CA Final – Direct Tax Laws and International Taxation (Paper – 7)

SUPER 50

(A last day revision to all important practical questions solutions)

Chapter 1 – Profits and Gains from Business or Profession

Section 44AD + 234B + 234C

Question 1:

A partnership firm consisting of three working partners A, B and C is engaged in the business of manufacturing and selling stationery.

Turnover of the business for the year ended 31st March, 2019 amounts to Rs. 190 lakh. Bad debts written off in the books are Rs. 80,000. Interest at 12% is provided to partner B on his capital of Rs. 10 lakh as authorized by the partnership deed.

The firm had business loss of Rs. 75,000 and unabsorbed depreciation of Rs. 1,20,000 carried forward from Assessment Year 2018-19. The firm did not pay tax under presumptive tax system in assessment year 2018-19. The firm opts for presumptive taxation under section 44AD for Assessment Year 2019-20. Assume that whole of the amount of turnover has been received by way of account payee cheque during the P.Y. 2018-19.

(i) Compute the income of the firm chargeable under the head "Profits and gains of business or profession."

(ii) What would be the liability for interest under sections 234B and 234C, if the firm has not paid any advance tax? Assume that no TDS/TCS to its credit.

Solution:

(i) **Computation of income of the firm chargeable under the head "Profits and Gains of business or profession"**

Particulars	Amount
Presumptive income under section 44AD (6% of Rs. 190 lakh) [See Note 1]	11,40,000
Less: Brought forward business loss under section 72 [See Note 4]	75,000
Income of the firm chargeable under the head "Profits and Gains of business or profession"	10,65,000
Tax liability at @ 31.20%	**3,32,280**

Notes:

(1) A partnership firm falls within the definition of "eligible assessee" under section 44AD. The threshold limit of turnover for applicability of presumptive taxation scheme under section 44AD is Rs. 200 lakh. In this case, since the turnover of the business of the firm is Rs. 190 lakh, it falls within the definition of "eligible business" and therefore, the firm is eligible to opt for presumptive taxation scheme under section 44AD. 6% of the total turnover would be deemed to be the business income of the firm as whole of the amount of turnover has been received by way of account payee cheque during the P.Y. 2018-19.

(2) As per section 44AD(2), all deductions allowable under sections 30 to 38 shall be deemed to have been allowed in full and no further deduction shall be allowed.

Accordingly, no deduction shall be allowed for bad debts since the same is deductible under section 36(1)(vii). Likewise, unabsorbed depreciation is not deductible since the same is deductible under section 32(2).

(3) Interest on capital and working partner salary are also not deductible while computing the presumptive income of a partnership firm under section 44AD for the assessment year 2019-20.

(4) However, brought forward business loss of previous year 2017-18 can be set- off against current year business income as per section 72.

(ii) Since the partnership firm has opted for computation of income on presumptive basis under section 44AD, it must pay the whole amount of advance tax in one installment on or before 15.03.2019. Further, any amount paid by way of advance tax on or before 31.3.2019 shall also be treated as advance tax paid during the financial year on or before 15th March 2019.

Since the firm has not paid advance tax –

a) it has to pay interest under section 234C at 1% on Rs. 3,32,280.

b) it has to pay interest under section 234B @1% per month or part of a month on Rs. 3,32,280 from 1st April, 2019 to the date of determination of total income under section 143(1) and where regular assessment is made, to the date of regular assessment.

Section 44AE

Question 2:

On April 1, 2017, DG owns 7 goods carriages (Tata Ace commercial vehicle, gross vehicle weight of each being 1285 kg.). On November 10, 2017, he purchases 2 heavy goods carriages (Tata LPT 3118, gross vehicle weight of each being 31,000 kg.). Calculate Income of DG under section 44AE.

Solution:

	AY 2018-19 Rs.	AY 2019-20 Rs.
Income from 7 light goods carriages (7500 *12*7)	**6,30,000**	**6,30,000**
Income from 2 heavy goods carriages-		
- Previous year 2017-18 (7500*5*2)	**75,000**	**-**
- Previous year 2018-19 (1000*31 Ton *12*2)	**-**	**7,44,000**
Income Under Section 44AE	**7,05,000**	**13,74,000**

Section 44A

Question 3:

Boat Club is an association governed by the provisions of Section 44A of the Income-tax Act, 1961. The subscription received from members for the year ended 31st March, 2019 was Rs.2,00,000. The expenditures in the normal course of its activities were Rs.3,85,000. Its other income taxable under the Act works out to Rs.2,75,000. You are consulted as to how Boat Club's income would be determined for assessment year 2019-20?

Solution:

As per section 44A, the deficiency arising on account of income from members by way of, inter alia, subscriptions, falling short of the expenditure incurred solely for the protection or advancement of the interest of its members, shall first be set off against the association's income under the head "Profits and gains of Business or Profession". If there is no such income under this head, the deficiency shall be set off against income under any other head.

Particulars		Amount (Rs.)
Income from subscription		2,00,000
Less: Expenses incurred in the course of its activities		3,85,000
	Deficiency	(1,85,000)
Other income		2,75,000
Less: Deficiency Rs.1,85,000 but limited to 50% of other income		1,37,500
	Income of the Association	1,37,500

There is a ceiling on the deduction admissible by way of deficiency being that it shall not exceed one-half of the total income of the association computed before making any allowance under this section. This ceiling has been exceeded above and the deficiency hence is limited to Rs. 1,37,500 being one-half of Rs. 2,75,000 [vide section 44A(3)].

Comprehensive Total Income Questions: Major Adjustments of PGBP with Special Focus on 33AB, 32, 80JJAA & Case Laws.

Question 4: [Remark: Students are advised to do this sum after going through Section 80JJA]

Net profit of Chai Ltd. engaged in growing & manufacturing tea for F.Y. 2018-19 is Rs.50 lakhs. This is the second year of the operation of the company which was incorporated on 01-06-2017. The following debits & credits were made in the books of accounts.

1. ***Depreciation as per books – Rs.5 lakh***
2. ***Profit from sale of green tea leaves plucked in own garden Rs.20 lakhs.***
3. ***Replacement of parts of plant & machinery amounting to Rs.15 lakhs for which a sum of Rs.25 lakhs was withdrawn from deposit maintained with NABARD. Rs.10 lakhs remained unutilized during the PY 2018-19.***
4. ***Interest on securities Rs.1 lakh***
5. ***Share issue expense of Rs.2 lakh***
6. ***Company's contribution to staff welfare trust (Recognized) deposited on 1-05-19 of Rs.1 lakh.***

Additional information:

1. ***The company has employed employees to whom salary paid for the previous year was debited to the P&L A/c & the details of their employment are as under:***

Date of Appointment	***No. of Employees***	***Designation***	***Salary (per month)***
1-7-17	***1***	***Factory worker***	***Rs.18,000 (paid in cash)***
1-7-18	***4***	***Garden worker***	***Rs.11,000 (A/c. payee cheque)***
1-8-18	***1***	***Supervisor***	***Rs.25,000 (ECS)***
1-10-17	***10***	***Helper***	***Rs.10,000 (ECS)***
15-10-18	***35***	***Various positions***	***Rs.30,000 (ECS)***

2. ***Employee contribution towards recognized PF of Rs.1 lakh deducted from their salary, but deposited after due date of the fund but, before filing of ROI.***
3. ***The company incurred expenditure towards set up of the transmission line for Rs.5 lakhs, the property of which shall vest with the state govt. The agreement enables the company to obtain the power at subsidized rate. However, the said expenditure is not debited to P & L A/c.***
4. ***The company has raised additional share capital as on 1-2-19 from foreign country to meet up its working capital requirement. The exchange gain as on 31-03-19 is Rs.5 Lakhs which has not been considered in the P&L A/c.***
5. ***The company acquired plant & machinery, factory building & furniture at the cost of Rs.40 lakhs, Rs.25 lakhs &Rs.10 lakhs respectively in PY 2017-18 to commence its operation. Further, the***

company had obtained 50% loan to acquire the Plant & machinery. The loan was waived off by the bank as a part of Government policy during the current year. Further, Rs.5 Lakhs is paid in cash during P.Y. 2018-19 to the supplier of Furniture.

6. ***Amount deposited in the NABARD on 1/7/19 is Rs.6 Lakhs.***
7. ***Brought forward business loss of AY 2018-19 is Rs.1 lakh.***

Compute the total income of the company for A.Y. 2019-20.

Solution:

Computation of Total Income of Chai Limited
For the P.Y. 2018-19 / A.Y. 2019-20

Particulars	Amount (Rs. in Lakhs)	Amount (Rs. in Lakhs)
Net Profit as per books	50.00	
(-) Income Chargeable Under the head IFOS	(1.00)	
Net Profit as per books for business	49.00	
(+) Depreciation as per Books	5.00	
(-) Profit from sale of green tea leaves plucked in own garden. Since it is an agriculture income & Hence, Exempt U/s 10(1)	(20.00)	
(+) Amount Utilized from deposit account towards replacement of parts of plant & machinery being a current repair shall be disallowed.	15.00	
(+) Share issue expenses being an expenditure in the capital field is an expenditure which is capital in nature and hence not allowed u/s 37(1) [Brookbond India Ltd.(SC)]	2.00	
(+) Employer Contribution to recognized staff welfare fund Allowed as deduction U/s 36(1)(v) read with 43B	NIL	
(+) Disallowance u/s 40A(3) on account of amount paid (to the factory worker) otherwise than by way of A/c. payee cheque or Demand Draft in excess of Rs.10,000 on a single day shall be disallowed (Rs.18,000 x 12)	2.16	
(+) Employee Contribution towards recognized staff welfare fund considered as employer's income — 1.00 (-) Deduction u/s 36(1)(va) not allowed as the amount deposited after the due date of the fund (Refer Note) — NIL	1.00	
(-) Expenditure Incurred in setup of transmission lines allowed as deduction since: a) The expenditure is not capital in nature as the property shall vest with the government. b) The expenses is for the purpose of business and profession as the expenses will lead to substantial saving in power bill [Dharampur Sugar Mills Ltd. (All)]	(5.00)	
(+) Exchange Rate gain on raising additional share capital is a		

capital receipt as the gain is in the capital field. It is irrespective of the manner of the application of the funds. [Jagatjit Industries Ltd.]	NIL	
(-) Depreciation u/s 32 (W.N. 1)	(3.55)	
(+) Deemed Income Under Section 33AB On account of non-utilization of deposit withdrawn during the P.Y. (Rs.10 Lakh)	10.00	
(-) Deduction u/s 33AB: Lower of the following: a) Amount Deposited Rs.6 Lakhs. OR b) 40% x 55.61	(6.00)	
Income	49.61	
Rule 8: 60% Agriculture Income	(29.766)	
Income	19.84	
(-) Brought forward business loss of AY 2018-19	(1)	
PROFIT AND GAINS FROM BUSINESS AND PROFESSION		18.844
Income from other sources		1.00
Gross Total Income		19.844
(-) Chapter VIA Deductions I. 80JJAA – (W.N. 2) [(11000 x 4 x 9) + (25000 x 1 x 8)] + (10,000 x 10 x 12) x 30%		(5.388)
TAXABLE INCOME		**14.456**

Working Notes:

1) Calculation of Depreciation U/s 32 **(Rs. In Lakhs)**

Particulars	Plant (15%)	Building (10%)	Furniture (10%)
P.Y. 2017-18 Actual Cost (-) Depreciation u/s 32(1)(ii) (-) Additional Depreciation u/s 32(1)(iia)	 40 (6) (8)	 25 (2.5) --	 10 (1) --
Opening WDV (01/04/2018) (-) Waiver of bank loan taken for plant shall imply that the portion of the cost is met or borne by the bank and hence shall be reduced in determining the actual cost u/s 43(1). [SAIL (Delhi)]	26 (20)	22.5 --	9 --
(-) Repayment of consideration in excess of Rs. 10,000 on a single day otherwise than by way of account payee cheque or DD shall be ***IGNORED*** while determining actual cost of WDV			(5)
Depreciation u/s 32(1)(ii) as on 31/03/19	(0.9)	(2.25)	(0.4)
Closing WDV (31/03/2019)	5.4	20.25	4.6

***Don't use the word DISALLOWED in this provision.**

It is assumed that the plant does not eligible for additional depreciation.

2) Note on deduction u/s 80JJAA:

Date of appointment	Year of deduction u/s 80JJAA	Remarks

1/7/2017	2nd	No deduction available as the amount is paid during the year (being the 2nd year) otherwise than by way of A/c. payee cheque or demand draft
1/7/2018	1st	All the conditions are met
1/8/2018	1st	Deduction is available since, the amount paid does not exceed Rs.25,000 p.m.
1/10/2017	1st	As per Finance Act, 2018, where an employee is employed during the previous year for a period <240 days/150 days, as the case may be, but is employed for a period of 240 days/150 days, as the case may be, in the immediately succeeding year, he shall be deemed to have been employed in the succeeding year and the provisions of this section shall apply accordingly
15/10/2018	NA	Since, the employee has been recruited for less than 240 days during the PY 2018-19 therefore, emoluments paid to such employee shall not qualify for deduction u/s 80JJAA (Ineligible employee)

Note:

The Gujarat HC in *Gujarat State Transport Corporation* has held that the deduction in respect of employee contribution will be allowed only if the contribution is made on or before the due date of the fund.

However, it was held by the other HCs that the deduction is available even if the contribution is made after the due-date of the fund.

Section 35AD: Consequences on Transfer of Specified Business Assets to a Non-specified One

Question 5:

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 1.4.2017 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. 2018-19. However, in February, 2019, 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.2018-19, the deeming provision under section 35AD(7B) is attracted during the A.Y. 2019-20.

Particulars	Amount (Rs.)
Deduction allowed under section 35AD for A.Y.2018-19	50,00,000
Less: Depreciation allowable u/s 32 for A.Y.2018-19 [10% of Rs. 50 lakhs]	5,00,000
Deemed income under section 35AD(7B)	**45,00,000**

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 the purpose of claiming depreciation on building in Unit B, the actual cost of the building would be

Particulars	Amount (Rs.)
Actual cost to the assessee	50,00,000
Less: Depreciation allowable u/s 32 for A.Y.2018-19 [10% of Rs. 50 lakhs]	5,00,000
Actual cost in the hands of ABC Ltd. in respect of building in its Unit B	**45,00,000**

Section 35AD + 73A

Question 6:

XYZ Ltd. commenced operations of the business of a new three-star hotel in Madurai, Tamil Nadu on 1.4.2018. The company incurred capital expenditure of Rs. 50 lakh during the period January, 2018 to March, 2018 exclusively for the above business, and capitalized the same in his books of account as on 1st April, 2018. Further, during the P.Y. 2018-19, 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.2019-20, 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.2019-20 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.2019-20. Also, assume that expenditure incurred during the previous year 2018-19 were paid by account payee cheque or use of ECS through bank account.

Solution:

Computation of profits and gains of business or profession for A.Y. 2019 – 20

Particulars	Amount (Rs. In Lakhs)	Amount (Rs. In Lakhs)
Profits from the specified business of new hotel in Madurai (before providing deduction under section 35AD)		25
Less: Deduction under section 35AD		
Capital expenditure incurred during the P.Y.2018-19 (excluding the expenditure incurred on acquisition of land) = Rs. 200 lakh – Rs. 150 lakh	50	
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	50	
Total deduction under section 35AD for A.Y.2019-20		100
Loss from the specified business of new hotel in Madurai Profit from the existing business of running a hotel in Coimbatore		**(75)** 120
Net profit from business after set-off of loss of specified business against profits of another specified business under section 73A		45

Section 35 + 35CCC + 35CCD

Question 7:

Isac limited is a company engaged in the business of biotechnology. The net profit of the company for the financial year ended 31.03.2019 is Rs. 35,25,890 after debiting the following items:

S.No.	Particulars	Amount (in Rs.)
1.	***Purchase price of raw material used for the purpose of in-house research and development***	***11,80,000***
2.	***Purchase price of asset used for in-house research and development*** ***a) Land*** ***b) Building***	 ***5,00,000*** ***3,00,000***
3.	***Expenditure incurred on notified agricultural extension project***	***25,50,000***
4.	***Expenditure on notified skill development project:*** ***a) Purchase of land*** ***b) Expenditure on training of skill development***	 ***40,00,000*** ***32,50,000***
5.	***Expenditure incurred on advertisement in the souvenir published by a political party***	***75,000***

Compute the income under the head "Profits and gains of business or profession" for the A.Y. 2019-20 of Isac Ltd.

Solution:

Computation of income under the head "Profits and gains of business or profession" for the A.Y.2019-20

Particulars		Amount	Amount
Net profit as per profit and loss account			35,25,890
Add:	Items debited to profit and loss account, but to be disallowed		
	Purchase price of Land used in in-house research and development - being capital expenditure not allowable as deduction under section 35	5,00,000	
	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)	---	
	Expenditure incurred on notified agricultural extension project (to be treated separately)	25,50,000	
	Expenditure incurred on notified skill development project: - Purchase of land - being capital expenditure not qualifying for deduction under section 35CCD	40,00,000	
	Expenditure incurred on notified skill development project - Expenditure on training for skill development (to be treated separately)	32,50,000	
	Expenditure incurred on advertisement in the souvenir published by a political party not allowed as deduction as per section 37(2B)	75,000	103,75,000
			139,00,890
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.	5,90,000	
Less:	Expenditure incurred on notified agricultural extension project qualifies for 150% deduction under section 35CCC.	38,25,000	
Less:	Expenditure incurred on training for skill development in a notified skill development project qualifies for 150% deduction under section 35CCD.	48,75,000	92,90,000
	Profit and Gain From Business		***46,10,890***

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.

Computation of PGBP for Banking Sector

Question 8:

The P/L A/C. of ABC Bank Ltd operating in India for the financial year 2018-19 contains, inter alia, the following particulars:

	(Rs.In crores)
Profit before taxation	***100***
Depreciation as per books	***25***
Depreciation admissible as per income tax rules	***40***
Corporation tax disputed by the bank and not paid	***10***
Bad debts written off	***45***
Provision of NPA as per prudential norms of RBI	***250***
Provision for standard assets at 2% of such advance as per above norms	***5***

Net depreciation on investments under "held for trading" and "available for sale" categories calculated on lower of cost price or market price as per RBI guidelines is Rs.30Crores.

Other information:

(a) In A.Y. 17-18 provision for doubtful debts allowed in assessment amounted to Rs.35 crores only.

(b) The assessment for A.Y. 18-19 resulted in a loss and unabsorbed depreciation amounting to Rs.30 crores and Rs.40 crores respectively and the bank was not allowed deduction on account of provision for doubtful debts.

(c) Unrealised interest income not recognized in the accounts in financial year 2018-19 in respect of NPA as per assets classification norms of RBI amounts to Rs.65 crores.

(d) The aggregate average rural advances calculated as per section 36(1)(viia) read with rule 6ABA amounts to Rs.30 crores.

From the above information compute the total income of the Bank for A.Y. 2019-20.

Solution:

Particulars	**(Rs. in Crores)**	
	Amount	**Amount**
Profit & Gains from Business		
Net Profit before taxation as per P/L A/c.		100
Add: Depreciation as per books	25	
Disputed corporation Tax not paid as per section 43B	10	

Bad debts not allowed, as will be set-off from provision created for that purpose	45	
Provision for NPA considered separately	250	
Provision for Standard asset	5	335
		435
Less: Depreciation as per Income-Tax Rule		(40)
		395
Less: Provision for doubtful debts U/s. 36(1)(viia):		
8.5% of total income before allowing deduction under chapter VIA [8.5% X (395-30-40)] 10% of aggregate average advance by rural branches (10% X 30)	27.625 3.00	(30.625)
Business Income		364.375
Less: Brought forward business loss for A.Y. 2018-19	30	
Unabsorbed depreciation of A.Y. 2018-19	40	(70)
Gross Total Income (GTI)/Total Income		**294.375**

Notes:

1. The **Supreme Court in the case of United Commercial Bank Ltd. V/s. CIT (1999)**, held that investments held under "Held for Trading" and "Available for Sale" categories are to be considered as stock in trade of bank even though they are showed under the head "Investments" in the balance sheet under the Banking Regulation Act. Therefore, such losses shall be allowable as deduction.
2. As per provision of Section 43D, interest on Bad or Doubtful categories of Debts as per RBI Guidelines is to be taxed in the P.Y. in which it is credited by the bank to its Profit /Loss A/c or in the year in which it is actually received by the bank whichever is earlier. Hence, unrealized interest on NPA amounting to Rs.65 crores is not taxable in the A.Y. 2019-20.
3. As per Section 36(1)(vii), in the case of bank, deduction under this clause shall be allowed only when the Bad Debts exceed the provision for Bad & Doubtful debts. Since the provision for Bad & Doubtful debts of the previous year as well as for the current year is Rs.65.625 crores (Rs.35 + Rs.30.625) which is more than Rs.45 crores of the bad debts allowed during the year, hence bad debts shall not be allowed as deduction, but will be adjusted against the provision for Bad & Doubtful debts.

Section 35D – Recent Case Laws

Question 9:

XYZ Ltd. is a company engaged in the manufacture of paints. The company incurred preliminary expenses of Rs. 42 lakhs. The cost of the project was Rs. 400 lakhs and the capital employed in the business of the company was Rs. 700 lakhs. For the purpose of claiming deduction under section 35D, the company restricted the said expenditure to

Rs. 35 lakhs, i.e., 5% of Rs. 700 lakhs, being the capital employed in the business of the company. For this purpose, the company treated share premium of Rs. 100 lakhs as part of the capital employed. For the A.Y.2019-20, it claimed deduction of Rs. 7 lakhs, being 1/5th of Rs. 35 lakhs, under section 35D. The Assessing Officer disallowed Rs. 1 lakh, being the portion relating to share premium (1/5th of 5% of Rs. 100 lakhs), contending that the same was not part of capital employed. Whether "premium" on

subscribed share capital is "capital employed in the business of the company" under section 35D to be eligible for a deduction? Examine the correctness of contention of the Assessing Officer, with the aid of a case law.

Solution:

The issue under consideration is whether "premium" on subscribed share capital can be treated "capital employed in the business of the company" under section 35D to be eligible for increased deduction

This issue came up before the Supreme Court in Berger Paints India Ltd v. CIT [2017] 393 ITR 113. The Supreme Court observed that the share premium collected by the assessee on its subscribed issued share capital could not be part of "capital employed in the business of the company" for the purpose of section 35D(3)(b). If it were the intention of the legislature to treat share premium as being "capital employed in the business of the company", it would have been explicitly mentioned. Moreover, Sl. No. IV(i) in Form MGT- 7 read with section 92 of the Companies Act, 2013 dealing with capital structure of the company provides the break-up of "issued share capital" and "subscribed share capital" which does not include share premium at the time of subscription. Hence, in the absence of the reference in section 35D, share premium is not a part of the capital employed. Also, section 52 of the Companies Act, 2013 requires a company to transfer the premium amount to be kept in a separate account called "securities premium account".

Accordingly, the amount qualifying for deduction under section 35D would be Rs. 30 lakhs, being 5% of Rs. 600 lakhs [i.e., Rs. 700 lakhs (-) share premium of Rs. 100 lakhs]. The deduction under section 35D for A.Y.2019-20 would be Rs. 6 lakhs, being 1/5th of Rs. 30 lakhs. The contention of the Assessing Officer is, therefore, correct.

Chapter 2 – Business Deductions under Chapter VIA and 10AA

Section 10AA Deduction + AMT

Question 10:

PQR LLP, a limited liability partnership in India is engaged in development of software and providing IT enabled services through two units, namely, Unit P and Unit Q. Unit P is setup in Special Economic Zone (SEZ) and Unit Q is set up in a Domestic Tariff Area (DTA). The LLP furnishes the following information relating to its 3rd year of operation ended on 31-3-2019:

Particulars	***Amount (Rs. In Lakhs)***	
	Unit P	***Unit Q***
Export Turnover	***1200***	***920***
Domestic Turnover	***200***	***460***
Duty Drawback	***38***	***38***
Profit on sale of Import Entitlement	***24***	***Nil***
Salaries paid	***540***	***192***
Other Expenses	***420***	***473***
Net Profit of the Year	***502***	***753***

Additional Information:

- ***(i) Unit P: Expenses of Rs. 24 lacs are disallowable under section 43B and export sales proceeds received in India amounted to Rs. 1040 lacs. Export sales of Rs. 1200 lacs include freight and insurance of Rs. 200 lacs and realization of Rs. 1040 lacs includes amount of insurance and freight charges of Rs. 140 lacs.***
- ***(ii) Unit Q: Export sales received in India was Rs. 850 lacs. Expenses charged and are to be disallowed as per section 40A(3) are of Rs. 47 lacs.***

Compute tax payable by PQR LLP for the Assessment Year 2019-20. (Ignore AMT)

Solution:

Computation of Income Tax Payable for A.Y. 2019-20

(Rs. In lakhs)

Particulars	Note	Amount	Amount
Profits and Gains from Business or Profession:			
Unit P		502.00	
Unit Q		753.00	1,255.00
Add: Expenses disallowed u/s 43B			24.00
Add: Expenses disallowed u/s 40A(3)			47.00
Total Income before Section 10AA			1,326.00
Less: Deduction for profit derived by the SEZ unit for export business u/s 10AA	**1**		(348.00)
Total Income			978.00
Basic Tax @ 30%		293.40	
Education Cess @ 2%		5.87	
Secondary Higher Education Cess @ 1%		2.93	
Health Cess @ 1%		2.93	
Total Income Tax Payable			**305.13**

Notes:

(1) **Statement Showing Computation of Deduction u/s 10AA**

(Rs. In lakhs)

Particulars	Amount	Amount
Net Profit of SEZ Unit (Unit P)		502
Add: Expenses disallowable		24
Less: Duty Drawback		(38)
Less: Profit on sale of entitlement		(24)
Profit Derived by the SEZ Unit		464
Export Turnover for the Purpose of Deduction u/s 10AA of SEZ Unit:		
Export Turnover of Unit P restricted to the extent of amount realized in convertible foreign currency	1,040	
Less: Insurance and freight charges	(140)	900
Total Turnover for the Purpose of Deduction u/s 10AA of SEZ Unit:		
Total turnover of Unit P	1,400	
Less: Insurance & freight charges	(200)	1,200
Deduction u/s 10AA:		
Profit derived by the SEZ unit from the eligible export business X $\frac{\text{Export Turnover}}{\text{Total Turnover}}$		348
= 464 x (900/1,200)		

(2) The deduction u/s 10AA is in respect of the profit derived by the eligible undertaking engaged in manufacturing and export of goods from SEZ Unit.

The word ‘derived’ is much narrower than the word ‘attributable to’ or ‘in relation to’.

The profit from the very activity of manufacturing and export shall only qualify for the purpose of deduction. Accordingly business income which is incidental like interest income on bank guarantee or duty drawback which arises in consequence of export of goods will not be forming part of the profit derived from the eligible business, although chargeable under the head PGBP.

Deductions u/s 80IA: Loss During Initial Period

Question 11:

VKS Ltd. is engaged in developing, operating and maintaining infrastructure facility, which qualifies for deduction under section 80-lA of the Income-tax Act. The company is also engaged in producing cement. Business of the infrastructure facility was commenced in the financial year 2016-17. During the financial years 2016-17, 2017-18 and 2018-19 profits/losses of the two businesses are as follows:

(Rs. In lakhs)

Financial Year	*Infrastructure Facility*	*Cement Manufacturing*
2016-17	***(-) 100***	***120***
2017-18	***60***	***140***
2018-19	***75****	***100***

**** includes freight subsidy of Rs. 10 lakhs under the scheme of the Central Government. Further Information:***

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

(ii) Profit of infrastructure facility business for financial year 2018-19 has been arrived at after charging purchase of consumable stores amounting to Rs. 10 lakhs from RR Ltd., a subsidiary company of VKS Ltd. as against fair market value of such items amounting to Rs. 7 lakhs.

Compute the amount admissible as deduction under section 80-IA for Assessment Year 2019-20. Give working notes and the reasons in the context of statutory provisions for giving treatment to each of the items.

Solution:

Computation of amount admissible as deduction u/s 80-IA for A.Y. 2019-20

(Rs. In lakhs)

Particulars	Amount	Amount
Net profit of VKS Ltd for A.Y. 2019-20		65
Add: Freight subsidy received		10
[There is a direct nexus between profit and gains of the business and reimbursement of freight subsidy, since reimbursement of a revenue subsidy by the Central Government is towards the elements of cost relating to developing an infrastructure facility. Hence, freight subsidy of Rs. 10 lakhs received from Central Government is part of the profits and gains of business "derived from" eligible business and thus, admissible for deduction under section 80-IA]		
		75
Less: Difference in price of cement purchased	5	
[Since cement has been transferred5 from cement manufacturing unit (non-eligible business) of VKS Ltd to eligible business of Infrastructure facility at Rs. 20 lakhs, which is less than the market value of the cement Rs. 25 lakhs, the profit of infrastructure facility eligible for deduction under section 80-IA shall be computed by deducting Rs. 5 lakh, being the difference between purchase price and fair market value as per section 80-IA(8)]		
Less: Notional loss of Rs. 40 lakhs of F.Y. 2016-17 [Note 1]	NIL	
Section 80-IA(2) permits an assessee developing, operating and maintaining an infrastructural facility to opt for claiming deduction there under for any 10 consecutive assessment years out of 20 years beginning from the year in which the undertaking develops and begins to operate any infrastructure facility. The question is silent as to the year from which VKS Ltd. exercises the option to claim deduction u/s 80-IA. Since, in the A.Y.2017-18, it has incurred loss from infrastructure facility, a prudent assessee will not opt A.Y.2017-18 as the initial assessment year for claiming deduction u/s 80-IA. Therefore, it is logical to assume that VKS Ltd. opts for deduction under section 80-IA from A.Y.2018-19 or A.Y.2019-20, since it has incurred losses in the first year of operations i.e., A.Y.2017-18. If it is so		

assumed, notional loss of Rs. 40 lakhs of A.Y.2017-18 should not be reduced.		5
 Add: Purchase of consumable stores at a price higher than the fair market value [The difference between the purchase price Rs. 10 lakhs and the fair market value Rs. 7 lakhs has to be added back since the purchase is from a related party RR Ltd, a company in which VKS Ltd has substantial interest, at a price higher than the fair market value. Specific disallowances, related to the business activity against which the Chapter VI-A deduction has been claimed, result in enhancement of the profits of the eligible business. Deduction under Chapter VI-A is admissible on the profits so enhanced on account of such disallowance.]		70 3
Profit eligible for deduction under section 80-IA for A.Y. 2019-20 100% of Rs. 73 lakhs is allowed as deduction u/s 80-IA for A.Y. 2019-20		**73**

Note –

(1) Where it is assumed that A.Y.2017-18 is the initial assessment year, then, the provisions of section 70(1) and section 80-IA(5) would come into play. As per section 70(1), an assessee is entitled to set off the losses from one source against income from another source under the same head of income. Therefore, in A.Y. 2017-18, VKS Ltd. is entitled to set off the losses of Rs. 100 lakhs of eligible business of Infrastructure facility unit against income of Rs. 120 lakhs of non-eligible Cement manufacturing unit.

However, once set-off is allowed under section 70(1) against income from another source under the same head, a deduction to such extent is not possible in the subsequent assessment year i.e., the loss of eligible business so set-off under section 70(1) in A.Y.2017-18 has to be first deducted while computing profits eligible for deduction under section 80-IA in the subsequent years. Accordingly, Rs. 60 lakhs would have been deducted from the profits of eligible business for the A.Y. 2018-19 and the balance Rs. 40 lakhs has to be deducted in the current assessment year i.e., A.Y. 2019-20.

In such a case, the deduction under section 80-IA for A.Y.2019-20 would be Rs. 33 lakhs [Rs. 73 lakhs (-) Rs. 40 lakhs].

Chapter 3 – Income Computation and Disclosure Standards (ICDS)

Comprehensive Total Income Question with Special Emphasis to ICDS - III

Question 12:

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

Statement of Profit & Loss for the year ended 31st March, 2019 reveals a net profit (before tax) amounting to Rs.85,00,000 after debiting/crediting the following items:

(a) Interest of Rs.3,00,000 due to a public financial institution for the last quarter of the financial year 2018-19 paid on 20th October, 20I9.

(b) Rs.6,00,000 paid in India to Mr. Philip a non-resident towards fee for technical services without deduction of tax at source. TDS was however, paid on 30th October, 2019.

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

(d) Depreciation charged Rs.20,00,000.

(e) Marked to market loss amounting to Rs.6,00,000 in respect of an unsettled derivative contract. The contract was settled in May, 2019 with a gain of Rs.1,00,000.

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

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

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

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

- ***Component of short-term capital gain on sale of development properties by the REIT Rs.6,00.000.***
- ***Component of rental income from properties owned by the REIT Rs.4,00,000.***

Other Information:

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

(ii) Land sold to Neptune Inc. was acquired at a cost of Rs.30,00,000 in the financial year 2014-15. Value on the date of sale assessed by the Stamp Valuation Authority was Rs.50,00,000 (Cost Inflation Index- Financial Year 2014-15 : 240; Financial Year 2018-19 : 280)

(iii) The company informs you that till Assessment Year 2018 - 19 the company did not include retention money in its total income in absence of right to receive such money based on judicial pronouncements, which has also been accepted by the Assessing Officer consistently.

(iv) During the year 20 new employees (qualifying as "workman" under the Industrial Disputes Act, 1947) were recruited. All these new employees contribute to recognized provident fund. 15 employees out of 20 employees joined on 1st May, 2018 and the other 5 employees joined in November, 2018. 10 employees, who joined on l May, 2018 were offered salary of Rs. 24,500 per month and the other employees who joined on the same date drew salary of Rs. 32,000 per month. One employee who joined on 1st May, 2018 at salary of Rs. 24,500 per month drew his salary by bearer cheques of Rs. 12,500 and Rs. 12,000 every fortnight in a month.

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

Compute total income for the Assessment Year 2019-20 indicating reasons for treatment of

each item and ignoring the provisions relating to minimum alternate tax (MAT). The due date for filing of return of income for Asst. Year 2019- 20 be taken as 30-09-2019.

Solution:

Computation of total income of M/s Jupiter Construction Ltd.

Sr. No.	PARTICULARS	NOTE No	Amount
	Net profit as per P/L A/c		85,00,000
	Add:		
1	Interest *disallowable u/s 43B*	2	3,00,000
2	Fees for technical service *disallowable u/s 40(a)(i)*	3	6,00,000
3	Damages for defects in construction	4	-
4	Depreciation as per books		20,00,000
5	Marked to market loss on unsettled derivate contract	5	6,00,000
	Less :		
1	Profit on sale of Land	6	(10,00,000)
2	Retention money	7	-
3	Interest on FD with *Ba*nk as margin money	8	-
4	Dividend from REIT- Short Term Capital Gain which is exempt	9	(6,00,000)
5	Depreciation as per IT Act		(25,00,000)
	PGBP		**79,00,000**
	Capital Gain	**6**	**15,00,000**
	Gross total Income		**94,00,000**
	Less : Deduction u/s 80JJAA	**10**	**(7,27,650)**
	Total Income		**86,72,350**

Notes:

1. Since, Jupiter Construction Ltd. is engaged in the business of executing civil contracts, ICDS III – Construction Contract will apply. As per ICDS –III, Contract revenue and contract costs shall be recognized on percentage completion basis (POCM)
   However, in the absence of percentage of work completed, it is assumed that Net Profit of Rs. 85 Lakhs is arrived on POCM basis. Only revenue & costs directly related to contract will be recognized on POCM basis. Other general and indirect costs and other income are recognized as per accrual basis following the commercial principles of accounting.
2. Interest of Rs. 3,00,000 due to public financial institution paid after due date of filing ROI (i.e. 30/09/2019) would be disallowed u/s 43B.
   It is assumed that the interest paid is not related directly to contract & is on general borrowing. This is assumed due to the fact that question does not provide for percentage of work completed. Hence, assuming it is on general borrowing, entire interest is disallowed.
3. Since, tax u/s 195 is not deducted on fees for technical services paid to Mr. Phillip, non-resident before the due date of filing ROI i.e. 30/09/2019, hence it would be disallowed u/s 40(a)(i). It is again assumed that fees for technical services is not specifically related to project in the absence of percentage of completion of contract.
4. Damages amounting to Rs. 15 lakh paid to govt. for defects found in construction of flyover is a trading loss arising in the normal course of the business which would be allowable. Further, ICDS III also recognizes that such losses shall be recognized in the year in which they are incurred as they do not have any direct relation with the recovery of the revenue. Since it is already debited, no effect is required.

5. ICDS I provides that Marked to market loss shall not be recognized as an expense. Therefore, Marked to market loss in respect of unsettled derivative contract shall not be allowed. Only actual loss/gain at the time of settlement would be allowed.
6. Profit of Rs. 10 lakh on sale of land to Neptune Inc. USA (WOS) would be capital asset for the construction contractor. Further, as per Sec. 50C, where the consideration received or accrued on transfer of property is less than stamp duty value of the property (SDV), then SDV shall be considered as full value of consideration
   In the instant case,
   Sale Consideration = 40,00,000 (30,00,000 cost + 10,00,000 profit).
   SDV = 50,00,000
   Since, SDV > sale consideration, SDV shall be considered as full value of consideration
   Capital Gain =
   FVC = 50,00,000
   Less : ICOA = 30,00,000 * 280/240 = 35,00,000
   Capital Gain = 15,00,000.
   Further, since Jupiter Constructions Ltd. & Neptune Inc. (WOS) would be associated enterprises, the transaction is assumed to be at ALP.
7. As per the judicial precedents, retention money would not be recognized on percentage completion & would be recognized only when right to receive is established. However ICDS III - Construction contract provides that the retention money is to be recognized on POCM.
   Further in absence of percentage of work completed, it is assumed that retention money is recognized on POCM. Hence no further effect is required.
8. Interest on fixed deposit made with a bank as margin money for obtaining a guarantee would be taxable as business income as per the decision in the case of K & Co. Further such income would not be directly related to contract & accordingly POCM will not apply on it. It would be recognized as per ICDS-IV on accrual basis. Therefore, no effect is required since it is already recognized as business income.
9. Dividend of Rs.10 lakh received from REIT:
   In case of unit holder, the characterization of income would be same as that in the hands of REIT i.e. it would be taxable in the like manner & to the same extent as in the case of REIT.
   Therefore,
   a) Short term capital gain on sale of development properties would be exempt in the hands of unit holder u/s 10(23FD) since, tax on it is paid by REIT.
   b) Rental income from properties owned by REIT of Rs.4 lakh would be business income as per Apex court decision in the case of Chennai Properties since the REIT is in the business of letting out of properties. This income would be taxable in the hands of the unit holder as business income.
10. Computation of deduction u/s 80JJAA :
   (i) 5 employees who joined in Nov, 2018 would not be eligible since employed for less than 240 days.
   (ii) 5 employees who have salary of Rs.32,000 p.m. would not be eligible since they have salary of more than Rs.25,000 p.m.
   (iii) 1 employee whose salary is paid through bearer cheque is also not eligible.
   Accordingly 9 employees drawing salary of Rs.24,500 p.m. would be eligible for deduction
   Additional employee cost = 24500*9*11 months
   = 24,25,500
   Deduction u/s 80JJAA = 30% of Rs.24,25,500
   = Rs.7,27,650.

Chapter 4 – AMT

Consequences on Tax Liability Because of Belated ROI vis-à-vis AMT

Question 13:

Victory Polyfibers, a partnership firm, has earned a gross total income of Rs. 300 Lakhs for the year ended 31-3-2019. There is no international transactions.

The above includes a profit of Rs. 220 Lakhs from an industrial undertaking having a turnover of Rs. 80 crores. This is the fifth year and deduction under section 80-IB of the Income-tax Act, 1961, is available to the extent of Rs. 200 Lakhs.

There are some grey areas in the taxation workings and hence, the assessee is contemplating to file the return of income on 7.12.2019, after seeking clarifications from tax experts.

Advise the assessee company by working out the total income and tax payable, where the return is filed on 30-09-2019 and when the same is filed on 7-12-2019.

What is the practical solution as regards obtaining clarifications, which might or might not have an impact on the total income?

Solution:

As per section 80AC, where in 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-IB, no such deduction shall be allowed unless it furnishes a return of its income for such assessment year on or before the due date as per section 139(1).

Since the turnover of the partnership firm has exceeded 100 lakh rupees 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. 2019-20 would be 30th September, 2019 as per section 139(1).

Where the firm files its return on 7-12-2019, it would be a belated return under section 139(4). Consequently, as per section 80AC, deduction under section 80-IB would not be available.

In such circumstances, the gross total income of Rs. 300 lakhs would be the total income of the firm.

The tax liability would be : -

	Rs. **in lakh**
Income-tax@30% of Rs. 300 lacs	90.00
Add: Surcharge@12% (since total income exceeds Rs. 100 lacs)	10.08
Income-tax (plus surcharge @ 12%)	100.80
Add: HEC @ 4%	4.03
	104.83
Add: Interest @ 3% u/s 234A (1% x 3 months)	3.14
Add: Penalty for late filing u/s 234F	0.05
Add: Penalty for delay in Tax Audit u/s 271B	1.50
Total+Interest+Penalty	**109.52**

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 30.9.2019 and claim deduction under section 80-IB. In such a case, the firm can claim deduction of Rs. 200 lakh under section 80-IB. Thereafter, consequent to the clarifications obtained, if any change is required, it can file a revised return under section 139(5) before 31.3.2020 (i.e., before the end of relevant A.Y.)

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**.**2019, its tax liability would stand reduced to Rs. 64.64 lakh **(See Working Note below)** as against Rs. 104.83 lakh, 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. 33.44 lakh**.** Therefore, the firm is advised to file its return of income on or before 30**.**9**.**2019**.**

Working Note **–** Computation of tax liability of the firm had it filed its return on or before 30**.**9**.**2019, being the due date of filing of return

Particulars	Rs. **In lakh**
Gross Total Income	300.00
Less**:** Deduction under section 80**-**IB	200.00
Total Income	**100.00**
Tax liability@ 30**%**	30.00
Add**:** HEC @ 4%	1.20
Regular income-tax payable	**31.20**
Computation of Alternate Minimum Tax payable	
Total Income	100.00
Add**:** Deduction under section 80**-**IB	200.00
Adjusted Total Income	**300.00**
Alternate Minimum Tax (AMT) @ 18.5% on Rs. 300 lakhs	**55.50**

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. **in lakh**
Tax @ 18**.**5**%** on Rs. 300 lakh **(**Adjusted total income**)**	55.50
Add**:** Surcharge @ 12**% (**Since adjusted total income > Rs. 1 crore**)**	6.66
	62.16
Add**:** HEC @ 4%	2.48
Total tax payable (AMT)	**64.64**

Tax credit for Alternate Minimum Tax [Section 115JD]	Rs. **In lakh**
Total tax payable for A**.**Y**.** 2019**-**20 **(**Alternate Minimum Tax**)**	64**.**64
Less**:** Regular income**-**tax payable	31**.**20
To be carried forward for set**-**off against regular income**-**tax payable **(**upto a maximum of fifteen assessment years**).**	33**.**44

Total Income of Tea Company + DDT + Tata Tea Co. Ltd. (SC)

Question 14:

Nikki Ltd. an Indian company, engaged in growing and manufacturing tea receives the following dividend income during the P.Y. 2018-19 and also the company has paid remuneration for realizing the dividend, break up of which is also given below:

Co. Information		Details about holding	Dividend income	Remuneration(Expense)
XYZ Inc.	Foreign Co.	25% of Nominal Value	80,000	4,000
PQR Inc.	Foreign Co.	30% of Nominal Value	1,85,000	9,000
LMN Inc.	Foreign Co.	55% of Nominal Value	2,15,000	-
ABC Ltd.	Indian Co.	> 50% of Nominal Value	90,000	5,000

(i) A shareholder holding 10% equity shares of the company borrowed Rs. 3,00,000 from the company @18% p.a. on 31.08.2018

(ii) On 01.08.2018, the company redeemed its redeemable bonus shares for Rs. 9,09,000

(iii) The company declared dividend of Rs. 4,20,000 at its AGM held on 30.09.2018. But the dividend remained unpaid up to 31.03.2019.

(iv) Business Income of Nikki Ltd. for PY 2018-19 is Rs. 40,00,000 before depositing the money in NABARD. On 01/08/2019 the company deposited Rs. 8,00,000 in NABARD account.

(v) 58% shares of Nikki Ltd are held by Neel Ltd.

Compute total income and tax liability of Nikki Ltd., ignoring MAT provisions. Also compute additional income tax payable by it u/s 115-O. The company is of the opinion that the scope of DDT would be restricted to 40% of the dividend declared as the source of the dividend declared is derived from the agricultural land. Analyse the contention of the company while computing the DDT.

Solution:

Computation of Total Income of Nikki Ltd for A.Y. 2019-20

Particulars		Amount (Rs.)
PGBP		
Business Income Before Deduction u/s 33AB		40,00,000
(-) Deduction u/s 33AB: Lower of:		
Amount deposited in NABARD	Rs. 8,00,000	
OR		
40% of PGBP before section 33AB	Rs. 16,00,000	(8,00,000)
Business Income		32,00,000
Rule 8: 60% Agricultural Income		(19,20,000)
PGBP (Taxable)		12,80,000
IFOS (Note 1)		4,76,000
Total Income		17,56,000

Computation of Tax Liability of Nikki Ltd for A.Y. 2019-20

Particulars	Amount (Rs.)
Tax @ 30% on 13,56,000 (17,56,000-1,85,000-2,15,000)	4,06,800
Tax @ 15% u/s 115BBD on 4,00,000 (1,85,000+2,15,000) (As LMN Inc. & PQR Inc. are specified foreign companies covered u/s 115BBD)	60,000

	4,66,800
Add: HEC @ 4%	18,672
Tax Liability	4,85,472

Computation of additional Income Tax payable by Nikki Ltd. u/s 115-O

Particulars	Amount (Rs.)	Amount (Rs.)
Dividend declared at AGM	4,20,000	
Redemption of Bonus Shares (Note 2)	9,09,000	
Taxable Dividend		13,29,000
Less: Relief u/s 115-O(1A)		
➢ Dividend received from Indian subsidiaries, on which DDT payable u/s 115-O has been paid	90,000	
➢ Dividend received from foreign subsidiaries, on which tax is payable u/s 115BBD – only LMN Inc (As holding in PQR Ltd is not>50% it is not eligible for relief u/s 115-O(1A) though it will be still covered under section 115BBD as holding is more than ≥26%)	2,15,000	(3,05,000)
		10,24,000
Add: Increase for the purpose of grossing up of dividend u/s 115-O(1B) {10,24,000 * 15/100-15}		1,80,705
Gross Dividend		12,04,705
DDT @ 15%	1,80,705	
Add : Surcharge @ 12% on Rs.1,80,705	21,685	2,02,390
Add: HEC @4% on 2,02,390		8,096
Additional Income Tax u/s 115-O (Note 3)		2,10,486

Notes:

1. Dividend income taxable under IFOS:

Particulars	Amount (Rs.)
From XYZ Inc.	80,000
From PQR Inc.	1,85,000
From LMN Inc.	2,15,000
From shares of Indian subsidiaries i.e. ABC Ltd.: Exempt u/s 10(34)	-
	4,80,000
Less: Expenses for realization of dividend	
• For XYZ Inc.(Allowed as Section 115BBD not applicable, holding less than 26%)	(4,000)
• For PQR Inc. (Disallowed u/s 115BBD, as holding is ≥26%)	-
• For LMN Inc.(No Expense)	-
• For ABC Ltd. (Disallowed u/s 14A and assumed that the expense is not being claimed anywhere else)	-
Total	4,76,000

2. Issue of bonus shares to preference shareholders is considered as deemed dividend u/s 2(22)(b).

However at the time of redemption of such shares where the payments are made in the favour of shareholders, consequences of Section 2(22)(a) are triggered as funds of the Co. are released.

3. The rate of tax on distributed profits as per Section 115-O is 17.65% (+) surcharge 12% (+) health and education cess 3% (+) secondary and higher secondary education cess of 1% i.e. EFFECTIVE RATE OF 20.5587%. (Cross check: Rs.10,24,000*20.5587% = Rs.2,10,521)
4. The tax on distributed profits shall be paid within 14 days from the date of declaration or distribution or payment of any dividend, whichever is earliest. Therefore, in this case, the dividend distribution tax is payable within 14 days of the declaration though dividend is not actually paid up to end of the previous year.
5. Borrowing by a shareholder holding 10% equity shares of the company is deemed dividend u/s 2(22)(e), taxable in the hands of shareholder. Therefore, the company is not liable to pay any tax on it.
6. If 58% shares of Nikki Ltd. are held by Neel Ltd., then Nikki Ltd. is a subsidiary company of Neel Ltd. Section 115-O(1A) has been amended by the Finance Act, 2012 to remove the condition that the holding company should not be a subsidiary of any other company for claiming reduction of dividend received from the subsidiary company from the dividend declared, distributed or paid by the holding company. Therefore, even if Nikki Ltd. is a subsidiary of Neel Ltd., it can reduce the amount of dividend received from other companies for computation of DDT.
7. The contention of the company is invalid in view of the decision of the apex court in Tata Tea Co. Ltd. where it was held that the scope of DDT u/s 115-O would not be restricted to 40% of the dividend declared and distributed as the source of such dividend declared and paid to the shareholder is not directly derived from the land but the dividend is derived from the investment made in the shares of the company.

Section 45(2) + 54EC

Question 15:

Tani purchased a land at a cost of Rs.10 Lakhs in the financial year 1984-85 and held the same as her capital asset till 31st March, 2012, fair market value of such land as on 1st April, 2001 is Rs.7 Lakhs. Tani started her real estate business on 1st April, 2012 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.150 Lakhs. She constructed 20 flats of equal size, quality and dimension. Cost of construction of each flat is Rs.8 Lakhs. Construction was completed in December, 2018. She sold 15 flats at Rs.20 Lakhs per flat between January, 2019 and March, 2019. The remaining 5 flats were held in stock as on 31st March, 2019. She invested Rs.50 Lakhs in bonds issued by Power Finance Corporation Ltd. on 31st March, 2019.

Compute the amount of chargeable capital gain and business income in the hands of Tani arising from the above transactions for Assessment Year 2019-20 indicating clearly there as on for treatment for each item. Cost Inflation Index: FY 2001-02: 100; FY 2012-13: 200; FY 2018-19: 280.

Solution:

Computation of capital gains and business income of Tani for A.Y. 2019-20

Particulars	Notes	Amount (Rs.)
Capital Gains		
Fair market value of land on the date of conversion deemed as the full value of consideration for the purposes of section 45(2)	4	1,50,00,000
Less: Indexed cost of acquisition [Rs.10,00,000 × 200/100]	3	(20,00,000)
		1,30,00,000
Proportionate capital gains arising during A.Y.2019-20 [Rs.1,30,00,000 × ¾]		97,50,000
Less: Exemption under section 54EC	6	(50,00,000)
Capital gains chargeable to tax for A.Y.2019-20		**47,50,000**
Business Income		
Sale price of flats [15 × Rs.20 Lakhs]	5	3,00,00,000
Less: Cost of flats		
Fair market value of land on the date of conversion [Rs.150 Lakhs × ¾]	4	(1,12,50,000)
Cost of construction of flats [15 × Rs.8 Lakhs]		(1,20,00,000)
Business income chargeable to tax for A.Y. 2019-20		**67,50,000**

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) As per section 55, where the capital asset acquired before the 1st April, 2001, cost of acquisition means the cost of acquisition to the assessee or the fair market value of the asset on the 1st April, 2001, at the option of the assessee. Therefore, cost of acquisition in financial year 1984-85 is more beneficial.

(5) 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 75% of the stock-in-trade (15 flats out of 20 flats) is sold in theP.Y.2018-19, only proportionate capital gains (i.e. 75%) would be chargeable in the A.Y.2019-20.

(5) On sale of such stock-in-trade, business income would arise. The business income chargeable to tax would be the difference between the price at which the stock-in-trade is sold and the fair market value on the date of conversion of the capital asset into stock-in-trade.

(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. In this case, since the investment in bonds of PFCL has been made within 6 months of sale of flats, the same qualifies for exemption under section 54EC.

Joint Development Agreement 45(5A) (+) Exemption u/s 54F

Question 16:

Mr. X was the owner of a Freehold land. In April 2017, he entered into a collaboration agreement with Arihant Builders for developing the property. According to the terms of the agreement, Arihant Builders were to develop, construct, and put up a building consisting of four independent floors – ground floor, first floor, second floor and third floor with terrace at its own cost. Mr. X handed over to Arihant Builders, the physical possession of the entire property, for the limited purpose of development. Arihant Builders was to get the third floor plus the undivided interest in the land to the extent of 25% for its exclusive enjoyment. The remaining floors (i.e., the ground floor, first and second) were to be handed over to Mr. X after construction.

The cost of construction of each floor was Rs. 1 crore, which was borne by Arihand Builders. In addition to the cost of construction incurred by Arihant Builders on development of the property, a further amount of Rs. 5 crore was payable by Arihant Builders to Mr. X as consideration against the rights of Mr. X. Part completion certificate of ground, first and 2nd floor was received on 31/03/2019. The SDV as on the said date was Rs. 50 lakhs, 60 lakhs, 75 lakhs respectively.

You are required to discuss and resolve the following issues arising in the assessment of Mr. X as a result of the above transaction –

(i) What is the year of chargeability of the capital gains on transfer of land?

(ii) For computation of capital gains, what should be the full value of consideration accruing as a result of transfer of the capital asset?

(iii) Is Mr. X eligible for exemption under section 54F?

(iv) If the answer to (ii) is yes, whether exemption is to be restricted to the cost of construction of one independent floor, on the reasoning that the floors given to Mr. X contained independent residential units having seprate entrances and therefore, cannot quality as a single residential unit?

Solution:

(i) Where an individual/HUF has entered into a joint development agreement with a builder, then subject to section 45(5A), Capital Gains arising to the individual on transfer of such land/building to the builder shall be taxable as income of the previous year in which the certificate of completion for whole or part of the project is issued by the competent authority.

In the present case the part completion certificate of ground, first and 2nd floor was received on 31/03/2019. Therefore the year of chargeability of capital gains arising on transfer of land shall be P.Y. 2018-19.

(ii) As per Section 45(5A) the stamp duty value of the share of owner of land/ building in the developed property on the date of issuing of said certificate of completion, as increased by any monetary consideration received, if any, shall be deemed to be the full value of consideration received or accruing as a result of the transfer of the capital asset.

Therefore in the present case the FVC = Rs. 50 lakhs + Rs. 60 lakhs + Rs. 75 lakhs + Rs. 5 crore = Rs. 6.85 crore.

(iii) Yes, Mr. X is eligible for exemption under section 54F. Since the cost of construction of the floors handed over to Mr. X has been included in the full value of consideration, the same would also represent investment by Mr. X in residential house. Hence, Mr. X is eligible for exemption under section 54F.

(iv) Section 54F uses the expression “residential house” and not “residential unit”. Section 54F requires the assessee to acquire a "residential house" and so long as the assessee acquires a building, which may be constructed, for the sake of convenience, in such a manner as to consist of several units which can, if the need arises, be conveniently and independently used as an independent residence, the requirement of the section should be taken to have been satisfied. There is nothing in the section which requires the residential house to be constructed in a particular manner. The only requirement is that it should be for residential use and not for commercial use. The physical structuring of the new building, whether lateral or vertical, should not come in the way of considering the building as a residential house.

The fact that the residential house consists of several independent units cannot be permitted to act as an impediment to the allowance of the exemption under section 54F. It is neither expressly nor by necessary implication prohibited. Therefore, Mr.X is entitled to exemption of capital gains in respect of investment of Rs. 3 crores in the residential house, comprising of independent residential units handed over to him.

Capital Gains Arising on Liquidation of Companies: 46(1) & 46(2) + Exemption u/s 54EC

Question 17:

Aries Tubes Private Ltd. went into liquidation on 01.06.2018. The company was seized and possessed of the following funds prior to the distribution of assets to the shareholders:

Particulars	*Amount (Rs.)*
Share Capital (issued on 01.04.2014)	*5,00,000*
Reserves prior to 1.6.2018	*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.

Solution:

→ 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 section2(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 profit 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.

Capital Gains Calculation u/s 112A: Effect of Amendment FA 2018

Question 18:

Mr. Investor, an individual aged about 50 years, resident of India, provides following details:

1) ***He had acquired 500 shares of “R” Ltd. on 01/04/2015 @ Rs. 700 per share.***
2) ***STT was paid on acquisition of such shares.***
3) ***Suppose, he sells the above shares on 01/05/2018 and the details are as under:***

Rs.

	A	***B***
Sale price per share	***1600***	***2000***
FMV as on 31/01/2018	***900***	***900***
Cost of Acquisition	***700***	***700***

4) ***He is entitled to get deduction u/s 80C to the extent of Rs. 1,25,000***

Solution:

Computation of total income and tax payable thereon for AY 2019-20 as follows:
Long Term Capital Fain on sale of shares

Rs.

Sale consideration (I)	8,00,000	1,000,000
Cost of Acquisition		
A. Actual cost (II)	3,50,000	3,50,000
B. Lower of the following		
a) Fair market value	4,50,000	4,50,000
b) Actual sale consideration (As per (I) above)	8,00,000	1,000,000
Lower of the above (III)	4,50,000	4,50,000
Deemed cost of acquisition		
Higher of (II) and (III) of above – (IV)	4,50,000	4,50,000
Long term capital gain/loss [(I) – (IV)]	3,50,000	5,50,000
Less: Deduction under Chapter VI-A	-	-
Total Income	**3,50,000**	**5,50,000**

Tax Payable on above		
Threshold limit *i.e.* no tax up to Rs. 2.5 lacs		
LTCG in excess of Rs. 1,00,000 & threshold	-	2,00,000
a) Tax payable @ 10% on above	-	20,000
b) Tax as per normal applicable rates	-	-
Aggregate Income Tax (a+b)	-	20,000
Less: Rebate i/s 87A	-	-
Balance Income Tax	-	20,000
Add: Health & Edcucation Cess @ 4%	-	800
Total tax payable	-	**20,800**

Explanatory Notes:

In Situation A:

- Rebate u/s 87A is available, if the total income us less than or equal to Rs. 3,50,000.
- In this situation, total income is Rs. 3.5 lacs and no tax is payable u/s 112A upto INR 1,00,000.
- After considering threshold limit of Rs. 2.5 lacs and exemption from tax u/s 112A up to Rs. 1,00,000, nothing remains taxable at all. Therefore, question of claiming rebate u/s 87A does not arise.
- However, the section provides that rebate is not available against tax payable as per section 112A, which as such does not have any impact at present.

In Situation B:

- No deduction under Chapter VI – A is available against long term capital gains.

Real Estate Tax Implication in the Hands of Seller & The Buyer

Question 19:

Ms. Kala purchased a residential flat from her friend Mr. Bala @ Rs.10 Lakh in the city of Jaipur on 3rd Oct, 2018. The value determined by the Stamp Valuation Authority for stamp duty purpose amounted to Rs.15 Lakhs. Mr. Bala had purchased the flat on 1st Jan, 2016 at a cost of Rs.3.5 Lakhs. Ms. Kala sold the

flat for Rs.20 Lakhs on 30th March, 2019. Determine the effect of the above transactions on the assessments of Mr. Bala & Ms. Kala for A.Y. 2019-20, assuming that the value for stamp duty purpose in case of second sale was not more than sale consideration.

Solution:

Tax treatment in the hands of the seller, Mr. Bala

Section 50C provides that where the consideration received or accruing as a result of transfer of a capital asset, being land or building or both, when SDV exceed 105% of actual consideration received then the value adopted or assessed or assessable by authority of a State Government for the purpose of payment of stamp duty in respect of such transfer, the value so adopted or assessed or assessable shall be deemed to be the full value of the consideration received or accruing as a result of such transfer for computing capital gain.

In the instant case, Mr. Bala sold the residential flat at Jaipur to his friend Ms. Kala for Rs.10 Lakhs, whereas the stamp duty value was Rs.15 Lakhs which exceed 10.5Lakhs (105% of 10Lalks) Therefore, stamp duty value shall be deemed to be full value of consideration for the sale of the property. Therefore, long-term capital gain arising to Mr. Bala for assessment year 2019-20 will be Rs.11.29Lakhs (i.e. Rs.15Lakhs –Rs.3.71Lakhs). 3.5*280/264=3.71Lakhs

Tax treatment in the hand of the buyer, Ms. Kala

The taxability provisions under section 56(2) (x), includes within its scope, any immovable property, being land or building or both, received for inadequate consideration by an individual or HUF.

As per section 56(2)(x), where any immovable property is received for a inadequate consideration and the difference between the consideration and stamp duty value exceeds Rs.5,00,000,being the higher of 50,000 and 5% of consideration.

Therefore,Rs 5,00,000,being the difference between the stamp duty value Rs15,00,000 and actual consideration 10,00,000 would be chargeable to tax in the hands of the recipient (Individual/HUF) as ‘income from other sources’ **Under section 56(2)(x)**.

As per section 49(4), the cost of acquisition of such property for computing capital gains would be the value which has been taken into account for section 56(2)(x). Accordingly Rs.15Lakhs would be taken as the cost of acquisition of the flat. Therefore, on sale of the flat by Ms. Kala, Rs.5Lakhs (i.e. Rs.20Lakhs –Rs.15Lakhs) would be chargeable to tax as short-term capital gains in her hands for A.Y.2019-20. Since this is a case covered by section 49(4) and not section 49(1), the period of holding of the previous owner, namely, Mr. Bala, will NOT be considered for determining whether the capital gain is short term or long term.

Tax Implications on Transfer of Capital Assets by a 100% Holding Company to Its Subsidiary or Vice Versa

Question 20:

A Ltd. holds 100% equity shares of B Ltd. It has acquired land on 01/06/2008 for Rs. 1 lakh. The said land was transferred to B Ltd. on 30/06/2017 for Rs. 15 lakhs. B Ltd. transferred the land on 01/10/2018 for Rs. 25 lakhs. Discuss the tax implications for AY 2018-19 & AY 2019-20 in the hands of A Ltd. & B Ltd. What shall be your answer if B Ltd. converts the capital asset into stock in trade on 01/09/2018. The FMV as on the date of conversion was Rs. 22 lakhs. B Ltd. has invested the consideration in acquiring the bonds of NHAI on 15/12/2018. You are also required to suggest the benefit of such investments in computing the capital gains in both the above cases.

Solution:

(1) **<u>Original Transfer as on 30/06/2017:</u>**
A Ltd. holds 100% Equity shares in B Ltd. Therefore the benefit of Section 47 shall be available to A Ltd. on transfer of capital asset being land to B Ltd.

However, in the following 2 cases the exemption availed by the transferor (A Ltd.) shall be revoked and it shall be chargeable in the hands of the transferor (A Ltd.) in the year of the original transfer (A.Y. 2018-19):

a) The holding company cease to be a 100% holding company; OR
b) Within 8 years from the date of the transfer, the transferee has converted the capital asset into stock-in-trade.
   Further the Finance Act, 2018 with retrospective effect has amended Section 56(2)(x) where by a transferee being a wholly owned company receiving capital assets from its 100% holding company or vice versa shall not be subject to the charge of section 56(2)(x).

(2) **On Subsequent Transfer of the Capital Asset by B Ltd. as on 01/10/2018:**
The lock-in period of 8 years mentioned in point 1 above is only for conversion into stock-in-trade. It does not require transferee to hold the capital asset for a period of 8 years. Therefore the exemption earlier availed by A Ltd. shall not be revoked. The capital gain chargeable in the hands of B Ltd. for AY 2019-20 shall be computed as follows:

Computation of Capital Gain u/s 48

(Rs. In Lakhs)

Particulars	Amount
Full Value of Consideration (Assuming: SDV < 105% consideration)	25.000
(-) Indexed cost of acquisition: Rs. 1 lakh X (280/137)	(2.043)
Long Term Capital Gains (-) Exemption u/s 54EC	22.956 (22.956)
Taxable LTCG	NIL

Note:

- Where the exemption u/s 47 is not revoked the cost of acquisition, on subsequent transfer, shall be the cost to the previous owner.
- Further, the period of holding of the previous owner (A Ltd.) shall be clubbed in determining the nature of the capital asset. Also the benefit of Indexation shall be available from the year when the previous owner has acquired the asset (Manjula J Shah).
- u/s 54EC, gain arising from transfer of land or building or both, being a long term capital asset, shall be eligible for exemption if the consideration is invested in the notified bonds within 6 months from the date of transfer. Therefore, B Ltd. shall be eligible for exemption u/s 54EC as the conditions laid therein is satisfied.

(3) **If B Ltd. Converts the Capital Assets into Stock-in-Trade on 01/09/2018:**
Since the capital asset is converted into stock-in-trade within the lock in period by the transferee, the following shall be the consequences:

a) In the hands of the transferor (A Ltd.):
   The exemption availed earlier u/s 47 shall be revoked. The capital gains chargeable for AY 2018-19 shall be as under:

Particulars	Amount
Full Value of Consideration (Assuming Consideration Received > SDV)	15,00,000
(-) Indexed cost of acquisition: Rs. 1 lakh X (272/137)	(1,98,540)
LTCG Chargeable for AY 2018-19	13,01,460

b) In the hands of B Ltd:

Conversion of capital asset into stock in trade is a transfer u/s 2(47). As per section 45(2) the capital gain shall be chargeable in the previous year in which the stock-in-trade is sold (and not in the year of conversion). Further, B Ltd. shall also be chargeable under the head PGBP in the year in which stock-in-trade is sold.

Computation of Capital Gains U/s 48

Particulars	Amount
Full Value of Consideration (Sec. 45(2): FMV of the Capital Asset as on the date of conversion)	22,00,000
Less: Cost of Acquisition	15,00,000
Short Term Capital Gains (-) Exemption u/s 54EC	7,00,000 NIL
Short Term Capital Gains	7,00,000

Note:

- Once the exemption is revoked in the hands of the transferor the cost of acquisition shall be the cost to the assessee (and not that of the previous owner). In determining the nature of capital asset the period of holding of the previous owner shall not be clubbed. Hence, in the present case the capital asset is a short term capital asset as the period of holding does not exceed 24 months (30/06/2017 to 01/09/2018).
- The benefit of exemption u/s 54EC is available in respect of long term capital asset only.

Computation of Business Income Arising from Such Transfer Chargeable in AY 2019-20

(Rs. In Lakhs)

Particulars	Amount
Sale Consideration	25,00,000
(-) Cost (FMV)	22,00,000
Business Income	3,00,000

Comprehensive Problem on Demerger

Question 21:

SS(P) Ltd., a domestic Indian company having two undertakings engaged in manufacture of cement and steel, decided to give off cement division to RV(P) Ltd., a domestic Indian company, by way of demerger. The net book value of assets of SS (P) Ltd. before demerger was Rs.40 crores. The net book value of assets transferred to RV (P) Ltd. was Rs.10 crores. The demerger was made in January 2019. 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 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 2005-06 for Rs.6, 00,000. Mr. N.K. received 50,000 equity shares from RV (P) Ltd. consequent to demerger in January 2019. He sold all the shares of RV (P) Ltd. for Rs.8, 00,000 in March, 2019. 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) ***State the conditions in brief, which are to be satisfied under the Act for a demerger.***

(iii) ***Compute the capital gain that could arise in the hands of Mr. N.K. on receipt of shares of RV (P) Ltd.***

(iv) ***Compute the capital gain that could arise in the hands of Mr. N.K. on sale of shares of RV (P) Ltd.***

(v) ***Will the sale of shares by Mr. N.K. affect the tax benefits availed by SS (P) Ltd. and/or RV (P) Ltd.?***

(vi) ***Is Mr. N.K. eligible to avail any tax exemption under any of the provisions of the Income-tax Act,***

1961 on the sale of shares of RV (P) Ltd.? If so, state in brief.

Financial Year	***Cost inflation index***
2005-06	***117***
2018-19	***280***

Solution:

(i)	No, the transaction of demerger would not attract any income-tax liability in the hands of SS (P) Ltd. 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)	As per section 2(19AA), demerger should satisfy the following conditions – i. All assets & liabilities of undertaking being transferred by the demerged co., immediately before the demerger, becomes assets & liabilities of the resulting co by virtue of the demerger ii. The assets & liabilities so transferred are transferred at book values (ignoring Revaluation) iii. The resulting company issues, in consideration of the demerger, its shares to the shareholders of the demerged co on a proportionate basis iv. The shareholders holding not less than 75% in value of the shares in the demerged co become shareholders of the resulting company or companies v. The transfer of the undertaking is on a going concern basis vi. Demerger is in accordance with conditions as may be specified by the CG.
(iii)	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

<table>
<tr>
<td>(iv)</td>
<td>
Yes, capital gains would arise in the hands of Mr. N.K. on sale of shares of RV (P) Ltd.
<table>
<tr><th>Particulars</th><th>Amount (Rs.)</th></tr>
<tr><td>Sale Consideration</td><td>8,00,000</td></tr>
<tr><td>Less: Indexed cost of acquisition of shares of RV (P) Ltd.
$=1,50,000 \times \frac{280}{117}$
Sec 49(2C): Cost of Shares of Resulting Co
Cost of shares of Demerged Co (Before Demerger) × <u>Net Book Value of assets transferred to Resulting Co</u> / Net Worth of Demerged Co.
$=600,000 \times \frac{10 \text{ Crores}}{40 \text{ Crores}} = 1,50,000$</td><td>(3,58,974)</td></tr>
<tr><td>LTCG (∵ POH of shares in demerged Co. is also to be considered)</td><td>4,41,026</td></tr>
</table>
</td>
</tr>
<tr>
<td>(v)</td>
<td>
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.
</td>
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<tr>
<td>(vi)</td>
<td>
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 in 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 or 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.
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Comprehensive Problem on Conversion of Private Company into LLP

Question 22:

Kalpesh Pvt Ltd. was converted into limited liability partnership (LLP) called Kalpesh LLP on 01-07-2018. You are provided with the following particulars of Kalpesh Pvt Ltd. as on 31-03-2018:

- ***a) Unabsorbed depreciation Rs.13 Lakhs***
- ***b) Business loss Rs.10 Lakhs (relating to P.Y. 2010-11)***
- ***c) Unadjusted MAT credit u/s 115JAA Rs.8 Lakhs***
- ***d) Written down value of the assets as per sec 43(6) of the Income Tax Act:***
  Plant and Machinery (15%) Rs.10 Lakhs (Market Value Rs.15 Lakhs)
  Plant and Machinery Rs.50 Lakhs (Cost) – deduction claimed u/s 35AD
  Building (10%) Rs.20 Lakhs (Market Value Rs.100 Lakhs)
- ***e) Cost of land (acquired in year 2001) Rs.50 Lakhs (Market value Rs.100 Lakhs)***
- ***f) Expenditure on voluntary retirement incurred by the company during the P.Y. 2016-17 is Rs.25***

Lakhs. The company has been allowed deduction of Rs.5 Lakhs each for each year for the P.Y. 2016-17 and P.Y. 2017-18 u/s 35DDA.

Explain the tax treatment of each item stated above in the hands of LLP, assuming that the conversion satisfies all the conditions laid down in section 47(xiiib).

Solution:

Tax implication on conversion of company into LLP

<table>
<tr><td>(a)</td><td>As per section 72A(6), Kalpesh LLP would be able to carry forward the unabsorbed depreciation of Kalpesh Pvt Ltd. as on 31-03-2018 indefinitely for set off against its income.</td></tr>
<tr><td>(b)</td><td>As per section 72A (6), Kalpesh LLP would be able to carry forward and set off the business loss of Kalpesh Pvt Ltd. as on 31-03-2018. The business loss is eligible for set off against business income of LLP in the A. Y. 2019-20. Such accumulated loss can be carried forward for fresh period of 8 years.</td></tr>
<tr><td>(c)</td><td>As per section 115JAA (7), the credit of MAT paid by Kalpesh Pvt Ltd. cannot be availed by the successor LLP.</td></tr>
<tr><td>(d)</td><td>As per Explanation 2C to section 43(6), the actual cost of the block of assets in the case of Kalpesh LLP would be the written down value of the block of assets of Kalpesh Pvt Ltd. on the date of conversion. The aggregate depreciation allowable to Kalpesh Pvt Ltd. and Kalpesh LLP in the P.Y. 2018-19 cannot exceed the depreciation calculated at the prescribed rates as if the conversion had not taken place [Sixth proviso to sec 32(1)(iii)]
The aggregate depreciation for the P.Y. 2018-19 shall be calculated as follows:
Plant and Machinery Rs.1.50 Lakhs (15% of Rs.10 Lakhs)
Building Rs.2 Lakhs (10% of Rs.20 Lakhs)

In this case, since the conversion took place on 01-07-2018, the depreciation has to be apportioned between the company and the LLP in the proportion to the number of days the assets were used by them. In such a case, the depreciation allowable in the hands of Kalpesh Pvt Ltd. and Kalpesh LLP would be calculated as given below:
<table>
<tr><th>Asset</th><th>In the hands of Kalpesh Pvt Ltd. (For 91 days)</th><th>In the hands of Kalpesh LLP (For 275 days)</th></tr>
<tr><td>Plant and Machinery</td><td>1,50,000 x 91/366 = Rs.37,295</td><td>1,50,000 x 275/366 = Rs.1,12,705</td></tr>
<tr><td>Building</td><td>2,00,000 x 91/366 = Rs.49,727</td><td>2,00,000 x 275/366 = Rs.1,50,273</td></tr>
</table>

The written down value of assets as on 01-07-2018 will be
<table>
<tr><th>Asset</th><th>WDV as on 01-07-2018</th></tr>
<tr><td>Plant and Machinery</td><td>Rs.10,00,000 – Rs.37,295 = Rs.9,62,705</td></tr>
<tr><td>Building</td><td>Rs.20,00,000 – Rs.49,727 – Rs.19,50,273</td></tr>
</table>
In the hands of Kalpesh LLP, the actual cost of Plant and Machinery in respect of which deduction has been claimed u/s 35AD by Kalpesh Pvt Ltd., would be NIL [Explanation 13 to section 43(1)]</td></tr>
</table>

(e)	The cost of acquisition of a non-depreciable asset, being land, in the hands of Kalpesh LLP would be the cost for which Kalpesh Pvt Ltd. acquired it, i.e. Rs.50 Lakhs [Section 49(1)]
(f)	Kalpesh LLP would be eligible for deduction of Rs.5 Lakhs each for the remaining three years i.e. P.Y. 2018-19, 2019-20 and 2020-21 as per sec 35DDA (4A).

Comprehensive Total Income Question Involving House Property, Capital Gains and Taxation of Income of the Securitisation Trust in the Hands of the Investor

Question 23:

Compute the taxable income of Mr. Singh for the P.Y. 2018-19.

Following are the details of income provided by Mr Singh, the assessee for the financial year ended 31st March 2019.

1. ***Rental income from property at Bangalore – Rs.2, 00,000/-. Standard rent – Rs.1, 50,000 Lakhs, Fair rent Rs.1, 80,000.***
2. ***Municipal & Water tax paid during 2018-2019 – Current year – Rs.35,000, Arrears – Rs.1, 50,000.***
3. ***Interest on Loan borrowed towards major repairs to the property – Rs.6, 00,000.***
4. ***Unrealized rent of Rs.5, 00,000 received during the year which was not charged to tax in earlier year.***

Mr Singh sold a house property in Chennai, the details are as under:

1. ***Mr. Singh's father acquired a residential house in April, 1993 for Rs.25,000 and thereafter gifted property to Mr. Singh on 1-03-1994.***
2. ***The property so gifted was sold by Mr. Singh on 10-06-2018 the consideration received was Rs.25,00,000***
3. ***Stamp duty charges paid by the purchaser at the time registration @ 13% was Rs.3, 90,000. The stamp duty value as on the date of agreement was Rs. 35, 00,000.***
4. ***On 2-01-2019, the assese had purchased 2 adjacent flats in the same building and made suitable modifications to make it as 1 unit. The investment was made by separate sale deeds, amount being Rs.18, 00,000 &Rs.17, 00,000 respectively.***

On 15-03-2019, Rs.15 lakhs was invested in bonds issued by NHAI, but allotment was made on 3-4-2019.

Mr. Singh being one of the investors of Securitisation Trust received Rs.5 lakh during the previous year 2018-19.The Securitisation Trust had the following incomes in previous year 2018-19:

Interest Income: Rs.5 lakhs

Dividend Income: Rs.7 Lakhs

STCG: Rs.15 lakhs

Mr Singh received dividend from investment in various companies during financial year 2018-19 to the tune of Rs.11.5 lakhs.

Compute the total income of A.Y – 2019-20. (CII: F.Y - 2018-19: 280, F.Y – 2013-14: 220, F.Y – 2001-02: 100)

Solution:

<u>Computation of total income of Mr Singh for A.Y 19-20</u>

Particulars	Amount	Amount
GAV (Higher of expected & actual rent)	**2,00,000**	
Expected rent **(**Lower of fair rent &std rent**)** 1,50,000		
- Actual rent 2,00,000		

(-) Municipal taxes paid **(**including the arrears**)**	**(**1,85,000**)**	
NAV	**15,000**	
(-) deduction u**/**s 24		
a**)** 30**%** of NAV 4,500		
b**)** Interest on loan borrowed for major repairs to property 6,00,000	(6,04,500)	
	(5,89,500)	
Unrealized rent 5,00,000		
(–) deduction @ 30**%** (1,50,000)	3,50,000	
Income from H.P (See note 3)	**(2,39,500)**	**(2,00,000)**
Income from Capital gains		
FVC (As sec 50C higher of the following :)	**35,00,000**	
Actual consideration 25,00,000		
Stamp duty value as on the date of agreement **Stamp duty exceed 105% of actual consideration** 35,00,000		
Where the date of agreement & date of registration of property are not same, the value assessable by the Stamp Valuation Authority as on the date of agreement may be taken**.** It is assumed that whole or part of the consideration is received on or before the date of agreement otherwise than by way of cash.		
(-) ICOA **(**Rs.25,000 x 280**/**100**)**	**(**70,000**)**	
*As per sec 49***(***1***)***, cost of acquisition of the residential house gifted to Mr. Singh would be the cost for which Mr. Singh***'***s father acquired the asset***.** *Indexation benefit shall be available w***.***e***.***f the p***.***y in which the previous owner held the asset* **(***CIT v***.** *Majula J Shah***)**		
LTCG	**34,30,000**	
(-) Exemption u**/**s 54 (See note 1)	**34,30,000**	**NIL**
(-) Exemption u/s 54EC (See note 4)		**NIL**
STCG		
STCG (5 lakhs * 15/27) (See note 2)		2,77,778
IFOS		
Interest Income (Rs.5 lakhs *5/27) (See note 2)		92,593
Dividend Income (Rs.5 lakhs *7/27) (See note 2)	1,29,630	-
Dividend received from other investments	11,50,000	
Less: Exempt u/s 10(34)	(10,00,000)	2,79,630
Total Income (See note 3)		**4,50,001**

Notes:

1) Section 54 and 54F have been amended by FA 2014, clarify that the exemption available there under would be in respect of the investment in one Residential house in India. In **Ananda Basappa's** case, the assesse had invested in two adjacent flats and necessary modifications were effected so that the flats can be used as single residence. The High court held that the assesse was entitled to exemption u/s 54 in respect of investment in both the residential flats,

since they were intended to be used as a single residence. It appears that even after the amendment by Finance Act 2014, the above ruling will continue to hold good, since section 54 and 54F use the expression " residential house" and not " residential unit".

2) In case taxability of income distributed by securitization trust to the investor the income will be taxable in the hands of investor in the same proportion as it is in the hands of securitization trust in the ratio of 5:7:15.
    i. Interest Income of Rs.5 lakh * 5/27 = Rs.92,593 @ normal slab rates applicable to the individual
    ii. Dividend Income of Rs.5 lakh * 7/27 = Rs.1, 29,630 is Exempt subject to section115BBDA.
    iii. STCG of Rs.5 lakh * 15/27 = Rs.2, 77,778 @ normal slab rates applicable to the individuals.
3) Section 71 regulates the provisions pertaining to Inter-head adjustments of losses. A new sub-section (3A) has been inserted to provide that set off of loss under the head "Income form House Property" against any other head of income shall be restricted to Rs.2 lakh for any assessment year. However, unabsorbed losses shall be allowed to be carried forward for set-off in subsequent years in accordance with the existing provisions of section 71B.
4) Although there is no further need of exemption u/s 54EC but even otherwise it is not available since the investment in the notified bonds is made on 15/03/2019, which is beyond 6 months from the date of transfer.

Chapter 7 – Set off and Carry Forward of Losses

Total Income Computation of Amalgamated Company with Adjustment Relating to Section 72A

Question 24:

ABC Ltd. was amalgamated with XYZ Ltd. on 01.04.2018. All the conditions of section 2(1B) were satisfied.ABC Ltd. has the following carried forward losses as assessed till the A.Y. 2018-19:

Sr. No.	Particulars	Amount (Rs. in Lakhs)
(i)	Speculative Loss	4
(ii)	Unabsorbed Depreciation	18
(iii)	Unabsorbed expenditure of capital nature on scientific research	2
(iv)	Business Loss	120

XYZ Ltd. has computed a profit of Rs. 140 Lakhs for the F.Y. 2018-19 before setting off the eligible losses of ABC Ltd. but after providing depreciation at 15% per annum on Rs. 150 Lakhs, being the consideration at which plant and machinery were transferred to XYZ Ltd. The written down value as per income tax record of ABC Ltd. as on 31st March, 2018 was Rs. 100 Lakhs.

The above profit of XYZ Ltd. includes speculative profit of Rs. 10 Lakhs.

Compute the total income of XYZ Ltd. for A.Y. 2019-20 and indicate the losses/other allowances to be carried forward by it.

Solution:

Computation of total income of XYZ Ltd. for the A.Y. 2019-20

Particulars	Amount (Rs. in Lakhs)	
Business income		
Business income before setting-off brought forward losses of ABC Ltd.		140
Add: Excess depreciation claimed in the scheme of amalgamation of ABC Ltd. with XYZ Ltd.		
Value at which assets are transferred by ABC Ltd.	150	
WDV in the books of ABC Ltd.	100	
Excess accounted	50	
Excess depreciation claimed in computing taxable income of XYZ Ltd. [Rs. 50 Lakhs × 15%] [Explanation 2 to section 43(6)]		7.50
		147.50
Set-off of brought forward business loss of ABC Ltd. **(Notes 2 & 4)**		(120.00)
Set-off of unabsorbed depreciation under section 32(2) read with section 72A **(Notes 2 & 4)**		(18.00)
Set-off of unabsorbed capital expenditure under section 35(1)(iv) read with section 35(4) **(Note 5)**		(2.00)
Total		**7.50**

Notes:

1. It is presumed that the amalgamation is within the meaning of section 72A of the Act.
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 Lakhs 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. 2018-19.

Whether Application by Other Person in the Transaction to the AO, will Prohibit the Foreign Company to Approach AAR on Similar Grounds?

Question 25:

A foreign company entered into contracts with several Indian companies for installation of mobile telephone system and made an application to the Authority for Advance Rulings for advance ruling on the rate of withholding tax on receipts from Indian companies. One of the Indian companies had also made an application to the Assessing Officer for determination of the rate at which tax is deductible on payment to the said foreign company. The Authority for Advance Rulings rejected the application of the foreign company 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 the foreign company justified in law?

Solution:

The matter relates to the admission or rejection of the application filed before the Advance Rulings Authority on the ground specified in clause (i) of the first proviso to sub-section (2) of section 245R of the Income-tax Act, 1961

Clause (i) of the first proviso of section 245R(2) provides that the Authority shall not allow the application where the question raised in the application is already pending before any income-tax authority or Appellate Tribunal or any court. (except in case of resident falling in sub-clause (iii) of clause (b) of section 245N)

In the above case, no application had been filed or contention urged by the applicant (foreign company) before any income-tax authority/Appellate Tribunal/court, raising the question raised in the application filed with AAR. One of the Indian companies, however, raised the question before the Assessing Officer, not on the applicant's behalf or with a view to benefit the applicant, but only to safeguard its own interest, as it had a statutory duty to deduct the proper amount of tax from payments made to a non-resident applicant, it was not one pending determination before any income-tax authority in the applicant's case.

Therefore, as held by the AAR in Ericsson Telephone Corporation India AB v. CIT (1997) 224 ITR 203, the application filed by the Indian company before the Assessing Officer cannot be treated to have been filed by the non-resident. Hence, it would not be proper to reject the application of the foreign company relying on clause (i) of the proviso to sub-section (2) of section 245R of the Income-tax Act, 1961.

Chapter 9 – Penalties and Prosecution

Violation of Section 269SS & Section 269T

Question 25:

Mr. Garib gave loan to Mr. Amir of Rs. 15,000 on 1st May, 2018 through account payee cheque and another Rs. 17,000 on 4th January, 2019 in cash.

Mr. Amir has repaid Rs. 16,500 towards Principal & Interest against first loan through bearer cheque on 4th July, 2019 and Rs. 18,500 on towards Principal & Interest against second loan through A/c. payee draft on 25th January, 2020.

Discuss the violation of Income Tax Provision if any and consequential penalty for each transaction. Will it make any difference if loan was given on joint name with Ms. Aiyashi, sister of Mr. Amir, while repaying back in cash or bearer in cash or bearer cheque?

Solution:

1. **First Loan of Rs. 15,000 (Cheque)**– No Violation: As the amount of Rs. 15,000 deposited on 01.05.2018 does not exceed Rs. 20,000, there is no violation under any of the clauses of Section 269SS.
2. **Second Loan of Rs.17,000 (Cash)** – Violation: The second deposit in cash on 04.01.2019 is in violation of Section 269SS, as there is already outstanding deposit of Rs. 15,000 & another cash deposit of Rs. 17,000 would make the aggregate amount of loan to Rs. 32,000, which exceeds the limit of Rs. 20,000. Hence, penalty u/s 271D is attracted, which is equal to the amount of loan taken from Mr. Garib.
3. **First repayment of loan of Rs. 16,500**–Violation: The repayment on 04.07.2019 is in violation of Section 269T, as the aggregate loan amount outstanding along with interest on 04.07.2019 exceeds Rs. 20,000. Hence, penalty u/s 271E is attracted, which is equal to the amounts so repaid, i.e.,Rs. 16,500.
4. **Second Repayment of loans of Rs. 18,500**–No Violation: The second repayment on 25.01.2020 is not in violation as per sec 269T, as neither the loan amount with interest nor the aggregate loan alongwith interest held by Mr. Amir on 25.01.2020 exceed the limit of Rs. 20,000.
5. **Loan in Joint Names**: If the Loan was taken in joint names of Amir and Aiyashi, it will not make any difference as regards the contraventions of the provisions of Section 269SS and 269T.

Actual Cost of Depreciable Asset When Repayment of the Consideration is in Cash & Default of Section 269ST in the Hands of Recipient

Question 26:

X Ltd. is a wedding planner. Different functions pertaining to the wedding of Y's son are arranged by X Ltd. For this event, four different invoices are issued by X Ltd. to Y (Invoice 1 for ring ceremony: Rs. 17,25,000. Invoice 2 for sagan ceremony: Rs. 21,00,000, Invoice 3 for marriage ceremony: Rs. 35,00,000 and Invoice 4 for reception: Rs. 28,00,000). Rs. 2,10,000 (i.e., Rs. 1,95,000 for Invoice 1 paid on June 3, 2018 and Rs. 15,000 for Invoice 2 paid on June 5, 2018) is received in cash/ bearer cheque/ crossed cheque. The balance is received on August 19, 2018 by RTGS (in the Current account of X Ltd. from the saving bank account of Y). Discuss whether provisions of section 269ST and 271DA are applicable.

Solution:

As per the payment pertaining to one event/occasion (*i.e.,* marriage of Y's son) received in cash/bearer cheque/crossed cheque is Rs. 2,10,000, it is covered by section 269ST. The Assessing Officer can impose 100% of Rs. 2,10,000 as penalty on X Ltd. under section 271DA.

Penalty u/s 271AAC

Question 27:

Mr. Rajiv is a retail trader and his total income for the last few years ranged between Rs. 8 lakh to Rs. 10 lakh. He celebrated his 25th wedding anniversary on a large scale on 2nd December, 2018 by hosting a cruise party in the luxury cruise liner "Ocean Princess", for which he had spent Rs. 30 lakh. The Assessing Officer, in the course of scrutiny assessment of Mr. Rajiv, asked him to explain the source of such expenditure. The explanation offered by Mr. Rajiv that the same was out of his savings for the last few years, was not found satisfactory by the Assessing Officer, since a couple of years ago, he had spent to tune of Rs. 60 lakh on the grand wedding celebrations of his daughter at Vijayaseshmahal in Chennai. You are required to examine the tax consequences.

Solution:

If any expenditure is incurred by an assessee in any financial year in respect of which he is not able to offer explanation about the source of such expenditure or the explanation offered by him is not satisfactory in the opinion of the Assessing Officer, then the amount of such unexplained expenditure may be deemed as income of the assessee for such financial year as per section 69C.

Therefore, in this case, since the Assessing Officer is not satisfied with the explanation offered by Mr. Rajiv, the expenditure of Rs. 30 lakh incurred by him in the financial year 2018-19 in hosting a grand cruise party may be deemed as his income for P.Y. 2018-19 as per section 69C.

Further, such unexplained expenditure which is deemed as the income of Mr. Rajiv shall not be allowed as deduction under any head of income.

Where the total income of Mr. Rajiv includes such unexplained expenditure of Rs. 30 lakh, which is deemed as his income under section 69C, such deemed income would be taxed at the rate of 60% as per section 115BBE plus surcharge@25% and cess@4%. The effective rate of tax would be 78%.

Further, no basic exemption or allowance or expenditure shall be allowed to him under any provision of the Income-tax Act, 1961 in computing such deemed income. No set-off of loss is permissible against such deemed income.

New section 271AAC has been inserted with effect from 1st April, 2018 in the Income-tax Act, 1961 to provide for levy of penalty@10% of tax payable under section 115BBE, in a case where income determined includes any income referred to in sections 68, 69, 69A to 69D for any previous year.

However, no such penalty would be levied on such income to the extent the same has been included by the assessee in return of income furnished under section 139 and tax in accordance with section 115BBE has been paid on or before the end of the relevant previous year.

Penalty u/s 271AAB: Various Situations

Question 28:

On 15th January 2018, a search u/s 132 was conducted in the premises of Mr. Rana, a jewellery manufacturer. The AO found Rs. 50 lakh in cash, which was comprised of demonetised currency notes, i.e. 500 and 1000 notes. Unexplained jewellery worth Rs. 2 crore and unaccounted property documents valued Rs. 80 lakh were also found.

a) The assessee did not disclose the income in the return of income

b) The assessee admitted the undisclosed income and submitted before the AO that he had derived such income in cash.
He paid the tax and interest on the income, declared such income in his ROI & furnished it within due date.

Referring to the provisions of the Act as amended by The Taxation Laws (Second Amendment) Act, 2016, you are required to compute the amount of penalty to be levied in both the above cases.

Solution:

As per the provisions of Sec 271AAB, in case where search u/s 132 has been initiated and

- the assessee does not admit nor discloses income in return filed for specified P.Y., then penalty @60% of undisclosed income shall be levied.
- The assessee admits the undisclosed income and specifies the manner in which it was derived, substantiates the manner in which the undisclosed income was derived and pay tax along with interest in respect of the undisclosed income within the specified date. Then penalty shall be 30% of the undisclosed income

Case (a) The amount of penalty u/s 271AAB = 60% of (50 lakh + 2 crore+ 80 lakh)

= Rs. 198 lakh

Case (b) The amount of penalty shall be 30% of the undisclosed income

Therefore, penalty u/s 271AAB= 30% *(50 lakh + 2 crore + 80 lakh)

= 99 lakh

Note: Penalty u/s 270A shall not be imposed on the Assessee in respect of Undisclosed Income referred u/s 271AAB.

Question 29:
ABC Charitable Trust is setup with the objectives of furtherance of yoga among people. Further, it undertakes business activities in its course of main object. The following is the statement of affairs of the trust as on 31/03/2019:

Liabilities	Amount (Rs.)	Assets	Amount (Rs.)
Corpus	12,00,000	Tractor	2,00,000
Loan for tractor	50,000	Building 1	5,50,000
Loan for building 2	1,50,000	Building 2	4,00,000
		Office furniture	2,00,000
		Cash	50,000
Total	14,00,000	Total	14,00,000

Notes:
1. ***Building 2 has been purchased at the time when the trust was not registered under section 12AA.***
2. ***Tractor is purchased from the income generated from agricultural operations and is also used for agricultural activities.***
3. ***Office Furniture has been donated to another trust registered under section 12AA with the object of preservation of environment.***
4. ***The values in the statement of affairs is as per the prescribed method of valuation***

Compute the liability of the trust on its accreted income if it is converted into an entity not eligible for registration under section 12AA on 31/03/2019
Further, compute the interest liability that shall arise in case if the trust makes the payment of the tax on the accreted income only on 28/04/2019.

Solution:

Computation of liability of the trust under section 115TD

Tax is liable to be paid by the trust on the accreted income as on the specified date. The specified date in the given case is the conversion date. The valuation of accreted income 01/04/2019 is as under:

Particulars	Amount (Rs.)	Amount (Rs.)
Total Assets		
Tractor	2,00,000	
(-) Tractor value (Note1)	(2,00,000)	0
Building 1		5,50,000
Building 2	4,00,000	
(-) Building 2 value (Note2)	(4,00,000)	0
Office Furniture	2,00,000	
(-) Office Furniture (Note3)	(2,00,000)	0
Cash		50,000
TOTAL ASSETS		**6,00,000**

<u>Total Liabilities</u>		
Loan from tractor	50,000	
(-) Loan value (Note1)	(50,000)	0
Loan for building 2	1,50,000	
(-) Loan for building 2 (Note 2)	(1,50,000)	0
TOTAL LIABILITIES (B)		**0**
ACCRETED INCOME (A-B)		**6,00,000**

<u>Tax on accreted income</u>

= Accreted Income * 34.94% (30%+12%+4%)
= 6,00,000*34.94%
= 2,09,640

The payment of the tax is supposed to be done within 14 days of the specified date. In the above case, the specified date is the date of conversion, i.e. 31/03/2019. Therefore, payment of tax has to be made within 14/04/2019.

The trust has paid the tax only on 28/04/2019. Thus, it is liable to pay interest along with the tax on the accreted income. The interest liability is as under:

No. of days delay: 14
<u>Beginning date:</u> 15/04/2019
<u>Ending date:</u> 28/04/2019

Thus interest will be charged at 1% for the part of the month of delay.

Interest amount= Rs.2,09,640*1%
= Rs.2,096.40

Notes:

1. Since the tractor is purchased from agricultural income, being exempt under the ITA, the assets and liabilities in respect thereof are ignored from the calculation of accreted income.
2. Building 2 is purchased with the income generated at the time when the trust was not registered under section 12AA. This implies that no exemption was allowed to the income that was used for the purchase of building. Thus, all assets and liabilities in connection with Building 2 are ignored.
3. The office furniture is donated to a trust registered under section 12AA. Therefore, that will not form part of the accreted income.
4. As per section 2(4) of the Finance Act, 2018, the surcharge for the purpose of section 115TD (and also for section 115-O) shall be calculated at 12%

Other Notes:

Students should note that the above solution said be applicable in cases where:

1. The objects of the trust are so modified that it is not eligible for registration under section 12AA; or
2. The trust fails to distribute its property to another registered trust/institution within 12 months of dissolution;

The only change that will be made is in the specified date.

Except in case where the receipt of charitable trust from advancement of object of general public utility exceeds 20% as per section 2(15). [CBDT Circular]

Question 30:

A public charitable trust registered under section 12AA runs a hospital and also a medical college. It furnishes you the following information for the year ended 31st March, 2019:

(i) Gross receipt from Hospital Rs.425 Lakhs (including voluntary contribution towards corpus)

(ii) Income from business - incidental to main objects Rs.2 Lakhs.

(iii) Voluntary contributions received from public Rs.32 Lakhs. It include corpus donation of Rs.3 Lakhs from another charitable trust and anonymous donation of Rs.5 Lakhs.
Note: Voluntary contributions are included in Gross receipt given in (i) above.

(iv) Hospital operational expenses incurred Rs.105 Lakhs. (This does not include capital expenditures and depreciation)

(v) Income from Medical College (solely for education purpose) Rs.10 Lakhs. Gross receipts of college for the year Rs.90 Lakhs.

(vi) Gross receipt given in (i) above includes a sum of Rs.55 Lakhs which has accrued but not received. Further, a sum of Rs.18 Lakhs was received only on 31st day of March, 2019.

(vii) The trust set apart Rs.80 Lakhs for acquiring a building to expand its hospital. But the amount was paid in December, 2019 when sale deed was registered in its name.

(viii) In June, 2018, the trust purchased and installed new computer software for Rs.28 Lakhs. The rate of depreciation is 40% as per Income-tax Act, 1961.

(ix) The trust incurred Rs.35 Lakhs towards purchase of laptops, computers and printers for the hospital.

(x) It repaid loan of Rs.15 Lakhs taken earlier for construction of hospital building.

(xi) Donation of Rs.2 Lakhs towards corpus to a trust registered u/s 10(23C) and another donation of Rs. 1 lakh paid by bearer cheque.

Compute the total income of the trust for the assessment year 2019-20 in order to avail maximum benefits within the four corners of law.

Solution:

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

Particulars	Amount (Rs.in Lakhs)	Amount (Rs.in Lakhs)
Gross receipts from Hospital (other than voluntary contribution of Rs.32 Lakhs) [Rs.425 Lakhs – Rs.32 Lakhs]		393.00
Less: Hospital operational expenses		105.00
		288.00
Income from business – incidental to main object[1]		2.00
		290.00
Add: Voluntary contributions other than corpus donations of 3 Lakhs		29
		319.00
Less: Anonymous donation taxable@30% under section 115BBC[See Note 1]		3.4
		315.60
Less: 15% of income eligible for accumulation or being set apart without any condition under section 11(1)(a)[2]		47.34
		268.26
Less: Deemed application as per Explanation 2 to section 11(1)[3]	55.00	
(i) Amount accrued but not received during the previous year	18.00	
(ii) Income received on 31st March 2019		73.00
		195.26

Less: Donation to trust registered u/s 10(23C) for corpus fund [See Note 5]		NIL
Less: Amount applied for the purposes of hospital [See Note 2]	28.00	
- Cost of new computer software [Assuming that the same was purchased for the purposes of the hospital]		
- Cost of laptops, computers and printers purchased for the hospital [Capital expenditure can be claimed as application of income. It was so held in *S.RM.M.CT.M. Tiruppani Trust* v *CIT*	35.00	
(1998)]	15.00	
- Repayment of loan taken earlier for construction of hospital		78.00
building - repayment of a debt incurred for the purpose of trust is application of income [*CIT* v *Janmbhoomi Press Trust* (2000)(Kar)]		117.26
Less: Amount set apart for acquisition of a building to expand its hospital [See Note 3]		
[The amount spent in December, 2019 in the immediately following year can be treated as application in the P.Y.2018-19,		80.00
provided the statement in prescribed form (i.e., Form 10) is given		Nil
to the Assessing Officer on or before the due date under section		37.26
139(1)].		3.40
Income of Rs.10 Lakhs from Medical College – exempt under section 10(23C) (iiiad) as gross receipts do not exceed Rs.1 crore.		**40.66**
Total income [other than anonymous donation taxable under section 115BBC]		
Add: Anonymous donation taxable @30%		
Total Income of the trust (including anonymous donation taxable@30%)		
In order to minimize and/or reduce the tax liability, the trustees may give a notice in writing to the Assessing Officer in the prescribed manner about their intention to accumulate minimum of Rs.34.76 Lakhs [Rs.37.26 Lakhs minus Rs.2.50 Lakhs (basic exemption limit)] specifying the period and the purpose for which the accumulation is proposed to be made and invest such sum in the modes specified under section 11(5). This accumulation would be in compliance with section 11(2) and in such a case, no tax will be payable on the total income (other than anonymous donations taxable@30% under section 115BBC) of Rs.37.26 Lakhs.		

1 It is assumed that separate books of account are maintained by the trust in respect of such business

2 A possible alternate view arising on account of the interpretation of the Supreme Court ruling in *CIT* v *Programme for Community Organisation* (2001)is that 15% of gross receipts would be eligible for accumulation under section 11(1)(a).

3 It is assumed that an option has been exercised in writing before the expiry of the time allowed under section 139(1) to treat such income as deemed application of income in the previous year in which the income is derived.

Notes:

1) As per section 115BBC(1), the anonymous donations in excess of the higher of the following would be subject to tax@30%;

- Rs.1.60 lakh, being 5% of the total donations received i.e., 5% of Rs.32 lakh; or
- Rs.1 lakh

Therefore, anonymous donations of Rs.3.4 lakh (Rs.5 lakh – Rs.1.60 lakh) would be subject to tax@30% under section 115BBC. As per section 13(7), such anonymous donations are not eligible for the benefit of exclusion from total income under sections 11 and 12.

2) As per section 11(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 new computer software, laptops, computers and printers purchased for the hospital has been claimed as application of income, no depreciation would be allowed on these assets while determining income for the purposes of application.
3) The word "applied" used in section 11 does not necessarily imply "spent". Even if a certain amount is irretrievably earmarked and allocated for charitable purposes, the said amount can be deemed to have been applied for charitable purposes. [*CIT* v *Trustees of H.E.H. Nizams Charitable Trust* (1981) (AP).]
4) A view is taken that 15% of Rs.1.60 Lakhs, representing the amount of anonymous donations exempt from the applicability of tax@30% (and hence, chargeable to tax at normal rates), is also eligible for retention/accumulation without conditions in line with other voluntary contributions. The above solution has been worked out on the basis of this view.
However, it is possible that the language used in section 13(7) may also be interpreted to mean that anonymous donations chargeable to tax at normal rates are not eligible for retention/ accumulation. In such a case, the whole of the anonymous donations of Rs.5 Lakhs has to be deducted from Rs.319 Lakhs to arrive at Rs.314 Lakhs and 15% of Rs.314 Lakhs, being Rs.47.10 Lakhs, would be eligible for accumulation under section 11(1) (a) without any condition.
5) w.e.f A.Y. 2018-19, it is provided that any donation given to a trust/institution (registered u/s 12AA/10 (23C) as contribution with specific direction that they shall form part of the corpus of the recipient trust/institution, SHALL NOT BE TREATED AS APPLICATION OF INCOME. w.e.f. A.Y. 2019-20, donation paid to another registered trust otherwise than by way of account payee cheque or demand draft shall not be considered as eligible application for the purpose of exemption u/s 11.

Question 31:

Examine the correctness or otherwise of the claims made by the following charitable trusts, registered under section 12AA, while computing income for the P.Y.2018 -19:

a) Kamala charitable trust, having its main object as medical relief, earned the following income during the P.Y.2018-19:

	Particulars	***Amount (Rs. In Lakhs)***
(i)	***Dividend income***	***0.50***
(ii)	***Income from mutual funds specified under section 10(23D)***	***0.85***
(iii)	***Agricultural income***	***3.25***

The trust claims exemption under section 10(1), 10(34) and 10(35) in respect of its agricultural income, dividend and income from mutual funds, respectively, without complying with the conditions laid down under section 11.

b) Gandhi charitable trust, having its main object as promoting education in rural areas, purchased computers and laptops for Rs. 15 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 and laptops for P.Y.2018-19, while computing income for the purpose of application for that year. Further it has claimed exemption under section 11 of Rs. 2,50,000 paid in cash towards application of charitable and religious in India.

Solution:

a) Section 11(7) provides that where a trust has been granted registration u nder 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. 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 Kamala 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 and laptops (i.e., Rs. 15 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 and laptops will not be allowed for the purpose of determining income for the purposes of application in the P.Y.2018-19. Also the amount paid in cash in excess of Rs. 10,000 cannot be considered as eligible application for the purpose of exemption u/s 11.

Therefore, the depreciation claim made by Gandhi charitable trust is not correct.

Question 32:

DS Pvt Ltd. Co. incorporated on 01/05/2018, is engaged in the manufacturing activity & has setup factory in notified region in Andhra Pradesh. It has reported the net profit of Rs.80 Lakhs for previous year 2018-19. The following items have been debited/credited to Profit and Loss a/c:

i. ***Dividend received from domestic companies Rs.12 Lakhs.***
ii. ***Contribution of Research association eligible for deduction u/s 35(i)(ii) of Rs.2 Lakhs.***
iii. ***Expenditure towards in house R & D (approved) of Rs.2lakhs.***
iv. ***Depreciation as per books Rs.40 Lakhs.***
v. ***Royalty received from patents developed & registered in India Rs.10 lakhs. Further expenditure debited in respect of said royalty is Rs.1 Lakh***
vi. ***Short Term capital gain on transfer of securities in a recognized stock exchange on which STT is paid Rs.10 Lakh.***
vii. ***The company has employed new employees to whom salary paid was debited to profit and loss account. Details of employment are as under:***

Date of Appointment	No. of employees	Designation	Salary (in Rs. Per Person per month)
01/05/2018	2	Storekeeper	18000 (Paid in cash)
01/06/2018	4	Sales person	25000 (ECS)
01/07/2018	1	Supervisor	28000 (Cheque)
01/10/2018	25	Helper	11000 (Cash)

Additional Information:

The Asset Acquired and installed/ put to use during the previous year :

i. ***Plant & machinery : Rs. 1crore (Rs.20 lakhs of consideration paid in cash).***
ii. ***Building : Rs.50 Lakhs.***

Compute the tax liability of the company for the AY 2019-2020?

Solution:

<u>Step I:</u> Computation of total income and tax liability as per normal tax provision of the Act:

<u>Computation of Total Income:</u>

Particulars	Amount(Rs.in lakhs)	Amount (Rs.in lakhs)
Net profit as per books	80.00	
(-) <u>Income chargeable under other heads:</u> • Dividend • STCG	 (12.00) (10.00)	
Net profit as per books for business.	58.00	
Weighted average deduction u/s 35(i)(ii) : 150% *2L= Rs.3L. Since Rs. 2lakhs is already debited in the profit therefore further deduction of only Rs. 1lakhs is required.	(1.00)	
Expenditure towards in house R & D eligible for deduction u/s 35(2AB) = 150%*2L = Rs.3 L. Therefore, Rs. 1L shall further be allowed as deduction.	(1.00)	

Depreciation as per books	40.00	
Expenditure on royalty income shall be disallowed as royalty shall be assessed on gross basis u/s 115BBF**(Note-1)**	1.00	
Disallowance u/s 40A(3): **(Note-2)** (2*1800*11)+(25*11000*6)	20.46	
(-) Depreciation u/s 32(1)(ii) **(Note-3)** [(1 crore (-) Rs.20 lakhs)*15%]+(50 lakhs*10%) (-) <u>Additional depreciation u/s 32(1)(iia)</u> (1 crore(-) 20 lakhs)*35%	(17.00) (28.00)	
(-) Investment allowance u/s 32AD (1 crore(-) 20 lakhs)*15%	(12.00)	
PGBP		**60.46**
Short Term capital gains		10.00
Dividend from Domestic Co.	12.00	
(-) Exempt u/s 10(34) (section 115BBDA is not applicable when the recipient of dividend income is a domestic co.)	(12.00)	Nil
Gross Total Income		**70.46**
(-) <u>Chapter VIA deduction:</u> **<u>(Note-6)</u>** Sec 80JJAA- [(2*18000*11)+(4*25000*10)]*30%		 (4.188)
Total Income		**66.272**
<u>Tax Liability</u> 1.<u>Tax as per special rate</u> u/s 111A: Rs.10 lakhs*15% u/s 115BBF:Rs.10 lakhs*10% 2. <u>Tax on balance income @30%</u> (66.272(-) 20)*30% (+) Cess@4% **Total Tax Liability**		 1.50 1.00 <u>13.8816</u> 16.3816 <u>0.6552</u> **<u>17.0364</u>**

<u>Step II: Tax u/s 115BA:</u>

The general rate of tax to be applied in respect of total income computed in accordance with section 115BA is 25%. This is however subject to special rates to be applied on specific income. Following shall be the adjustment required to be made to compute the total income in accordance with section 115BA in the present problem.

1. Disallowance of additional depreciation , investment allowance claim u/s 32(i)(iia) and section 32AD respectively.
2. Deduction u/s 80JJAA is available
3. Although no deduction is allowed u/s 35(2AB), the expenditure incurred in respect of in house scientific research shall still qualify for deduction u/s 37(1) being expenditure incurred for the purpose of business and profession. Therefore, the weighted deduction (Rs.1 lakhs) shall only be disallowed.
4. Similarly, no deduction is allowed u/s 35(i)(ii), towards the contribution to research association. However, the said contribution is eligible for deduction u/s 80GGA

(100%). Accordingly, the weighted deduction u/s 35(i)(ii) (Rs.1 Lakhs) shall only be disallowed in computing the total income in accordance with section 115BA.

Total Income u/s 115BA

Particulars	Amt.(Rs.in Lakhs)
Total Income as per Step 1	66.272
(+) Additional Depreciation u/s 32(i)(iia)	28.00
(+) Investment Disallowance u/s32(AD)	12.00
(+) Disallowance portion u/s 35(2AB) (Note 3 Above)	1.00
(+)Disallowance portion u/s 35(i)(ii) (Note 4 Above)	1.00
Total income as per sec 115BA	**108.272**

Tax Liability as per section 115BA:

Particulars	Amt.(Rs.in Lakhs)
1) Tax as per special Rate: u/s 111A: Rs 10 Lakh * 15% u/s 115BBF: Rs. 10 Lakh * 10%	 1.50 1.00
2) Tax on balance Income @ 25% (108.272 – 20L) * 25%	22.068
	24.568
(+) Surcharge @ 7% (Total income > Rs.1cr)	1.720
	26.288
(+) Cess 4%	1.052
Total Tax Liability	**27.34**

Step III: Since the tax as per step I is lower as compared to tax as per step II it is advised that the company should not opt for the provision u/s 115BA

Step IV: Determination of MAT

Computation of Book Profit u/s 115JB

Particulars	Amt.(Rs.in Lakhs)
NP as per the Cos Act	80.00
(-) Royalty income assessable u/s 115BBF is excluded from Book profit	(10.00)
(+) Royalty Expenditure on above too shall be excluded from Book profit	1.00
(-) Dividend Income Exempt u/s 10(34)	(12.00)
Book Profit u/s 115JB	**59.00**
MAT @18.5%	10.915
(+) surcharge(book profit does not exceed Rs. 1 crore)	Nil
(+) cess @4%	0.4366
MAT	**11.3516**

Step V: The Tax liability of DS Pvt Ltd for AY 2019-20 shall be Rs. 17.0368 lakhs being higher of Step III & Step IV.

Note:

1) Gross basis of taxation for royalty income is u/s 115BBF. Before Amendment FA 2018 Section

115BA overrides all other provisions of the Act **except** for Sec.111A/112. Therefore, the special tax rates (eg. u/s 115BF) shall not be available if the option is exercised u/s 115BA. However, **FA 2018 has clarified that income taxed at scheduler rate would continue to be taxed at scheduler rate.therefore,even the income u/s 115BBF would continued to be taxed at beneficial rate of 10%.Therefore,Sec 115BA would not apply to sec 112 and 111A, and every income taxed at scheduler rate.**

Therefore, royalty income shall be taxed u/s 115BBF @ 10% on Gross basis. Further, expenses incurred for earning royalty income shall also not be allowed u/s 115BA

2) As per Finance Act, 2017 expenditure in cash in excess of Rs.10,000 shall be disallowed u/s 40(A)(3) accordingly in the above question expenditure on salary Rs.3,96,000 to shopkeeper and Rs.16,50,000 to helpers is disallowed u/s 40(A)(3).
3) Depreciation as per Income Tax:

Particulars	P & M	Building	Total
Actual cost	(100 – 20*)80	50	
Depreciation Rate	15%	10%	
Depreciation	12	5	
Additional Depreciation @ 35% (80 Lakhs x 35%)	28		
Total	**30**	**5**	**35**

4) Since the assessee has setup an undertaking for manufacturing an article or thing in the state of Andhra Pradesh and asset is acquired and installed during 01/04/2015 to 31/03/2020, additional depreciation @ 35% of actual cost is available under section 32(1)(iia).
5) *Actual cost of machinery would not include machinery purchased in cash.
Depreciation & Additional Depreciation shall not be available on machinery purchased in cash >Rs.10,000.Even deduction u/s 32AD shall also be not available.
6) Additional employee cost shall be **NIL** if payment is made otherwise than by an account payee cheque/bank draft/ECS. So in this case, payments made to store keeper & helper shall be disallowed as they are made in cash. It is the first year of the co and hence the said provision shall not apply.
Additional employee cost shall exclude Employee whose total emoluments >Rs.25,000 p.m. So, in this case, payments made to supervisor shall be excluded.
7) U/s 111A, STCG on transfer of listed shares on which STT is paid at the time of transfer shall be subject to tax rate of 15%. The STT paid at the time of purchase is irrelevant for Sec.111A]. Further, Sec.115BA does not override Sec.111A & 112.
8) MAT is not applicable to income chargeable u/s 115BBF (for detailed discussion on taxation of Royalty Income u/s 115BBF refer chapter international taxation).

Question 33:

ABC Ltd., an Indian Company, was registered on 01.04.2015. It is solely engaged in the manufacture of textiles. Its turnover for the P.Y. 2016-17, P.Y. 2017-18 and P.Y. 2018-19 are Rs.190 crore, Rs.250 crore and Rs.255 crore respectively. What would be the total tax payable by ABC Ltd., for A.Y.2019-20, if its total income for the P.Y. 2018-19 is Rs.9 crore?

Would the rate of tax for A.Y.2019-20 in the case of ABC Ltd. be different, if it was registered on 01.04.2018 instead of 01.04.2015? If yes, what are the conditions to be fulfilled by it to avail such differential rate of tax?

[Note-Ignore provisions relating to Minimum Alternate Tax]

Solution:

Case 1: Where ABC Ltd. was registered on 1st April, 2015

Since the total turnover of ABC Ltd. in the P.Y. 2016-17 does not exceed Rs.50 crore, the applicable rate of tax for A.Y. 2019-20 is 25% of total income of Rs.9 crores. Further, since the total income exceeds Rs.1 crore but does not exceed Rs.10 crore, the applicable rate of surcharge would be 7% of tax on total income. This would be further increased by health & education cess @ 4% of tax and surcharge.

Accordingly, tax payable by ABC Ltd. for A.Y.2019-20 would be calculated as follows:

Particulars	Amount(Rs.)
Tax @ 25% on total income of Rs.9 crore for the P.Y. 2018-19	2,25,50,000
Add: Surcharge @ 7% on tax on total income	15,75,000
	2,41,25,000
Add: 4% Health & education Cess on tax plus surcharge	9,65,000
Total Tax Payable	**2,50,90,000**

Case 2: Where ABC Ltd. is registered on 1st April, 2018

Section 115BA has been inserted to provide a concessional rate of tax @25% in case of a domestic company for any previous year relevant to A.Y.2018-19 and thereafter, at the option of the company, if:

i. The company has been setup and registered on or after 1st March, 2016;
ii. The company is not engaged in any business other than the business of manufacture or production of any article or thing and research in relation to, or distribution of, such article or thing manufactured or produced by it; and
iii. The company while computing its total income has not claimed additional depreciation and deduction u/s 10AA, 32AC, 32AD, 33AB, 33ABA, 35(1)(ii)/35(1)(iia)/35(1)(iii)/ 35(2AA)/ (2AB), 35AC, 35AD, 35CCC, 35CCD, section 80H to 80TT (not being section 80JJAA).

In this case, ABC Ltd is domestic company registered after 01.03.2016 and is solely engaged in the manufacture of textiles. Hence, it can opt for concessional rate of tax @ 25% (plus surcharge and cess), provided it does not claim any benefits mentioned in (iii) above. The option should be exercised in the prescribed manner on or before 30.9.2019, being the due date of filing of return of income of A.Y. 2019-20.

Assessment of Fees for Technical Service, Income of Non – Resident with Significance of PE

Question 34:

(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 ` 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 –

	Particulars	Amount
(1)	Fees for technical services received from Alpha Ltd.	Rs. 2 crore
(2)	Expenses incurred for earning such income	Rs. 8 lakhs
(3)	Fees for technical services received from other Indian companies in pursuance of approved agreement entered into between the years 2005 to 2010	Rs. 4 crore
(4)	Expenses incurred for earning such income	Rs. 15 lakhs
(5)	Expenditure not wholly and exclusively incurred for the business of such PE [not included in (2) & (4) above]	Rs. 6 lakhs
(6)	Amounts paid by the PE to Head Office (not being in the nature of reimbursement of actual expenses)	Rs. 12 lakhs

What are the other requirements, if any, under the Income-tax Act, 1961 in this case?

Solution:

(i) <u>Where Xylo Inc., a US company, does not have a PE in India</u>

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) <u>Where Xylo Inc., a US company, has a PE in India and rendering technical services is effectively connected with the PE in India.</u>

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.

Question 35:

As per agreement between S Limited, a company incorporated in Korea and Bharti Motors Limited, an Indian company, S limited rendered both off-shore and on-shore technical services to Bharti Motors Limited for setting up a car manufacturing plant in Gujarat. S Limited rendered off-shore services and on-shore services at a fee of Rs. 2 crore and Rs. 3 crore, respectively. S Limited claims that it is not liable to tax in India in respect of fee of Rs. 2 crore as it is for rendering services outside India. Is the view taken by S Limited correct?

Solution:

As per section 9(1)(vii), income by way of fees for technical services payable by a person who is a resident would be deemed to accrue or arise in India except where the fees are payable in respect of services utilized in a 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.

As per Explanation below section 9(2), 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, S Ltd., were for setting up a car manufacturing plant in Gujarat by Bharti Motors Ltd., an Indian company. Therefore, the services were utilized in India.

Consequently, the fee of Rs. 5 crore for technical services rendered by S Ltd. (both off-shore and on-shore services) to Bharati Motors Limited is **deemed to accrue or arise in India and includible in the total income of S Ltd**.

Therefore, the view of S Ltd. that it is not liable to tax in India in respect of fee of Rs. 2 crore (as it is for rendering services outside India) is **not correct**.

Question 36:

RIL is an Indian Company engages in multifaceted business activities. Barabara Inc. a US Investment giant wants to get 20% stake in the Indian Company.

Considering a favourable treaty position between India & Mauritius, the US giant floated a company in Mauritius by acquiring its shares on 01/01/2017 for Rs. 10 crores. The Mauritius company in turn acquired shares of RIL on 01/03/2018.

The accounting period of the Mauritius company ends on 31st December. As on 31st December, 2018, its book value of total assets was Rs. 25 crores.

On 31/03/2019, Barbara Inc. transferred the shares of the Mauritius Co. to another Investor in US (unrelated) at a price of Rs. 50 crores. The book value (after reduction of liabilities), FMV (after reduction of liabilities) as on 31/03/2019 is a below:

Particulars	***Book Value (INR Crores)***	***FMV (INR Crores)***	***Liabilities (INR Crores)***
Mauritius Co.	***30***	***50***	***0***
RIL	***110***	***180***	***20***

You are required to:

i) ***Explain whether the capital gains on transfer of shares of Mauritius Co. shall be taxable in India?***
ii) ***Calculate the amount of tax on Capital Gains on such transfer.***
iii) ***(The third part of question to be answered only by new course student). What shall be your answer if the Mauritius Company directly transfers the shares in RIL on 15/12/2018, in light of the recent amendment in India Mauritius DTAA.***

Solution:

i) As per explanation 5 to Section 9(1)(i):

→ Where the shares of a foreign company derives its value substantially from the underlying lying asset situated in India, then the shares of such foreign company shall be deemed to situated in India.

→ Further explanation 6 to section 9(1)(i), provides that the shares of the foreign company shall be deemed to derive its value substantially from the assets located in India, if on the specified date, the value (FMV without reduction of liabilities) of the Indian assets:

- Exceeds the amounts of Rs. 10 crores

AND

- Represents at least 50% of the value of all the assets owned by the foreign company.

Specified date for this purpose would be last date of the accounting period before the date of transfer. However in case the book value of the assets of the company or entity on the date of transfer exceeds by at least 15%, the book value of the assets as on the last balance sheet date preceding the date of transfer, the date of transfer shall be the specified date

→ In the given situation Barbara Inc., USA, has through a Mauritius company made investment in India. It has subsequently transferred the shares of the Mauritius Company. The issue under consideration is whether shares of the Mauritius Company is situated in India?

Step 1: In the instant case the specified date is 31/3/2019 as the book value of the assets as on the date of transfer (Rs. 30 crore), exceeds the book value of accounting period preceding the date of transfer (Rs. 25 crore) by more than 15%.

Step 2: Substantial Interest Test on Specified Date:

- FMV of Mauritius intermediary company as on 31/3/2019 – Rs. 50 crore.
- FMV of RIL as on 31/3/2019 (without reduction of liabilities) – Rs. 200 crore.
- FMV of RIL as held by Mauritius Company (20%) – Rs. 40 crore

→ Since the value of assets located in India i.e.,
Rs. 40 crores exceeds Rs. 10 crore

and

also exceeds 50% of the value of assets of Mauritius intermediary company; (total FMV of its assets Rs. 50 crore), the shares of Mauritius intermediary company could be deemed to derive its value substantially from assets located in India.

→ Hence, the shares of Mauritius intermediary company would be deemed to be a capital asset situated in India and the capital gains from transfer of shares of Mauritius Company would deemed to accrue or arise to Barbara Inc. in India.

ii) Computation of capital goods chargeable to tax and tax amount in India on transfer of shares of Mauritius Co. by Barbara Inc.

Particulars	***Amount (in crores)***
FVC for transfer of Mauritius Co. shares Cost of acquisition of shares	50 (10)
Long term capital gains	40
FMV of all the assets of the Mauritius Company as on specified date FMV of RIL as held by Mauritius Company as on specified date	50 40
Long term capital gains attributed to assets - Located in India (40x4/5) - Long term capital gains tax @ 10% (Sec. 112)	 32 3.2

<u>Notes</u> – 1) Barabara Inc. has held the shares of Mauritius Co. for a period greater than 24 months. Therefore the shares are long term capital asset (unlisted). 2) As per section 112, in case of foreign company, the long term gain on unlisted securities (Mauritius Company is not listed in any stock exchange in India) is chargeable to tax @ 10% without indexation and fluctuation benefit. <u>iii) Only for new course student</u> Capital gain arising to the Mauritius Co. on transfer of shares of RIL as on 31/12/2018 shall be taxable in India as per the revised India – Mauritius DTAA. However, the tax rate on the gain shall not exceed <u>50% of the tax rate applicable on such gains in India</u>

Question 37:

Mr. DS, an individual resident, had sources of income from abroad as well as India, the details of which are as under:

USA	
a) Income from profession (tax paid in US on 01/05/2018- $ 300)	***$ 3,000***
b) interest income from deposits (tax deducted in US on 01/08/2018 - $500)	***$5,000***
UK	
Rental income from property (tax deducted on 01/9/2018 in UK - £ 1,000)	***£ 10,000***
India	
Interest income in India from FDRs	***Rs. 5,00,000***

As per India-UK and India-USA DTAA, tax credit for the taxes paid in the foreign country shall be available in India at the lower of foreign tax paid or the rate of Indian tax on such income.

Compute the tax liability of Mr. DS in India

TTBR on 30/04/2018 is $ = Rs. 58

TTBR on 31/7/2018 is 1$ = Rs. 60

TTBR on 31/8/2018 is 1£= Rs. 90

TTBR on 31/3/2019 is 1$ = Rs. 62, 1£ = Rs. 85

Solution:

Particulars	Amount (Rs.)
I] Indian income	**5,00,000**
II] Foreign Income	
a) IFHP	
Rental Income earned in UK (£ 10,000 * Rs. 85) (Note 1)	8,50,000
Less: Standard deduction u/s 24(a) @ 30%	(2,55,000)
	5,95,000
b) PGBP	
Income from profession ($3,000 * Rs. 62) (Note 1)	**1,86,000**
c) IFOS	
Interest earned in USA ($5,000* Rs. 62) (Note 1)	**3,10,000**
GTI	**15,91,000**

Computation of tax liability		
Tax liability		2,89,800
Add: Cess @ 4%		11,592
Total Indian tax liability		**3,01,392**
Tax credit u/s 90 (lower of Indian rate of tax or foreign tax rate) a) Average rate of Indian tax (**3,01,392**/15,91,000*100)	**18.94%**	
b) For rental income earned in UK Tax deducted in UK (£ 1,000/£10,000*100) Therefore, FTC = £1,000 * Rs. 90 (Note 4)	**10%**	**(90,000)**
c) For income from profession in USA Tax paid in USA ($300/$3,000*100) Therefore, FTC = $300 * Rs. 58 (Note 4)	**10%**	**(17,400)**
d) For interest on deposits in USA Tax paid in USA ($500/$5,000*100) Therefore, FTC = $500 * Rs. 60 (Note 4)	**10%**	**(30,000)**
Total tax payable		**1,63,992**

Notes:

1. Rule 115 states that for conversion of any income derived in foreign currency and considered under the head 'PGBP','IFOS' and 'IFHP' –TTBR as on last day of P.Y is to be taken for converting into Indian currency.
2. Since India has entered into DTAA with USA and UK, tax credit would be available to Mr. DS u/s 90.
3. As per Rule 128, tax credit needs to be computed country wise and source wise
   It shall be LOWER OF:
   a) Tax payable under Act
   b) Foreign tax payable
4. Credit shall be determined by conversion of the currency of payment of foreign tax at the telegraphic transfer buying rate on the last day of the month immediately preceding the month in which such tax has been paid or deducted.

Question 38:

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 AY 2019-20.

Solution:

Computation of taxable income and tax payable of Amrutha for AY 2019-20

Particulars	Amount	Amount
Profits and Gains from Business and Profession		
Income from sole proprietary concern in India	50,00,000	
Share of profit from a partnership firm in India of Rs. 30 lakhs, is exempt	NIL	

Business Profit	50,00,000	
Less: Business Loss[2] in Country A (USD 10,000 x Rs. 64/USD[3])	6,40,000	43,60,000
Income from Other Sources Agricultural income from rubber estate in Country A, is taxable in India (USD 70,000 x Rs. 64/USD)		44,80,000
Gross Total Income/ Total Income		**88,40,000**
Tax on Total Income Tax on Rs. 88,40,000 [30% x Rs. 78,40,000 plus Rs. 1,12,500]		24,64,500
Add: Surcharge @ 10%, since total income exceeds Rs. 50 lakhs		2,46,450
		27,10,950
Add: HEC @ 4%		1,08,438
		28,19,388
Average rate of Tax in India [i.e., Rs. 28,19,388/Rs. 88,40,000 x 100]	31.89%	
Average rate of tax in Country A [i.e., USD 10,500/USD 70,000]	15%	
Doubly taxed income [Rs. 44,80,000 – Rs. 6,40,000]	38,40,000	
Rebate under section 91 on Rs. 38,40,000 @ 15% (lower of average Indian tax rate and rate of tax in Country A)		5,76,000
Tax payable in India [Rs. 28,19,388 – Rs. 5,76,000]		22,43,388
Tax Payable (Rounded off)		**22,43,390**

Notes:

(1) Since Amrutha is resident in India for the PY 2018-19, 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) It is assumed that eight years has not expired from the assessment year in which such business loss was incurred.

(3) It is also assumed that foreign currency conversion rate i.e., Rs. 64/USD (given in the question) was also prevailing on the last day of the previous year in which such business loss in Country A was incurred.

Question 39:

Sagwaan 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 PLC., a Londonm based company. During the previous year 2018-191 Sagwaan Ltd. paid Rs. 5 lakhs to PQR PLC for such services. Discuss the tax implication/TDS implications of such payment and receipt in the hands of Sagwaan Ltd. and PQR PLC respectively, if-

(i) PQR PLC has no permanent establishment in India.

(ii) PQR PLC has permanent establishment in India.

Solution:

Chapter VIII of 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

- i Online advertisement;
- ii Any provision for digital advertising space or any other facility or service for the purpose of online advertisement and;
- iii Any other services 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 purpose of carrying our business or profession.

(i) Where PQR PLC has no permanent establishment in India

In the present case, Sagwaan Ltd. is required to deduct equalization levy of Rs. 30,000 i.e., @ 6% of Rs. 5 lakhs, being the amount paid towards online advertisement services provided by PQR PLC., a non-resident having no permanent establishment in India. Non-deduction of equalization levy would attract disallowance under section 40(a)(ib) of 100% of the amount paid while computing business income.

(ii) Where PQR PLC has permanent establishment in India

Equalization levy would not be attracted where the non-resident service provider (PQR PLC in this case) has a permanent establishment in India. Therefore, the Sagwaan Ltd. is not required to deduct equalization levy on Rs. 5 lakh, being the amount paid towards online advertisement services to PQR PLC in this case.

However, tax has to be deducted by Sagwaan 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.

Question 40:

Identify whether the transfer pricing would apply in the following case:

Shiva Ltd., an Indian company has two units (S1 and S2). S1 is engaged in the business of infrastructure development and is claiming deduction u/s 80-IA(8). S2, engaged in the manufacture of cement, transfers goods to S1 for Rs. 80 crores (Market value of Goods is Rs. 100 crores). The total income of Shiva for PY 2018-19 is Rs. 10 crores.

Compute adjusted total income after giving effect to TP adjustments and state whether it can claim exemption u/s 80-IA for enhanced income by applying TP provision. What would be your answer if the goods would have been transferred for Rs. 120 crores.

Solution:

- S1 is claiming deduction u/s 80-IA(8). S2 has transferred the goods to S1 at a price lower than FMV. Transaction between S1 and S2 [inter unit transfer of goods where one of the unit is claiming deduction u/s 80-IA(8)] shall be considered as specified domestic transaction. Accordingly, TP adjustment of Rs. 20 crores (100 – 80) would be required.

Computation of adjusted total income:

Particulars	Amount (Rs. in crores)
Total income	10
Add: TP adjustment	20
Adjusted total income	30

- **NO DEDUCTION** under Chapter VIA or Section 10AA is allowed for enhanced income.
- It is pertinent to note that **transfer pricing adjustment is not required if it has the effect of increasing the loss or reducing the income.** If the goods would have been transferred by S2 to S1 for Rs. 120 crores, then no TP adjustment is required, since S2 would have booked higher profits and S1 anyways is eligible for deduction under section 80-IA.

Question 41:

Daimler Ltd an Indian company is a subsidiary of Daimler Pte Singapore. Daimler India has sold raw material amounting to 7,000 units at Rs. 9,200/unit to Daimler Pte. Daimler Ltd. has also sold similar raw material to other unrelated enterprises. The details of the comparables are provided below. Compute the Arm's Length Price (ALP) and determine whether Daimler Ltd. has supplied the raw material at ALP. The total income of Daimler Ltd. during the P.Y. 2018-19 was Rs. 9,00,000. [Assume Comparable Uncontrolled Price (CUP) method as the most appropriate method].

Comparable Unrelated Parties	*Price for P.Y. 2018-19*	*Price for P.Y. 2017-18*
Reyant Ltd.	***Rs. 8,990/unit***	***Rs. 9,800/unit***
Ciaz Ltd.	***Rs. 9,400/unit***	***Rs. 10,000/unit***
Shivam Ltd.	***Rs. 8,400/unit***	***Rs. 10,000/unit***
Ariham Ltd.	***Rs. 11,000/unit***	***Rs. 9,690/unit***
Rihan Ltd.	***No transaction***	***Rs. 8,980/unit***
Divam Ltd.	***Rs. 10,000/unit***	***Rs. 11,100/unit***
Duke Ltd.	***Rs. 10,990/unit***	***Rs. 6,000/unit***
Super Ltd.	***Rs. 9,900/unit***	***Rs. 8,790/unit***
Christler Ltd.	***Rs. 10,330/unit***	***Rs. 7,980/unit***

Solution:

1. **Associated Enterprise:**
   In this case, Daimler Ltd. is a subsidiary of Daimler Pte. Accordingly, both are associated enterprises within the meaning of Section 92A.
2. **International transaction:**
   Sale of goods to a non-resident associated enterprise would fall within the meaning of international transaction. Accordingly, the provisions of transfer pricing would apply and the price is required to be computed with regard to Arm's length price (ALP).
3. **Assumptions:**
   a. Assuming, Daimler India is tested party.
   b. Company has not entered into safe harbour and APA provisions.
4. **Determination of ALP:**
   a. As per third proviso to Section 92C(2) of the Income-tax Act, 1961, if more than 1 price is determined by using most appropriate method, then ALP shall be computed by applying the range concept.
   b. As per rule 10CA of Income-tax Rules, range concept would apply only if the number of comparables is 6 or more than 6.
   c. Since, in the instant case there are 8 comparables available, the range concept would apply.

5. **Use of multiple year data:**
In the instant case, CUP method is used, the concept of multiyear data would not apply. Accordingly, only the data of the current year i.e. P.Y. 2018-19 is to be considered. Data pertaining to P.Y. 2017-18 is irrelevant. Further the data relating to the current year is already available and hence, the question of applying the earlier year data shall not arise.

6. **ALP as per Range Concept:**

Step 1: Arrange the dataset in the ascending order:

Sr. No	Comparable	Price for P.Y. 2018-19
1	Shivam Ltd.	Rs. 8,400/unit
2	Reyant Ltd.	Rs. 8,990/unit
3	Ciaz Ltd.	Rs. 9,400/unit
4	Super Ltd.	Rs. 9,900/unit
5	Divam Ltd.	Rs. 10,000/unit
6	Christler Ltd.	Rs. 10,330/unit
7	Duke Ltd.	Rs. 10,990/unit
8	Ariham Ltd.	Rs. 11,000/unit

Step 2: Determine the 35th and 65th percentile:

i. The data place of 35th percentile = 8*35% = 2.8
Since, this is not whole number, the next number shall be taken i.e. 3. Therefore, the value at 3rd place is Rs. 9,400/unit.

ii. The data place of 65th percentile = 8*65% = 5.2
Since, this is not whole number, the next number shall be taken i.e. 6. Therefore, the value at 6th place is Rs. 10,330/unit.

Accordingly, the ALP range is between Rs. 9,400/unit – Rs. 10,330/unit.
However, the transaction price is Rs. 9,200/unit and is not within the ALP range.

Step 3: Determine the median:
The data place of the median, i.e., 50th percentile = 8*50% = 4
Since, this is whole number, average of prices at 4th and 5th place shall be taken, i.e.,
(Rs. 9,900 + Rs. 10,000)/2 =Rs. 9,950/unit
Therefore, ALP shall be Rs. 9,950/unit.

Step 4 : Adjustment to Transfer Price:
Since, the transfer price is lower than ALP, adjustment of Rs. 750/unit (Rs. 9,950-Rs. 9,200) is required.

Computation of adjusted total income:

Particulars	Amount (Rs.)
Total income	9,00,000
Add: TP adjustment (7000 units* Rs. 750/unit)	52,50,000
Total Income as determined	61,50,000

Question 42:

Examine the following transactions and discuss whether the transfer price declared by the following assessees, who have exercised a valid option for application of safe harbour rules, can be accepted by the Income-tax Authorities-

Sr No.	***Assessee***	***International transaction***	***Aggregate value of transactions entered into in the P.Y. 2018-19***	***Declared Operating Margin***	***Operating Expense***
1.	***C & Co., a partnership firm registered under the Partnership Act, 1932***	***Provision of contract R & D services relating to development of internet technology, to XYZ & Co., a foreign firm, which holds 12% interest in C & Co.***	***Rs. 100 crore***	***Rs. 20 crore***	***Rs. 70 crore***
2.	***D Ltd., an Indian company***	***Provision of contract R &D services relating to generic pharmaceutical drug, to ABC Inc., a foreign company which guarantees 15% of the total borrowings of D Ltd.***	***Rs. 50 crore***	***Rs. 9 crore***	***Rs. 30 crore***

In all the above cases, it may be assumed that the Indian entity which provides the services assumes insignificant risk. It may also be assumed that the foreign entities referred to above are non-resident in India.
Would your answer change, if in any of the cases mentioned above, the foreign entity is located in a notified jurisdictional area?

Solution:

1. XYZ & Co. & C & Co are deemed to be AEs as the condition of one enterprise, being a foreign firm, holding not less than 10% interest in another enterprise, being an Indian firm, is satisfied. Therefore, provision of contract R & D services relating to software development by C & Co., an Indian firm, to XYZ & Co., a foreign firm, is an **international transaction** between AEs, and consequently, the provisions of **transfer pricing** are attracted in this case.
   C & Co. should have declared an **operating profit margin of not less than 24%** in relation to operating expense, to be covered within the safe harbour rules. However, since C & Co. has declared an operating profit margin of only 28.57% $\left(\text{i.e.}\frac{20}{70}\times 100\right)$, the same is in accordance with the circumstances mentioned in Rule 10TD. Hence, it should binding on the Income-tax Authorities to accept the transfer price declared by C & Co.
2. ABC Inc., a foreign company, guarantees 15% of the total borrowings of D Ltd., an Indian company. Since ABC Inc. guarantees not less than 10% of the total borrowings of D Ltd., ABC Inc. and D Ltd. are deemed to be associated enterprises. Therefore, provision of contract R & D services relating to generic pharmaceutical drug by D Ltd., an Indian company, to ABC Inc., a foreign company, is an **international transaction** between associated enterprises, and consequently, the provisions of **transfer pricing** are attracted in this case.
   Provision of contract R & D services in relation to generic pharmaceutical drug is an eligible international transaction. Since D 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.
   Irrespective of the aggregate value of transactions entered into in the P.Y. 2018-19, D 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 D Ltd. has declared an operating profit margin of 30% $\left(\text{i.e.}\frac{9}{30} \times 100\right)$, the same is in accordance with the circumstance mentioned in Rule 10TD. Hence, the Income-tax Authorities shall accept the transfer price declared by D Ltd in respect of such international transaction.

The safe harbour rules shall not apply in respect of eligible international transactions entered into with an AE located in a notified jurisdictional area.

Question 43:

Z Ltd. An Indian multinational group has a holding company A Co. in Singapore for global reporting purpose. The A. Co. also has 100% downstream subsidiaries B. Co. and C. Co. in Singapore and D. Co. in China. The POEM of A Co. is in India and is exercised by Indian Multinational Company of the group. The subsidiaries B, C and D are engaged in active business outside India. The meetings of BOD of B Co., C. Co. and D Co. are held in their respective countries.

D Co. transfers process knowhow to Z Ltd. For which it is paid royalty at Rs. 15 crore. Similar process transfer made by XY Ltd. To TN Ltd. fetched the former a royalty of Rs. 12 crore. (Both XY Ltd. & TN Ltd. are unrelated party).

Z Ltd. processes the goods and sells to B Co. the finished product for Rs. 85 Crore. Similar goods sold by Z Ltd. to E Co. were for Rs. 90 crore. The only difference being the price charged to E Co. was cum-warranty. The warranty charges could be estimated to Rs. 2.5 crore.

During the year Z Ltd. took a loan of Rs. 150 crore @ 10% rate of interest. The interest expenses claimed as deduction was Rs. 7.5 crore. The loan was guaranteed by C Co. EBITDA of Z Ltd. was Rs. 20 crore.

Z Ltd. distributes the common H.O. expenditure to A, B, C & D Co. The common H.O. expenses are Rs. 30 crores. The expenses debited in its profit and loss account are Rs. 30 crore, whereas the recovery credited to P&L Account is Rs. 20 crore. The relative contributions of the entities are 50% (Z Ltd.), 10% (A), 20% (B), 10% (C), 10% (D).

You are required to:

(i) Ascertain residential status of A Co., B Co., C Co. and D Co.

(ii) Workout the total income after carrying necessary adjustments. The total income before these adjustments is Rs. 25 crore. Also discuss the consequences aftermath.

(iii) What could be the possible reporting compliance and who could be responsible to report the same? The consolidated group revenue is Rs. 800 crore during the relevant P.Y.

Solution:

i. W.e.f. AY 2017-18, a company would be resident in India in any previous year if:

-It is an Indian Company, or

-Its place of effective management, in that year, is in India.

"Place of Effective Management" (POEM) means a place –

- where key management and commercial decisions that are necessary for the business of an entity as a whole
- are in substance made.

Based on above the residential status for AY 2019-20 of various companies is as under:

1 Z Ltd. Resident in India as it is an Indian Company.

2	<u>A Co.</u>	The foreign company A Co. shall be considered as tax resident of India for AY 2018-19 as the question clearly provides that its POEM is exercised by the Indian Co. Z Ltd.
3	<u>B Co., C. Co., D Co.</u>	Merely because the POEM of the intermediate holding company A Co. is in India, the POEM of its subsidiaries shall not be taken to be in India. Each subsidiary has to be examined separately. As indicated in the facts, since B Co., C Co., and D Co. are independently engaged in active business outside India and majority of Board meetings of these companies are also held outside India, the POEM of B Co., C Co. and D Co. shall be presumed to be outside India.

ii. Z Ltd., A Co., B Co., C Co. and D Co. are all associated enterprises falling within the scope of Sec. 92A

Further the transactions entered by Z Ltd. with its AE are in the course of International Transaction as its AE are non-resident.

→ As per Section 92(1) any income arising from an international transaction shall be computed having regard to the arm's length price.

→ As per section 92(2) where in an international transaction, two or more associated enterprises enter into a mutual agreement for the allocation or apportionment of any cost or expenses incurred, the cost or expense allocated or apportioned to any such enterprise shall be determined having regard to the arm's length price.

→ Further as per section 92(3), the provisions of the section shall not apply in a case where the computation of income u/s 92(1) or 92(2) has the effect of reducing the income chargeable to tax or increasing the loss, as the case may be.

Keeping in mind the above statutory provisions, the Total Income of Z Ltd. for AY 2019-20 is computed as under:

Total Income of Z Ltd. for AY 2019-20

Particulars	*Most Appropriate Method*	*TP Adjustment (Rs. In crores)*	*Amount (Rs.) (in crores)*
Total Income before transfer pricing adjustment	---	---	25
(+) *<u>T.P. Adjustments (Primary):</u>*			
(i) Royalty paid to D Co. towards transfer of process knowhow	CUP	(15-12)	3
(ii) Sales of goods to B Co. at ex-warranty	CUP	90 – 2.5 87.5 (-) transfer price <u>85.0</u>	2.5
(iii) Allocation of HO expenditure: Since the recovery made by Z Ltd. is more than the relative contribution of its AE, no adjustments are required in view of Section 92(3).	---	---	---
Total Income after primary adjustment			30.5
(+) <u>Adjustment u/s 94B</u>			

Z Ltd. pays interest in respect of debt which is guaranteed by its AE. Interest paid in excess of 30% EBITDA shall be disallowed and will be allowed to be carried forward. It is assumed that the rate of interest is at arm's length. [7.5 (-)(30% x 20)]			1.5
Total Income			Rs. 32 Crore

Note: Since the amount of primary adjustment made in case of Z Ltd. for AY 2019-20 (Rs. 5.5 crore) exceed Rs. 1 crore, the assessee may be liable to carry out secondary adjustment u/s 92CE, if the amount of primary adjustment is not repatriated within the time limit prescribed in Rule 10CB.

iii) As per section 92D r.w. Rule 10DA and Section 286 r.w. Rule 10DB, the following reporting compliance shall be applicable for Z Ltd./A Co.:

Master File: The consolidated group revenue exceeds Rs. 500 crores, the assessee would be required to furnish report electronically in Part A & Part B of Form 3CEAA on or before the date of filing of ROI. Further the ggregate value of International Transactions as per per books exceeds Rs. 50 crore. Also the aggregate value of international transaction involving intangible property as per books exceeds Rs. 10 crore.

Country by Country reporting (CbCr)

Section 286 r.w. Rule 10DB requires submission of CbCr in the case of an international group for an accounting year, if total consolidated group revenue exceeds Rs. 5500 crore. The above threshold in not crossed CbCr is not required to be filed.

Local File:

As per section 92D if the aggregate value of international transaction exceeds Rs. 1 crore, the documents prescribed under Rule 10D shall be required to be maintained. In the present case the local file will be required to be maintained.

Question 44:

Duplex Inc., a UK incorporated company holds 30% stake in Duplex Ltd. an Indian company. Duplex Ltd. sold 500 units of raw material @ Rs. 9,700/unit to Duplex Inc. (UK) during the PY 2019-20. Duplex Ltd. has sold similar raw material to other unrelated enterprises. Further, Duplex Inc. transferred shares of SS Ltd. to Duplex Ltd. without any consideration. The FMV of the shares of SS Ltd. is Rs. 2,50,000.

Details of supplies of similar raw material to other unrelated enterprises:

While the sales to Duplex Inc. was at CIF (Rs. 200/unit for Insurance & Freight) and at ex- warranty price, the sale to Nano Inc. (unrelated) was at FOB and at cum-warranty price @ Rs. 10,500/unit. If the transaction with Nano Inc. would have been at CIF then Rs. 300/unit of additional amount towards insurance & freight would have been charged. Further the cost of providing warranty to Nano Inc. is Rs. 500/unit.

Similar raw material was sold by Y Ltd. to Z PLC UK (uncontrolled transaction) at Rs. 9,500/unit. The price charged is 10,000 quantity level. Whereas the price charged by Duplex Ltd. to Duplex Inc. is at 3,000 quantity level. The list price of Y Ltd.shows price at different quantity level as under:

Quantity Level	***Price Charged***
0 – 2,500	***Rs. 11,000/unit***
2,501 – 5,000	***Rs. 10,500/unit***
5,001 – 10,000	***Rs. 9,500/unit***

Compute total income of Duplex Ltd.

Solution:

1. Duplex Inc. holds more than 26% in Duplex Ltd. Therefore the parties to the transaction are AE within the scope of Sec. 92A. Further, the transaction is in the course of international transaction as Duplex Inc. is a non-resident.
2. Duplex Ltd. has sold to Duplex Inc. 500 units of raw material at a transfer price of Rs. 9,700/unit.
3. Determination of ALP

	Comparable	***Uncommon factor***	***Most Appropriate Method***	***Comparable Adjustment***
1	Internal Sale to non-AE	FOB Cum-warranty	CUP	Rs. 10,500/unit (+) CIF factor: Rs. 300/unit (-) Warranty factor: Rs. 500/unit ALP: 10,300/unit
2	External	Quantity	CUP	ALP at same qty. level = Rs. 10,500/unit

Since more than one comparable was available resulting in to more than one ALP, the arithmetic mean of the two price shall be determined:
(Rs. 10,300/unit + Rs. 10,500/unit)/2 = Rs. 10,400/unit
Difference between the Arithmetic mean and the transfer price Rs. 10,400 (-) Rs. 9,700 = Rs. 700 per unit
3% of transfer price: Rs. 291
Since the difference > 3% of transfer price, therefore the ALP shall be adopted as Rs. 10,400/unit.

4. Extract of computation of total income of Duplex Ltd.:

Total Income before adjustment (+) (i) Sale to Duplex Inc. [10,400 (-) 9,700] x 500 (ii) Receipt of shares of SS Ltd. without any consideration (Sec. 56(2)(x)): FMV	xxx 3,50,000 2,50,000
Total Income after Adjustment	Xxxx

Chapter 12: GAAR

Question 45:

Company X borrowed money from Company Y and used it to buy shares in three 100% subsidiary companies of X. Though the fair market value per share was Rs. 100, X paid Rs. 600. The amount received by the said subsidiary companies was transferred back to another company connected to
Y. The said shares were sold by X for Rs. 100/ each and a short-term capital loss was claimed. This was set off against short-term capital gains from other sources. All the companies are Indian companies. Can GAAR be invoked?

Solution:

By the above arrangement, the tax payer has obtained a tax benefit and created rights or obligations which are not ordinarily created between persons dealing at arm's length. Since transactions of purchase and sale of shares of a closely held company at a price other than the fair market value are covered under section 56 of the Act, GAAR may not be invoked as section 56, being SAAR, is applicable. However, if SAAR is not applicable considering the limited scope of section 56 to the shares of closely held companies only, then GAAR may be invoked.

Question 46:

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?

Solution:

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.

Chapter 13: TDS

TDS in Various Situations

Question 47:

Discuss and compute the liability for deduction of tax at source, if any, in the cases stated hereunder, for the financial year ended 31st March, 2019.

(i) ***Mr. X, a resident, acquired a house property at Mumbai from Mr. Y for a consideration of Rs.90 lakhs, on 20.06.2018. 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 17.6.2018, 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) ***Mr. S won a motor car in a lucky draw held by 'P' marketing. The market price of car was Rs.4,00,000. P marketing erroneously gave the car to Mr. S without deducting tax at source. Examine the liability of P marketing to make such payment, if any.***

(iv) ***Raj is working with AB Ltd. He is entitled to a salary of Rs.45,000 per month w.e.f. 1.4.2018. He has a house property which is self-occupied. He paid an interest of Rs.80,000 on loan, during the previous year 2018-19. 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 31.3.2019.***

Solution:

Particulars	Amount (Rs.)
(i) 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.	90,000
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.	Nil
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.	Nil
Note - 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.	
(ii) 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. In the given case, 'ABC Packaging Ltd.', the consignee, has not remitted the commission of Rs. 50,000 to the consignor 'XYZ 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 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 and any other game of any sort in an amount exceeding Rs. 10,000 shall deduct tax at source @30%. However, in case where winnings are wholly in kind, the person responsible for paying shall, before releasing the winnings, ensure that tax has been paid in respect of the winnings. Where the winnings are wholly in kind, the responsibility cast under section 194B is to ensure that tax is paid by the winner of the prize before the prize is released in his favour. This can be done, by collecting from the winner, a sum equal to the tax deductible at source on the winnings in kind and, thus, meeting the liability for TDS, 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 *[Circular No. 763, dated 7/2/1998]* In the given case, P marketing has released the car without ensuring tax payment of Rs. 1,20,000, being 30% of Rs. 4,00,000 (being the value of car) by Mr. S. P Marketing is therefore liable for penalty under section 271C and prosecution under section 276B **[*CIT* v *Hindustan Lever Ltd.* (2014) 361ITR 1 (Kar)]** (iv) 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:	2,500	

Income under the head Salary (Rs. 45,000 x 12)	5,40,000
Less : Standard deduction under section 16 (ia) FA 2018	(40,000)
	5,00,000

Income under the head "house property"	(80,000)	
Gross total income	4,20,000	
Less: Deduction under chapter VI A	Nil	
Total Income	4,20,000	
Tax @ 5% 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	8,500	
Less: Rebate u/s 87A	(Nil)	
	8,500	
Add: Health & Education Cess @ 4%	340	**8,840**
Tax to be deducted at source	**8,840**	

Consequences of TDS default

Question 48:

A sum of Rs. 60,000 was paid to Mr. Dastur, a Senior Advocate on 01/07/2018 towards fee for his professional services without deducting TDS. Later on, further sum of Rs. 70,000 was due to him on 27th February, 2019 from which tax of Rs. 13,000/- was deducted at source. The tax so deducted was deposited on 26/06/2019.

Compute Interest payable u/s 201(1A).

Solution:

Defaults & Consequences:

Failure to deduct tax on Rs. 60,000 @ 10% u/s 194J	Failure to deposit tax of Rs. 13,000
Interest @1% per month for 8 months (Rs. 6,000 * 1% * 8m = 480)	Interest @1.5% per month for 4 months (Rs. 13,000 * 1.5% * 4m = 780)

Therefore, Total Interest Payable u/s 201(1A)= 480 + 780 = Rs. 1,260

Consequences of TDS Default

Question 49:

Mr. Madhusudan is regular in deducting tax at source and depositing the same. In respect of the quarter ended 31st December, 2018 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, 2019 for the quarter ended 31.12.2018.

(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?

Solution:

(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, 2018 has to be filed on or before 31st January, 2019. However, the same has been filed only on 23rd March, 2019. Hence, there has been a 51 day 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 51 days, he would be liable to pay a fee of Rs.10,200 (Rs. 200 x 51 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 50:
Mr. X sold his house property in Bangalore as well as his rural agriculture land for a consideration of Rs. 60 Lakhs and Rs. 15 Lakhs, respectively, to Mr. Y on 1.8.2018. He has purchased the house property and the land in the year 2017 for Rs. 40 Lakhs and Rs. 10 Lakhs, respectively. The stamp duty value on the date of transfer, i.e., 1.8.2018, is Rs. 85 Lakhs and Rs. 20 Lakhs for the house property and rural agricultural land, respectively. Detemine 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:

(i) <u>Tax implications in the hands of Mr. X</u>

As per section 50C, the stamp duty value of the house property (i.e., Rs. 85 Lakh) would be deemed to be the full value of consideration arising on transfer of property because stamp duty exceed 105% of actual consideration. Therefore, Rs. 45 Lakh (i.e., Rs. 85 Lakhs – Rs. 40 Lakhs, being the purchase price) would be taxable as short-term capital gains in the A.Y. 2019-20.
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.

(ii) <u>Tax implication in the hands of Mr. Y</u>

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 Rs. 50,000 or 5% of the consideration as per FA 2018.
Therefore, in this case Rs. 25 Lakhs (Rs. 85 Lakhs – Rs. 60 lakhs) 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 there under.

(iii) <u>TDS implications in hands of Mr. Y</u>

Since the sale consideration of house property exceeds Rs. 50 Lakhs, 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 Lakhs. TDS provisions under section 194-IA are not attracted in respect of transfer of rural agricultural land.

Chapter 13 – Specific Anti Avoidance Rule (SAAR)

Background

- Section 2(22) defines the term 'Dividend' and covers within its scope of distributions under certain circumstances made by the companies **to the extent of accumulated profits**, whether capitalised or not.
- Section 115-O levies tax on domestic companies paying dividend and simultaneously, such dividend was made exempt in the hands of the shareholders.
- Certain companies having large accumulated reserves resorted to reverse mergers with companies having no or neglible reserves, and consequently, adopted capital reduction to circumvent the levy of DDT.
- To elucidate the above, let's take an example of company A which amalgamates into company B having agreed to a purchase consideration of Rs. 10 lakhs. Given below are the Proforma Balance Sheets of the companies before and after amalgamation:

Before Amalgamation

Liabilities	Co. A	Co. B	Assets	Co. A	Co. B
Share Capital	10 Lakhs	5 Lakhs	Fixed Assets	14 Lakhs	3 Lakhs
Profit and Loss Account	10 Lakhs	NIL	Cash	6 Lakhs	2 Lakhs
Total	**20 Lakhs**	**5 Lakhs**	**Total**	**20 Lakhs**	**5 Lakhs**

After Amalgamation
Balance Sheet of Co. B

Liabilities	Amount	Assets	Amount
Share Capital	15 Lakhs	Fixed Assets (14+3)	17 Lakhs
Profit and Loss Account	NIL	Cash (6+2)	8 Lakhs
Capital Reserve	10 Lakhs		
Total	**25 Lakhs**	**Total**	**25 Lakhs**

In the case of ITAT Ahemdabad bench, Gautum Sarabhai Trust Case, the legal propositions governing the operation of section 2(22)(d) are summarised as follows:

- Surplus arisen on the amalgamation of companies would not result in revenue gain since amalgamation, even if treated as an activity of purchase, would not result in profit to the amalgamated company.
- Since the amalgamating company is a separate entity, profits in its balance sheet, after amalgamation cannot be treated as accumulated profits of the amalgamated company.

Amendment

The following explanation 2A is inserted in section 2(22) by the Finance Act, 2018 to widen the scope of accumulated profits and to negate the propositions mentioned in the above case law:

"In the case of an amalgamated company, the accumulated profits, whether capitalised or not, or loss, as the case may be, shall be increased by the accumulated profits, whether capitalised or not, of the amalgamating company on the date of amalgamation."

(**Note:** by using the expression 'whether capitalised or not' the legislative intent clearly is that the profits which are deemed to be dividend would be those which were capable of being accumulated and which would also be capable of being capitalised).

Analysis and Conclusion

Accordingly post the amendment the accumulated profits in the above example shall be Rs. 10 Lakhs thereby paving the way to attract DDT.