50 lakhs for his services from LK Limited.

Determine the residential status of Mr. Soham for the Assessment Year 2020-21 and examine whether the fees charged from LK Limited would be chargeable to tax as per the Income-tax Act, 1961.

Solution
Determination of residential status of Mr. Soham
As per section 6(1), an individual is said to be resident in India in any previous year if he satisfies the conditions:-

(i) He has been in India during the previous year for a total period of 182 days or more, or

(ii) He has been in India during the 4 years immediately preceding the previous year for a total period of 365 days or more and has been in India for at least 60 days in the previous year.

In the case of an Indian citizen leaving India for the purposes of employment outside India during the previous year or an Indian citizen, who being outside India, comes on a visit to India in any previous year, the period of stay during the previous year in condition (ii) above, to qualify as a resident, would be 182 days instead of 60 days.

In this case, Mr. Soham is an Indian citizen who left India to set up a software firm in Singapore on 20.04.2017. Therefore, he is an Indian citizen living in Singapore, who
comes on a visit to India during the P.Y.2019-20. His stay in India during the period of his visit is only 99 days (i.e., 17+30+31+21 days). Since his stay in India during the previous year 2019-20 is only 99 days, he does not satisfy the minimum criterion of 182 days stay in India for being a resident. Hence, his residential status for A.Y.2020-21 is Non-Resident.

**Taxability of income**

As per section 5(2), in case of a non-resident, only income which accrues or arises or which is deemed to accrue or arise to him in India or which is received or deemed to be received in India in the relevant previous year is taxable in India.

In this case, Mr. Soham, a non-resident, charges fees from LK Ltd., an Indian company, for transfer of technical documents and designs to set up an automobile factory in Faridabad. He renders the requisite services in India for which he stays in India for 99 days during the P.Y.2019-20.

Section 9(1)(vi) defines “royalty” to mean consideration for transfer of all or any rights in respect of, inter alia, a design and also for the rendering of services in connection with such activity. Transfer of rights in the above definition includes transfer of right for use or right to use a computer software also. Therefore, the fees received by Mr. Soham for transfer of technical documents and designs and rendering of requisite services in relation thereto would fall within the meaning of “royalty”.

As per section 9(1)(vi), income by way of royalty payable by a person who is a resident (in this case, LK Limited, an Indian company) would be deemed to accrue or arise in India in the hands of the non-resident (Mr. Soham, in this case), except where such royalty is payable in respect of any right or property or information used or for services utilized for the purpose of a business carried on by such person outside India or for the purposes of making or earning income from any source outside India.

In this case, since the royalty is payable by LK Limited, an Indian company, to Mr. Soham, a non-resident, in respect of services utilized for a business in India (namely, for setting up an automobile factory in Faridabad), the same is deemed to accrue or arise in India and is hence, taxable in India in the hands of Mr. Soham, a non-resident for the A.Y. 2020-21.

**Illustration 4**

Miss Vivitha paid a sum of 5000 USD to Mr. Kulasekhara, a management consultant practising in Colombo, specializing in project financing. The payment was made in Colombo. Mr. Kulasekhara is a non-resident. The consultancy is related to a project in India with possible Ceylonese collaboration. Is this payment chargeable to tax in India in the hands of Mr. Kulasekhara?

**Solution**

A non-resident is chargeable to tax in respect of income received outside India only if such income accrues or arises or is deemed to accrue or arise to him in India.

The income deemed to accrue or arise in India under section 9 comprises, inter alia, income by way of fees for technical services, which includes any consideration for rendering of any managerial, technical or consultancy services. Therefore, payment to a management consultant relating to project financing is covered within the scope of “fees for technical services”.

The Explanation below section 9(2) clarifies that income by way of, inter alia, fees for technical services, from services utilized in India would be deemed to accrue or arise in
India in case of a non-resident and be included in his total income, whether or not such services were rendered in India or whether or not the non-resident has a residence or place of business or business connection in India.

In the instant case, since the services were utilized in India, the payment received by Mr. Kulasekhara, a non-resident, in Colombo is chargeable to tax in his hands in India, as it is deemed to accrue or arise in India.

**Illustration 5**

Compute the total income in the hands of an individual, aged 55 years, being a resident and ordinarily resident, resident but not ordinarily resident, and non-resident for the A.Y. 2020-21:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Amount (Rs.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest on UK Development Bonds, 50% of interest received in India</td>
<td>5,000</td>
</tr>
<tr>
<td>Income from a business in Chennai (50% is received in India)</td>
<td>10,000</td>
</tr>
<tr>
<td>Short term capital gains on sale of shares of an Indian company received</td>
<td>20,000</td>
</tr>
<tr>
<td>in London</td>
<td></td>
</tr>
<tr>
<td>Dividend from British company received in London</td>
<td>5,000</td>
</tr>
<tr>
<td>Long term capital gains on sale of plant at Germany, 50% of profits are</td>
<td>40,000</td>
</tr>
<tr>
<td>received in India</td>
<td></td>
</tr>
<tr>
<td>Income earned from business in Germany which is controlled from Delhi</td>
<td>70,000</td>
</tr>
<tr>
<td>(Rs. 40,000 is received in India)</td>
<td></td>
</tr>
<tr>
<td>Profits from a business in Delhi but managed entirely from London</td>
<td>15,000</td>
</tr>
<tr>
<td>Income from house property in London deposited in an Indian Bank at</td>
<td>50,000</td>
</tr>
<tr>
<td>London, brought to India (Computed)</td>
<td></td>
</tr>
<tr>
<td>Interest on debentures in an Indian company received in London</td>
<td>12,000</td>
</tr>
<tr>
<td>Fees for technical services rendered in India but received in London</td>
<td>8,000</td>
</tr>
<tr>
<td>Profits from a business in Bombay managed from London</td>
<td>26,000</td>
</tr>
<tr>
<td>Pension for services rendered in India but received in Burma</td>
<td>4,000</td>
</tr>
<tr>
<td>Income from property situated in Pakistan received there</td>
<td>16,000</td>
</tr>
<tr>
<td>Past foreign untaxed income brought to India during the previous year</td>
<td>5,000</td>
</tr>
<tr>
<td>Income from agricultural land in Nepal received there and then brought to</td>
<td>18,000</td>
</tr>
<tr>
<td>India</td>
<td></td>
</tr>
<tr>
<td>Income from profession in Kenya which was set up in India, received there</td>
<td>5,000</td>
</tr>
<tr>
<td>but spent in India</td>
<td></td>
</tr>
<tr>
<td>Gift received on the occasion of his wedding</td>
<td>20,000</td>
</tr>
<tr>
<td>Interest on savings bank deposit in State Bank of India</td>
<td>12,000</td>
</tr>
<tr>
<td>Income from a business in Russia, controlled from Russia</td>
<td>20,000</td>
</tr>
<tr>
<td>Dividend from Reliance Petroleum Limited, an Indian Company</td>
<td>5,000</td>
</tr>
<tr>
<td>Agricultural income from a land in Rajasthan</td>
<td>15,000</td>
</tr>
</tbody>
</table>

**Solution**

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

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Resident and ordinarily resident Rs.</th>
<th>Resident but not ordinarily resident Rs.</th>
<th>Non-resident Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest on UK Development Bonds, 50% of</td>
<td>10,000</td>
<td>5,000</td>
<td>5,000</td>
</tr>
</tbody>
</table>

25.10
<table>
<thead>
<tr>
<th>Description</th>
<th>Amount in India</th>
<th>Amount in India</th>
<th>Amount in India</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest received in India</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Income from a business in Chennai (50% is received in India)</td>
<td>20,000</td>
<td>20,000</td>
<td>20,000</td>
</tr>
<tr>
<td>Short term capital gains on sale of shares of an Indian company received in London</td>
<td>20,000</td>
<td>20,000</td>
<td>20,000</td>
</tr>
<tr>
<td>Dividend from British company received in London</td>
<td>5,000</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Long term capital gain on sale of plant at Germany, 50% of profits are received in India</td>
<td>40,000</td>
<td>20,000</td>
<td>20,000</td>
</tr>
<tr>
<td>Income earned from business in Germany which is controlled from Delhi, out of which <strong>Rs. 40,000</strong> is received in India</td>
<td>70,000</td>
<td>70,000</td>
<td>40,000</td>
</tr>
<tr>
<td>Profits from a business in Delhi but managed entirely from London</td>
<td>15,000</td>
<td>15,000</td>
<td>15,000</td>
</tr>
<tr>
<td>Income from property in London deposited in a Bank at London, later on remitted to India</td>
<td>50,000</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Interest on debentures in an Indian company received in London</td>
<td>12,000</td>
<td>12,000</td>
<td>12,000</td>
</tr>
<tr>
<td>Fees for technical services rendered in India but received in London</td>
<td>8,000</td>
<td>8,000</td>
<td>8,000</td>
</tr>
<tr>
<td>Profits from a business in Bombay managed from London</td>
<td>26,000</td>
<td>26,000</td>
<td>26,000</td>
</tr>
<tr>
<td>Pension for services rendered in India but received in Burma</td>
<td>4,000</td>
<td>4,000</td>
<td>4,000</td>
</tr>
<tr>
<td>Income from property situated in Pakistan received there</td>
<td>16,000</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Past foreign untaxed income brought to India during the previous year</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Income from agricultural land in Nepal received there and then brought to India</td>
<td>18,000</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Income from profession in Kenya which was set up in India, received there but spent in India</td>
<td>5,000</td>
<td>5,000</td>
<td>-</td>
</tr>
<tr>
<td>Gift received on the occasion of his wedding [not taxable]</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Interest on savings bank deposit in State Bank of India</td>
<td>12,000</td>
<td>12,000</td>
<td>12,000</td>
</tr>
<tr>
<td>Income from a business in Russia, controlled from Russia</td>
<td>20,000</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Dividend from Reliance Petroleum Limited, an Indian Company ([Exempt under section 10(34)])</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Agricultural income from a land in Rajasthan ([Exempt under section 10(1)])</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td><strong>Gross Total Income</strong></td>
<td><strong>3,51,000</strong></td>
<td><strong>2,17,000</strong></td>
<td><strong>1,82,000</strong></td>
</tr>
<tr>
<td>Less: Deduction under section 80TTA [Interest on savings bank account subject to a maximum of <strong>Rs.10,000</strong>]</td>
<td>10,000</td>
<td>10,000</td>
<td>10,000</td>
</tr>
<tr>
<td><strong>Total Income</strong></td>
<td><strong>3,41,000</strong></td>
<td><strong>2,07,000</strong></td>
<td><strong>1,72,000</strong></td>
</tr>
</tbody>
</table>
Illustration 6

Sea Port Shipping Line, a non-resident foreign company operating its ships on the Indian Ports during the previous year ended on 31.3.2020, had collected freight of Rs. 100 lakhs, demurrages of Rs. 20 lakhs and handling charges of Rs. 10 lakhs. The expenses of operating its fleet during the year for the Indian Ports were Rs. 110 lakhs. The company denies its liability to tax in India. Examine.

Solution

The provisions of section 44B would be beneficial in this case. This section provides that in the case of an assessee, being a non-resident, engaged in the business of operation of ships, a sum equal to 7.5% of the aggregate of the following amounts would be deemed to be the profits and gains of such business chargeable to tax under the head “Profits and gains of business or profession”.

(i) The amount paid or payable, whether within India or outside, to the assessee or to any person on his behalf on account of the carriage of passengers, livestock, mail or goods shipped at any port in India; and

(ii) The amount received or deemed to be received in India by the assessee himself or by any other person on behalf of or on account of the carriage of passengers, livestock, mail or goods shipped at any port outside India.

The above amounts will include demurrage charges and handling charges.

These provisions for computation of the income from the shipping business in case of non-residents would apply notwithstanding anything to the contrary contained in the provisions of sections 28 to 43A of the Income-tax Act, 1961.

Therefore, in this case, M/s. Sea Port Shipping Line is required to pay tax in India on the basis of presumptive scheme as per the provisions of section 44B. The assessee shall not be entitled to set off any of the expenses incurred for earning of such income. Therefore, the Shipping Line is required to pay tax on deemed profit of Rs. 9.75 lacs (7.50% on the total receipts of Rs. 130 lacs). The tax payable would be reduced by the amount of tax paid under section 172(4).

Illustration 7

Mr. Q, a non-resident, operates an aircraft between Singapore and Chennai. He received the following amounts while carrying on the business of operation of aircrafts for the year ended 31.3.2020:

(i) Rs. 2 crores in India on account of carriage of passengers from Chennai.

(ii) Rs. 1 crore in India on account of carriage of goods from Chennai.

(iii) Rs. 3 crores in India on account of carriage of passengers from Singapore.

(iv) Rs. 1 crore in Singapore on account of carriage of passengers from Chennai.

The total expenditure incurred by Mr. Q for the purposes of the business during the year ending 31.3.2020 was Rs. 6.75 Crores.

Compute the income of Mr. Q chargeable to tax in India under the head “Profits and gains of business or profession” for the assessment year 2020-21.

What would be your answer in case the business was carried on by a foreign company, Q Airlines (P) Ltd?
Solution
Section 44BBA says for computing profits and gains of the business of operation of aircraft in the case of non-residents a sum equal to 5% of the aggregate of the following amounts -
(a) paid or payable, whether in or out of India, to the assessee or to any person on his behalf on account of the carriage of passengers, livestock, mail or goods from any place in India; and
(b) received or deemed to be received in India by or on behalf of the assessee on account of the carriage of passengers, livestock, mail or goods from any place outside India.

Keeping in view the provisions of section 44BBA, the income of Mr. Q chargeable to tax in India under the head "Profits and gains of business or profession" is worked out hereunder-

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Amount received in India on account of carriage of passengers from Chennai</td>
<td>2,00,00,000</td>
</tr>
<tr>
<td>Amount received in India on account of carriage of goods from Chennai</td>
<td>1,00,00,000</td>
</tr>
<tr>
<td>Amount received in India on account of carriage of passengers from Singapore</td>
<td>3,00,00,000</td>
</tr>
<tr>
<td>Amount received in Singapore on account of carriage of passengers from Chennai</td>
<td>1,00,00,000</td>
</tr>
<tr>
<td></td>
<td>7,00,00,000</td>
</tr>
</tbody>
</table>

Income from business under section 44BBA at 5% of Rs. 7,00,00,000 is Rs. 35,00,000, which is the income of Mr. Q chargeable to tax in India under the head “Profits and gains of business or profession” for the A.Y. 2020-21.

In case the assessee is a foreign company, say, Q Airlines (P) Ltd, the answer would be the same since section 44BBA does not distinguish corporate and non-corporate taxpayers who operate aircraft provided their residential status is that of non-resident.

Illustration 8
The net result of the business carried on by a branch of foreign company in India for the year ended 31.03.2020 was a loss of Rs. 100 lakhs after charge of head office expenses of Rs. 200 lakhs allocated to the branch. Explain with reasons the income to be declared by the branch in its return for the assessment year 202-21.

Solution
Section 44C restricts the allowability of the head office expenses to the extent of lower of an amount equal to 5% of the adjusted total income or the amount actually incurred as is attributable to the business of the assessee in India.

For the purpose of computing the adjusted total income, the head office expenses of Rs. 200 Lakhs charged to the profit and loss account have to be added back.

The amount of income to be declared by the assessee for A.Y. 2020-21 will be as under:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net loss for the year ended 31.03.2020</td>
<td>(100 lakhs)</td>
</tr>
<tr>
<td>Add: Amount of head office expenses to be considered separately as per section 44C</td>
<td>200 lakhs</td>
</tr>
<tr>
<td>Adjusted total income</td>
<td>100 lakhs</td>
</tr>
<tr>
<td>Less: Head Office expenses allowable under section 44C is the lower of</td>
<td></td>
</tr>
</tbody>
</table>

25.13
(i) Rs. 5 lakhs, being 5% of Rs. 100 lakhs, or
(ii) Rs. 200 lakhs.

Income to be declared in return  95 lakhs

**Illustration 9**

Mr. A, a non-resident Indian remits US $ 40,000 to India on 16.09.2005. The amount is partly utilised on 3.10.2005 for purchasing 10,000 equity shares in A Ltd, an Indian Company, at the rate of Rs. 12 per share. These shares are sold for Rs. 48 per share on 30.03.2020. Fair Market value of these shares on 31.01.2018 was Rs. 35 per share.

The telegraphic transfer buying and selling rate of US dollars adopted by the State Bank of India is as follows:

<table>
<thead>
<tr>
<th>Date</th>
<th>Buying Rate (1 US$)</th>
<th>Selling Rate (1 US $)</th>
</tr>
</thead>
<tbody>
<tr>
<td>16.09.2005</td>
<td>18</td>
<td>20</td>
</tr>
<tr>
<td>3.10.2005</td>
<td>19</td>
<td>21</td>
</tr>
<tr>
<td>30.3.2020</td>
<td>59</td>
<td>61</td>
</tr>
</tbody>
</table>

Compute Capital gain chargeable to tax for the A.Y. 2020-21 on the assumption that –
(a) These shares have not been sold through a recognised stock exchange
(b) These shares have been purchased and sold through a recognised stock exchange.

**Solution**

(a) Where the shares are not sold through recognised stock exchange

<table>
<thead>
<tr>
<th>Particulars</th>
<th>US $</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sale consideration (Rs. 4,80,000/60)</td>
<td>8000</td>
</tr>
<tr>
<td>Less: Cost of Acquisition (1,20,000/20)</td>
<td>6000</td>
</tr>
<tr>
<td><strong>Long term capital gain</strong></td>
<td><strong>2000</strong></td>
</tr>
</tbody>
</table>

Long-term capital gain converted into $ 2000 x Rs. 59 = Rs. 1,18,000

(b) Where the shares are purchased and sold through a recognised stock exchange

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sale consideration</td>
<td>4,80,000</td>
</tr>
<tr>
<td>Less: Cost of Acquisition</td>
<td></td>
</tr>
<tr>
<td>Higher of the following</td>
<td></td>
</tr>
<tr>
<td>Cost of acquisition of assets</td>
<td>1,20,000</td>
</tr>
<tr>
<td>Lower of Fair market value as on 31.1.2018 and Full value of consideration (i.e., lower of Rs. 3,50,000 and Rs. 4,80,000)</td>
<td>3,50,000</td>
</tr>
<tr>
<td><strong>Long term capital gain</strong></td>
<td><strong>1,30,000</strong></td>
</tr>
</tbody>
</table>

Long term capital gains upto Rs. 1,00,000 would be exempt. Long term capital gains exceeding Rs. 1,00,000, i.e., Rs. 30,000 is taxable @10% under section 112A.

**Illustration 10**

A non-resident Indian acquired shares in an Indian company, A Ltd., on 1.1.2009 for Rs. 1,00,000 in foreign currency. These shares are sold by him on 1.1.2019 for Rs. 3,00,000. He invests Rs. 3,00,000 in shares on 31.03.2019 and these shares are sold by him on 30.06.2019 for Rs. 3,50,000. Discuss the tax implications. Ignore the effect of first proviso to section 48.
Solution

**Computation of Long term Capital Gain for Assessment Year 2019-20**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Amount (Rs.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sale consideration</td>
<td>3,00,000</td>
</tr>
<tr>
<td>Less: Cost of Acquisition</td>
<td>1,00,000</td>
</tr>
<tr>
<td>Long term capital gain</td>
<td>2,00,000</td>
</tr>
<tr>
<td>Less: Exemption under section 115F</td>
<td>2,00,000</td>
</tr>
<tr>
<td><strong>Exempt long-term capital gain</strong></td>
<td><strong>NIL</strong></td>
</tr>
</tbody>
</table>

**Capital Gain for Assessment year 2020-21:**

1. LTCG of **Rs. 2,00,000** which was exempt in A.Y.2018-19 becomes taxable this year.
2. STCG of **Rs. 50,000** is also taxable this year.

**Illustration 11**

Mr. John, a non-resident Indian, purchased unlisted shares of an Indian Company at a cost of **Rs. 70,000** on 01.07.20010 in foreign currency. Mr. John sold the said shares for a consideration of **Rs. 2,50,000** on 01.08.2019 and the expenditure incurred wholly or exclusively in connection with the transfer is **Rs. 10,000**. Compute the taxable capital gain if he deposited in specified assets **Rs. 1,50,000** out of sale consideration. Ignore the effect of first proviso to section 48.

**Solution**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Amount (Rs.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sale Consideration</td>
<td>2,50,000</td>
</tr>
<tr>
<td>Less: Transfer Expenses</td>
<td>10,000</td>
</tr>
<tr>
<td>Net Consideration</td>
<td>2,40,000</td>
</tr>
<tr>
<td>Less: Cost of Acquisition</td>
<td>70,000</td>
</tr>
<tr>
<td>Long-term capital gain</td>
<td>1,70,000</td>
</tr>
<tr>
<td>Less: Exemption u/s 115F</td>
<td>1,06,250*</td>
</tr>
<tr>
<td><strong>Taxable long-term capital gain</strong></td>
<td><strong>63,750</strong></td>
</tr>
</tbody>
</table>

*1,70,000 × 1,50,000 = Rs. 1,06,250*

**Illustration 12**

During the financial year 2019-20, Nadal, a tennis professional and a non-Indian citizen participated in India in a Tennis Tournament and won prize money of **Rs. 15 lacs**. He contributed articles on the tournament in a local newspaper for which he was paid **Rs. 1 lac**. He was also paid **Rs. 5,00,000** by a Soft Drink company for appearance in a T.V. advertisement. Although his expenses in India were met by the sponsors, he had to incur **Rs. 3,00,000** towards his travel costs to India. He was a non-resident for tax purposes in India.

What would be his tax liability in India for A.Y. 2020-21? Is he required to file his return of income?

**Solution**

Under section 115BBA, all the three items of receipts in India viz. prize money of **Rs. 15 lakhs**, amount received from newspaper of **Rs. 1 lakh** and amount received towards
TV advertisement of Rs. 5 lakhs - are chargeable to tax. No expenditure is allowable against such receipts. The rate of tax chargeable under section 115BBA is 20%, plus health and education cess @4%. The total tax liability works out to Rs. 4,36,800 being 20.8% of Rs. 21 lakhs. Thus, Nadal will be liable to tax on the income earned in India

He is not required to file his return of income if -
(a) his total income during the previous year consists only of income arising under section 115BBA; and
(b) the tax deductible at source under the provisions of Chapter XVII-B have been deducted from such incomes.

Illustration 13

Smith, a foreign national and a cricketer came to India as a member of Australian cricket team in the year ended 31st March, 2020. He received Rs. 5 lakhs for participation in matches in India. He also received Rs. 1 lakh for an advertisement of a product on TV. He contributed articles in a newspaper for which he received Rs. 10,000. When he stayed in India, he also won a prize of Rs. 20,000 from horse racing in Mumbai. He has no other income in India during the year.

(i) Compute tax liability of Smith for Assessment Year 2020-21.
(ii) Are the income specified above subject to deduction of tax at source?
(iii) Is he liable to file his return of income for Assessment Year 2020-21?
(iv) What would have been his tax liability, had he been a match referee instead of a cricketer?

Solution

(i) Computation of tax liability of Smith for the A.Y.2020-21

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income taxable under section 115BBA</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Income from participation in matches in India</td>
<td>5,00,000</td>
<td></td>
</tr>
<tr>
<td>Advertisement of product on TV</td>
<td>1,00,000</td>
<td></td>
</tr>
<tr>
<td>Contribution of articles in newspaper</td>
<td>10,000</td>
<td></td>
</tr>
<tr>
<td>Income taxable under section 115BB</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Income from horse races</td>
<td>20,000</td>
<td></td>
</tr>
<tr>
<td><strong>Total income</strong></td>
<td>6,30,000</td>
<td></td>
</tr>
<tr>
<td>Tax@ 20% under section 115BBA on Rs. 6,10,000</td>
<td>1,22,000</td>
<td></td>
</tr>
<tr>
<td>Tax@ 30% under section 115BB on income of Rs. 20,000 from horse races</td>
<td>6,000</td>
<td></td>
</tr>
<tr>
<td>Add: Health and Education cess@4%</td>
<td>1,28,000</td>
<td>5,120</td>
</tr>
<tr>
<td><strong>Total tax liability of Smith for the A.Y.2019-20</strong></td>
<td>1,33,120</td>
<td></td>
</tr>
</tbody>
</table>

(ii) Yes, the above income is subject to tax deduction at source.

Income referred to in section 115BBA (i.e., Rs. 6,10,000, in this case) is subject to tax deduction at source@ 20% under section 194E.

Income referred to in section 115BB (i.e., Rs. 20,000, in this case) is subject to tax deduction at source@30% under section 194BB.
Since Smith is a non-resident, the amount of tax to be deducted calculated at the prescribed rates mentioned above, would be increased by health and education cess@4%.

(iii) Section 115BBA provides that if the total income of the non-resident sportsman comprises of only income referred to in that section and tax deductible at source has been fully deducted, it shall not be necessary for him to file his return of income. However, in this case, Mr. Smith has income from horse races as well. Therefore, he cannot avail the benefit of exemption from filing of return of income as contained in section 115BBA. Hence, he would be liable to file his return of income for A.Y.2020-21.

(iv) The Calcutta High Court in Indcom v. CIT (TDS)(2011) 335 ITR 485 has held that ‘match referee’ would not fall within the meaning of “sportsmen” to attract the provisions of section 115BBA. Therefore, although the payments made to non-resident ‘match referee’ are “income” which has accrued and arisen in India, the same are not taxable under the provisions of section 115BBA. They are subject to the normal rates of tax.

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax@30% under section 115BB on winnings of Rs. 20,000 from horse races</td>
<td>6,000</td>
</tr>
<tr>
<td><strong>Tax on Rs. 6,10,000 at the rates in force</strong></td>
<td></td>
</tr>
<tr>
<td>Upto Rs. 2,50,000</td>
<td>Nil</td>
</tr>
<tr>
<td>2,50,000 – 5,00,000 @ 5%</td>
<td>12,500</td>
</tr>
<tr>
<td>5,00,000 – 6,10,000 @ 20%</td>
<td>22,000</td>
</tr>
<tr>
<td>Add: Health and Education cess@4%</td>
<td></td>
</tr>
<tr>
<td></td>
<td>1,620</td>
</tr>
<tr>
<td></td>
<td><strong>42,120</strong></td>
</tr>
</tbody>
</table>
EXERCISE

Question 1
Cosmos Limited, a company incorporated in Mauritius, has a branch office in Hyderabad opened in April, 2019. The Indian branch has filed return of income for assessment year 2020-21 disclosing income of Rs. 50 lacs. It paid tax at the rate applicable to domestic company i.e. 30% plus education cess on the basis of paragraph 2 of Article 24 (Non- Discrimination) of the Double Taxation Avoidance Agreement between India and Mauritius, which reads as follows:

"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 in the same circumstances."

However, the Assessing Officer computed tax on the Indian branch at the rate applicable to a foreign company i.e. 40% plus education cess.

Is the action of the Assessing Officer in accordance with law?

Answer

Under section 90(2), where the Central Government has entered into an agreement for avoidance of double taxation with the Government of any country outside India or specified territory outside India, as the case may be, then, in relation to the assessee to whom such agreement applies, the provisions of the Income-tax Act, 1961 shall apply to the extent they are more beneficial to the assessee. Thus, in view of paragraph 2 of the Article 24 (Non- discrimination of the Double Taxation Avoidance Agreement (DTAA), it appears that the Indian branch of Cosmos Limited, incorporated in Mauritius, is liable to tax in India at the rate applicable to domestic company (30%), which is lower than the rate of tax applicable to a foreign company (40%).

However, Explanation 1 to section 90 clarifies that the charge of tax in respect of a foreign company at a rate higher than the rate at which a domestic company is chargeable, shall not be regarded as less favourable charge or levy of tax in respect of such foreign company. Therefore, in view of this Explanation, the action of the Assessing Officer in levying tax @40% on the Indian branch of Cosmos Ltd. is in accordance with law.

Question 2
Kalpesh Kumar, a resident individual, is a musician deriving income of Rs. 7,50,000 from concerts performed outside India. Tax of Rs. 1,00,000 was deducted at source in the country where the concerts were performed. India does not have any double tax avoidance agreement with that country. His income in India amounted to Rs. 30,00,000.

Compute tax liability of Kalpesh Kumar for the assessment year 2019-20 assuming he has deposited Rs. 1,50,000 in Public Provident Fund and paid medical insurance premium in respect of his father, resident in India, aged 65 years, Rs. 52,000.
Answer

Computation of tax liability of Mr. Kalpesh for A.Y.2020-21

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Indian Income</td>
<td>30,00,000</td>
<td></td>
</tr>
<tr>
<td>Foreign Income</td>
<td>7,50,000</td>
<td></td>
</tr>
<tr>
<td><strong>Gross Total Income</strong></td>
<td>37,50,000</td>
<td></td>
</tr>
<tr>
<td>Less: Deduction under section 80C</td>
<td></td>
<td>1,50,000</td>
</tr>
<tr>
<td>PPF Contribution</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Deduction under section 80D</td>
<td></td>
<td>2,00,000</td>
</tr>
<tr>
<td>Medical insurance premium of father, being a resident senior citizen, restricted to</td>
<td>50,000</td>
<td></td>
</tr>
<tr>
<td><strong>Total Income</strong></td>
<td>35,50,000</td>
<td>35,100</td>
</tr>
<tr>
<td>Tax on total income</td>
<td>8,77,500</td>
<td></td>
</tr>
<tr>
<td>Add: Health and Education cess @4%</td>
<td>9,12,600</td>
<td></td>
</tr>
<tr>
<td>Average rate of tax in India [i.e., Rs. 9,12,600 /Rs. 35,50,000 x 100]</td>
<td>25.71%</td>
<td></td>
</tr>
<tr>
<td>Average rate of tax in foreign country [i.e. Rs. 1,00,000/ Rs. 7,50,000 x 100]</td>
<td>13.33%</td>
<td></td>
</tr>
<tr>
<td>Doubly taxed income</td>
<td>7,50,000</td>
<td>1,00,000</td>
</tr>
<tr>
<td>Deduction under section 91 on Rs. 7,50,000 @13.33% (lower of average Indian tax rate and foreign tax rate)</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Tax payable in India [Rs. 9,12,600 – Rs.1,00,000]</strong></td>
<td>8,12,600</td>
<td></td>
</tr>
</tbody>
</table>

Note: An assessee shall be allowed deduction under section 91 provided all the following conditions are fulfilled:

(a) The assessee is a resident in India during the relevant previous year.
(b) The income accrues or arises to him outside India during that previous year.
(c) Such income is not deemed to accrue or arise in India during the previous year.
(d) The income in question has been subjected to income-tax in the foreign country in the hands of the assessee and the assessee has paid tax on such income in the foreign country.
(e) There is no agreement under section 90 for the relief or avoidance of double taxation between India and the other country where the income has accrued or arisen.

In this case, Kalpesh Kumar is eligible for deduction under section 91 since all the above conditions are fulfilled.

Question 3

The following are the particulars of income earned by Miss Vivitha, a resident Indian aged 25, for the assessment year 202-21:

<table>
<thead>
<tr>
<th>(Rs. In lacs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income from playing snooker matches in country L</td>
</tr>
<tr>
<td>Tax paid in country L</td>
</tr>
<tr>
<td>Income from playing snooker tournaments in India</td>
</tr>
<tr>
<td>Life Insurance Premium paid</td>
</tr>
<tr>
<td>Medical Insurance Premium paid for her father aged 62 years (paid through credit card)</td>
</tr>
</tbody>
</table>
Compute her total income and tax liability for the assessment year 2020-21. There is no Double Taxation Avoidance Agreement between India and country L.

**Answer**

Computation of total income and tax liability of Miss Vivitha for the A.Y. 2020-21

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Indian Income [Income from playing snooker tournaments in India]</td>
<td>19,20,000</td>
<td></td>
</tr>
<tr>
<td>Foreign Income [Income from playing snooker matches in country L]</td>
<td>12,00,000</td>
<td></td>
</tr>
<tr>
<td><strong>Gross Total Income</strong></td>
<td>31,20,000</td>
<td></td>
</tr>
</tbody>
</table>

Less: Deduction under Chapter VIA

**Deduction under section 80C**  
Life insurance premium of Rs. 1,10,000 paid during the previous year deduction, is within the overall limit of Rs. 1.5 lakh. Hence, fully allowable as deduction

**Deduction under section 80D**  
Medical insurance premium of Rs. 54,000 paid for her father aged 62 years. Since her father is a senior citizen, the deduction is allowable to a maximum of Rs. 50,000 (assuming that her father is also a resident in India). Further, deduction is allowable where payment is made by any mode other than cash. Here payment is made by credit card hence, eligible for deduction.

**Total Income**  
29,60,000

**Tax on Total Income**

Income-tax  
7,00,500
Add: Health and education cess @4%  
28,020

Average rate of tax in India  
(i.e. Rs. 7,28,520/Rs. 29,60,000 × 100)  
24.61%
Average rate of tax in foreign country (i.e. Rs. 1,80,000/Rs. 12,00,000 × 100)  
15.00%

Deduction under section 91 on Rs. 12 lakh @ 15% (lower of average Indian-tax rate or average foreign tax rate)  
1,80,000
Tax payable in India (Rs. 7,28,520 – Rs. 1,80,000)  
5,48,520

**Note**: Miss Vivitha shall be allowed deduction under section 91, since the following conditions are fulfilled:-

(a) She is a resident in India during the relevant previous year.
(b) The income accrues or arises to her 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 the foreign country L in her hands and she has paid tax on such income in the foreign country L.
(d) There is no agreement under section 90 for the relief or avoidance of double taxation between India and country L where the income has accrued or arisen.
Question 4
The concept of Permanent Establishment is one of the most important concepts in determining the tax implications of cross border transactions. Examine the significance thereof, when such transactions are governed by Double Taxation Avoidance Agreements (DTAA).

Answer
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 in the country of source, and such income can be attributed to the permanent establishment.

As per section 92F(iiia), the term “Permanent Establishment” includes 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 permanent establishment in India.

Therefore, in cases covered by DTAAs, where there is no permanent establishment in India, business income cannot be brought to tax due to existence of business connection as per section 9(1)(i).

However, in cases not covered by DTAAs, business income attributable to business connection is taxable.

Question 5
An individual resident in India, having income earned outside India in a country with which no agreement under section 90 exists, asks you to examine whether the credit for the tax paid on the foreign income will be allowed against his income-tax liability in India.

Answer
The assessee is a resident in India and accordingly, the income accruing or arising to him globally is chargeable to tax in India. However, section 91 specifies that if a person resident in India has paid tax in any country with which no agreement under section 90 exists, then, for the purpose of relief or avoidance of double taxation, a deduction is allowed from the Indian income-tax payable by him, of a sum calculated on such doubly taxed income at Indian rate of tax or the rate of tax of such foreign country, whichever is lower, or at the Indian rate of tax, if both the rates are equal.

Accordingly, the assessee shall not be given any credit of the tax paid on the income in other country, but shall be allowed a deduction from the Indian income-tax payable by him as per the scheme of section 91.

Question 6
The Income-tax Act, 1961 provides for taxation of a certain income earned in India by Mr. X, a non-resident. The Double Taxation Avoidance Agreement, which applies to Mr. X provides for taxation of such income in the country of residence. Is Mr. X liable to pay tax on such income earned by him in India? Examine.
Answer

Section 90(2) makes it clear that where the Central Government has entered into a Double Taxation Avoidance Agreement with a country outside India, then in respect of an assessee to whom such agreement applies, the provisions of the Act shall apply to the extent they are more beneficial to the assessee. This means that where tax liability is imposed by the Act, the Double Taxation Agreement may be resorted to for reducing or avoiding the tax liability.

However, as per section 90(4), the assessee, in order to claim relief under the agreement, has to obtain a certificate [Tax Residence Certificate (TRC)] from the Government of that country, declaring the residence of the country outside India. Further, he also has to provide the following information in Form No. 10F:

(i) Status (individual, company, firm etc.) of the assessee;
(ii) PAN of the assessee, if allotted;
(iii) Nationality (in case of an individual) or country or specified territory of incorporation or registration (in case of others);
(iv) Assessee's tax identification number in the country or specified territory of residence and in case there is no such number, then, a unique number on the basis of which the person is identified by the Government of the country or the specified territory of which the assessee claims to be a resident;
(v) Period for which the residential status, as mentioned in the certificate referred to in section 90(4) or section 90A(4), is applicable; and
(vi) Address of the assessee in the country or specified territory outside India, during the period for which the certificate, as mentioned in (v) above, is applicable.

However, the assessee may not be required to provide the information or any part thereof, if the information or the part thereof, as the case may be, is already contained in the TRC referred to in section 90(4) or section 90A(4).

The Supreme Court has held, in CIT v. P.V.A.L. Kulandagan Chettiar (2004) 267 ITR 654, that in case of any conflict between the provisions of the Double Taxation Avoidance Agreement and the Income-tax Act, 1961, the provisions of the Double Taxation Avoidance Agreement would prevail over those of the Income-tax Act, 1961. Mr. X is, therefore, not liable to pay tax on the income earned by him in India provided he submits the Tax Residence Certificate obtained from the government of the other country, and provides such other documents and information as may be prescribed.

Question 7

Arif is a resident of both India and another foreign country in the previous year 2019-20. He owns immovable properties (including residential house) in both the countries. He earned income of Rs. 50 lacs from rubber estates in the foreign country during the financial year 2019-20. He also sold some house property situated in foreign country resulting in short-term capital gain of Rs. 10 lacs during the year. Arif has no permanent establishment of business in India. However, he has derived rental income of Rs. 6 lacs from property let out in India and he has a house in Lucknow where he stays during his visit to India.

Article 4 of the Double Taxation Avoidance Agreement between India and the foreign country where Arif is a resident, provides that “where an individual is a resident of both the Contracting States, then he shall be deemed to be resident of the Contracting State in which he has permanent home available to him. If he has permanent home in both the
Contracting States, he shall be deemed to be a resident of the Contracting State with which his personal and economic relations are closer (centre of vital interests). You are required to examine with reasons whether the business income of Arif arising in foreign country and the capital gains in respect of sale of the property situated in foreign country can be taxed in India.

**Answer**

Section 90(1) of the Income-tax Act, 1961 empowers the Central Government to enter into an agreement with the Government of any country outside India for avoidance of double taxation of income under the Indian law and the corresponding law of that country. Section 90(2) provides that where the Central Government has entered into an agreement with the Government of any other country for granting relief of tax or for avoidance of double taxation, then, in relation to the assessee to whom such agreement applies, the provisions of the Income-tax Act, 1961 shall apply to the extent they are more beneficial to that assessee.

Arif has residential houses both in India and foreign country. Thus, he has a permanent home in both the countries. However, he has no permanent establishment of business in India. The Double Taxation Avoidance Agreement (DTAA) with foreign country provides that where an individual is a resident of both the countries, he shall be deemed to be resident of that country in which he has a permanent home and if he has a permanent home in both the countries, he shall be deemed to be resident of that country, which is the centre of his vital interests i.e. the country with which he has closer personal and economic relations.

Arif owns rubber estates in a foreign country from which he derives business income. However, Arif has no permanent establishment of his business in India. Therefore his personal and economic relations with foreign country are closer, since foreign country is the place where –

(a) the property is located and  
(b) the permanent establishment (PE) has been set-up

Therefore, he shall be deemed to be resident of the foreign country for A.Y. 2020-21. The fact of the case and issues arising therefrom are similar to that of CIT vs. P.V.A.L. Kulandagan Chettiar (2004) 267 ITR 654, where the Supreme Court held that if an assessee is deemed to be a resident of a contracting State where his personal and economic relations are closer, then in such a case, the fact that he is a resident in India to be taxed in terms of sections 4 and 5 would become irrelevant, since the DTAA prevails over sections 4 and 5.

However, as per section 90(4), in order to claim relief under the agreement, Arif has to obtain a certificate [Tax Residency Certificate (TRC)] declaring his residence of the country outside India from the Government of that country. Further, he also has to provide such other documents and information, as may be prescribed.

Therefore, in this case, Arif is not liable to income tax in India for assessment year 2020-21 in respect of business income and capital gains arising in the foreign country provided he furnishes the Tax Residency Certificate and provides such other documents and information as may be prescribed.
Question 8

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 2019-20. India has not entered into double taxation avoidance agreement with these two countries.

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income from profession carried on in India</td>
<td>7,50,000</td>
</tr>
<tr>
<td>Agricultural income in Country &quot;X&quot; (gross)</td>
<td>50,000</td>
</tr>
<tr>
<td>Dividend received from a company incorporated in Country &quot;Y&quot; (gross)</td>
<td>1,50,000</td>
</tr>
<tr>
<td>Royalty income from a literary book from Country &quot;X&quot; (gross)</td>
<td>6,00,000</td>
</tr>
<tr>
<td>Expenses incurred for earning royalty</td>
<td>50,000</td>
</tr>
<tr>
<td>Business loss in Country &quot;Y&quot; (Proprietary business)</td>
<td>65,000</td>
</tr>
<tr>
<td>Rent from a house situated in Country &quot;Y&quot; (gross)</td>
<td>2,40,000</td>
</tr>
<tr>
<td>Municipal tax in respect of the above house (not allowed as deduction in country “Y”)</td>
<td>10,000</td>
</tr>
</tbody>
</table>

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 2020-21.

Answer

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

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Income from House Property [House situated in country Y]</strong></td>
<td></td>
</tr>
<tr>
<td>Gross Annual Value</td>
<td>2,40,000</td>
</tr>
<tr>
<td>Less: Municipal taxes (assumed as paid in that country)</td>
<td>10,000</td>
</tr>
<tr>
<td>Net Annual Value</td>
<td>2,30,000</td>
</tr>
<tr>
<td>Less: Deduction under section 24 – 30% of NAV</td>
<td>69,000</td>
</tr>
<tr>
<td><strong>Profits and Gains of Business or Profession</strong></td>
<td></td>
</tr>
<tr>
<td>Income from profession carried on in India</td>
<td>7,50,000</td>
</tr>
<tr>
<td>Royalty income from a literary book from Country X (after deducting expenses of Rs. 50,000)</td>
<td>5,50,000</td>
</tr>
<tr>
<td>Less: Business loss in country Y set-off</td>
<td>65,000</td>
</tr>
<tr>
<td><strong>Income from Other Sources</strong></td>
<td></td>
</tr>
<tr>
<td>Agricultural income in country X</td>
<td>50,000</td>
</tr>
<tr>
<td>Dividend received from a company in country Y</td>
<td>1,50,000</td>
</tr>
<tr>
<td><strong>Gross Total Income</strong></td>
<td>15,96,000</td>
</tr>
<tr>
<td>Less: Deduction under Chapter VIA</td>
<td></td>
</tr>
<tr>
<td>Under section 80QQB – Royalty income of a resident from literary work</td>
<td>3,00,000</td>
</tr>
<tr>
<td><strong>Total Income</strong></td>
<td>12,96,000</td>
</tr>
</tbody>
</table>

**Computation of tax liability of Mr. Kamesh for A.Y.2020-21**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax on total income [30% of Rs. 2,96,000 + Rs. 1,12,500]</td>
<td>2,01,300</td>
</tr>
<tr>
<td>Add: Health and Education cess@4%</td>
<td>8,052</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>2,09,352</td>
</tr>
<tr>
<td>Less: Deduction under section 91 (See Working Note below)</td>
<td>69,739</td>
</tr>
</tbody>
</table>
Working Note: Calculation of Rebate under section 91

<table>
<thead>
<tr>
<th>Description</th>
<th>Rs.</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Average rate of tax in India [i.e., Rs. 2,09,352 / Rs. 12,96,000 x 100]</td>
<td></td>
<td>16.154%</td>
</tr>
<tr>
<td>Average rate of tax in country X</td>
<td></td>
<td>10%</td>
</tr>
<tr>
<td>Doubly taxed income pertaining to country X</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Agricultural Income</td>
<td>50,000</td>
<td></td>
</tr>
<tr>
<td>Royalty Income [Rs. 6,00,000 – Rs. 50,000 (Expenses) – Rs. 3,00,000 (deduction under section 80QQB)]</td>
<td>2,50,000</td>
<td></td>
</tr>
<tr>
<td>Deduction under section 91 on Rs. 3,00,000 @10% [being the lower of average Indian tax rate (16.154%) and foreign tax rate (10%)]</td>
<td>3,00,000</td>
<td>30,000</td>
</tr>
<tr>
<td>Average rate of tax in country Y</td>
<td></td>
<td>25%</td>
</tr>
<tr>
<td>Doubly taxed income pertaining to country Y</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Income from house property</td>
<td>1,61,000</td>
<td></td>
</tr>
<tr>
<td>Dividend</td>
<td>1,50,000</td>
<td></td>
</tr>
<tr>
<td>Less: Business loss set-off</td>
<td>3,11,000</td>
<td>65,000</td>
</tr>
<tr>
<td>Deduction under section 91 on Rs. 2,46,000 @16.154% (being the lower of average Indian tax rate (16.154%) and foreign tax rate (25%))</td>
<td>2,46,000</td>
<td>39,739</td>
</tr>
<tr>
<td>Total rebate under section 91 (Country X + Country Y)</td>
<td></td>
<td>69,739</td>
</tr>
</tbody>
</table>

Note: Mr. Kamesh 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 (i.e., P.Y.2019-20).
(b) The income in question accrues or arises to him outside India in foreign countries X and Y 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 the foreign countries X and Y in his hands and it is presumed that he has paid tax on such income in those countries.
(d) There is no agreement under section 90 for the relief or avoidance of double taxation between India and Countries X and Y where the income has accrued or arisen.

Question 9
Examine the correctness or otherwise of the following statement with reference to the provisions of Income-tax Act, 1961.
The double taxation avoidance treaties entered into by the Government of India override the domestic law.

Answer
The statement is correct.
Section 90(2) provides that where a double taxation avoidance treaty is entered into by the Government, the provisions of the Income-tax Act, 1961 would apply to the extent they are more beneficial to the assessee.
In case of any conflict between the provisions of the double taxation avoidance agreement and the Income-tax Act, 1961, the provisions of the DTAA would prevail over the Act in view of the provisions of section 90(2), to the extent they are more beneficial to the assessee [CIT v. P.V.A.L. Kuldagan Chettiar (2004) 267 ITR 654 (SC)].

**Question 10**

Nandita, an individual resident retired employee of the Prasar Bharati aged 60 years, is a well-known dramatist deriving income of Rs. 1,10,000 from theatrical works played abroad. Tax of Rs. 11,000 was deducted in the country where the plays were performed. India does not have any Double Tax Avoidance Agreement under section 90 of the Income-tax Act, 1961, with that country. Her income in India amounted to Rs. 6,10,000. In view of tax planning, she has deposited Rs. 1,50,000 in Public Provident Fund and paid contribution to approved Pension Fund of LIC Rs. 32,000. She also contributed Rs. 28,000 to Central Government Health Scheme during the previous year and gave payment of medical insurance premium of Rs. 26,000 to insure the health of her father, a non-resident aged 84 years, who is not dependent on her. Compute the tax liability of Nandita for the Assessment year 2020-21.

**Answer**

**Computation of tax liability of Nandita for the A.Y. 2020-21**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Indian Income</td>
<td>5,10,000</td>
<td></td>
</tr>
<tr>
<td>Foreign Income</td>
<td>1,10,000</td>
<td></td>
</tr>
<tr>
<td><strong>Gross Total Income</strong></td>
<td><strong>7,20,000</strong></td>
<td></td>
</tr>
<tr>
<td>Less: Deduction under section 80C</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Deposit in PPF</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Under section 80CCC</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Contribution to approved Pension Fund of LIC</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Under section 80CCE</td>
<td></td>
<td></td>
</tr>
<tr>
<td>The aggregate deduction under section 80C, 80CCC and 80CCD(1) has to be restricted to Rs. 1,50,000</td>
<td>1,50,000</td>
<td></td>
</tr>
<tr>
<td>Contribution to Central Government Health Scheme Rs. 28,000</td>
<td>28,000</td>
<td></td>
</tr>
<tr>
<td>Since she is a resident senior citizen, the deduction is allowable to a maximum of Rs. 50,000 (See Note 1)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Medical insurance premium of Rs. 26,000 paid for father aged 84 years. Since the father is a non-resident in India, he will not be entitled for the higher deduction of Rs. 50,000 eligible for a senior citizen, who is resident in India. Hence, the deduction will be restricted to maximum of Rs. 25,000.</td>
<td>25,000</td>
<td>2,03,000</td>
</tr>
<tr>
<td><strong>Total Income</strong></td>
<td><strong>5,17,000</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Tax on Total Income</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Income-tax (See Note below)</td>
<td>13,400</td>
<td></td>
</tr>
<tr>
<td>Add: Health and Education Cess @4%</td>
<td>536</td>
<td></td>
</tr>
<tr>
<td><strong>Average rate of tax in India</strong> (i.e. Rs.13,936/Rs. 5,17,000 × 100)</td>
<td>2.696%</td>
<td></td>
</tr>
</tbody>
</table>
Average rate of tax in foreign country
(i.e. Rs. 1,10,000/Rs. 1,1,00,000 × 100)

<table>
<thead>
<tr>
<th>Deduction under section 91 on Rs. 1,10,000 @ 2.696% (lower of average Indian-tax rate or average foreign tax rate)</th>
<th>10%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax payable in India (Rs. 13,936 – Rs. 2,966)</td>
<td>2,966</td>
</tr>
</tbody>
</table>

Notes:

1. Section 80D allows a higher deduction of up to Rs. 50,000 in respect of the medical premium paid to insure the health of a senior citizen. Therefore, Nandita will be allowed deduction of Rs. 28,000 under section 80D, since she is a resident Indian of the age of 60 years.

2. The basic exemption limit for senior citizens is Rs. 3,00,000 and the age criterion for qualifying as a “senior citizen” for availing the higher basic exemption limit is 60 years. Accordingly, Nandita is eligible for the higher basic exemption limit of Rs. 3,00,000, since she is 60 years old.

3. An assessee shall be allowed deduction under section 91 provided all the following conditions are fulfilled:
   (a) The assessee is a resident in India during the relevant previous year.
   (b) The income accrues or arises to him outside India during that previous year.
   (c) Such income is not deemed to accrue or arise in India during the previous year.
   (d) The income in question has been subjected to income-tax in the foreign country in the hands of the assessee and the assessee has paid tax on such income in the foreign country.
   (e) There is no agreement under section 90 for the relief or avoidance of double taxation between India and the other country where the income has accrued or arisen.

In this case, since all the above conditions are satisfied, Nandita is eligible for deduction under section 91.

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CHAPTER 27 - ADVANCE RULING

EXERCISE

Question 1
Examine whether a person resident in India can seek advance ruling from the Authority for Advance Ruling.

Answer
A resident can make an application to the Authority for Advance Ruling to seek an advance ruling in the following cases:

(i) Section 245N(b)(A)(III) enables a resident referred in section 245N(a)(iia) falling within any such class or category of persons as may be notified by the Central Government to make an application to Authority for Advance Rulings. Such notified resident applicant can seek ruling in relation to his tax liability arising out of a transaction which has been undertaken or is proposed to be undertaken by such applicant, and such determination shall include the determination of any question of law or of fact specified in the application.

A resident in relation to his tax liability arising out of one or more transactions valuing Rs. 100 crore or more in total which has been undertaken or proposed to be undertaken would be an applicant for this purpose.

(ii) Section 245N(b)(A)(IV) enables a resident falling within any such class or category of persons as may be notified by the Central Government to make an application for Advance Ruling. Such notified resident applicant can seek ruling in respect of issues relating to computation of total income which is pending before any income-tax authority or the Appellate Tribunal. Such a resident applicant can make an application to seek determination or decision by the AAR on a question of law or a question of fact relating to such computation of total income specified in the application.

“Public sector companies” as defined in section 2(36A) of the Income-tax Act, 1961 have been notified as applicant for this purpose.

(iii) A resident can also make an application seeking advance ruling in relation to the tax liability of a non-resident arising out of a transaction undertaken or proposed to be undertaken by him with such non-resident.

(iv) A resident can make an application seeking advance ruling on whether an arrangement proposed to be undertaken by him is an impermissible avoidance arrangement under Chapter X-A.

Question 2
Q, a non-resident, made an application to the Authority for Advance Rulings on 2.7.2019 in relation to a transaction proposed to be undertaken by him. On 31.8.2019, he decides to withdraw the said application. Can he withdraw the application on 31.8.2019?

Answer
Section 245Q(3) of the Income-tax Act, 1961 provides that an applicant, who has sought for an advance ruling, may withdraw the application within 30 days from the date of the application. Since more than 30 days have elapsed since the date of application by Q to the Authority for Advance Rulings, he cannot withdraw the application.
However, the Authority for Advance Rulings (AAR), in M.K.Jain AAR No.644 of 2004, has observed that though section 245Q(3) provides that an application may be withdrawn by the applicant within 30 days from the date of the application, this, however, does not preclude the AAR from permitting withdrawal of the application after the said period with the permission of the AAR, if the circumstances of the case so justify.

Question 3
Examine when can an advance ruling pronounced by the Authority for Advance Rulings be declared void. What is the consequence?

Answer
As per section 245T, an advance ruling can be declared to be void ab initio by the Authority for Advance Rulings if, on a representation made to it by the Principal Commissioner or Commissioner or otherwise, it finds that the ruling has been obtained by fraud or misrepresentation of facts. Thereafter, all the provisions of the Act will apply as if no such advance ruling has been made. A copy of such order shall be sent to the applicant and the Principal Commissioner or Commissioner.

Question 4
Mr. Balram is a non-resident. The appeal pertaining to the assessment year 2018-19 is pending before the Income-tax Appellate Tribunal, the issue involved being computation of export profit and tax thereon. The same issue persists for the assessment year 2019-20 as well. Mr. Balram’s brother Mr. Krishna has obtained an advance ruling under Chapter XIX - B of Income-tax Act, 1961 from the Authority for Advance Ruling on an identical issue. Mr. Balram proposes to use the said ruling for his assessment pertaining to the assessment year 2019-20. Can he do so?

Answer
As per section 245S(1), the advance ruling pronounced under section 245R by the Authority for Advance Rulings shall be binding only on the applicant who had sought it and in respect of the specific transaction in relation to which advance ruling was sought. It shall also be binding on the Principal Commissioner/Commissioner and the income-tax authorities subordinate to him, in respect of the concerned applicant and the specific transaction.

In view of the above provision, Mr. Balram cannot use the advance ruling, obtained on an identical issue by his brother, for his assessment pertaining to the assessment year 2019-20.

Note – Though the ruling of the Authority for Advance Rulings is not binding on others but there is no bar on the Tribunal taking a view or forming an opinion in consonance with the reasoning of the Authority for Advance Rulings de hors the binding nature [CIT v. P. Sekar Trust (2010) 321 ITR 305 (Mad.)].

Question 5
The Authority for Advance Rulings has the powers of compelling the production of books of account – Examine the correctness or otherwise of this statement.

Answer
The statement is correct.

Under section 245U, the Authority for Advance Rulings shall have all the powers vested in the Civil Court under the Code of Civil Procedure, 1908 as are referred to in section 131.
Accordingly, the Authority for Advance Rulings shall have the same powers as are vested in a court under the Code of Civil Procedure, 1908, when trying a suit in respect of the following matters, namely -

1. discovery and inspection;
2. enforcing the attendance of any person, including any officer of a banking company and examining him on oath;
3. compelling the production of books of account and other documents; and
4. issuing commissions.

Therefore, the Authority for Advance Ruling has the powers of compelling the production of books of account.

**Question 6**

The term 'Advance Ruling' includes within its scope, a determination by the Authority for Advance Rulings only in relation to a transaction undertaken by a non-resident applicant. Examine the correctness of this statement, with reference to the provisions of the Income-tax Act 1961.

**Answer**

The statement is not correct.

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

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

A resident in relation to his tax liability arising out of one or more transactions valuing Rs. 100 crore or more in total which has been undertaken or proposed to be undertaken would be an applicant for this purpose.

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

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

**Question 7**

An Irish company, Phi plc., entered into a contract with an Indian company, Beta Ltd., for provision of technical know-how and made an application to the Authority for Advance Rulings for advance ruling on the rate of withholding tax on receipts from Beta Ltd. Beta Ltd. had also made an application to the Assessing Officer for determination of the rate at which tax is deductible on the said payment to Phi plc. The Authority for Advance
Rulings rejected the application of Phi plc. on the ground that the question raised in the application is already pending before an income tax authority. Is the rejection of the application of Phi plc. justified in law?

**Answer**

This issue came up before the AAR in, Nuclear Power Corporation of India Ltd. In Re, [2012] 343 ITR 220, wherein it was held that an advance ruling is not only applicant specific, but is also transaction specific. The advance ruling is on a transaction entered into or undertaken by the applicant. That is why section 245S specifies that a ruling is binding on the applicant, the transaction and the Principal Commissioner or Commissioner of Income-tax and those subordinate to him, and not only on the applicant.

What is barred by the first proviso to section 245R(2) of the Act in the context of clause (i) thereof is the allowing of an application under section 245R(2) of the Act where “the question raised in the application is already pending before any Income-tax authority, or Appellate Tribunal or any court”. The significance of the dropping of the words, “in the applicant’s case” with effect from June 1, 2000, cannot be wholly ignored.

On the basis of this view expressed by the AAR in the above case, explaining the impact of the dropping of the words “in the applicant’s case” with effect from 1.6.2000, a view can be taken that the AAR can reject the application made by Phi plc. before the AAR on the ground that similar issue is pending before the Assessing Officer in respect of the same transaction i.e., provision of technical know to Beta Ltd.

**Note** – The issue relates to the admission or rejection of the application filed before the Advance Rulings Authority on the grounds specified in clause (i) of the first proviso to sub-section (2) of section 245R of the Income-tax Act, 1961. The first proviso to section 245R(2) has been substituted by the Finance Act, 2000 with effect from 1.6.2000. Clause (i) of the first proviso, prior to and post amendment, reads as follows:

<table>
<thead>
<tr>
<th>Prior to 1.6.2000</th>
<th>On or After 1.6.2000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Provided that the Authority shall not allow the application <strong>except in the case of a resident applicant</strong> where the question raised in the application is already pending <strong>in the applicant’s case</strong> before any income-tax authority, the Appellate Tribunal or any court;</td>
<td>Provided 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.</td>
</tr>
</tbody>
</table>

The words “except in the case of a resident applicant” and “in the applicant’s case” has been removed in clause (i) of the first proviso with effect from 1.6.2000. However, the Explanatory Memorandum to the Finance Act, 2000, explaining the impact of the substitution, reads as follows “It is proposed to substitute the proviso to provide that the Authority shall not allow the application when the question raised is already pending in the applicant’s case before any income-tax authority, Appellate Tribunal or any court in regard to a non-resident applicant and resident applicant in relation to a transaction with a non-resident”. Therefore, according to the intent expressed in the Explanatory Memorandum, the AAR shall not allow the application both in the case of resident and non-resident applicant if the question raised is already **pending in the applicant’s case** before any income-tax authority. Thus, as per the Explanatory Memorandum, it is possible to take a view that even post-amendment, the Authority shall not allow the application only where a question is **pending in the applicant’s case** before any income-tax authority. Thus, an alternative view is possible on the basis of the AAR ruling in Ericsson Telephone
Corporation India AB v. CIT (1997) 224 ITR 203, which continues to hold good even after the amendment, if we consider the intent expressed in the Explanatory Memorandum. Accordingly, based on this view, the AAR can allow the application made by Phi plc., even if the question raised in the application is pending before the Assessing Officer in Beta Ltd.’s case.

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Exercise

Question 1
Explain the core reasons for difference between the e-commerce transactions and the traditional business transactions causing difficulty to tax the income of e-commerce transactions.

Answer
The core reasons for difference between e-commerce transactions and traditional business transactions causing difficulty to tax the income from e-commerce transactions under the Income-tax Act, 1961 are absence of national boundaries, no requirement of physical presence of goods and no requirement of physical delivery (in certain cases). Since e-commerce transactions are completed in cyberspace, it is often not clear as to the place where the transaction is effected, thereby causing difficulty in implementing source rule taxation.

Question 2
E-commerce transactions have replaced concepts generally associated with international transactions traditionally. Discuss briefly the issues involving such transactions.

Answer
The typical taxation issues relating to e-commerce are:
(1) the difficulty in characterizing the nature of payment and establishing a nexus or link between taxable transaction, activity and a taxing jurisdiction,
(2) the difficulty of locating the transaction, activity and identifying the taxpayer for income tax purposes.

Question 3
ABC Ltd., an Indian company, is carrying on the business of manufacture and sale of teakwood furniture under the brand name “PUREWOOD”. In order to expand its overseas sales/exports, it launched a massive advertisement campaign of its products. For the purpose of online advertisement, it utilized the services of PQR Inc., a London based company. During the previous year 2019-20, ABC Ltd. paid Rs. 5 lakhs to PQR Inc. for such services. Discuss the tax implications/TDS implications of such payment and receipt in the hands of ABC Ltd. and PQR Inc., respectively, if –
(i) PQR Inc. has no permanent establishment in India
(ii) PQR Inc. has a permanent establishment in India

Answer
Chapter VIII of the Finance Act, 2016, "Equalisation Levy", provides for an equalisation levy of 6% of the amount of consideration for specified services received or receivable by a non-resident not having permanent establishment in India, from a resident in India who carries out business or profession, or from a non-resident having permanent establishment in India. “Specified Service” means
(1) online advertisement;
(2) any provision for digital advertising space or any other facility or service for the purpose of online advertisement and

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

However, equalisation levy shall not be levied-
- where the non-resident providing the specified services has a permanent establishment in India
- the aggregate amount of consideration for specified service received or receivable during the previous year does not exceed Rs. 1 lakh.
- where the payment for specified service is not for the purposes of carrying out business or profession

(i) Where PQR Inc. has no permanent establishment in India

In the present case, ABC Ltd. is required to deduct equalisation levy of Rs. 30,000 i.e., @6% of Rs. 5 lakhs, being the amount paid towards online advertisement services provided by PQR Inc., a non-resident having no permanent establishment in India. Non-deduction of equalisation levy would attract disallowance under section 40(a)(ib) of 100% of the amount paid while computing business income.

(ii) Where PQR Inc. has permanent establishment in India and the service is effectively connected to the permanent establishment in India

Equalisation levy would not be attracted where the non-resident service provider (PQR Inc., in this case) has a permanent establishment in India. Therefore, the ABC Ltd. is not required to deduct equalisation levy on Rs. 5 lakhs, being the amount paid towards online advertisement services to PQR Inc, in this case. However, tax has to be deducted by ABC Ltd. at the rates in force under section 195 in respect of such payment to PQR Inc. Non-deduction of tax at source under section 195 would attract disallowance under section 40(a)(i) of 100% of the amount paid while computing business income.

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28.2
EXERCISE

Question 1
What do you mean by double taxation? Discuss the connecting factors which lead to Double taxation.

Answer
The taxability of a foreign entity in any country depends upon two distinct factors, namely, whether it is doing business with that country or in that country. Internationally, the term used to determine the jurisdiction for taxation is “connecting factors”. There are two types of connecting factors, namely, “Residence” and “Source”. It means a company can be subject to tax either on its residence link or its source link with a country. Broadly, if a company is doing business with another country (i.e. host/source country), then it would be subject to tax in its home country alone, based on its residence link. However, if a company is doing business in a host/source country, then, besides being taxed in the home country on the basis of its residence link, it will also be taxed in the host country on the basis of its source link.

• **Jurisdictional double taxation**: Accordingly, when source rules overlap, double taxation may arise i.e. tax is imposed by two or more countries as per their domestic laws in respect of the same transaction, income arises or is deemed to arise, in their respective jurisdictions. This is known as “jurisdictional double taxation”.

  In order to avoid such double taxation, a company can invoke provisions of Double Taxation Avoidance Agreements (DTAAs) (also known as Tax Treaty or Double Taxation Convention– DTC) with the host/source country, or in the absence of such an agreement, an Indian company can invoke provisions of section 91 of the Income-tax Act, 1961, providing unilateral relief in the event of double taxation.

• **Economic double taxation**: ‘Economic double taxation’ happens when the same transaction, item of income or capital is taxed in two or more states but in hands of different person (because of lack of subject identity)

Question 2
“In addition to allocating the taxing rights and elimination of double taxation, there are various other important considerations while entering into tax treaty”. Elucidate.

Answer
In addition to allocating the taxing rights and elimination of double taxation, there are various other important considerations while entering into a tax treaty, as mentioned below:

• Ensuring non-discrimination between residents and non-residents
• Resolution of disputes arising on account of different interpretation of tax treaty by the treaty partner.
• Providing assistance in the collection of the fair and legitimate share of tax.

Further, in addition to above, there are some other principles which must be considered by countries in their tax system –

(i) **Equity and fairness**: Same income earned by different taxpayers must be taxed at the same rate regard less of the source of income.
(ii) **Neutrality and efficiency**: Neutrality factor provides that economic processes should not be affected by external factors such as taxation. Neutrality is two-fold.

(a) Capital export neutrality and
(b) Capital import neutrality (CIN).

Capital export neutrality (CEN) provides that business decision must not be affected by tax factors between the country of residence and the target country; whereas CIN provides that the level of tax imposed on non-residents as well as the residents must be similar.

(iii) **Promotion of mutual economic relation, trade and investment**: In some cases, it is observed that avoidance of double taxation is not the only objective. The other objective may be to give impetus to a country’s overall economic growth and development.

**Question 3**

What is the General Rule of Interpretation under Vienna Convention of Law of Treaties?

**Answer**

Article 31 of Vienna Convention of Law of Treaties contains the General Rule of Interpretation. It lays down that following general rule of interpretation:

- A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms thereof in the context and in the light of its object and purpose.
- The context for the purpose of interpretation of a treaty shall comprise, in addition to the text, including its preamble and annexure
  (a) Any agreement relating to the treaty which was made between all the parties in connection with the conclusion of the treaty;
  (b) Any instrument which was made by one or more parties in connection with the conclusion of the treaty and accepted by the other parties as an instrument related thereto.
- The following shall be taken into account, together with the context in that:
  (a) Any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions;
  (b) Any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation;
  (c) Any relevant rules of international law applicable to relation between the parties.
- A special meaning shall be given to a term if it is established that the parties so intended.

**Question 4**

What are the Extrinsic Aids to interpretation of a tax treaty?

**Answer**

A wide range of extrinsic material is permitted to be used in interpretation of tax treaties. According to Article 32 of the Vienna Convention the supplementary means of interpretation include the preparatory work of the treaty and the circumstances of its conclusion.

According to Prof. Starke one may resort to following extrinsic aids to interpret a tax treaty provided that clear words are not thereby contradicted:

(i) Interpretative Protocols, Resolutions and Committee Reports, setting out agreed interpretations;
(ii) A subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions [Art. 31(3) of the VCLT];
(iii) Subsequent conduct of the state parties, as evidence of the intention of the parties and their conception of the treaty;
(iv) Other treaties, in pari materia (i.e., relating to the same subject matter), in case of doubt.

**Provisions in Parallel Tax Treaties**

If the language used in two tax treaties (say treaties: X and Y) are same and one treaty is more elaborative or clear in its meaning (say treaty X) can one rely on the interpretation/explanations provided in a treaty X while applying provisions of a treaty Y? However, the views of the Indian Judiciary are not consistent in this respect. There are contradictory judgments by Indian courts/tribunal in this regard.

**International Articles/Essays/Reports**

International Article/Essays/Reports are referred as extrinsic aid for interpretation of tax treaties. Like, in case of CIT v. Vishakhapatnam Port Trust (1983) 144 ITR 146 (AP), the High Court obtained “useful material” through international articles.

**Cahiers published by International Fiscal Association (IFA), Netherlands**

“Cahiers de Droit Fiscal International” is the main publication of the IFA, which is published annually and deals with two major topics each year. Cahiers were relied upon in case of Azadi Bachao Andolan’s (supra) case by the SC.

**Protocol**

Protocol is like a supplement to the treaty. In many treaties, in order to put certain matters beyond doubt, there is a protocol annexed at the end of the treaty, which clarifies borderline issues.

A protocol is an integral part of a tax treaty and has the same binding force as the main clauses therein.

Protocol to the India-US tax treaty provides many examples to elucidate the meaning of the term “make available”. Protocol to India France treaty contains the Most Favoured Nation Clause. Thus, one must refer to protocol before arriving at any final conclusion in respect of any tax treaty provision.

**Preamble**

Preamble to a tax treaty could guide in interpretation of a tax treaty. In case of Azadi Bachao Andolan, the Apex Court observed that ‘the preamble to the Indo-Mauritius Double Tax Avoidance Convention (DTAC) recites that it is for the ‘encouragement of mutual trade and investment’ and this aspect of the matter cannot be lost sight of while interpreting the treaty’. These observations are very significant whereby the Apex Court has upheld ‘economic considerations’ as one of the objectives of a Tax Treaty.

**Mutual Agreement Procedure [MAP]**

MAP helps to interpret any ambiguous term/provision through bilateral negotiations. MAP is more authentic than other aids as officials of both countries are in possession of materials/documents exchanged at the time of signing the tax treaty which would clearly indicate the object or purpose of a particular provision. Successful MAPs also serve as precedence in case of subsequent applications.

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EXERCISE

Question 1
What do you understand by base erosion and profit shifting? Describe briefly its adverse effects.

Answer
Base Erosion and Profit Shifting (BEPS) refers to tax planning strategies that exploit gaps and mismatches in tax rules to make profits ‘disappear’ for tax purposes or to shift profits to locations where there is little or no real activity but the taxes are low, resulting in little or no overall corporate tax being paid.

Adverse Effects of BEPS:
(1) Governments have to cope with less revenue and a higher cost to ensure compliance.
(2) In developing countries, the lack of tax revenue leads to significant under-funding of public investment that could help foster economic growth.
(3) BEPS undermines the integrity of the tax system, as reporting of low corporate taxes is considered to be unfair. When tax laws permit businesses to reduce their tax burden by shifting their income away from jurisdictions where income producing activities are conducted, other taxpayers, especially individual taxpayers in that jurisdiction bear a greater share of the burden. This gives rise to tax fairness issues on account of individuals having to bear a higher tax burden.
(4) Enterprises that operate only in domestic markets, including family-owned businesses or new innovative businesses, may have difficulty competing with MNEs that have the ability to shift their profits across borders to avoid or reduce tax. Fair competition is harmed by the distortions induced by BEPS.

Question 2
What are the significant OECD Recommendations under Action Plan 1 of BEPS? Which recommendation has been adopted in Indian tax laws?

Answer
The OECD has recommended several options to tackle the direct tax challenges which include:
(1) Modifying the existing Permanent Establishment (PE) rule to provide that whether an enterprise engaged in fully de-materialized digital activities would constitute a PE, if it maintained a significant digital presence in another country's economy.
(2) A virtual fixed place of business PE in the concept of PE i.e., creation of a PE when the enterprise maintains a website on a server of another enterprise located in a jurisdiction and carries on business through that website.
(3) Imposition of a final withholding tax on certain payments for digital goods or services provided by a foreign e-commerce provider or imposition of a equalisation levy on consideration for certain digital transactions received by a non-resident from a resident or from a non-resident having permanent establishment in other contracting state.
Taking into consideration the potential of new digital economy and the rapidly evolving nature of business operations, it becomes necessary to address the challenges in terms of taxation of such digital transactions.

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

Meaning of “Specified Service”:

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.

Further, in order to reduce burden of small players in the digital domain, it is also provided that no such levy shall be made if the aggregate amount of consideration for specified services received or receivable by a non-resident from a person resident in India or from a non-resident having a permanent establishment in India does not exceed ₹1 lakh in any previous year.

Note: The Finance Act, 2018 has amended section 9(1)(i) to provide that significant economic presence would also constitute business connection from A.Y.2019-20. However, Rules in this regard are yet to be notified.

Question 3
Discuss the provision incorporated in the Income-tax Act, 1961 in line with the OECD recommendations under Action Plan 4 of BEPS.

Answer
In line with the recommendations of OECD BEPS Action Plan 4, new section 94B has been inserted in the Income-tax Act, 1961, to provide a cap on the interest expense that can be claimed by an entity to its associated enterprise. The total interest paid in excess of 30% of its earnings before interest, taxes, depreciation and amortization (EBITDA) or interest paid or payable to associated enterprise for that previous year, whichever is less, shall not be deductible.

The provision is applicable to an Indian company, or a permanent establishment of a foreign company, being the borrower, who pays interest in respect of any form of debt issued by a non-resident who is an 'associated enterprise' of the borrower. Further, the debt is deemed to be treated as issued by an associated enterprise where it provides an implicit or explicit guarantee to the lender, being a non-associated enterprise, or deposits a corresponding and matching amount of funds with such lender.

The provision allows for carry forward of disallowed interest expense for 8 assessment years immediately succeeding the assessment year for which the disallowance is first made and deduction against the income computed under the head "Profits and gains of business or profession" to the extent of maximum allowable interest expenditure.

In order to target only large interest payments, it provides for a threshold of interest expenditure of ₹1 crore in respect of any debt issued by a non-resident, being an associated
enterprise, exceeding which the provision would be applicable. Banks and Insurance business are excluded from the ambit of the said provisions keeping in view of special nature of these businesses.

Question 4
Describe the three tier structure for transfer pricing documentation mandated by BEPS Action Plan 13.

Answer
Action 13 contains a three-tiered standardized approach to transfer pricing documentation which consists of:
(a) **Master file**: Master file requires MNEs to provide tax administrations with high-level information regarding their global business operations and transfer pricing policies. The master file is to be delivered by MNEs directly to local tax administrations.
(b) **Local file**: Local file requires maintaining of transactional information specific to each country in detail covering related-party transactions and the amounts involved in those transactions. In addition, relevant financial information regarding specific transactions, a comparability analysis and analysis of the selection and application of the most appropriate transfer pricing method should also be captured. The local file is to be delivered by MNEs directly to local tax administrations.
(c) **Country-by-country (CBC) report**: CBC report requires MNEs to provide an annual report of economic indicators viz. the amount of revenue, profit before income tax, income tax paid and accrued in relation to the tax jurisdiction in which they do business. CBC reports are required to be filed in the jurisdiction of tax residence of the ultimate parent entity, being subsequently shared between other jurisdictions through automatic exchange of information mechanism.

Question 5
Explain the nexus approach recommended by OECD in BEPS Action Plan 5 which has been adopted in the Income-tax Act, 1961.

Answer
In India, the Finance Act, 2016 has introduced a concessional taxation regime for royalty income from patents for the purpose of promoting indigenous research and development and making India a global hub for research and development. The purpose of the concessional taxation regime is to encourage entities to retain and commercialise existing patents and for developing new innovative patented products. Further, this beneficial taxation regime will incentivise entities to locate the high-value jobs associated with the development, manufacture and exploitation of patents in India.

The nexus approach has been recommended by the OECD under BEPS Action Plan 5. This approach requires attribution and taxation of income arising from exploitation of Intellectual property (IP) in the jurisdiction where substantial research and development (R & D) activities are undertaken instead of the jurisdiction of legal ownership. Accordingly, new section 115BBF has been inserted in the Income-tax Act, 1961 to provide that where the total income of the eligible assessee (being a person resident in India who is the true and first inventor of the invention and whose name is entered in the patent register as the patentee in accordance with the Patents Act, 1970 and includes every such person, being the true and the
first inventor of the invention, where more than one person is registered as patentee under Patents Act, 1970 in respect of that patent.) includes any income by way of royalty in respect of a patent developed and registered in India, then such royalty shall be taxable at the rate of 10% (plus applicable surcharge and cess). For this purpose, developed means atleast 75% of the expenditure should be incurred in India by the eligible assessee for any invention in respect of which patent is granted under the Patents Act, 1970.

Question 6
What are the ways in which hybrid mismatch arrangements are used to achieve unintended double non-taxation or long-term tax deferral?

Answer
Hybrid mismatch arrangements are sometimes used to achieve unintended double non-taxation or long-term tax deferral in one or more of the following ways -

1. Creation of two deductions for a single borrowal;
2. Generation of deductions without corresponding income inclusions;
3. Misuse of foreign tax credit; and
4. Participation exemption regimes.

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EXERCISE

Question 1
Explain briefly the significant differences between the UN and OECD Model Tax Convention.

Answer
OECD Model is essentially a model treaty between two developed nations whereas UN Model is a model convention between a developed country and a developing country. Further, OECD Model advocates the residence principle, i.e., it lays emphasis on the right of state of residence to tax the income, whereas the UN Model is a compromise between the source principle and residence principle, giving more weight to the source principle as against the residence principle.

Question 2
When does it become necessary to apply the tie-breaker rule? Discuss the manner of application of the tie-breaker rule.

Answer
Every jurisdiction, in its domestic tax law, prescribes the mechanism to determine residential status of a person. If a person is considered to be resident of both the Contracting States, relief should be sought from Article 4 of the Tax Treaty. A series of tie-breaker rules are provided in Paragraph 2 Article 4 of Model Convention to determine single state of residence for an individual.

The tie-breaker rule would be applied in the following manner:

(i) The first test is based on where the individual has a permanent home. Permanent home would mean a dwelling place available to him at all times continuously and not occasionally and includes place taken on rent for a prolonged period of time. Any place taken for a short duration of stay or for temporary purpose, may be for reasons such as short business travel, or a short holiday etc. is not regarded as a permanent home.

(ii) If that test is inconclusive for the reason that the individual has permanent home available to him in both Contracting States, he will be considered a resident of the Contracting State where his personal and economic relations are closer, in other words, the place where lies his centre of vital interests. Thus, preference is given to family and social relations, occupation, place of business, place of administration of his properties, political, cultural and other activities of the individual.

(iii) Paragraph (ii) establishes a secondary criterion for two quite distinct and different situations:
   • The case where the individual has a permanent home available to him in both Contracting States and it is not possible to determine in which one he has his centre of vital interests;
   • The case where the individual has a permanent home available to him in neither Contracting State.
In the aforesaid scenarios, preference is given to the Contracting State where the individual has an habitual abode.
(iv) If the individual has habitual abode in both Contracting States or in neither of them, he shall be treated as a resident of the Contracting State of which he is a national.

(v) If the individual is a national of both or neither of the Contracting States, the matter is left to be considered by the competent authorities of the respective Contracting States.

Question 3

Explain the meaning of “interest” and “fees for technical services” under the UN Model Convention.

Answer

As per Article 11 of the UN Model Convention, “Interest” essentially means income from debt claims of every kind, whether or not secured by mortgage and whether or not carrying a right to participate in the debtor’s profits, and in particular, income from government securities and income from bonds or debentures, including premiums and prizes attaching to such securities, bonds or debentures. Penalty charges for late payment are not regarded as interest for the purpose of this Article.

As per Article 12A of the UN Model Convention, “Fees for technical services” is defined as payments for managerial, technical or consultancy services but excludes payment to an employee, payment for teaching in an educational institution or for teaching by an educational institution, payments by an individual for services for personal use.
CHAPTER 32 – PAST EXAMS RTP’S

REVISION TEST PAPER – NOV 2019:

OBJECTIVE TYPE QUESTIONS:
From the options (a), (b), (c) and (d) given in each question, choose the most appropriate option.

(i) X Ltd. is engaged in the business of letting out of properties. As per the memorandum of association of X Ltd., letting out of properties is its main objective. The total income of X Ltd. comprises only of rental income from the business of letting out of properties. Y Ltd. is engaged in the construction and sale of properties, which is also its main objective as per its memorandum of association. Incidentally, it lets out some properties which are held as stock-in-trade and earns rental income therefrom. Which of the following statements are correct?
(a) Rental income from letting out of properties by X Ltd. and Y Ltd. is taxable under the head “Income from house property”
(b) Rental income from letting out of properties by X Ltd. and Y Ltd. is taxable under the head “Profits and gains of business or profession”
(c) Rental income from letting out of properties by X Ltd. is taxable under the head “Income from house property” and by Y Ltd is taxable under the head “Profits and gains of business or profession”
(d) Rental income from letting out of properties by Y Ltd. is taxable under the head “Income from house property” and X Ltd is taxable under the head “Profits and gains of business or profession”

(ii) PQ Ltd. is a company having two units – Unit P carries on specified business of setting up and operating warehousing facility for storage of agricultural produce and Unit Q carries on specified business of setting up and operating warehousing facility for storage of edible oil. Unit P commenced operations on 1.4.2017 and claimed deduction of Rs. 120 lakhs incurred in April, 2017 on purchase of two buildings for Rs. 70 lakhs and Rs. 50 lakhs (for operating warehousing facility for storage of agricultural produce) under section 35AD for A.Y.2018-19. However, in March, 2019, Unit P transferred its building costing Rs. 70 lakhs to Unit Q. What are the tax implications of such transfer in the hands of PQ Ltd.?
(i) Rs. 70 lakhs would be deemed as business income in the hands of PQ Ltd. for A.Y.2019-20
(ii) Rs. 63 lakhs would be deemed as business income in the hands of PQ Ltd. for A.Y.2019-20
(iii) Actual cost of building for computing depreciation for P.Y.2018-19 would be Rs. 70 lakhs
(iv) Actual cost of building for computing depreciation for P.Y.2018-19 would be Rs. 63 lakhs
Which of the above statements are correct?
(a) (i) and (iii) above
(b) (i) and (iv) above
(c) (ii) and (iii) above
(d) (ii) and (iv) above.
(iii) XYZ Ltd. engaged in the business of manufacture of steel, claimed deduction under section 80-IB on the profits and gains of business which included transport subsidy, interest subsidy and power subsidy received from the Government and duty drawback receipts. XYZ Ltd. contended that all the above receipts are profits derived from the business of the industrial undertaking and are hence, eligible for deduction under section 80-IB. Is the contention of XYZ Ltd. correct?

(a) Yes; transport subsidy, interest subsidy, power subsidy and duty drawback are profits derived from the business of the industrial undertaking and hence, eligible for deduction under section 80-IB.

(b) No; none of the above receipts can be treated as profits “derived” from the business of the industrial undertaking and hence, deduction under section 80-IB cannot be claimed in respect of any such receipt.

(c) No; transport subsidy, interest subsidy and power subsidy received from Government are profits derived from the business of the industrial undertaking and hence, eligible for deduction under section 80-IB. However, duty drawbacks belong to the category of ancillary profits and hence, deduction under section 80-IB cannot be claimed in respect of such receipt.

(d) No; transport subsidy, interest subsidy and power subsidy received from Government are ancillary profits and hence, deduction under section 80-IB cannot be claimed in respect of such receipts. However, duty drawbacks are profits derived from the business of the industrial undertaking and hence, deduction under section 80-IB can be claimed in respect of such receipt.

(iv) A REIT has distributed Rs. 2 crore to its unitholders, which comprises of -

(i) Rental income from real estate property directly held by it Rs. 80 lakhs
(ii) Interest income from special purpose vehicle Rs. 50 lakhs
(iii) Dividend income from special purpose vehicle Rs. 40 lakhs
(iv) Capital gains on disposal of assets Rs. 30 lakhs

In this case, the special purpose vehicle is an Indian company, in which REIT holds 100% of shares. Which of the following statements relating to taxability of the above income are correct?

1. All the above income are taxable in the hands of REIT. The said income are exempt in the hands of unit holders.
2. Only income referred to in (i) and (ii) are taxable in the hands of REIT. Income referred to in (iii) and (iv) are taxable in the hands of unit holders.
3. Only income referred to in (i) and (ii) are taxable in the hands of REIT. Income referred to in (iv) is taxable in the hands of unit holders. Income referred to in (iii) is exempt both in the hands of REIT and unitholders.
4. Only income referred to in (iv) is taxable in the hands of REIT. Income referred to in (i) and (ii) is taxable in the hands of unit holders. Income referred to in (iii) is exempt both in the hands of REIT and unitholders.
5. Tax is deductible by REIT from income referred to in (i) and (ii).
6. Tax is deductible by REIT from income referred to in (iii) and (iv).
7. Tax is deductible by REIT only from income referred to in (iv)
8. No tax is deductible by REIT since the entire income is taxable in its hands.

The correct option is –

(a) (1) and (8) above
(b) (2) and (6) above
(c) (3) and (7) above
(d) (4) and (5) above

(v) During the P.Y.2018-19, HelpAid Charitable Trust registered under section 12AA received donations of Rs. 80 lakhs, out of which Rs. 10 lakhs were corpus donations and Rs. 20 lakhs were anonymous donations. The trust applied Rs. 40 lakhs towards its objects during the P.Y.2018-19. The tax liability of the trust for A.Y.2019-20 is -
(a) Rs. 6,24,000
(b) Rs. 5,92,800
(c) Rs. 5,30,920
(d) Rs. 5,97,220

(vi) In the course of search operations under section 132 in May, 2019, Mr. Hari makes a declaration under section 132(4) on the earning of income in respect of P.Y.2018-19 not disclosed in the books of account. Mr. Hari explains the manner in which income was derived and pays the tax, together with interest in respect of such income. However, he does not disclose such income in his return of income filed on 31.7.2019. Is penalty leviable in this case, and if so what is the quantum of penalty?
(a) No penalty is leviable since Mr. Hari has made a declaration under section 132(4)
(b) Penalty@10% is leviable
(c) Penalty@30% is leviable
(d) Penalty@60% is leviable.

(vii) A Ltd. filed its return of income for A.Y.2019-20 on 30th September, 2019. The return is selected for regular assessment under section 143(3). The time limit for service of notice under section 143(2) in this case is -
(a) 31.3.2020
(b) 30.6.2020
(c) 30.9.2020
(d) 31.3.2021

(viii) Shipcargo Inc., a company based in Netherlands operating its ships to and fro Cochin port, collected freight of Rs. 85 lakhs, demurrage of Rs. 5 lakhs and handling charges of Rs. 2 lakhs in respect of goods shipped at Cochin port. It incurred expenses of Rs. 35 lakhs during the year for operating its fleet. In respect of goods shipped at Rotterdam, Netherlands, it received Rs. 50 lakhs in India. Its tax liability (rounded off) for the A.Y.2019-20 is -
(a) Rs. 4,21,200
(b) Rs. 4,43,040
(c) Rs. 3,12,000
(d) Rs. 1,77,840

(ix) Mr. Ganesh, a citizen of India, is employed in the Indian embassy in the USA. He is a non-resident for A.Y.2019-20. He received salary and allowances in the USA from the Government of India for the year ended 31.3.2019 for services rendered by
him in the USA. In addition, he was allowed perquisites by the Government. Which of the following statements are correct?

(a) Salary, allowances and perquisites received outside India are not taxable in the hands of Mr. Ganesh, since he is a non-resident.
(b) Salary, allowances and perquisites received outside India by Mr. Ganesh is taxable in India since they are deemed to accrue or arise in India.
(c) Salary received by Mr. Ganesh is taxable in India but allowances and perquisites are exempt.
(d) Salary received by Mr. Ganesh is exempt but allowances and perquisites are taxable.

(x) Mr. Rajesh, a resident Indian, is an employee of M/s. ABC Ltd., Bangalore. In addition to the salary income from M/s. ABC Ltd., he also earns interest from fixed deposits. M/s. PQR Inc., a foreign company not having permanent establishment in India, rendered online advertisement services to Mr. Rajesh, for which Mr. Rajesh made a payment of Rs. 2 lakhs in the F.Y.2018-19. Which of the statements is correct?

(a) The transaction is subject to equalisation levy since payment exceeding Rs. 1 lakh has been made for online advertisement services by a resident to a non-resident not having permanent establishment in India.
(b) Equalisation levy@6% has to be deducted from the consideration of Rs. 2 lakhs payable to M/s. PQR Inc.
(c) Both (a) and (b)
(d) The transaction is not subject to equalisation levy

DESCRIPTIVE QUESTIONS:

1. PQR Ltd. is a company in which the whole of its share capital was held by LMN Ltd. Both PQR Ltd. and LMN Ltd. are Indian companies. PQR Ltd. had made investment in shares of Berkley Ltd. in 1992 for Rs. 7,00,000 which it sold to LMN Ltd. on April 1, 2010 for a consideration of Rs. 42,00,000.

   The fair market value of these shares of Berkley Ltd., as on April 1, 2001 is Rs. 32,00,000. LMN Ltd. disinvested 7% of the shares held by it in PQR Ltd., in November 2018 by sale to public. It sold the shares in Berkley Ltd. acquired by it from PQR Ltd. in February, 2019 for a sum of Rs. 95,00,000.

   Examine the capital gains tax effect of these transactions in the hands of PQR Ltd. and LMN Ltd. in the relevant assessment years, presuming that the shares of Berkley Ltd. are unlisted shares.

   The cost inflation index for the F.Y.2010-11 is 167 and F.Y.2018-19 is 280.

2. Ms. Janani reports to you that her gross receipt from interior decoration profession carried on by her during the year ended 31-03-2019 is Rs. 47,80,000. Her net income as per income and expenditure account is Rs. 25,00,000 before adjustment of depreciation of Rs. 1,50,000. She did not pay any amount by way of advance tax during the financial year 2018-19. She has two residential house properties, of which one is self-occupied for residence and another is let out for the monthly rent of Rs. 15,000 during the financial year 2018-19.

   Is Janani eligible to opt for presumptive tax provisions, if any, under the Income-tax Act, 1961? If so, is it beneficial for her to opt for such provisions? Advise, assuming that she approached you for consulting on this matter in April, 2019.
3. Calculate the capital gains/loss on transfer of listed equity shares (STT paid both at the time of acquisition and transfer of shares) for the A.Y.2019-20, in the following cases:

(i) Mr. Ravi purchased 500 shares in Tapti Ltd. on 15.11.2016 at a cost of Rs. 1,200 per share. The Fair Market Value (FMV) of the share as on 31.1.2018 is Rs. 2,300. Ravi sold all the shares of Tapti Ltd. on 15.5.2018 for Rs. 3,000.

(ii) Mr. Giri purchased 700 shares in Narmada Ltd. on 3.12.2016 at a cost of Rs. 3,100 per share. The Fair Market Value (FMV) of the share as on 31.1.2018 is Rs. 4,500. Mr. Giri sold all the shares of Narmada Ltd. on 24.4.2018 for Rs. 4,200.

(iii) Mr. Mani purchased 300 shares in Cauvery Ltd. on 12.1.2017 at a cost of Rs. 2,500 per share. The Fair Market Value (FMV) of the share as on 31.1.2018 is Rs. 1,800. Mr. Mani sold all the shares of Cauvery Ltd. on 15.7.2018 for Rs. 3,200.

(iv) Mr. Sathy purchased 600 shares in Mahanadi Ltd. on 25.1.2017 at a cost of Rs. 1,900 per share. The Fair Market Value (FMV) of the share as on 31.1.2018 is Rs. 2,400. Mr. Sathy sold all the shares of Mahanadi Ltd. on 31.1.2019 for Rs. 1,700.

4. PQR Ltd. is engaged in the manufacture of multi-layer tubes and other speciality packaging and plastic products. It came out with an initial public issue of shares during the year 2017-18 and deposited the share application money received in banks till the allotment of shares was completed. The company earned interest of Rs. 75 lakhs on such deposits, which it set off against the public issue expenses, while computing total income for A.Y.2018-19. Accordingly, the company paid the tax on total income, after adjusting tax deducted at source and advance tax paid, and filed its return of income in September, 2018. On scrutiny, the Assessing Officer contended that interest of Rs. 75 lakhs is not eligible for set-off against public issue expenses but is taxable under the head ‘Income from Other Sources’. Examine the correctness of contention of the Assessing Officer.

5. ABC Ltd. has approached the Supreme Court under a special leave petition. There has been a delay of 439 days in filing the appeal under section 260A for which reason ABC Ltd. requested for a condonation of delay under section 14 of Limitation Act, 1963. The company submitted that the delay was on account of pursuing an alternate remedy of filing a miscellaneous application before the Income-tax Appellate Tribunal (ITAT) under section 254(2). From the above facts, examine whether delay in filing appeal under section 260A can be condoned under section 14 of Limitation Act, 1963 where the stated reason for delay is the pursuance of an alternate remedy by way of filing an application before the ITAT under section 254(2) for rectification of mistake apparent on record.

6. (a) HelpAll charitable trust, having its main object as relief of poor, earned agricultural income of Rs. 2.80 lakh, dividend income of Rs. 1.10 lakh and income of Rs. 1.30 lakh from mutual funds specified under section 10(23D) during the P.Y.2018-19. The trust claims exemption under section 10(1), 10(34) and 10(35) in respect of its agricultural income, dividend income and income from mutual funds,
respectively, without complying with the conditions laid down under section 11. Examine the correctness or otherwise of the claim of the trust.

(b) HistoSpace charitable trust, having its main object as preservation of monuments of historic interest, purchased computers for Rs. 12 lakh in March, 2018 for the purposes of the trust and claimed the same as application of income in the P.Y.2017-18. It also claims depreciation @ 40% on such computers for P.Y.2018-19, while computing income for the purpose of application for that year. Examine the correctness or otherwise of the claim of the trust.

7. Sigma Ltd., incorporated on 1.4.2017, is a technology enabled eligible start-up engaged in innovation of processes. The company filed its return of income for A.Y.2019-20 after claiming deduction of Rs. 18 lakhs under section 80-IAC. The return was selected for scrutiny. In the assessment, a sum of Rs. 7 lakhs, being 30% of Rs. 21 lakhs, towards payment of fees for professional services was disallowed for non-deduction of tax at source by invoking section 40(a)(ia). The Assessing Officer, however, limited the deduction under section 80-IAC to the original amount claimed by Sigma Ltd. Sigma Ltd. contended that it was eligible for a higher deduction of Rs. 25 lakhs under section 80-IAC consequent to disallowance under section 40(a)(ia). Examine the correctness of contention of Sigma Ltd.

8. Satpura Ltd. is an Indian company in which 52% of shares are held by Vindhyas Ltd. Satpura Ltd. declared a dividend amounting to Rs. 60 lakhs to its shareholders for the financial year 2017-18 in its Annual General Meeting held on 29th May, 2018. Dividend distribution tax was paid by Satpura Ltd. on 5th June, 2018. Vindhyas Ltd. declared an interim dividend amounting to Rs. 48 lakhs on 2nd December, 2018. Compute the amount of tax on dividend payable by Vindhyas Ltd., an Indian company.
   Would your answer change if Vindhyas Ltd. held 48% of shares of Satpura Ltd? Examine.

9. The following are the details pertaining to M/s. Aravali, a partnership firm, for the year ended 31-3-2019:
   (i) Gross total income of Rs. 600 lakhs, which includes a profit of Rs. 550 lakhs from an undertaking engaged in an irrigation project.
   (ii) The profits of the undertaking are eligible for deduction under section 80-IA. This is the third year and the deduction available is Rs. 510 lakhs.
   (iii) The firm has undertaken “specified domestic transactions” referred to in section 92BA during the said year and has to obtain a report from an accountant under section 92E and furnish such report.
   Since M/s. Aravali wishes to seek opinion of tax consultants in relation to certain issues before filing its return of income, it is planning to file its return of income only in the month of March, 2020. Advise M/s. Aravali the right course of action. You may ignore interest under section 234A, 234B, 234C and 234F while making your computations in support of your advice.

10. Godavari Ltd., an Indian Company engaged in manufacture and sale of electrical appliances in India and abroad, started adoption of Ind AS with effect from 1st April, 2017. The following particulars are furnished for the year ended 31st March, 2019:-
(a) The book profit after adjustment of all items specified in section 115JB(2) amounted to Rs. 87.34 lakhs (except the adjustment for brought forward losses/ unabsorbed depreciation), for the year ended 31.3.2019.

(b) Brought forward losses as per books are as under: (Rs. In lakhs)

<table>
<thead>
<tr>
<th>Financial Year</th>
<th>Business loss</th>
<th>Depreciation</th>
</tr>
</thead>
<tbody>
<tr>
<td>2016-17</td>
<td>8.20</td>
<td>7.60</td>
</tr>
<tr>
<td>2017-18</td>
<td>7.30</td>
<td>9.50</td>
</tr>
</tbody>
</table>

(c) The particulars of “Other Comprehensive Income” for the year ended 31.03.2019:

<table>
<thead>
<tr>
<th>Other Comprehensive Income (OCI) that will not be re-classified to profit and loss:</th>
<th>Debit (Rs. In lakhs)</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i) Deferred costs of hedging</td>
<td>3.80</td>
<td></td>
</tr>
<tr>
<td>(ii) Changes in fair values of equity instruments</td>
<td></td>
<td>8.00</td>
</tr>
<tr>
<td>(iii) Revaluation surplus for assets</td>
<td></td>
<td>8.20</td>
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<tr>
<td>(iv) Deferred gains on cash flow hedges</td>
<td></td>
<td>6.70</td>
</tr>
<tr>
<td>(v) Re-measurement of post-employment benefit obligations</td>
<td></td>
<td>5.20</td>
</tr>
<tr>
<td>(vi) Share of other comprehensive income of other associates</td>
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<td>2.80</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Other Comprehensive Income (OCI) that may be re-classified to profit and loss:</th>
<th>Debit (Rs. In lakhs)</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i) Deferred gains on cash flow hedges</td>
<td>8.20</td>
<td></td>
</tr>
<tr>
<td>(ii) Comprehensive income from discontinued operations</td>
<td></td>
<td>5.30</td>
</tr>
<tr>
<td>(iii) Exchange Differences of foreign exchange operations</td>
<td>1.80</td>
<td></td>
</tr>
<tr>
<td>(iv) Deferred costs of hedging</td>
<td></td>
<td>0.80</td>
</tr>
</tbody>
</table>

(d) The transition amount as on convergence date (01-04-2017) stood at Rs. 48 lakhs (credit balance) including capital reserve of Rs. 6 lakhs and adjustment of Rs. 5 lakhs relating to translation difference in a foreign operation.

(e) The National Company Law Tribunal (NCLT), Mumbai Bench has admitted an application under section 7 of Insolvency and Bankruptcy Code, 2016 (IBC) made by financial creditor against the company for initiation of Corporate Insolvency Resolution Process on 30th March, 2019.

You are required to compute the MAT liability for the assessment year 2019-20, applying the provisions relating to Ind AS compliant companies. Assuming that the income tax under normal provisions of Income-tax Act, 1961 for the assessment year 2019-20 works out to Rs. 13.20 lakhs, compute the tax credit, if any, to be carried forward by the company including the period up to which it will be available to be carried forward.

11. M/s. Uranus LLP filed its return of income for the A.Y. 2016-17 on 23-07-2016. The assessment u/s 143(3) was completed on 27th April, 2017. The Assessing Officer made two additions to the income of the LLP, namely, Rs. 12 lakhs towards unexplained investment u/s 69 and Rs. 4 lakhs u/s 40(b) due to excess interest paid to partners.
The LLP, being aggrieved, contested the addition of Rs. 12 lakhs under section 69 and filed an appeal before the Commissioner (Appeals). The appeal was decided on 12th February, 2019 against the LLP.

In March, 2019, the LLP approaches you to know whether it should apply for revision to Principal Commissioner u/s 264 or for rectification u/s 154 to the Assessing Officer as regards disallowance u/s 40(b). You are required to advise the LLP, keeping in mind the relevant provisions of income-tax law.

12. M/s. Pluto LLP filed its return of income for A.Y.2019-20, declaring total income of Rs. 25 lakhs, on 2nd October, 2019. On processing of return, the total income determined under section 143(1)(a) was Rs. 30 lakhs, after disallowing claim for deduction under section 10AA on account of late furnishing of return of income. Thereafter, on scrutiny, the Assessing Officer made some additions under section 40(a)(ia) and section 43B and passed an assessment order under section 143(3) assessing total income of Rs. 40 lakhs. Later on, the Assessing Officer noticed that certain income had escaped assessment and issued notice for reassessment under section 148. The total income reassessed under section 147 was Rs. 45 lakhs.

Considering that none of the additions or disallowances made in the assessment or re-assessment as above qualifies under section 270A(6), compute the amount of penalty to be levied under section 270A of the Income-tax Act, 1961 at the time of assessment under section 143(3) and at the time of reassessment under section 147 (Assume under-reporting of income is not on account of misreporting).

13. Neptune Inc, a notified Foreign Institutional Investor (FII), derived the following incomes for the financial year 2018-19:-

(1) Interest received on investment in Rupee Denominated Bonds of ABC Ltd., an Indian company (investment was made in the F.Y.2017-18) - Rs. 8,50,000

(2) Dividend from listed shares of Indian companies – Rs. 6,20,000

(3) Interest on securities – Rs. 17,32,000 (Expenses of Rs. 26,000 has been incurred to earn such income)

(4) **Income from sale of securities and shares:**
   (i) **Bonds of Jupiter Ltd.**
       [Date of purchase 5 May 2015; Date of sale 7 March 2019]
       Sale proceeds : Rs. 47,00,000
       Cost of purchase : Rs. 32,00,000
   (ii) **Listed Shares of Earth Ltd.**
       [Date of purchase – 2 May, 2018; Date of sale – 9 February, 2019]
       Sale Consideration Rs. 12,40,000
       Purchase cost Rs. 7,80,000
       [STT paid both at the time of purchase and sale]
   (iii) **Unlisted equity shares of Mars Ltd.**
       [Date of purchase – 1 July, 2018; Date of sale – 7 March, 2019]
       Sale Consideration Rs. 8,40,000
       Purchase cost Rs. 3,72,000

Compute the total income and tax liability of the FII, Neptune Inc., for the A.Y. 2019-20, assuming that no other income is derived by Neptune Inc. during the F.Y.2018-19.
14. Examine the following transactions and discuss whether the transfer price declared by the following assessee, who have exercised a valid option for application of safe harbour rules, can be accepted by Income-tax authorities –

(i) Mercury Ltd., an Indian company, provided data processing services to Venus Inc., which is a specified foreign company in relation to Mercury Ltd. The aggregate value of such international transactions entered into in the P.Y.2018 - 19 is Rs. 105 crores. It declared an operating profit margin of Rs. 16 crores. Its operating expenses were Rs. 80 crores.

(ii) Jupiter Ltd., an Indian company, provides contract R & D services relating to software development to Saturn Inc., a US company which guarantees 12% of the borrowings of Jupiter Ltd. The value of such international transactions entered into in the P.Y.2018-19 is Rs. 190 crores. It declared an operating profit margin of Rs. 40 crores against an operating expenses of Rs. 175 crores.

In case it is not binding on the income-tax authorities to accept the transfer price declared by Mercury Ltd. or Jupiter Ltd., what is the primary adjustment, if any, to be made by either company in the A.Y.2019-20?

15. Mr. Gopal, aged 50 years, is a resident individual having income from the following sources:

(i) Income from a sole-proprietary business in Pune Rs. 75 lakhs.

(ii) Share of profit from a partnership firm in Mumbai Rs. 25 lakhs.

(iii) Agricultural Income (gross) from tea gardens in Country G, a foreign country with which India has no DTAA, CGD 45000. Withholding Tax on the above income CGD 9,000

(iv) Brought forward business loss of F.Y.2015-16 in Country G was CGD 5,000 which is not permitted to be set off against other income as per the laws of that country.

(v) Mr. Gopal has deposited Rs. 1,50,000 in public provident fund and paid medical insurance premium of Rs. 28,000 by account payee cheque to insure the health of himself and his wife.

Compute total income and tax liability of Mr. Gopal for the A.Y. 2019-20, assuming that 1 CGD = Rs. 70.

16. Explain the meaning of “fees for technical services” and “professional services” under the relevant articles of the UN Model Convention, 2017. Does the Contracting State in which such income arises have the right to tax such income, and if so, what are the conditions/limitations for such taxability? Discuss.

17. Which action plan of BEPS requires introduction of Limitation of Benefits clause in a tax treaty? Has India introduced Limitation of Benefits clause in its tax treaties in line with the BEPS Action Plan? Discuss.
SOLUTION:

MOST APPROPRIATE OPTION – OBJECTIVE TYPE QUESTIONS

(i) (d)  (ii) (d)
(iii) (c)  (iv) (d)
(v) (c)  (vi) (d)
(vii) (c)  (viii) (b)
(ix) (c)  (x) (d)

SUGGESTED ANSWERS/HINTS – DESCRIPTIVE QUESTIONS

1. (i) **Sale of shares of Berkley Ltd. by PQR Ltd. to LMN Ltd. on 1.4.2010**

Since LMN Ltd. is an Indian company which holds 100% of shares of PQR Ltd., the transfer of capital asset, namely, shares of Berkley Ltd., by PQR Ltd. to LMN Ltd. would not be treated as a transfer for attracting capital gains tax liability as per section 47(v).

Hence, no capital gains tax would have been attracted on such transfer in the hands of PQR Ltd.

(ii) **Disinvestment by LMN Ltd., of 7% shares held in PQR Ltd. in November, 2018**

As per section 47A(1), where a holding company ceases to hold 100% of shares of the subsidiary company before the expiry of a period of eight years from the date of transfer of capital asset, the amount of capital gains not charged to tax at the time of transfer would be deemed to be income chargeable under the head “Capital gains” of the previous year in which such transfer took place.

However, in this case, the above deeming provision would not apply because the eight year period from the date of transfer expires on 31.3.2018 and the disinvestment by LMN Ltd. of 7% shares held in PQR Ltd. was only in November, 2018.

(iii) **Sale of shares of Berkley Ltd. by LMN Ltd. in February 2019**

This transaction would attract capital gains tax in the hands of LMN Ltd. for the A.Y.2019-20. The capital gains would be long-term, since the period of holding is more than 24 months.

The cost of acquisition to PQR Ltd. in the year 1992 (i.e., Rs. 7,00,000) or the fair market value as on 1.4.2001 (Rs. 32,00,000), whichever is higher, would be deemed as the cost of acquisition in the hands of LMN Ltd.

**Computation of capital gains in the hands of LMN Ltd.**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sale consideration</td>
<td>95,00,000</td>
</tr>
<tr>
<td>Less: Indexed cost of acquisition [Rs. 32,00,000 x 280/100]</td>
<td>89,60,000</td>
</tr>
<tr>
<td><strong>Long-term capital gains</strong></td>
<td><strong>5,40,000</strong></td>
</tr>
<tr>
<td>Tax on long-term capital gains@20.8% (Rs. 5,40,000 x 20.8%)</td>
<td>1,12,320</td>
</tr>
</tbody>
</table>

2. Since gross receipts of Rs. 47,80,000 of Ms. Janani from interior decoration profession carried on by her is less than Rs. 50,00,000, she can opt for presumptive tax provisions under section 44ADA.

In such a case, her income from interior decoration profession would be Rs. 23,90,000, being 50% of Rs. 47,80,000. Since all deductions allowable under sections 30 to 38 are
deemed to have been given full effect to, no deduction in respect of depreciation would be allowable from the income computed on presumptive basis under section 44ADA.

I. Where Ms. Janani declares income from profession on presumptive basis u/s 44ADA

<table>
<thead>
<tr>
<th>Computation of total income of Ms. Janani</th>
<th>Rs.</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Income from house property</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Self-occupied property</td>
<td>Nil</td>
<td></td>
</tr>
<tr>
<td><strong>Let-out Property:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Annual Value [Rs. 15,000 x 12]</td>
<td>1,80,000</td>
<td></td>
</tr>
<tr>
<td>Less: Deduction u/s 24 [30% of Rs. 1,80,000]</td>
<td>54,000</td>
<td></td>
</tr>
<tr>
<td><strong>Profits and gains from business or profession</strong></td>
<td></td>
<td>1,26,000</td>
</tr>
<tr>
<td>Income from interior decoration profession</td>
<td></td>
<td></td>
</tr>
<tr>
<td>[50% of Rs. 47,80,000]</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total Income</strong></td>
<td>23,90,000</td>
<td>25,16,000</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Computation of tax liability of Ms. Janani</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax on total income = [30% of Rs. 15,16,000 (Rs. 25,16,000 – Rs.10,00,000) + Rs. 1,12,500]</td>
<td>5,67,300</td>
</tr>
<tr>
<td>Add: Health and education cess@4%</td>
<td>22,692</td>
</tr>
<tr>
<td><strong>Total tax liability</strong></td>
<td>5,89,992</td>
</tr>
<tr>
<td>Add: Interest under section 234B [1% of Rs. 5,89,900]</td>
<td>5,899</td>
</tr>
<tr>
<td>Interest under section 234C [1% of Rs. 5,89,900, since the advance tax liability has to be paid in one instalment or before 15.3.2019]</td>
<td>5,899</td>
</tr>
<tr>
<td><strong>Total tax and interest liability</strong></td>
<td><strong>6,01,790</strong></td>
</tr>
</tbody>
</table>

Ms. Janani can, however, declare lower profits than the presumptive profits of Rs. 23,90,000, if she maintains books of accounts under section 44AA and gets the same audited under section 44AB. In such case, she can file return on or before 30.9.2019.

II Where Ms. Janani declares income from profession as per books of account

<table>
<thead>
<tr>
<th>Computation of total income of Ms. Janani</th>
<th>Rs.</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Income from house property</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Self-occupied property</td>
<td>Nil</td>
<td></td>
</tr>
<tr>
<td><strong>Let-out property:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Annual Value [Rs. 15,000 x 12]</td>
<td>1,80,000</td>
<td></td>
</tr>
<tr>
<td>Less: Deduction u/s 24 [30% of Rs. 1,80,000]</td>
<td>54,000</td>
<td>1,26,000</td>
</tr>
<tr>
<td><strong>Profits and gains from business or profession</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Income from interior decoration profession</td>
<td></td>
<td></td>
</tr>
<tr>
<td>[Rs.25,00,000–Rs.1,50,000]</td>
<td></td>
<td>23,50,000</td>
</tr>
<tr>
<td><strong>Total Income</strong></td>
<td>24,76,000</td>
<td></td>
</tr>
</tbody>
</table>

| Computation of tax liability:            |     |     |
| Tax on total income = [30% of Rs. 14,76,000 (Rs. 24,76,000 – Rs.10,00,000) + Rs. 1,12,500] | 5,55,300 |     |
| Add: Health and education cess@4%        | 22,212 |     |
| **Total tax liability**                  | 5,77,512 |     |
Add: Interest under section 234B [1% of Rs.5,77,500] 5,775
Interest under section 234C [See Working Note below] 29,164
Total tax and interest liability 6,12,451
Total tax and interest liability (rounded off) 6,12,450

Although the income from profession computed as per books of account is lower than the income from profession computed on presumptive basis under section 44ADA, however, the cumulative tax and interest liability would be higher by Rs. 10,660 (i.e., Rs. 6,12,450 - Rs. 6,01,790) in case of the former. Therefore, Ms. Janani should opt to declare income on presumptive basis under section 44ADA, in which case, she has to file her return of income on or before 31st July, 2019.

**Working Note: Computation of interest under section 234C**

<table>
<thead>
<tr>
<th>Date</th>
<th>Advance tax payable till date</th>
<th>Short-fall (Rs.)</th>
<th>Rate of interest [1% per month]</th>
<th>Interest (Rs.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>15.06.2018</td>
<td>15%</td>
<td>86,625</td>
<td>3% [1% x 3]</td>
<td>2,599</td>
</tr>
<tr>
<td>15.09.2018</td>
<td>45%</td>
<td>2,59,875</td>
<td>3% [1% x 3]</td>
<td>7,796</td>
</tr>
<tr>
<td>15.12.2018</td>
<td>75%</td>
<td>4,33,125</td>
<td>3% [1% x 3]</td>
<td>12,994</td>
</tr>
<tr>
<td>15.03.2019</td>
<td>100%</td>
<td>5,77,500</td>
<td>1%</td>
<td>5,775</td>
</tr>
</tbody>
</table>

**Note** – The above solution has been worked out by considering that Ms. Janani pays the advance tax required to be paid in April, 2019 itself, after consulting the tax advisor in the month of April, 2019.

3. For the purpose of computation of long-term capital gains chargeable to tax under section 112A, the cost of acquisition in relation to the long-term capital asset, being an equity share in a company or a unit of an equity oriented fund or a unit of a business trust acquired before 1st February, 2018 shall be the higher of
   (i) cost of acquisition of such asset, i.e., actual cost; and
   (ii) lower of
       (a) the fair market value of such asset; and
       (b) the full value of consideration received or accruing as a result of the transfer of the capital asset.

In the four independent cases given in the question, the shares are long-term capital asset, since they are held for a period of more than 12 months preceding the date of its transfer. Accordingly, long-term capital gain/loss on transfer of STT paid listed equity shares would be determined as follows:
   (i) In the case of Mr. Ravi, the cost of acquisition of equity share of Tapti Ltd. would be Rs. 2,300, being higher of actual cost i.e., Rs. 1,200 and Rs. 2,300 (being the lower of FMV of Rs. 2,300 as on 31.1.2018 and actual sale consideration of Rs. 3,000). Thus, the long-term capital gain would be Rs. 3,50,000 i.e., (<Rs. 3,000 – Rs. 2,300> x 500 shares).
   (ii) In the case of Mr. Giri, the cost of acquisition of equity shares of Narmada Ltd. would be Rs. 4,200, being higher of actual cost i.e., Rs. 3,100 and Rs. 4,200 (being the lower of FMV of Rs. 4,500 as on 31.1.2018 and actual sale consideration of Rs. 4,200). Thus, the long-term capital gains would be Nil (<Rs. 4,200 – Rs.4,200> x 700 shares).
   (iii) In the case of Mr. Mani, the cost of acquisition of equity shares of Cauvery Ltd. would be Rs. 2,500, being higher of actual cost i.e., Rs. 2,500 and Rs.
1,800 (being the lower of FMV of Rs. 1,800 as on 31.1.2018 and actual sale consideration of Rs. 3,200). Accordingly, the long-term capital gains would be Rs. 2,10,000 i.e., \[(\text{Rs. 3,200} - \text{Rs. 2,500}) \times 300\].

(iv) In the case of Mr. Sathy, the cost of acquisition of equity shares of Mahanadi Ltd. would be Rs. 1,900, being higher of actual cost i.e., Rs. 1,900 and Rs. 1,700 (being the lower of FMV of Rs. 2,400 as on 31.1.2018 and actual sale consideration of Rs. 1,700). The long-term capital loss would be Rs. 1,20,000 \((\text{Rs. 1,700} – \text{Rs. 1,900}) \times 600 \text{ shares}\).

4. The issue under consideration is whether the interest income from share application money is taxable under the head ‘Income from Other Sources’, or can the same be set-off against public issue expenses.

This issue came up before the Supreme Court in CIT v. Sree Rama Multi Tech Ltd. [2018] 403 ITR 426. The Supreme Court observed that the assessee-company was statutorily required to keep share application money in a separate account till the allotment of shares was completed. Part of the share application money would normally have to be returned to unsuccessful applicants, and therefore, the entire share application money would not ultimately be appropriated by the company. The interest earned was inextricably linked with the requirement of raising share capital. The Supreme Court further observed that any surplus money deposited in the bank for the purpose of earning interest is liable to be taxed as “Income from Other Sources”; however, in this case, the share application money was deposited with the bank not to make additional income by earning interest but to comply with the statute. The interest accrued on such deposit is merely incidental. Moreover, the issue of shares relates to capital structure of the company and hence, expenses incurred in connection with the issue of shares are to be capitalized. Accordingly, the Supreme Court held that the accrued interest on deposit of share application money is eligible to be set-off against public issue expenses.

Applying the rationale of the Supreme Court ruling to the case on hand, the contention of the Assessing Officer that interest income is taxable under the head “Income from Other Sources” is not correct.

5. The issue under consideration is whether delay in filing appeal under section 260A can be condoned under section 14 of the Limitation Act, 1963, where the stated reason for delay is the pursuance of an alternate remedy by way of filing an application before the ITAT under section 254(2) for rectification of mistake apparent on record.

This issue came up before the Supreme Court in Spinacom India (P.) Ltd. v. CIT [2018] 258 Taxman 128. The Supreme Court rejected the question of invoking section 14 of the Limitation Act 1963 which allows condonation of delay on demonstration of sufficient cause. The Apex Court did not accept the submission that the application before the ITAT under section 254(2) was an alternate remedy to filing of the application under section 260A. The former is an application for rectifying a ‘mistake apparent from the record’ which is much narrower in scope than the latter. Under section 260A, an order of the ITAT can be challenged on substantial questions of law. The Court stated that the appellant had the option of filing an appeal under section 260A while also mentioning in the Memorandum of Appeal that its application under section 254(2) was pending before the ITAT. The Supreme Court, therefore, held that the time period for filing an appeal under section
260A does not get suspended on account of the pendency of an application before the ITAT under section 254(2).

Accordingly, applying the rationale of the above Supreme Court ruling to the facts of this case, the delay in filing appeal under section 260A due to pursuance of an alternate remedy by way of filing an application before the ITAT under section 254(2) cannot be condoned.

6. (a) Section 11(7) provides that where a trust has been granted registration under section 12AA and the registration is in force for a previous year, then, such trust cannot claim any exemption under any provision of section 10 [other than exemption of agricultural income under section 10(1) and exemption available under section 10(23C)].

Therefore, a charitable trust cannot claim exemption under section 10(35) in respect of income from mutual funds and exemption under section 10(34) in respect of dividends, since it has voluntarily opted for the special dispensation under sections 11 to 13, and consequently has to be governed by the provisions of these sections. Accordingly, it has to apply 85% of such income for charitable purposes to claim exemption under section 11. However, it can claim exemption under section 10(1) in respect of agricultural income, since section 11(7) provides an exception in respect of such income.

Therefore, the claim of Help All charitable trust, as regards exemption under section 10(34) and section 10(35), is not correct.

(b) Section 11(6) provides that income for the purposes of application shall be determined without allowing any deduction for depreciation or otherwise in respect of any asset, the cost of acquisition of which has been claimed as an application of income under section 11 in the same or any other previous year.

Accordingly, in this case, since the cost of computers (i.e., Rs. 12 lakh) has been claimed and allowed as application of income under section 11 while computing the income of the trust for the P.Y.2017-18, depreciation on computers will not be allowed for the purpose of determining income for the purposes of application in the P.Y.2018-19.

Therefore, the depreciation claim made by HistoSpace charitable trust is not correct.

7. The issue under consideration in this case is whether the increase in gross total income on account of disallowance of expenditure under section 40(a)(ia) can be considered for the purpose of deduction under section 80-IAC.

The Bombay High Court, in CIT v. Sunil Vishwambharnath Tiwari (2016) 388 ITR 630, observed that if, on account of non-deduction of tax at source by a company, expenses have been disallowed under section 40(a)(ia) which goes to increase the income chargeable under the head ‘Profits and gains of business or profession’, such enhanced income becomes eligible for deduction, as profit-linked deduction under Chapter VI-A is with reference to an assessee’s gross total income.

The High Court held that the company is entitled to claim profit-linked deduction under Chapter VI-A in respect of the enhanced gross total income as a consequence of disallowance of expenditure under section 40(a)(ia).

Further, the CBDT has, in its Circular No.37/2016 dated 2.11.2016, mentioned that the courts have generally held that if the expenditure disallowed is related to the business activity against which the Chapter VI-A deduction has been claimed, the
deduction needs to be allowed on the enhanced profits. Thus, the settled position is that the disallowances made under, *inter alia*, section 40(a)(ia), relating to the business activity against which the Chapter VI-A deduction has been claimed, result in enhancement of the profits of the eligible business, and that deduction under Chapter VI-A is admissible on the profits so enhanced by the disallowance.

Accordingly, applying the rationale of the Bombay High Court ruling and the CBDT Circular in this regard to the facts of this case, Sigma Ltd. would be entitled to claim deduction under section 80-IAC in respect of the enhanced profits of Rs. 25 lakhs, consequent to disallowance under section 40(a)(ia). The contention of Sigma Ltd. is, therefore, correct.

8. As per section 115-O, dividend distribution tax at the rate of 17.472% (i.e., 15% plus surcharge @12% and health and education cess@4%) is leviable on dividend declared, distributed or paid by a domestic company. As per section 115-O(1A), a holding company receiving dividend from its domestic subsidiary company can reduce the same from dividend declared, distributed or paid by it for the purpose of payment of dividend distribution tax. The dividend from its domestic subsidiary company should be received in the same financial year in which the holding company declares, distributes or pays the dividend. Further, the dividend shall not be considered for reduction more than once.

The conditions to be fulfilled for this purpose are as follows:

(1) The domestic subsidiary company should have paid the dividend distribution tax which is payable on such dividend;

(2) The recipient holding company should be a domestic company;

For this purpose, a holding company is a company which holds more than 50% of the nominal value of equity shares of another company.

Section 115-O(1B) provides that for the purposes of determining the tax on distributed profits payable in accordance with section 115-O, any amount by way of dividends referred to in section 115-O(1), as reduced by the amount referred to in section 115- O(1A) [referred to as net distributed profits], shall be increased to such amount as would, after reduction of the tax on such increased amount at the rate specified in section 115- O(1), be equal to the net distributed profits.

(i) **Where Vindhyas Ltd. holds 52% of shares of Satpura Ltd.**

In this case, Vindhyas Ltd. is the holding company of Satpura Ltd. It receives dividend during the year from its subsidiary company, Satpura Ltd., which has paid the DDT as payable on such dividend. Accordingly, dividend distributed by the holding company, Vindhyas Ltd., in the same year to the extent of dividend received from the subsidiary, Satpura Ltd., shall not be subject to DDT under section 115-O. Therefore, Vindhyas Ltd. can reduce the amount of dividend received from Satpura Ltd. from the dividend distributed by it for computation of dividend distribution tax payable.

On the basis of the aforesaid provisions, dividend distribution tax payable by Vindhyas Limited shall be computed as follows:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.in lakh</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dividend distributed by Vindhyas Ltd.</td>
<td>48.00</td>
</tr>
<tr>
<td>Less: Dividend received from subsidiary Satpura Ltd. (52% of Rs. 60 lakhs)</td>
<td>31.20</td>
</tr>
<tr>
<td>Net distributed profits</td>
<td>16.80</td>
</tr>
<tr>
<td>Add: Increase for the purpose of grossing up of dividend 16.80 × 2.96</td>
<td>2.96</td>
</tr>
</tbody>
</table>
Past Exams RTP’s

15/85

**Gross dividend** 19.76
Additional income-tax payable by Vindhyas Ltd. u/s 115-O 2.96
[15% of Rs. 19.76 lakh]
Add: Surcharge@12% 0.36
Add: Health and education cess@4% 0.13

Therefore, dividend distribution tax payable by Vindhyas Ltd. shall be 17.472% of Rs. 19.76 lakhs (grossed up amount) i.e. Rs. 3.45 lakhs.

(ii) **Where Vindhyas Ltd. holds 48% of shares of Satpura Ltd.**
In this case, since Vindhyas Ltd. is not the holding company of Satpura Ltd., it cannot reduce the dividend received from Satpura Ltd. from dividend distributed by it, for computing dividend distribution tax payable.

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs. in lakh</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dividend distributed by Vindhyas Ltd.</td>
<td>48.00</td>
</tr>
<tr>
<td>Add: Increase for the purpose of grossing up of dividend 48 × 15/85</td>
<td>8.47</td>
</tr>
<tr>
<td><strong>Gross dividend</strong></td>
<td>56.47</td>
</tr>
<tr>
<td>Additional income-tax payable by Vindhyas Ltd. u/s 115-O</td>
<td>8.47</td>
</tr>
<tr>
<td>[15% of Rs. 56.47 lakh]</td>
<td></td>
</tr>
<tr>
<td>Add: Surcharge@12%</td>
<td>1.02</td>
</tr>
<tr>
<td>Add: Health and education cess@4%</td>
<td>0.38</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>9.87</strong></td>
</tr>
</tbody>
</table>

9. As per section 80AC, while computing the total income of an assessee of a previous year (**P.Y. 2018-19, in this case**) relevant to any assessment year (**A.Y. 2019-20, in this case**), any deduction is admissible, *inter alia*, under section 80-IA, such deduction shall not be allowed unless it furnishes a return of income for such assessment year on or before the due date specified in section 139(1).

Since the partnership firm, M/s. Aravali, has undertaken specified domestic transactions and has to file transfer pricing report under section 92E for A.Y.2019-20, its due date of filing return of income for A.Y.2019-20 would be 30th November, 2019 as per section 139(1). Therefore, the difference in tax liability where return is filed on or before 30th November, 2019 and where return is filed in March, 2020 has to be computed to understand the impact of late filing of return on the tax liability of the firm.

**Computation of total income and tax liability of M/s. Aravali for A.Y.2019-20**

**I. Where the firm files its return of income on 30th November 2019:**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs. in lakhs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross Total Income</td>
<td>600.00</td>
</tr>
<tr>
<td>Less: Deduction under section 80-IA</td>
<td>510.00</td>
</tr>
<tr>
<td><strong>Total Income</strong></td>
<td><strong>90.00</strong></td>
</tr>
<tr>
<td>Tax liability@30%</td>
<td>27.00</td>
</tr>
<tr>
<td>Add: Health and education cess@4%</td>
<td>1.08</td>
</tr>
<tr>
<td><strong>Regular income-tax payable</strong></td>
<td><strong>28.08</strong></td>
</tr>
</tbody>
</table>
Computation of Alternate Minimum Tax payable [Section 115JC]

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs. in lakhs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Income</td>
<td>90.00</td>
</tr>
<tr>
<td>Add: Deduction under section 80-IA</td>
<td>510.00</td>
</tr>
<tr>
<td><strong>Adjusted Total Income</strong></td>
<td><strong>600.00</strong></td>
</tr>
<tr>
<td><strong>Alternate Minimum Tax (AMT) @ 18.5% on Rs. 600 lakhs</strong></td>
<td>111.00</td>
</tr>
<tr>
<td>Add: Surcharge@12% (Since adjusted total income &gt; Rs. 1 crore)</td>
<td>13.32</td>
</tr>
<tr>
<td>Add: Health and education cess@4%</td>
<td>4.97</td>
</tr>
<tr>
<td><strong>Total tax payable (AMT)</strong></td>
<td><strong>129.29</strong></td>
</tr>
</tbody>
</table>

Since the regular income-tax payable by the firm is less than the alternate minimum tax payable, the adjusted total income shall be deemed to be the total income of the firm for P.Y.2018-19 and it shall be liable to pay income-tax on such total income@18.5% [Section 115JC(1)]. Therefore, the tax payable for the A.Y.2019-20 would be Rs. 129.29 lakhs.

Tax credit for Alternate Minimum Tax [Section 115JD]

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs. in lakhs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total tax payable for A.Y.2019-20 (Alternate Minimum Tax)</td>
<td>129.29</td>
</tr>
<tr>
<td>Less: Regular income-tax payable</td>
<td>28.08</td>
</tr>
<tr>
<td>To be carried forward for set-off against regular income-tax payable (upto a maximum of fifteen assessment years).</td>
<td>101.21</td>
</tr>
</tbody>
</table>

II. Where the firm files its return of income in March, 2020:

Where the firm files its return in March, 2020, it would be a belated return under section 139(4). Consequently, as per section 80AC, deduction under section 80-IA would not be available. In such circumstances, the gross total income of Rs. 600 lakhs would be the total income of the firm.

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs. in lakhs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income-tax@30% of Rs. 600 lakhs</td>
<td>180.00</td>
</tr>
<tr>
<td>Add: Surcharge@12% (since total income exceeds Rs. 100 lakhs)</td>
<td>21.600</td>
</tr>
<tr>
<td>Income-tax (plus surcharge)</td>
<td>201.600</td>
</tr>
<tr>
<td>Add: Health and education cess@4%</td>
<td>8.064</td>
</tr>
<tr>
<td><strong>Total tax liability</strong></td>
<td><strong>209.664</strong></td>
</tr>
</tbody>
</table>

Right course of action to minimize tax liability

The right course of action to minimize tax liability would be to file the return of income under section 139(1) on or before the due date 30.11.2019 and claim deduction under section 80-IA. In such a case, the firm can claim deduction of Rs. 510 lakhs under section 80-IA. Thereafter, consequent to the clarifications obtained, if any change is required, it can file a revised return under section 139(5) within 31.3.2020 (i.e., within the end of A.Y. 2019-20) which would replace the original return filed under section 139(1). A revised return filed under section 139(5) would replace the original return filed under section 139(1).

If the firm files the return of income under section 139(1) on or before 30.11.2019, its tax liability would stand reduced to Rs. 129.29 lakhs, as against Rs. 209.664 lakhs to be paid if return is furnished after due date. Further, it would also be eligible for tax credit for alternate minimum tax under section 115JD to the extent of Rs. 101.21 lakhs. Therefore, the firm is advised to file its return of income on or before 30.11.2019.
10. Computation of MAT liability of Godavari Ltd. under section 115JB for A.Y.2019-20

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Book profit after adjustment of items under section 115JB(2) [except brought forward business loss and unabsorbed depreciation]</td>
<td>87,34,000</td>
<td></td>
</tr>
<tr>
<td><strong>Less: Brought forward business loss [Rs. 8,20,000 + Rs. 7,30,000]</strong></td>
<td>15,50,000</td>
<td>32,60,000</td>
</tr>
<tr>
<td>Unabsorbed depreciation [Rs. 7,60,000 + Rs. 9,50,000]</td>
<td>17,10,000</td>
<td></td>
</tr>
<tr>
<td>[Since Godavari Ltd. is a company against which an application for corporate insolvency resolution process has been admitted by NCLT under section 7 of the Insolvency and Bankruptcy Code, 2016, the amount of total loss brought forward (including unabsorbed depreciation) is allowed to be reduced from the book profit for the purposes of levy of MAT under section 115JB].</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Book profit computed in accordance with Explanation 1 to section 115JB(2)</strong></td>
<td>54,74,000</td>
<td></td>
</tr>
<tr>
<td><strong>Add: Items credited to OCI that will not be reclassified to profit or loss:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Deferred gains on cash flow hedges</td>
<td>6,70,000</td>
<td></td>
</tr>
<tr>
<td>Share of Other Comprehensive Income of Other Associates</td>
<td>2,80,000</td>
<td></td>
</tr>
<tr>
<td>Re-measurement of post-employment benefit obligations</td>
<td>5,20,000</td>
<td></td>
</tr>
<tr>
<td>Revaluation surplus for assets Rs. 8,20,000 [Book profit not to be increased by revaluation surplus for assets as per proviso to section 115JB(2A)]</td>
<td>Nil</td>
<td>14,70,000</td>
</tr>
<tr>
<td><strong>Less: Items debited to OCI that will not be reclassified to profit or loss:</strong></td>
<td></td>
<td>69,44,000</td>
</tr>
<tr>
<td>Deferred costs of hedging</td>
<td>3,80,000</td>
<td></td>
</tr>
<tr>
<td>Changes in fair values of equity instruments Rs. 8,00,000 [Book profit not to be decreased by changes in fair values of equity instruments as per proviso to section 115JB(2A)]</td>
<td>Nil</td>
<td>3,80,000</td>
</tr>
<tr>
<td><strong>Add: One-fifth of Transition amount [Credit Balance]</strong></td>
<td></td>
<td>65,64,000</td>
</tr>
<tr>
<td>Transition amount</td>
<td>48,00,000</td>
<td></td>
</tr>
<tr>
<td><strong>Less: Amounts to be excluded from above</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Capital Reserve</td>
<td>6,00,000</td>
<td></td>
</tr>
<tr>
<td>Translation difference in foreign operations</td>
<td>5,00,000</td>
<td></td>
</tr>
<tr>
<td><strong>One-fifth of Rs. 37,00,000</strong></td>
<td>7,40,000</td>
<td></td>
</tr>
<tr>
<td><strong>Book Profit for levy of MAT</strong></td>
<td>73,04,000</td>
<td></td>
</tr>
<tr>
<td>MAT on book profit under section 115JB = 18.5% of Rs. 73,04,000</td>
<td>13,51,240</td>
<td></td>
</tr>
<tr>
<td><strong>Add: Health and education cess@4%</strong></td>
<td>54,050</td>
<td></td>
</tr>
</tbody>
</table>

32.18
Past Exams RTP’s  AJ Education NeXt

**Computation of tax credit to be carried forward**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>MAT liability for A.Y.2019-20 (rounded off)</td>
<td>14,05,290</td>
</tr>
<tr>
<td>Income-tax computed as per the normal provisions of the Act for A.Y.2019-20</td>
<td>13,20,000</td>
</tr>
<tr>
<td>Since the income-tax liability computed as per the regular provisions of the Income-tax Act, 1961 is less than the MAT payable, the book profit would be deemed to be the total income and tax is leviable @18.5%: The total tax liability (rounded off) is Rs. 14,05,290.</td>
<td></td>
</tr>
</tbody>
</table>

**Computation of tax credit to be carried forward**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax payable for A.Y.2019-20 on deemed total income</td>
<td>14,05,290</td>
</tr>
<tr>
<td>Less: Income-tax payable as per the normal provisions of the Act</td>
<td>13,20,000</td>
</tr>
<tr>
<td>Tax credit in respect of tax paid on deemed income</td>
<td>85,290</td>
</tr>
</tbody>
</table>

[Can be carried forward for 15 Assessment Years i.e., upto A.Y.2034-35]

11. Section 264(4)(c) provides that the Principal Commissioner or Commissioner has no power to revise any order which has been made the subject matter of an appeal to the Commissioner (Appeals), even if the relief claimed in the petition is different from the relief claimed in appeal. The concept of total merger would apply in the case of section 264. It was so held by the Supreme Court in the case of *Hindustan Aeronautics Ltd v. CIT* (2000) 243 ITR 898.

Section 154(1A) provides that where any matter had been considered and decided in any proceeding by way of appeal or revision relating to an order, Assessing Officer may amend the order for rectification of mistake apparent from the record, in relation to a matter other than the matter which has been considered and decided. The concept of partial merger would apply in the case of section 154.

In the present case, since the order passed by the Assessing Officer in respect of the addition of unexplained investment of Rs. 12 lakhs became the subject matter of an appeal to the Commissioner (Appeals), the assessee, M/s. Uranus LLP, cannot apply for revision under section 264 even if the subject matter of revision i.e., addition of Rs. 4 lakhs under section 40(b) is different from the subject matter of appeal.

However, M/s. Uranus LLP can apply to the Assessing Officer for rectification of the order in respect of addition of Rs. 4 lakh under section 40(b), if the mistake is apparent from the record, as this matter has not been considered and decided in any proceeding by way of appeal or revision.

In the view of above, the assessee, M/s. Uranus LLP should seek rectification under section 154.

12. M/s. Pluto LLP is deemed to have under-reported its income since:

(1) its income assessed under 143(3) exceeds its income determined in a return processed under section 143(1)(a); and

(2) the income reassessed under section 147 exceeds the income assessed under section 143(3).

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

**Computation of penalty leviable under section 270A**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Assessment under section 143(3)</td>
<td></td>
</tr>
<tr>
<td>Under-reported income:</td>
<td></td>
</tr>
</tbody>
</table>

32.19
Total income assessed under section 143(3) | 40,00,000
(-) Total income determined u/s 143(1)(a) | 30,00,000
10,00,000

Tax payable on under-reported income:
- Tax on under-reported income of Rs. 10 lakhs plus tax on total income of Rs. 30 lakhs determined u/s 143(1)(a) \[30\% \text{ of Rs. } 40 \text{ lakh } + \text{ HEC@4\%}\] \[12,48,000\]
- Less: Tax on total income determined u/s 143(1)(a) \[30\% \text{ of Rs. } 30 \text{ lakh } + \text{ HEC@4\%}\] \[9,36,000\]
- Penalty leviable\@50\% of tax payable \[3,12,000\]

Reassessment under section 147
Under-reported income:
- Total income reassessed under section 147 | 45,00,000
(-) Total income assessed under section 143(3) | 40,00,000
5,00,000

Tax payable on under-reported income:
- Tax on under-reported income of Rs. 5 lakhs plus tax on total income of Rs. 40 lakhs assessed u/s 143(3) \[30\% \text{ of Rs. } 45 \text{ lakh } + \text{ HEC@4\%}\] \[14,04,000\]
- Less: Tax on total income assessed u/s 143(3) \[30\% \text{ of Rs. } 40 \text{ lakh } + \text{ HEC@4\%}\] \[12,48,000\]
- Penalty leviable\@50\% of tax payable \[1,56,000\]

13. Computation of total income of Neptune Inc., a notified FII, for A.Y.2019-20

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest on Rupee Denominated Bonds</td>
<td>8,50,000</td>
<td></td>
</tr>
<tr>
<td>Dividend income of Rs. 6,20,000 [Exempt under section 10(34)]</td>
<td>Nil</td>
<td></td>
</tr>
<tr>
<td>Interest on securities [No deduction is allowable in respect of expenses incurred in respect thereof]</td>
<td>17,32,000</td>
<td>25,82,000</td>
</tr>
<tr>
<td>Long-term capital gains on sale of bonds of Jupiter Ltd.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sale consideration</td>
<td>47,00,000</td>
<td>32,00,000</td>
</tr>
<tr>
<td>[Benefit of indexation is not allowable]</td>
<td></td>
<td>15,00,000</td>
</tr>
<tr>
<td>Short-term capital gains on sale of STT paid equity shares of Earth Ltd.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sale consideration</td>
<td>12,40,000</td>
<td></td>
</tr>
<tr>
<td>Short-term capital gains on sale on unlisted equity shares of Mars Ltd.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sale consideration</td>
<td>8,40,000</td>
<td>7,80,000</td>
</tr>
<tr>
<td>Short-term capital gains on sale on listed equity shares of Mars Ltd.</td>
<td></td>
<td>4,60,000</td>
</tr>
<tr>
<td>Total Income</td>
<td>50,10,000</td>
<td></td>
</tr>
</tbody>
</table>
### Computation of tax liability of Neptune Inc. for A.Y.2019-20

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax@5% on interest of Rs. 8,50,000 received from an Indian company on investment in rupee denominated bonds = 5% x Rs. 8,50,000</td>
<td>42,500</td>
<td></td>
</tr>
<tr>
<td>Tax@20% on interest on securities of Rs. 17,32,000 = 20% x Rs. 17,32,000</td>
<td>3,46,400</td>
<td></td>
</tr>
<tr>
<td>Tax@10% on long-term capital gains on sale of bonds of Jupiter Ltd. = 10% x Rs. 15,00,000</td>
<td>1,50,000</td>
<td></td>
</tr>
<tr>
<td>Tax@15% on short-term capital gains on sale of listed equity shares of Earth Ltd., in respect of which STT has been paid = 15% of Rs. 4,60,000</td>
<td>69,000</td>
<td></td>
</tr>
<tr>
<td>Tax@30% on short-term capital gains on sale of unlisted equity shares of Mars Ltd. = 30% of Rs. 4,68,000</td>
<td>1,40,400</td>
<td></td>
</tr>
<tr>
<td>Add: HEC@4%</td>
<td>7,48,300</td>
<td></td>
</tr>
<tr>
<td>Tax Liability</td>
<td>7,78,232</td>
<td></td>
</tr>
<tr>
<td>Tax Liability (roundedoff)</td>
<td>7,78,230</td>
<td></td>
</tr>
</tbody>
</table>

14. (i) Venus Inc. is a specified foreign company in relation to Mercury Ltd. Therefore, the condition of Mercury Ltd. holding shares carrying not less than 26% of the voting power in Venus Inc is satisfied. Hence, Venus Inc. and Mercury Ltd. are deemed to be associated enterprises as per section 92A(2). Therefore, provision of data processing services by Mercury Ltd., an Indian company, to Venus Inc., a foreign company, is an international transaction between associated enterprises, and consequently, the provisions of transfer pricing are attracted in this case.

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. Since Mercury 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.

Since the aggregate value of transactions entered into in the P.Y.2018-19 exceeds Rs. 100 crore but does not exceed Rs. 200 crore, Mercury Ltd. should have declared an operating profit margin of not less than 18% in relation to operating expense, to be covered within the scope of safe harbour rules. In this case, since Mercury Ltd. has declared an operating profit margin of $16 \div 80 \times 100$, the same is in accordance with the circumstance mentioned in Rule 10TD. Hence, the income-tax authorities shall accept the transfer price declared by Mercury Ltd in respect of such international transaction. Therefore, Mercury Ltd. need not make any primary adjustment.

(ii) Saturn Inc., a foreign company, guarantees 12% of the total borrowings of Jupiter Ltd., an Indian company. Since Saturn Inc. guarantees not less than 10% of the total borrowings of Jupiter Ltd., Saturn Inc. and Jupiter Ltd. are deemed to be associated enterprises as per section 90A(2). Therefore, provision of contract R & D services relating to software development by Jupiter Ltd., an Indian company, to Saturn 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 software development is an eligible international transaction. Since Jupiter 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. Since the value of the international transaction does not exceed Rs. 200 crore, Jupiter Ltd. should have declared an operating profit margin of not less than 24% in relation to operating expense, to be covered within the scope of safe harbour rules. In this case, since Jupiter Ltd. has declared an operating profit margin of 22.86% \( \left( \frac{40}{175} \times 100 \right) \), the same is not in accordance with the circumstance mentioned in Rule 10TD. Hence, it is not binding on the income-tax authorities to accept the transfer price declared by Jupiter Ltd.

Jupiter Ltd. has to, therefore, make a primary adjustment of Rs. 2 crores [i.e., Rs. 42 crores, being 24% of Rs. 175 crores – Rs. 40 crores] in the A.Y.2019-20.

15. **Computation of total income and tax liability of Mr. Gopal for A.Y. 2019-20**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Profits and gains from business and profession</strong></td>
<td>75,00,000</td>
<td>Nil</td>
</tr>
<tr>
<td>Income from sole proprietary concern in India</td>
<td>75,00,000</td>
<td>Nil</td>
</tr>
<tr>
<td>Share of profit from a partnership firm in India of Rs. 25 lakhs, is exempt</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Business profit</td>
<td>75,00,000</td>
<td>71,50,000</td>
</tr>
<tr>
<td>Less: Business Loss in Country G (CGD 5000 x Rs. 70/C GD)</td>
<td>3,50,000</td>
<td>71,50,000</td>
</tr>
<tr>
<td><strong>Income from Other Sources</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Agricultural income from tea gardens in Country G, is taxable in India (CGD 45000 x Rs. 70/C GD)</td>
<td>31,50,000</td>
<td></td>
</tr>
<tr>
<td><strong>Gross Total Income</strong></td>
<td>1,03,00,000</td>
<td></td>
</tr>
<tr>
<td>Less: Deductions under Chapter VI-A</td>
<td>1,50,000</td>
<td></td>
</tr>
<tr>
<td>Under section 80C [deposit in PPF]</td>
<td>1,50,000</td>
<td></td>
</tr>
<tr>
<td>Under section 80D</td>
<td>25,000</td>
<td></td>
</tr>
<tr>
<td>[Medi-claim premium paid Rs. 28,000, restricted to]</td>
<td>1,75,000</td>
<td></td>
</tr>
<tr>
<td><strong>Total Income</strong></td>
<td>1,01,25,000</td>
<td></td>
</tr>
<tr>
<td><strong>Tax on total income</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tax on Rs. 1,01,25,000 [(30% x Rs. 91,25,000) plus Rs. 1,12,500]</td>
<td>28,50,000</td>
<td></td>
</tr>
<tr>
<td>Add: Surcharge@15%, since total income exceeds Rs. 1 crore</td>
<td>4,27,500</td>
<td></td>
</tr>
<tr>
<td>Less: Marginal Relief (See Working Note below)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Add: HEC@4%</td>
<td>1,28,750</td>
<td>33,47,500</td>
</tr>
<tr>
<td>Average rate of tax in India [i.e., Rs.33,47,500/Rs. 1,01,25,000 x 100]</td>
<td>33.06%</td>
<td></td>
</tr>
<tr>
<td>Average rate of tax in Country G [i.e., CGD 9000/CGD 45000]</td>
<td>20%</td>
<td></td>
</tr>
<tr>
<td>Doubly taxed income [Rs. 31,50,000 – Rs. 3,50,000]</td>
<td>28,00,000</td>
<td></td>
</tr>
<tr>
<td>Rebate under section 91 on Rs. 28,00,000 @20% (lower of average Indian tax rate and rate of tax in Country G)</td>
<td>5,60,000</td>
<td></td>
</tr>
<tr>
<td>Taxpayable in India [Rs. 33,47,500 – Rs. 5,60,000]</td>
<td>27,87,500</td>
<td></td>
</tr>
</tbody>
</table>

**Note:** Since Mr. Gopal is resident in India for the P.Y.2018-19, his global income would be subject to tax in India. He is eligible for deduction under section 91 since the following conditions are fulfilled:

(a) He is a resident in India during the relevant previous year.
(b) Agricultural income accrues or arises to him outside India during that previous year.
(c) *Such agricultural income is not deemed to accrue or arise in India during the previous year.*
(d) The income in question i.e., agricultural income, has been subjected to income-tax in Country G in his hands and he has paid tax on such income in Country G.
(e) *There is no agreement under section 90 for the relief or avoidance of double taxation between India and Country G, where the income has accrued or arisen.*

**Working Note : Computation of Marginal Relief**

(A) Tax payable including surcharge on total income of Rs. 1,01,25,000

| Rs. 2,50,000 – Rs. 5,00,000 @5% | Rs. 12,500 |
| Rs. 5,00,000 – Rs. 10,00,000 @20% | Rs. 1,00,000 |
| Rs. 10,00,000 – Rs. 1,01,25,000 @30% | Rs. 27,37,500 |
| **Total** | **Rs. 28,50,000** |
| Add: Surcharge @ 15% | **Rs. 4,27,500** |

(B) Tax payable on total income of Rs. 1 crore

| ([Rs. 12,500 plus Rs. 1,00,000 plus Rs. 27,00,000) plus surcharge @10%] | Rs. 30,93,750 |

(C) Excess tax payable (A)-(B) | Rs. 1,83,750 |

(D) Marginal Relief (Rs. 1,83,750 – Rs. 1,25,000, being the amount of income in excess of Rs. 1,00,00,000) | Rs. 58,750 |

16. **Meaning of Fees for technical services and professional services under the UN Model Convention, 2017**

**Fees for technical services**

Article 12A of the UN Model Convention pertains to Fees for technical services (FTS). FTS is defined as payments for managerial, technical or consultancy services but excludes payment to an employee, payment for teaching in an educational institution or for teaching by an educational institution, payments by an individual for services for personal use.

**Professional services**

Article 14 of the UN Model Convention pertains to Independent Personal Services. As per this article, “professional services” includes especially independent scientific, literary, artistic, educational or teaching activities as well as the independent activities of physicians, lawyers, engineers, architects, dentists and accountants.

**Right of Source State to tax FTS and income for professional services under the UN Model Convention, 2017**

**Fees for technical Services (FTS)**
Article 12A(1) provides that the FTS may be taxed in the Residence State but does not provide that the FTS is exclusively taxable in the Residence State. Article 12A(2) establishes the right of the country in which FTS arises to tax in accordance with its domestic law, subject to the limitation on the maximum rate of tax, if the beneficial owner is a resident of the other Contracting State. The maximum rate of tax is to be established through bilateral negotiations.

**Income for Professional Services**

As per article 14, income derived by a resident of a Contracting State in respect of professional services or other activities of an independent character shall be taxable only in that State (i.e., Residence State) except in the following circumstances, when such income may also be taxed in the other Contracting State (i.e., Source State):

(a) If he has a fixed base regularly available to him in the Source State for the purpose of performing his activities; in that case, only so much of the income as is attributable to that fixed base may be taxed in the Source State; or

(b) If his stay in the Source State is for a period or periods amounting to or exceeding in the aggregate 183 days in any twelve-month period commencing or ending in the fiscal year concerned; in that case, only so much of the income as is derived from his activities performed in the Source State may be taxed in that State.

17. **BEPS Action Plan 6 – Preventing Treaty Abuse** requires introduction of Limitation of Benefits (LOB) clause or Principal Purpose Test (PPT) rule or both to protect against treaty shopping. Treaty shopping is a practice by which a resident of a third country takes advantage of beneficial treaty provisions between two countries by establishing a shell or conduit company in one of the two countries, where tax incidence is low.

Given the risk to revenues posed by treaty shopping, countries have committed to ensure a minimum level of protection against treaty shopping (the minimum standard). That commitment will require countries to include in their tax treaties an express statement that their common intention is to eliminate double taxation without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance, including through treaty shopping arrangements.

Accordingly, on 10th May, 2016, India and Mauritius has signed a protocol amending the India-Mauritius tax treaty at Mauritius. In the said treaty, for the first time, it has been provided that gains from the alienation of shares acquired on or after 1.4.2017 in a company which is a resident of India may be taxed in India. The tax rate on such capital gains arising during the period from 1.4.2017-31.3.2019 should, however, not exceed 50% of the tax rate applicable on such capital gains in India. A Limitation of Benefit (LOB) Clause has been introduced which provides that a resident of a Contracting State shall not be entitled to the benefits of 50% of the tax rate applicable in transition period if its affairs are arranged with the primary purpose of taking advantage of concessional rate of tax. Further, a shell or a conduit company claiming to be a resident of a Contracting State shall not be entitled to this benefit. A shell or conduit company has been defined as any legal entity falling within the meaning of resident with negligible or nil business operations or with no real and continuous business activities carried out in that Contracting State.
REVISION TEST PAPER – MAY 2019:

OBJECTIVE TYPE QUESTIONS:
From the options (a), (b), (c) and (d) given in each question, choose the most appropriate option.

(i) A Pvt. Ltd. is a closely held Indian company. It is a subsidiary of a foreign company Y Inc. which had already issued 5,00,000 shares to its shareholders. During P.Y. 2017-18, it incurred a loss of Rs. 10 crores which couldn’t be set off and hence, was carried forward. Further, there was also unabsorbed depreciation of Rs. 1 crore. During P.Y. 2018-19, Y Inc. amalgamated with Z Inc. and persons holding 2,45,000 shares of Y Inc. became the shareholders of Z Inc. Determine whether the brought forward loss of Rs. 10 crores and unabsorbed depreciation of Rs. 1 crore can be set off by A Pvt. Ltd. during P.Y. 2018-19.

(a) Loss cannot be set off but the unabsorbed depreciation can be set off.
(b) Loss can be set off but the unabsorbed depreciation cannot be set off.
(c) Both loss and unabsorbed depreciation can be set off.
(d) Both loss and unabsorbed depreciation cannot be set off.

(ii) Mr. Shiv was travelling from Delhi to Jodhpur on 05.07.2018 carrying FDRs of Rs. 20 Lakhs. The said FDRs were seized by the police authorities and subsequently, requisitioned by the income-tax authorities u/s 132A. The requisition was made on 20.07.2018. Now, the Assessing Officer has issued notices to Shiv u/s 153A for A.Y. 2009-10 to A.Y. 2018-19. Whether the said notices issued by the Assessing Officer u/s 153A are valid?

(a) Invalid. Notices can be issued u/s 153A in the present case by the Assessing Officer only for A.Y. 2013-14 to A.Y. 2018-19, since FDRs do not constitute an asset for the purpose of section 153A.
(b) Invalid. Notices can be issued u/s 153A in the present case by the Assessing Officer for A.Y. 2013-14 to A.Y. 2019-20.
(c) Notices are valid for A.Y. 2013-14 to A.Y. 2018-19. However, for A.Y. 2009-10 to A.Y. 2012-13, notices can be issued u/s 153A only if the Assessing Officer has any evidence which reveals that income, represented in form of asset is greater than or equal to Rs. 50 lakhs.
(d) Notices are valid for A.Y. 2009-10 to A.Y. 2018-19 as notices in case of requisition can be issued for 10 assessment years immediately preceding the A.Y. relevant to the P.Y. in which requisition is made.

(iii) XYZ is a charitable trust registered u/s 12AA w.e.f 01.04.2010. During the P.Y. 2017-18, it received a specific corpus donation for construction of building which was claimed as exempt u/s 11 during the said previous year. Now, during the P.Y. 2018-19, it desires to claim depreciation on such building as application of its income. Comment upon the validity of the said claim of depreciation.

(a) Depreciation can be claimed as the acquisition of building was not claimed as application of income u/s 11(1)(a).
(b) Depreciation cannot be claimed as the specific corpus donation was already claimed as exempt during P.Y. 2017-18.
(c) Depreciation can be claimed as it is a statutory deduction and no restriction regarding the same has been provided in section 11.

(d) It is upon the discretion of XYZ to either claim specific corpus donation for construction of building as exempt in the year of receipt or claim depreciation on building as application of income during various years.

(iv) A is a resident individual aged 45 years. Find out his tax liability for A.Y. 2019-20 on the basis of the following particulars:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Business income</td>
<td>5,00,000</td>
</tr>
<tr>
<td>Dividend from different domestic companies</td>
<td></td>
</tr>
<tr>
<td>(dividend distribution tax has been paid by these companies)</td>
<td></td>
</tr>
<tr>
<td>- G Ltd.</td>
<td>40,00,000</td>
</tr>
<tr>
<td>- H Ltd.</td>
<td>10,000</td>
</tr>
<tr>
<td>- I Ltd.</td>
<td>11,90,000</td>
</tr>
<tr>
<td>Expenditure for earning dividend income</td>
<td>2,60,000</td>
</tr>
<tr>
<td>(a)</td>
<td>Rs. 4,49,800</td>
</tr>
<tr>
<td>(b)</td>
<td>Rs. 6,09,180</td>
</tr>
<tr>
<td>(c)</td>
<td>Rs. 4,22,760</td>
</tr>
<tr>
<td>(d)</td>
<td>Rs. 13,000</td>
</tr>
</tbody>
</table>

(v) The tax liability of Mr. Sunil for the financial year 2018-19 came to Rs. 1,54,000. He has paid advance tax of Rs. 1,38,000 and there was a TDS credit of Rs. 44,000 in his account. He filed his return of income on 30th July, 2019 claiming the refund due. His assessment was completed under section 143(1) and he was granted the refund on 15th February, 2020. Subsequently, his case was selected for scrutiny and his income was assessed under section 143(3). As per the assessment order dated 25th August, 2020, his income was recomputed after making certain additions and his revised tax liability was computed at Rs. 1,76,000. Whether he will be liable to pay any interest on the excess refund granted to him? If yes, then for what period?

(a) Sunil will be liable to pay interest on the excess refund of Rs. 22,000 at the rate of ½ percent for a period of 7 months.

(b) Sunil will not be liable to pay any interest on the excess refund granted to him.

(c) Sunil will be liable to pay interest on the excess refund of Rs. 22,000 at the rate of 1 percent for a period of 6 months.

(d) Sunil will be liable to pay interest on the total refund of Rs. 28,000 at the rate of ½ percent for a period of 7 months.

(vi) P Ltd. is a domestic company which filed its return of income for A.Y. 2019-20 declaring a total income of Rs. 1,15,00,000. The assessment in its case was opened by the Assessing Officer by issuing notice u/s 143(2). The Assessing Officer doubted the genuineness of loans taken by the company and added an amount of Rs. 5,00,000 to the total income u/s 68 as cash credits. What shall be the effective rate at which the said income of Rs. 5,00,000 shall be taxable in the hands of P Ltd.?

(a) 77.25 %
(b) 66.768 %
(c) 78 %
(d) 33.384 %
(vii) Mr. A who is the tax consultant of X Pvt. Ltd. is computing the income from business of the company for A.Y. 2018-19 for determining the tax liability. X Pvt. Ltd. is not liable for tax audit u/s 44AB during the said year. While computing the business income under the normal provisions of the Income-tax Act, 1961, Mr. A has duly considered the provisions of the Income Computation and Disclosure Standards (“ICDS”) wherever applicable. However, Mr. A is confused regarding the applicability of ICDS while computing book profits for determining the MAT liability of the company u/s 115JB. Advise Mr. A regarding the same.

(a) Provisions of ICDS will not apply while computing “book profits” for the purposes of MAT as ICDS are applicable only for computation of income under the regular provisions of the Income-tax Act, 1961.

(b) Provisions of ICDS will apply while computing “book profits” for the purposes of MAT as ICDS are applicable for computing income under the “Profits and gains of business or profession”, whether computed under the normal provisions or on the basis of book profits under MAT provisions.

(c) Provisions of ICDS will not apply while computing “book profits” for the purposes of MAT as ICDS are not applicable in the case of an assessee not liable for tax audit.

(d) Provisions of ICDS will apply while computing “book profits” for the purposes of MAT as no exception regarding the same has been carved out in the notification with respect to ICDS.

(viii) Mr. X purchases 1,000 unlisted equity shares of Rs. 10 each in A Ltd. on 10.05.2018 @ Rs. 60. On 20.10.2018, he transfers 800 equity shares @Rs. 30 per share and remaining 200 shares are transferred on 20.12.2018 @Rs. 20 per share. A Ltd. declares 50 percent dividend (record date: 03.08.2018). Also, during the previous year 2018-19, X has also earned long term capital gain of Rs. 96,000 on sale of a capital asset. Compute the amount of short term capital loss on sale of shares in question that can be set off from the long term capital gain of Rs. 96,000.

(a) Rs. 28,000  
(b) Rs. 32,000  
(c) Rs. 27,000  
(d) Rs. 8,000

(ix) Mr. Gagan, aged 67 years and resident, is a retired person earning a monthly pension of Rs. 12,000 from his employer. He purchased a piece of land in Delhi in December, 2010 and sold the same in April, 2018. Taxable LTCG amounted to Rs. 2,80,000. Apart from pension income and gain on sale of land, he is not having any other income. What will be his tax liability (rounded off) for the year 2018-19?

(a) Rs. 25,790  
(b) Rs. 6,450  
(c) Rs. 4,370  
(d) Rs. 17,470

(x) ABC India Pvt. Ltd and XYZ India Pvt. Ltd are related parties, as defined under section 40A(2)(b), who have entered into a transaction for purchase of goods for Rs. 25 lacs on 2nd April, 2018. The Arm Length Price for such goods is Rs. 15 lacs. Aggregate value of such transactions in the previous year 2018-19 is Rs. 22.5 crores. Can the transaction be considered as a specified domestic transaction to attract transfer pricing provisions?

(a) Yes, as the aggregate transaction value exceeds Rs. 20 crores  
(b) Yes, as parties are related parties.  
(c) No, transfer pricing provisions are not applicable in this case
(d) Yes, since parties are related parties and the aggregate transaction value exceeds Rs. 20 crores

**DESCRIPTIVE QUESTIONS:**

1. Mr. Prem commenced operations of the businesses of setting up a warehousing facility for storage of food grains, sugar and edible oil on 1.4.2018.

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Food grains</th>
<th>Sugar</th>
<th>Edible Oil</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1) Profits from business (computed) before allowing deduction under section 35AD/section 32</td>
<td>Rs. in lakhs</td>
<td>125</td>
<td>60</td>
</tr>
<tr>
<td>(2) Capital expenditure on land and building purchased exclusively for the business (January 2018 - March 2018) and capitalized in the books of account as on 1st April, 2018</td>
<td>Rs. in lakhs</td>
<td>120</td>
<td>90</td>
</tr>
<tr>
<td>(3) Cost of land included in (2) above</td>
<td>Rs. in lakhs</td>
<td>75</td>
<td>60</td>
</tr>
<tr>
<td>(4) Capital expenditure incurred during P.Y.2018-19 on extension/reconstruction of building purchased and used exclusively for the business</td>
<td>Rs. in lakhs</td>
<td>30</td>
<td>20</td>
</tr>
</tbody>
</table>

Compute Mr. Prem’s total income and tax liability for the A.Y. 2019-20, assuming that Mr. Prem does not have any income other than income from the above businesses.

2. Compute the long-term capital gains/loss on transfer of listed equity shares (STT paid both at the time of acquisition and transfer of shares) for the A.Y. 2019-20, in the four independent cases given below:

<table>
<thead>
<tr>
<th>Name of Co.</th>
<th>No. of shares</th>
<th>Date of acquisition</th>
<th>Cost of acquisition (per share)</th>
<th>Date of transfer</th>
<th>Sale price (per share)</th>
<th>FMV as on 31.1.2018 (per share)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mr. Ganesh</td>
<td>A Ltd.</td>
<td>1,000</td>
<td>28.12.2016</td>
<td>Rs. 1,000</td>
<td>1.5.2018</td>
<td>Rs. 2,500</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Rs. 2,000</td>
</tr>
<tr>
<td>Mr. Rajesh</td>
<td>B Ltd.</td>
<td>2,000</td>
<td>30.11.2016</td>
<td>Rs. 3,000</td>
<td>1.6.2018</td>
<td>Rs. 5,000</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Rs. 6,500</td>
</tr>
<tr>
<td>Mr. Sridhar</td>
<td>C Ltd.</td>
<td>3,000</td>
<td>1.1.2017</td>
<td>Rs. 2,000</td>
<td>1.7.2018</td>
<td>Rs. 3,000</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Rs. 1,500</td>
</tr>
<tr>
<td>Mr. Vaibhav</td>
<td>D Ltd.</td>
<td>4,000</td>
<td>15.1.2017</td>
<td>Rs. 4,000</td>
<td>1.8.2018</td>
<td>Rs. 2,500</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Rs. 6,000</td>
</tr>
</tbody>
</table>

3. Mr. Dheeraj has commenced the business of manufacture of paper on 1.4.2018. He employed 180 new employees during the P.Y. 2018-19, the details of whom are as follows -

<table>
<thead>
<tr>
<th>No. of employees</th>
<th>Date of employment</th>
<th>Regular/ Contractual</th>
<th>Total monthly emoluments per employee (Rs.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i) 51</td>
<td>1.4.2018</td>
<td>Regular</td>
<td>23,000</td>
</tr>
<tr>
<td>(ii) 46</td>
<td>1.6.2018</td>
<td>Regular</td>
<td>26,000</td>
</tr>
</tbody>
</table>
The regular employees participate in recognized provident fund while the contractual employees do not. The emoluments are paid by use of ECS through a bank account.

(i) Compute the deduction, if any, available to Mr. Dheeraj for A.Y.2019-20, if the profits and gains derived from manufacture of paper that year is Rs. 74 lakh and his total turnover is Rs. 2.56 crore.

(ii) Would your answer change if Mr. Dheeraj has commenced the business of manufacturing of leather products (and not paper) on 1.4.2018 and the above particulars related to such business?

4. Mega Tea Ltd. is a tea company engaged in cultivating and processing tea in its factory for marketing. The company distributed dividend of Rs. 25 lakhs to its shareholders. The Assessing Officer was of the view that the entire dividend is subject to dividend distribution tax. The company, however, contended that the tax on dividend declared by it in this case is nothing but a tax on agricultural income; and the legislative competence for taxing agricultural income lies with the State Government and not the Central Government. On appeal, the Appellate Authority held that since the company is carrying on cultivation of tea, which is an agricultural process as also the processing of tea in the factory, which is an industrial process, 40% of dividend distributed by the company is to be taxed under Section 115-O. Discuss the correctness or otherwise of the contention of the Appellate Authority.

5. Rhombus (P) Limited is engaged in manufacture and sale of ceramic tiles. The net profit of the company as per its profit and loss account for the year ended 31st March, 2019 is Rs. 210 lakh after debiting or crediting the following items:

(i) One-time license fee of Rs. 32 lakh paid to ABC Ltd (an Indian company) for obtaining franchise on 1st June, 2018.

(ii) Rs. 32,000 paid to Beta & Co., a goods transport operator, in cash on 31st January, 2019 for carrying company’s products to the warehouse.

(iii) Rent of Rs. 50,000 p.m. received from letting out a part of its office premises. Municipal tax in respect of the said part of the building is Rs. 8,000 remains unpaid due to court litigation.

(iv) Rs. 1 lakh, being contribution to a scientific research association approved and notified under section 35(1)(ii).

(v) Rs. 2 lakh, being loss due to destruction of a machinery caused by a fire due to short circuit. The Insurance Company did not admit the claim of the company.

(vi) Rs. 5 lakh paid to a contractor for repair work at the company’s factory. No tax was deducted on such payment.

(vii) Dividend of Rs. 10,000 from Gama Limited on 1,000 equity shares of Rs. 10 each purchased at Rs. 100 per share on 10th October, 2018. The rate of dividend declared is 100%, the record date being 10th December, 2018. The shares were sold on 1st March, 2019 at Rs. 80 per share.

(viii) Depreciation on tangible fixed assets as per books of account Rs. 2.20 lakh.

Additional Information:

(i) Depreciation on tangible fixed assets as per Income-tax Rules Rs. 2.60 lakh.
(ii) The company has obtained a loan of Rs. 2 lakh from Theta Private Limited in which it holds 16% voting rights. The accumulated profits held by Theta Private Limited on the date of loan were Rs. 0.50 lakh.
Compute total income of Rhombus (P) Ltd. for the Assessment Year 2019-20 indicating reasons for treatment of each item. Ignore the provisions relating to minimum alternate tax.

6. Edu All Charitable Trust registered under section 12AA, following cash system of accounting, furnishes you the following information for P.Y. 2018-19:
   (i) Gross receipts from hospital Rs.200 lakhs.
   (ii) Gross receipts from medical college Rs. 95 lakhs (offering recognized degree courses).
   (iii) Corpus donations by way of cheque Rs.42 lakhs and by way of cash Rs.6 lakhs.
   (iv) Anonymous donations by cash Rs.12 lakhs.
   (v) Administrative expenses for hospital Rs.75 lakhs.
   (vi) Fees not realized from patients Rs. 18,00,000 as on 31st March, 2019.
   (vii) Depreciation on assets of the trust Rs. 37,50,000. The entire cost of assets Rs. 250 lakhs claimed as application in the earlier years.
   (viii) Acquired a building for Rs. 80 lakhs on 01.06.2018 for expansion of hospital (cost of land included therein Rs. 50 lakhs). Stamp duty value of the land and building on the date of registration of sale deed Rs. 210 lakhs.
   (ix) The trust gave corpus donation of Rs. 19 lakhs to Help Aid Trust having objects of charitable nature registered under section 12AA but not similar to the objects of the donor trust.
You are required to compute the total income of the trust and its income-tax liability in such a manner that it can avail the optimal benefit within the four corners of the Income- Tax Act, 1961.
Note: The trust does not want to seek accumulation of income by virtue of section 11(2) of the Act.

7. Auto Ltd., a manufacturer of automobiles, sells premium cars (each of value between Rs.12 lakh to Rs.25 lakh) and small cars (each of value between Rs.5 lakh to Rs. 9 lakh) to its dealers across the country. Discuss whether the manufacturers are liable to collect tax at source under section 206C. Also, discuss the liability, if any, of dealers to collect tax at source on sale of these cars to the retail customers, if no part of the consideration is received in cash? Would your answer change, if part of the consideration is received in cash?

8. The assessment of Lambda Ltd. was completed under section 143(3) with an addition of Rs. 22 lakhs to the returned income. The assessee-company preferred an appeal before the Commissioner (Appeals) which is pending now.
In this backdrop, answer the following:
   (i) Based on fresh information that there was escapement of income for the same assessment year, can the Assessing Officer initiate reassessment proceedings when the appeal is pending before Commissioner (Appeals)?
   (ii) Can the Assessing Officer pass an order under section 154 for rectification of mistake in respect of issues not being subject matter of appeal?
(iii) Can the assessee-company seek revision under section 264 in respect of matters other than those preferred in appeal?
(iv) Can the Commissioner make a revision under section 263 both in respect of matters covered in appeal and other matters?

9. Examine the correctness or otherwise of the following statements with reference to the provisions of the Income-tax Act, 1961:
(i) The Commissioner (Appeals) cannot admit an appeal filed beyond 30 days from the date of receipt of order by an assessee.
(ii) The Appellate Tribunal is empowered to grant indefinite stay for the demand disputed in appeals before it.

10. Mr. Vallish had approached the Settlement Commission for waiver of interest under sections 234A to 234C of the Income-tax Act, 1961. The Settlement Commission partially waived the interest but refused to grant interest on refund on the grounds that section 244A does not provide for payment of interest in such cases. Further, the Settlement Commission contended that its power to waive interest does not enable it to provide for payment of interest under section 244A. Discuss the correctness of the Settlement Commission’s action in denying to grant interest on refund.

11. (i) Xylo Inc., a US company, received income by way of fees for technical services of Rs.2 crore from Alpha Ltd., an Indian company, in pursuance of an agreement between Alpha Ltd. and Xylo Inc. entered into in the year 2012, which is approved by the Central Government. Expenses incurred for earning such income is Rs. 8 lakhs. Examine the taxability of the above sum in the hands of Xylo Inc as per the provisions of the Income-tax Act, 1961 and the requirement, if any, to file return of income, assuming that Xylo Inc does not have a permanent establishment in India.
(ii) If Xylo Inc. has a permanent establishment in India and the contract/agreement with Alpha Ltd. for rendering technical services is effectively connected with such PE in India, examine the taxability based on the following details provided –

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1) Fees for technical services received from Alpha Ltd.</td>
<td>Rs.2 crore</td>
</tr>
<tr>
<td>(2) Expenses incurred for earning such income</td>
<td>Rs.8 lakhs</td>
</tr>
<tr>
<td>(3) Fees for technical services received from other Indian companies in pursuance of approved agreement entered into between the years 2005 to 2010</td>
<td>Rs.4 crore</td>
</tr>
<tr>
<td>(4) Expenses incurred for earning such income</td>
<td>Rs.15 lakhs</td>
</tr>
<tr>
<td>(5) Expenditure not wholly and exclusively incurred for the business of such PE [not included in (2) &amp; (4) above]</td>
<td>Rs.6 lakhs</td>
</tr>
<tr>
<td>(6) Amounts paid by the PE to Head Office (not being in the nature of reimbursement of actual expenses)</td>
<td>Rs.12 lakhs</td>
</tr>
</tbody>
</table>

What are the other requirements, if any, under the Income-tax Act, 1961 in this case?

12. Mr. Hari, an individual resident in India aged 59 years, furnishes you the following particulars of income earned in India, Foreign Countries "P" and "Q" for the previous year 2018-19. Compute the total income and tax payable by Mr. Hari in
India for A.Y. 2019-20 assuming that India has not entered into double taxation avoidance agreement with countries P & Q.

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Indian Income:</strong></td>
<td></td>
</tr>
<tr>
<td>Income from business carried on in Calcutta</td>
<td>4,40,000</td>
</tr>
<tr>
<td>Interest on savings bank with HDFC Bank</td>
<td>42,000</td>
</tr>
<tr>
<td><strong>Income earned in Foreign Country “P” [Rate of tax – 16%]:</strong></td>
<td></td>
</tr>
<tr>
<td>Agricultural income in Country &quot;P&quot;</td>
<td>94,000</td>
</tr>
<tr>
<td>Royalty income from a book on art from Country &quot;P&quot; (Gross)</td>
<td>7,80,000</td>
</tr>
<tr>
<td>Expenses incurred for earning royalty</td>
<td>50,000</td>
</tr>
<tr>
<td><strong>Income earned in Foreign Country “Q” [Rate of tax – 20%]:</strong></td>
<td></td>
</tr>
<tr>
<td>Dividend received from a company incorporated in Country &quot;Q&quot;</td>
<td>2,65,000</td>
</tr>
<tr>
<td>Rent from a house situated in Country &quot;Q&quot; (gross)</td>
<td>3,30,000</td>
</tr>
<tr>
<td>Municipal tax paid in respect of the above house (not allowed as deduction in Country “Q”)</td>
<td>10,000</td>
</tr>
</tbody>
</table>

13. (i) Research & Co. is engaged in providing scientific research services to several non-resident clients. Such services are also provided to B Inc., which guarantees 15% of the total loans of Research & Co. Examine whether transfer pricing provisions are attracted in respect of this transaction.

(ii) Without prejudice to the answer to (i) above, assuming that transfer pricing provisions are attracted in this case and that the Assessing Officer had made a primary adjustment of Rs. 225 lakhs to transfer price in the P.Y.2016-17 vide order dated 1.4.2018 and the same was accepted by Research & Co., what are the consequent requirements as per the Income-tax Act, 1961 and the implications of non-compliance with the said requirements? Assume that the transaction is denominated in Indian Rupees and no amount has been repatriated up to 31.3.2019. The one year marginal cost of fund lending rate of State Bank of India as on 1.4.2018 is 8.15%.

14. Narmada Ltd., an Indian Company has borrowed Rs. 80 crores on 01-04-2018 from M/s. Thames Inc, a Company incorporated in London, at an interest rate of 10% p.a. The said loan is repayable over a period of 5 years. Further, loan is guaranteed by M/s Tyne Inc. incorporated in UK. M/s. Tweed Inc, a non-resident, holds shares carrying 40% of voting power both in M/s Narmada Ltd. and M/s Tyne Inc.

Net profit of M/s. Narmada Ltd. for P.Y. 2018-19 was Rs. 7 crores after debiting the above interest, depreciation of Rs. 4 crores and income-tax of Rs. 3 crores.

Calculate the amount of interest to be disallowed under the head “Profits and gains of business or profession” in the computation of M/s Narmada Ltd., giving appropriate reasons.

15. Explain the meaning of “significant economic presence”. Does “significant economic presence” constitute “business connection” for attracting deemed accrual provisions under section 9(1)? Examine, in line with which action plan of BEPS, has this provision been introduced in the Income-tax Act, 1961.
16. What is the difference between OECD Model Convention, 2017 and UN Model Convention, 2017 relating to right of Source State to tax business profits of an enterprise? Explain.

**SOLUTION:**

**MOST APPROPRIATE OPTION:**

(i) (a) 
(ii) (c) 
(iii) (a) 
(iv) (a) 
(v) (a) 
(vi) (c) 
(vii) (a) 
(viii) (a) 
(ix) (d) 
(x) (c)

**SUGGESTED ANSWERS/HINTS:**

1. Computation of total income of Mr. Prem for A.Y.2019-20

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.(in lakhs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profits and gains of business or profession</td>
<td>60.00</td>
</tr>
<tr>
<td>Profits and gains from the specified business of setting up a warehousing facility for storage of food grains and sugar [See Working Note below]</td>
<td>30.00</td>
</tr>
<tr>
<td>Profit from business of setting up of warehouse for storage of edible oil (before providing for depreciation under section 32)</td>
<td>26.00</td>
</tr>
<tr>
<td>Less: Depreciation under section 32</td>
<td>4.00</td>
</tr>
<tr>
<td>10% of Rs. 40 lakh, being (Rs. 75 lakh – Rs. 45 lakh + Rs. 10 lakh)</td>
<td>26.00</td>
</tr>
<tr>
<td>Total Income</td>
<td>86.00</td>
</tr>
</tbody>
</table>

Computation of tax liability for A.Y.2019-20

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.(in lakhs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax liability under the normal provisions of the Income-tax Act, 1961 [30% of Rs. 76 lakhs (Rs. 86 lakhs – Rs. 10 lakhs) + Rs. 1,12,500]</td>
<td>23.93</td>
</tr>
<tr>
<td>Add: Surcharge @10% (Since total income &gt; Rs. 50 lakhs but does not exceed Rs. 1 crore)</td>
<td>2.39</td>
</tr>
<tr>
<td>Add: Health and education cess @4%</td>
<td>1.05</td>
</tr>
<tr>
<td>Total tax liability</td>
<td>27.37</td>
</tr>
</tbody>
</table>

Adjusted Total Income | Rs.(in lakhs) |
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Income</td>
<td>86.00</td>
</tr>
<tr>
<td>Add: Deduction under section 35AD [See Working Note below]</td>
<td>125.00</td>
</tr>
<tr>
<td>Less: Depreciation under section 32 [10% of Rs. 125 lakh]</td>
<td>12.50</td>
</tr>
<tr>
<td>Adjusted Total Income</td>
<td>198.50</td>
</tr>
<tr>
<td>AMT@18.5%</td>
<td>36.72</td>
</tr>
</tbody>
</table>
Add: Surcharge@15% (Since adjusted total income > Rs. 1 crore)  
5.51

Add: Health and Education cess @4%  
1.69

Tax liability under section 115JC  
43.92

Since the regular income-tax payable is less than the AMT payable, the adjusted total income of Rs. 198.50 lakhs shall be deemed to be the total income of Mr. Prem and tax is payable @18.5% thereof plus surcharge@15% (since adjusted total income exceeds Rs. 1 crore) plus cess@4%. Therefore, the tax liability is Rs. 43.92 lakhs.

AMT Credit to be carried forward under section 115JD  
Tax liability under section 115JC  
43.92
Less: Tax liability under the regular provisions of the Income-tax Act, 1961  
27.37
Working Note:

Computation of income from specified business under section 35AD

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Food Grains (Rs. in lakhs)</th>
<th>Sugar (Rs. in lakhs)</th>
<th>Total (Rs. in lakhs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>(A) Profits from the specified business of setting up a warehousing facility (before providing deduction under section 35AD)</td>
<td>125.00</td>
<td>60.00</td>
<td>185.00</td>
</tr>
<tr>
<td>Less: Deduction under section 35AD</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(B) Capital expenditure incurred prior to 1.4.2018 (i.e., prior to commencement of business) and capitalized in the books of account as on 1.4.2018 (excluding the expenditure incurred on acquisition of land)=Rs.45lakh(Rs.120 lakh–Rs.75 lakh)andRs.30 lakh(Rs.90lakh–Rs.60lakh)</td>
<td>45.00</td>
<td>30.00</td>
<td>75.00</td>
</tr>
<tr>
<td>(C) Capital expenditure incurred during the P.Y.2018-19</td>
<td>30.00</td>
<td>20.00</td>
<td>50.00</td>
</tr>
<tr>
<td>(D) Total capital expenditure (B + C)</td>
<td>75.00</td>
<td>50.00</td>
<td>125.00</td>
</tr>
<tr>
<td>(E) Deduction under section 35AD</td>
<td>100% of capital expenditure</td>
<td>75.00</td>
<td>50.00</td>
</tr>
<tr>
<td>(F) Profits from specified business of setting up and operating a warehousing facility for storage of food gains and sugar (A-E)</td>
<td>50.00</td>
<td>10.00</td>
<td>60.00</td>
</tr>
</tbody>
</table>

Notes:

(i) Deduction of 100% of the capital expenditure is available under section 35AD for A.Y.2019-20 in respect of specified business of setting up and operating a warehousing facility for storage of food grains and sugar.

(ii) Since setting up and operating a warehousing facility for storage of edible oil is not a specified business, Mr. Prem is not eligible for deduction under section 35AD in respect of capital expenditure incurred for such business. Mr. Prem can, however, claim depreciation@10% under section 32 in respect of the capital expenditure incurred on buildings. It is presumed that the buildings were put to use for more than 180 days during the P.Y.2018-19.

32.34
2. For the purpose of computation of long-term capital gains chargeable to tax under section 112A, the cost of acquisition in relation to the long-term capital asset, being an equity share in a company or a unit of an equity oriented mutual fund or a unit of a business trust acquired before 1\textsuperscript{st} February, 2018 shall be the higher of

(i) cost of acquisition of such asset; and

(ii) lower of

(a) the fair market value of such asset; and

(b) the full value of consideration received or accruing as a result of the transfer of the capital asset.

In short, the cost of acquisition for the long-term capital asset acquired on or before 31.01.2018 will be the actual cost.

However, if the actual cost is less than the fair market value of such asset as on 31.01.2018, the fair market value will be deemed to be the cost of acquisition.

Further, if the full value of consideration on transfer is less than the fair market value, then such full value of consideration or the actual cost, whichever is higher, will be deemed to be the cost of acquisition.

In the four independent cases given in the question, the shares are long-term capital asset, since they are held for a period of more than 12 months preceding the date of its transfer. Accordingly, long-term capital gain/loss on transfer of STT paid listed equity shares would be determined as follows:

<table>
<thead>
<tr>
<th>Person</th>
<th>Particulars</th>
<th>LTCG/LTCL (in Rs.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mr. Ganesh</td>
<td>In this case, the cost of acquisition of equity share of A Ltd. would be Rs. 2,000, being higher of actual cost i.e., Rs. 1,000 and Rs. 2,000 (being the lower of FMV of Rs. 2,000 as on 31.1.2018 and actual sale consideration of Rs. 2,500). Thus, the long-term capital gain would be (Rs. 2,500 – Rs. 2,000) x 1,000 shares.</td>
<td>5,00,000</td>
</tr>
<tr>
<td>Mr. Rajesh</td>
<td>In this case, the cost of acquisition of equity shares of B Ltd. would be Rs. 5,000, being higher of actual cost i.e., Rs. 3,000 and Rs. 5,000 (being the lower of FMV of Rs. 6,500 as on 31.1.2018 and actual sale consideration of Rs. 5,000). In other words, actual cost of acquisition (i.e., Rs. 3,000) is less than the FMV of Rs. 6,500 as on 31.1.2018. However, the sale value of Rs. 5,000 is also less than the FMV of Rs. 6,500 as on 31.1.2018. Accordingly, the sale value of Rs. 5,000 will be taken as the cost of acquisition. The long-term capital gains would be Nil (Rs. 5,000 – Rs. 5,000) x 2,000 shares.</td>
<td>Nil</td>
</tr>
<tr>
<td>Mr. Sridhar</td>
<td>In this case, the cost of acquisition of equity shares of C Ltd. would be Rs. 2,000, being higher of actual cost i.e., Rs. 2,000 and Rs. 1,500 (being the lower of FMV of Rs. 1,500 as on 31.1.2018 and actual sale consideration of Rs. 3,000). In other words, the FMV of equity shares of C Ltd. on</td>
<td>30,00,000</td>
</tr>
</tbody>
</table>
31.1.2018 (i.e., Rs. 1,500) is less than Rs. 2,000, being the actual cost of acquisition of equity shares, and therefore, the actual cost of Rs. 2,000 would be taken as cost of acquisition. Accordingly, the long-term capital gains would be 
(Rs. 3,000 – Rs.2,000) x 3,000

Mr. Vaibhav

In this case, the cost of acquisition of equity shares of D Ltd. would be Rs. 4,000, being higher of actual cost i.e., Rs. 4,000 and Rs. 2,500 (being the lower of FMV of Rs. 6,000 as on 31.1.2018 and actual sale consideration of Rs. 2,500).

In other words, the actual cost of acquisition of equity shares D Ltd. (i.e., Rs. 4,000) is less than the FMV of Rs. 6,000 as on 31.1.2018. However, the sale value of Rs. 2,500 is also less than the FMV of Rs. 6,000 as on 31.1.2018 and also the cost of acquisition. Accordingly, the actual cost of Rs. 4,000 will be taken as the cost of acquisition.

The long-term capital loss would be Rs. 6,00,000 (Rs. 2,500 – Rs. 4,000) x 4,000 shares.

3. (i) **Case 1: Where Mr. Dheeraj has commenced the business of manufacture of paper on 1.4.2018**

Mr. Dheeraj is eligible for deduction under section 80JJAA since he is subject to tax audit under section 44AB for A.Y.2019-20, as his total turnover from business exceeds Rs. 1 crore and he has employed “additional employees” during the P.Y.2018-19. Also, emoluments are paid by use of ECS through a bank account.

Since this is the first year of his new business, emoluments paid or payable to employees employed during this year shall be deemed to be the additional employee cost.

Deemed additional employee cost = Rs. 23,000 × 12 × 51 [See Working Note below] = Rs. 1,40,76,000

Deduction under section 80JJAA = 30% of Rs. 1,40,76,000 = Rs. 42,22,800.

**Working Note:**

**Number of additional employees**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>No. of employees</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total number of employees employed during the year</td>
<td>180</td>
</tr>
<tr>
<td>Less: Contractual employees employed on 1.8.2018, since they do not participate in recognized provident fund and their total monthly emoluments exceed Rs.25,000</td>
<td>48</td>
</tr>
<tr>
<td>Regular employees employed on 1.6.2018, since their total monthly emoluments exceed Rs.25,000</td>
<td>46</td>
</tr>
<tr>
<td>Regular employees employed on 1.10.2018 since they have been employed for less than 240 days in the P.Y.2018-19.</td>
<td>35 129</td>
</tr>
<tr>
<td><strong>Number of “additional employees”</strong></td>
<td><strong>51</strong></td>
</tr>
</tbody>
</table>

**Notes –**
1. Since contractual employees do not participate in recognized provident fund, they do not qualify as additional employees. In any case, their total monthly emoluments exceed Rs. 25,000, and hence do not qualify as additional employees. Further, 46 regular employees employed on 1.6.2018 also do not qualify as additional employees since their monthly emoluments exceed Rs. 25,000. Also, 35 regular employees employed on 1.10.2018 do not qualify as additional employees for the P.Y.2018-19, since they are employed for less than 240 days in that year. Therefore, only 51 employees employed on 1.4.2018 qualify as additional employees, and the total emoluments paid or payable to them during the P.Y.2018-19 is deemed to be the additional employee cost.

2. As regards the 35 regular employees employed on 1.10.2018, they would be treated as “additional employee” for the P.Y. 2019-20, if they continue to be employed in that year for a minimum period of 240 days. Accordingly, 30% of additional employee cost in respect of such employees would be allowable as deduction under section 80JJAA in the hands of Mr. Dheeraj for the A.Y. 2020-21.

(ii) Case 2: Where Mr. Dheeraj has commenced the business of manufacture of leather products on 1.4.2018

Yes, the answer would change, since in the case of an assessee engaged in the business of manufacture of leather products, the requirement of minimum period of employment of 240 days in the previous year to qualify as an additional employee for the purpose of deduction under section 80JJAA has been relaxed due to the seasonal nature of business of manufacture of apparel. The minimum period of employment required in case of this industry, to qualify as an additional employee for the purpose of deduction under section 80JJAA, is 150 days. Therefore, the 35 regular employees employed on 1.10.2018 would also qualify as “additional employees” and the deemed additional employee cost pertaining to these employees would also be eligible for deduction under section 80JJAA.

Deemed Additional Employee Cost = Rs. 1,40,76,000 (as calculated in (i) above) + Rs. 50,40,000 (35 employees × Rs. 24,000 × 6 months) = Rs. 1,91,16,000

Deduction under section 80JJAA = 30% × Rs. 1,91,16,000 = Rs. 57,34,800

4. The issue under consideration is whether dividend distribution tax under section 115-O can be levied on dividend income of a tea company, and if so, whether in whole or in part, to be restricted to 40%, being the proportion of business income of a tea company. This issue came up before the Supreme Court in Union of India v. Tata Tea and Others [2017] 398 ITR 260 (SC).

The Supreme Court observed that as per Entry 82 of List I, the Union Parliament has the competence to tax “income other than agricultural income”. Section 115-O pertains to additional tax at the stage of distribution of dividend by a domestic company which is covered by Entry 82 in List I. When dividend is declared to be distributed and paid to a company’s shareholders, it is not impressed with character of the source of its income. The Court relied on Mrs. Bacha F Guzdar v. CIT AIR 1955 SC 74 which looked into the nature of the dividend income in the hands of the shareholders. Dividend is derived from the investment made in the company’s shares and the foundation rests on the contractual relations between the company and the shareholder.
Dividend is not ‘revenue derived from land’ and therefore, cannot be termed as agricultural income in the hands of a shareholder. Hence, despite the company being involved in agricultural activities, in the shareholder’s hands, the income is only dividend and not agricultural income.

The Calcutta High Court had upheld the vires of section 115-O but put a qualification that additional tax levied under section 115-O shall be only to the extent of 40% which is the taxable income of the tea company. The Supreme Court overturned this cap placed by the Calcutta High Court. Section 115-O is within the competence of the Parliament and hence, no limits can be placed on the same.

Accordingly, applying the rationale of the Supreme Court ruling to the facts of this case, the contention of the Appellate Authority that only 40% of dividend distributed by the company is to be taxed under section 115-O is not correct. The entire dividend distributed would be subject to dividend distribution tax under section 115-O.

5. **Computation of total income of Rhombus(P) Ltd. for the A.Y. 2019-20**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Income from House Property (Note 1)</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Gross Annual Value (GAV) (Rental income has been taken as GAV in the absence of other information) [Rs. 50,000 x 12]</td>
<td>6,00,000</td>
<td></td>
</tr>
<tr>
<td>Less: Municipal taxes (not deductible since it has not been paid)</td>
<td>Nil</td>
<td></td>
</tr>
<tr>
<td>Net Annual Value (NAV)</td>
<td>6,00,000</td>
<td>4,20,000</td>
</tr>
<tr>
<td>Less: Deduction under section 24 (30% of NAV)</td>
<td>1,80,000</td>
<td></td>
</tr>
<tr>
<td><strong>Profits and gains of business or profession</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net profit as per profit and loss account</td>
<td>2,10,00,000</td>
<td></td>
</tr>
<tr>
<td>Add: Licence fee for obtaining franchise (Note 2)</td>
<td>32,00,000</td>
<td></td>
</tr>
<tr>
<td>Municipal taxes in respect of let-out part of office premises (Note 1)</td>
<td>8,000</td>
<td></td>
</tr>
<tr>
<td>Contribution to approved and notified scientific research association (treated separately) (Note 4)</td>
<td>1,00,000</td>
<td></td>
</tr>
<tr>
<td>Loss due to destruction of machinery by fire (Note 5)</td>
<td>2,00,000</td>
<td></td>
</tr>
<tr>
<td>Amount paid to contractor without deduction of tax at source [Rs. 5 lakhs x 30%] (Note 6)</td>
<td>1,50,000</td>
<td></td>
</tr>
<tr>
<td>Short-term capital loss on sale of shares of Gama Ltd. (Note 7)</td>
<td>20,000</td>
<td>1,50,000</td>
</tr>
<tr>
<td>Depreciation on tangible fixed assets (Note 8)</td>
<td>2,20,000</td>
<td></td>
</tr>
<tr>
<td>Less: Depreciation under section 32 (Note 8)</td>
<td>2,48,98,000</td>
<td></td>
</tr>
<tr>
<td>Tangible fixed assets (Note 8)</td>
<td>2,60,000</td>
<td></td>
</tr>
<tr>
<td>Intangible asset (Franchise)</td>
<td>8,00,000</td>
<td></td>
</tr>
<tr>
<td>25% of Rs.32,00,000 (Note 2)</td>
<td>10,60,000</td>
<td></td>
</tr>
<tr>
<td>Weighted deduction under section 35(1)(ii) (Note 4)</td>
<td>1,50,000</td>
<td></td>
</tr>
<tr>
<td>Rs. 1,00,000 x 150% (Contribution of scientific research association)</td>
<td>1,50,000</td>
<td></td>
</tr>
<tr>
<td>Rental income to be taxed under “Income from house property” (Note 1)</td>
<td>6,00,000</td>
<td></td>
</tr>
</tbody>
</table>
Dividend credited to profit and loss account to be excluded (Note 7) 10,000

**Capital Gains (Note 7)**
- Short-term capital loss (Rs. 20 x 1000 shares) 20,000
- Less: Dividend exempt under section 10(34) 10,000
- Short-term capital loss to be carried forward to A.Y. 2020-21 10,000

**Income from Other Sources (Note 9)**
- Deemed dividend under section 2(22)(e) subject to DDT in the hands of Theta (P) Ltd. -

**Total Income** 2,34,98,000

**Notes:**

1. Rental income from letting out a part of the office premises is taxable under “Income from house property”. Therefore, it has to be deducted while calculating business income, since the income has been credited to profit and loss account. Likewise, municipal taxes due in respect of such property, debited to profit and loss account has to be added back to compute business income.

2. Franchise is an intangible asset eligible for depreciation @ 25%. Since one-time licence fees of Rs. 32 lakh paid for obtaining franchise has been debited to profit and loss account, the same has to be added back. Depreciation @ 25% has to be provided in respect of the intangible asset since it has been used for more than 180 days during the year.

3. Rs. 32,000 paid to Beta & Co., a goods transport operator in cash is deductible while computing business income, as the limit for disallowance under section 40A(3) would be attracted in case of payment to a transport contractor only when it exceeds Rs. 35,000. Since it is already debited to profit and loss account, no further adjustment is required.

4. Contribution to a scientific research association approved and notified under section 35(1)(ii) is eligible for a weighted deduction of 150%. Therefore, the contribution of Rs. 1,00,000 debited to profit and loss account has been added back and Rs. 1,50,000 (being 150% of Rs. 1,00,000) has been deducted while computing business income.

5. Loss of Rs. 2 lakh due to destruction of machinery caused by fire is not deductible since it is capital in nature.

6. Payment to contractor without deduction of tax at source would attract disallowance at 30% of the expenditure under section 40(a)(ia).

7. As per section 94(7), where any person buys any shares within 3 months prior to the record date and sells such shares within 3 months after such date and the dividend received on such shares is exempt, then, the loss arising out of such purchase and sale of shares shall be ignored to the extent of dividend income.

<table>
<thead>
<tr>
<th>Description</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loss on sale of shares (Rs. 100 - Rs. 80) x 1000 shares</td>
<td>20,000</td>
</tr>
<tr>
<td>Less: Dividend exempt under section 10(34)</td>
<td>10,000</td>
</tr>
<tr>
<td>Short-term capital loss</td>
<td>10,000</td>
</tr>
</tbody>
</table>

Since short term capital loss can be set-off only against income under the head “Capital Gains”, the short-term capital loss of Rs. 10,000 has to be carried forward to the next year. Dividend of Rs. 10,000 credited to profit and loss
account has to be deducted and short-term capital loss of Rs. 20,000 debited to profit and loss account has to be added back.

(8) Depreciation as per Income-tax Rules, 1962, is deductible while calculating business income. Therefore, Rs. 2.60 lakh depreciation on tangible fixed assets and Rs. 8 lakh on intangible assets is deducted. The amount of Rs. 2.20 lakh depreciation debited to profit and loss account as per books of account has been added back.

(9) As per section 2(22)(e), any payment by a company in which the public are not substantially interested by way of loan to a shareholder, who is the beneficial owner of shares holding not less than 10% of voting power, is deemed as dividend to the extent to which the company possesses accumulated profits. Accordingly, in this case, Rs. 50,000 would be deemed as dividend under section 2(22)(e) and subject to dividend distribution tax @30% (plus surcharge @12% and health and education cess @4%) in the hands of Theta (P) Ltd. Hence, such dividend is exempt in the hands of Rhombus (P) Ltd. under section 10(34).

6. **Computation of total income of Edu All Charitable Trust for the A.Y.2019-20**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross receipts from Hospital</td>
<td>2,00,00,000</td>
<td></td>
</tr>
<tr>
<td>Gross receipts from Medical College [exempt, since less than Rs.1 crore]</td>
<td></td>
<td>2,00,00,000</td>
</tr>
<tr>
<td><strong>Add:</strong> Anonymous donations [to the extent not chargeable to tax@30% under section 115BBC(1)(i)] [See Note 1 &amp; 2]</td>
<td>3,00,000</td>
<td>2,03,00,000</td>
</tr>
<tr>
<td><strong>Less:</strong> 15% of income eligible for being set apart without any condition</td>
<td></td>
<td>30,45,000</td>
</tr>
<tr>
<td><strong>Less:</strong> Amount applied for charitable purposes</td>
<td></td>
<td></td>
</tr>
<tr>
<td>- <strong>On revenue account</strong> – Administrative expenses</td>
<td>75,00,000</td>
<td></td>
</tr>
<tr>
<td>- <strong>On capital account</strong> – Land &amp; Building [Section 56(2)(x) is not attracted in respect of value of property received by a trust or institution registered u/s 12AA]</td>
<td>80,00,000</td>
<td></td>
</tr>
<tr>
<td>- Corpus donation to Help Aid Trust registered u/s 12AA – not allowable even if it is out of current year income of the trust</td>
<td></td>
<td>1,55,00,000</td>
</tr>
<tr>
<td><strong>Total income [other than anonymous donation taxable@30% under section 115BBC(1)(i)]</strong></td>
<td>17,55,000</td>
<td></td>
</tr>
<tr>
<td><strong>Add:</strong> Anonymous donation taxable @30% u/s 115BBC(1)(i) [See Note 1]</td>
<td>9,00,000</td>
<td></td>
</tr>
<tr>
<td><strong>Total Income of the trust (including anonymous donation taxable@30%)</strong></td>
<td><strong>26,55,000</strong></td>
<td></td>
</tr>
</tbody>
</table>
Computation of tax liability of the trust for the A.Y. 2019-20

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax on total income of Rs. 17,55,000 [Excluding anonymous donations]</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Upto Rs. 2,50,000</td>
<td></td>
<td>Nil</td>
</tr>
<tr>
<td>Rs.2,50,001 – Rs. 5,00,000 [Rs.2,50,000 x 5%]</td>
<td>12,500</td>
<td></td>
</tr>
<tr>
<td>Rs.5,00,001 – Rs.10,00,000[Rs.5,00,000 x 20%]</td>
<td>1,00,000</td>
<td></td>
</tr>
<tr>
<td>&gt; Rs.10,00,000 [Rs.7,55,000 x 30%]</td>
<td>2,26,500</td>
<td>3,39,000</td>
</tr>
<tr>
<td>Tax on anonymous donations taxable@30%[Rs.9,00,000 x 30%]</td>
<td>2,70,000</td>
<td>6,09,000</td>
</tr>
<tr>
<td>Add: Health and education cess @4%</td>
<td></td>
<td>24,360</td>
</tr>
<tr>
<td><strong>Total tax liability</strong></td>
<td></td>
<td><strong>6,33,360</strong></td>
</tr>
</tbody>
</table>

Notes:
(1) Anonymous donations taxable @30% |
    Anonymous Donations received (lakhs) | 12.00 |
    5% of total donations received, i.e. 5% of 60 lakhs | 3.00 |
    Monetary limit | 1.00 |
    Higher of the above | 3.00 |
    Anonymous donations taxable@30% | 9.00 |
(2) The provisions of section 13(7) have been interpreted in a manner that it excludes only anonymous donations subject to tax@30% under section 115BBC(1)(i). All taxable income of the trust [excluding anonymous donations taxable@30% u/s 115BBC(1)(i)] falls under section 115BBC(1)(ii), and are subject to tax at normal rates and eligible for benefit of unconditional accumulation u/s 11(1). Anonymous donation of Rs. 3,00,000 taxable at normal rates also falls under section 115BBC(1)(ii) and hence, like other taxable income of the trust falling within the scope of this clause, the same would also be eligible for the benefit of unconditional accumulation under section 11(1). The above solution has been worked out on the basis of this interpretation of section 13(7). Accordingly, in the above solution, the benefit of unconditional accumulation upto 15% under section 11(1) has been given in respect of anonymous donation of Rs. 3,00,000 subject to tax at normal rates. However, an alternative view is also possible on the basis of the plain reading of section 13(7), as per which anonymous donation referred to in section 115BBC has to be excluded from the purview of exemption under sections 11 and 12. As per this view, even the anonymous donations of Rs. 3,00,000 subject to tax at normal rates would not be eligible for unconditional accumulation of upto 15%.
(3) Corpus donations, whether received by way of cheque or cash, are not includible in the total income of the trust by virtue of section 11(1)(d).
(4) Since corpus donations and anonymous donations are indicated separately and the question does not mention that the same are included in gross receipts, the solution has been worked out on the assumption that corpus donations and anonymous donations are not included in the figure of gross receipts of Rs. 200 lakhs from hospital.
(5) Since the trust follows cash system of accounting, fees not realized from patients would not form part of gross receipts. Therefore, there is no need of applying the provisions of Explanation 1 to section 11(1) to exclude such income.
(6) Where the cost of assets is claimed as application, no deduction for depreciation on such assets would be allowed in determining income for the purposes of application.
Therefore, since cost of assets of the trust has been claimed as application of income, no depreciation would be allowed on these assets while determining income for the purposes of application.

7. Section 206C(1F) provides for collection of tax at source @1% by the seller from the buyer, at the time of receipt of consideration for sale of motor vehicle, the value of which exceeds Rs. 10 lakhs. CBDT Circular No.22/2016 dated 8.6.2016 clarifies that section 206C(1F) covers all transactions of retail sales and accordingly, it will not apply to sale of motor vehicles by manufacturers to dealers. Hence, car manufacturers are not liable to collect tax at source under section 206C(1F).

In respect of sale of premium cars (each of value ranging between Rs. 12 lakhs to Rs.25 lakhs) by dealers to retail customers, tax has to be collected at source @1% under section 206C(1F), even if no part of the consideration is received in cash.

As regards small cars (each of value ranging between Rs. 5 lakhs and Rs. 9 lakhs), no tax has to be collected at source whether the consideration is received by way of cash or otherwise. Accordingly, the answer would not undergo a change if part of consideration is received in cash.

8. (i) As per the third proviso to section 147, the Assessing Officer may assess or reassess such income, other than the income involving matters which are the subject matters of any appeal, reference or revision, which is chargeable to tax and has escaped assessment.

Therefore, even when an appeal is pending before Commissioner (Appeals), the Assessing Officer can initiate reassessment proceedings in respect of income chargeable to tax which has escaped assessment, provided such income is not the subject matter of the appeal before the Commissioner (Appeals) i.e., such income which has escaped assessment does not form part of the additions of Rs.22 lakhs to the returned income, which is the subject matter of appeal.

(ii) As per section 154(1A), the Assessing Officer can pass an order under 154(1) to rectify a mistake apparent from the record, provided the rectification is in relation to a matter, other than the matter which has been considered and decided in the appeal before Commissioner (Appeals).

Since the issue under consideration in this case relates to rectification of a mistake in respect of a matter which is not the subject matter of appeal, the Assessing Officer can pass an order under section 154 for rectification of the same provided the same is a mistake apparent from the record.

(iii) As per section 264(4), the Principal Commissioner or Commissioner shall not revise any order under section 264, where such order has been made the subject of an appeal to the Commissioner (Appeals).

Therefore, under section 264, the Principal Commissioner or Commissioner cannot revise an order which is pending before the Commissioner (Appeals), even if the revision pertains to a matter, other than the matter(s) covered in the appeal.

(iv) As per section 263, the Commissioner has the power to revise an order prejudicial to the interests of revenue, even if the order is the subject matter of appeal before Commissioner (Appeals). However, the power of the Commissioner under section 263 shall extend to only such matters as had not been considered and decided in such appeal.
In a case where the appeal is pending but not yet decided, the Commissioner cannot exercise his revisionary jurisdiction in respect of those issues which are the subject matter of appeal [*CWT v. Sampathmal Chordia (2002) 256 ITR 440 (Mad.)*].

9. (i) The statement is **not** correct.
   As per section 249(3) of the Income-tax Act, 1961, the Commissioner (Appeals) may admit an appeal after the expiry of the period of 30 days specified in section 249(2), if he is satisfied that the appellant had sufficient cause for not presenting the appeal within the prescribed time.

(ii) The statement is **not** correct.
   Section 254(2A) provides that the Appellate Tribunal, where it is possible, may hear and decide an appeal within a period of four years from the end of the financial year in which such appeal is filed. The Appellate Tribunal may, on merit, pass an order of stay in any proceedings relating to an appeal. However, such period of stay cannot exceed 180 days from the date of such order. The Appellate Tribunal has to dispose of the appeal within this period of stay.
   Where the appeal has not been disposed of within this period and the delay in disposing the appeal is not attributable to the assessee, the Appellate Tribunal can further extend the period of stay originally allowed. However, the aggregate of period originally allowed and the period so extended should not exceed 365 days even if the delay in disposing of the appeal is not attributable to the assessee. The Appellate Tribunal is required to dispose off the appeal within this extended period. If the appeal is not disposed of within such period or periods, the order of stay shall stand vacated after the expiry of such period or periods.

10. This issue came up before the Supreme Court in *K. Lakshmansa and Co. v. Commissioner of Income-tax and Anr [2017] 399 ITR 657*. The Supreme Court observed that the right to claim refund is automatic once the statutory provisions have been complied with. The statutory obligation to refund, being non-discretionary, carries with it the right to interest. Section 244A is clear and plain – it grants a substantive right of interest and is not procedural.
   Under section 244A, it is enough if the refund becomes due under the Income-tax Act, 1961, in which case, the assessee shall, subject to the provisions of that section, be entitled to receive simple interest. The expression “due” only means that a refund becomes due pursuant to an order under the Act which either reduces or waives tax or interest. It does not matter that the interest being waived is discretionary in nature; the moment that discretion is exercised and refund becomes due consequently, a concomitant right to claim interest springs into being in favour of the assessee.
   The Supreme Court, thus, did not agree with the Karnataka High Court opinion that when discretionary power has been exercised, no concomitant right to claim interest on refund arises in favour of the assessee. Overruling the High Court Decision, the Supreme Court held that the assessee has a right to interest on refund under section 244A.
   Applying the rationale of the Supreme Court ruling to the case on hand, the action of the Settlement Commission in refusing to grant interest on refund is **not** correct.
11. (i) **Where Xylo Inc., a US company, does not have a PE in India**

In this case, Xylo Inc. would be eligible for a concessional rate of tax@10% of Rs. 2 crore under section 115A on the fees for technical services received from Alpha Ltd., an Indian company, since the same is in pursuance of an agreement entered into after 31.3.1976, which has been approved by the Central Government. No deduction, however, would be allowed in respect of expenditure of Rs. 8 lakhs incurred to earn such income. Also, Xylo Inc. has to file its return of income in India under section 139 and there is no exemption in this regard.

(ii) **Where Xylo Inc., a US company, has a PE in India and rendering technical services is effectively connected with the PE in India.**

Since Xylo Inc. carries on business through a PE in India, in pursuance of an agreement with Alpha Ltd. or other Indian companies entered into after 31.3.2003, and the income by way of fees for technical services is effectively connected with the PE in India as per section 44DA, such income shall be computed under the head “Profits and gains of business or profession” in accordance with the provisions of the Income-tax Act, 1961. Accordingly, expenses of Rs. 23 lakhs (Rs. 8 lakhs + Rs. 15 lakhs) incurred for earning fees for technical services of Rs. 6 crore (Rs. 2 crore + Rs. 4 crore) is allowable as deduction therefrom. However, expenditure of Rs. 6 lakhs which is not incurred wholly and exclusively for the business of the PE and the amount of Rs. 12 lakhs paid by the PE to the Head Office is not allowable as deduction.

Xylo Inc. is required to maintain books of account under section 44AA and get the same audited under section 44AB and furnish report along with the return of income under section 139.

12. **Computation of total income of Mr. Hari for A.Y.2019-20**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Income from House Property [House situated in Country Q]</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Gross Annual Value</td>
<td>3,30,000</td>
<td></td>
</tr>
<tr>
<td>Less: Municipal taxes paid in Country Q</td>
<td>10,000</td>
<td></td>
</tr>
<tr>
<td>Net Annual Value</td>
<td>3,20,000</td>
<td></td>
</tr>
<tr>
<td>Less: Deduction under section 24 – 30% of NAV</td>
<td>96,000</td>
<td>2,24,000</td>
</tr>
<tr>
<td><strong>Profits and Gains of Business or Profession</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Income from business carried on in India</td>
<td>4,40,000</td>
<td></td>
</tr>
<tr>
<td><strong>Income from Other Sources</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interest on savings bank with HDFC Bank</td>
<td>42,000</td>
<td></td>
</tr>
<tr>
<td>Agricultural income in Country P [Not exempt]</td>
<td>94,000</td>
<td></td>
</tr>
<tr>
<td>Dividend received from a company in Country Q</td>
<td>2,65,000</td>
<td></td>
</tr>
<tr>
<td>Royalty income from a book of art in Country P (after deducting expenses of Rs. 50,000)</td>
<td>7,30,000</td>
<td>11,31,000</td>
</tr>
<tr>
<td><strong>Gross Total Income</strong></td>
<td>17,95,000</td>
<td></td>
</tr>
<tr>
<td><strong>Less: Deduction under Chapter VIA</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Under section 80QQB – Royalty income of a resident</td>
<td>3,00,000</td>
<td></td>
</tr>
</tbody>
</table>
Computation of tax liability of Mr. Hari for A.Y.2019-20

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax on total income [30% of Rs. 4,85,000 + Rs. 1,12,500]</td>
<td>2,58,000</td>
</tr>
<tr>
<td>Add: Health and education cess @4%</td>
<td>10,320</td>
</tr>
<tr>
<td>Less: Rebate under section 91 (See Working Note below)</td>
<td>1,72,197</td>
</tr>
<tr>
<td>Tax Payable</td>
<td>96,123</td>
</tr>
<tr>
<td>Tax payable (rounded off)</td>
<td>96,120</td>
</tr>
</tbody>
</table>

Calculation of Rebate under section 91:

| Average rate of tax in India [i.e., Rs. 2,68,320/Rs. 14,85,000 x 100] | 18.069% |
| Average rate of tax in country P | 16% |
| Doubly taxed income pertaining to country P | Rs. |
| Agricultural Income | 94,000 |
| Royalty Income [Rs. 7,80,000 – Rs. 50,000 (Expenses) – Rs. 3,00,000 (deduction under section 80QQB)] | 4,30,000 |
| Doubly taxed income pertaining to country P | |
| Income from house property | 2,24,000 |
| Dividend | 2,65,000 |
| Doubly taxed income pertaining to country Q | |
| Income from house property | 2,24,000 |
| Dividend | 2,65,000 |
| Rebate under section 91 on Rs. 5,24,000 @16% [being the lower of average Indian tax rate (18.069%) and foreign tax rate (16%)] | 83,840 |
| Average rate of tax in country Q | 20% |
| Doubly taxed income pertaining to country Q | |
| Income from house property | 2,24,000 |
| Dividend | 2,65,000 |
| Rebate under section 91 on Rs. 4,89,000 @18.069% (being the lower of average Indian tax rate (18.069%) and foreign tax rate (20%)) | 88,357 |
| Total rebate under section 91 (Country A + Country B) | 1,72,197 |

Note: Mr. Hari 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 i.e., P.Y.2018-19.
(b) The income in question accrues or arises to him outside India in foreign countries P & Q 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 the foreign countries “P” and “Q” in his hands and it is presumed that he has paid tax on such income in those countries.
(d) There is no agreement under section 90 for the relief or avoidance of double taxation between India and Countries P and Q where the income has accured or arisen.
13. (i) Provision of scientific research services falls within the scope of international transaction under section 92B. Research & Co. and B Inc. are deemed to be associated enterprises as per section 92A(2), since B Inc. guarantees not less than 10% of the total borrowings of Research & Co. Since there is an international transaction between associated enterprises, transfer pricing provisions are attracted in this case.

(ii) Where the Assessing Officer has made a primary adjustment of Rs. 225 lakhs to the transfer price and the same has been accepted by Research & Co., secondary adjustment has to be made in the books of account. The excess money determined based on the primary adjustment has to be repatriated to India within 90 days from the date of order, failing which the same would be deemed as an advance and interest would be attracted at the one year marginal cost of fund lending rate of State Bank of India as on 1.4.2018 + 3.25%, since the international transaction has been denominated in Indian Rupees. In this case, since the excess money has not been repatriated within 90 days, the same would be deemed to be an advance made by Research & Co. to B Inc. and interest would be attracted@11.40% (8.15% + 3.25%).

14. If an Indian company, being the borrower, incurs any expenditure by way of interest in respect of any debt issued by its non-resident associated enterprise (AE) and such interest exceeds Rs. 1 crore, then, the interest paid or payable by such Indian company in excess of 30% of its earnings before interest, taxes, depreciation and amortization (EBITDA) or interest paid or payable to associated enterprise, whichever is lower, shall not be allowed as deduction as per section 94B. Further, where the debt is issued by a lender which is not associated but an associated enterprise either provides an implicit or explicit guarantee to such lender or deposits a corresponding and matching amount of funds with the lender, such debt shall be deemed to have been issued by an associated enterprise and limitation of interest deduction would be applicable.

In the present case, since M/s Tweed Inc holds 40% of voting power i.e., more than 26% of voting power in both Narmada Ltd and M/s Tyne Inc, Narmada Ltd. and M/s Tyne Inc are deemed to be associated enterprises. Since loan of Rs. 80 crores taken by Narmada Ltd., an Indian company from M/s Thames Inc, is guaranteed by M/s Tyne Inc, an associated enterprise of Narmada Ltd., such debt shall be deemed to have been issued by an associated enterprise and interest payable to M/s Thames Inc shall be considered for the purpose of limitation of interest deduction under section 94B.

**Computation of interest to be disallowed as per section 94B in the computation of income under the head profits and gains of business or profession of M /s. Narmada Ltd.**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net profit</td>
<td>7,00,00,000</td>
</tr>
<tr>
<td><em>Add:</em> Interest already debited (Rs. 80 crores x 10%)</td>
<td>8,00,00,000</td>
</tr>
<tr>
<td>Depreciation</td>
<td>4,00,00,000</td>
</tr>
<tr>
<td>Income tax</td>
<td>3,00,00,000</td>
</tr>
<tr>
<td><strong>EBITDA</strong></td>
<td><strong>22,00,00,000</strong></td>
</tr>
<tr>
<td>Interest paid or payable by Narmada Ltd.</td>
<td>8,00,00,000</td>
</tr>
<tr>
<td>Lower of the following would be disallowed</td>
<td>8,00,00,000</td>
</tr>
<tr>
<td>- Total interest paid or payable in excess of 30%</td>
<td>Rs. 1,40,00,000</td>
</tr>
</tbody>
</table>

---

32.46
15. As per Explanation 2A to section 9(1)(i), “significant economic presence” of a non-resident in India shall constitute “business connection” for attracting deemed accrual provisions in India.

“Significant Economic Presence” means-

(a) transaction in respect of any goods, services or property carried out by a non-resident in India including provision of download of data or software in India, if the aggregate of payments arising from such transaction or transactions during the previous year exceeds the prescribed amount; or

(b) systematic and continuous soliciting of business activities or engaging in interaction with such prescribed number of users in India through digital means.

Further, the above transactions or activities shall constitute significant economic presence in India, whether or not,—

(i) the agreement for such transactions or activities is entered in India;

(ii) the non-resident has a residence or place of business in India; or

(iii) the non-resident renders services in India:

However, where a business connection is established by reason of significant economic presence in India, only so much of income as is attributable to the transactions or activities referred to in (a) or (b) above shall be deemed to accrue or arise in India.

This provision has been inserted in the Income-tax Act, 1961 in line with “BEPS Action Plan 1 Addressing the challenges of the digital economy” to take care of new business models such as digitized businesses, which do not require physical presence of itself or any agent in India. Such businesses can now be covered within the scope of section 9(1)(i).

16. Business profits of an enterprise can only be taxed by the Residence State. Right of Source State to tax business profits of an enterprise only arises if it carries on business through a Permanent Establishment (PE) situated in that State.

As per the approach under the OECD Model Convention, once a PE is proven, the Source State can tax only such profits as are attributable to the PE. The UN Model Convention amplifies this attribution principle by a limited Force of Attraction rule (FOA).

The FOA rule implies that when a foreign enterprise sets up a PE in State of Source, it brings itself within the fiscal jurisdiction of that State (State of Source) to such a degree that profits that the enterprise derives from Source State of Source, whether through the PE or not, can be taxed by it (State of Source State).

As per Article 7 of the UN Model Convention, if the enterprise carries on business in the other Contracting State through a PE, the profits of the enterprise may be taxed in the other State but only so much of them as is attributable to:

(a) that PE;

(b) sales in that other State of goods or merchandise of the same or similar kind as those sold through that PE; or

(c) other business activities carried on in that other State of the same or similar kind as those effected through that PE.
Question No. 1 is compulsory.

Answer any four questions from the remaining five questions.

Working notes should form part of the respective answers.

All questions relate to Assessment Year 2019-20, unless stated otherwise in the question.

Question 1

Sankar Ltd, engaged in the manufacture of footwear and leather products, for the past 8 years, reported a net profit of Rs. 272 lakhs as per the statement of profit and loss for the year ended 31st March, 2019. The company was subject to tax audit under section 44AB of the Income-tax Act, 1961. The net profit is arrived at after debiting or crediting the following amounts:

(i) Depreciation charged on the basis of useful life of assets as per Companies Act is Rs. 32 lakhs.

(ii) A sundry creditor whose amount of Rs. 32 lakhs was outstanding since long time, has been settled for Rs. 26 lakhs on 31st March, 2019 based on compromise settlement. The amount waived has been credited to the statement of profit and loss.

(iii) Employers' contribution to EPF of Rs. 3 lakhs for the month of March, 2019 was deposited on 29th July, 2019.

(iv) Interest payments debited Rs. 30 lakhs (Includes interest on term loan of Rs. 25 lakhs availed on 1-4-2018 at interest rate of 12% p.a towards purchase of machinery during the year).

(v) Payment of Rs. 30 lakhs to A & Co., a subcontractor, for processing raw leather without deduction of tax is debited to statement of profit & loss. This amount includes Rs. 20 lakhs for purchase of chemicals and Rs. 10 lakhs towards labour charges which is separately shown in bills submitted.

Additional Information:

(1) The company has not made provision for an amount of Rs. 12 lakhs being a fair estimate of the amount as payable to workers towards periodical wage revision once in 3 years in respect of existing employees. The provision is estimated on a reasonable certainty of the revision once in 3 years.

(2) The written down values of assets before allowing depreciation as per Income-tax Rules are as under:

<table>
<thead>
<tr>
<th>Description</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Factory Buildings</td>
<td>Rs. 180 lakhs;</td>
</tr>
<tr>
<td>Plant &amp; Machinery</td>
<td>Rs. 170 lakhs (inclusive of Rs. 30 lakhs of machinery acquired on 1.11.2018 and put to use)</td>
</tr>
<tr>
<td>Computers</td>
<td>Rs. 15 lakhs</td>
</tr>
</tbody>
</table>
It may be noted that the above values have been duly recognised while providing depreciation in the books of accounts.

(3) During the year 2018-19, the company has employed 24 additional employees (qualified as "workman" under the Industrial Disputes Act, 1947). All these employees contribute to a recognized provident fund. 12 out of 24 employees joined on 1.6.2018 on a salary of Rs. 23,000 per month, 4 joined on 1.7.2018 on a salary of Rs. 26,000 per month, and 8 joined on 1.11.2018 on a salary of Rs. 20,000 per month. The salaries of 2 employees who joined on 1.6.2018 are being settled by bearer cheques every month.

(4) Sales includes 5000 leather bags sold to M/s Sankar (firm), a related party, at a price of Rs. 1,000 each. The selling price to others in the market is at Rs. 1,300 each.

(5) Employees contribution to EPF of Rs. 3 lakhs recovered from their salaries for the month of March 2019 and shown in the Balance Sheet under the head Sundry Creditors was remitted on 31st May, 2019.

Compute the total income and tax payable of Sankar Ltd. for the Assessment Year 2019-20. The turnover of the company for the year ended 31.3.2017 was Rs. 52 crores. Ignore the provisions of MAT.

(14 Marks)

Question 2

(a) Alpha and Beta Tyres Limited, an Indian Company engaged in the manufacture of Tyres in Andhra Pradesh, has adopted IndAS from 1-4-2016. The following particulars are provided for the year ended 31.3.2019:

1. Net profit as per statement of profit and loss is Rs. 20 crores after debit and credit of the following items:

   **Items Debited:**
   (i) Depreciation Rs. 18 crores. Included in depreciation is Rs. 3 crores, being amount provided on revalued assets.
   (ii) Interest charged for delay in remittance of tax deducted at source Rs. 20 lakhs.

   **Items Credited:**
   (i) Share Income from Association of Persons in which the company is a member Rs. 50 lakhs. (The AOP is charged to tax at Maximum Marginal Rate)
   (ii) Amount of Rs. 6 crores withdrawn from revaluation reserves on account of revaluation of assets.

**Other Information:**

1. The application of a financial creditor for corporate insolvency resolution process has been admitted by the Hyderabad Bench of the National Company Law Tribunal under section 7 of the Insolvency and Bankruptcy Code, 2016.
2. Brought forward business loss and depreciation.

<table>
<thead>
<tr>
<th>Assessment Year</th>
<th>Business Loss</th>
<th>Depreciation</th>
</tr>
</thead>
<tbody>
<tr>
<td>2015-16</td>
<td>Rs.3 crores</td>
<td>Rs.1 crore</td>
</tr>
<tr>
<td>2016-17</td>
<td>Rs.5 crores</td>
<td>Rs.2 crores</td>
</tr>
</tbody>
</table>

3. Items credited to other comprehensive income which will not be reclassified to profit or loss:
   (i) Re-measurement of defined employee retirement benefits plan Rs. 50 lakhs.
   (ii) Revaluation surplus of property, plant and equipment Rs. 1 crore.
4. The transition amount as on convergence date 1-4-2016 stood at Rs. 5 crores including capital reserve of Rs. 50 lakhs (credit balance).
5. Tax payable under the regular provisions of the Income-tax Act, 1961 is Rs. 0.73 crores.

(i) **Compute Minimum Alternate Tax payable by the company for the Assessment Year 2019-20.**

(ii) **Compute the amount of MAT credit eligible for carried forward.** (8 Marks)

(b) The following data is furnished by Mr. Sumedh, a non-resident and a person of Indian Origin, for the financial year ended 31-3-2019:

<table>
<thead>
<tr>
<th>A:</th>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Long-term capital gains arising on transfer of foreign exchange asset on 31.7.2018 (computed)</td>
<td>Rs. 6,50,000</td>
</tr>
<tr>
<td></td>
<td>Expenditure wholly and exclusively incurred in connection with such transfer (not considered above)</td>
<td>Rs. 80,000</td>
</tr>
<tr>
<td></td>
<td>Interest on deposits held with private limited companies</td>
<td>Rs. 5,90,000</td>
</tr>
<tr>
<td></td>
<td>Interest on Government Securities</td>
<td>Rs. 95,000</td>
</tr>
<tr>
<td></td>
<td>Interest on deposits with public limited companies</td>
<td>Rs. 2,60,000</td>
</tr>
<tr>
<td></td>
<td>Dividends from Domestic Companies</td>
<td>Rs. 75,000</td>
</tr>
<tr>
<td>B:</td>
<td>Savings and Investments</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Investment in notified savings certificates referred to in section 10(4B) on 30.3.2019</td>
<td>Rs. 2,00,000</td>
</tr>
<tr>
<td></td>
<td>Investment in shares of Indian public limited companies on 31.12.2019</td>
<td>Rs. 3,00,000</td>
</tr>
<tr>
<td>C:</td>
<td>Tax deducted at source</td>
<td>Rs. 1,83,000</td>
</tr>
</tbody>
</table>

Compute balance tax payable / refund due for the assessment year 2019-20 in accordance with special provisions applicable to non-residents. (6 Marks)

**Question 3**

(a) M/s Mahan Charitable Trust is running an Educational Institution with hostel facility for the orphan children. It is registered under section 12AA.

The details of income and expenditure of the Trust are as given below:

(a) Voluntary contributions received during the year Rs. 150 lakhs.

This includes:

(i) Corpus donation Rs. 20 lakhs

(ii) Donation of Rs. 20 lakhs from Mr. Michael, a foreign donor, which was received on 31-3-2019.

(b) Salary paid to teachers and administrative staff Rs. 40 lakhs.

(c) Other general expenses Rs. 10 lakhs include payment to grocery stores of Rs. 30,000 by crossed cheque.

(d) A land belonging to the Trust in a nearby village which was purchased in the year 2013-14 for Rs. 5 lakhs was sold for Rs. 10.50 lakhs and another land adjacent to the Trust premises was purchased for Rs. 12 lakhs to be used as playground for the children.

(e) Five laptops costing Rs. 50,000 each were purchased during the year for teaching purposes.
(f) The Trust had accumulated Rs. 30 lakhs under section 11(2) in the financial year 2014-15 for constructing a school building. Amount spent for the said purpose till 31-3-2019 was Rs. 27 lakhs. The project is completed with a saving in project cost.

(g) Two additional rooms measuring 1500 sq. ft each was constructed in the existing hostel for the children. Cost of construction is Rs. 1200 per sq. ft.

(h) It made a corpus donation of Rs. 20 lakhs to a charitable trust registered u/s 12AA having similar objects.

Compute taxable income of Mahan Charitable Trust for the assessment year 2019-20. Support your answer with necessary working notes. (8 Marks)

(b) Beta Inc. having its business in Singapore has advanced a loan of SD 1,60,000 to Beta Ltd, Mumbai. Book value of total assets of Beta Ltd was Rs. 125 lakhs. Beta Ltd provides software backup support to Beta Inc. Beta Ltd has spent 50,000 manhour during the financial year 2018-19 for the services rendered to Beta Inc. The cost for Beta Ltd is SD 75 / manhour. Beta Ltd has billed Beta Inc. at SD 90.75 / manhour.

Gama Ltd. in Mumbai which has a similar business model, provides software backup support to Olive Inc. in Penang, Malaysia. Gama Ltd's cost and operating profits are as hereunder:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>INR in lakhs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Direct costs</td>
<td>600</td>
</tr>
<tr>
<td>Indirect costs</td>
<td>200</td>
</tr>
<tr>
<td>Operating profits</td>
<td>200</td>
</tr>
</tbody>
</table>

(1) Calculate Arm’s Length Price for the transaction between Beta Ltd. and Beta Inc. based on the above data of Gama Ltd. using the Transactional Net Margin Method. Assume ISD = Rs. 45.

(2) Explain, if there is any adjustment to be made to the total income of Beta Ltd. Note: SD = Singapore Dollars (6 Marks)

Question 4

(a) Deer Co Ltd engaged in the business of manufacture of furniture items on contract basis. It sub-contracted the production of cushion for the chairs to M/s Lion & Co, a sole proprietary concern. The sub-contractor M/s. Lion & Co procured the raw materials for production of cushions, performed further labour works and supplied the same to Deer Co Ltd. It raised its bill on Deer Co Ltd, showing the cost of raw materials Rs. 4,00,000 and labour charges Rs. 1,50,000, separately. Explain briefly the tax deduction requirement in the hands of Deer Co Ltd. (2 Marks)

(b) M/s PMPC, a partnership firm, is engaged in the manufacture of cardboard carton boxes used in packaging industry. During the year, it has sold cutting waste generated amounting to Rs. 30 lakhs to M/s PAPC Ltd, a paper manufacturing company. It uses such cutting waste purchased as raw material for its production. Discuss the implication of this transaction with respect to tax collected at source. (2 Marks)

(c) First Alternative

Maha Bank Ltd accepted fixed deposits of Rs. 20 crores in the name of Registrar General of the High Court and issued a fixed deposit receipt in compliance with a direction passed by the court in relation to certain proceedings. The Bank did not deduct tax on the interest accrued. The Assessing Officer issued a notice to the
bank to show cause as to why it should not be treated as an assessee in default under sections 201(1) and 201 (1A) for not deducting tax at source on interest accrued. Examine whether the bank is correct in not deducting tax on the interest accrued.  

(4 Marks)

Second Alternative

"Blue Moon", a popular television channel, incurred the following expenses:

(a) It paid Rs. 50 lakhs as prize money to the winner of a famous quiz programme "Who will be a Millionaire?"

(b) It paid Rs. 6 lakhs to a cameraman for shooting multi-episodes of a long documentary serial.

Examine TDS obligations in the hands of television channel for the above said payments.  

(4 Marks)

(d) ABC & Co, an Indian LLP, is solely engaged in the manufacture and export of engine, engine parts including cooling systems and engine valves. It had supplied auto components worth Rs. 72 crores during financial year 2018-19 to XYZ LLP, a foreign LLP located in Germany, controlled by A & B, the partners of Indian LLP along with their relatives. Against the aggregate value of transactions entered into as mentioned above, the Indian LLP incurred an operating expenditure of Rs. 60 crores leaving an operating profit of Rs. 4.50 crores.

(i) Compute the primary adjustment required to be made in A.Y.2019-20, if any, assuming that the Indian LLP exercised a valid option for application of safe harbour rules prescribed under Rule 10TD read with section 92CB of the Income-tax Act, 1961.

(ii) Examine the applicability of safe harbour rules, if the Foreign LLP is located in a Notified Jurisdictional Area.  

(6 Marks)

Question 5

(a) Mr. Harish, a resident of India, for the financial year ended on 31-3-2019, owned

(i) a land in Canada purchased in September, 2003
(ii) a flat in New Jersey (USA) purchased in April 2004 and
(iii) a shop in a commercial complex in Finland purchased in June 2004.

He also has authority to operate a bank account (maintained with Citibank, London) of a company in which his son and daughter are 100% shareholders since April 2017. He has been served with notices u/s 148 for the Assessment Years 2004-05 to Assessment Years 2018-19 based on the information that he has not disclosed source of income for those asset acquisitions in his income tax returns in India.

Are the notices issued u/s 148 tenable in law?  

(4 Marks)

(b) The Assessing Officer surveyed a popular cinema hall by name "Thriller" which is within his jurisdiction at 12 o’clock in the midnight for collecting information which may be useful for the purpose of Income-tax Act, 1961. The concerned cinema hall is kept open for business everyday between 9 p.m. and 1 a.m. The owner of the cinema hall claims that the A.O. could not enter his business premises after sunset and at late in the midnight. The Assessing Officer wanted to take away with him the books of account kept at the premises of the cinema hall. Examine the validity of the claim made by the owner of cinema hall and the proposed action of the Assessing Officer.  

(4 Marks)
(c) Balmart Inc. of USA entered into the contract with three Indian startup companies operating in e-commerce segment, namely Klipkart Ltd., Mozon Ltd., and Run Run Ltd. for supplying know-how to develop an electronic retailer network. Balmart Inc. made an application to the Authority for Advance Rulings (AAR) on the rate of withholding tax on receipts applicable to it. Klipkart Ltd. also made an application to the Assessing Officer for determination of the rate at which tax is deductible on the payments made to the said non-resident company. The Authority for Advance Rulings (AAR) rejected the application of Balmart Inc. on the ground that the question raised in the application is already pending before an income-tax authority.

Examine whether the rejection of application by the AAR is justified in law. 

(3 Marks)

(d) Raghu Ltd made a payment of Rs. 3,00,000 on 30-6-2018 towards procuring online advertisement space to a foreign company which had no place of business in India. The company remitted the equalization levy on 23-3-2019. Calculate interest and penalty payable by Raghu Ltd. if any.

(3 Marks)

Question 6

(a) You are appointed as the taxation manager of Tatla Well Ltd. In the context of tax planning, what all are the tests that are to be satisfied for the tax planning strategy to be successful? State them briefly.

(4 Marks)

(b) Mr. Srinivasan was a Central Government pensioner, who expired on 10-5-2019. An amount of Rs. 10 lakhs in cash was deposited into his savings bank account maintained in a nationalized bank on 28-2-2019, which was reported by the banker u/s 285BA. A notice was issued by the Assessing Officer to Mrs. Srinivasan who is his legal representative to file his Return of Income. Mrs. Srinivasan has approached you as a Tax Consultant as to the course of action to be undertaken by her, since she is unaware of her deceased husband's financial dealings.

What will be your advice to Mrs. Srinivasan?

(4 Marks)

(c) Examine and state the correctness or otherwise of each of the following statements in the context of international tax treaties between the countries and answer in brief with reasons/contents thereof:

(i) "Providing assistance in the collection of the fair and legitimate share of tax by the countries involved" is the sole objective of Tax Treaties entered among Countries.

(ii) A Protocol is an integral part of the Tax Treaty and has the same binding force as the main clauses therein.

(6 Marks)
SOLUTION:

Question 1

Answer

Computation of Total Income of Sankar Ltd. for the A.Y. 2019-20

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Amount (Rs.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net profit as per the statement of profit and loss</td>
<td>2,72,00,000</td>
</tr>
<tr>
<td><strong>Add: Items debited but to be considered separately or to be disallowed</strong></td>
<td></td>
</tr>
<tr>
<td>(i) Depreciation charged as per Companies Act, 2013</td>
<td>32,00,000</td>
</tr>
<tr>
<td>(iii) <strong>Employer’s contribution to EPF</strong></td>
<td>Nil</td>
</tr>
<tr>
<td>[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) i.e., 30.9.2019. Since the same has been debited to statement of profit and loss, no further adjustment is necessary]</td>
<td></td>
</tr>
<tr>
<td>(iv) <strong>Interest on term loan for purchase of plant and machinery</strong> [Rs. 25 lakhs x 12% x 7/12]</td>
<td>1,75,000</td>
</tr>
<tr>
<td>[As per the proviso to section 36(1)(iii), interest paid in respect of capital borrowed for acquisition of an asset for the period from the date of borrowing till the date on which such asset is first put to use shall not be allowed as deduction. Since the same has been debited to statement of profit and loss, it has to be added back while computing business income]</td>
<td></td>
</tr>
<tr>
<td>(v) <strong>Payment of labour charges to A &amp; Co., a sub-contractor, without deduction of tax</strong> [30% of Rs. 10 lakh]</td>
<td>3,00,000</td>
</tr>
<tr>
<td>[Under section 40(a)(ia), 30% of any sum paid to any resident on which tax is deductible is disallowed if tax is not deducted at source. In this case, TDS provisions under section 194C are attracted on labour charges which are shown separately in the bills. Since tax has not been deducted on labour charges, 30% of the expenditure shall be disallowed]</td>
<td>36,75,000</td>
</tr>
<tr>
<td><strong>Add: Amount taxable but not credited to profit and loss account</strong></td>
<td>3,08,75,000</td>
</tr>
<tr>
<td>AI(4) <strong>Sale of leather bag at a price lower than the fair market value</strong> [Rs. 300 x 5,000] [The difference between the sale price (Rs. 1,000 per leather bag) and the fair market value (Rs. 1,300 per leather bag) multiplied by the quantity sold (5000 leather bags) has to be added since the sale is to a related party at a price lower than the fair market value]</td>
<td>15,00,000</td>
</tr>
<tr>
<td>AI(5) <strong>Employee’s contribution to EPF</strong></td>
<td>3,00,000</td>
</tr>
<tr>
<td>[Any sum received by the assessee from his employees]</td>
<td></td>
</tr>
</tbody>
</table>
as contribution to any provident fund is treated as income of the assessee. Since employees contribution to EPF has not been deposited on or before the due date under the PF Act, the same is not allowable as deduction as per section 36(1)(va).

**Less: Items credited to statement of profit and loss, but not includible in business income / permissible expenditure and allowances**

(ii) Waiver of sundry creditor’s outstanding amount

[Waiver of Rs. 6,00,000 from the sundry creditors is a benefit in respect of a trading-liability by way of remission or cessation thereof and is, hence, taxable under section 41(1). Since the amount is already credited to statement of profit & loss, no adjustment is necessary.

### AI (1) Provision for wages payable to workers

[The provision based on fair estimate of wages and reasonable certainty of revision is allowable as deduction, since ICDS X requires ‘reasonable certainty’ for recognition of a provision, which is present in this case. As the provision has not been debited to statement to profit and loss, the same has to be reduced while computing business income]

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less: Depreciation as per Income-tax Rules, 1962</td>
<td></td>
</tr>
<tr>
<td>A(2) Depreciation under section 32</td>
<td></td>
</tr>
<tr>
<td>Depreciation on factory building [10% of Rs.180 lakh]</td>
<td>18,00,000</td>
</tr>
<tr>
<td>Depreciation on plant and machinery</td>
<td></td>
</tr>
<tr>
<td>- Depreciation@7.5% on Rs. 31.75 lakhs [Rs. 30 lakh, being machinery cost + Rs. 1.75 lakh, being interest from 1.4.2018 to 31.10.2018] since machinery is put to use for less than 180 days.</td>
<td>2,38,125</td>
</tr>
<tr>
<td>- Depreciation@15% on Rs. 140 lakh [Rs. 170 lakh – Rs. 30 lakh]</td>
<td>21,00,000</td>
</tr>
<tr>
<td>- Depreciation on computers [40% of Rs. 15 lakh]</td>
<td>6,00,000</td>
</tr>
<tr>
<td>Add: Additional depreciation @10% on Rs. 31.75 lakh, since machinery is put to use for less than 180 days</td>
<td>3,17,500</td>
</tr>
<tr>
<td>Add: Additional depreciation @10% on Rs. 31.75 lakh, since machinery is put to use for less than 180 days</td>
<td>50,55,625</td>
</tr>
</tbody>
</table>

### Gross Total Income

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross Total Income</td>
<td>2,64,19,375</td>
</tr>
</tbody>
</table>

**Less: Deduction under Chapter VI-A**

Under section 80JJAA [See Working Note below]

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Income</td>
<td>2,54,89,375</td>
</tr>
<tr>
<td>Total Income (Rounded off)</td>
<td>2,54,89,380</td>
</tr>
</tbody>
</table>
Computation of tax payable by Sankar Ltd. for the A.Y. 2019-20

<table>
<thead>
<tr>
<th>Description</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax payable on Rs. 2,54,89,380@25%, since the turnover of the company for</td>
<td>63,72,345</td>
</tr>
<tr>
<td>the P.Y. 2016-17 does not exceed Rs. 250 crores</td>
<td></td>
</tr>
<tr>
<td>Add: Surcharge@7% (since the total income of the company exceeds Rs. 1</td>
<td>4,46,064</td>
</tr>
<tr>
<td>crore but does not exceed Rs. 10 crore)</td>
<td></td>
</tr>
<tr>
<td>Add: Health and education cess@4%</td>
<td>68,18,409</td>
</tr>
<tr>
<td>Tax liability</td>
<td>2,72,736</td>
</tr>
<tr>
<td>Tax liability (Rounded off)</td>
<td>70,91,145</td>
</tr>
</tbody>
</table>

Working Note:
Computation of deduction under section 80JJAA

<table>
<thead>
<tr>
<th>Description</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sankar Ltd. is eligible for deduction under section 80JJAA since the company is subject to tax</td>
<td></td>
</tr>
<tr>
<td>audit under section 44AB for A.Y.2019-20 and has employed “additional employees” during the</td>
<td></td>
</tr>
<tr>
<td>P.Y.2018-19</td>
<td></td>
</tr>
<tr>
<td><strong>Number of additional employees</strong></td>
<td></td>
</tr>
<tr>
<td>Total number of employees employed during the year</td>
<td>24</td>
</tr>
<tr>
<td>Less: Employees employed on 1.7.2018, since their total monthly</td>
<td>4</td>
</tr>
<tr>
<td>emoluments exceed Rs. 25,000</td>
<td></td>
</tr>
<tr>
<td>Employees employed on 1.6.2018 whose emoluments are paid by</td>
<td>2</td>
</tr>
<tr>
<td>bearer cheque</td>
<td></td>
</tr>
<tr>
<td><strong>Number of additional employees [10 employees employed on 1.6.2018 and 8 employees on 1.11.2018]</strong></td>
<td>18</td>
</tr>
<tr>
<td>Additional employee cost</td>
<td>Rs. 31,00,000</td>
</tr>
<tr>
<td>Rs. 23 lakh, being Rs. 23,000 × 10 × 10 + Rs. 8 lakh, being Rs. 20,000 × 5 × 8</td>
<td>9,30,000</td>
</tr>
<tr>
<td>Deduction under section 80JJAA [30% of Rs. 31 lakh]</td>
<td></td>
</tr>
</tbody>
</table>

Question 2
Answer
(a) (i) Computation of MAT payable by Alpha and Beta Tyres Limited under section 115JB for A.Y.2019-20

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net profit as per statement of profit and loss</td>
<td>20,00,00,000</td>
</tr>
<tr>
<td>Add: Net profit to be increased by the following amounts as per Explanation</td>
<td></td>
</tr>
<tr>
<td>1 to section 115JB(2):</td>
<td>18,00,00,000</td>
</tr>
<tr>
<td>Depreciation</td>
<td>20,00,000</td>
</tr>
<tr>
<td>Interest charged for delay in remittance of TDS [As per Explanation 2 to</td>
<td>18,20,00,000</td>
</tr>
<tr>
<td>section 115JB, income-tax shall include, inter alia, any interest charged</td>
<td></td>
</tr>
<tr>
<td>under the Act. Therefore, interest on delay in remittance of TDS has to be</td>
<td></td>
</tr>
<tr>
<td>be added back]</td>
<td></td>
</tr>
<tr>
<td>Less: Net profit to be decreased by the following amounts as per Explanation</td>
<td>38,20,00,000</td>
</tr>
<tr>
<td>1 to section 115JB(2):</td>
<td></td>
</tr>
</tbody>
</table>

33.9
<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Depreciation other than depreciation on revaluation of assets (Rs. 18 crore – Rs. 3 crore)</td>
<td>15,00,00,000</td>
</tr>
<tr>
<td>Share income from Association of Persons</td>
<td>50,00,000</td>
</tr>
<tr>
<td>Amount withdrawn from revaluation reserve (Rs. 6 crore) to the extent it does not exceed depreciation on revaluation of assets (Rs. 3 crore)</td>
<td>3,00,00,000</td>
</tr>
<tr>
<td>Brought forward business loss of Rs. 8 crore (Rs. 3 crore + Rs. 5 crore) and unabsorbed depreciation of Rs. 3 crore (Rs. 1 crore + Rs. 2 crore)</td>
<td>11,00,00,000</td>
</tr>
</tbody>
</table>

Since Alpha and Beta Tyres Limited is a company against which an application for corporate insolvency resolution process has been admitted by NCLT under section 7 of the Insolvency and Bankruptcy Code, 2016, the amount of total loss brought forward (including unabsorbed depreciation) is allowed to be reduced from the book profit for the purposes of levy of MAT under section 115JB.

**Book profit computed in accordance with Explanation 1 to section 115JB(2)**

Add: **Items credited to OCI that will not be reclassified to profit or loss:**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Re-measurement of defined employee benefit plan</td>
<td>50,00,000</td>
</tr>
<tr>
<td>Revaluation surplus of property, plant and equipment</td>
<td>Nil</td>
</tr>
<tr>
<td>Rs. 1 crore [Book profit not to be increased by revaluation surplus for assets]</td>
<td>Nil</td>
</tr>
</tbody>
</table>

Add: **One-fifth of Transition amount [Credit Balance]**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Transition amount</td>
<td>5,00,00,000</td>
</tr>
</tbody>
</table>

Less: **Amounts to be excluded from transition amount**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital Reserve</td>
<td>50,00,000</td>
</tr>
<tr>
<td>One-fifth of Rs. 4,50,00,000</td>
<td>4,50,00,000</td>
</tr>
</tbody>
</table>

**Book Profit for levy of MAT**

10,10,00,000

**Computation of MAT**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>MAT on book profit under section 115JB = 18.5% of Rs. 10,10,00,000</td>
<td>1,86,85,000</td>
</tr>
<tr>
<td>Add: Surcharges@12% (since book profit exceeds Rs. 10 crore)</td>
<td>22,42,200</td>
</tr>
<tr>
<td>Less: Marginal relief (See Working Note below)</td>
<td>2,07,95,000</td>
</tr>
<tr>
<td>Add: Health and education cess@4% MAT liability for A.Y.2019-20</td>
<td>2,16,26,800</td>
</tr>
</tbody>
</table>
### Working Note: Computation of marginal relief

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>MAT on book profit (including surcharge) computed on total income of Rs. 10.10 crore</td>
<td>2,09,27,200</td>
</tr>
<tr>
<td>Less: Maximum tax (including surcharge) which can be levied on total income of Rs. 10.10 crore:</td>
<td></td>
</tr>
<tr>
<td>Tax (including surcharge@7%) on Rs. 10 crore</td>
<td>1,97,95,000</td>
</tr>
<tr>
<td>Add: Income exceeding Rs. 10 crore</td>
<td>10,00,000</td>
</tr>
<tr>
<td></td>
<td>2,07,95,000</td>
</tr>
<tr>
<td><strong>Marginal relief</strong></td>
<td><strong>1,32,200</strong></td>
</tr>
</tbody>
</table>

### Computation of MAT credit to be carried forward

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>MAT liability for A.Y.2019-20 (rounded off)</td>
<td>2,16,26,800</td>
</tr>
<tr>
<td>Income-tax computed as per the normal provisions of the Act for A.Y.2019-20</td>
<td>73,00,000</td>
</tr>
<tr>
<td>Since the income-tax liability computed as per the regular provisions of the Income-tax Act, 1961 is less than the MAT payable, the book profit of Rs. 10,10,00,000 would be deemed to be the total income and tax is leviable@18.5%: The total tax liability (rounded off) is Rs. 2,16,26,800.</td>
<td></td>
</tr>
<tr>
<td><strong>Computation of tax credit to be carried forward:</strong></td>
<td></td>
</tr>
<tr>
<td>Tax payable for A.Y.2019-20 on deemed total income</td>
<td>2,16,26,800</td>
</tr>
<tr>
<td>Less: Income-tax payable as per the normal provisions of the Act</td>
<td>73,00,000</td>
</tr>
<tr>
<td><strong>Tax credit in respect of tax paid on deemed income</strong></td>
<td><strong>1,43,26,800</strong></td>
</tr>
</tbody>
</table>

### Computation of tax payable/refund due to Mr. Sumedh for A.Y.2019-20

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Capital Gains</strong></td>
<td></td>
</tr>
<tr>
<td>Long-term capital gains on transfer of foreign exchange asset on 31.7.2018</td>
<td>6,50,000</td>
</tr>
<tr>
<td>Less: Expenditure wholly and exclusively incurred with such transfer</td>
<td>80,000</td>
</tr>
<tr>
<td><strong>Less: Exemption under section 115F</strong></td>
<td></td>
</tr>
<tr>
<td>- Investment of Rs. 2,00,000 in notified saving certificates referred to in section 10(4B) on 30.3.2019</td>
<td>Nil</td>
</tr>
<tr>
<td>[Investment in notified saving certificates referred to in section 10(4B) is to be made within six months after the date of transfer i.e., on or before 31.1.2019. Since investment is made after 31.1.2019, no exemption would be allowed]</td>
<td></td>
</tr>
<tr>
<td>- Investment of Rs. 3,00,000 in shares of Indian Public Limited Companies on 31.12.2019 [Investment in specified assets, being shares in an Indian company is to be made within six months after the date of transfer i.e., on or before 31.1.2019. Since investment is made after 31.1.2019, no exemption would be allowed]</td>
<td>Nil</td>
</tr>
<tr>
<td><strong>Income from other sources</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Investment Income</strong></td>
<td></td>
</tr>
</tbody>
</table>

33.11
Interest on Government Securities 95,000
Interest on deposits with public limited companies 2,60,000

Other Incomes
Dividend from domestic companies of Rs. 75,000 [Exempt under section 10(34)] Nil
Interest on deposits with private limited companies 5,90,000

Total Income
Tax liability [applying the special provisions under Chapter XII-A]
Tax@20% on investment income = 20% of Rs. 3,55,000 71,000
Tax@10% on long-term capital gains = 10% of Rs. 5,70,000 57,000
Tax on balance income of Rs. 5,90,000 at slab rate [Rs. 18,000, being 20% of Rs. 90,000 + Rs. 12,500] 30,500
Add: Health and education cess@4% 6,340
Tax liability 1,64,840
Less: TDS 1,83,800
Refund due 18,960

Question 3
Answer
(a) Computation of total income of M/s. Mahan Charitable Trust for the A.Y.2019-20

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Voluntary contributions received during the year</td>
<td>1,50,00,000</td>
<td></td>
</tr>
<tr>
<td>Less: Corpus Donation</td>
<td>20,00,000</td>
<td>1,30,00,000</td>
</tr>
<tr>
<td>Income from property held under trust [Capital Gains from sale of land (Rs. 10.50 lakhs – Rs. 5 lakhs)]</td>
<td>5,50,000</td>
<td></td>
</tr>
<tr>
<td>Less: 15% of income eligible for being set apart without any condition</td>
<td>1,35,50,000</td>
<td>20,32,500</td>
</tr>
<tr>
<td>Less: Amount applied for charitable purposes</td>
<td>1,15,17,500</td>
<td></td>
</tr>
<tr>
<td>Salary paid to teachers and administrative staff</td>
<td>40,00,000</td>
<td></td>
</tr>
<tr>
<td>General expenses [Rs. 10,00,000 – Rs. 30,000, payment by crossed cheque disallowed due to application of section 40A(3)]</td>
<td>9,70,000</td>
<td></td>
</tr>
<tr>
<td>Capital gains re-invested in purchase of land for the purpose of the trust deemed to be applied for charitable purposes [Rs. 10.50 lakhs – Rs. 5 lakhs]</td>
<td>5,50,000</td>
<td></td>
</tr>
<tr>
<td>Excess of purchase price of new land over sale consideration of old land treated as application of income, since the new land is used for the purpose of the trust [Rs. 12 lakhs – Rs. 10.50 lakhs]</td>
<td>1,50,000</td>
<td></td>
</tr>
<tr>
<td>- Cost of laptops purchased for teaching purposes [Rs. 50,000 x 5]</td>
<td>2,50,000</td>
<td></td>
</tr>
</tbody>
</table>
- Cost of construction of hostel rooms \([2 \times Rs. 1200 \times 1500 \text{ sq. ft}]\)
  - Rs. 36,00,000

- Corpus donations of Rs. 20 lakhs to a trust registered u/s 12AA not permissible as deduction
  - Nil

Amount accumulated for constructing a school building (Rs. 30 lakhs) less amount actually spent (Rs. 27 lakhs) taxable in the P.Y.2019-20 (A.Y.2020-21), being the year immediately succeeding the P.Y.2018-19 (A.Y.2019-20), the year in which project is completed

**Total income [See Note below]**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Billing per manhour [SD 90.75/hour x Rs.45]</td>
<td>4,083.75</td>
</tr>
<tr>
<td>Cost per man hour [SD 75/hour x Rs.45]</td>
<td>3,375.00</td>
</tr>
<tr>
<td><strong>Operating profit per manhour</strong></td>
<td>708.75</td>
</tr>
<tr>
<td><strong>Operating profits to cost (%)</strong></td>
<td>21%</td>
</tr>
</tbody>
</table>

**Note** – If the trust exercises the option to apply the donations received (to the extent of Rs. 17.475 lakhs, being taxable portion of income of the trust i.e., Rs. 19,97,500 – Rs. 2,50,000, the basic exemption limit) from Mr. Michael on 31.3.2019 on or before the due date of filing of return u/s 139(1) in the prescribed form, the income would be deemed to have been applied for charitable purposes in the A.Y.2019-20. However, Rs. 17.475 lakhs should be applied before the end of the previous year 2019-20.

(b) Two enterprises are deemed to be associated enterprises where one enterprise advances loan constituting not less than 51% of the book value of the total assets of the other enterprise.

In this case, since Beta Inc., a foreign company, has advanced loan to Beta Ltd., an Indian company, and such loan constitutes 57.6% \([\frac{Rs. 45 \times 1,60,000 \times 100}{1,25,00,000}]\) of the book value of total assets of Beta Ltd., Beta Inc and Beta Ltd. are deemed to be associated enterprises.

Since the transaction of provision of software backup support by Beta Ltd. to Beta Inc. is an international transaction between associated enterprises the provisions of transfer pricing would be attracted in this case.

**Determination of Operating Margin of transaction of provision of software backup support by Beta Ltd. to Beta Inc**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Billing per manhour [SD 90.75/hour x Rs.45]</td>
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<tr>
<td><strong>Operating profit per manhour</strong></td>
<td>708.75</td>
</tr>
<tr>
<td><strong>Operating profits to cost (%)</strong></td>
<td>21%</td>
</tr>
</tbody>
</table>

**Determination of Operating Margin of Comparable Uncontrolled transaction i.e., provision of software backup support by Gama Ltd. to Olive Inc**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs. in lakhs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Direct Cost</td>
<td>600</td>
</tr>
<tr>
<td>Indirect Cost</td>
<td>200</td>
</tr>
<tr>
<td><strong>Total cost</strong></td>
<td>800</td>
</tr>
<tr>
<td>Operating profits</td>
<td>200</td>
</tr>
<tr>
<td><strong>Operating profits to cost (%)</strong></td>
<td>25%</td>
</tr>
</tbody>
</table>
(1) Computation of Arm’s Length Price of provision of software backup support provided by Beta Ltd. to Beta Inc. by applying TNMM

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost for Beta Ltd. (per man hour) [SD 75 x Rs.45/SD]</td>
<td>3,375.00</td>
</tr>
<tr>
<td>Add: Arm’s length operating profit margin as % of cost (25% of Rs. 3,375)</td>
<td>843.75</td>
</tr>
<tr>
<td>Arm’s length price (per manhour) in INR [See Note]</td>
<td>4,218.75</td>
</tr>
<tr>
<td>Arm’s length price of total manhours spent by Beta Ltd. for providing software backup support to Beta Inc. [Rs. 4,218.75 x 50,000 man hours] = Rs. 21,09,37,500</td>
<td></td>
</tr>
</tbody>
</table>

(2) Adjustment to be made to the total income of Beta Ltd.

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Arm’s length price of total manhours spent by Beta Ltd. for providing software backup support to Beta Inc.</td>
<td>21,09,37,500</td>
</tr>
<tr>
<td>Less: Amount actually billed [90.75 SD x Rs.45/SD x 50,000 manhours]</td>
<td>20,41,87,500</td>
</tr>
<tr>
<td>Arm’s length adjustment to be made to the total income of Beta Ltd.</td>
<td>67,50,000</td>
</tr>
</tbody>
</table>

Question 4
Answer
(a) TDS under section 194C is attracted on any sum payable to a resident contractor/sub-contractor for carrying out any work. However, “work” shall not include manufacturing or supplying a product according to the requirement or specification of a customer by using raw material purchased from a person, other than such customer, as such a contract is a ‘contract for sale’.

In this case, M/s Lion & Co. has to supply cushion for the chairs to Deer Co Ltd., according to the specifications of the customer by using materials purchased from a person other than the customer, Deer Co Ltd. Thus, the sub-contract for production of cushions is a ‘contract for sale’ and not a ‘works contract’.

Consequently, there is no liability to deduct tax at source under section 194C in this case.

(b) As per section 206C(1), a seller of, inter alia, scrap is required to collect tax@1% from the buyer. Scrap means waste and scrap from the manufacture or mechanical working of materials which is definitely not usable as such because of breakage, cutting up, wear and other reasons.

However, tax is not required to be collected at source if the resident buyer furnishes to the person responsible for collecting tax, a declaration in the prescribed form that such scrap is to be utilised for the purposes of, inter alia, manufacturing.

Thus, no tax is required to be collected at source by M/s.PMPC, the seller, on sale of scrap to M/s PAPC, if M/s. PAPC furnishes to M/s. PMPC, a declaration in the prescribed form that such scrap is to be utilised as raw material for production of paper.

(c) [First Alternative]

The issue under consideration is whether the bank is required to deduct tax at source on the amount of interest paid or payable on fixed deposits in the name of Registrar General of High Court.
Under section 194A, the bank is obliged to deduct tax at source in respect of any credit or payment of interest (exceeding Rs. 10,000) on deposits made with it. The expression “payee” under section 194A would mean the recipient of income whose account is maintained by the person paying interest.

However, in this case, the actual payee is not ascertainable and the person in whose name the interest is credited is not a person liable to pay tax under the Act. The Registrar General is recipient of neither the amount credited to his account nor to interest accruing thereon. Therefore, he cannot be considered as a ‘payee’ for the purposes of section 194A. In the absence of a payee, the machinery provisions for deduction of tax from interest credited become ineffective. The credit by the bank in the name of the Registrar General would, thus, not attract the provisions of section 194A. Therefore, the bank is correct in not deducting tax on the interest accrued.

Note – This issue came up before the Delhi High Court in UCO Bank v. Dy. CIT (2014) 369 ITR 335. The above answer is based on the Delhi High Court ruling in the said case. The CBDT has, vide Circular No. 23/2015 dated 28.12.2015 accepted the aforesaid judgment and clarified that interest on fixed deposits made in the name of the Registrar General of the Court or the depositor of the fund on the directions of the Court, will not be subject to TDS till the matter is decided by the Court.

(c) [Second Alternative]

(a) Under section 194B, the person responsible for paying by way of winnings from any card game and other game in an amount exceeding Rs. 10,000 shall, at the time of payment, deduct income-tax at 30%.

Therefore, Blue Moon, a popular television channel, is required deducted tax at source @30% from the prize money of Rs. 50 lakh at the time of payment to the winner of a famous quiz programme.

(b) Section 194J requires deduction of tax at source @10% from the amount credited or paid by way of fees for professional services, where such amount or aggregate of such amounts credited or paid to a person exceeds Rs. 30,000 in a financial year.

“Blue Moon”, a television channel is required to deduct tax at source @10% under section 194J at the time of credit or payment, whichever is earlier, on the professional fees payable to the cameraman for shooting multi-episodes of a long documentary serial, since such amount exceeds Rs. 30,000 during the financial year.

Note - Alternatively, if the cameraman is an employee of the T.V. Channel, the provisions of section 192 will apply at the time of payment and tax would have to be deducted at the average rate of tax.

(d) (i) ABC & Co., an Indian LLP, and XYZ LLP, a foreign LLP, are deemed to be associated enterprises, since XYZ LLP is controlled by A & B, who are the partners of ABC & Co., along with their relatives.

Engine, engine parts including cooling systems and engine valves fall within the meaning of “core auto components”, and hence, export of all such parts originally manufactured by ABC & Co. is an eligible international transaction.

Since the Indian LLP is solely engaged in the manufacture and export of such parts and has exercised a valid option for Safe Harbour Rules, it is an eligible assessee.
The Indian LLP should have declared an operating profit margin of not less than 12% in relation to operating expense, to be covered within the Safe Harbour Rules.

However, since ABC & Co., an Indian LLP has declared an operating profit margin of only 7.5% (Rs. 4.5/Rs. 60 crore x 100), the same is not in accordance with the circumstance mentioned in Rule 10TD.

Hence, ABC & Co., an Indian LLP, has to make primary adjustment. Accordingly, it has to declare operating profits margin of Rs. 7.2 crore, being 12% of operating expenses i.e., Rs.60 crore.

Thus, primary adjustment of Rs. 2.7 crore [i.e., Rs. 7.2 crore – Rs. 4.5 crore] has to be made by ABC & Co.

(ii) The Safe Harbour Rules shall not apply in respect of eligible international transactions entered into with an associated enterprise located in a notified jurisdictional area.

Therefore, if the foreign LLP is located in a NJA, the Safe Harbour Rules shall not be applicable, irrespective of the operating profit margin declared by the assessee.

**Question 5**

**Answer**

(a) 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 re-computation 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, 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 Mr. Harish 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 15 assessment years i.e., from A.Y.2004-05 to A.Y.2018-19.

Hence, the Assessing Officer is justified in invoking reassessment provisions in respect of the earlier assessment years i.e., from A.Y.2004-05 and thereafter, since Mr. Harish first purchased an asset outside India in September 2003.

Accordingly, in view of the above provisions, the action of the Assessing Officer in issuing notices to Mr. Harish under section 148 for 15 assessment years i.e., from A.Y. 2004-05 to A.Y. 2018-19 is tenable in law.
(b) The Assessing Officer can exercise his power of survey under section 133A only after obtaining the approval of the Joint Commissioner or Joint Director, as the case may be.

Assuming that he has obtained such approval in this case, he is empowered under section 133A to enter any place of business of the assessee within his jurisdiction only during the hours at which such place is open for the conduct of business.

In the case given, the “Thriller” a popular cinema hall is open from 9.00 p.m. to 1.00 a.m. for the conduct of business. The Assessing Officer entered the cinema hall at 12 o’clock in the night which falls within the working hours of the cinema hall. Therefore, the claim made by the owner to the effect that the Assessing Officer could not enter the cinema hall at late night is not valid.

Further, as per section 133A(3)(ia), the Assessing Officer may, impound and retain in his custody for such period as he thinks fit, any books of account or other documents inspected by him. However, he shall not impound any books of account or other documents except after recording his reasons for doing so.

(c) The issue under consideration is whether the Authority for Advance Rulings shall allow/reject an application for advance ruling where the question raised in the application is already pending before any income-tax authority or Appellate Tribunal or any Court.

An advance ruling is not only applicant specific, but is also transaction specific. The advance ruling is on a transaction entered into or undertaken by the applicant. That is why section 245S specifies that a ruling is binding (i) on the applicant, (ii) the transaction and (iii) the Principal Commissioner or Commissioner of Income-tax and those subordinate to him.

Therefore, AAR can reject the application made by Balmart Inc. before the AAR on the ground that similar issue is pending before the Assessing Officer in respect of the same transaction i.e., provision of technical know in case of Klipkart Ltd.

Notes – (1) The facts of the case are similar to the facts in Nuclear Power Corporation of India Ltd. In Re, [2012] 343 ITR 220, wherein the above issue came up before the AAR. What is barred by the first proviso to section 245R(2) of the Act in the context of clause (i) thereof is the allowing of an application under section 245R(2) of the Act where “the question raised in the application is already pending before any Income-tax authority, or Appellate Tribunal or any court”. The significance of the dropping of the words, “in the applicant’s case” with effect from June 1, 2000, cannot be wholly ignored. On the basis of this view expressed by the AAR in the above case, explaining the impact of the dropping of the words “in the applicant’s case” with effect from 1.6.2000, a view can be taken that the AAR can reject the application made by Balmart Inc. before the AAR on the ground that similar issue is pending before the Assessing Officer in respect of the same transaction i.e., provision of technical know in case of Klipkart Ltd. The above answer is based on these lines.

(2) Alternate Answer - The issue relates to the admission or rejection of the application filed before the Advance Rulings Authority on the grounds specified in clause (i) of the first proviso to sub-section (2) of section 245R of the Income-tax Act, 1961.

The first proviso to section 245R(2) has been substituted by the Finance Act, 2000 with effect from 1.6.2000. Clause (i) of the first proviso, prior to and post amendment, reads as follows:
Provided that the Authority shall not allow the application except in the case of a resident applicant where the question raised in the application is already pending in the applicant's case before any income-tax authority, the Appellate Tribunal or any court;

Provided that the Authority shall not allow the application where the question raised in the application is already pending before any income-tax authority, the Appellate Tribunal or any court.

The words “except in the case of a resident applicant” and “in the applicant’s case” has been removed in clause (i) of the first proviso with effect from 1.6.2000. However, the Explanatory Memorandum to the Finance Act, 2000, explaining the impact of the substitution, reads as follows “It is proposed to substitute the proviso to provide that the Authority shall not allow the application when the question raised is already pending in the applicant’s case before any income-tax authority, Appellate Tribunal or any court in regard to a non-resident applicant and resident applicant in relation to a transaction with a non-resident”. Therefore, according to the intent expressed in the Explanatory Memorandum, the AAR shall not allow the application both in the case of resident and non-resident applicant if the question raised is already pending in the applicant’s case before any income-tax authority. Thus, as per the Explanatory Memorandum, it is possible to take a view that even post-amendment, the Authority shall not allow the application only where a question is pending in the applicant’s case before any income-tax authority. Thus, an alternative view is possible on the basis of the AAR ruling in Ericsson Telephone Corporation India AB v. CIT (1997) 224 ITR 203, which continues to hold good even after the amendment, if we consider the intent expressed in the Explanatory Memorandum. Accordingly, based on this view, the rejection of application by the AAR is not justified in law, since the question raised in the application made by Balmart Inc. is pending before the Assessing Officer in Klipkart Ltd.’s case, and not in the applicant’s case.

**Interest for failure to remit the equalization levy**

An assessee who fails to credit the equalisation levy or any part thereof within 7th of the month following the calendar month in which it is deducted, to the account of the Central Government, has to pay simple interest at the rate of 1% of such levy for every month or part of a month by which such crediting of the tax or any part thereof is delayed.

In the present case, Raghu Ltd. is required to remit the equalization levy of Rs. 18,000 i.e., 6% of Rs. 3,00,000 by 07.7.2018. However, since it remitted the said levy only on 23.3.2019, the interest Rs. 1,620 i.e., @1% would be levied for 9 months.

**Penalty for failure to pay equalisation levy**

Failure to remit equalisation levy to the Central Government on or before 7th of the following month, after deduction would attract a penalty of Rs. 1,000 for every day during which the failure continues. However, such penalty shall not exceed the amount of equalisation levy that he failed to pay.

Thus, in the present case, penalty of Rs. 2,59,000 (Rs. 1000 x 259) would be limited to Rs. 18,000, being the amount of equalization levy which the assessee has failed to pay.
Question 6

Answer

(a) Successful tax planning must conform to two tests viz, conformity with the current law and flexibility.

In order to satisfy the first test, the essential requisite is a comprehensive knowledge of the law, rules and regulations on the part of the tax planner. This knowledge of law extends not only to the provisions of the taxing statutes and the case law that has developed on those statutes, but also to other branches of law, both civil and personal, so that the tax planner’s device does not get defeated by the universal principles of jurisprudence.

The second test of flexibility seeks to ensure that the success of the tax planning device is not nullified by statutory negation. Flexibility essentially means that the device provides for suitable changes in accepted forms. Wherever possible, tax planning schemes should be flexible, designed so as to avoid irretrievable situations. The tax planner should, therefore, be watchful of all significant developments related to his field.

(b) The advice to Mrs. Srinivasan would be on the following lines –

Mrs. Srinivasan, the legal representative of Mr. Srinivasan, would be deemed to be an assessee for the purpose of the Income-tax Act, 1961. Mrs. Srinivasan would be liable to file return of income as a legal representative and pay any sum which Mr. Srinivasan would have been liable to pay if he had not died, in the like manner and to the same extent as the deceased. Any sum includes tax, penalties, interest or any other sum that would have been payable by her deceased husband. The liability of Mrs. Srinivasan would be limited to the extent to which, the estate of the deceased is capable of meeting the liability. No prosecution can, however, be initiated on Mrs. Srinivasan for any offence committed by her deceased husband.

(c) (i) The statement is not correct.

The objectives of tax treaties also include
• allocating tax rights,
• elimination of double taxation,
• ensuring non-discrimination between residents and non-residents and
• resolution of disputes of on account of different treaty interpretation.

(ii) The statement is correct.

Protocol is like a supplement to the treaty. In many treaties, in order to put certain matters beyond doubt, there is a protocol annexed at the end of the treaty, which clarifies borderline issues. Thus, one must refer to protocol before arriving at any final conclusion in respect of any tax treaty provision.
Past New Course Suggested AJ Education NeXt

**NOV 2018 (NEW COURSE):**

*Question No. 1 is compulsory.*

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

*Working notes should form part of the respective answers.*

*All questions relate to Assessment Year 2018-19, unless stated otherwise in the question.*

**Question 1**

(a) M/s. Hind Udyog, a manufacturing partnership firm, consisting of three partners namely X, Y and Z, provides following information relating to the year ending on 31.03.2018:

Net profit of Rs. 28.75 lakhs, as per profit and loss account, was arrived at after debiting/crediting the following items:

(i) The firm had provided an amount of Rs. 2 lakhs being sum estimated as payable to workers based on agreement to be entered with the workers union towards periodical wage revision once in three years. The provision is based on a fair estimation on wage and reasonable certainty of revision once in three years.

(ii) Sale proceeds of import entitlements amounting to Rs. 1 lakh have been credited to profit and loss account, which the firm claims as capital receipt not chargeable to income tax.

(iii) Goods and Service Tax demand paid includes an amount of Rs. 5,300 charged as penalty for delayed filing of returns and Rs. 12,750 towards interest for delay in deposit of tax.

(iv) A free air ticket was provided by a supplier for reaching a certain volume of purchase during the F.Y. 2017-18. The same is not credited in profit & loss account because it was encashed by the firm for Rs. 2 lakhs in April 2018.

(v) Interest amounting Rs. 20,000 paid to X as a Karta of HUF @ 18% per annum.

(vi) The firm had taken on lease an old building for the purpose of locating its business. Due to old age of building, it was demolished and a new building put up, which was used by the firm from September, 2017. The cost of new building Rs. 10 lakh was written off as revenue expenditure. The lessor permitted the firm to have an extension of the lease by another 20 years.

(vii) Loss incurred in transactions of purchase and sale of shares (without delivery) of various companies Rs. 3 lakhs.

The Suggested Answers for Paper 7: Direct Tax Laws and International Taxation are based on the provisions of direct tax laws as amended by the Finance Act, 2017. The relevant assessment year is A.Y.2018-19.

(viii) A scheduled bank sanctioned and disbursed a term loan in the financial year 2014-15 for a sum of Rs. 50 lakhs. Interest of Rs. 8 lakhs was in arrears. The bank has converted the arrear of interest into a new loan repayable in 10 equal instalments. During the year, the company has paid 2 instalments and the amount so paid has been reduced from Funded Interest in the Balance Sheet.

*The firm furnishes following additional information relating to it:*
(1) Provision for audit fees Rs. 2.5 lakhs was made in the books for the year ended on 31.03.2017 without deducting tax at source. Such fees was paid to the auditors in September, 2017 after deducting tax under section 194J and the tax so deducted was deposited on 7th October, 2017.

(2) The firm had made an investment of Rs. 23 lakhs and Rs. 12 lakhs on the construction of two warehouses (excluding the cost of land), in rural areas for the purpose of storage of agricultural produce and edible oil respectively. These were made available for use from 15.09.2017. The profits from setting of these warehouses (before claiming deduction under section 35AD and 32) for the A.Y. 2018-19 is Rs.15 lakhs and Rs.5 lakhs respectively.

(3) In July, 2017 firm received a dividend of Rs. 11 lakhs from A Ltd. in which it holds 10% of shares.

Compute the total income of M/s Hind Udyog for the A.Y. 2018-19 by analysing, integrating and applying the relevant provisions of Income tax law. Explain in brief, the reasons for the treatment of each item.

(b) Red Ltd., a non-resident foreign company, had entered into a collaboration agreement, approved by the Central Government, with Blue Ltd., an Indian company on February 21, 2003 and is in receipt of following payments during the previous year ending on March 31, 2018:

(i) Interest on 8% debentures for Rs. 40 lakhs issued by Blue Ltd. on July 1, 2017 in consideration of providing of technical know-how, manufacturing process and designs (date of payment of interest being March 31 every year).

(ii) Service charges @ 2.5% of the value of plant and machinery for Rs. 500 Lakhs leased out to Blue Ltd. payable each year before March 31.

(iii) Apart from the above incomes, Red Ltd. received a long term capital gain amounting to Rs. 1.90 Lakhs on sale of debentures of Green Ltd., an Indian company, subscribed in US$.

Compute the Total Income of Red Ltd. and determine its tax liability for the assessment year 2018-19. (6 Marks)

Question 2

(a) Anustup Chandra Flour Mills Ltd., a domestic company engaged in manufacture of wheat flour, furnishes the following information pertaining to the year ended 31-3-2018:

(i) Net profit as per the Statement of Profit and Loss is Rs. 77 lakhs after considering the items listed in (ii) to (vi) below.

(ii) The company is a member of Vishnu Foods & Co., an AOP in which the members' shares are determinate and their shares in profit/loss are clearly known. The entire income of the AOP is from business activities. During the year, the company has derived share income of Rs. 9 lakhs from the AOP. The company has spent a sum of Rs.90,000 towards earning such income.

(iii) The company has provided for income-tax (including interest under sections 234B and 234C of Rs. 62,000) for Rs. 3 lakhs and Rs. 5 lakhs towards share in loss of foreign subsidiary.

(iv) Amount debited to the Statement of Profit and Loss towards interest to a public financial institution is Rs. 12 lakhs. Of this, Rs. 4 lakhs was paid on 12-12-2017 only.

(v) The company committed breach of building norms while extending the factory building. The City Corporation initiated proceedings against the company and
the company settled the issue by paying compounding fee of Rs. 1 lakh. This amount forms part of general expenses, which has been debited to the Statement Profit and Loss.

(vi) In the administrative expenses, the company has debited a sum of Rs. 70,000 towards fee for delayed filing of statement of TDS under section 234E of the Income-tax Act, 1961.

(vii) The company has credited revaluation surplus of Rs. 10 lakhs on fair valuation of assets under Ind AS 16 and Ind AS 38 to other equity.

(viii) The company has credited Rs. 5 lakhs to other comprehensive income on fair valuation of equity instruments in which the company has Investment.

During the current year, the depreciation charged as per books of account of the company is the same as allowable under the Income-tax Act, 1961 [before considering the provisions of section 32(2)]. The company proposes to adopt this practice consistently in the future years.

You are required to compute the income-tax payable by the company for the assessment year 2018-19. The company is an Indian Accounting standard compliant company.

**Note:** The Turnover of company for the P.Y 2015-16 was Rs. 50 crore. (14 Marks)

(b) Mr. Manav, a resident, has derived certain income from a nation Q with which no DTAA exists. In Q, any income chargeable to tax is charged at a flat rate of 18%.

Mr. Manav has derived the following income from Q:

(i) Agricultural income from lands in Q Rs. 14 lakhs
(ii) Share income from a partnership firm in Q Rs. 18 lakhs

In nation Q, agricultural income is exempt and does not form part of total income.

State with reasons, whether, Mr. Manav (assessee) can claim double taxation relief in respect of the above two items of income and also determine the quantum of double taxation relief available.

The "Indian rate of tax" may be taken as 20%.

**Question 3**

(a) Eden Fab's Private Ltd. went into liquidation on 31.07.2017. The company was seized and possessed of the following funds prior to the distribution of assets to the shareholders:

<table>
<thead>
<tr>
<th>Description</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Share capital (issued on 01.04.2012)</td>
<td>8,00,000</td>
</tr>
<tr>
<td>Reserves prior to 31.07.2017</td>
<td>4,00,000</td>
</tr>
<tr>
<td>Excess realization in the course of liquidation</td>
<td>6,00,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>18,00,000</strong></td>
</tr>
</tbody>
</table>

There are 8 shareholders, each of whom received Rs. 2,25,000 from the liquidator in full settlement. You are required to examine the various issues and advice the shareholders about their liability to income tax.

(b) Mani foundations, a charitable trust registered under section 12AA of the Income-tax Act, 1961, run schools for primary and secondary education. The following particulars pertaining to the previous year 2017-18 are furnished to you by the trust:

<table>
<thead>
<tr>
<th>Description</th>
<th>Rs. (in lakhs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i) Gross receipts from students towards tuition fees, development fees, laboratory fees etc.</td>
<td>200</td>
</tr>
<tr>
<td>(ii) Voluntary contributions received from public (including</td>
<td>25</td>
</tr>
<tr>
<td>anonymous donation Rs. 5 lakhs)</td>
<td>8</td>
</tr>
<tr>
<td>Government grants</td>
<td>2</td>
</tr>
<tr>
<td>Donation given towards corpus to a trust registered under section 10(23C)</td>
<td>90</td>
</tr>
<tr>
<td>Amount applied for the purpose of schools</td>
<td></td>
</tr>
<tr>
<td>Included in (v) above, a sum of 5 lakhs, being the amount applied for the benefit of the founder of the trust.</td>
<td></td>
</tr>
<tr>
<td>The trust set apart Rs. 55 lakhs for acquiring a building to expand its schools. But the amount was paid in December 2018 when the sale deed was registered in its name</td>
<td>25</td>
</tr>
<tr>
<td>Excess of expenditure over income in the previous year 2016-17</td>
<td></td>
</tr>
</tbody>
</table>

Compute the total income of the trust for the assessment year 2018-19 in order to avail maximum benefits within the four corners of law.

(c) State with reasons, whether Netlon LLC., (Incorporated in Singapore) and Briggs Ltd., a domestic company, are/can be deemed to be associated enterprises for the transfer pricing regulations (Each situation is independent) of the others:

(i) Netlon LLC. has advanced a loan of Rs. 53 crores to Briggs Ltd. on 12-1-2018. The total book value of assets of Briggs Ltd. is Rs. 100 crores. The market value of the assets, however, is Rs. 150 crores. Briggs Ltd. repaid Rs. 10 crores before 31-3-2018.

(ii) Netlon LLC. has the power to appoint 2 of the directors of Briggs Ltd, whose total number of directors in the Board is 4.

(iii) Total value of raw materials and consumables of Briggs Ltd. is Rs. 900 crores. Of this, Netlon LLC. supplies to the tune of Rs. 820 crores, at prices mutually agreed upon once in six months and depending upon the market conditions.

**Question 4**

(a) Tulsi Private Ltd., a company engaged in ship breaking activity, sold some old and used plates, wood etc., in respect of which it did not collect tax from the buyer. The company claimed that such items are usable as such. Hence these are not 'scrap' to attract the provisions for collection of tax at source. The Assessing Officer treated such items in the nature of 'scrap' and raised a demand under section 201(1) and interest under section 201(1A).

Is the action of the Assessing Officer in treating such items as 'scrap' tenable in law? Discuss.

(b) Discuss whether liability to deduct tax at source arises in the under-mentioned (independent) situations in respect of following payments made by residents in India:

(i) Dindayal & Co., a partnership firm, has credited a sum of Rs. 67,000 and Rs. 4,000 respectively, as interest to partners L (Resident in India) and M (non-resident) respectively.

(ii) Lumnous Pvt. Ltd., whose accumulated profits are Rs. 20 lakhs, wants to disburse a loan of Rs. 25 lakhs to Mrs. Nisha, a resident shareholder holding 20% of the equity shareholding in the company. Can the entire amount of loan be disbursed to the shareholder, keeping in mind the provisions of the Income-tax Act, 1961? The Finance Manager feels that this being a pure loan

33.23
transaction, there is no bar for disbursing the entire amount. Is his view correct?  

(4 Marks)

(iii) Payment of Rs. 5 lakhs made by Shiv & Company (partnership firm) to Jyoti & Company Ltd. for organising debate competition on the subject 'Rural Heritage of Rajasthan'.  

(2 Marks)

(c) "Every jurisdiction, in the domestic law, prescribes the mechanism to determine residential status of a person. In case, a person is considered to be resident of both contracting states, it becomes necessary to apply the tie-breaker rule." Discuss the manner for application of the tie-breaker rule.  

(6 Marks)

Question 5

Attempt Either 5(a)(i) OR 5(a)(ii)

(a) (i) The business premise of Mr. Rajneesh was subjected to a survey under section 133A of the Act. There were some indiscriminating materials found at the time of survey. The assessee apprehends reopening of assessments of the earlier years. He wants to know whether he can approach the Settlement Commission. Explain briefly the basic conditions to be satisfied and the benefits that may accrue to Mr. Rajneesh by approaching the Settlement Commission.  

(5 Marks)

(ii) The assessment of Foundation Bank Ltd. for Assessment Year 2014-15 was made under section 143(3) on 30th November, 2015 allowing deduction under section 36(1)(vii) and deduction in respect of foreign exchange rate difference as claimed in the return of income. Subsequently, two notices of reassessment were issued under section 148 and an order of reassessment was passed under section 147 on 31st December, 2017 which did not deal with the above deductions. Later the Principal Commissioner after examining the records of assessment, initiated revisionary proceeding under section 263 on 31st May, 2018 for disallowing deduction under section 36(1)(vii) and deduction in respect of foreign exchange rate difference. The bank claims that the order passed by the Principal Commissioner under section 263 is barred by limitation. Is the claim made by Foundation Bank tenable in law?  

(5 Marks)

(b) State with brief reason, whether the following statements are true or false: (No mark will be awarded for answers without reason.)

(i) Where a notice under section 143(2) is issued to the assessee, it is not required to process under section 143(1), the return of income filed by the assessee.  

(ii) Even without rejecting the books of account, if any, maintained by the assessee, the Assessing Officer can make a reference to the Valuation Officer under section 142A for estimating the cost of construction of an immovable property.  

(iii) Expenses of special audit conducted under section 142 shall be paid by the Central Government.  

(iv) Only an individual can be regarded as a Tax Return Preparer under section 139B.  

(6 Marks)
(c) In the course of search operation under section 132 of the Income-tax Act, 1961, in the month of July, 2018, Mr. Khemka has made a declaration under section 132(4) to the Income Tax authorities on the earning of his income not disclosed in respect of previous year 2017-18. Can that statement save Mr. Khemka from a levy of penalty, if he is yet to file his return of income for assessment year 2018-19?

(3 Marks)

(d) John Butler Tex. Inc. is a company incorporated in Colombo, Sri Lanka. 60% of its shares are held by I Pvt. Ltd., a domestic company. John Butler Tex. Inc. has its presence in India also. The data relating to John Butler Tex. Inc., are as under:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>India</th>
<th>Sri Lanka</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fixed assets at depreciated values for tax purposes (Rs. in crores)</td>
<td>90</td>
<td>70</td>
</tr>
<tr>
<td>Intangible assets(Rs. in crores)</td>
<td>40</td>
<td>180</td>
</tr>
<tr>
<td>Other assets (Rs. in crores)</td>
<td>30</td>
<td>90</td>
</tr>
<tr>
<td>Income from trading operations (Rs. in crores)</td>
<td>15</td>
<td>42</td>
</tr>
<tr>
<td>Income from investments(Rs. in crores)</td>
<td>30</td>
<td>13</td>
</tr>
<tr>
<td>Number of employees (Residents in respective countries)</td>
<td>40</td>
<td>60</td>
</tr>
</tbody>
</table>

For POEM purposes, state whether,
(i) The company shall be said to be engaged in 'active business outside India'.
(ii) Because of increased operations in India, more manpower is needed. 30 more employees may be required in this regard. The company can either take these employees directly in its roll or can outsource the increased operation to an external agency which will engage the 15 employees in its roll and finish the work for the company. Which choice will be better?

Note: If for any test, average figures are needed, the same may be ignored and the data as given above to the applicant may be used.

Question 6

(a) Mr. B proposes to purchase for his business, certain raw materials from Mr. S. In view of the scarcity of the products, S insists on cash payments for the purchases, to which B agrees. On 27-3-2018, the purchases are effected through a cash invoice for Rs. 3,20,000.

In respect of the above transactions, will there be any detrimental effect in the hands of B and S under the provisions of the Income-tax Act, 1961? Explain briefly.

Will your answer be different, if the cash purchases are effected by the buyer B on two different dates for different raw materials for Rs. 1,80,000 and Rs. 1,40,000 respectively?

(5 Marks)

(b) Mr. Sarthak a software engineer wants to commence a business in manufacture of solar powered car. He provides the following information:

(i) The project cost is estimated at Rs. 5 crores.

(ii) He has a residential house in Surat since 2010 which could be sold for Rs. 3 crores.

(iii) And the balance Rs. 2 crores could be financed through bank borrowings at a cost of 13% per annum.

(iv) He has another option viz. his friend Miss Juhi who is willing to contribute Rs. 2 crores and become a co-promoter.
The indexed cost of acquisition of the residential house (Computed) is Rs. 70 lakhs.

Mr. Sarthak seeks your guidance on the project finance taking into account any tax incentives available under Income Tax Law besides the funding of project through bank finance or accepting Miss Juhi as Co-promoter.

You are requested to advise Mr. Sarthak, on Income tax aspects to avail tax benefits within the four corners of law.

(c) T Inc., a non-resident entity incorporated in Mauritius, has permanent Establishment (PE) in India. The PE filed its return of income for the assessment year 2018-19 disclosing income of Rs. 100 lakhs and paid tax at the rate applicable to the domestic company i.e. 30% plus applicable surcharge and cess on the basis of paragraph 2 of Article 24 of Double Tax Avoidance Agreement (non-discrimination) between India and Mauritius, which reads as follows:

"The taxation on PE which is 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 enterprise of that other state carrying on the same activities in the same circumstances."

However, the Assessing Officer computed the Tax on the PE at the rate applicable to a foreign company (40%). Is the action of AO in accordance with law? *(3 Marks)*

(d) Alpha Inc., a non-resident company has an IT enabled business process outsourcing Unit in India (BPO) and it provides certain outsourcing services to a resident Indian entity.

Discuss, the tax implications, in the hand of Alpha Inc. due to presence of BPO unit in India. *(3 Marks)*

**SOLUTION:**

**Question 1**

**Answer**

(a) **Computation of Total Income of M/s Hind Udyog for the A.Y.2018-19**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Amount (Rs.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profits and gains from business or profession</td>
<td></td>
</tr>
<tr>
<td>Profits and gains from regular business</td>
<td>28,75,000</td>
</tr>
<tr>
<td>Net profit as per the profit and loss account</td>
<td></td>
</tr>
<tr>
<td><em>Add: Items debited but to be considered separately</em></td>
<td></td>
</tr>
<tr>
<td>or to be disallowed/amount taxable but not credited</td>
<td></td>
</tr>
<tr>
<td>(i) Provision for wages payable to workers</td>
<td></td>
</tr>
<tr>
<td>[Since the provision is based on a fair estimate of wages payable with reasonable certainty, the provision is allowable as deduction. ICDS X requires a reliable estimate of the amount of obligation and reasonable certainty for recognition of a provision, which is present in this case. As the provision of Rs. 2 lakhs has been debited to profit and loss account, no adjustment is required]</td>
<td></td>
</tr>
<tr>
<td>Description</td>
<td>Amount</td>
</tr>
<tr>
<td>-----------------------------------------------------------------------------</td>
<td>---------</td>
</tr>
<tr>
<td>(ii) Penalty for delayed filing of GST returns</td>
<td>5,300</td>
</tr>
<tr>
<td>[Penalty imposed for delay in filing GST return is not deductible since it</td>
<td></td>
</tr>
<tr>
<td>is on account of infraction of the law requiring filing of the return</td>
<td></td>
</tr>
<tr>
<td>within the specified period. Since the same has been debited to profit</td>
<td></td>
</tr>
<tr>
<td>and loss account, the same is required to be added back while computing</td>
<td></td>
</tr>
<tr>
<td>business income]</td>
<td></td>
</tr>
<tr>
<td>(iii) Interest for delay in deposit of GST</td>
<td>-</td>
</tr>
<tr>
<td>[Interest paid on delayed deposit of GST is not penal in nature but is</td>
<td></td>
</tr>
<tr>
<td>compensatory in character and is an allowable deduction under section 37]</td>
<td></td>
</tr>
<tr>
<td>(iv) Free air ticket provided by a supplier</td>
<td>2,00,000</td>
</tr>
<tr>
<td>[Value of free air ticket provided by a supplier is taxable as business</td>
<td></td>
</tr>
<tr>
<td>income under section 28, as the value of any benefit, whether convertible</td>
<td></td>
</tr>
<tr>
<td>into money or not, arising from business is taxable as business income.</td>
<td></td>
</tr>
<tr>
<td>Since the same is not credited to profit and loss account, the same is</td>
<td></td>
</tr>
<tr>
<td>required to be added while computing business income]</td>
<td></td>
</tr>
<tr>
<td>(v) Interest paid to X as Karta of HUF</td>
<td>-</td>
</tr>
<tr>
<td>[Where an individual is a partner in a firm otherwise than in a</td>
<td></td>
</tr>
<tr>
<td>representative capacity, the provisions of section 40(b) shall not apply</td>
<td></td>
</tr>
<tr>
<td>to any interest payable by the firm to such individual on behalf of any</td>
<td></td>
</tr>
<tr>
<td>other person. Hence, assuming that the provisions of section 40A(2)</td>
<td></td>
</tr>
<tr>
<td>do not get attracted in this case, such interest shall be allowed as</td>
<td></td>
</tr>
<tr>
<td>deduction in full even though the interest rate is more than 12% p.a.]</td>
<td></td>
</tr>
<tr>
<td>(vi) Cost of new building</td>
<td>10,00,000</td>
</tr>
<tr>
<td>[Cost of new building is not allowed as deduction since it is capital in</td>
<td></td>
</tr>
<tr>
<td>nature. Since the same has been debited to profit and loss account, it has</td>
<td></td>
</tr>
<tr>
<td>to be added back]</td>
<td></td>
</tr>
<tr>
<td>(vii) Loss from trading in shares [without delivery]</td>
<td>3,00,000</td>
</tr>
<tr>
<td>[Loss incurred on purchase and sale of shares of other companies without</td>
<td></td>
</tr>
<tr>
<td>delivery is a speculative transaction. Since the same is debited to profit</td>
<td></td>
</tr>
<tr>
<td>and loss account, the same is required to be added back while computing</td>
<td></td>
</tr>
<tr>
<td>business income]</td>
<td></td>
</tr>
<tr>
<td>**Less: Items credited to profit and loss account, but not includible in</td>
<td></td>
</tr>
<tr>
<td>business income/ permissible expenditure and allowances**</td>
<td></td>
</tr>
</tbody>
</table>
(ii) Sale proceeds of import entitlements

[Sale of import entitlements gives rise to profits or gains taxable under section 28. Since the amount has already been credited to profit and loss account, no further adjustment is required]

(vi) Depreciation as per Income-tax Rules, 1962 on building [Rs. 10 lakhs \times 10\%]

[Where any capital expenditure is incurred by the assessee for the purposes of the business by way of construction of any structure or doing of any work by way of renovation, extension or improvement to the building which is not owned by him but in respect of which the assessee holds a lease, then, depreciation would be allowed as if the said structure or work is a building owned by the assessee.]

(viii) Payment of new loan converted from arrear interest

[Conversion of unpaid interest into loan shall not be construed as payment of interest for the purpose section 43B. The amount of unpaid interest converted into a new loan will be allowable as deduction only in the year in which such converted loan is actually paid. Since Rs. 1,60,000 (Rs. 8,00,000/10 \times 2) has been paid in the P.Y. 2017-18, the same would be allowed as deduction]

Note: Since the question specifies that the “net profit was arrived at after debiting/crediting the following items”, Rs. 8 lakhs, being interest in arrears, has to be added back, on the basis of the assumption that it has been already debited in the profit and loss account and then reduced Rs. 1,60,000, being interest deduction allowable. In such case income will increase by Rs. 6,40,000

A(1) Audit fees of P.Y. 2016-17

[30\% of Rs. 2,50,000, being the audit fees disallowed in the P.Y. 2016-17 for non-deduction of TDS in the P.Y. 2016-17 would be allowed in the year of deduction and payment of TDS i.e., P.Y. 2017-18]

Profits and gains from Speculation business

Loss from the speculation business of trading of shares without delivery [to be carried forward for A.Y. 2019-20 for set-off against profits of any speculative business, assuming the firm has filed the return of income on or before the due date u/s 139(1)].
### Profits and gains from the business of setting up a warehouse for storage of edible oil

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount (Rs.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profit from setting up of warehouse (before providing for depreciation)</td>
<td>5,00,000</td>
</tr>
<tr>
<td>Less: Depreciation as per Income-tax Rules, 1962 on construction of warehouse</td>
<td>1,20,000</td>
</tr>
<tr>
<td>[Since it is not a specified business under section 35AD]</td>
<td>3,80,000</td>
</tr>
</tbody>
</table>

### Profits and gains from the business of setting up a warehouse for storage of agricultural produce

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount (Rs.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profit from setting up of warehouse (before providing for deduction)</td>
<td>15,00,000</td>
</tr>
<tr>
<td>Less: Deduction under section 35AD [100% of capital expenditure is allowable as deduction, since setting up and operating a warehousing facility for storage agricultural produce is a specified business, where operations are commenced on or after 01.04.2009]</td>
<td>23,00,000</td>
</tr>
<tr>
<td>Loss from the specified business under section 35AD to be carried forward indefinitely for set-off against profits of the specified business, assuming that the firm has filed the return of income on or before the due date under section 139(1)</td>
<td>(8,00,000)</td>
</tr>
</tbody>
</table>

### Profit and gains from business or profession

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount (Rs.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income from Other Sources</td>
<td>1,00,000</td>
</tr>
</tbody>
</table>

### Gross Total income/ Total Income

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount (Rs.)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>45,25,300</td>
</tr>
</tbody>
</table>

**Note**: The number used in the computation are not the serial number but are the number of each of the adjustment or of additional information given there against in the question.

### (b) Computation of total income of Red Ltd., a foreign company, for A.Y.2018-19

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Fees for technical services</strong></td>
<td>40,00,000</td>
</tr>
<tr>
<td>Debentures issued by Blue Ltd. in consideration for provision of technical know-how by Red Ltd., a foreign company, is in the nature of fee for technical services, deemed to accrue or arise in India to Red Ltd., a foreign company</td>
<td></td>
</tr>
<tr>
<td><strong>Royalty</strong></td>
<td>12,50,000</td>
</tr>
<tr>
<td>Service charges for leased out plant and machinery [Rs. 500 lakhs × 2.5%] [Service charges paid by Blue Ltd. for leased out plant and machinery is in the nature of royalty, which is deemed to accrue or arise in India to Red Ltd., a foreign company]</td>
<td></td>
</tr>
<tr>
<td><strong>Capital Gains</strong></td>
<td>1,90,000</td>
</tr>
<tr>
<td>Long term capital gain on sale of debentures of Green Ltd. an Indian company</td>
<td></td>
</tr>
<tr>
<td><strong>Interest on debentures</strong></td>
<td></td>
</tr>
</tbody>
</table>
Interest on debentures [Rs.40 lakhs $\times 8\% \times \frac{9}{12}]$ [interest on debentures of Blue Ltd., an Indian company, is deemed to accrue or arise in India, since the debt incurred is not used for a business outside India or for earning income from a source outside India] = 2,40,000

Total Income = 56,80,000

**Computation of taxliability of Red Ltd. for A.Y.2018-19**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax@10% on royalty of Rs.12.50 lakhs and fees for technical services of Rs.40 lakhs</td>
<td>5,25,000</td>
</tr>
<tr>
<td>Tax @20% on long term capital gains of Rs. 1,90,000, assuming debentures are listed on recognised stock exchange</td>
<td>38,000</td>
</tr>
<tr>
<td>Tax @40% on interest on debentures of Rs. 2,40,000 since debt is not incurred by Blue Ltd. in foreign currency</td>
<td>96,000</td>
</tr>
</tbody>
</table>

Add: Education cess and SHEC@3% = 6,59,000

**Tax Liability** = 6,78,770

*Note* – The above answer is based on the assumption that debentures of Green Ltd. are listed on a recognized stock exchange. However, question can also be answered on the basis of the assumption that the debentures are not listed on recognized stock exchange. In such case, long term capital gains on sale of debentures would be subject to tax @10% and tax thereon shall be Rs. 19,000/- and total tax liability of Red Ltd. would be Rs. 6,59,200/-.

**Question 2**

**Answer**

(a) Computation of Total Income of Anustup Chandra Flour Mills Ltd. as per the normal provisions of the Act for A.Y. 2018-19

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net Profit as per statement of profit and loss</td>
<td>77,00,000</td>
</tr>
<tr>
<td>Add: Items debited but to be considered separately or to be disallowed/ amount taxable but not credited</td>
<td>90,000</td>
</tr>
<tr>
<td>Expenditure on earning share income in AOP</td>
<td></td>
</tr>
<tr>
<td>[Share income in AOP, which pays tax at the maximum marginal rate is exempt in the hands of the member. Consequently, expenditure incurred on earning exempt income is not allowable as deduction. Since the same has been debited in the statement of profit and loss, it has to be added back]</td>
<td></td>
</tr>
<tr>
<td>Provision of income-tax (including interest u/s 234B and 234C)</td>
<td>3,00,000</td>
</tr>
<tr>
<td>[Provision of income-tax is not allowable as deduction. Also, any interest payable for default committed by the assessee for discharging his statutory obligations under Income-tax Act, 1961 which is calculated with reference to the tax on income is not allowable as deduction. Since the provision and interest have been debited to Statement of profit and loss, they have to be added back]</td>
<td></td>
</tr>
</tbody>
</table>

33.30
| (iii) Provision for loss of foreign subsidiary | 5,00,000 |
| [Since the loss of foreign subsidiary is not a loss incurred for the purpose of business of the assessee, it is not allowed while computing business income. Since the same has been debited in the statement to profit and loss, it has to be added back] |
| (iv) Interest to a public financial institution | 8,00,000 |
| [Deduction of any sum, being interest payable on any loan or borrowing from a public financial institution shall be allowed, if such interest has been actually paid. Since Rs. 4 lakhs has been paid on 12.12.2017, the balance Rs. 8 lakhs debited to statement of profit and loss has to be added back, assuming that such sum is not paid on or before due date of filing of return of income] |
| (v) Compounding fee paid for violation of building norms | 1,00,000 |
| [The amount paid for compounding an offence is inevitably a penalty and the mere fact that it has been described as compounding fee cannot, in any way, alter the character of the payment which is in the nature of penalty. Hence, the same is not allowable as revenue expenditure. Since the same has been debited to statement of profit and loss, it has to be added back] |
| (vi) Fee for delayed filing of statement of TDS | - |
| [Under section 37, any expenditure incurred wholly and exclusively for the purpose of business or profession is allowed as deduction. The fee for delayed submission of the statement of TDS is not in the nature of interest for delayed remittance of TDS or in the nature of penalty, which are not allowable as deduction while computing business income. Hence, it is allowable as deduction. Since the same has been debited to statement of profit and loss, no further adjustment is required] |
| (vii) Revaluation surplus on fair valuation of assets under Ind AS 16 and 38 credited to other equity | - |
| [No treatment is required under the regular provisions of the Income-tax Act, 1961. Since the same has not been credited to statement of profit and loss, no adjustment is required] |
| (viii) Fair valuation of equity instruments | 17,90,000 |
| [No treatment is required under the regular provisions of the Income-tax Act, 1961. Since the same has not been credited to statement of profit and loss, no adjustment is required] |

**Less:** Items credited to statement of profit and loss, but not includible in business income/ permissible expenditure and allowances

| (ii) Share income in AOP | 9,00,000 |

**33.31**
Where a company is a member in an AOP, the AOP would have to pay tax at the maximum marginal rate owing to which, company's share in the total income of AOP will not be included in its total income and will be exempt. Since the same has been credited to the statement of profit and loss, the same has to be reduced while computing business income.

| Total income | 85,90,000 |

### Computation of book profit under section 115JB for A.Y. 2018-19

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net profit as per the statement of profit and loss</td>
<td>77,00,000</td>
<td></td>
</tr>
<tr>
<td>Add: Net profit to be increased by the following amounts as per Explanation 1 to section 115JB(2):</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(ii) Expenditure on earning share income in AOP</td>
<td>90,000</td>
<td></td>
</tr>
<tr>
<td>[Expenditure related to share income in AOP has to be added back while computing the book profit, since no income-tax is payable by the company on share income in AOP]</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(iii) Provision of income-tax(including interest under section 234B and 234C)</td>
<td>3,00,000</td>
<td></td>
</tr>
<tr>
<td>[Income-tax shall include, inter alia, any interest charged under the Act, therefore, whole of the amount of provision for income-tax including Rs. 62,000 towards interest payable has to be added]</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(iii) Provision for loss of foreign subsidiary</td>
<td>5,00,000</td>
<td>8,90,000</td>
</tr>
<tr>
<td>[Provision for losses of subsidiary companies has to be added back]</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Less: profit to be decreased by the following amounts as per Explanation 1 to section 115JB(2):</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(i) Share income in AOP</td>
<td>9,00,000</td>
<td></td>
</tr>
<tr>
<td>[Share income of company in AOP has to be reduced while computing the book profit, since no income-tax is payable by the company on share income in AOP]</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Book profit computed in accordance with Explanation 1 to section 115JB(2)</td>
<td>76,90,000</td>
<td></td>
</tr>
<tr>
<td>Add: Items credited to OCI that will not be reclassified to profit or loss:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(vii) Revaluation surplus on fair valuation of assets Rs. 10 lakhs</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>[Book profit not to be increased by revaluation surplus for assets]</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(viii) Income on fair valuation of equity instruments of Rs. 5 lakhs</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>[Book profit not to be increased by income in fair values of equity instruments]</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Book Profit for levy of MAT</td>
<td>76,90,000</td>
<td></td>
</tr>
</tbody>
</table>
Computation of tax liability for A.Y. 2018-19

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Minimum Alternate Tax on book profit under section 115JB = 18.5% of Rs. 76,90,000</td>
<td>14,22,650</td>
</tr>
<tr>
<td>Income-tax computed as per the normal provisions of the Act [Rs. 85,90,000 (\times) 25% since, the turnover of the company for the P.Y. 2015-16 does not exceed Rs. 50 crores]</td>
<td>21,47,500</td>
</tr>
<tr>
<td>Since the income-tax liability of Rs. 21,47,500 is higher than the MAT liability of Rs. 14,22,650, the income-tax liability would be computed as per the normal provisions of the Income-tax Act, 1961:</td>
<td></td>
</tr>
<tr>
<td>Income-tax computed as per the normal provisions of the Act</td>
<td>21,47,500</td>
</tr>
<tr>
<td>Add: Education cess and SHEC@3%</td>
<td>64,425</td>
</tr>
<tr>
<td>Tax Payable</td>
<td>22,11,925</td>
</tr>
<tr>
<td>Tax Payable (rounded off)</td>
<td>22,11,930</td>
</tr>
</tbody>
</table>

*Note - The number used in the computation are not the serial number but are the number of each of the adjustment or of additional information given there against in the question.*

(b) Mr. Manav is resident in India for the P.Y. 2017-18, his global income would be subject to tax in India.

Agricultural income from lands located outside India would not be exempt from income-tax in India under section 10(1) in the hands of a resident. The said income would be chargeable to tax in his hands in India.

Share income from a partnership firm in County Q would not be exempt from income-tax in India under section 10(2A) in the hands of a partner. The same would be chargeable to tax in his hands in India.

Thus, both the above items of income are chargeable to tax in India in the hands of Mr. Manav.

The following are the conditions to be fulfilled for claiming benefit deduction under section 91: -

(i) Mr. Manav should be a resident in India during the relevant previous year.
(ii) The income accrues or arises to him outside India during that previous year.
(iii) Such income is not deemed to accrue or arise in India during the previous year.
(iv) Both the income given in question has been subjected to income-tax in Country Q in his hands and he has paid tax on such income in Country Q.
(v) There is no agreement under section 90 for the relief or avoidance of double taxation between India and Country Q, where the income has accrued or arisen.

Since all the conditions mentioned above are fulfilled, Mr. Manav is eligible for deduction under section 91 in respect of double taxed income i.e., share income from a firm in Country Q.

However, he would not be eligible for deduction under section 91 in respect of agricultural income from lands in Country Q since such income is exempt in Country Q and consequently, is not a doubly taxed income.

Mr. Manav is entitled for deduction under section 91 of a sum calculated on share income from firm in Country Q at the Indian rate of tax (20\%) or the rate of tax in Country Q (18\%), whichever is lower.

Accordingly, deduction under section 91 available to Mr. Manav would be Rs. 3,24,000, being 18\% of Rs. 18,00,000.

*Note - It is logical to take a view that exemption under section 10(2A) in hands of the partner would be available only in respect of share income from an Indian firm.*
In this case, since the share income is from a foreign firm, the same is taxable in India in the hands of the partner. The above solution has been worked out on the basis of this view.

An alternate view that the share income from foreign firm is also exempt under section 10(2A) may also be possible, in which case, Mr. Manav would not be eligible for any deduction under section 91, since there would be no double taxed income.

Question 3

Answer

(a) Where the assets of a company are distributed to its shareholders on its liquidation, such distribution shall not be regarded as transfer in the hands of the company for the purpose of section 45.

However, where the shareholder, on liquidation of a company, receives any money or other assets from the company, he shall be chargeable to income-tax under the head “capital gains”, in respect of the money so received or the market value of the other assets on the date of distribution as reduced by the amount of dividend deemed under section 2(22)(c) and the sum so arrived at shall be deemed to be the full value of the consideration for the purposes of section 48.

As per section 2(22)(c), dividend includes any distribution made to the shareholders of a company on its liquidation, to the extent to which the distribution is attributable to the accumulated profits of the company immediately before its liquidation, whether capitalized or not.

In this case, one-eighth share in the distribution made to a shareholder attributable to the accumulated profits immediately before liquidation would be deemed dividend under section 2(22)(c). The same is exempt under section 10(34) in the hands of the shareholder, since the company, Eden Fabs Pvt. Ltd., is liable to dividend distribution tax in respect of the same.

Therefore, Rs. 2,25,000 minus deemed dividend under section 2(22)(c) would be the full value of consideration in the hands of each shareholder. Against this, the indexed cost of acquisition computed by applying the relevant CII to the cost of acquisition of Rs. 1,00,000 of each shareholder [i.e., Rs. 8,00,000/8] is to be deducted to arrive at the long-term capital gains. Since the shares are held for more than 24 months, they constitute a long-term capital asset.

Since the equity shares are not listed, securities transaction tax would not have been paid and hence, the capital gain (long term) is not exempt under section 10(38). The benefit of concessional rate of tax @10% without indexation benefit would also not be available. Hence, such long term capital gain would be taxable at 20% with indexation benefit.

Therefore, the shareholders have to be advised that capital gains tax liability would arise in their hands, the same should be computed in the manner given above and would be subject to tax@20%.

(b) Computation of total income of Mani Foundations for the A.Y.2018-19

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross receipts from students towards tuition fees, development fees etc.</td>
<td>2,00,00,000</td>
<td></td>
</tr>
<tr>
<td>Government Grants (taxable, since only grant for the purpose of corpus of a trust established by the Central or State Government is excluded from the definition of</td>
<td>8,00,000</td>
<td></td>
</tr>
</tbody>
</table>
Voluntary contributions (other than anonymous donations)  
[Rs.25 lakh – Rs.5 lakh]

Add: Anonymous donations [to the extent not chargeable to tax @30% under section 115BBC(1)(i)] [See Note below]

Less: 15% of income eligible for being set apart without any condition

Less: Amount applied for charitable purposes
- Amount applied for the purpose of schools (excluding amount applied for the benefit of the founder) = Rs.90 lakh – Rs. 5 lakh
- Amount set apart for acquiring a building to expand its schools
[The word "applied" used in section 11 means that the income is actually applied for the charitable purposes of the trust. The word "applied" does not necessarily imply "spent". Even if a certain amount is irrevocably earmarked and allocated for charitable purposes, the said amount can be deemed to have been applied for charitable purposes.]
- Corpus donations to a trust registered under section 10(23C) [Deduction is not permissible only in respect of corpus donations to a trust registered u/s 12AA]
- Excess of expenditure over income in the P.Y.2016-17

Add: Amount applied for the benefit of the founder of the trust chargeable to tax under section 12(2) read with section 13(6)
Anonymous donation taxable @30% under section 115BBC(1)(i) [See Note below]

Total Income of the trust (including anonymous donation taxable@30%)

Note - As per section 115BBC(1)(i), the anonymous donations in excess of the higher of the following would be subject to tax@30%;
- Rs.1.25 lakh, being 5% of the total donations received i.e., 5% of Rs.25 lakh; or Rs.1 lakh
Therefore, anonymous donations of Rs. 3.75 lakh (Rs. 5 lakh – Rs. 1.25 lakh) would be subject to tax@30% under section 115BBC(1)(i).
Such anonymous donations which are subject to tax@30% are not eligible for the benefit of exclusion from total income under sections 11 and 12.

[Alternate Answer] – As per the plain reading of section 13(7), it is possible to take a view that the entire anonymous donations may not be eligible for benefit of exclusion from total income under sections 11 and 12. If this view is taken, then Rs. 1.25 lakhs should not be added to Rs. 228 lakhs. Accordingly, Rs. 34.20 lakhs, being 15% of Rs. 228 lakhs would be the income eligible for accumulation without any condition. The total income of the trust (including anonymous donations) would be Rs. 36.80 lakhs.

(e) (i) Netlon LLC, a foreign company, has advanced loan of Rs. 53 crores to Briggs Ltd., a domestic company, which amounts to 53% of book value of assets of Briggs Ltd. Since the loan advanced by Netlon Inc. is not less than 51% of the book value of assets of Briggs Ltd., Netlon Inc. and Briggs Ltd. are deemed to be associated enterprises for the transfer pricing regulations. The deeming provisions would be attracted even if there is a repayment of loan during the same previous year which brings down his percentage below 51%.

(ii) Netlon LLC has the power to appoint 50% (2 out of 4) of the directors of Briggs Ltd.
Two enterprises would be deemed to be associated enterprises if more than half of the board of directors of one enterprise are appointed by the other enterprise.
In this case, since Netlon LLC has the power to appoint exactly half (and not more than half) of the directors of Briggs Ltd., they are not deemed to be associated enterprises.

(iii) Even though Netlon LLC supplies 91.11% of the raw materials and consumables required by Briggs Ltd. which is more than the specified threshold of 90%, Netlon LLC and Briggs Ltd. are not deemed to be associated enterprises.
Reason for not deemed to be associated enterprises is since the price of supply is not influenced by Netlon LLC but is mutually agreed upon once in six months depending upon prevailing market conditions.

Question 4
Answer
(a) The issue under consideration in the present case is, can items which are usable as such be treated as “Scrap” to attract provisions for tax collection at source under section 206C.
The waste and scrap must be from manufacture or mechanical working of material which is definitely not usable as such because of breakage, cutting up, wear and other reasons.
Any material which is usable as such would not fall within the ambit of the expression scrap. In case of a company engaged in ship breaking activity, the old and used plates, wood etc. are usable as such. Since the items in question were usable as such, therefore, they do not fall within the definition of "scrap"
Thus, in the present case, the action of Assessing Officer in treating such items in the nature of scrap and raising a demand under section 201(1) and interest under section 201(1A), is not tenable in law.
Note – The facts of the case given are similar to the facts in CIT v. Priya Blue Industries (P) Ltd (2016) 381 ITR 210, wherein the above issue came up before the Gujarat High Court. The answer is based on the rationale of the Gujarat High Court in the said case.

(b) (i) Section 194A requiring deduction of tax at source on any income by way of interest, other than interest on securities credited or paid to a resident, excludes from its scope, income credited or paid by a firm to its partner. Section 195 which requires tax deduction at source on payment to non-residents, does not provide for any exclusion in respect of payment of interest by firm to its non-resident partner. Therefore, Dindayal & Co., a partnership firm is not required to deduct tax at source under section 194A on the amount of interest of Rs. 67,000 credited to the account of L, resident in India.

Tax at source under section 195 @ 30.9% [30%, being the rate in force + cess@3%] in respect of interest of Rs. 4,000 credited to the account of M, a non-resident is required to be deducted.

(ii) As per section 2(22)(e), the loan amount of Rs. 25,00,000 disbursed by Lumnous Pvt. Ltd. a company in which the public are not substantially interested to Mrs. Nisha, being a shareholder holding not less than 10% (20%, in the present case) of the equity shares of the company would be deemed as dividend to the extent of accumulated profits of Rs. 20,00,000. Rs. 20,00,000 would be deemed as dividend in the hands of Mrs. Nisha, and therefore, would be chargeable to tax in her hands.

Consequently, Lumnous Pvt. Ltd. would be required to deduct tax at source under section 194 at the rates in force i.e., deduct tax of Rs. 2,00,000, being 10% on the deemed dividend of Rs. 20,00,000, since such amount exceeds the threshold limit of Rs. 2,500. Only the balance amount of Rs. 23,00,000 [i.e., Rs. 25,00,000 – Rs. 2,00,000] can be disbursed to the shareholders.

Thus, the view of the Finance Manager that this being a pure loan transaction, the entire amount can be disbursed is incorrect. Only the balance amount of Rs. 23,00,000, after deducting tax of Rs. 2,00,000 at source on deemed dividend of Rs.20,00,000, can be disbursed.

(iii) The services of event managers in relation to sports activities alone have been notified by the CBDT as “professional services” for the purpose of section 194J. In this case, payment of Rs. 5 lacs was made to Jyoti & Company Ltd., an event management company for organization of a debate competition. Hence, the provisions of section 194J are not attracted in this case.

However, TDS provisions under section 194C relating to contract payments would be attracted and consequently, tax has to be deducted @2% under section 194C.

(c) The tie-breaker rule would be applied in the following manner:

(i) The first test is based on where the individual has a permanent home i.e., a dwelling place available to him at all times continuously and not occasionally.

(ii) If the individual has permanent home available to him in both Contracting States, he will be considered a resident of the Contracting State where his personal and economic relations are closer, in other words, the place where lies his centre of vital interests.
Thus, preference is given to family and social relations, occupation, place of business, place of administration of his properties, political, cultural and other activities of the individual.

(iii) In a case where the individual has a permanent home available to him in both Contracting States and it is not possible to determine in which one he has his centre of vital interests; and in a case where the individual has a permanent home available to him in neither Contracting State, preference is given to the Contracting State where the individual has an habitual abode.

(iv) If the individual has habitual abode in both Contracting States or in neither of them, he shall be treated as a resident of the Contracting State of which he is a national.

(v) If the individual is a national of both or neither of the Contracting States, the matter is left to be considered by the competent authorities of the respective Contracting States.

Question 5

Answer

(a) (i) An assessee may, at any stage of a case relating to him, make an application in the prescribed form and manner to the Settlement Commission under section 245C.

“Case” means any proceeding for assessment which may be pending before an Assessing Officer on the date on which such application is made. A proceeding for assessment or reassessment or recomputation under section 147 shall be deemed to have commenced from the date on which a notice under section 148 is issued.

In this case, Mr. Rajneesh cannot approach the Settlement Commission merely due to his apprehension that assessment of earlier years may be reopened, since there is no case pending before an Assessing Officer.

Therefore, he has to wait for the Assessing Officer to issue notice under section 148. Thereafter, he can make an application to the Settlement Commission under section 245C, since there would be a “case pending” before the Assessing Officer on that date.

Another basic condition to be satisfied for making an application is that the additional amount of income-tax payable on the income disclosed in the application should exceed Rs. 10 lakh, and such tax and interest thereon which would have been paid had the income disclosed in the application been declared in the return of income should be paid on or before the date of making the application and proof of such payment should be attached with the application.

If the Settlement Commission is satisfied that Mr. Rajneesh has co-operated in the proceedings and made true and full disclosure of his income and the manner in which it has been derived, it may, subject to such conditions as it may think fit to impose, grant to Mr. Rajneesh -

(i) immunity from prosecution for any offence under the Income-tax Act, 1961, where the proceedings for such prosecution have been instituted on or after the date of receipt of application under section 245C; and

(ii) immunity from imposition of penalty under the Income-tax Act, 1961, either wholly or in part, with respect to the case covered by the settlement.

This is the benefit that may accrue to Mr. Rajneesh, if he approaches the
(ii) No revisionary order shall be made under section 263 after the expiry of two years from the end of the financial year in which the order sought to be revised was passed.

The issue under consideration is whether the period of limitation for an order passed under section 263 has to be reckoned from the original order passed by the Assessing Officer under section 143(3) of the Income-tax Act, 1961 or from the order of reassessment passed under section 147, where the subject matter of revision is different from the subject matter of reassessment under section 147. Where the subject matter of revision was not the same as the subject matter of reassessment, the period of limitation would commence from the date of original assessment and not from the date of reassessment.

In this case, the period of limitation as referred to in section 263 is with reference to the assessment in which the claim of the assessee as to deduction under section 36(1)(vii) and deduction in respect of foreign exchange rate difference was considered. These issues were not the subject matter of reassessment proceedings. Accordingly, the period of limitation shall be reckoned with reference to the original assessment order and not from the date of the order of reassessment. Therefore, in this case, the revision proceedings are barred by limitation since the original assessment order was made on 30.11.2015 and the revision should have been made by 31.3.2018. However, the revision order was passed only on 31st May, 2018 and hence, the same is barred by limitation.

Accordingly, the claim of the Foundation Bank Ltd. that the order passed by the Principal Commissioner under section 263 is barred by limitation is tenable in law.

Note: The facts of the case are similar to the facts in CIT v. ICICI Bank Ltd. (2012) 343 ITR 74, wherein the above issue came up before the Bombay High Court. Similar issue also came up before the Bombay High Court in CIT v. Lark Chemicals Ltd (2014) 368 ITR 655. The Bombay High Court relied on the Apex Court decision in the case of CIT v. Alagendran Finance Ltd. (2007) 293 ITR 1. The above answer is based on the rationale of the Bombay High Court in the said case.

(b) (i) The statement is false

In respect of returns furnished for A.Y.2017-18 or thereafter, processing of a return under section 143(1) is necessary even where a notice has been issued to the assessee under section 143(2).

(ii) The statement is true

Section 142A(2) provides that the Assessing Officer may make a reference to the Valuation Officer whether or not he is satisfied about the correctness or completeness of the accounts of the assessee. Thus, even without rejecting the books of accounts maintained by the assessee, the Assessing Officer may make reference to the Valuation Officer under section 142A.

(iii) The statement is true

Where the direction for special audit is issued by the Assessing Officer, the expenses of, and incidental to, such special audit, shall be determined by the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner in accordance with the prescribed guidelines. The expenses so determined shall be paid by the Central Government.
(iv) The statement is true
The definition of Tax Return Preparer includes only an individual who has been authorised to act as a Tax Return Preparer under the Scheme framed under section 139B.

(c) Since the search is conducted post 15.12.2016, and return is yet to be filed for the P.Y. 2017-18, the penalty would be as follows:
(1) penalty@30%, if undisclosed income is admitted during the course of search in the statement furnished under section 132(4), and the assessee explains the manner in which such income was derived, pays the tax, together with interest if any, in respect of the undisclosed income, and furnishes the return of income for the specified previous year declaring such undisclosed income on or before the specified date (i.e., the due date of filing return of income or the date on which the period specified in the notice issued under section 153A expires, as the case may be).

(2) penalty@60%, in any other case.
Therefore, even if Mr. Khemka has made a declaration under section 132(4), penalty@30% of undisclosed income of the specified previous year i.e., P.Y. 2017-18 would be attracted under section 271AAB.

(d) (i) For determining the POEM of a company, the important criteria is whether the company is engaged in active business outside India or not.
A company shall be said to be engaged in “Active Business Outside India” (ABOI) for POEM, if
- the passive income is not more than 50% of its total income; and
- less than 50% of its total assets are situated in India; and
- less than 50% of total number of employees are situated in India or are resident in India; and
- the payroll expenses incurred on such employees is less than 50% of its total payroll expenditure.

John Butler Tex. Inc. shall be regarded as a company engaged in active business outside India for P.Y. 2017-18 for POEM purpose only if it satisfies all the four conditions cumulatively.

**Condition 1: The passive income of John Butler Tex. Inc. should not be more than 50% of its total income**

Total income of John Butler Tex. Inc. during the P.Y. 2017-18 is Rs. 100 crores [(Rs. 15 crores + Rs. 30 crores) + (Rs. 42 crores + Rs. 13 crores)]

Passive income is the aggregate of,
- income from the transactions where both the purchase and sale of goods is from/to its associated enterprises; and
- income by way of royalty, dividend, capital gains, interest or rental income;

Passive Income of John Butler Tex. Inc. is Rs. 43 crores, being income from investment of Rs. 30 crores in India and Rs. 13 crores in Sri Lanka.

Percentage of passive income to total income = Rs. 43 crore / Rs. 100 crore x 100 = 43%
Since passive income of John Butler Tex. Inc. is 43% i.e., is not more than 50% of its total income, the first condition is satisfied.

**Condition 2: John Butler Tex. Inc. should have less than 50% of its total assets situated in India**

Value of total assets of John Butler Tex. Inc. during the P.Y. 2017-18 is Rs. 500 crores [Rs. 160 crores, in India + Rs. 340 crores, in Sri Lanka].
Value of total assets of John Butler ex. Inc. in India during the P.Y. 2017-18 is Rs. 160 crores.

Percentage of assets situated in India to total assets = Rs. 160 crores/Rs. 500 crores x 100 = 32%

Since the value of assets of John Butler Tex. Inc. situated in India is less than 50% of its total assets, the second condition for ABOI test is satisfied.

Condition 3: Less than 50% of the total number of employees of John Butler Tex. Inc. should be situated in India or should be resident in India

Number of employees situated in India or are resident in India is 40

Total number of employees of John Butler Tex. Inc. is 100 [40 + 60]

Percentage of employees situated in India or are resident in India to total number of employees is 40/100 x 100 = 40%.

Since employees situated in India or are residents in India of John Butler Tex. Inc. are less than 50% of its total employees, the third condition for ABOI test is satisfied.

Condition 4: The payroll expenses incurred on employees situated in India or residents in India should be less than 50% of its total payroll expenditure

Since the information pertaining to payroll expenditure of employees situated in India and outside India is not given in the question it is assumed that the condition pertaining to payroll expenditure is also satisfied by John Butler Tex. Inc.

Thus, since the John Butler Tex. Inc. has satisfied all the four conditions, the company would be said to be engaged in “active business outside India”.

Note – Since the information pertaining to payroll expenditure of employees situated in India and situated outside India is not given in the question it is also possible to assume that the condition pertaining to payroll expenditure is not satisfied by John Butler Tex. Inc.

In such case, the company would not be said to be engaged in “active business outside India”, since John Butler Tex. Inc. has not satisfied one of condition i.e., payroll expenditure out of the specified four conditions.

(ii) Option 1: 30 more employees employed in India for the increased operations

In case John Butler Tex. Inc. employed 30 more employees in India, then

Percentage of employees situated in India or are resident in India to total number of employees would be 70/130 x 100 = 53.85%.

In such a case, one of the four conditions would not be satisfied and therefore, John Butler Tex. Inc. would not be considered to be engaged in ABOI.

It may be noted that place of effective management of a company passing the ABOI test would be presumed to be outside India, if majority of the board meetings are held outside India. Consequently, the global income of the company would not be subject to tax in India. However, such a presumption cannot be made if the company does not fulfil any of the four conditions for ABOI.

Option 2: Increased operations outsourced to external agency which will get the work done by engaging 15 employees in India

For the purpose of ABOI, employees shall include persons, who though not employed directly by the company, perform tasks similar to those performed by the employees.

Thus, 15 employees engaged by external agency have also to be included while determining the percentage of employees situated in India or are resident in India to the total number of employees.
In such a case, the percentage of employees situated in India or are resident in India to total number of employees would be $\frac{55}{115} \times 100 = 47.83\%$

In such a case, John Butler would continue to satisfy the four conditions for ABOI. Thus, it would be better to outsource the increased operation to an external agency.

**Question 6**

**Answer**

(a) (1) **Where purchases are effected through cash invoice of Rs.3,20,000**

(i) **In the hands of Mr. B**

Since Mr. B is making cash payment of Rs. 3,20,000 for purchase of raw materials from Mr. S for his business, disallowance under section 40A(3) would be attracted, since the payment otherwise than by way of account payee cheque or bank draft or use of ECS through a bank account to a person in a day exceeds Rs. 10,000. Accordingly, Rs. 3,20,000 would not be allowable as deduction while computing his business income.

(ii) **In the hands of Mr. S**

Section 269ST prohibits, *inter alia*, receipt of an amount of Rs. 2 lakh or more in aggregate from a person in a day otherwise than by way of account payee cheque or account payee bank draft or use of ECS through a bank account. If any person receives any sum in contravention of the provisions of section 269ST, he shall be liable to pay penalty under section 271DA of a sum equal to the amount of such receipt. In this case, since S has received Rs. 3,20,000 by way of cash from Mr. B on 27.3.2018, he has violated the provisions of section 269ST, and hence, is liable to pay penalty of Rs. 3,20,000 under section 271DA.

(2) **Where cash purchases of Rs. 1,80,000 and Rs. 1,40,000 are effected in respect of different raw materials on two different dates**

(i) **In the hands of Mr. B**

Even if cash payment of Rs. 1,80,000 and Rs. 1,40,000 are made by Mr. B on two different dates for different raw materials, disallowance under section 40A(3) would be attracted, since the payment in cash in a day to Mr. S exceeds Rs. 10,000.

(ii) **In the hands of Mr. S**

If S receives cash of Rs. 1,80,000 and Rs. 1,40,000 on two different dates, for purchase of different raw materials, there would be no violation of section 269ST since receipt on a day is less than Rs. 2 lakh and the receipts are not in respect of the same transaction but for purchase of different raw materials. Hence, provision of section 271DA shall not be attracted.

(b) Under section 80-IAC, where the gross total income of an eligible start-up includes any profits and gains derived from eligible business, a deduction of 100% of the profits and gains derived from such business would be available for any 3 consecutive assessment years out of 7 consecutive assessment years, beginning from the previous year in which eligible start-up is incorporated.

Under section 54GB, the capital gains arising to an individual from transfer of his long-term capital asset, being a residential house, would be exempt if invests the net consideration in a company which is an eligible start-up carrying on eligible business under section 80-IAC.
In this case, the business of manufacture of a solar powered car falls within the meaning of eligible business, since it is driven by technology.

In order to avail the benefit of deduction under section 54GB, Mr. Sarthak must invest the net consideration of Rs. 3 crores on transfer of long-term capital asset, being his residential house in Surat, in an eligible start up, by setting up a new company before 1.4.2019 and subscribing to the equity shares of the company.

The start-up company formed to carry on the business of manufacture of solar powered car would be an eligible start-up which is technology driven, if it obtains a certificate of eligible business from IMBC and its turnover does not exceed Rs. 25 crores in any of the previous years upto P.Y. 2020-21.

Mr. Sarthak should subscribe to more than 50% of the share capital of the company on or before the due date of filing of return of income under section 139(1) and the company should purchase new plant and machinery within one year from the date of subscription in equity shares by him.

If these conditions are fulfilled, the long-term capital gains of Rs. 2,30,00,000 [Rs. 3,00,00,000 – Rs. 70,00,000] arising to Mr. Sarthak would not be chargeable to tax, since the entire net consideration of Rs. 3 crores has been utilised to subscribe to the shares of a company, being an eligible start up.

Furthermore, in any three consecutive assessment years out of seven consecutive assessment years, beginning from the previous year in which eligible start-up is incorporated, the company would be eligible to claim deduction of 100% of the profits and gains of business.

If the balance Rs. 2 crores is funded through bank borrowings, the interest payable would qualify for deduction under section 36 while computing the business income of the company, which would be beneficial in those years in which the company has not availed 100% deduction under section 80-IAC.

On the other hand, if Rs. 2 crores is funded through subscription of shares by Miss Juhi, who would be a co-promoter, there would be sharing of both the risks and rewards with Miss Juhi. Since her shareholding would be only 40%, this arrangement will also not affect Mr. Sarthak's claim for deduction under section 54GB.

(e) Under section 90(2), where the Central Government has entered into an agreement for avoidance of double taxation with the Government of any country outside India or specified territory outside India, as the case may be, then, in relation to the assessee to whom such agreement applies, the provisions of the Income-tax Act, 1961 shall apply to the extent they are more beneficial to the assessee.

Thus, in view of paragraph 2 of the Article 24 (Non-discrimination of the Double Taxation Avoidance Agreement (DTAA), it appears that the PE of T Inc. a non-resident entity, incorporated in Mauritius, is liable to tax in India at the rate applicable to domestic company (30%), which is lower than the rate of tax applicable to a foreign company (40%).

However, Explanation 1 to section 90 clarifies that the charge of tax in respect of a foreign company at a rate higher than the rate at which a domestic company is chargeable, shall not be regarded as less favourable charge or levy of tax in respect of such foreign company.

Therefore, in view of this Explanation, the action of the Assessing Officer in levying tax@40% on the PE of T Inc. a non-resident entity, incorporated in Mauritius is in accordance with law.

(d) The CBDT had, vide Circular No.5/2004 dated 28.9.2004, clarified that the non-resident entity or the foreign company will be liable to tax in India only if the IT enabled BPO unit in India constitutes its Permanent Establishment.
In the present case, since Alpha Inc. has an IT enabled Business Process Outsourcing unit in India (BPO) which provides certain outsourcing services to a resident Indian entity, such BPO would be considered as PE of Alpha Inc., as it carries on business in India through the BPO Unit.

In such a case, the profits of Alpha Inc., attributable to the business activities carried out in India by the Permanent Establishment would become taxable in India. Profits are to be attributed to the Permanent Establishment as if it were a distinct and separate enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the enterprise of which it is a Permanent Establishment.

In determining the profits of a Permanent Establishment, there shall be allowed as deduction, expenses which are incurred for the purposes of the Permanent Establishment including executive and general administrative expenses so incurred, whether in the State in which the Permanent Establishment is situated or elsewhere.

**MAY 2018 (NEW COURSE):**

*Question No. 1 is compulsory.*

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

*Working notes should form part of the respective answers*

*All questions relate to Assessment Year 2018-19, unless stated otherwise in the question.*

**Question 1**

(a) SDK Ltd. is engaged in the manufacture of textile since 01-04-2010. Its Statement of Profit and Loss for the previous year ended 31st March, 2018 shows a profit of Rs. 600 lakhs after debiting or crediting the following items:

(i) Depreciation charged on the basis of useful life of assets as per Companies Act is Rs. 40 Lakhs.

(ii) Industrial power tariff concession of Rs. 3.5 Lakhs, received from State Government was credited to P & L Account.

(iii) The company had provided Rs. 25 Lakhs being sum fairly estimated as payable with reasonable certainty, to workers on agreement to be entered with the workers union towards periodical wage revision once in every three years.

(iv) Dividend received from a foreign company Rs. 10 Lakhs.

(v) Loss Rs. 25 Lakhs, due to destruction of a machine worth Rs. 30 Lakhs by fire due to short circuit and Rs. 5 Lakhs received as scrap value. The insurance company did not admit the claim of the company on charge of gross negligence.

(vi) Provision for gratuity based on actuarial valuation was Rs. 400 Lakhs. Actual gratuity paid debited to gratuity provision account was Rs. 275 lakhs.

(vii) The company has purchased 500 tons of industrial paper as packing material at a price of Rs. 30,000 per ton from M/s. Shivramha, a firm in which majority of the directors of SDK Ltd. are partners. The firm's normal selling price of the same material in market is Rs. 28,000 per ton.

(viii) Advertisement charges Rs. 1.5 Lakhs, paid by cheque for advertisement published in the souvenir of a political party registered with the Election Commission of India.
(ix) Long term capital gain **Rs. 4.5 Lakhs** on sale of equity shares on which Securities Transaction Tax (STT) was paid at the time of acquisition and sale.

**Additional Information:**

(i) Normal depreciation as per Income-tax Rules is **Rs. 65 Lakhs**.

The Suggested Answers for Paper 7:- Direct Tax Laws and International Taxation are based on the provisions of direct tax laws as amended by the Finance Act, 2017, which is relevant for May, 2018 examination. The relevant assessment year is A.Y.2018-19.

(ii) The sales tax **Rs. 11 Lakhs** collected from its customers was paid by the company on the due dates. On an appeal, the High Court directed the sales tax department to refund **Rs. 4 Lakhs** to the company. The company in turn refunded **Rs. 3 lakhs** to the customers from whom it was collected and the balance **Rs. 1 lakh** is still lying under the head "Current Liabilities".

Compute the total income of SDK Ltd. for the A.Y. 2018-19 by analyzing and applying the relevant provisions of income-tax law. Briefly explain the reasons for treatment of each item. Ignore the provisions relating to Minimum Alternate Tax.  

(14 Marks)

(b) **X Ltd., a resident Indian Company**, on 01-04-2017 has borrowed **Rs. 100 crores** from M/s. A Inc, a Company incorporated in US, at an interest rate of 9 % p.a. The said loan is repayable over a period of 10 years. Further, loan is guaranteed by M/s B Inc incorporated in US. M/s. K Inc, a non-resident, holds shares carrying 30% of voting power both in M/s X Ltd. and M/s B. Inc. M/s K Inc has also deposited **Rs. 100 crores** with M/s A Inc.

**Other information**

Net profit of M/s. X Ltd. was **Rs. 10 crores** after debiting the above interest, depreciation of **Rs. 5 crores** and income-tax of **Rs. 3.40 crores**. Calculate the amount of interest to be disallowed under the head “Profits and gains of business or profession” in the computation of M/s X Ltd.

Substantiate your answer with reasons.  

(6 Marks)

**Question 2**

(a) **M/s. Gomati P Ltd., a closely held company**, is in the business of growing rubber. The profit & loss account for the year ended 31-03-2018 of the company shows a net profit **Rs.37.65 crores** after debiting depreciation of **Rs.30 crores**.

The company has provided the following additional information:

(i) The company has deposited **Rs. 30 crores** in a special account with NABARD on 29- 04-2018.

(ii) The company has brought forward losses of **Rs. 6 crores** pertaining to Assessment Year 2015-16. Mr. A who continuously held 60% of shares carrying voting power since incorporation of the company, had sold his entire holding to Mr. B on 01-08-2017.

(iii) The company had an accumulated balance of **Rs. 200 crores** in the special account with NABARD as on 01-04-2017. It has withdrawn **Rs. 40 crores** and utilized the same for the following purposes:

- Purchase of a new sprinkling machine for use in its operation **Rs. 10 crores**,  
- Purchase of office appliances for corporate office at Chennai **Rs. 10 crores**.  
- Purchase of computers and accessories **Rs. 5 crores**.
• Construction of a godown at a cost of Rs. 1 crore near the rubber estate to store raw rubber.
• Repairs to machinery Rs. 35 lakhs.

(iv) On 31-03-2018, the company has sold machinery which was purchased on 10-05-2009 for Rs. 10 crores. The purchase of the said machinery was in accordance with the scheme of deposit.

(v) Depreciation allowable as per Tax Audit Report is Rs. 28 crores.

(b) The Gross Total Income of Mr. Bharadwaj who is a resident of Varanasi for the year ended 31-03-2018 is Rs. 15 lakhs.

Further
(i) He has contributed Rs. 2 lakh towards Clean Ganga Fund set up by the Central Government
(ii) He has incurred medical expenditure of Rs. 50,000 towards surgery for his grandmother who is 85 years of age. (No Premium is paid to keep in force an insurance on her health)
(iii) He has donated Rs. 2 lakhs in cheque and Rs. 50,000 in cash to a political party during its annual conference of which he is a member.
(iv) Repayment of housing loan instalment Rs. 1 lakh during the financial year to his employer XYZ Private Limited.

Discuss the allowable deduction to Mr. Bharadwaj from the above information.

(6 Marks)

(c) Amrutha is a resident Individual. She has income from the following sources:
(i) Taxable income from a sole-proprietary concern in Kochi Rs. 50 lakhs.
(ii) Share of profit from a partnership firm in Chennai Rs. 30 lakhs.
(iii) Agricultural Income from rubber estate in Country A which has no DTAA with India, USD 70000. Withholding Tax on the above income USD 10500 (Assume 1 USD = Rs 64).
(iv) Brought forward Business Loss in Country A was USD 10000 which is not permitted to be set off against other income as per the laws of that country.

Compute taxable income and tax payable by Amrutha for the A.Y. 2018-19.

(6 Marks)

Question 3

(a) X Ltd. is a company in which the whole of its share capital was held by Y Ltd. Both X Ltd. and Y Ltd. are Indian companies. X Ltd. had made investment in shares of ABC Ltd. in 1979 for Rs. 3,00,000 which it sold to Y Ltd. on April 1, 2009 for a consideration of Rs. 30,00,000.

The fair market value of these shares of ABC Ltd., as on April 1, 2001 is Rs. 20,00,000. Y Ltd. disinvested 5% of the shares held by it in X Ltd., in January 2018 by sale to public. It sold the shares in ABC Ltd. in March 2018 acquired by it from X Ltd. for a sum of Rs. 70,00,000.

Discuss the issue with relevant provisions and tax effects of these transactions in the hands of X Ltd. and Y Ltd. in the relevant assessment years.

The cost inflation index Value for the Financial Year 2017-18 is 272. (7 Marks)

(b) Dr. Juhi reports to you that her gross receipt from her medical profession for the year ended 31-03-2018 is Rs. 49,20,000. Her net income as per income and
Past New Course Suggested AJ Education NeXt

expenditure account is Rs. 26,40,000 before adjustment of depreciation of Rs. 2,10,000. She did not pay any amount by way of advance tax during the financial year 2017-18. She has two residential house properties, of which one is self-occupied for residence and another is let out for the monthly rent of Rs. 10,000 during the financial year 2017-18.

Advise Dr. Juhi with reference to section 44ADA on filing of return with optimal tax liability besides compliance cost. Assume that she approached you in April, 2018 and you have given your advise then.

(c) Nikanu Ltd. is an Indian Company involved in manufacturing and trading in cotton garments under the brand name “PCOTT”. In order to expand its exports sale, it launched a massive publicity campaign in overseas market. For the purpose of online advertising, it hired the Sky Inc., a New York based company which has no permanent establishment in India and paid Rs. 10 lakhs for its services in the previous year 2017-18.

Discuss the tax and TDS implications of such transaction both in the hands of Nikanu Ltd. and Sky Inc.

(d) "The term 'Advance ruling' includes within its scope, a determination by the Authority for Advance Rulings only in relation to a transaction undertaken by a non-resident applicant". Discuss the correctness or otherwise of this statement, as per the income tax law.

Question 4

(a) Discuss the TDSITCS implications if any, for the following transactions. What is the amount payable to the payee?:

(i) X is a bookmaker and Mr. Y is a punter. On 22-01-2018, B has won Rs. 50,000 in Horse Race 1 and suffered a loss of Rs. 20,000 in Horse Race 2.

(ii) Mr. Santosh has let out his house property on a monthly rent of Rs. 60,000 from 15·01·2018 to Mrs. Preeti.

(iii) H. Ltd., a manufacturer of luxury cars sold 50 cars on 01·09·2017 to NMP Ltd., its dealer, each car costing Rs. 20 Lakhs.

(iv) AKL Ltd., a third party administrator on behalf of an Insurance Company has settled medical bills of Rs. 5,00,000 submitted by Kay Hospitals Ltd. from a patient under a cashless scheme.

(b) Holy Mission Charitable Trust filed an application in Form 10G along with copies of trust deed and registration certificate, for grant of approval under section 80 G(5), with the approving authority. In order to verify the stated objects of education, social activities etc. and the facts in the application, the trust was asked to produce the relevant books of account, vouchers, donation book and minutes in original.

After considering the same, the Commissioner rejected the application for approval under section 80G(5) on the ground that the trust had failed to apply 85% of its income.

Whether the order of Commissioner is justified in law?

(c) Surat Limited, engaged in the business of textiles also effected the sales and purchase of shares of other companies. It suffered loss from such transactions:

(1) Whether such company can set off its losses from share trading from the profit of textile business?
(2) If principal business of such company is sale and purchase of shares of other company, then, what would be your answer? (4 Marks)

(d) Amar P Ltd., Bangalore is engaged in IT Enabled services. It is the subsidiary of ABC Inc in US. It also provides similar services to a company SAK Ltd. at Singapore. Its billings and other information is as given hereunder:

(i) Billings per month to ABC Inc. - USD 85000
(ii) Billings per month to SAK Ltd. - USD 70000
(iii) ABC Inc has provided a loan of USD 100000 to Amar P Ltd. towards purchase of hardware for executing its project. Rate of interest charged for the said loan is at 3% p.a.
(iv) Direct and indirect cost incurred are USD 100 and USD 200 per hour, respectively.
(v) Amar P Ltd. works 9 hours per day for 15 days to execute the projects for ABC Inc and 8 hours per day for 15 days to execute projects for SAK Ltd. Service was provided by the company to both its customers throughout the year.
(vi) Warranty was provided to SAK Ltd. for a period of 2 years. Cost of warranty is calculated at 1% of direct cost incurred. The cost of warranty is neither included in the direct nor indirect cost.

Assume conversion rate 1 USD = Rs. 64. Compute Arm's Length Price as per the cost-plus method and the amount to be added, if any, to the income of Amar P Ltd. (6 Marks)

Question 5

(a) A search as per section 132 of the Act was conducted on 02-01-2018 and cash Rs. 40 lakhs was seized. The assessee moved an application on 30-01-2018 to release such cash with explanation of the nature and sources thereof, which was turned down by the department. Now, the assessee seeks your advice on whether the department can withhold the explained money? If yes, then to what extent, and upto what period? (4 Marks)

(b) AUM Enterprises, a partnership firm, filed its return of income for the A.Y. 2015-16 on 30- 07-2015. The assessment u/s 143(3) was completed on 15th June, 2017 and the A.O. made two additions to the income of assessee, namely,

(i) Addition of Rs. 8 Lakhs for unexplained cash credit u/s 68 and
(ii) Addition of Rs. 3 lakhs u/s 40(a)(ia) due to non-furnishing of the evidence of TDS payment.

The assessee, being aggrieved, contested the addition of Rs. 8 Lakhs u/s 68 and appeal to the CIT (A). The appeal was decided on 5th January, 2018 against the assessee.

Now, the assessee seeks your advice as to whether it should apply for revision to CIT U/S 264 or for rectification u/s 154 to the A.O. as regards disallowance u/s 40(a)(ia). Advise. (4 Marks)

(c) Pramod, a resident individual of age of 52 years, has not furnished his return of income for the A.Y. 2017-18. However, his total income for such year as assessed u/s 143(3) is Rs. 14 Lakhs.

Whether penalty U/s 270A attracted? If yes, what will be the quantum of penalty leviable?
Can prosecution be launched for the following defaults? Examine the relevant provisions with quantum of prescribed punishment, if any.

(i) The assessee deliberately has failed to comply with the requirement of section 142(i) and/or 142(2A).

(ii) The assessee has failed deliberately to make the payment of tax collected u/s 206C.

(iii) The assessee had restrained and not allowed the officer authorized as per section 132(1)(iib) of the Act to inspect the documents maintained in form of electronic record and the books of account.

(c) Explain the term "Royalty" as per UN model Tax Convention. Is it different from the definition contained in OECD Model? Discuss.

(d) Explain the meaning of "Treaty" as per Article 2 of Vienna Convention on Law of Treaties, 1969. Why it come into play?

Question 6

(a) Whether the Commissioner (Appeals) is empowered to consider an appeal filed by an assessee challenging the order of assessment in respect of which the proceedings before the Settlement Commission abates? Examine with the relevant provisions of law.

(b) (i) The regular assessment of Ms. Swati for the A.Y. 2014-15 was completed u/s 143(3) on 16-07-2016. On 18-01-2018, she received a notice issued u/s 148 for income escaping assessment for the same A.Y. 2014-15. Further, on 25-03-2018, during the pendency of such proceeding for income escaping assessment, the A.O. attaches the house property of Ms. Swati.

Now, aggrieved Swati seeks your opinion (being a Chartered Accountant) as to:

(i) The circumstances under which the A.O. can make provisional attachment of property of the assessee.

(ii) The period of time for which such attachment can take place.

(iii) Can such attachment be revoked by the A.O. and if yes, how?

Discuss the relevant provisions of law to satisfy the aggrieved assessee, Ms. Swati.

(ii) Denim Ltd. was incorporated on 01-04-2017 to carry on the business of innovation, development, deployment and commercialisation of new processes driven by technology. It holds a certificate of eligible business from the notified IBMC (Inter Ministerial Board of Certification).

Its total turnover and the profits and gains from such business for the P.Y. 2017-18 and expected turnover and profits and gains in the following years are as follows:

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Turnover in Crores</td>
<td>15</td>
<td>18</td>
<td>20</td>
<td>22</td>
<td>24</td>
<td>24.5</td>
<td>24.75</td>
</tr>
<tr>
<td>Profits (Losses) in Crores</td>
<td>(2.52)</td>
<td>(1.5)</td>
<td>6.5</td>
<td>8.25</td>
<td>9.5</td>
<td>8</td>
<td>9.50</td>
</tr>
</tbody>
</table>
Is Denim Ltd. eligible for any benefit under the provisions of the Income-tax Act, 1961? If yes, what is the benefit available? (5 Marks)

(c) Discuss the taxability or otherwise of the following transactions:
(i) Mr. A purchased 10 acres of agricultural land from Mr. B at the rate of Rs. 2 lakh per acre on 10-05-2017. The guideline value of the land on the date of the transaction was Rs. 3 lakhs per acre. However, he had entered into an agreement for purchase of the land on 10-03-2017 when the guideline value was Rs. 2.20 lakhs per acre. He had paid a token advance of Rs. 1 lakh by account payee cheque.
(ii) Mr. A received cash gift of Rs. 4.75 lakhs from B on the occasion of his 61st birthday which was celebrated like marriage as per tradition, and Rs. 25,000 from C. Both B and C are his distant relatives.
(iii) Mr. Dileep contributed Rs. 2 lakhs to a Trust created for the purpose of marriage of his friend's daughter.

Note: (Guideline value means Assessable stamp duty value) (6 Marks)

(d) State with reasons whether the following transactions are subject to tax as deemed income.
(i) XYZ Ltd. is a broadcaster of News Channel in India. It had made payments to a Malaysian company having no PE in India for downlinking Television Channels into India and international footprint through a channel.
(ii) Mr. A, a foreign citizen and a diamond merchant from US, has earned income of Rs. 10 crores from display of uncut and unassorted diamonds in the Bharat Diamond Bourse, a notified special zone in Surat. (2 × 3 = 6 Marks)

SOLUTION:

Question 1

Answer

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

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Amount (Rs.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>I Profits and gains of business and profession</td>
<td></td>
</tr>
<tr>
<td>Net profit as per the statement of profit and loss</td>
<td>6,00,00,000</td>
</tr>
<tr>
<td>Add: Items debited but to be considered separately or items of expenditure to be disallowed</td>
<td></td>
</tr>
<tr>
<td>(i) Depreciation as per Companies Act</td>
<td>40,00,000</td>
</tr>
<tr>
<td>(ii) Provision for wages payable to workers</td>
<td>-</td>
</tr>
<tr>
<td>[Since the provision is based on a fair estimate of wages payable with reasonable certainty, the provision is allowable as deduction. ICDS X requires a reliable estimate of the amount of obligation and ‘reasonable certainty’ for recognition of a provision, which is present in this case. As the provision of Rs. 25 lakhs has been debited to statement of profit and loss, no adjustment is required]</td>
<td></td>
</tr>
</tbody>
</table>
while computing business income]

(v) **Loss due to destruction of machinery by fire**

[Loss of Rs. 25 lakhs due to destruction of machinery caused by fire is not deductible since it is capital in nature. Since the loss has been debited to statement of profit and loss, the same is required to added back while computing business income]

<table>
<thead>
<tr>
<th>(v)</th>
<th>Loss due to destruction of machinery by fire</th>
<th>25,00,000</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>[Loss of Rs. 25 lakhs due to destruction of machinery caused by fire is not deductible since it is capital in nature. Since the loss has been debited to statement of profit and loss, the same is required to added back while computing business income]</td>
<td></td>
</tr>
</tbody>
</table>

(vi) **Provision for gratuity**

[Provision of Rs. 400 lakhs for gratuity based on actuarial valuation is not allowable as deduction. However, actual gratuity of Rs. 275 lakhs paid is allowable as deduction. Hence, the difference has to be added back to income [Rs. 400 lakhs (-) Rs. 275 lakhs]]

<table>
<thead>
<tr>
<th>(vi)</th>
<th>Provision for gratuity</th>
<th>1,25,00,000</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>[Provision of Rs. 400 lakhs for gratuity based on actuarial valuation is not allowable as deduction. However, actual gratuity of Rs. 275 lakhs paid is allowable as deduction. Hence, the difference has to be added back to income [Rs. 400 lakhs (-) Rs. 275 lakhs]]</td>
<td></td>
</tr>
</tbody>
</table>

(vii) **Purchase of paper at a price higher than the fair market value**

[Since the purchase is from a related party, a firm in which majority of the directors of the company are partners, at a price higher than the fair market value, the difference between the purchase price (Rs. 30,000 per ton) and the fair market value (Rs. 28,000 per ton) multiplied by the quantity purchased (500 tons, i.e., [Rs. 2,000 \times 500]) has to be added back]

<table>
<thead>
<tr>
<th>(vii)</th>
<th>Purchase of paper at a price higher than the fair market value</th>
<th>10,00,000</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>[Since the purchase is from a related party, a firm in which majority of the directors of the company are partners, at a price higher than the fair market value, the difference between the purchase price (Rs. 30,000 per ton) and the fair market value (Rs. 28,000 per ton) multiplied by the quantity purchased (500 tons, i.e., [Rs. 2,000 \times 500]) has to be added back]</td>
<td></td>
</tr>
</tbody>
</table>

(viii) **Advertisement in souvenir of a political party**

[Advertisement charges paid in respect of souvenir published by a political party is not allowable as deduction from business profits of the company. Since, the expenditure has been debited to statement of profit and loss, the same has to be added back while computing business income]

<table>
<thead>
<tr>
<th>(viii)</th>
<th>Advertisement in souvenir of a political party</th>
<th>1,50,000</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>[Advertisement charges paid in respect of souvenir published by a political party is not allowable as deduction from business profits of the company. Since, the expenditure has been debited to statement of profit and loss, the same has to be added back while computing business income]</td>
<td></td>
</tr>
</tbody>
</table>

**Add: Income taxable but not credited to statement of profit and loss**

AI(ii) **Sales tax not refunded to customers out of sales tax refund**

[The amount of sales tax refunded to the company by the Government is a revenue receipt chargeable to tax. Out of the refunded amount of Rs. 4 lakhs, the amount of Rs. 3 lakh stands refunded to customers would not be chargeable to tax. The balance amount of Rs. 1,00,000 lying with the company would be chargeable to tax]

<table>
<thead>
<tr>
<th>AI(ii)</th>
<th>Sales tax not refunded to customers out of sales tax refund</th>
<th>1,00,000</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>[The amount of sales tax refunded to the company by the Government is a revenue receipt chargeable to tax. Out of the refunded amount of Rs. 4 lakhs, the amount of Rs. 3 lakh stands refunded to customers would not be chargeable to tax. The balance amount of Rs. 1,00,000 lying with the company would be chargeable to tax]</td>
<td></td>
</tr>
</tbody>
</table>

**Less: Items credited to statement of profit and loss, but not includible in business income/ permissible expenditure and allowances**

(ii) **Industrial power tariff concession received from State Government**

[Any assistance in the form of, inter alia, concessions received from the Central or State Government would...]

<table>
<thead>
<tr>
<th>(ii)</th>
<th>Industrial power tariff concession received from State Government</th>
<th>8,02,50,000</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>[Any assistance in the form of, inter alia, concessions received from the Central or State Government would...]</td>
<td></td>
</tr>
</tbody>
</table>
be treated as income. Since the same has been credited to statement of profit and loss, no adjustment is required]

(iv) **Dividend received from foreign company**

<table>
<thead>
<tr>
<th></th>
<th>10,00,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>[Dividend received from foreign company is taxable under “Income from other sources”. Since the said same has been credited to the statement of profit and loss, it has to be deducted while computing business income]</td>
<td></td>
</tr>
</tbody>
</table>

(v) **Scrap value of machinery**

<table>
<thead>
<tr>
<th></th>
<th>50,00,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>[Scrap value of machinery, being capital in nature, has to be reduced from WDV of machinery. Since the same has been credited to the statement of profit and loss, it has to be deducted while computing business income]</td>
<td></td>
</tr>
</tbody>
</table>

(ix) **Long term capital gains of sale of equity shares**

<table>
<thead>
<tr>
<th></th>
<th>4,50,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>[The taxability or otherwise of long term capital gain on sale of equity shares has to be considered while computing income under the head “Capital Gains”. Since such capital gains has been credited to statement of profit and loss, the same has to be reduced to arrive at the business income.]</td>
<td></td>
</tr>
</tbody>
</table>

A1(i) **Depreciation as per Income-tax Rules, 1961 [See Note below]**

<table>
<thead>
<tr>
<th></th>
<th>65,00,000</th>
<th>84,50,000</th>
</tr>
</thead>
</table>

I | **Profits and gains from business and profession** |
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Income from Other Sources</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Dividend received from foreign company</strong></td>
<td></td>
</tr>
<tr>
<td>[Dividend received from a foreign company is chargeable to tax under the head” Income from other sources”]</td>
<td></td>
</tr>
</tbody>
</table>

II | **Dividend received from foreign company** |
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>[Dividend received from foreign company is chargeable to tax under the head” Income from other sources”]</td>
<td></td>
</tr>
</tbody>
</table>

III | **Capital Gains** |
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Long term capital gain on sale of equity shares</strong></td>
<td></td>
</tr>
<tr>
<td>[Long term capital gains on sale of equity shares on which STT is paid at the time of acquisition and sale is exempt under section 10(38).]</td>
<td></td>
</tr>
</tbody>
</table>

**Gross Total Income**

<table>
<thead>
<tr>
<th></th>
<th>7,28,00,000</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Less: Deduction under Chapter VI-A</strong></td>
<td></td>
</tr>
<tr>
<td>[Under section 80GGB [Contribution by a company to a registered political party is allowable as deduction, since payment is made otherwise than by cash. Expenditure incurred by an Indian company on advertisement in souvenir published by such political party tantamounts to contribution to such political party.]</td>
<td></td>
</tr>
</tbody>
</table>

**Total Income**

<table>
<thead>
<tr>
<th></th>
<th>7,26,50,000</th>
</tr>
</thead>
</table>

**Note** – As per section 43(6)(c), for computation of written down value (WDV) of a block of asset at the end of the year, the amount of scrap value received has to be reduced from the value of block of assets at the beginning of the previous year and cost of assets purchased during the year. Depreciation is calculated on the value so arrived of the block of asset as on 31.3.2018. In the question, adjustment (v) states that scrap value of Rs. 5 lakh is received in respect of destroyed machinery and same is credited in the statement.
of profit and loss. In the additional information, since, depreciation as per Income-tax Rules, 1962 is given, no further adjustment for scrap value is done, presuming that the same has already been reduced and depreciation has been calculated on the value so arrived at of the block as on 31.3.2018.

However, since scrap value has been credited to the statement of profit and loss, it is possible to take a view that the amount of scrap value is not reduced while computing the value of the assets. In such a case, depreciation allowable would be Rs. 64,25,000 [i.e., Rs. 65,00,000 – Rs. 75,000, being 15% of Rs. 5,00,000]. The business income and total income would be Rs. 7,18,75,000 and Rs. 7,27,25,000, respectively.

(b) If an Indian company, being the borrower, incurs any expenditure by way of interest in respect of any debt issued by its non-resident associated enterprise (AE) and such interest exceeds Rs. 1 crore, then, the interest paid or payable by such Indian company in excess of 30% of its earnings before interest, taxes, depreciation and amortization (EBITDA) or interest paid or payable to associated enterprise, whichever is lower, shall not be allowed as deduction as per section 94B.

Further, where the debt is issued by a lender which is not associated but an associated enterprise either provides an implicit or explicit guarantee to such lender or deposits a corresponding and matching amount of funds with the lender, such debt shall be deemed to have been issued by an associated enterprise and limitation of interest deduction would be applicable.

In the present case, since M/s K Inc holds 30% of voting power i.e., more than 26% of voting power in both X Ltd and M/s B Inc, X Ltd. and M/s B Inc are deemed to be associated enterprises.

Since loan of Rs. 100 crores taken by X Ltd., an Indian company from M/s A Inc, is guaranteed by M/s B Inc, an associated enterprise of X Ltd., such debt shall be deemed to have been issued by an associated enterprise and interest payable to M/s A. Inc shall be considered for the purpose of limitation of interest deduction under section 94B.

**Computation of interest to be disallowed as per section 94B in the computation of income under the head profits and gains of business or profession of M/s. X Ltd.**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net profit</td>
<td>10,00,00,000</td>
</tr>
<tr>
<td>Add: Interest already debited (Rs. 100 crores × 9%)</td>
<td>9,00,00,000</td>
</tr>
<tr>
<td>Depreciation</td>
<td>5,00,00,000</td>
</tr>
<tr>
<td>Income tax</td>
<td>3,40,00,000</td>
</tr>
<tr>
<td><strong>EBITDA</strong></td>
<td><strong>27,40,00,000</strong></td>
</tr>
<tr>
<td>Interest paid or payable by X Ltd.</td>
<td>9,00,00,000</td>
</tr>
<tr>
<td>Interest paid or payable in excess of the lower of the following would be disallowed</td>
<td></td>
</tr>
<tr>
<td>- 30% of EBITDA</td>
<td>Rs. 8,22,00,000</td>
</tr>
<tr>
<td>- Interest paid or payable to non-resident AE</td>
<td>Rs. 9,00,00,000</td>
</tr>
<tr>
<td>Interest to be disallowed as deduction</td>
<td>8,22,00,000</td>
</tr>
</tbody>
</table>

*Note – Since K Inc, an associated enterprise of X Ltd., has deposited a matching amount of Rs. 100 crores with A Inc., the interest payable by X Ltd. to A Inc. on loan of Rs. 100 crores borrowed from A Inc. would be subject to limitation of interest deduction on the basis of this line of reasoning also.*
**Question 2**

**Answer**

(a) **Computation of Taxable and Exempt Income of M/s Gomati (P) Ltd. for the A.Y. 2018-19**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net profit as per Profit and Loss Account</td>
<td>37,65,00,000</td>
</tr>
<tr>
<td>Add: <strong>Excess depreciation as per books of account</strong></td>
<td></td>
</tr>
<tr>
<td>Depreciation as per books of account</td>
<td>30,00,00,000</td>
</tr>
<tr>
<td>Less: Depreciation allowable as per the Income-tax Act, 1961</td>
<td></td>
</tr>
<tr>
<td></td>
<td>28,00,00,000</td>
</tr>
<tr>
<td>Net profit before allowing deduction under section 33AB</td>
<td>39,65,00,000</td>
</tr>
<tr>
<td>Less: Deduction under section 33AB would be the lower of:</td>
<td></td>
</tr>
<tr>
<td>- Amount deposited in Rubber Development Account on or before 30.9.2018</td>
<td>15,86,00,000</td>
</tr>
<tr>
<td>[i.e., Rs. 30,00,00,000]</td>
<td></td>
</tr>
<tr>
<td>- 40% of profits of such business [i.e., Rs. 15,86,00,000, being 40% of Rs. 39,65,00,000]</td>
<td></td>
</tr>
<tr>
<td>Net profit after allowing deduction under section 33AB</td>
<td>23,79,00,000</td>
</tr>
<tr>
<td>Add: Amount withdrawn from special account with NABARD, which is deemed as profits and gains of business or profession</td>
<td>Nil</td>
</tr>
<tr>
<td>(i) Purchase of a new sprinkling machine for use in its operation for Rs. 10 crores, would not be deemed as profits and gains of business or profession, since the said amount is utilised as per the specified scheme.</td>
<td>10,00,00,000</td>
</tr>
<tr>
<td>(ii) Purchase of office appliances for corporate office at Chennai for Rs. 10 crores, out of the amount withdrawn from the deposit account, would be deemed as profits and gains of business or profession, since the said utilisation is not permissible.</td>
<td>Nil</td>
</tr>
<tr>
<td>(iii) Rs. 5 crores utilised for purchase of computers and accessories is permissible. Thus, such amount would not be deemed as profits and gains of business or profession.</td>
<td>Nil</td>
</tr>
<tr>
<td>(iv) Rs. 1 crore utilised for construction of a godown near rubber estate to store raw rubber, would not be deemed as profits and gains of business or profession, since the said amount is utilised as per the specified scheme.</td>
<td>Nil</td>
</tr>
<tr>
<td>(v) Rs. 35 lakhs utilised for repairs to machinery would not be deemed as profits and gains of business or profession, since the said amount is utilised as per the specified scheme.</td>
<td>Nil</td>
</tr>
<tr>
<td>Note - However, no deduction would be allowed in respect of such expenditure mentioned in (i), (iii), (iv) and (v) during the P.Y. 2017-18, since amount is spent out of the amount deposited in special account with NABARD, which has already been allowed as deduction in an earlier assessment year.</td>
<td></td>
</tr>
<tr>
<td>(vi) The remaining amount of Rs. 13.65 crores {Rs. 40 crores less</td>
<td>13,65,00,000</td>
</tr>
</tbody>
</table>
Rs. 26.35 crores [utilised above in (i) to (v)], which is not utilised during the previous year in which such amount is withdrawn, would be deemed as profits and gains of business or profession.

Add: Sale of machinery acquired out of the amount withdrawn from special account in accordance with the scheme of deposit. The cost of such machinery would be deemed as profits and gains of business or profession, since such machinery is sold before the expiry of eight years from the end of the previous year of its acquisition. [See Note at the end of the solution]

Total Composite business profits
Less: 65% of Rs. 57,44,00,000, being agricultural income Exempt
Business income
Less: Brought forward business loss of Rs. 6 crores pertaining to A.Y.2015-16 not allowed to be set-off against the business profits of the P.Y. 2017-18, since as on 31.3.2018, the shares of M/s Gomati P Ltd carrying 60% (i.e., not less than 51%) of the voting power is held by Mr. B and not by Mr. A, being the person who held such shares as on 31.03.2015, being the last day of previous year 2014-15, in which such loss was incurred.

Business income chargeable to tax

Note – As per section 33AB(5), the cost of the asset acquired would be deemed as profits of the year in which it is sold, only if the sale takes place before the expiry of eight years from the end of the previous year in which it was acquired. In this case the asset was acquired in the P.Y.2009-10. The eight year period from the end of P.Y.2009-10 would expire on 31.3.2018. As per the plain reading of section 33AB(5), if the sale takes place exactly on 31.3.2018 and not before 31.3.2018, the cost of asset would be deemed as profits of the previous year of sale. However, in this case, the sale took place exactly on 31.3.2018 and not before 31.3.2018. Therefore, it is possible to take a view that the deeming provision would not apply in this case. If this alternate view is taken, total composite business profits would be Rs. 47,44,00,000. Agricultural income would be Rs. 30,83,60,000 and business income chargeable to tax would be Rs. 16,60,40,000.

(b) Allowable deduction to Mr. Bhardwaj from Gross Total Income

(i) Contribution towards Clean Ganga Fund set up by the Central Government: Whole of the contribution i.e., Rs. 2 lakh towards Clean Ganga Fund, set up by the Central Government, is allowable as deduction under section 80G to Mr. Bharadwaj, since he is a resident of India.

(ii) Medical Expenditure of Rs. 50,000 towards surgery of his grandmother: Deduction is allowable under section 80D, in respect of medical expenditure incurred by an assessee for himself or any member of the family or parents, if any of such person(s) is of the age of 80 years or more and no payment has been made to keep in force an insurance on the health of such person(s). In the present case, no deduction is allowable to Mr. Bharadwaj, since he incurred medical expenditure towards surgery of his grandmother, who does not fall within the definition of “family” under section 80D. Apart from family, deduction is only allowable in respect of premium paid for parents, and not grandparents.
(iii) **Donation to political party:** Deduction under section 80GGC is allowable to Mr. Bharadwaj in respect of donation of **Rs. 2 lakhs** made by cheque to a political party. However, no deduction is allowed to him in respect of donation of **Rs. 50,000**, since such payment is made in cash.

(iv) **Repayment of housing loan:** As per section 80C, deduction in respect of repayment of housing loan is allowable, if the loan is taken from, *inter alia*, an employer company, where such employer company is a public company or public sector company. Accordingly, in this case, no deduction would be allowable to Mr. Bharadwaj in respect repayment of housing loan, since such loan is taken from his employer company XYZ Private Limited, not being a public company or a public sector company.

(c) **Computation of taxable income and tax payable of Amrutha for A.Y. 2018-19**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Profits and gains from business and profession</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Income from sole proprietary concern in India</td>
<td>50,00,000</td>
<td></td>
</tr>
<tr>
<td>Share of profit from a partnership firm in India</td>
<td>Nil</td>
<td>30</td>
</tr>
<tr>
<td>Business profit</td>
<td>50,00,000</td>
<td>6,40,000</td>
</tr>
<tr>
<td><em>Less: Business Loss in Country A (USD 10,000 x Rs. 64/USD)</em></td>
<td>43,60,000</td>
<td></td>
</tr>
<tr>
<td><strong>Income from Other Sources</strong></td>
<td>44,80,000</td>
<td>88,40,000</td>
</tr>
<tr>
<td>Agricultural income from rubber estate in Country A, is taxable in India (USD 70,000 x Rs. 64/USD)</td>
<td>44,80,000</td>
<td></td>
</tr>
<tr>
<td><strong>Gross Total Income/ Total Income</strong></td>
<td>88,40,000</td>
<td></td>
</tr>
<tr>
<td><strong>Tax on total income</strong></td>
<td>24,64,500</td>
<td>22,16,279</td>
</tr>
<tr>
<td>Tax on Rs. 88,40,000 [30% x Rs. 78,40,000 plus Rs. 1,12,500]</td>
<td>24,64,500</td>
<td></td>
</tr>
<tr>
<td><em>Add: Surcharge@10%, since total income exceeds Rs. 50 lakhs</em></td>
<td>2,46,450</td>
<td>27,10,950</td>
</tr>
<tr>
<td><em>Add: Education cess &amp; SHEC @3%</em></td>
<td>81,329</td>
<td>27,92,279</td>
</tr>
<tr>
<td><strong>Average rate of tax in India</strong></td>
<td>31.59%</td>
<td></td>
</tr>
<tr>
<td>[i.e., Rs. 27,92,279/Rs. 88,40,000 x 100]</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Average rate of tax in Country A</strong></td>
<td>15%</td>
<td></td>
</tr>
<tr>
<td>[i.e., USD 10,500/USD 70,000]</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Doubly taxed income [Rs. 44,80,000 – Rs. 6,40,000]</strong></td>
<td>38,40,000</td>
<td></td>
</tr>
<tr>
<td><strong>Rebate under section 91 on Rs. 38,40,000 @15%</strong></td>
<td>5,76,000</td>
<td>22,16,279</td>
</tr>
<tr>
<td>(lower of average Indian tax rate and rate of tax in Country A)</td>
<td>5,76,000</td>
<td></td>
</tr>
<tr>
<td><strong>Tax payable in India [Rs. 27,92,279 – Rs. 5,76,000]</strong></td>
<td>22,16,279</td>
<td>22,16,280</td>
</tr>
<tr>
<td><strong>Tax payable (rounded off)</strong></td>
<td>22,16,280</td>
<td></td>
</tr>
</tbody>
</table>

**Notes:**

(1) Since Amrutha is resident in India for the P.Y.2017-18, her global income would be subject to tax in India. She would be allowed deduction under section 91 provided all the following conditions are fulfilled:-

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

(b) Income accrues or arises to her outside India during that previous year.
(c) Such income is not deemed to accrue or arise in India during the previous year.

(d) The income in question has been subjected to income-tax in Country A in her hands and she has paid tax on such income in Country A.

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

Amrutha is eligible for deduction under section 91 since all the conditions specified thereunder stand fulfilled by her during the previous year.

(2) The above solution has been worked out assuming that the agricultural income of USD 70,000 is the gross amount.

Alternatively, if it is assumed that the agricultural income of USD 70,000 is net of taxes, in such case, the total income would be Rs. 95,12,000 (Rs. 43,60,000 plus agricultural income of Rs. 51,52,000 (USD 80,500 x Rs. 64/USD), tax payable without relief under section 91 would be Rs. 30,20,691 and relief under section 91 would be Rs. 5,88,523 [Rs. 45,12,000 – Rs. 6,40,000] \times 13.0435\% (USD10,500/USD 80,500)] and net tax payable would be Rs. 24,32,170 (rounded off).

**Question 3**

**Answer**

(a) **Particulars**

| (i) Sale of shares of ABC Ltd. by X Ltd. to Y Ltd. on 1.4.2009 |
| Since both X Ltd and Y Ltd. are Indian companies and Y Ltd. holds 100% of shares of X Ltd., the transfer of capital asset, namely, shares of ABC Ltd., by X Ltd. to Y Ltd. would not be treated as a transfer for attracting capital gains tax liability as per section 47(v). Hence, no capital gains tax would have been attracted on such transfer in the hands of X Ltd. |

| (ii) Disinvestment by Y Ltd., of 5% shares held in X Ltd. in January, 2018 |
| As per section 47A(1), where a holding company ceases to hold 100% of shares of the subsidiary company before the expiry of a period of eight years from the date of transfer of capital asset, the amount of capital gains not charged to tax at the time of transfer would be deemed to be income chargeable under the head “Capital gains” of the previous year in which transfer took place. However, in this case, the above deeming provision would not apply because the eight year period from the date of transfer expires on 31.3.2017 and the disinvestment by Y Ltd. of 5% shares held in X Ltd. was only in January 2018. |

| (iii) Sale of shares of ABC Ltd. by Y Ltd. in March 2018 |
| This transaction would attract capital gains tax in the hands of Y Ltd. for the A.Y.2018-19. The capital gains would be long-term, since the period of holding is more than 24 months. The cost of acquisition to X Ltd. in the year 1979 (i.e. Rs. 3,00,000) or the fair market value as on 1.4.2001 (Rs. 20,00,000), whichever is higher, would be deemed as the cost of acquisition. |
Computation of capital gains in the hands of Y Ltd.

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sale consideration</td>
<td>70,00,000</td>
</tr>
<tr>
<td>Less: Indexed cost of acquisition [Rs. 20,00,000 \times 272/100]</td>
<td>54,40,000</td>
</tr>
<tr>
<td>Long-term capital gains</td>
<td>15,60,000</td>
</tr>
<tr>
<td>Tax on long-term capital gains@20.6% (\text{Rs.}\ 15,60,000 \times 20.6%)</td>
<td>3,21,360</td>
</tr>
</tbody>
</table>

Note – It is presumed that the shares are not listed on a recognized stock exchange.

(b)

Particulars
Since gross receipts of Rs. 49,20,000 of Dr. Juhi from her medical profession is less than Rs. 50,00,000, she can opt for presumptive tax provisions under section 44ADA.
In such a case, her income from medical profession would be Rs. 24,60,000, being 50\% of Rs. 49,20,000. Since all deductions allowable under sections 30 to 38 are deemed to have been given full effect to, no deduction in respect of depreciation would be allowable from the income computed on presumptive basis under section 44ADA.

I. Where Dr. Juhi declares income from profession on presumptive basis u/s 44ADA

Computation of total income of Dr. Juhi

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income from house property</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Self-occupied property</td>
<td>Nil</td>
<td></td>
</tr>
<tr>
<td>Let-out Property:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Annual Value [Rs. 10,000 \times 12]</td>
<td>1,20,000</td>
<td>84,000</td>
</tr>
<tr>
<td>Less: Deduction u/s 24 [30% of Rs. 1,20,000]</td>
<td>36,000</td>
<td></td>
</tr>
<tr>
<td>Profits and gains from business or profession</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Income from medical profession [50% of Rs. 49,20,000]</td>
<td>24,60,000</td>
<td>25,44,000</td>
</tr>
</tbody>
</table>

Computation of tax liability of Dr. Juhi

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax on total income = [30% of Rs. 15,44,000 (\text{Rs.}\ 25,44,000 – Rs. 10,00,000) + Rs. 1,12,500]</td>
<td>5,75,700</td>
</tr>
<tr>
<td>Add: Education cess and SHEC@3%</td>
<td>17,271</td>
</tr>
<tr>
<td>Total tax liability</td>
<td>5,92,971</td>
</tr>
<tr>
<td>Add: Interest under section 234B [1% of Rs. 5,92,900]</td>
<td>5,929</td>
</tr>
<tr>
<td>Interest under section 234C [1% of Rs. 5,92,900, since the advance tax liability has to be paid in one instalment on or before 15.3.2018]</td>
<td>5,929</td>
</tr>
<tr>
<td>Total tax and interest liability</td>
<td>6,04,829</td>
</tr>
<tr>
<td>Total tax and interest liability (rounded off)</td>
<td>6,04,830</td>
</tr>
</tbody>
</table>

Dr. Juhi can, however, declare lower profits than the presumptive profits of Rs. 24,60,000, if she maintains books of accounts under section 44AA and gets the same audited under section 44AB. In such case, she can file return on or before 30.9.2018.

II. Where Dr. Juhi declares income from profession as per books of account
Income from house property  
Self-occupied property  Nil  
Let-out property  
Annual Value [Rs. 10,000 x 12]  1,20,000  
Less: Deduction u/s 24 [30% of Rs. 1,20,000]  36,000  84,000  
Profits and gains from business or profession  
Income from medical profession [Rs. 26,40,000 – Rs. 2,10,000]  24,30,000  
Total Income  25,14,000  
Computation of tax liability:  
Tax on total income = [30% of Rs. 15,14,000 (Rs. 25,14,000 – Rs. 10,00,000) + Rs. 1,12,500]  5,66,700  
Add: Education cess and SHEC@3%  17,001  
Total tax liability  5,83,701  
Add: Interest under section 234B [1% of Rs. 5,83,700]  5,837  
Interest under section 234C [See Working Note below]  29,477  
Total tax and interest liability  6,19,015  
Total tax and interest liability (rounded off)  6,19,020  

Although the income from profession computed as per books of account is lower than the income from profession computed on presumptive basis under section 44ADA, however, the cumulative tax and interest liability would be higher by Rs. 14,190 (i.e., Rs. 6,19,020 - Rs. 6,04,830) in case of the former. Therefore, Dr. Juhi should opt to declare income on presumptive basis under section 44ADA, in which case she has to file her tax return on or before 31st July, 2018.  

Working Note: Computation of interest under section 234C  
<table>
<thead>
<tr>
<th>Date</th>
<th>Advance tax payable till date</th>
<th>Short-fall (Rs.)</th>
<th>Rate of interest 1% per month</th>
<th>Interest (Rs.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>15.06.2017</td>
<td>15%</td>
<td>87,555</td>
<td>3% [1% x 3]</td>
<td>2,627</td>
</tr>
<tr>
<td>15.09.2017</td>
<td>45%</td>
<td>2,62,665</td>
<td>3% [1% x 3]</td>
<td>7,880</td>
</tr>
<tr>
<td>15.12.2017</td>
<td>75%</td>
<td>4,37,775</td>
<td>3% [1% x 3]</td>
<td>13,133</td>
</tr>
<tr>
<td>15.03.2018</td>
<td>100%</td>
<td>5,83,700</td>
<td>1%</td>
<td>5,837</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>29,477</td>
</tr>
</tbody>
</table>

Note – The above solution has been worked out by considering that Dr. Juhi pays the advance tax required to be paid in April, 2018 itself, after consulting the tax advisor in the month of April, 2018.  

e) Equalisation levy of 6% is attracted in respect of the amount of consideration exceeding Rs. 1 lakh for, inter alia, online advertisement, received or receivable by a non-resident not having permanent establishment in India, from, inter alia, a resident in India who carries on business or profession.  
In this case, the payment of Rs. 10 lakhs by Nikanu Ltd., a resident in India (since it is an Indian company) to Sky Inc., New York, a non-resident not having PE in India,
for online advertisement services would be subject to Equalisation Levy @6%. Such income is, however, exempt under the Income-tax Act, 1961 by virtue of section 10(50) thereof.

Nikanu Ltd. is required to deduct equalisation levy of Rs. 60,000 i.e., @6% of Rs. 10 lakhs from such payment.

(d) The statement is not correct.

As per section 245N, advance ruling not only includes a determination by the AAR in relation to a transaction which has been undertaken or is proposed to be undertaken by a non-resident applicant, but also includes, inter alia, determination by the AAR -

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

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

Question 4

Answer

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

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

Thus, in the present case, Mr. X is liable to deduct tax of Rs. 15,000 (Rs. 50,000 x 30%) from winnings of Rs. 50,000. The net amount payable to Mr. B would be Rs. 15,000 (i.e., Rs. 50,000 – Rs. 20,000, being loss – Rs. 15,000, being TDS).

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

Since Mrs. Preeti, an individual, pays rent exceeding Rs. 50,000 per month in the F.Y. 2017-18 to Mr. Santosh, she is liable to deduct tax at source @5% of such rent for F.Y. 2017-18 under section 194-IB.

Thus, Rs. 7,500 [Rs. 60,000 x 5% x 2.5] has to be deducted from rent payable for March, 2018. The rent payable to Mr. Santosh for March, 2018 would be Rs. 52,500.

Note – The above answer is based on the provisions of section 194-IB, which would be attracted in Mrs. Preeti’s case.

Alternatively, in case it is assumed that Mrs. Preeti carries on business or profession and her total sales, gross receipts or turnover from the business or profession carried on by her exceeds the monetary limit specified under section 44AB in the immediately preceding financial year, she is required to
deduct tax at source @10% under section 194-I in respect of rent payable for use of any land or building, if the rent payable during the financial year exceeds Rs. 180,000. In the present case, since the rent of Rs. 1,50,000 i.e., Rs. 60,000 × 2.5 months is less than Rs. 180,000, no tax is required to be deducted at source under section 194-I.

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

However, this provision applies only in respect of transactions of retail sales and does not apply to sale of motor vehicles by manufacturers to dealers. Therefore, H Ltd., a manufacturer, is not required to collect tax at source from NMP Ltd., the dealer, on receipt of consideration for sale of motor cars. Hence, the amount payable by NMP Ltd. to H Ltd. is Rs. 1,00,000 lakhs i.e., Rs. 20 lakhs × 50.

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

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

The CBDT has, vide Circular No.8/2009 dated 24.11.2009, clarified that since the services rendered by hospitals to various patients are primarily medical services, TPAs (Third Party Administrator’s), who are making payment on behalf of insurance companies to hospitals for settlement of medical/insurance claims etc. under various schemes including cashless schemes are liable to deduct tax at source on all such payments to hospitals etc.

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

(b) The issue under consideration in the present case is whether an application for grant of approval under section 80G(5) can be rejected on the ground that the trust has failed to apply 85% of its income for charitable purposes.

Section 80G provides that donation to any institution or fund would qualify for deduction thereunder only if it is established in India for a charitable purpose and derives such income which would not be liable to inclusion in its total income under the provisions of, inter alia, sections 11 and 12.

Section 80G does not relate to assessment of the trust or the institution whose income is not liable to be included in the computation of taxable income under various provisions of the Act. Primarily, section 80G is related to giving deduction in respect of donations made by a person to such trusts and institutions.

Once a trust is registered under section 12AA, its income from property includes donations received. Such donations are deemed to be income from property, which are not to be included in the total income under section 11 or section 12. The enquiry under section 80G, hence, cannot go beyond that.

The scope of enquiry cannot include an enquiry as to whether, at the close of the previous year, the donee-trust will actually be able to apply 85% of its income. This is because non-fulfillment of some conditions by the donee-trust as regards
application or accumulation cannot be ascertained in praesenti, when the donation is made. The question of whether the trust will be able to apply 85% of its income can be determined only from the facts existing at the close of the assessment year. It was so held by the Gujarat High Court in CIT v. Shree Govindbhai Jethalal Nathavani Charitable Trust (2015) 373 ITR 619.

Applying the rationale of the Gujarat High Court ruling to the facts of the present case, the rejection by the Commissioner, of the application made by Holy Mission Charitable Trust for approval under section 80G, on the ground that it had not spent 85% of its income for charitable purposes, is not valid.

(e) As per section 73(1), loss in speculation business can be set-off only against the profits of any other speculation business and not against any other business or professional income.

Explanation below section 73(1) clarifies that where any part of the business of a company consists in the purchase and sale of the shares of other companies, such a company shall be deemed to be carrying on speculation business to the extent to which the business consists of the purchase and sale of such shares.

However, this deeming provision does not apply, inter alia, to a company, the principal business of which is the business of trading in shares.

(i) Since part of the business of Surat Ltd. consists of sale and purchase of shares of other companies, the company would be deemed to be carrying on speculation business to the extent of purchase and sale of such shares.

Thus, the loss from speculative business i.e., loss from share trading cannot be set-off against the profit of textile business of Surat Ltd.

(ii) If the principal business of Surat Ltd. is to sell and purchase shares of other companies, Surat Limited would not be deemed to be carrying on speculation business.

In such a case, the loss arising from the sale and purchase of shares of other company can be set-off against any other business income. Surat Ltd. can, accordingly, set-off such losses against its profits from textile business.

(d) Determination of Gross Margin of Comparable Uncontrolled transaction i.e., of SAK Ltd.

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Amt in USD</th>
</tr>
</thead>
<tbody>
<tr>
<td>Direct Cost (USD 100 x 8 hours x 15 days)</td>
<td>12,000</td>
</tr>
<tr>
<td>Indirect Cost (USD 200 x 8 hours x 15 days)</td>
<td>24,000</td>
</tr>
<tr>
<td>Total Direct and Indirect cost</td>
<td>36,000</td>
</tr>
<tr>
<td>Billing per month</td>
<td>70,000</td>
</tr>
<tr>
<td>Gross Margin being gross profit</td>
<td>34,000</td>
</tr>
<tr>
<td>Gross Margin to cost (%) [34,000 x 100/36,000]</td>
<td>94.44%</td>
</tr>
</tbody>
</table>

Adjustment for functional difference on account of cost of warranty

Total Direct and Indirect Cost                                           36,000
Add: Cost of warranty [1% of direct cost of USD 12,000]                    120
Total Cost                                                                36,120
Billing per month                                                        70,000
Margin after cost of warranty being profit margin [70,000 - 36,120]       33,880
Profit margin to cost (%) [after considering functional difference on account of cost of warranty [33,880 x 100/36,120] | 93.80%
**Computation of Arm’s Length Price by applying Cost Plus Method**

<table>
<thead>
<tr>
<th>Description</th>
<th>ABC Inc (USD)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Direct Cost (USD 100 x 9 hours x 15 days)</td>
<td>13,500</td>
</tr>
<tr>
<td>Indirect Cost (USD 200 x 9 hours x 15 days)</td>
<td>27,000</td>
</tr>
<tr>
<td><strong>Total Direct and Indirect cost</strong></td>
<td><strong>40,500</strong></td>
</tr>
<tr>
<td><em>Add:</em> Interest on loan of USD 1,00,000 borrowed for purchase of hardware [USD 3,000 (i.e., USD 1,00,000@3%) / 12]</td>
<td>250</td>
</tr>
<tr>
<td><strong>Total Cost</strong></td>
<td><strong>40,750</strong></td>
</tr>
<tr>
<td>Profit margin by applying the margin of 93.80% of total cost of USD 40,750</td>
<td></td>
</tr>
<tr>
<td><strong>Arm’s length price of billing per month</strong></td>
<td><strong>78,974</strong></td>
</tr>
<tr>
<td>Arm’s length price (in Rs.) [USD 78,974 x 64] = <strong>Rs. 50,54,336</strong></td>
<td></td>
</tr>
<tr>
<td>Actual Billing per month</td>
<td>85,000</td>
</tr>
</tbody>
</table>

In the present case, since actual billing of USD 85,000 per month to the ABC Inc, an AE, is higher than the Arm’s length price of USD 78,974 determined by applying cost plus method, no adjustment is to be made to the income of Amar P Ltd.

**Question 5**

**Answer**

(a) As per section 132B, where the person concerned makes an application to the Assessing Officer, within 30 days from the end of the month in which the asset was seized, for release of the asset and the nature and source of acquisition of the asset is explained to the satisfaction of the Assessing Officer, then, the Assessing Officer may, with the prior approval of the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner, release the asset after recovering the existing liability under the Income-tax Act, 1961, etc. out of such asset.

Such asset or portion thereof has to be released within 120 days from the date on which the last of the authorizations for search under section 132 was executed.

In the present case, since the application was made to the Assessing Officer on 30.1.2018 i.e., within the 30 day period, the amount of existing liability may be recovered out of the cash seized and the balance cash may be released within 120 days from the date on which the last of the authorizations for search under section 132 was executed.

**Note** – As per section 132B, one of the conditions for release of an asset is that the nature and source of acquisition of the asset should be explained to the satisfaction of the Assessing Officer. However, in the facts of the question, it has been given that the assessee’s application for release of the asset, explaining the sources thereof, was turned down by the Department. If the application was turned down by the Department due to the reason that it was not satisfied with the explanation given by the assessee as to the nature and source of acquisition of the asset, then, the cash cannot be released, since the condition mentioned above is not satisfied.

(b) Section 264 provides that the Principal Commissioner or Commissioner has no power to revise any order which has been made the subject matter of an appeal to the Commissioner (Appeals), even if the relief claimed in the petition is different from the relief claimed in appeal. The concept of total merger would
apply in the case of section 264. It was so held by the Supreme Court in the case of *Hindustan Aeronautics Ltd v. CIT* (2000) 243 ITR 898.

Section 154 provides that where any matter had been considered and decided in any proceeding by way of appeal or revision relating to an order, Assessing Officer may amend the order for rectification of mistake apparent from the record, in relation to a matter other than the matter which has been considered and decided. The concept of partial merger would apply in the case of section 154.

In the present case, since the order passed by the Assessing Officer in respect of the addition of unexplained cash credit of Rs. 8 lakhs became the subject matter of an appeal to the Commissioner (Appeals), the assessee, AUM Enterprise cannot apply for revision under section 264 even if the subject matter of revision i.e., addition of Rs. 3 lakhs under section 40(a)(ia) is different from the subject matter of appeal.

However, AUM Enterprise can apply to the Assessing Officer for rectification of the order in respect of addition of Rs. 3 lakh under section 40(a)(ia), as this matter has not been considered and decided in any proceeding by way of appeal or revision. In the view of above, the assessee, AUM Enterprise should seek rectification under section 154.

(e) Mr. Pramod is deemed to have under-reported his income since he has not filed his return of income and his assessed income exceeds the basic exemption limit of Rs. 2,50,000. Hence, penalty under section 270A is leviable in his case.

**Computation of penalty leviable under section 270A**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Under-reported income:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total income assessed</td>
<td>14,00,000</td>
<td>2,50,000</td>
</tr>
<tr>
<td>(-) Basic exemption limit</td>
<td></td>
<td><strong>11,50,000</strong></td>
</tr>
<tr>
<td>Tax payable on Rs. 14,00,000 [being, under-reported income of Rs. 11,50,000 plus basic exemption limit of Rs. 2,50,000 [30% of Rs. 4 lakhs + Rs. 1,25,000]</td>
<td>2,45,000</td>
<td></td>
</tr>
<tr>
<td>Add: EC &amp; SHEC@3%</td>
<td>7,350</td>
<td><strong>2,52,350</strong></td>
</tr>
<tr>
<td><strong>Penalty leviable@50% of tax payable of Rs. 2,52,350</strong></td>
<td></td>
<td><strong>1,26,175</strong></td>
</tr>
</tbody>
</table>

*Note - The relevant assessment year for candidates appearing in May, 2018 examination is A.Y.2018-19. The rates of taxes for A.Y.2017-18 have also not been given in the question. The rate of tax for the income range Rs. 2,50,000 to Rs. 5,00,000 has been reduced from 10% to 5% for A.Y.2018-19. Therefore, if penalty is computed considering that Mr. Pramod has not furnished his return of income for A.Y. 2018-19, which is the relevant assessment year for May, 2018 Examination, the answer would be as follows:-*

“Mr. Pramod is deemed to have under-reported his income since he has not filed his return of income and his assessed income exceeds the basic exemption limit of Rs. 2,50,000. Hence, penalty under section 270A is leviable in his case.
<table>
<thead>
<tr>
<th>(-) Basic exemption limit</th>
<th>2,50,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax payable on Rs. 14,00,000 [being, under-reported income of Rs. 11,50,000 plus basic exemption limit of Rs. 2,50,000 [30% of Rs. 4 lakhs + Rs. 1,12,500]</td>
<td>11,50,000</td>
</tr>
<tr>
<td>Add: EC &amp; SHEC@3%</td>
<td>2,32,500</td>
</tr>
<tr>
<td>Penalty leviable@50% of tax payable</td>
<td>2,39,475</td>
</tr>
<tr>
<td>Add: Penalty leviable@50% of tax payable</td>
<td>1,19,738</td>
</tr>
</tbody>
</table>

(d) | Section | Default | Prosecution |
<table>
<thead>
<tr>
<th></th>
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</tr>
</thead>
<tbody>
<tr>
<td>(i) 276D</td>
<td>Willful failure to produce books of account and documents as required under section 142(1) or willful failure to comply with a direction to get the accounts audited under section 142(2A)</td>
<td>Rigorous imprisonment for a term which may extend to one year and with fine.</td>
<td></td>
</tr>
<tr>
<td>(ii) 276BB</td>
<td>Deliberate failure to deposit the tax collected under section 206C to the credit of the Central Government</td>
<td>Rigorous imprisonment for a term which shall not be less than three months but which may extend to seven years and with fine.</td>
<td></td>
</tr>
<tr>
<td>(iii) 275B</td>
<td>Failure to afford facility to the officer authorised as per section 132(1)(iib)</td>
<td>Rigorous imprisonment for a term which may extend to two years and with fine.</td>
<td></td>
</tr>
</tbody>
</table>

(e) As per UN Model Tax Convention, “royalty” means payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic, or scientific work including cinematograph films, or films or tapes used for radio or television broadcasting, any patent, trademark, design or model, plan, secret formula or process, or for the use of, or the right to use, industrial, commercial or scientific equipment, or for information concerning industrial, commercial or scientific experience”.

The definition of “royalty” in OECD Model Tax Convention is identical to the definition of “royalty” in UN Model Tax Convention except that the OECD Model specifically excludes the following from the definition of “royalty”:
- Rentals for “films or tapes used for radio or television broadcasting”;
- Equipment rentals like rentals for industrial, commercial or scientific equipment

In certain situations, the lease rental for industrial, commercial or scientific equipment may include an element of “royalty” (e.g. for use of a patent). In such cases, the lease rent may be treated as a “royalty” as per OECD Model Tax Convention to the extent it could be attributed to the use of the patent.

(f) Article 2 of Vienna Convention on Law of Treaties, 1969 defines “treaty” as an international agreement concluded between States in written form and governed by international law, whether embodied in a single instrument or in two or more related instruments and whatever its particular designation. Treaties (Double Tax Avoidance Agreements) come into play to mitigate hardship caused by subjecting the same income to double taxation.
Tax Treaties attempt to eliminate double taxation and try to achieve balance and equity. They aim at sharing of tax revenues by the concerned States on a rational basis.

Question 6

Answer

(a) As per section 251(1)(aa), in disposing of an appeal against the assessment order in respect of which the proceeding before the Settlement Commission abates under section 245HA, the Commissioner (Appeals) has the power to confirm, reduce, enhance or annul the assessment, after taking into consideration the following -

(1) all the material and other information produced by the assessee before the Settlement Commission in the course of the proceeding before it;
(2) the results of the inquiry held by the Settlement Commission in the course of the proceeding before it;
(3) the evidence recorded by the Settlement Commission in the course of the proceeding before it; and
(4) such other material as may be brought on his record.

(b) (i) [First Alternative]

(i) As per section 281B(1), the Assessing Officer is empowered to provisionally attach any property of Ms. Swati, by an order in writing, during the pendency of assessment or reassessment proceedings, with the prior approval of the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner or Principal Director General or Director General or Principal Director or Director, if he is of the opinion that it is necessary to do so for the purpose of protecting the interests of the revenue.

(ii) As per section 281B(2), the provisional attachment shall be valid for a period of 6 months from the date of the order issued for provisional attachment.

However, the income-tax authority may extend the period of provisional attachment, for reasons to be recorded in writing, by a further period as he thinks fit.

However, the total period of extension shall not exceed two years or sixty days after the date of assessment or reassessment, whichever is later.

(iii) Section 281B(3) empowers the Assessing Officer to revoke, by an order in writing, provisional attachment of property if Ms. Swati 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) [Second Alternative]

Denim Ltd. is an eligible start-up, since –

(1) it is a company engaged in eligible business of innovation, development, deployment and commercialization of new processes driven by technology.

(2) it is incorporated on 1.4.2017, which is during the period 1.4.2016 to 31.3.2019.
its total turnover does not exceed Rs. 25 crores in any previous year from P.Y.2017-18 to P.Y.2023-24.

(4) it holds a certificate of eligible business from the notified IMBC.

Therefore, Denim Ltd., being an eligible start-up, is eligible for deduction under section 80-IAC of 100% of the profits and gains derived by it from an eligible business for any three consecutive assessment years, at its option, out of seven years beginning from the year in which the eligible start up is incorporated i.e. P.Y.2017-18.

In the first and second year i.e., P.Y.2017-18 and P.Y. 2018-19, Denim Ltd. has incurred a loss. In the subsequent five years i.e., P.Y. 2019-20, P.Y. 2020-21, P.Y. 2021-22, P.Y. 2022-23 and P.Y. 2023-24, Denim Ltd. has earned profits from eligible business and can hence, claim 100% of its profits as deduction for any three consecutive assessment years under section 80-IAC from the P.Y.2019-20 to P.Y.2023-24.

However, for P.Y.2019-20, the profits eligible for deduction would be the profits after set-off of brought forward losses of P.Y.2017-18 and P.Y. 2018-19, i.e., Rs. 2.48 crores [i.e., Rs. 6.50 crores – Rs. 2.52 crores – Rs. 1.50 crores] would be the profits eligible for deduction under section 80-IAC in the P.Y.2019-20.

Since the profits eligible for deduction in the P.Y.2019-20 gets reduced due to set-off of earlier year losses, it would be advisable for Denim Ltd. to claim deduction in respect of any three years from P.Y.2020-21 to P.Y.2023-24.

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

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

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

Mr. B, the seller, can consider the stamp duty value of Rs. 2.20 lakhs per acre on 10.3.2017, being the date of agreement, as the full value of consideration as per section 50C for computation of capital gains (instead of the stamp duty value of Rs. 3 lakhs per acre on 10.5.2017, being the date of sale), since he has received an advance of Rs. 1 lakh by account payee cheque at the time of entering into an agreement.

In the hands of the buyer, Mr. A, Rs. 2 lakhs would be taxable under section 56(2) as “Income from other sources”, by considering the difference between the stamp duty value of Rs. 2.20 lakhs per acre on 10.3.2017 and the actual purchase price of Rs. 2 lakh per acre [(Rs. 2.20 lakhs – Rs. 2 lakhs) x 10 acres].

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

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

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

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

(d) (i) As per section 9(1)(vi)(b), any income by way of royalty payable by a person who is a resident would be deemed to accrue or arise in India in the hands of the recipient, except where the royalty is payable in respect of any right, property or information or services utilised for the purposes of business or profession carried on by such person outside India or for the purposes of making or earning any income from any source outside India.

Explanation 2 to section 9(1)(vi) defines “royalty” to mean consideration for the transfer of any right in respect of, inter alia, a process. Explanation 6 to section 9(1)(vi) clarifies that “process” includes transmission by satellite (including conversion for down-linking of any signal).

Accordingly, the payment made by XYZ Ltd., a resident in India (since it is an Indian company), for downlinking television channels into India and international footprint through the channel, would constitute “royalty”.

Such royalty income would be deemed to accrue or arise in India in the hands of the Malaysian company not having a PE in India, since it is paid by XYZ Ltd., a company resident in India in relation to its business in India.

(ii) As per section 9(1)(i)(e), in the case of a foreign company engaged in the business of mining of diamonds, no income shall be deemed to accrue or arise in India to it through or from the activities which are confined to display of uncut and unassorted diamonds in any notified special zone.

Since this benefit is available only in case of a foreign company engaged in the business of mining of diamonds, Mr. A, a foreign citizen and a diamond merchant from US, cannot avail of such benefit.

The income of Rs. 10 crores from display of uncut and unassorted diamonds would, accordingly, be deemed to accrue or arise in the hands of Mr. A by virtue of business connection in India.
MOCK TEST PAPER

FINAL (NEW) COURSE: GROUP - II
PAPER – 7: DIRECT TAX LAWS AND INTERNATIONAL TAXATION

Working Notes should form part of the answer. Wherever necessary, suitable assumptions may be made by the candidates and disclosed by way of a note. However, in answers to Question in Division A, working notes are not required.

All questions relate to Assessment Year 2019-20, unless stated otherwise in the question.

Time Allowed – 3 Hours Maximum Marks – 100

Division A – Multiple Choice Questions

Write the most appropriate answer to each of the following multiple choice questions by choosing one of the four options given. All questions in this division are compulsory.

1. Mr. A, aged 59 years, won Rs. 60 lakh and Mr. B, aged 50 years, won Rs. 8 lakh from lotteries. Tax deductible at source under section 194B was duly deducted. Assuming that this is the only source of income of Mr. A and Mr. B for A.Y.2019-20, are Mr. A and Mr. B liable to pay advance tax for that year?
   (a) No, Mr. A and Mr. B are not liable to pay advance tax as tax deductible at source under section 194B has been fully deducted.
   (b) Yes, Mr. A and Mr. B are liable to pay advance tax on the balance tax liability arising out of levy of higher education cess.
   (c) Mr. A is liable to pay advance tax but Mr. B is not liable to pay advance tax
   (d) Mr. B is liable to pay advance tax but Mr. A is not liable to pay advance tax

2. Mr. Vallish, employed as Manager with ABC Ltd. pays rent of Rs. 50,000 per month to his landlord. Which of the following statements are correct?
   (a) Mr. Vallish is liable to deduct tax@10% under section 194-I, since his annual rent exceeds Rs. 1,80,000.
   (b) Mr. Vallish is liable to deduct tax@5% under section 194-IB every month, since he pays rent of Rs. 50,000 per month.
   (c) Mr. Vallish is liable to deduct tax@5% under section 194-IB on the annual rent in the month of March, since he pays rent of Rs. 50,000 per month.
   (d) Mr. Vallish is not liable to deduct tax at source

3. Mr. Sanjay, a resident, and Mr. Andrew, a British citizen and a non-resident in India, are both sports commentators deriving income of Rs. 5 lakh from sports commentaries in India for A.Y. 2019-20.
   (i) Tax is deductible u/s 194J from remuneration payable to Mr. Sanjay
   (ii) Tax is deductible u/s 194E from remuneration payable to Mr. Andrew
   (iii) Tax is deductible u/s 195 from remuneration payable to Mr. Andrew
   (iv) Mr. Andrew is not required to file his return of income u/s 139, if tax deductible at source is fully deducted.
(v) Mr. Sanjay is not required to file his return of income u/s 139, if tax deductible at source is fully deducted.

Which of the above statements are correct, assuming that this is the only source of income for Mr. Sanjay and Mr. Andrew?
(a) (i), (ii) and (iv)
(b) (i), (ii), (iv) and (v)
(c) (i) and (iii)
(d) (i), (iii) and (iv)

4. Mr. X is aggrieved by an order passed under section 143(3) by the Assessing Officer. Mr. Y is aggrieved by an order passed under section 272A by the Director General. What is the remedy available to Mr. X and Mr. Y and the time limit within which they should exercise the remedy?
(a) Both Mr. X and Mr. Y have to file an appeal before Commissioner (Appeals) under section 246A within 30 days from the date on which the order sought to be appealed against is communicated to them.
(b) Both Mr. X and Mr. Y have to file an appeal before the Appellate Tribunal under section 253 within 60 days from the date on which the order sought to be appealed against is communicated to them.
(c) Mr. X has to file an appeal before Commissioner (Appeals) under section 246A within 30 days from the date of service of the notice of demand relating to the assessment. Mr. Y has to file an appeal before the Appellate Tribunal within 60 days from the date on which the order sought to be appealed against is communicated to him.
(d) Mr. Y has to file an appeal before Commissioner (Appeals) under section 246A within 60 days from the date on which the order sought to be appealed against is communicated to him. Mr. X has to file an appeal before the Appellate Tribunal within 30 days from the date of service of the notice of demand relating to the assessment.

5. Mr. Ram Mohan, a non-resident, operates an aircraft between Malaysia and Cochin. He received the following amounts while carrying on the business of operation of aircrafts for the year ended 31.3.2019:
(i) Rs. 2 crores in India on account of carriage of passengers from Cochin.
(ii) Rs. 1 crore in India on account of carriage of goods from Cochin.
(iii) Rs. 3 crores in India on account of carriage of passengers from Malaysia.
(iv) Rs. 0.50 crore in Malaysia on account of carriage of passengers from Cochin.
(v) Rs. 1.30 crores in Malaysia on account of carriage of passengers from Malaysia.
(vi) Rs. 1.20 crore in Malaysia on account of carriage of goods from Malaysia.
(vii) Rs. 0.50 crore in Malaysia on account of carriage of goods from Cochin.

The total expenditure incurred by Mr. Ram Mohan for the purposes of the business during the year ending 31.3.2019 was Rs. 3 crores. What is the income of Mr. Ram Mohan chargeable to tax in India under the head “Profits and gains of business or profession” for the A.Y.2019-20?
(a) Rs. 35 lakh  (b) Rs. 30 lakh
(c) Rs. 20 lakh  (d) Rs. 47.50 lakh

6. Alpha Ltd., an Indian company, provides contract R & D services relating to generic pharmaceutical drug, to Beta Inc., a Swiss company which guarantees 17% of the total

(2 Marks)
borrowings of Alpha Ltd. The aggregate value of such transactions entered into in the P.Y.2018-19 is Rs. 40 crores and the operating expenses are Rs. 30 crores. Assuming that Alpha Ltd. has exercised a valid option for application of safe harbour rules, what is the minimum operating profit margin to be declared by it, which can be accepted by the income-tax authorities?
(a) Rs. 5.4 crores
(b) Rs. 6.30 crores
(c) Rs. 7.20 crores
(d) Rs. 9.60 crores

7. As per section 245N(a)(iv), advance ruling means determination by the Authority for Advance Rulings or decision whether an arrangement, which is proposed to be undertaken by a person is an impermissible avoidance arrangement as referred to in Chapter X-A or not. For making an application in this regard, the applicant has to be -
(a) Only a Non-resident
(b) Only a Resident
(c) Only a Resident falling within such class or category of persons as notified by the Central Government
(d) Either a resident or a non-resident (1 Mark)

8. Gamma Ltd. has distributed on 15/12/2018 dividend of Rs. 460 lakhs to its shareholders. On 12/11/2018, Gamma Ltd. has received dividend of Rs. 120 lakhs from its domestic subsidiary company Phi Ltd., on which Phi Ltd. has paid dividend distribution tax under section 115-O. Compute the additional income-tax payable by Gamma Ltd. under section 115-O.
(a) Rs. 59,40,480
(b) Rs. 66,76,800
(c) Rs. 69,88,800
(d) Rs. 80,37,120

9. Mr. Hari has income of Rs. 52 lakhs under the head “Profits and gains of business or profession”. One of his businesses is eligible for deduction@100% of profits under section 80 -IA for A.Y.2019-20. The profit from such business included in the business income is Rs. 35 lakhs. Compute the tax payable (rounded off) by Mr. Hari for A.Y.2019-20, assuming that he has no other income during the P.Y.2019-20 and credit for alternate minimum tax, if any, to be carried forward -
(a) Rs. 3,35,400; AMT credit to be carried forward is Nil.
(b) Rs. 10,00,480; AMT credit to be carried forward is Rs. 6,65,080
(c) Rs. 11,00,530; AMT credit to be carried forward is Rs. 7,65,130
(d) Rs. 11,50,550; AMT credit to be carried forward is Rs. 8,15,150 (2 Marks)

10. A charitable trust was created on 1.4.2016 with the objective of relief of poor. It applied for registration in 1st November, 2017. The application was not disposed of by the Commissioner even after the expiry of period of 6 months stipulated under section 12AA(2). Which of the following statements are correct -
(a) Since the application has not been disposed of by the Commissioner, the trust is not deemed to be registered and hence, is not entitled to benefit of exemption under section 11 and 12 for any of the assessment years
(b) Since the application has not been disposed of by the Commissioner within the stipulated period, the trust is deemed to be registered with effect from 1.4.2016, being the date of creation of trust, and is entitled to benefit of exemption under sections 11 and 12 w.e.f. A.Y. 2017-18.
(c) Since the application has not been disposed of by the Commissioner within the stipulated period, the trust is deemed to be registered with effect from 1.11.2017, being the date of application for registration, and is entitled to benefit of exemption under sections 11 and 12 w.e.f. A.Y. 2018-19.
(d) Since the application has not been disposed of by the Commissioner within the stipulated period, the trust is deemed to be registered with effect from 1.6.2018, being the date immediately following the expiry of the six month period, but is entitled to benefit of exemption under sections 11 and 12 w.e.f. A.Y. 2018-19.

(2 Marks)

11. In the P.Y. 2018-19, Mr. Ganguly, a resident individual aged 60 years, earned income from profession (computed) Rs. 1,45,000, winnings from card games Rs. 1,50,000 (gross). He also has interest of Rs. 40,000 on fixed deposit with banks and Rs. 9,000 on savings bank account with banks. He deposited Rs. 1,50,000 in PPF. What is the total income of Mr. Ganguly for P.Y. 2018-19?
(a) Rs. 1,45,000 (b) Rs. 1,50,000 (c) Rs. 1,85,000 (d) Rs. 1,90,000

12. Dinesh, a resident individual of age of 47 years, has not furnished his return of income for the A.Y. 2019-20. However, his total income for such year as assessed u/s 144 is Rs. 18 lakhs. Is penalty under section 270A attracted and if so, what is the quantum of penalty?
(a) No; penalty under section 270A is not attracted since he has not filed his return of income, hence, this is not a case of underreporting or misreporting of income.
(b) Yes; penalty is Rs. 3,66,600, assuming it is a case of underreporting of income
(c) Yes; penalty is Rs. 1,83,300, assuming it is a case of underreporting of income
(d) Yes; penalty is Rs. 1,44,300, assuming it is a case of underreporting of income

(1 Mark)

13. The assessment of M/s. Epsilon Associates for A.Y. 2017-18 was made u/s 143(3) on 28th July, 2019. The Assessing Officer added Rs. 3 lakh being 30% of Rs. 10 lakh, for non-deduction of tax at source and Rs. 4 lakh on account of unexplained investments. The assessee contested the addition on account of unexplained investments in appeal before Commissioner (Appeals). The appeal was decided against the assessee in December, 2019. What is remedy available to the assessee in respect of disallowance under section 40(a)?
(a) The assessee can file an application for revision to the Commissioner under section 264
(b) The assessee can file an application for rectification under section 154, if it is a mistake apparent from the record
(c) The assessee can opt for either (a) or (b)
(d) The assessee can neither opt for remedy stated in (a) nor for remedy stated in (b)

(1 Mark)

14. The Assessing Officer within his jurisdiction surveyed a popular Cyber Café at 1 a.m. in night for the purpose of collecting information which may be useful for the purposes of the Income-tax Act, 1961. The Cyber Café is kept open for business every day between 2 p.m. and 2 a.m. He impounded and retained in his custody, books of account and other documents inspected by him, after recording his reasons for doing so, for 12 days. Which of the following statements are correct?
(a) The Assessing Officer’s action in entering the cyber café at 1 a.m. and impounding books of account and documents inspected by him are in order.
(b) The Assessing Officer’s action in entering the cyber café at 1 a.m. is not in order, since he can enter the cyber café only after sunrise but before sunset
(c) The Assessing Officer’s action in entering the cyber café at 1 a.m. and in impounding books of account and documents inspected by him are not in order, since he can enter the cyber café only after sunrise but before sunset and he does not have the power to impound books of account under section 133B

(d) The Assessing Officer’s action in entering the cyber café at 1 a.m. is in order but impounding books of account and documents inspected by him is not in order, since he does not have the power to impound books of account under section 133B

15. Mr. X made a fixed deposit of Rs. 12,000 with a non-banking finance company (NBFC) on 1.4.2018 in cash. Thereafter, he made another fixed deposit of Rs. 7,500 with the same NBFC on 1.8.2018 by bearer cheque. On 31.3.2019, he made yet another fixed deposit of Rs. 8,000 with the same NBFC by an account payee cheque. Which of the following statements are correct?

(a) Penalty under section 271D is attracted at the time of acceptance of first deposit on 1.4.2018
(b) Penalty under section 271D is attracted at the time of acceptance of second deposit on 1.8.2018
(c) Penalty under section 271D is attracted at the time of acceptance of third deposit on 31.3.2019
(d) Penalty under section 271D is not attracted. (1 Mark)


(a) The action of the Assessing Officer is not correct, since notice u/s 148 can be issued only in respect of A.Y.2016-17 to A.Y.2018-19.
(b) The action of the Assessing Officer is not correct, since notice u/s 148 can be issued only in respect of A.Y.2013-14 to A.Y.2018-19.
(c) The action of the Assessing Officer is not correct, since notice u/s 148 can be issued only in respect of A.Y.2011-12 to A.Y.2018-19.
(d) The action of the Assessing Officer in issuing notice u/s 148 in respect of A.Y.2008-09 to A.Y.2018-19 is correct, since notice u/s 148 can be issued within 16 years from the end of the relevant assessment year, in case income in relation to any asset outside India has escaped assessment. In this case, income chargeable to tax is deemed to have escaped assessment since Mr. Kamesh owns assets located outside India. (1 Mark)

17. Mr. Rajesh is engaged in the profession of technical consultancy and his gross receipts for the P.Y.2018-19 is Rs. 45 lakhs. He does not maintain books of account. He is also a partner of a LLP, Rajesh LLP, which carries on the profession of technical consultancy. The gross receipts of Rajesh LLP during the P.Y.2018-19 is Rs. 48 lakhs. Which of the following statements are correct?

(a) Mr. Rajesh and Rajesh LLP have to pay entire advance tax on or before 15th March, 2019
(b) Mr. Rajesh does not have to pay advance tax. However, Rajesh LLP has to pay the entire advance tax on or before 15th March.
(c) Mr. Rajesh does not have to pay advance tax. However, Rajesh LLP has to pay advance tax in four instalments.
(d) Mr. Rajesh has to pay entire advance tax on or before 15th March and Rajesh LLP has to pay advance tax in four instalments.  
(2 Marks)

18. Mr. Rajan purchased 300 shares in Vaigai Ltd. on 12.1.2017 at a cost of Rs. 2,500 per share. The Fair Market Value (FMV) of the share as on 31.1.2018 is Rs. 1,800. Mr. Vaigai sold all the shares of Cauvery Ltd. on 15.7.2018 for Rs. 3,200. Mr. Rajan’s brother Mr. Ravi purchased 600 shares in Tapti Ltd. on 25.1.2017 at a cost of Rs. 1,900 per share. The FMV of the share as on 31.1.2018 is Rs. 2,400. Mr. Ravi sold all the shares of Tapti Ltd. on 31.1.2019 for Rs. 1,700 per share. What is the chargeable capital gains on sale of shares of Vaigai Ltd. and Tapti Ltd. in the hands of Mr. Rajan and Mr. Ravi, respectively, for A.Y. 2019-20?

(a) Long-term capital gains of Mr. Rajan Rs. 2,10,000; Long-term capital loss of Mr. Ravi Rs. 4,20,000
(b) Long-term capital gains of Mr. Rajan Rs. 4,20,000; Long-term capital loss of Mr. Ravi Rs. 4,20,000
(c) Long-term capital gains of Mr. Rajan Rs. 4,20,000; Long-term capital loss of Mr. Ravi Rs. 1,20,000.
(d) Long-term capital gains of Mr. Rajan Rs. 2,10,000; Long-term capital loss of Mr. Ravi Rs. 1,20,000.  
(2 Marks)

19. The Settlement Commission passed an order on 25.6.2018 under section 245D(4). The applicant noticed a mistake apparent from the record and filed an application for rectification on 3.7.2018. Under section 245D(6B), the Settlement Commission can amend its order on or before -

(a) 25.12.2018  (b)31.12.2018  (c)3.1.2019  (d)31.1.2019  
(1 Mark)

20. Under which of the following methods, arm’s length price shall be the arithmetical mean of all values included in the dataset, irrespective of the number of entries in the dataset. It may be assumed that the variation between the arm’s length price computed and the transaction price is 5%.

(a) Profit split method  (b) Resale price method
(c) Cost plus method  (d) Transactional net margin method  
(1 Mark)
Division B – Descriptive Questions

Question No. 1 is compulsory

Attempt any four questions from the remaining five questions.

1. The statement of profit & loss of Trust Me Private Ltd., a resident company engaged in manufacturing, shows net profit of Rs. 77,00,000 for the financial year ended on 31st March, 2019, after debit/credit of the following items.

A. Credited to the Statement of Profit and Loss:
   (i) Rent received from vacant land Rs. 2,05,000
   (ii) Rent received (gross) from a commercial property owned by the company Rs. 4,30,000 (Tax deducted by tenant @ 10%)
   (iii) Interest received on income tax refund Rs. 42,000
   (iv) Profit on sale of unused land Rs. 2,00,000.

B. Debited to the Statement of Profit and Loss:
   (i) Depreciation Rs. 11,75,000.
   (ii) Donation of Rs. 70,000 paid to Swachh Bharat Kosh by accountpayee cheque.
   (iii) Contribution to Political Party amounting to Rs. 1,50,000 paid in cash.
   (iv) Payment made to transporter Rs. 60,000 by account payee cheque, but no tax has been deducted at source. (Transporter is having PAN and furnished declaration that he is covered under section 44AE and not having more than 10 goods carriages at any time during the previous year).
   (v) Bonus to employees Rs. 3,20,000 provided. However, payment was made on the occasion of Diwali festival on 2nd November, 2019.
   (vi) Provision made for income-tax Rs. 4,20,000 (including interest of Rs. 70,000 thereon)
   (vii) Contribution of Rs. 1,00,000 to a University approved and notified under section 35(1)(ii)
   (viii) Loss of Rs. 1,80,000 incurred by way of trading in derivatives in shares in a recognized stock exchange.

Additional information:
(1) The company during the financial year 2017-18 made a provision for an outstanding bill of Rs. 90,000 for purchase of raw material. Out of such outstanding amount, the company has paid Rs. 45,000 in cash on 20th August, 2018.
(2) During the year, the company has issued 1,00,000 equity shares of face value of Rs. 10 each at premium of Rs. 90 each. The fair market value is Rs. 60 per share at the time of issue of shares.
(3) Unused land which was sold in March, 2019 for Rs. 52,00,000 was acquired by the company in January, 2017 for Rs. 50,00,000.
(4) Depreciation as per Income-tax Act, 1961 Rs. 18,00,000. However, while calculating such depreciation, rate applicable to computers has been adopted for (i) accessories like printers and scanners, and (ii) EPABX. The written down value of these items as on 01.04.2018 is given below:
   (a) Printers and Scanners Rs. 3,00,000
   (b) EPABX Rs. 5,00,000
(5) Additional depreciation on plant and machinery purchased for Rs. 34,00,000 on 18th November, 2018 has not been considered while calculating depreciation as per Income-tax Act, 1961 as above.

(6) Provision for audit fee Rs. 1,00,000 was made in the books for the year ended on 31st March, 2018 without deducting tax at source.
Such fee was paid to auditors in September 2018 after deducting tax at source under section 194J and tax so deducted was deposited on 6th October, 2018.

Cost Inflation Index – FY 2016-17: 264; FY 2018-19: 280
Compute total income of the company for the Assessment Year 2019-20 stating reasons for treatment of each item. Ignore provisions relating to Minimum Alternate Tax.

2.  
(a) M/s. Jeevan Pvt. Ltd., a closely held company, is in the business of growing rubber. The profit & loss account for the year ended 31-03-2019 of the company shows a net profit Rs. 37.65 crores after debiting depreciation of Rs. 30 crores. The company has provided the following additional information:
   (i) The company has deposited Rs. 30 crores in a special account with NABARD on 29-04-2019.
   (ii) The company has brought forward losses of Rs. 6 crores pertaining to Assessment Year 2016-17. Mr. Alok who continuously held 60% of shares carrying voting power since incorporation of the company, had sold his entire holding to Mr. Bhola on 01-08-2018.
   (iii) The company had an accumulated balance of Rs. 200 crores in the special account with NABARD as on 01-04-2018. It has withdrawn Rs. 40 crores and utilized the same for the following purposes:
       • Purchase of a new machine for use in its operation Rs. 10 crores,
       • Purchase of office appliances for corporate office at Hyderabad Rs. 10 crores.
       • Purchase of computers and accessories Rs. 5 crores.
       • Construction of a godown at a cost of Rs. 1 crore near the rubber estate to store raw rubber.
       • Repairs to machinery Rs. 35 lakhs.
   (iv) Depreciation allowable as per Tax Audit Report is Rs. 28 crores.
Compute Taxable and Exempt income of M/s. Jeevan (P) Ltd. (8 Marks)

(b) Compute total income and tax payable by Madhuvan, a senior citizen for the A.Y. 2019-20, from the following information:
   (i) Taxable income from a sole-proprietary concern in Ranchi Rs. 50 lakhs.
   (ii) Share of profit from a partnership firm in Bhopal Rs. 30 lakhs.
   (iii) Agricultural Income from rubber estate in Country T which has no DTAA with India, USD 70000 (Gross). Withholding Tax on the above income USD 10500.
   (iv) Brought forward Business Loss of A.Y. 2016-17 in Country T was USD 10000 which is not permitted to be set off against other income as per the laws of that country.

Note: 1 USD = Rs 64
3. (a) (i) Seva charitable trust registered under section 12AA of the Income-tax Act, 1961 has, out of its income of Rs. 4,90,000 for the year ending 31.3.2019 and sale proceeds of a capital asset, held by it for less than 24 months, amounting to Rs. 10,60,000, purchased a building during the year ending 31.3.2019 for Rs. 15,50,000. The capital asset was sold during the year ending 31.3.2019. The building is held only for charitable purposes. The trust claims that the purchase of the building amounts to application of its income for charitable purposes and that the capital gain arising on the sale of the capital asset is deemed to have been applied to charitable purposes. Is the claim made by the charitable trust valid in law? (4 Marks)

(ii) A Mannat charitable trust registered under Section 12AA, for the previous year ending 31.3.2019, derived gross income of Rs. 21 Lacs, which consists of the following:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>(Rs. in Lacs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) Income from properties held by trust (net)</td>
<td>10</td>
</tr>
<tr>
<td>(b) Income (net) from business (incidental to main objects)</td>
<td>4</td>
</tr>
<tr>
<td>(c) Voluntary contributions from public</td>
<td>7</td>
</tr>
</tbody>
</table>

The trust applied a sum of Rs. 11.60 lacs towards charitable purposes during the year which includes repayment of loan taken for construction of orphanage Rs. 3.60 lacs. Determine the taxable income of the trust for the assessment year 2019-20. (4 Marks)

(b) (i) Examine the tax consequence for Assessment Year 2019-20 in respect of fees for technical services (FTS) received by Mr. Richard Grill, a non-resident, from Trim Ltd., an Indian company, in pursuance of an agreement approved by the Central Government, if -

(I) India has no Double Tax Avoidance Agreement (DTAA) with Country F

(II) India has a DTAA with Country F, which provides for taxation of such FTS@5%.

(III) India has a DTAA with Country F, which provides for taxation of such FTS@15%.

Assume that Richard Grill is a resident of Country F and he has no fixed place of his profession in India. The technical services are utilised by Trim Ltd. for its business in Indore. (3 Marks)

(ii) If Zing Inc., a UK based company has a permanent establishment in India and the contract/agreement with Swing Ltd. for rendering technical services is effectively connected with such PE in India, examine the taxability based on the following details provided –

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1) Fees for technical services received from Swing Ltd.</td>
<td>Rs. 3.5 crore</td>
</tr>
<tr>
<td>(2) Expenses incurred for earning such income</td>
<td>Rs. 10 lakhs</td>
</tr>
<tr>
<td>(3) Fees for technical services received from other Indian companies in pursuance of approved agreement entered into between the years 2005 to 2010</td>
<td>Rs. 5.5 crore</td>
</tr>
<tr>
<td>(4) Expenses incurred for earning such income</td>
<td>Rs. 12 lakhs</td>
</tr>
<tr>
<td>(5) Expenditure not wholly and exclusively incurred for the business of such PE [not included in (2) &amp; (4) above]</td>
<td>Rs. 6 lakhs</td>
</tr>
<tr>
<td>(6) Amounts paid by the PE to Head Office (not being in the nature of reimbursement of actual expenses)</td>
<td>Rs. 12 lakhs</td>
</tr>
</tbody>
</table>
What are the other requirements, if any, under the Income-tax Act, 1961 in this case?

4. (a) (i) T Ltd., a manufacturer of automobiles, sells premium model cars, the value of which ranges from above Rs. 10 lakh to Rs. 50 lakh and small cars, value of which ranges from Rs. 5 lakh up to Rs. 10 lakh to its dealers across the country. Examine whether T Ltd. is liable to collect tax at source under section 206C on sale of these cars to the different dealers across the country.

Also, examine the liability, if any, of dealers to collect tax at source on sale of these cars to the retail customers, if no part of the consideration is received in cash. (4 Marks)

(ii) M/s Fitband Limited entered into an agreement for the warehousing of its products with Star Warehousing and deducted tax at source as per provisions of section 194C out of warehousing charges paid during the year ended on 31.03.2019. The Assessing Officer, while completing the assessment for A.Y. 2019-20 of Fitband Limited in April 2020, treated the warehousing charges as rent as defined in section 194-I and asked the company to make payment of difference amount of TDS with interest. It was submitted by the company that the recipient had already paid tax on the entire amount of warehousing charges and therefore, now the difference amount of TDS cannot be recovered. However, it will make the payment of due interest on the difference amount of TDS. Examine critically in the context of provisions contained in Income-tax Act, 1961 as to the correctness of the submission of M/s. Fitband Ltd. (4 Marks)

(b) Examine whether transfer pricing provisions under the Income-tax Act, 1961 would be attracted in respect of the following cases -

(i) Scientific research services provided by L Inc., an Italian company to X Ltd., an Indian company. L Inc. is a “specified foreign company” as defined in section 115BBD, in relation to X Ltd.

(ii) Ms. Chiya, a resident Indian, is a director of T Ltd, an Indian company. T Ltd. pays salary of Rs. 40 lakhs per annum to Samya, who is Ms. Chiya’s daughter.

(iii) Transfer of technical knowhow by Y Ltd., an Indian company, to A Inc, a French company, which guarantees 15% of the borrowings of Y Ltd. (6 Marks)

5. Attempt either 5(a)(i) OR 5(a)(ii)

(a) (i) The Commissioner of Income-tax issued notice to revise the order passed by an Assessing Officer under section 143. During the pendency of proceedings before the Commissioner, on the basis of material gathered during survey under section 133A after issue of the first notice, the Commissioner of Income-tax issued a second notice, the contents of which were different from the contents of the first notice. Examine whether the action of the Commissioner is justified as to the second notice. (4 Marks)

OR
(ii) (I) In an order of assessment for the A.Y. 2018-19, the assessee noticed a mistake for which application under section 154 was moved and the order was rectified. Subsequently, the assessee moved further application for rectification under section 154 which was rejected by the Assessing Officer on the ground that the order once rectified cannot be rectified again. Examine the correctness or otherwise of the contention of the Assessing Officer. (2 Marks)

(II) The return for A.Y.2019-20 was filed on time as per section 139(1) and proceedings were taken up for assessment under section 143(3). Later on, the assessee, noticed certain omissions and therefore filed a revised return on 20.4.2020. The Assessing Officer ignoring the revised return so filed framed the order on 25.4.2020. Is the action of Assessing Officer correct? Examine. (2 Marks)

(iii) Theory Diagnostics is a diagnostic laboratory in Kanpur and has a branch at Lucknow. A survey under section 133A was conducted, consequent to which the assessee filed return of income. On the basis of certain incriminating documents and materials unearthed during the survey, a notice under section 148 was issued. Subsequently, the incom es were assessed for assessment years 2017-18 and 2018-19 under section 143(3) read with section 147.

The assessee raised additional jurisdictional grounds before the Appellate Tribunal. The assessee contended that for the relevant assessment years, the assessment was completed under section 143(3) read with section 147. However, a notice under section 143(2) was not issued by the Assessing Officer for those years. The Tribunal held that in view of section 292BB, the assessee’s participation in the reassessment proceedings would condone the omission to issue a notice.

Discuss, with the aid of a Supreme Court case law, whether failure to issue notice under section 143(2) would vitiate the assessment notwithstanding the assessee’s participation in the proceedings. Would section 292BB come to the rescue of the Revenue authority if they omit to issue notice under section 143(2)? Examine. (4 Marks)

(b) What is the meaning of, and difference between, a hybrid mismatch and branch mismatch? Briefly mention the reasons why hybrid mismatch arrangements arise. Which Action Plan of BEPS gives recommendations in this regard? (6 Marks)

6. (a) (i) Examine the following cases and state whether the same are liable for penalty as per the provisions of the Income-tax Act, 1961.

(I) Harish & Associates had made payment in excess of the limits prescribed to the contractors for carrying out labour job work at various sites, but had not deducted tax at source as per section 194C.

(II) Sunshine Hotels were asked by Income-tax Officer (CIB) to furnish details of all such tourists who stayed in their hotels and had paid bill amount in excess of Rs. 10,000. They have not furnished the requisite information in spite of various reminders. (4 Marks)

(ii) (I) The merger of a loss making company with a profit making one results in losses setting off profits, a lower net profit and lower tax liability for the merged company. Would the losses be disallowed by applying GAAR?
(II) In the above facts, let us presume, the profit making company merges with a loss making one. This results in losses setting off profits, a lower net profit and lower tax liability for both companies taken together. Can this be examined under GAAR? (4 Marks)

(b) (i) LMN Ltd., an Indian company, is carrying on the business of manufacture and sale of Indo-western Apparels under the brand name “STYLE&SHINE”. In order to expand its overseas sales/exports, it launched a massive advertisement campaign of its products. For the purpose of online advertisement, it utilized the services of Xylo Inc., a London based company. During the previous year 2018-19, LMN Ltd. paid Rs. 15 lakhs to Xylo Inc. for such services. Discuss the tax implications/TDS implications of such payment and receipt in the hands of LMN Ltd. and Xylo Inc., respectively, if Xylo Inc. has no permanent establishment in India.

(ii) Mr. Sarthak, a non-resident, made an application to the Authority for Advance Rulings on 10.8.2018 in relation to a transaction proposed to be undertaken by him. On 13.9.2018, he decides to withdraw the said application. Can he withdraw the application on 13.9.2018? Examine. (3 Marks)
manufacturing as per section 70(1) since it is not speculative in nature  
[See Note below]

III Capital Gains
Sale consideration 52,00,000
Less: Indexed Cost of Acquisition [Rs. 50,00,000 × 280/264] 53,03,030
Long-term capital loss to be carried forward to A.Y.2020-21 for set-off against long-term capital gains, if any, in that year (1,03,030)

IV Income from Other Sources
Rent received from vacant land 2,05,000
Interest received on income-tax refund 42,000
Excess of issue price of shares over the fair market value of shares is taxable as per section 56(2)(viib) in the case of TrustMe Private Ltd., not being a company in which public are substantially interested [Rs. 40 (i.e., Rs. 100 – Rs. 60) × 1,00,000 shares] -

Gross Total Income 1,14,56,000
Less: Deductions under Chapter VI-A
Deduction under section 80G
Donation to Swachh Bharat Kosh [qualifies for 100% deduction – assuming that the same has not been spent in pursuance of corporate social responsibility under section 135(5) of the Companies Act, 2013] 70,000
Deduction under section 80GGB
Contribution to Political Party [Not allowable as deduction since the contribution is made in cash] Nil 70,000

Total Income 1,13,86,000

Working Note:
Computation of profits and gains from the business of manufacturing

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Amount (Rs.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net profit as per statement of profit and loss</td>
<td>77,00,000</td>
</tr>
<tr>
<td>Add: Items debited but to be considered separately or to be disallowed</td>
<td></td>
</tr>
<tr>
<td>B(ii) Donation paid to Swachh Bharat Kosh, considered separately</td>
<td>70,000</td>
</tr>
<tr>
<td>[Not an expenditure incurred wholly and exclusively for the manufacturing business. Hence, not allowable under section 37]</td>
<td></td>
</tr>
<tr>
<td>B(iii) Contribution to political party</td>
<td>1,50,000</td>
</tr>
<tr>
<td>[Not an expenditure incurred wholly and exclusively for the manufacturing business. Hence, not allowable u/s 37]</td>
<td></td>
</tr>
<tr>
<td>B(iv) Payment to transport contractor</td>
<td>-</td>
</tr>
<tr>
<td>[As per section 194C(6), no tax is required to be deducted at source since the payment is to a transport contractor not having more than 10 goods carriages at any time during the previous year and he has given a declaration to that effect along with his PAN. Hence, disallowance under section 40(a)(ia) for non-deduction of tax at source is not attracted.</td>
<td></td>
</tr>
</tbody>
</table>
Also, since payment is made by account payee cheque, no disallowance under section 40A(3) is attracted.

B(v) Bonus to employees  
[Since the payment is made after the due date of filing return of income, disallowance under section 43B is attracted]

B(vi) Provision for income-tax (including interest of Rs. 70,000 thereon)  
[Not allowable as deduction. Disallowance under section 40(a)(ii) is attracted]

B(viii) Loss from trading in derivatives in shares in a recognized stock exchange [See Note below]  
[Since loss from trading in derivatives in shares is not related to the business of manufacturing, the same is not incurred wholly and exclusively for this business, and hence, is not allowable as deduction under section 37 while computing profits from the business of manufacturing]

Add: Cash Payment for purchase of raw material deemed as income  
AI(1) [Since the provision for outstanding bill for purchase of raw material has been allowed as deduction during the P.Y.2017-18, cash payment in excess of Rs. 10,000 against such bill in the P.Y.2018-19 would be deemed as income of P.Y.2018-19 as per section 40A(3A)]

Less: Expenditure to be allowed  
B(i) & AI(4) Depreciation  
[Difference between the normal depreciation of Rs. 16.75 lakhs as per Income-tax Act, 1961 [See Note below] and depreciation charged to the statement of profit and loss of Rs. 11.75 lakhs].

Note – Printers and scanners form an integral part of the computer system and they cannot be used without the computer. Hence, they are part of the computer system, they would be eligible for depreciation at the higher rate of 40% applicable to computers including computer software. However, EPABX is not a computer and is, hence, not entitled to higher depreciation@40%

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Depreciation computed as per Income-tax Act, 1961</td>
<td>18,00,000</td>
</tr>
<tr>
<td>Less: Depreciation@40% wrongly provided in respect of EPABX = 40% of Rs. 5,00,000</td>
<td>2,00,000</td>
</tr>
<tr>
<td>Add: Depreciation@15% on EPABX = 15% of Rs. 5,00,000</td>
<td>16,00,000</td>
</tr>
<tr>
<td>Correct Depreciation as per Income-tax Act, 1961</td>
<td>16,75,000</td>
</tr>
<tr>
<td>AI(5) Additional depreciation on new plant and machinery</td>
<td></td>
</tr>
</tbody>
</table>
Since plant and machinery was purchased only on 18.11.2018, it was put to use for less than 180 days during the year. Hence additional depreciation is to be restricted to 10% (i.e., 50% of 20%) of Rs. 34 lakhs.

Al(6) Audit Fees relating to P.Y.2017-18

[Rs. 30,000, being 30% of audit fees of Rs. 1,00,000 provided for in the books of account of F.Y.2017-18 would have been disallowed due to non-deduction of tax at source. Since tax has been deducted in September, 2018 and paid on 6.10.2018, the amount of Rs. 30,000 is deductible while computing business income of P.Y.2018-19].

B(vii) Contribution to University

[Contribution to a University approved and notified under section 35(1)(ii) would qualify for weighted deduction@150%. Since Rs. 1,00,000 has already been debited to the statement of profit and loss, the balance Rs. 50,000 has to be deducted while computing business income]

<table>
<thead>
<tr>
<th>Less: Items credited to statement of profit and loss, but not includible in business income.</th>
</tr>
</thead>
<tbody>
<tr>
<td>A(i) Rent received from vacant land [Chargeable to tax under the head “Income from other sources”]</td>
</tr>
<tr>
<td>A(ii) Rent received from commercial property owned by the company [Chargeable to tax under the head “Income from house property”]</td>
</tr>
<tr>
<td>A(iii) Interest received on income tax refund [Chargeable to tax under the head “Income from other sources”]</td>
</tr>
<tr>
<td>A(iv) Profit on sale of unused land [Chargeable to tax under the head “Capital Gains”]</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Profits and gains from the business of manufacturing</th>
</tr>
</thead>
<tbody>
<tr>
<td>70,88,000</td>
</tr>
</tbody>
</table>

Note: As per section 43(5), an eligible transaction of trading in derivatives in shares in a recognized stock exchange is not a speculative transaction.

In this case, the company is engaged in the business of manufacturing and hence, the loss on account of trading in derivatives is not incurred wholly and exclusively in relation to such business and hence, has to be disallowed while computing profits from the business of manufacturing. Trading in derivatives in shares is also not incidental to the business of manufacturing. Therefore, it has to be assumed that the company is also carrying on the business of trading in derivatives in shares in addition to its manufacturing business.

In this case, the loss has to be disallowed at the first instance while computing income from the business of manufacturing since it is not wholly and exclusively incurred for the said business and thereafter, loss from trading in derivatives has to be set-off against the profits from manufacturing business applying the provisions of section 70(1) permitting inter-source set-off of losses.
2. (a) Computation of Taxable and Exempt Income of M/s Jeevan Pvt Ltd. for the A.Y. 2019-20

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net profit as per Profit and Loss Account</td>
<td>37,65,00,000</td>
</tr>
<tr>
<td>Add: Excess depreciation as per books of account</td>
<td></td>
</tr>
<tr>
<td>Depreciation as per books of account</td>
<td>30,00,00,000</td>
</tr>
<tr>
<td>Less: Depreciation allowable as per the Income-tax Act, 1961</td>
<td>28,00,00,000</td>
</tr>
<tr>
<td>Net profit before allowing deduction under section 33AB</td>
<td>39,65,00,000</td>
</tr>
<tr>
<td>Less: Deduction under section 33AB would be the lower of:</td>
<td></td>
</tr>
<tr>
<td>- Amount deposited in Rubber Development Account on or before 30.9.2019</td>
<td>15,86,00,000</td>
</tr>
<tr>
<td>[i.e., Rs. 30,00,00,000]</td>
<td></td>
</tr>
<tr>
<td>- 40% of profits of such business [i.e., Rs. 15,86,00,000, being 40% of</td>
<td>15,86,00,000</td>
</tr>
<tr>
<td>Rs. 39,65,00,000]</td>
<td></td>
</tr>
<tr>
<td>Net profit after allowing deduction under section 33AB</td>
<td>23,79,00,000</td>
</tr>
<tr>
<td>Add: Amount withdrawn from special account with NABARD, which is deemed</td>
<td></td>
</tr>
<tr>
<td>as profits and gains of business or profession</td>
<td></td>
</tr>
<tr>
<td>(i) Purchase of a new machine for use in its operation for Rs. 10 crores,</td>
<td>Nil</td>
</tr>
<tr>
<td>would not be deemed as profits and gains of business or profession,</td>
<td></td>
</tr>
<tr>
<td>since the said amount is utilised as per the specified scheme.</td>
<td></td>
</tr>
<tr>
<td>(ii) Purchase of office appliances for corporate office at Hyderabad for</td>
<td>10,00,00,000</td>
</tr>
<tr>
<td>Rs. 10 crores, out of the amount withdrawn from the deposit account,</td>
<td></td>
</tr>
<tr>
<td>would be deemed as profits and gains of business or profession, since</td>
<td></td>
</tr>
<tr>
<td>the said utilisation is not permissible.</td>
<td></td>
</tr>
<tr>
<td>(iii) Rs. 5 crores utilised for purchase of computers and accessories</td>
<td>Nil</td>
</tr>
<tr>
<td>is permissible. Thus, such amount would not be deemed as profits and</td>
<td></td>
</tr>
<tr>
<td>gains of business or profession.</td>
<td></td>
</tr>
<tr>
<td>(iv) Rs. 1 crore utilised for construction of a godown near rubber estate</td>
<td>Nil</td>
</tr>
<tr>
<td>to store raw rubber, would not be deemed as profits and gains of</td>
<td></td>
</tr>
<tr>
<td>business or profession, since the said amount is utilised as per the</td>
<td></td>
</tr>
<tr>
<td>specified scheme.</td>
<td></td>
</tr>
<tr>
<td>(v) Rs. 35 lakhs utilized for repairs to machinery would not be deemed</td>
<td>Nil</td>
</tr>
<tr>
<td>as profits and gains of business or profession, since the said amount</td>
<td></td>
</tr>
<tr>
<td>is utilised as per the specified scheme.</td>
<td></td>
</tr>
<tr>
<td>Note - However, no deduction would be allowed in respect of such</td>
<td></td>
</tr>
<tr>
<td>expenditure mentioned in (i), (iii), (iv) and (v) during the P.Y.</td>
<td></td>
</tr>
<tr>
<td>2018-19, since amount is spent out of the amount deposited in a</td>
<td></td>
</tr>
<tr>
<td>special account with NABARD, which has already been allowed as</td>
<td></td>
</tr>
<tr>
<td>deduction in an earlier assessment year.</td>
<td></td>
</tr>
<tr>
<td>(vi) The remaining amount of Rs. 13.65 crores [Rs. 40 crores less Rs.</td>
<td></td>
</tr>
<tr>
<td>26.35 crores [utilised above in (i) to (v)], which is not utilised</td>
<td>13,65,00,000</td>
</tr>
<tr>
<td>during the previous year in which such amount is utilised, would be</td>
<td></td>
</tr>
<tr>
<td>deemed as profits and gains of business or profession.</td>
<td></td>
</tr>
<tr>
<td>Total Composite business profits</td>
<td>47,44,00,000</td>
</tr>
<tr>
<td>Less: 65% of Rs. 47,44,00,000, being agricultural income exempt</td>
<td>30,83,60,000</td>
</tr>
<tr>
<td>Business income</td>
<td>16,60,40,000</td>
</tr>
</tbody>
</table>
| Less: Brought forward business loss of Rs. 6 crores pertaining to
A.Y. 2016-17 not allowed to be set-off against the business profits of the P.Y. 2018-19, since as on 31.3.2019, the shares of M/s Jeevan Pvt Ltd carrying 60% (i.e., not less than 51%) of the voting power is held by Mr. Bhola and not by Mr. Alok, being the person who held such shares as on 31.03.2016, being the last day of previous year 2015-16, in which such loss was incurred.

### Business income chargeable to tax

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Business income chargeable to tax</td>
<td>16,60,40,000</td>
</tr>
</tbody>
</table>

(b) Computation of total income and tax payable of Madhuvan for A.Y. 2019-20

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profits and gains from business and profession</td>
<td></td>
</tr>
<tr>
<td>Income from sole proprietary concern in India</td>
<td>50,00,000</td>
</tr>
<tr>
<td>Share of profit from a partnership firm in India of Rs. 30 lakhs, is exempt</td>
<td>Nil</td>
</tr>
<tr>
<td>Business profit</td>
<td>50,00,000</td>
</tr>
<tr>
<td>Less: Business Loss in Country T (USD 10,000 x Rs. 64/USD)</td>
<td>6,40,000</td>
</tr>
<tr>
<td>Income from Other Sources</td>
<td></td>
</tr>
<tr>
<td>Agricultural income from rubber estate in Country T, is taxable in India (USD 70,000 x Rs. 64/USD)</td>
<td>44,80,000</td>
</tr>
<tr>
<td>Gross Total Income/ Total Income</td>
<td>88,40,000</td>
</tr>
<tr>
<td>Tax on total income</td>
<td></td>
</tr>
<tr>
<td>Tax on Rs. 88,40,000 [(30% x Rs. 78,40,000 plus Rs. 1,10,000) applicable for an individual, resident in India who is of the age of 60 years or more]</td>
<td>24,62,000</td>
</tr>
<tr>
<td>Add: Surcharge@10%, since total income exceeds Rs. 50 lakhs</td>
<td>2,46,200</td>
</tr>
<tr>
<td>Add: Health &amp; Education cess @4%</td>
<td>1,08,328</td>
</tr>
<tr>
<td>Average rate of tax in India [i.e., Rs. 28,16,528/Rs. 88,40,000 x 100]</td>
<td>31.86%</td>
</tr>
<tr>
<td>Average rate of tax in Country T [i.e., USD 10,500/USD 70,000]</td>
<td>15%</td>
</tr>
<tr>
<td>Doubly taxed income [Rs. 44,80,000 – Rs. 6,40,000]</td>
<td>38,40,000</td>
</tr>
<tr>
<td>Rebate under section 91 on Rs. 38,40,000 @15% (lower of average Indian tax rate and rate of tax in Country T)</td>
<td>5,76,000</td>
</tr>
<tr>
<td>Tax payable in India [Rs. 28,16,528 – Rs. 5,76,000]</td>
<td>22,40,528</td>
</tr>
<tr>
<td>Tax payable (rounded off)</td>
<td>22,40,530</td>
</tr>
</tbody>
</table>

Note:
Since Madhuvan, is resident in India for the P.Y.2018-19, his global income would be subject to tax in India. He would be allowed deduction under section 91 provided all the following conditions are fulfilled:-

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

(b) Income accrues or arises to him outside India during that previous year.

(c) Such income is not deemed to accrue or arise in India during the previous year.

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

(e) There is no agreement under section 90 for the relief or avoidance of double taxation between India and Country T, where the income has accrued or arisen.
Madhuvan is eligible for deduction under section 91 since all the conditions specified thereunder stand fulfilled by him during the previous year.

3. (a) (i) Section 11(1)(a) stipulates that in order to avail exemption of income derived from property held under trust wholly for charitable or religious purposes, the trust is required to apply for charitable or religious purposes, 85% of its income from such property. In this case, the trust has earned income of Rs. 4,90,000 for the year ended 31.3.2019. It has also earned short term capital gain from sale of capital asset for Rs. 10,60,000. The trust had utilized the entire amount of Rs. 15,50,000 for the purchase of a building meant for charitable purposes.

The Supreme Court, in *S.R.M. M. CT. M. Tiruppani Trust v. CIT (1998) 230 ITR 636*, ruled that the assessee-trust, which applied its income for charitable purposes by purchasing a building for use as a hospital, was entitled to exemption under section 11(1) in respect of such income. The ratio of the decision squarely applies to the case of the charitable trust in question. Therefore, the charitable trust is justified in claiming that the purchase of the building amounted to application of its income for charitable purposes.

Under section 11(1A), where the whole of the sale proceeds of a capital asset held by a charitable trust is utilised by it for acquiring another capital asset, the capital gain arising therefrom is deemed to have been applied to charitable purposes and would be exempt. Section 11(1A) does not make any distinction between a long-term capital asset and a short-term capital asset. The claim of the charitable trust to the effect that the capital gain is deemed to have been applied to charitable purposes is tenable in law.

(ii) Computation of taxable income of Mannat charitable trust

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i) Income from property held under trust (net)</td>
<td>10,00,000</td>
</tr>
<tr>
<td>(ii) Income (net) from business (incidental to main objects)</td>
<td>4,00,000</td>
</tr>
<tr>
<td>(iii) Voluntary contributions from public</td>
<td>7,00,000</td>
</tr>
<tr>
<td>Voluntary contribution made with a specific direction towards corpus are alone to be excluded under section 11(1)(d). In this case, there is no such direction and hence, included.</td>
<td>21,00,000</td>
</tr>
<tr>
<td>Less: 15% of the income eligible for retention / accumulation without any conditions</td>
<td>3,15,000</td>
</tr>
<tr>
<td>Less: Amount applied for the objects of the trust</td>
<td>17,85,000</td>
</tr>
<tr>
<td>(i) Amount spent for charitable purposes (Rs. 11,60,000 - Rs. 3,60,000)</td>
<td>8,00,000</td>
</tr>
<tr>
<td>(ii) Repayment of loan for construction of orphan home</td>
<td>3,60,000</td>
</tr>
</tbody>
</table>

**Taxable Income**  
6,25,000

(b) (i) As per section 9(1)(vii)(b), income by way of fees for technical services payable by a resident is deemed to accrue or arise in India, except where the fees is payable, *inter alia*, in respect of services utilized in a business or profession carried on by such person outside India. In this
case, since Trim Ltd. utilizes the technical services for its business in Indore, the fees for technical services payable by Trim Ltd. is deemed to accrue or arise in India in the hands of Mr. Richard Grill.

In accordance with the provisions of section 115A, where the total income of a non-corporate non-resident includes any income by way of royalty or fees for technical services other than the income referred to in section 44DA(1), received from an Indian concern in pursuance of an agreement made by him with the Indian concern and the agreement is approved by the Central Government, then, the special rate of tax at 10% of such fees for technical services is applicable. No deduction would be allowable under sections 28 to 44C and section 57 while computing such income.

Section 90(2) makes it clear that where the Central Government has entered into a DTAA with a country outside India, then, in respect of an assessee to whom such agreement applies, the provisions of the Act shall apply to the extent they are more beneficial to the assessee. Therefore, if the DTAA provides for a rate lower than 10%, then, the provisions of DTAA would apply.

(I) In this case, since India does not have a DTAA with Country F, of which Richard Grill is a resident, the fees for technical services (FTS) received from Trim Ltd., an Indian company, would be taxable @10%, by virtue of section 115A.

(II) In this case, the FTS from Trim Ltd. would be taxable @5%, being the rate specified in the DTAA, even though section 115A provides for a higher rate of tax, since the tax rates specified in the DTAA are more beneficial. However, since Richard Grill is a non-resident, he has to furnish a tax residency certificate from the Government of Country F for claiming such benefit. Also, he has to furnish other information, namely, his nationality, his tax identification number in Country F and his address in Country F.

(III) In this case, the FTS from Trim Ltd. would be taxable @10% as per section 115A, even though DTAA provides for a higher rate of tax, since the provisions of the Act (i.e. section 115A in this case) are more beneficial.

(ii) Where Zing Inc., a UK company, has a PE in India and rendering technical services is effectively connected with the PE in India.

Since Zing Inc. carries on business through a PE in India, in pursuance of an agreement with Swing Ltd. or other Indian companies entered into after 31.3.2003, and the income by way of fees for technical services is effectively connected with the PE in India as per section 44DA, such income shall be computed under the head “Profits and gains of business or profession” in accordance with the provisions of the Income-tax Act, 1961.

Accordingly, expenses of Rs. 22 lakhs (Rs. 10 lakhs + Rs. 12 lakhs) incurred for earning fees for technical services of Rs. 9 crore (Rs. 3.5 crore + Rs. 5.5 crore) is allowable as Head Office is not allowable as deduction.
Zing Inc. is required to maintain books of account under section 44AA and get the same audited under section 44AB and furnish report along with the return of income under section 139.

4. (a) (i) Section 206C(1F) provides for collection of tax at source@1% by the seller from the buyer, at the time of receipt of consideration for sale of motor vehicle, the value of which exceeds Rs. 10 lakhs. CBDT Circular No.22/2016 dated 8.6.2016 clarifies that this section has been inserted to cover all transactions of retail sales and accordingly, it will not apply to sale of motor vehicles by manufacturers to dealers. Hence, car manufacturers are not liable to collect tax at source under section 206C(1F).

In respect of sale of premium model cars (of value ranging above Rs. 10 lakhs and upto Rs. 50 lakhs) by dealers to retail customers, tax has to be collected at source@1% under section 206C(1F), even if no part of the consideration is received in cash.

As regards small cars of value ranging from Rs. 5 lakhs upto Rs. 10 lakhs, there is no requirement to collect tax at source.

(ii) The first proviso to section 201 provides that the payer (including the principal officer of the company) who fails to deduct the whole or any part of the tax on the amount credited or payment made to a resident payee shall not be deemed to be an assessee-in-default in respect of such tax if such resident payee –

1. has furnished his return of income under section 139;
2. has taken into account such sum for computing income in such return of income; and
3. has paid the tax due on the income declared by him in such return of income,

and the payer furnishes a certificate to this effect from an accountant in such form as may be prescribed.

The date of deduction and payment of taxes by the payer shall be deemed to be the date on which return of income has been furnished by the resident payee.

However, where the payer fails to deduct the whole or any part of the tax on the amount credited or payment made to a resident and is not deemed to be an assessee-in-default under section 201(1) as mentioned above, interest under section 201(1A)(i) i.e., @1% p.m. or part of month, shall be payable by the payer from the date on which such tax was deductible to the date of furnishing of return of income by such resident payee.

Therefore, M/s Fitband Limited shall not be required to pay the difference tax in case the above mentioned conditions are fulfilled. However, the company shall be liable to make payment of interest from the date on which such tax was deductible to the date of furnishing of return of income by Star Warehousing.

Therefore, the submission of the assessee company, in this case, is correct.
(b) (i) Clause (i) of *Explanation* to section 92B amplifies the scope of the term “international transaction”. According to the said *Explanation*, international transaction includes, *inter alia*, provision of scientific research services. L Inc. is a specified foreign company in relation to X Ltd. Therefore, the condition of X Ltd. holding shares carrying not less than 26% of the voting power in L Inc. is satisfied, assuming that all shares carry equal voting rights. Hence, L Inc. and X Ltd. are deemed to be associated enterprises under section 92A(2). Since the provision of scientific research services by L Inc. to X Ltd. is an “international transaction” between associated enterprises, transfer pricing provisions are attracted in this case.

(ii) In this case, salary payment has been made to a related person referred to in section 40A(2)(b) i.e., relative (i.e., daughter) of Mrs. Chiya, who is a director of T Ltd. However, with effect from A.Y.2018-19, section 92BA has been amended to exclude such transactions from the scope of “specified domestic transaction”. Consequently, transfer pricing provisions would not be attracted in this case.

(iii) The scope of the term “intangible property” has been amplified to include, *inter alia*, technical knowhow, which is a technology related intangible asset. Transfer of intangible property falls within the scope of the term “international transaction”. Since A Inc., a French company, guarantees not less than 10% of the borrowings of Y Ltd., an Indian company, A Inc. and Y Ltd. are deemed to be associated enterprises under section 92A(2). Therefore, since transfer of technical knowhow by Y Ltd., an Indian company, to A Inc., a French company, is an international transaction between associated enterprises, the provisions of transfer pricing are attracted in this case.

5. (a) (i) The action of the Commissioner in issuing the second notice is not justified. The term “record” has been defined in clause (b) of Explanation to section 263(1). According to this definition “record” shall include and shall be deemed always to have included all records relating to any proceeding under the Act available at the time of examination by the Commissioner. In other words, the information, material, report etc. which were not in existence at the time the assessment was made and came into existence afterwards can be taken into consideration by the Commissioner for the purpose of invoking his jurisdiction under section 263(1). However, at the same time, in view of the express provisions contained in clause (b) of the Explanation to section 263(1), such information, material, report etc. can be relied upon by the Commissioner only if the same forms part of record when the action under section 263 is taken by the Commissioner.

Issuance of a notice under section 263 succeeds the examination of record by Commissioner. In the present case, the Commissioner initially issued a notice under section 263, after the examination of the record available before him. The subsequent second notice was on the basis of material collected under section 133A, which was totally unrelated and irrelevant to the issues sought to be revised in the first notice. Accordingly, the material on the basis of which the second notice was
issued could not be said to be “record” available at the time of examination as emphasized in Explanation (b) to section 263(1).

(ii) (I) It has been held by the Apex Court in the case of Hind Wire Industries Ltd. v. CIT (1995) 212 ITR 639 that the order once amended can also be rectified subsequently provided the mistake apparent from record is rectifiable under section 154. The Apex Court enlarged the scope of the words used in that section by stating that it does not necessarily mean the original order. It could be any order including the amended or rectified order. The action of the Assessing Officer is, therefore, incorrect.

(II) The original return for A.Y.2019-20 was filed in time and the proceedings were already taken up for assessment under section 143(3). A revised return was filed by the assessee after the end of the relevant assessment year. The action of the Assessing Officer in making the assessment in disregard of the revised return filed on 20.4.2020 is correct because as per the provisions of section 139(5) the assessee can file the revised return only within the end of the relevant assessment year to which the return relates or before completion of the assessment, whichever is earlier.

(iii) The issue under consideration in this case is, whether omission to issue notice under section 143(2) is a defect not curable in spite of section 292BB

This issue came up before the Apex Court in Asstt. CIT v. Hotel Blue Moon (2010) 321 ITR 362, wherein it was held that without the statutory notice under section 143(2), the Assessing Officer could not assume jurisdiction. In that case, the Assessing Officer recorded his inability to generate a notice due to certain reasons. Such defect cannot be cured subsequently, since it is not procedural but one that goes to the root of the jurisdiction. Even though the assessee had participated in the proceedings, in the absence of mandatory notice, section 292BB cannot help the Revenue officers who have no jurisdiction, to begin with. Section 292BB helps Revenue in countering claims of assessee who have participated in proceedings once a due notice has been issued.

Applying the rationale of the Supreme Court ruling to the case on hand, the failure to issue notice under section 143(2) would vitiate the assessment proceedings notwithstanding the assessee’s participation in the proceedings. Section 292BB would not come to the rescue of the Revenue Authority if they omit to issue notice under section 143(2).

(b) A hybrid mismatch is an arrangement that exploits a difference in the tax treatment of an entity or an instrument under the laws of two or more tax jurisdictions to achieve double non-taxation.

Branch mismatches arise where the ordinary rules for allocating income and expenditure between the branch and head office result in a portion of the net income of the taxpayer escaping the charge to taxation in both the branch and residence jurisdiction. Unlike hybrid mismatches, which result from conflicts in the legal treatment of entities or instruments, branch mismatches are the result of differences in the way the branch and head office account for a payment made by or to the branch.
Hybrid mismatch arrangements arise due to -

(i) Creation of two deductions for a single borrowal
(ii) Generation of deductions without corresponding income inclusions
(iii) Misuse of foreign tax credit
(iv) Participation exemption regimes

Specific country laws that allow taxpayers to opt for the tax treatment of certain domestic and foreign entities may aid hybrid mismatches.

BEPS Action Plan 2 gives recommendations to neutralise the effects of hybrid mismatch arrangements, which include general changes to domestic law followed by a set of dedicated anti-hybrid rules. Treaty changes are also recommended. The 2017 report includes specific recommendations for improvements to domestic law intended to reduce the frequency of branch mismatches as well as targeted branch mismatch rules which adjust the tax consequences in either the residence or branch jurisdiction in order to neutralise the hybrid mismatch without disturbing any of the other tax, commercial or regulatory outcomes.

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

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

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

(ii) (I) As regards setting off of losses, the provisions relating to merger and amalgamation already contain specific anti-avoidance safeguards. Therefore, GAAR need not be invoked when SAAR is applicable, though as per CBDT Circular No. 7/2017 dated 27.01.2017, GAAR and SAAR can co-exist.

(II) In case of merger of a profit-making company with loss making company, there is no specific anti-avoidance safeguards. However, since such merger would be under the order of High Court,
GAAR would not be invoked if the High Court has explicitly and adequately considered the tax implication while sanctioning the merger scheme.

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

“Specified Service” means
(1) online advertisement;
(2) any provision for digital advertising space or any other facility or service for the purpose of online advertisement and
(3) any other service as may be notified by the Central Government.

However, equalisation levy shall not be levied-
- where the non-resident providing the specified services has a permanent establishment in India and the specified service is effectively connected with such permanent establishment.
- the aggregate amount of consideration for specified service received or receivable during the previous year does not exceed Rs. 1 lakh.
- where the payment for specified service is not for the purposes of carrying out business or profession.

In the present case, equalisation levy @6% is chargeable on the amount of Rs. 15,00,000 received by Xylo Inc., a non-resident not having a PE in India from LMN Ltd., an Indian company. Accordingly, LMN Ltd. is required to deduct equalisation levy of Rs. 90,000 i.e., @6% of Rs. 15 lakhs, being the amount paid towards online advertisement services provided by Xylo Inc., a non-resident having no permanent establishment in India. Non-deduction of equalisation levy would attract disallowance under section 40(a)(ib) of 100% of the amount paid while computing business income.

(ii) Section 245Q(3) of the Income-tax Act, 1961 provides that an applicant, who has sought for an advance ruling, may withdraw the application within 30 days from the date of the application. Since more than 30 days have elapsed from the date of application by Mr. Sarthak to the Authority for Advance Rulings, he cannot withdraw the application.

However, the Authority for Advance Rulings (AAR), in M.K. Jain AAR No.644 of 2004, has observed that though section 245Q(3) provides that an application may be withdrawn by the applicant within 30 days from the date of the application, this, however, does not preclude the AAR from permitting withdrawal of the application after the said period with its permission, if the circumstances of the case so justify.