PROFESSIONAL PROGRAMME
MODULE 1, PAPER 2

PRACTICE QUESTIONS

Advanced Tax Laws

(Relevant for June, 2022 examination)

Direct Tax & International Taxation

THE INSTITUTE OF
Company Secretaries of India
भारतीय कम्पनी सचिव संस्थान
IN PURSUIT OF PROFESSIONAL EXCELLENCE
Statutory body under an Act of Parliament
(Under the jurisdiction of Ministry of Corporate Affairs)

March, 2022

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Corporate Tax Planning & Tax Management

Question 1

Distinguish between 'tax evasion' and 'tax avoidance'.

Answer

Tax evasion means a method of evading tax liability by dishonest means like suppression, conscious violation of rules, inflation of expenses etc. while tax avoidance means planning for minimization of tax burden according to the provisions of the tax laws and within legal framework, though it defeats the basic intention of legislature.

Tax evasion generally begins after the liability of tax has arisen, whereas tax avoidance begins before the actual liability of tax has arisen.

Tax evasion involves use of unfair means while tax avoidance takes into account various lacunas of law.

Question 2

Distinguish between tax planning and tax evasion.

Answer

Tax planning is carried out within the framework of law by availing the deductions and exemptions permitted by law and thereby minimising the tax liability. Tax planning is an arrangement by which full advantage is taken of the concessions and benefits conferred by the statute, without violation of legal provisions.

Tax evasion on the other hand is an attempt to reduce tax liability by dubious or artificial methods or downright fraud. It is illegal and denies the state its legitimate share of tax.

Question 3

Specify with the reason, whether the following acts can be considered as tax planning or tax management or tax evasion or tax avoidance.

i. *"Mr. P deposit Rs.1 lakh in PPF account so as to reduce his total income from Rs. 6 lakh to Rs. 5 lakh" assuming Mr. P does not opt for concessional tax regime u/s 115BAC of the Income tax Act, 1961.*

ii. *To reduce tax payable, Mr. Kunal Sharma, a resident individual, paid Rs. 55,000 as life insurance premium on the policy of his minor son. Assuming Mr. Kunal does not opt for concessional tax regime u/s 115BAC of the Income tax Act, 1961.*

iii. *Company claiming depreciation on the motor car which is being used by director for personal purposes.*

Answer

i. The investment of Rs.1 lakh in PPF account so as to reduce his total income from Rs.6 lakh to Rs. 5 lakh is considered as Tax Planning because the same is carried out within the framework of law by availing the deductions permitted by law and thereby minimising the tax liability.

ii. Premium paid on life insurance policy of minor son is allowed as deduction under section 80C of the Income tax Act, 1961. Therefore, Rs. 55,000 paid, by Mr. Kunal Sharma, as premium on life insurance policy of his minor son is an act of Tax Planning.

iii. Claiming depreciation on motor car being used for personal purpose is not allowed under section 32 of the Income Tax Act, 1961. Therefore, the depreciation claimed by the company on the motor car which is being used by the director for personal purpose is an act of Tax Evasion.

Question 4

Indicate whether the following acts can be considered as tax evasion/tax avoidance or otherwise:

(i) Samarth deposits Rs. 65,000 in the term deposit of 5 years with the Post Office to avail tax deduction under section 80C. Assuming Mr. Samarth does not opt for concessional tax regime u/s 115BAC of the Income tax Act, 1961.

(ii) Sushil is using a motor car for his personal purposes, but charges as business expenditure.

(iii) PQR industries Ltd installed an air-conditioner costing Rs. 75,000 at the residence of a director as per terms of his appointment but treats it as fitted in quality control section in the factory. This is with the objective to treat it as plant for the purpose of computing depreciation.

(iv) SQL limited maintains a register of tax deduction at source affected by it to enable timely compliance.

(v) R. Ltd issues a credit note for Rs.90,000 for brokerage payable to Suresh who is son of R, managing director of the company. The purpose is to increase his total income from Rs.1,60,000 to Rs.2,50,000 and reduce it's income correspondingly.

Answer

(i) It is neither a tax avoidance nor tax evasion. The claiming of deduction from gross total income under Section 80C by depositing Rs. 65,000 in the term deposit of 5 years with the Post Office falls under the purview of tax planning.

(ii) It is an unlawful act to treat a personal expenditure as business expenditure, which is disallowed under the law. Sushil is resorting to unfair means to claim deduction by falsification of records. Therefore it is tax evasion and illegal.

(iii) It is a case of tax evasion as the air-conditioner fitted at residential place is furniture, depreciable at 10% whereas the rate of depreciation applicable for plant and machinery fitted at Quality control section in the factory is 15%. The wrong treatment unjustifiably increases the amount of depreciation and consequently, reduces profit unlawfully.

(iv) It is tax management because maintaining register of payment subject to TDS helps in complying with the obligations under the Income Tax Act, 1961.

(v) Net effect of transaction is reduction of tax liability of the company by improper means. The company is liable to tax at the flat rate of 30% whereas Suresh would not be liable to pay tax since income does not exceed the basic exemption limit of Rs.2, 50,000. The issue of credit note to reduce the liability of company amounts to tax evasion.

Question 5

Suresh is employed in Delhi and is drawing Rs. 50,000 per month as salary. Besides, he got one month salary as bonus. He is given an option by the employer, either to accept HRA or a rent-free accommodation which is owned by the employer. HRA is payable @ Rs. 10,000 per month, while the rent for accommodation in Delhi is Rs. 12,000 per month. Advise Suresh, whether it would be beneficial for him to avail HRA or rent-free accommodation provided by the employer (assuming Mr. Suresh has not opted for section 115BAC of the Income tax Act, 1961).

Answer

Calculation of Tax Liability of Suresh, in case he accepts rent free accommodation

Particulars	*Amount (Rs.)*
Salary (Rs. 50,000 x 12)	6,00,000
Bonus (One month salary)	50,000
Value of rent free accommodation 15% x Rs.(6,00,000 + 50,000)	97,500
Gross salary Less : Standard deduction u/s16(ia) Taxable Salary/Total Income	7,47,500 (50,000) 6,97,500
Tax Liability	
On first Rs. 2,50,000	Nil
(Rs. 250000 to Rs. 500000) @5%	12,500
On remaining Rs. 1,97,500@ 20%	39500
Rebate under section 87A	(Nil)
Net Tax	52000
Add: Health & Education Cess @ 4%	2080
Net Tax Liability	54080
Rounded off Tax Liability	54080

Calculation of Tax Liability of Suresh, in case, if he accepts H.R.A

Particulars	*Amount (Rs.)*
Salary (Rs. 50,000 x 12)	6,00,000

Bonus (One month salary)	50,000
Taxable HRA (Note 1)	41,000
Gross salary Less : deduction u/s 16(ia) Taxable Salary/Total Income	6,91,000 (50,000) 6,41,000
Tax Liability	
On first Rs. 2,50,000	Nil
Rs. 250000 to Rs. 500000 @5%	12,500
On remaining Rs. 1,41,000 @20%	28200
Rebate under section 87A	(Nil)
Net Tax	40700
Add: Health & Education Cess @ 4%	1628
Net Tax Liability	42328
Rounded off Tax Liability	42330

Extra tax paid by Suresh, if Rent free accommodation opted is Rs. (54080- 42330) i.e. Rs. 11,750. **Thus, option II of accepting HRA is better.**

Notes:

1. According to section 10(13A) and rule 2A of Income Tax Act, HRA is exempted as least of the following limits:
   (i) HRA actually received i.e. Rs.1,20,000
   (ii) 50% of the salary i.e. 50% x Rs.6,50,000 = Rs.3,25,000
   (iii) Rent paid in excess of 10% of the salary i.e. (Rs. 1,44,000 -Rs. 65,000) = Rs. 79000
   Least of the above is Rs. 79,000, is allowed as exemption. Thus, taxable HRA would be : (Rs. 1,20,000- 79,000)= Rs.41,000
2. It is assumed that both the houses under HRA and Rent free accommodation are identical.
3. Bonus is not a part of salary for the purpose of computation of HRA.
4. It is assumed that the assessee has not opted for Section 115BAC of the Income tax Act, 1961.

Question 6

Differentiate between the diversion of income and application of income in context of Income Tax Act.

Answer

Sr. No.	*Diversion of income*	*Application of Income*
1	It is an obligation to apply the income in a particular way before it is received by the assessee or before it has arisen or accrued to the assessee.	It is an obligation to apply income, which has accrued or has arisen or has been received.
2	Obligation is on the source of income.	Obligation is on the receipt of income.
3	The source is charged with an overriding title, which diverts the income.	There is no overriding title in this case.
4	The income is not included in the income of the assessee.	The income is included in the income of the assessee.
5	Since, the income is diverted from the source before coming to the hands of the assessee, hence he is not liable for tax.	Income is said to have accrued/arisen and therefore, is taxable in the hands of assessee.

Question 7

Peer Ltd. took over the running business of a Ramu, a sole-proprietor by a sale deed. As per the sale deed, Peer Ltd. undertook to pay overriding charges of Rs. 15,000 p.a. to Ramu's wife in addition to the sale consideration. The sale deed also specifically mentioned that the amount was charged on the net profits of Peer Ltd., who had accepted that obligation as a condition of purchase of the going concern. Examine, in the light of a decided case law that whether the payment of overriding charges by Peer Ltd. is in the nature of diversion of income or application of income.

Answer

The facts of the case are similar to that of the case *Jit & Pal X-Rays (P.) Ltd. v. CIT (2004) 134 Taxman 62 (All)*, *where* the Allahabad High Court observed that the overriding charge which had been created in favour of the wife of the sole-proprietor was an integral part of the sale deed by which the going concern was transferred to the assessee. The obligation, therefore, was attached to the very source of income i.e. the going concern transferred to the assessee by the sale deed. The sale deed also specifically mentioned that the amount in question was charged on the net profits of the assessee-company and the assessee-company had accepted that obligation as a condition of purchase of the going concern. Hence, it is clearly a case of diversion of income by an overriding charge and not a mere application of income.

Thus, the payment of overriding charges by Peer Ltd to Ramu's wife is a case of diversion of income and hence allowed to be deducted from Income of Peer ltd.

Question 8

Teerath Ltd. is a widely held company. It is currently considering a major expansion of its production facilities and the following alternatives are available:

Particulars	*Alt-1*	*Alt-2*	*Alt-3*
	(Rs.)	*(Rs.)*	*(Rs.)*
Share capital	*10,00,000*	*20,00,000*	*50,00,000*
14% Debentures	*15,00,000*	*20,00,000*	
18% Loan from Bank	*25,00,000*	*10,00,000*	

Expected rate of return before tax is 30%. Rate of dividend of the company since 2000 has not been less than 22% and date of dividend declaration is 30th June every year. Corporate tax rate is 30%. Which alternative should the company opt with reference to tax planning?

Answer

Analysis of Financing Options for expansion of Teerath Ltd.

Particulars	*Amount in Rs.*		
	Option 1	*Option 2*	*Option 3*
Share Capital	10,00,000	20,00,000	50,00,000
14% Debentures	15,00,000	20,00,000	-
Bank Loan @ 18%	25,00,000	10,00,000	-
Total Capital	50,00,000	50,00,000	50,00,000
PBIT (Expected Rate of Return @ 30% of total Capital)	15,00,000	15,00,000	15,00,000
Less: Interest on debenture@14%	(2,10,000)	(2,80,000)	-
Less: Interest on bank loan @18%	(4,50,000)	(1,80,000)	-
Profit Before Tax	8,40,000	10,40,000	15,00,000
Tax @ 31.20% on PBT	(2,62,080)	(3,24,480)	(4,68,000)
Net Profit After Tax	5,77,920	7,15,520	10,32,000
Rate of Return in % (Net profit / Share Capital)	57.79%	35.78	20.64

Since, Alternative 1 offers the maximum rate of return. Thus, with reference to tax planning, company should opt for the same.

Question 9

Beaker Ltd. wants to acquire a machine on 1st April, 2022. If he purchases the same, it will cost Rs. 60 lakhs, have the expected useful life of 5 years and scrap value will be Rs.10,000. The company could either purchase the machinery with its own fund or borrowed funds. If the machine is purchased through borrowed funds, rate of interest will be 11.5% per annum and the loan will be repayable at the end of 5 years. If machine is acquired through lease, lease rent would be 16 lakh per annum.

Profit before depreciation and tax is expected to be 4.50 crore every year. Depreciation is charged @ 15% on written down value. Besides, additional depreciation is available in the first year. Investment allowance is, however, not available. Average rate of tax may be taken at 32.445%.

Advice Beaker Ltd. whether it should — (i) Acquire the machine through own funds or borrowed funds; or (ii) Take it on lease.

Present value factor shall be taken @10%. At this rate present values of rupee one are — year 1 : 0.9091; year 2 : 0.8264; year 3 : 0.7513; year 4 : 0.6830; and year 5 : 0.6209.

Answer

Purchasing Machine out of own fund

Particulars	*Amount in Rs.*					
	Year 0	*Year 1*	*Year 2*	*Year 3*	*Year 4*	*Year 5*
Profit before Interest, depreciation and tax (PBDT)		4,50,00,000	4,50,00,000	4,50,00,000	4,50,00,000	4,50,00,000
Less: Depreciation (including additional depreciation)		(21,00,000)	(5,85,000)	(4,97,250)	(4,22,663)	(3,59,263)
PBT		4,29,00,000	4,44,15,000	4,45,02,750	4,45,77,337	4,46,40,737
Less: Tax @ 32.445% of PBT		(1,39,18,905)	(1,44,10,447)	(1,44,38,917)	(1,44,63,117)	(1,44,83,687)
Profit After Tax		2,89,81,095	3,00,04,553	3,00,63,833	3,01,14,220	3,01,57,050
Add: Depreciation (including additional depreciation)		21,00,000	5,85,000	4,97,250	4,22,663	3,59,263
Cash Inflows after tax		3,10,81,095	3,05,89,553	3,05,61,083	3,05,36,883	3,05,16,313
Add: Scrap Value						10,000
Less: Cash	(60,00,000)					
Outflow						
Net cash flow	(60,00,000)	3,10,81,095	3,05,89,553	3,05,61,0833	3,05,36,883	3,05,26,313

Present Value Factor @ 10%	1	0.9091	0.8264	0.7513	0.683	0.6209
Present Value	(60,00,000)	2,82,55,823	2,52,79,207	2,29,60,542	2,08,56,690	1,89,53,788
Net Present Value	11,03,06,050					

Purchasing Machine out of borrowed fund

Particulars	*Amount in Rs.*					
	Year 0	*Year 1*	*Year 2*	*Year 3*	*Year 4*	*Year 5*
Profit before Interest, depreciation and tax (PBDT)		4,50,00,000	4,50,00,000	4,50,00,000	4,50,00,000	4,50,00,000
Less: Depreciation including additional depreciation		(21,00,000)	(5,85,000)	(4,97,250)	(4,22,663)	(3,59,263)
Less: Interest (60,00,000 x 115)		(6,90,000)	(6,90,000)	(6,90,000)	(6,90,000)	(6,90,000)
PBT		4,22,10,000	4,37,25,000	4,38,12,750	4,38,87,337	4,39,50,737
Less: Tax @ 32.445% of PBT		(1,36,95,035)	(1,41,86,576)	(1,42,15,047)	(1,42,39,247)	(1,42,59,817)
PAT		2,85,14,965	2,95,38,424	2,95,97,703	2,96,48,090	2,96,90,920
Add: Depreciation including additional depreciation		21,00,000	5,85,000	4,97,250	4,22,663	3,59,263
Cash Inflows after tax		3,06,14,965	3,01,23,424	3,00,94,953	3,00,70,753	3,05,07,183
Add: Scrap Value						10,000
Less: Cash Outflow						(60,00,000)
Net cash flows		3,06,14,965	3,01,23,424	3,00,94,953	3,00,70,753	2,40,60,183
Present Value (PV) Factor @ 10%	1	0.9091	0.8264	0.7513	0.683	0.6209
Present Value (Net Cash Flow x PV Factor)	0	2,78,32,065	2,48,81,948	2,26,10,338	2,05,38,324	1,49,38,968
Net Present Value	11,08,01,643					

Take Machine on lease (Assumption: Lease rental is payable at each year end)

Particulars	*Amount in Rs.*				
Cash Outflow	*Year 1*	*Year 2*	*Year 3*	*Year 4*	*Year 5*
PBDT	4,50,00,000	4,50,00,000	4,50,00,000	4,50,00,000	4,50,00,000

Lease rent	(16,00,000)	(16,00,000)	(16,00,000)	(16,00,000)	(16,00,000)
PBT	4,34,00,000	4,34,00,000	4,34,00,000	4,34,00,000	4,34,00,000
Tax @ 32.445% of PBT	(1,40,81,130)	(1,40,81,130)	(1,40,81,130)	(1,40,81,130)	(1,40,81,130)
Net Inflow	2,93,18,870	2,93,18,870	2,93,18,870	2,93,18,870	2,93,18,870
Present Value Factor@10%	0.9091	0.8264	0.7513	0.683	0.6209
Present Value	2,66,53,785	2,42,29,114	2,20,27,267	2,00,24,788	1,82,04,086
Net Present Value	11,11,39,040				

Advice:

From purely financial perspective, Beaker Ltd. should take the machine on lease instead out of borrowed funds or on lease as the Net Present Value in that case is highest.

Working Note: Calculation of Depreciation and Additional Depreciation

Particulars	*Amount in Rs.*		
*Depreciation**	*Cost/ WDV*	*Depreciation@15 %*	*Additional Depreciation @ 20%*
For Year 1	60,00,000	9,00,000	12,00,000
For Year 2	39,00,000	5,85,000	-
For Year 3	33,15,000	4,97,250	-
For Year 4	28,17,750	4,22,663	-
For Year 5	23,95,087	3,59,263	-
Scrap Value	10,000		

*Additional Depreciation is available as per provisions of Income Tax.

*Assuming this is the only asset in the block.

Question 10

Specify whether the following acts can be considered as (i) Tax planning; or (ii) Tax management; or (iii) Tax evasion.

(i) *P pays premium of Rs.10,000 for health Insurance policy so as to reduce his total income from Rs. 6,40,000 to Rs. 6,30,000 by claiming deduction u/s 80D (assuming Mr. P has not opted for section 115BAC of the Income tax Act, 1961).*

(ii) *SQL Ltd. pays advance tax by estimating his total income in previous year to ensure timely compliance.*

(iii) *An individual tax payer making tax saver fixed deposit of Rs. 1,00,000 in a nationalized bank.*

(iv) *A bank obtaining declaration from depositors in Form No. 15G /15H and forwarding the same to income-tax authorities.*

(v) *Z debits his household expenses as business expenses in the books.*

Answer

(i) Paying premium for health insurance policy in order to reduce the total income by claiming deduction u/s 80D and hence reducing tax liability is an act of Tax Planning.

(ii) Payment of Advance tax by estimation of Total income to enable timely compliance is an act of Tax Management. Therefore, such act of by SQL Ltd. to enable timely compliance is an act of Tax Management.

(iii) Investment in tax saver fixed deposits is allowed as deduction u/s 80C of the Income Tax Act, 1961 and is an act of Tax Planning. Therefore, depositing Rs. 1,00,000 in tax saver fixed deposit by an Individual tax payer is an act of Tax Planning.

(iv) Obtaining declaration from depositors by a bank in Form 15G / 15H and forwarding the same to the Income Tax Authorities is an act of Tax Management.

(v) Claiming the household expenses as business expenses in the books of account is not allowed as deduction u/s 37 of the Income Tax Act, 1961 and is an act of Tax Evasion. Therefore, the act of Z debiting his household expenses as business expenses is an act of Tax Evasion.

Question 11

Examine the doctrine of form and substance in the context of tax planning?

Answer

The following are certain principles enunciated by the Courts on the question as to whether it is the form or substance of a transaction, which will prevail in income-tax matters:

i. Form of transaction is to be considered in case of genuine transactions – It is well settled that when a transaction is arranged in one form known to law, it will attract tax liability whereas, if it is entered into in another form which is equally lawful, it may not. Therefore in considering whether a transaction attracts tax or not, the form of transaction put through is to be considered and not the substance. However this rule applies only to genuine transactions.

ii. True Legal relation is crucial element for taxability – It is open for the authorities to pierce the corporate veil and look behind the legal façade at the reality of the transaction. The taxing authority is entitled as well as bound to determine the true legal relation resulting from a transaction. The true legal relation arising from a transaction alone determines the taxability of a receipt arising from the transaction.

iii. Substance (i.e. actual nature of expenses) is relevant and not the form – In order to determine whether a particular item of expenditure is of revenue or capital nature, the substance and not merely the form should be looked into.

***

Taxation of Companies, LLP and Non-Resident

Question 1

There is a two-fold distribution of legislative powers as stipulated in Article 246 read with schedule VII of the Constitution of India. Comment

Answer

The statement that “There is a two-fold distribution of legislative powers as stipulated in Article 246 read with schedule VII of the Constitution of India” is incorrect as there is a threefold distribution of legislative powers as stipulated in Article 246 read with Schedule VII. List I of the Union list which comprises of 97 entries containing various subjects over which the Parliament shall have the exclusive powers of legislation, list II of the State list comprises of 66 entries over which the State Legislature shall have the exclusive powers of legislation and list III of the concurrent list comprises of 47 entries over which the Parliament and the Legislatures of States shall have concurrent powers to make laws.

Question 2

A non-Indian company is treated as resident, only if the place of effective management is situated wholly in India during the previous year. Comment

Answer

All Indian companies within the meaning of Section 2(26) of the Act are always resident in India regardless of the place of effective management of its affairs.

The Finance Act, 2015 has amended the test of residence for foreign companies to provide that a company would be treated as resident in India if its place of effective management at any time during the previous year is in India.

“Place of effective management” to mean a place where key management and commercial decisions that are necessary for the conduct of the business of an entity as a whole are, in substance made[Explanation to section 6(3)]

Question 3

XYZ Ltd., a foreign company, has its head office at UK. The Board of Directors (BOD) meetings are held in UK. However, the Board of Directors has delegated major powers to a committee in Delhi and the members of this committee are based in Delhi. The Board of Directors ratified the decisions of the said committee. In the light of above,

(1) Discuss the place of effective management (POEM) of XYZ Ltd.

(2) Discuss the guiding factors of POEM for Board of Directors delegating authorities to Committee

Answer

The location where company's Board of Directors (BOD) regularly meets and makes decisions may be the company's Place of Effective Management (POEM) provided the Board:

1. Retain and exercises its authority to govern the company: and
2. Does, in substance, make the key management and commercial decisions necessary for the conduct of the company's business as a whole.

In given case the board meetings are held in UK, but the same formalise the decisions taken by the committee at Delhi. Hence Place of Board meeting held at UK cannot be POEM, as power is delegated to committee which is based at Delhi.

Guiding factors when Board Delegating Authorities to Committee are as under:

If Board of Director had delegated some or all of its major authorities to one or more committees consisting senior management, then POEM shall be at the place where:

1. Members of executive committee are based and
2. Where committee develops and formulate key decisions for formal approval by Board. Hence in given case, POEM of XYZ Ltd. will be Delhi, as discussed above

Question 4

A Ltd. incurred an expenditure of Rs. 50 lakhs on glow-sign boards displayed at dealer outlets. Examine with the help of a decided case law, whether the above expenditure is revenue or capital in nature.

Answer

The facts of the case are similar with that of the CIT v. Orient Ceramics and Industries Ltd. (2013) 358 ITR 49 where the Delhi High Court noted the following observations of the Punjab and Haryana High Court, in CIT v. Liberty Group Marketing Division (2009) 315 ITR 125, while holding that such expenditure was revenue in nature.

The expenditure incurred on the glow sign boards are revenue in nature as these were incurred with the object of facilitating the business operation and not with the object of acquiring an asset of enduring nature.

Thus, the expenditure incurred by A Ltd. on glow-sign boards are revenue in nature.

Question 5

Bace drinks Ltd. was carrying more than one business activity, namely manufacturing soft drink and trading in soft drinks. However, the manufacturing activity was not profitable and was hence, discontinued. The employees who were directly connected with this manufacturing activity were laid off and severance cost was paid to those employees. The same was claimed by the assessee as revenue expenditure. The Assessing Officer disallowed the same treating it as capital expenditure, on the argument that it was incurred as a result of closure of business of the assessee. Discuss what would be the nature of expenditure.

Answer

The facts of the case are similar to that of the CIT vs. KJS India P. Ltd. (2012) 340 ITR 380 (Delhi), where the Delhi High Court, held that though one of the business activities was suspended, it cannot be construed that the assessee has closed down its entire business. The assessee still continues to trade in soft drinks. Therefore, the said expenditure will be allowed as revenue expenditure even though it was related to a manufacturing activity which was suspended.

Question 6

Sharad Hospitals purchased second-hand medical equipment for use as spare parts of existing equipment. Examine with the help of a decided case law, that whether the above expenditure is revenue or capital in nature.

Answer

The Karnataka High Court, in *Dr. Aswath N. Rao* v. *ACIT* (2010) 326 ITR 188, held that since the second hand machinery purchased by the assessee was for use as spare parts for the existing old machinery, the same had to be allowed as revenue expenditure.

Question 7

Sukriti Ltd. incurred expenses of Rs. 76,000 for the issue of shares. However, the public issue could not materialize on account of non-clearance by SEBI. Examine with the help of a decided case law, whether the above expenditure is revenue or capital in nature.

Answer

The facts of the case are similar to that of the *Mascon Technical Services Ltd.* v. *CIT* (2013) 358 ITR 545, where the Madras High Court observed that the assessee had taken steps to go in for a public issue and incurred share issue expenses. However, it could not go in for the public issue by reason of the orders issued by the SEBI just before the proposed issue. The High Court observed that though the efforts were aborted, the fact remains that the expenditure incurred was only for the purpose of expansion of the capital base. The capital nature of the expenditure would not be lost on account of the abortive efforts.

Thus, the expenditure incurred by Sukriti Ltd. constitutes capital expenditure.

Question 8

S Ltd., a subsidiary of H Ltds. has been incurring losses year after year. The holding company H Ltd. paid an amount of Rs. 1 crore to S Ltd. as a grant to recoup the losses. The assessing officer contends to consider this receipt as a trading receipt and includes it in the assessable income. Examine the case in the light of provisions of Income Tax Act and decided case law, if any.

Answer

The facts of the case are similar to *CIT* v. *Handicrafts and Handlooms Export Corporation of India Ltd.* (2014) 360 ITR 0130 (Delhi), where the assessee was a Government company operating a channelizing agency for sale of handicrafts and handlooms abroad. In the relevant previous year, it received a grant of Rs. 25 lakh from its holding company, the State Trading Corporation of India (STC) to recoup the losses. The Assessing Officer opined that the said amount was a revenue receipt and therefore chargeable to tax.

Tribunal's view: The Appellate Tribunal held that the grant received was not taxable as revenue receipt since the said grant was given to recoup the losses incurred by the assessee and was hence, in the nature of capital contribution.

High Court's Observations: The High Court examined the judgment of the Supreme Court in *Sahney Steel and Press Works Ltd.* v. *CIT* (1997) 228 ITR 253, which laid down the test for determining whether subsidy received by an assessee is taxable as capital or revenue

receipt. As per the said test, if any subsidy is given, the character of the subsidy in the hands of the recipient - whether revenue or capital - will have to be determined by having regard to the purpose for which the subsidy is given. The point of time, the source and the form of subsidy are immaterial. The object for which the subsidy is given, would, thus determine the nature of subsidy. If it is given by way of assistance to the assessee in carrying on of his trade or business, it has to be treated as trading receipt.

The High Court observed that grant was not paid by a third party or by a public authority but by the holding company. However, it was not on account of any trade or commercial transaction between the subsidiary and holding company. Further, the intention and purpose behind the said payment was to secure and protect the capital investment made by STC Ltd. The payment of grant by STC Ltd. and receipt thereof by the assessee was not during the course of trade or performance of trade, and thus, could not partake the character of a trading receipt. The same was in the nature of a capital grant.

The High Court observed the difference between Government Grant and payment made by STC, as pointed out by the *Division Bench in Handicrafts and Handlooms Corporation Ltd.* v. CIT (1983) 140 ITR 532. The grants given were specific amounts paid by STC to the assessee, in order to enable the assessee, which was its subsidiary and was incurring losses year after year, to recoup these losses and to enable it to meet its liabilities. These amounts, therefore, cannot form part of the trading receipts of the assessee since these were not in the nature of grants received from an outsider or the Government on general grounds such as for carrying on of trade.

Thus, the grant given by the holding company in this case is in the nature of capital receipt since its purpose is to secure and protect the capital investment made in the subsidiary company.

Question 9

X Ltd. owns a barren land of 9,000 sq. mtrs., adjacent to the factory premises. It enters into an agreement with Y Ltd. for granting of the above land on lease to Y Ltd. for a period of 12 years.

Under the terms of the agreement, Y Ltd. had to build a factory building, pay an annual rent @ Rs.100 per sq. mtr. of the leased land of 9,000 sq. mtrs. and surrender the building to X Ltd. at the end of the lease without any consideration. Y Ltd. complied with the terms and conditions of the lease agreement.

The depreciated value of the building surrendered and taken possession by X Ltd. in June, 2021 was Rs. 4.22 crore. Accounts department of X Ltd. is of the opinion that an equivalent amount is to be taken in the accounts of the year 2021-22 as income received. Critically examine the matter in the light of decided case law, if any.

Answer

The opinion of the Accounts Department of X Ltd. is incorrect. The depreciated value of the building is of course to be brought into the books of accounts. However, the equivalent amount viz. Rs. 4.22 crores cannot be treated as income from the business or operations. By its very nature it is a capital receipt and is not a revenue income.

The amount cannot be treated as a revenue receipt unless it is conclusively established that

this represented deferred rent as the lease rent was unreasonably low. Further, X Ltd. is not in the business of real estate to treat the benefit as incidental revenue receipt earned during the course of such business. Further, the facts of the case of *CIT* v. *Elphinstone Dye Works Pvt. Ltd.* 82 ITR 654 were similar and the Bombay High Court held that the written down value of the building in such a situation can be treated only as a capital receipt.

Question 10

Examine the taxability of the following receipts with reference to Income tax Act, 1961:

a) *Bonus shares received by equity shareholder.*

b) *Medical allowance received by an employee, the entire amount of which has been spent by him for medical treatment.*

c) *Gift of a plot of land given to a company secretary by one of his clients. The company secretary has been fully compensated for his services and this gift has been given in appreciation of his personal qualities.*

d) *Receipt of a cash gift of Rs. 60,000 from a friend on the occasion of wedding anniversary.*

e) *Contribution to provident fund recovered from an employee by an employer but not deposited in his PF Account.*

Answer

(a) Issue of bonus shares to equity shareholders does not amount to distribution of dividend, as there is no release of assets. Therefore, bonus shares received by an equity shareholder are not taxable as deemed dividend.

(b) Fixed medical allowance received by an employee is taxable under the head "Salaries", even if the entire amount has been spent by him for medical treatment.

(c) The value of any benefit or perquisite arising from exercise of profession is taxable as income under the head "Profits and gains of business or profession", irrespective of whether the benefits or perquisites are contractual or gratuitous. Therefore, the value of plot of land would be taxable in the hands of the company secretary under the head "Profits and gains of business or profession". However if the gift was only in appreciation of his personal qualities, such receipt of immovable property without consideration from a non-relative would be taxable under section 56(2)(x) under the head "Income from other sources".

(d) Cash gift of Rs. 60,000 received from a friend on the occasion of wedding anniversary is taxable under the head "Income from other sources", since it represents an amount exceeding Rs. 50,000 received from a non- relative on a occasion other than marriage.

(e) Contribution of provident fund recovered from an employee but not deposited in his Provident Fund account on or before the due date specified under the relevant provident fund Act is treated as income by virtue of section 2(24)(x) and is taxable in the hands of the employer under the head "Profits and gains of business or profession" or "Income from other sources".

However, the employer can claim deduction under section 36(1)(va) or under section 57(ia), as the case may be, if the same is deposited on or before the due date specified under the relevant provident fund Act. In the present case, the deducted contribution is not deposited by the employer, hence deduction u/s 36(1)(va) will not be allowed.

Question 11

A corporate assessee, who inadvertently failed to claim deduction under section 80IB during the initial years, cannot claim deduction under the said section for the remaining years during the period of eligibility, inspite of fulfillment of stipulated conditions. Examine the above statement in the light of judicial decision.

Answer

The provisions contained in Section 80IB of the Income tax Act, nowhere stipulates any condition that such a claim has to be made in the first year failing which there would be forfeiture of such claim in the remaining years. As decided in *Praveen Soni* v. *Commissioner of Income Tax* (2011) (Delhi), if the assessee fulfils the conditions mentioned under Section 80IB of Income Tax Act, he will be eligible for claiming the deduction for 10 consecutive years. Merely because of the reason that though the assessee was eligible to claim this benefit from a specific year, but did not claim in that year would not mean that he would be deprived from claiming this benefit for the remaining years during his eligibility.

Further, had the assessee claimed this benefit in the year in which he became eligible, he would have been allowed this benefit for 10 consecutive years but now he could claim the benefit only for the remaining period. For example, if the assessee became eligible in assessment year 2012-13, he would have claimed deduction for 10 years up to assessment year 2021-22, but he failed to claim deduction from A/Y 2012-13, now he could start claimingexemption from current AY upto AY 2021-22 only.

Question 12

Duty drawback receipts cannot be treated as profit derived from business of the industrial undertaking to be eligible for deduction under section 80-IB of Income tax Act. Examine in the light of decided case law.

Answer

The above statement is correct, in the case of Liberty India v. Commissioner of Income-tax, the Supreme Court held that the tax incentives under Chapter VI A are attracted only to the generation of operational profits and the benefit of deduction under section 80- IB will not be available in respect of the receipts, which do not have any direct nexus with the operation of industrial undertaking of the assessee. Thus, the profits derived by way of incentives like duty drawback did not fall within the expression ‘profits derived from industrial undertaking’ under section 80-IB.

Question 13

Mobile phones were purchased during the year and were exclusively used for the business purpose. The assessee wants to claim depreciation amounting to Rs. 20 lacs at higher rate of 40% treating them at par with computer. Examine with the help of decided case law.

Answer

Mobile phones are not computers and therefore, are not entitled to higher depreciation @ 40%. It was so held by the Kerala High Court in the case of *Federal Bank Ltd.* v. *ACIT* (2011) 332 ITR 319. Therefore, mobile phones would be entitled to depreciation by applying the rate of 15%, being the general rate applicable to plant and machinery.

Question 14

A Ltd. purchased a new bus for Rs. 12 lacs and donated it to a school where the children of employees were studying. Examine whether A Ltd could claim deduction under section 37(1) of the Income Tax Act, 1961.

Answer

The expenditure incurred for acquiring a new bus and donating it to the school is for the welfare of the children of staff/workmen of the company. Such expenditure is a part of employee's welfare expenses incurred for the purpose of securing healthy services for staff members. Therefore, such expenses were incurred wholly and exclusively for the purpose of the business.

Further, since the bus has been donated to the school, no benefit of enduring nature was derived by the company as the right of ownership was transferred to school. Hence, it is not a capital expenditure Thus, A Ltd. is entitled to claim deduction in full under section 37(1). The same was also held by the Rajasthan High Court in *CIT* v. *Rajasthan Spinning and Weaving Mills Ltd.* (2006) 281 ITR 408.

Question 15

The assessee, purchased a running business from M/s R.G.K. At the time of acquiring the business, the assessee had paid certain amount in respect of trade name, goodwill and for all other business and commercial rights and claimed depreciation on said amount. The Assessing Officer rejected the assessee's claim holding that goodwill could not be treated as intangible asset and, therefore, not depreciable. Decide.

Answer

As per Section 32(1)(ii) of Income tax Act, depreciation is allowable in respect of knowhow, patent, copyrights, trademarks, licenses, franchises or any other business or commercial rights of similar nature being intangible assets. Scanning the anatomy of this section, it can safely be stated that the provision allows depreciation on both tangible and intangible assets and clause (ii) enumerates the intangible assets on which depreciation is allowable. The assets which are included in the definition of 'intangible assets' under Section 32(1)(ii) includes, along with other things, any other business or commercial rights of similar nature.

To effectively understand what would constitute an intangible asset, certain aspects, like the nature of goodwill involved, how the goodwill has been generated, how it has been valued, agreement under which it has been acquired, what intangible asset it represents, namely, trademark, right, patent, etc. and further whether, it would come within the clause, namely, 'any other business or commercial rights which are of similar nature are to be borne in mind.

Yet, allowability of depreciation on goodwill has been a matter of debate before various Courts/Tribunal. In various cases, it has been held that depreciation is not allowable on goodwill because it is not of similar nature to that of intangible assets viz. know-how, patents, trademarks, licences, franchise, etc. as specified under Section 32 of the Income-tax Act, 1961 (the Act).

The Supreme Court in the case of Smifs Securities Ltd. has put the above controversy at rest and held that the goodwill being a difference between the amount paid and cost of shares in case of amalgamation scheme, is an asset eligible for depreciation under Section 32 of the Act. The Supreme Court has applied the principle of *ejusdem generis* and held that the expression 'any other business or commercial rights of a similar nature includes goodwill for the purpose of allowability of depreciation.

Question 16

Mr. Buddhadev is carrying on a business as sole proprietor. He died on 31st March, 2022 and on his death, the same business was continued by his legal heirs, by forming a firm. As on 31st March 2022, a determined business loss of Rs. 4 lakhs is to be carried forward under the Income- tax Act, 1961. Does the firm consisting of all legal heirs of Mr. Buddhadev, get a right to have this loss adjusted against its current income? Examine in the light of provisions of the Act and decided case law.

Answer

Section 78(2) provides that where a person carrying on any business or profession has been succeeded in such capacity by another person, otherwise than by inheritance, then, the successor is not entitled to carry forward and set-off the loss of the predecessor against his/her income. This implies that generally, set-off of business losses should be claimed by the same person who suffered the loss and the only exception to this provision is when the business passes on to another person by inheritance.

The facts of case given in the question are similar to the case of *CIT* v. *Madhukant M. Mehta* (2001) 247 ITR 805, where the Supreme Court has held that if the business is succeeded by inheritance, the legal heirs are entitled to the benefit of carry forward of the loss of the predecessor. Even if the legal heirs constitute themselves as a partnership firm, the benefit of carry forward and set off of the loss of the predecessor would be available to the firm.

In the given case, the business of Mr. Buddhadev was continued by his legal heirs after his death by constituting a firm. Hence, the exception contained in section 78(2) along with the decision of the Apex Court discussed above, would apply in this case. Therefore, the firm is entitled to carry forward the business loss of Rs. 4 lakhs of Mr. Buddhadev.

Question 17

Examine the taxability or allowability or otherwise in the following cases while computing income under the head "Profits and gains from business or profession" to be declared in the return of income for the assessment year 2022-23:

(a) The amount of margin money forfeited by a bank on the failure of its constituents of not taking the delivery of the shares purchased by such bank on their behalf.

(b) Amount received towards power subsidy with a stipulation that the same is to be adjusted in the electricity bills.

(c) Profit derived by an assessee engaged in carrying on the business as dealer in shares, on exchange of the shares held as stock in trade of one company with the shares of another company.

(d) Donations received by a person in the course of carrying on vocation, from his followers.

Answer

(a) Since the bank is purchasing shares on behalf of the constituents, the forfeiture of margin money by the bank from the constituents for not paying the balance amount of purchase price and not taking delivery of shares purchased by the bank on their behalf is in the normal course of its banking business and hence, the forfeited amount is assessable as business income of the bank. The forfeited amount being revenue in nature cannot be adjusted against the purchase price of the shares. The Supreme Court has, in the case of *CIT* v. *Lakshmi Vilas Bank Ltd.* (1996) 220 ITR 305, confirmed this view.

(b) As per section 2(24)(xviii) of Income tax Act, assistance in the form of subsidy or grant or cash incentive by the Central Government or a State Government or any authority or body or agency in cash or kind is chargeable to tax as income. Also, ICDS VII seeks admission of such grant as income. Government grants should not be recognized until there is reasonable assurance that (i) the person shall comply with the conditions attached to them, and (ii) the grants shall be received. However, recognition of such grant shall not be postponed beyond the date of actual receipt. Since power subsidy has been received by the assessee, it is revenue in nature and therefore chargeable to tax.

(c) The difference between the price of shares of the first company and the market value of shares of the new company on the date of such exchange has to be treated as "profit" derived by the dealer in shares (on exchange of shares held as stock-in-trade of the first company with the shares of the new company) in the normal course of business, and hence such profit is taxable as business income. It was so held by the Supreme Court in *Orient Trading Co. Ltd*. v. *CIT* (1997) 224 ITR 371.

d) Donations received by a person from his followers in the course of carrying on vocation for the furtherance of the objects of his vocation are receipts arising from carrying on of his vocation and are not casual or non-recurring receipts. The Supreme Court, in *Dr. K. George Thomas* v. *CIT* (1985) 156 ITR 412, has held that such donations are taxable as business income as there is a direct nexus between the vocation carried on by the assessee and the receipt of such donations.

Question 18

Income & Expenditure A/c of Lawyers & Co. for the year ending March 31, 2022

Particulars	*Amount Rs.*	*Particulars*	*Amount Rs.*
To Expenses	*1,50,000*	*By Professional*	
To Depreciation	*20,000*	*Receipts*	*3,80,000*
To Remuneration to partners	*1,50,000*	*By Other fees*	*90,000*
Interest on Capital to partners @ 20 per cent	*20,000*		
To Net Profit	*1,30,000*		
Total	*4,70,000*		*4,70,000*

Other Information:

1. *Expenses include Rs. 18,000 and Rs. 12,000 paid in cash as brokerage to a single party on a single day.*
2. *Depreciation calculated as per section 32 is Rs. 40,000*

Compute the total income of the firm.

Answer

Computation of Total Income of Lawyers & Co. for A. Y. 2022-23

Particulars		*Amount Rs.*
Net profit as per profit and loss account		1,30,000
Add : Expenses not allowable		
Section 40A(3)- Cash payments to a broker exceeding	30,000	
Rs. 10,000 (Note 1)		
Section 40(b)-Excess interest on capital to partners 20%-12% i.e. (20000*8/20) (Note 2)	8,000	38,000
Add : Remuneration to partners debited to profit and loss account		1,50,000
Less : Depreciation u/s 32		
(Rs. 40,000-Rs. 20,000 debited in profit and loss account)		(20,000)

Book profit (Note 3)		2,98,000
Maximum permissible remuneration(lower of the two :		
(i.e. 90 per cent of Rs. 2,98,000)	2,68,200	
Actual	1,50,000	(1,50,000)
Business Income of the Firm		1,48,000
Tax Liability (30% of 1,48,000)		44,400
Add : Health & Education Cess @ 4%		1,776
Total Tax Liability		46,176

Notes :

1. As per section 40A(3) of the Act, if the aggregate payment made (otherwise than by an account payee cheque/draft) to the same person during a day exceeds Rs. 10,000/- the entire amount of such payment is disallowed.
2. As per section 40 (b) of the Act, if the interest payable to the partners exceeds simple interest of 12% per annum, the excess amount is not deductible.
3. It is assumed the partners are working partners. The remuneration paid to the working partners cannot exceed the permissible limits specified under section 40 (b) of the Act.

Question 19

Alpha Ltd., a manufacturing company, which maintains accounts under mercantile system, has disclosed a net profit of Rs.12.50 lakhs for the year ending 31st March, 2022. You are required to compute the taxable income of the company for the Assessment year 2022-23, after considering the following information, duly explaining the reasons for each item of adjustment:

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

(ii) *Legal charges debited to profit and loss account include a sum of Rs. 45,000 paid to consultant for framing a scheme of amalgamation duly approved by the Central Government.*

(iii) *Repairs of plant and machinery debited to profit and loss account include Rs. 1.80 lakhs towards replacement of worn out parts of machineries.*

(iv) *A sum of Rs. 6,000 on account of liability foregone by a creditor has been taken to general reserve. The same was charged to the Revenue Account in the A.Y. 2012-13.*

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

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

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

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

The total amount of Rs. 2,00,000 is debited to the profit and loss account. Assume Tax Rate 30%

Answer

Computation of total income of Alpha Ltd. for A.Y. 2022-23

Particulars	*Amount (Rs.)*
Net profit as per profit and loss account	12,50,000
Add : Items debited to profit and loss A/c but not deductible	
1. Payment of advertisement expenditure of Rs. 60,000	
(i) Rs. 8,000, being the excess payment to a relative disallowed under section 40A(2)	8,000
(ii) As the payment is made in cash and since the remaining amount of Rs. 52,000 exceeds Rs. 10,000, 100% shall be disallowed under section 40A(3)	52,000
2. Legal charges for framing amalgamation scheme (deductible under section 35DD in five years). 1/5th of Rs.45,000 i.e. Rs. 9,000 to be allowed in the current year. Balance Rs. 36,000 (Rs. 45,000 - Rs.9,000)is to be added back (Note)	36,000
3. Under section 31, expenditure relatable to current repairs regarding plant, Machinery or furniture is allowed as deduction.	
The test to determine whether replacement of parts of machinery amounts to repair or renewal is whether the replacement is one which is in substance replacement of defective parts or replacement of the entire machinery or substantial part of the entire machinery [CIT v. Darbhanga Sugar Co. Ltd. [1956] 29 ITR 21 (Pat)].	
Here expenditure on repairs does not bring in any new asset into existence. Such replacement can only be considered as current repairs.	
Hence, no adjustment is required.	
Add: Items chargeable as business income but not credited to profit and loss A/c	
4. Liability foregone by creditor [taxable under section 41(1)]	6,000
5. Sale proceeds of import entitlements. The sale of the rights gives rise to profits or gains taxable under section 28(iiia). As the amount has already been credited to profit and loss account, no further	

adjustment is necessary.	—
6. Expenditure on in-house research and development is entitled to a weighted deduction of 150% of the expenditure (both capital and revenue) so incurred under section 35(2AB)(1) = Rs. 2 lakhs x 150% = Rs. 3 lakhs Expenditure of Rs. 2,00,000 has already been debited to Profit & Loss Account, therefore only additional deduction of Rs. 1 lakh further to be allowed.	(1,00,000)

Taxable Income	12,52,000
Tax Liability (30% of 12,52,000)	3,75,600
Add : Health & Education cess @ 4%	15024
Total Tax Liability R/O	390620

Note: As per section 35DD, any expenditure incurred wholly and exclusively for the purpose of amalgamation, would be allowed as a deduction in 5 successive years (1/5th each year) commencing from the year in which the amalgamation takes place.

Question 20

XYZ LLP is being liquidated. Examine the liability of its partners in respect of its tax dues?

Answer

Section 167C of the Income Tax Act, 1961 provides for the liability of partners of LLP in the event of its liquidation. In case of liquidation of an LLP, where tax due from the LLP cannot be recovered, every person who was a partner of the LLP at any time during the relevant previous year will be jointly and severally liable for payment of tax unless he proves that non-recovery cannot be attributed to any gross neglect, misfeasance or breach of duty on his part in relation to the affairs of the LLP. This provision would also apply where tax is due from any other person in respect of any income of any previous year during which such other person was a LLP.

Question 21

XYZ LLP has an income of Rs. 72,00,000 under the head 'profits and gains of business or profession'. One of its business is eligible for deduction @ 100% of profits under section 80-IB for the assessment year 2021-22. The profit from such business included in the business income is Rs. 58,00,000. Compute the tax payable by the LLP, assuming that it has no other income during the previous year 2022-23.

Answer

Computation of Tax payable by XYZ LLP for AY 2022-23

Particulars	*Amount (Rs.)*
Total Income	72,00,000
Less : Deduction under section 80 IB	(58,00,000)
Taxable Income	14,00,000
Tax @ 30%	4,20,000
Health & Education Cess @4%	16800
Total Tax	4,36,800

Computation of Alternate Minimum Tax

Particulars	*Amount (Rs.)*
Total Income	72,00,000
AMT on adjusted Total Income @ 18.5%	13,32,000
Health & Education Cess @4%	53280
Total Tax	13,85,280

Since, the regular income tax payable is less than AMT, the adjusted total income would be deemed to be the income of LLP and it would be liable to tax @ 18.5% plus cess and Tax payable will be higher of AMT or Normal tax i.e. Rs. 13,85,280. Further, the LLP would be eligible for credit in 15 subsequent years to the extent of difference between the AMT and Normal Tax i.e. Rs. 9,48,480, in the year in which the tax payable under regular provisions exceeds the AMT.

Question 22

Mr. X, carrying on the business of operating a warehousing facility for storage of sugar, has a total income of Rs. 80 lakh. In computing the total income, he had claimed deduction under section 35AD to the tune of Rs. 70 lakh on investment in building (on 1.4.2020) for operating the warehousing facility for storage of sugar. Compute his tax liability for A.Y.2022-23. Show the calculations of Alternate minimum Tax also.

Answer

Computation of Tax payable by Mr. X for AY 2022-23

Computation of Normal Tax

Particulars	*Amount (Rs. in lakh)*
Tax liability under the normal provisions of the Income-tax Act, 1961	22.125
Add: Health & Education Cess @4%	0.885
Total Tax Liability	23.01

Computation of Alternate Minimum Tax

Particulars	*Amount (Rs. in lakh)*
Adjusted Total Income	80.00
Add : Deduction under section 35AD	70.00
Less : Depreciation under section 32	(7.00)
Adjusted Total Income	143.00
AMT @18.5%	26.455
Surcharge @ 15% (since adjusted total income> Rs. 100 lakh)	3.968
Tax	30.423
Add: Health & Education cess @4%	1.216
Total tax Liability	31.639

Since, the regular income tax payable is less than the AMT payable, the adjusted total income of Rs. 143 lakhs shall be deemed to be the total income of Mr. X and tax is payable @18.5% thereof plus surcharge @ 15% and cess @4%. Therefore, tax liability is 31.639 lakhs.

However, Mr. X would be eligible for credit in 15 subsequent years to the extent of difference between the AMT and Normal Tax i.e. Rs. 8.629 lakhs.

Question 23

Minimum Alternate Tax (MAT) is attracted under section 115JB, on account of tax on total income being less than 15% of net profit as per the profit and loss account for the relevant previous year. Comment

Answer

The statement is incorrect as, the minimum alternate tax (MAT) is attracted under section 115JB, on account of tax on total income being less than 15% of book profit. Chapter XII-B is a self contained code for computation of book profit. The net profit as per the profit and loss account for the relevant previous year prepared in accordance with the provisions of Companies Act, 2013, as increased/reduced by the specified adjustments provided for in Explanation 1 to section 115JB would be the book profit for levy of MAT under section 115JB.

The rate of MAT has been reduced from 18.5% to 15% vide amendment in sub-section (1) of section 115JB by the Taxation Laws (Amendment) Act applicable for FY 2019-20onwards.

Question 24

"The provisions of section 115JB are not applicable in case of foreign companies". Examine in the context of the provisions contained in the various Chapters of the Income Tax Act, 1961.

Answer

The statement is incorrect; since, there is no provision in section 115JB restricting its applicability to only domestic companies and therefore, section 115JB is applicable to both domestic and foreign companies. The provisions of section 115JB are applicable in the case of an assessee, being a company, where 15% of its book profit exceeds the tax payable on the total income computed under the normal provisions of the Act. Therefore, the provisions of section 115JB would be attracted both in the case of a domestic as well as a foreign company, if the tax payable on its total income is less than 15% of its book profit.

However, section 115JB will not be applicable to a foreign company which has no presence or permanent establishment in India - *Timken Company., In re. (2010) 326 ITR 193 / 193 Taxman 20 (AAR- New Delhi).*

The rate of MAT has been reduced from 18.5% to 15% vide amendment in sub-section (1) of section 115JB by the Taxation Laws (Amendment) Act applicable for FY 2019-20 onwards.

Question 25

Parul Pvt. Ltd. made a provision of Rs. 50 lakhs for doubtful debts by debit to profit and loss account. The Assessing Officer, while computing book profit under section 115JB, disallowed the provision for doubtful debts. Is the action of Assessing Officer justified? Comment.

Answer

Explanation 1 under section 115JB(2) has been amended to provide that the net profit should also be increased by, inter alia, the amount set aside as provision for diminution in the value of any asset, if the same has been debited to profit and loss account, for computing the book profit.

Therefore, the Assessing Officer is justified in disallowing (adding back) the provision of Rs.50 lakhs for doubtful debts while computing book profit.

Question 26

> *ABC Ltd. has invested in bonds of National Highway Authority of India within the prescribed time and claimed exemption on the income from long-term capital gains under section 54EC. Further, it also claimed exclusion of long-term capital gains in the computation of "book profit" under section 115JB because of exemption available on it by virtue of section 54EC.*
>
> *The Assessing Officer however, reckoned the book profit including long-term capital gains for the purpose of levy of minimum alternate tax payable under section 115JB. Is the action of the Assessing Officer justified? Comment.*

Answer

The issue under consideration in this case is whether long-term capital gain exempted by virtue of section 54EC can be included in the book profit computed under section 115JB for levy of minimum alternate tax.

As long-term capital gains are part of the profits included in the profit and loss account prepared in accordance with the provisions of Companies Act, capital gains cannot be excluded unless provided under Explanation 1 to section 115JB.

Since, Explanation 1 to section 115JB does not provide for deduction in respect of capital gain in course of investment in bonds of National Highways Authority of India within the prescribed time, the long term capital gains so exempt would still be taken into account for computing book profit under section 115JB for levy of MAT. The same was so held by the *Kerala High Court in N. J. Jose and Co. (P.) Ltd.* v. *ACIT* (2010) 321 ITR 0132.

Therefore, the action of the Assessing Officer is justified in law.

Question 27

> *Whether MAT credit admissible under section 115JAA has to be set-off against the assessed tax payable before calculating interest under sections 234A, 234B and 234C? Comment.*

Answer

The right to carry forward and set-off MAT credit under section 115JAA arises as soon as the tax is paid by the assessee under section 115JB. The tax credit allowable can be set-off by the assessee while computing advance tax/self assessment tax payable for the year.

Hon'ble Supreme Court in the case of *CIT* v. *Tulsyan NEC Ltd.* (2011) 330 ITR 226 decided that MAT Credit admissible under section 115JAA has to be set-off against the Assessed tax payable, before calculating interest under section 234A, 234B and 234C.

Question 28

Compute the net income and tax liability of X Ltd. For the assessment year 2022-23 assuming that X Ltd. has a deemed long-term capital gain of Rs. 60,000 under proviso (i) tosection 54D(2) which is not credited in profit and loss account.

Particulars		*Amount (Rs.)*
Sale proceeds of goods (domestic sale)		*22,23,900*
Sale proceeds of goods (export sale)		*5,76,100*
Amount withdrawn from General Reserve (created bydebiting the P&L a\c)		*2,00,000*
Amount withdrawn from revaluation reserve		*1,50,000*
Total		*31,50,000*
Less:		
Business Expenses	*2,10,000*	
Depreciation (normal)	*6,16,000*	
Depreciation (extra depreciation because of revaluation)	*2,70,000*	
Salary & wages	*2,85,820*	
Income-tax	*3,50,000*	
Outstanding customs duty (not paid as yet)	*17,500*	
Proposed Dividend	*60,000*	
Consultation fees paid to a tax expert	*1,39,000*	
Other expenses	*21,000*	*(19,69,320)*
Net profit		*11,80,680*

The company wants to claim/ set off the following:-

1. *Deduction under section 80-IB (30% of Rs. 11,80,680)*
2. *Depreciation under section 32 (Rs. 5,36,000)*
3. *Bought forward the loss of 2013-14 being Rs. 14,80,000 for tax purposes and Rs. 40,00,000 for accounting purpose.*
4. *Unabsorbed depreciation being Rs. 70,000 for accounting purpose.*
5. *Assume Tax rate at 25%*

Answer

Computation of the net income and tax liability of X Ltd. for the assessment year 2022-23

Tax Liability under normal provisions of Income Tax Act

Particulars	*Amount (Rs.)*	*Amount (Rs.)*
Net profit as per P&L A/c		11,80,680
Add:		
Excess depreciation	3,50,000	
[i.e., Rs. 6,16,000+Rs. 2,70,000 – Rs. 5,36,000]		
Income Tax	3,50,000	
Customs Duty which is not paid	17,500	
Proposed dividend	60,000	7,77,500
Less:		
Amount withdrawn from General reserve	2,00,000	
Amount withdrawn from Revaluation reserve	1,50,000	
Unabsorbed loss	14,80,000	(18,30,000)
Business Income		1,28,180
Long term capital gain		60,000
Deductions under section 80-IB (30% of 1,28,180)		(38,454)
Net Income		1,49,726
Tax Liability		38929

Computation of Book Profits and Tax Liability as per MAT provisions under section 115 JB of the Act

Particulars	*Amount (Rs.)*	*Amount (Rs.)*
Net Profit		11,80,680
Add:		
Depreciation (Rs. 6,16,000+Rs. 2,70,000)	8,86,000	
Income Tax	3,50,000	
Proposed dividend	60,000	12,96,000
Less:		
Amount withdrawn from general reserve	2,00,000	
Unabsorbed depreciation	70,000	
Normal depreciation	6,16,000	
Amount withdrawn from revaluation reserve to the extent it does not exceed extra depreciation because of revaluation	1,50,000	(10,36,000)
Book Profit		14,40,680
Tax Liability @ 15.6% (15% plus HEC @ 4%)		2,24,746

X Ltd. will pay Rs. 2,24,746 as tax for the A.Y 2021-22 as per section 115JB. Tax credit however is available in respect of excess tax (Rs. 1,85,817) under section 115JBB).

Question 28

A non-resident Indian acquired shares on 01.02.2009 for Rs. 2,00,000 in foreign currency. These shares are sold by him on 01.02.2021 for Rs. 6,00,000. He invests Rs. 6,00,000 in shares on 31.03.2021 and these shares are sold by him on 30.06.2021 for Rs. 7,00,000. Discuss the tax implications. Ignore the effect of first proviso to section 48.

Answer

Computation of Long term Capital Gains for AY 2021-22

Particulars	**Amount (Rs.)**
Sale Consideration	6,00,000
Less: Cost of Acquisition	2,00,000
Long Term Capital Gains	4,00,000
Less: Exemption u/s 115F	4,00,000
Long Term Capital Gains	Nil

Long Term Capital Gain for AY 2022-23:

LTCG of Rs. 4,00,000 which was exempt in AY 2021-22 becomes taxable.

STCG of Rs. 1,00,000 is also taxable in AY 2022-23.

Question 29

During the Financial Year 2022-23, a badminton professional and a non-Indian citizen participated in India in a badminton tournament and won prize money of Rs. 30 lakhs. He contributed articles on the tournament in a local newspaper for which he was paid Rs. 2 lakh. Although his expenses were met by sponsors, he had incur Rs. 6,00,000 towards his travel costs to India. He was non-resident for tax purposes in India.

What would be his tax liability in India for AY 2022-23? Is he required to file his return of income?

Answer

As per the provision of Section 115BBA, where the total income of an assessee being a sportsman (including an athlete), who is not a citizen of India and is a non-resident, includes any income received or receivable by way of—

(i) participation in India in any game (other than a game the winnings wherefrom are taxable under section 115BB) or sport; or

(ii) advertisement; or

(iii) contribution of articles relating to any game or sport in India in newspapers, magazines or journals;

the income-tax payable by the assessee shall be the aggregate of the amount of income-tax calculated on income referred above at the rate of 20% and the amount of income-tax with which the assessee would have been chargeable had the total income of the assessee been reduced by the amount of income referred above.

Further, no deduction in respect of any expenditure or allowance shall be allowed under any provision of this Act in computing the income referred above.

It shall not be necessary for the assessee to furnish under sub-section (1) of section 139 a return of his income if his total income in respect of which he is assessable under this Act during the previous year consisted only of income referred above and tax deductible at source under the provisions of Chapter XVII-B has been deducted from such income.

Accordingly, both the receipts in India i.e. prize money of Rs. 30 lakhs and amount received from newspaper of Rs. 2 lakhs are chargeable to tax u/s 115BBA is @ 20% plus surcharge (if applicable) and 4% health and education cess. The total tax liability is Rs. 6,65,600. Further, he is not required to file his return of Income his total income in India consists only of income arising u/s 115BBA and tax have been deducted.

Question 30

Write short note on tax on distributed income by a company for buy-back of unlisted shares. Also comment would there be any tax implication in the hands of the shareholders.

Answer

As per section 10 (34A) of Income Tax Act, any income arising on account of buy back of

shares by the company as referred to in section 115QA shall be exempt in the hands shareholders. However, the company shall be liable to pay tax @ 20% plus surcharge @12% and health and cess @ 4% on such distributed income on account of buy back of shares. For the purpose of the said section, distributed income means the consideration paid by the company on buy-back of shares asreduced by the amount which was received by the company for issue of such shares.

The income arising to the shareholders in respect of such buyback of unlisted shares by the Company would be exempt under section 10(34A) in their hands.

Question 31

Lal Ltd., a domestic company, purchases its own unlisted shares on 17th August, 2021. The consideration for buyback amounted to Rs. 18 lakh, which was paid on the same day. Lal Ltd. had received Rs. 11 lakh on issue of these shares one year back. Compute the additional income-tax payable by Lal Ltd. Further, determine the interest, if any, payable if such tax is paid to the credit of the Central Government on 7th November, 2021. Discuss.

Answer

Computation of Tax Liability of Lal Ltd.

Particulars	*Amount (lakh Rs.)*
Consideration for Buy-Back	18.000
Less : Amount received on Issue of shares	(11.000)
Distributed income	7.000
Tax @ 20%	1.400
Surcharge @ 12% of Rs. 1.4 lakhs	0.168
Total tax and surcharge	1.56800
Health & Education Cess @ 4% of Rs. 1.568 lakhs	0.06272
Tax Liability	1.63072

The additional income-tax was payable on or before 31st August, 2021. However, the same was paid only on 7th November, 2021. Thus, interest under section 115QB is attracted @1% for every month or part of the month on the amount of tax not paid or short paid for the period beginning from the date immediately after the last date on which such tax was payable and ending with the date on which the tax is actually paid.

In this case, the period for which interest @1% per month or part of a month is leviable is calculated as under for 3 months (September-November):

Interest = Rs. (1,63,072 x 1/100 x 3) = Rs. 4,892.

Question 32

Explain which income received by a foreign company, be taxable in India. Also mention the basic tax rate applicable to a foreign company which is based in US.

Answer

A non-resident company be chargeable to tax in India in respect of following incomes:

(i) Income received or deemed to be received in India.

(ii) Income accruing or arising or deemed to accrue or arise in India.

The basic tax rate applicable in respect of the above incomes for the US based company which is a foreign company is 40% in India. Further, surcharge @ 2% is applicable in case the taxable income exceeds Rs. 1 crore and is up to Rs. 10 crore, and @5% if the income exceeds Rs. 10 crore in the previous year. The Health & Education cess @ 4% are also payable.

Question 33

Determine the tax liability of income of Japan based company Fujistu Ltd., in India on entering following transactions during the financial year 2022-23:

a) Rs. 5 lakhs received from an Indian domestic company for providing technical know how in India.

b) Rs. 6 lakhs from an Indian firm for conducting the feasibility study for the new project in Finland.

c) Rs. 4 lakhs from a non-resident for use of patent for a business in India.

d) Rs. 8 lakhs from a non-resident Indian for use of know how for a business in Singapore.

e) Rs. 10 lakhs for supply of manuals and designs for the business to be established in Singapore.

Assume there is no Double Avoidance Tax Agreement and all foreign Income are taxable in India only.

Answer

Computation of Tax Liability of Fujitsu Ltd.

S. No	*Particulars*	*Amount in lakhs (Rs.)*
a)	Amount received from an Indian domestic company for providing technical know how in India (From Business Connection in India, therefore taxable in India)	5.00
b)	Amount received from Indian firm for conducting the feasibility study for the new project in Finland	Nil

(Not taxable in India as it is for the business outside India)

c)	Money received from a non resident for use of patent for a business in India (Amount received for business set up in India is taxable in India)	4.0
d)	Money received from a non resident Indian for use of know-howfor a business in Singapore (The business is outside India, therefore non taxable in India)	Nil
e)	Payment made for supply of manuals and designs for the business to be established in Singapore (Business is to be established outside India, thus not taxable inIndia)	Nil

Tax on Total Income	9.0
Tax @ 40%	3.6
Surcharge	-
Health and Education Cess @4%	.144
Total tax Liability	3.744

Question 34

Would non-resident match referees and umpires in the games played in India fall within the meaning of sportsmen to attract taxability under the provisions of section 115BBA of Income Tax Act, 1961? Discuss briefly with the help of decided case law, if any.

Answer

In the case of *Indcom* v. *CIT*, the High Court has held that the payment made to non-resident match referees & umpires is "income" which has accrued & arisen in India, however, the same are not taxable under section 115BBA of Income Tax Act as the Umpires and Match Referee are neither sportsmen (including an athlete) nor they are non-resident sports association or institution so they do not attract the provisions contained in said section and the payments made to them do not come within the purview of Section 115BBA.

Question 35

In the context of provisions contained in the Income Tax Act, 1961 examine the correctness of the following statements:

"Liaison office maintained in India to explore the opportunity of business in India does not constitute business connection".

Answer

The statement is correct. If a liaison office is maintained solely for the purpose of carrying out activities which are preparatory or auxiliary in character, and such activities are approved by the Reserve Bank of India, then no business connection is established. In this case the liaison office is maintained for the purpose of exploring the business opportunity which is in the nature of preparatory or auxiliary activity. It is assumed that such activities are approved by the Reserve Bank of India. Since it does not undertake any commercial, trading on industrial activity, directly or indirectly, the liaison office does not constitute a business connection in this case.

Question 36

X Ltd., a company incorporated in USA has entered into an agreement with Y Ltd. an Indian company for rendering technical services to the latter for setting up a fertilizer plant in Orissa. As per the agreement, X Ltd. rendered both off-shore and on-shore services to Y Ltd at a fees of Rs. 50 lakhs and 1 crores respectively. X Ltd. is of the view that it is not liable to tax in India in respect of fee of Rs. 50 lakhs as it is for rendering services outside India. Discuss the correctness of the view of X Ltd.

Answer

The explanation below section 9(2) clarifies that income by way of, inter alia, fess 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 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, X Ltd, were for setting up fertilizer plant in Orissa. Therefore the services were utilized in India. Consequently, as per section 9(2), the fees of Rs. 1.5 crores for technical services rendered by X Ltd. (both off-shore and on-shore) to Y Ltd. is deemed to accrue or arise in India and includible in the total income of X LTd.

Therefore, the view of X Ltd. that it is not liable to tax in India in respect of fee of Rs. 50 lakhs (as it is for rendering service outside India) is not correct.

Question 37

ABC & Co. is a partnership firm consisting of four partners. The partnership deed provides for remuneration of Rs. 4,00,000 to partners and interest to partners at 12%. Profit for the year ended 31st March, 2022 is Rs. 1,00,000 after arriving the following adjustments :

Particulars	Amount Rs.
Remuneration to partners	4,00,000
Interest to partners on capital account @ 12%	20,000
Municipal tax of house property	5,000
Rent received on house property	50,000

Compute the book profit and remuneration deductible under section 40(b) of the Income tax Act, 1961.

Answer

Computation of book profit for AY 2022-23 and remuneration allowed under section 40(b) of Income-Tax Act, 1961

Particulars	**Amount (Rs.)**	**Amount (Rs.)**
Net Profit as per Profit and Loss Account		1,00,000
Add: Remuneration to Partners	4,00,000	
Add: Municipal Tax of House Property	5,000	4,05,000
Total		**5,05,000**
Less : Rent received on House Property		(50,000)
Book Profit as per section 40(b)		**4,55,000**

Remuneration allowed is lower of the amount as per partnership deed (Rs. 4,00,000) or amount actually paid (Rs. 4,00,000) or the amount computed as under:

Maximum amount deductible on account of payment of remuneration to partners

Particulars	**Amount**
First Rs. 300000 @ 90%	2,70,000
Balance of Rs.155000@ 60%	93,000
Total	**3,63,000**

Lower of above i.e. Rs. 363000 is the maximum remuneration permissible u/s 40(b).

Question 38

Briefly explain the provision of section 115 BBG of the Income Tax Act, 1961, regarding taxability of income earned from transfer of "Carbon Credits"?

Answer

Tax on Income from transfer of Carbon Credits [Section 115BBG]: Where the total income of an assessee includes any income by way of transfer of carbon credits, the income-tax payable shall be the aggregate of:

(a) amount of income-tax calculated on the income by way of transfer of carbon credits, at the rate of 10%; and
(b) the amount of income-tax with which the assessee would have been chargeable had his total income been reduced by the amount of income referred to in clause (a).

Notwithstanding anything contained in this Act, no deduction in respect of any expenditure or allowance shall be allowed to the assessee under any provision of this Act in computing his income referred to in clause (a) of sub-section (1).

Explanation : "carbon credit" in respect of one unit shall mean reduction of one tonne of carbon dioxide emissions or emissions of its equivalent gases which is validated by the United Nations Framework on Climate Change and which can be traded in market at its prevailing market price.

Question 39

An individual has business income of Rs. 35,00,000 for previous year 2021-22. He for the previous year 2020-21 was subject to Alternate Minimum Tax (AMT) because of claiming deduction under section 80-IE of Income Tax Act, 1961. He has an AMT credit of Rs. 5,00,000.

Calculate the tax to be paid by him for assessment year 2022-23 assuming assessee has not opted for section 115BAC of the Income tax Act, 1961. Also work out the amount of balance of available AMT credit.

Answer

Computation of Tax Liability for AY 2022-23 of an Individual

Particulars	Amount (Rs.)
Normal Tax Liability on Income of Rs. 35,00,000	
On Rs. 2,50,000 – Nil	Nil
On (Rs. 5,00,000 – Rs. 2,50,000) @ 5%	12,500
On (Rs. 10,00,000 – Rs. 5,00,000) @ 20%	1,00,000
Balance (Rs. 35,00,000 – Rs. 10,00,000) @ 30%	7,50,000
Total Tax Liability (excluding cess)	8,62,500
Add : Health and Education Cess @ 4%	34,500
Total Tax Liability	8,97,000
Alternate Minimum Tax 'AMT' @ 19.24% (18.5% + 4% cess) on Rs. 35,00,000	6,73,400

The tax payable by the assessee shall be Rs. 6,73,400 out of total tax liability of Rs. 8,97,000 after taking credit of AMT of Rs. 2,23,600. The Assessee will carry forward the balance AMT of Rs. 2,76,400 (Rs. 5,00,000 – Rs. 2,23,600)

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General Anti Avoidance Rules

Question 1

What is General Anti Avoidance Rules 'GAAR' and it applicability?

Answer

GAAR refers to General Anti-Avoidance Rules. These rules target any transaction or business arrangement that is entered into with the objective of avoiding tax. The objective is to check aggressive tax planning.

It may be noted that the GAAR provisions would be applicable to all taxpayers irrespective of their residential or legal status (i.e. resident or non-resident, corporate entity or non-corporate entity). The provisions also apply to all transactions and arrangements irrespective of their nature (i.e. business or non-business) if, the tax benefit accrues to the taxpayer and he fails to establish that the main purpose of entering into that transaction/arrangement was not to obtain tax benefit. For GAAR provisions, it is also not relevant whether transactions/ arrangements are entered into with group concerns or third parties and whether they are domestic or cross-border transactions.

For calculation of threshold of INR 30 million (that is, Rs 3 Crores as per the Rules), only the tax benefit enjoyed in Indian jurisdiction due to the arrangement or part of the arrangement is to be considered. Such benefit is assessment year specific. GAAR is with respect to an arrangement or part of the arrangement and limit of INR 30 million cannot be read in respect of a single taxpayer only

Question 2

What is the Implication of GAAR implementation?

Answer:

- The implication of GAAR is that the Income-tax department will have powers to deny tax benefit if a transaction was carried out exclusively for the purpose of avoiding tax.
- For example, if an entity is set up in Mauritius with the sole intention of claiming exemption from capital gains tax, the tax authorities have the right to deny the claim for exemption provided under the India-Mauritius tax treaty.

Question 3

When can an arrangement be declared as an Impermissible Avoidance Arrangement (IAA)?

Answer:

The Income Tax Commissioner will be empowered to declare an arrangement as an Impermissible Avoidance Arrangement (IAA) if:

(a) creates rights, or obligations, which are not ordinarily created between persons dealing at arm's length;

(b) results, directly or indirectly, in the misuse, or abuse, of the provisions of this Act;

(c) lacks commercial substance or is deemed to lack commercial substance under section 97, in whole or in part; or

(d) is entered into, or carried out, by means, or in a manner, which are not ordinarily employed for bona fide purposes.

This is so far reaching in nature that almost each and every transaction, which results in saving tax could be regarded as an IAA.

This means that GAAR enables tax authorities to declare any arrangement entered into by a taxpayer as an IAA. If it is so declared, then the tax authorities can disregard, combine or re-characterize any step of such arrangement or the entire arrangement, disregard any accommodating party involved in such arrangement, treat the transaction as if it had not been entered into or carried out, reallocate any income or expenditure, look through any arrangement by disregarding any corporate structure, re-characterize debt as equity or vice-versa and so on.

In effect, for tax purposes, any transaction can be treated in a manner different from the manner in which it is carried out if it is regarded as an IAA.

Question 4

Difference between Tax Avoidance and Tax Evasion?

Answer:

Tax Evasion and Tax avoidance are two different things. While Avoidance is legal management to avoid tax, evasion is illegal means to reduce tax liabilities, i.e. falsification of books, suppression of income, overstatement of deductions, etc.

Tax planning, as opposed to tax evasion which is illegal, is an accepted practice whereby the tax-payer uses provisions of the law or loopholes to minimise his tax liability.

Some countries, in addition to GAAR, have Specific Anti-Avoidance Rules (SAAR) to plug particular loopholes in the law or prevent some types of transactions that result in loss to Revenue. GAAR has been a part of the tax code of Canada since 1988, Australia since 1981, South Africa from 2006 and China from 2008. Australia and China also have SAAR in place to check abuse of tax treaties and transfer pricing.

Question 5

What is Round Trip Financing?

Answer:

Section 97(2) of the Income Tax Act defines round trip financing to include any arrangement in which, through a series of transactions, funds are transferred among the

parties to the arrangement and such transactions do not have any substantial commercial purpose other than obtaining the tax benefit.

Question 6

Difference between General Anti Avoidance Rules 'GAAR' and Specific Anti Avoidance Rules 'SAAR'?

Answer:

Specific Anti Avoidance Rules 'SAAR'

- These are specific and help reduce time and costs involved in tax litigation
- These provide certainty to any tax payer while formalising specific arrangements
- These don't provide any discretion to the tax authorities
- There is always a possibility that the tax payers find loopholes and circumvent these limited application, specific provisions

General Anti Avoidance Rules 'GAAR'

- These involve necessarily granting the discretion to the tax authorities to invalidate the arrangements as impermissible tax avoidance
- They have a far broader application and hence interpreted in a more extensive manner
- GAAR has the potential to counter more effectively and outsmart the tax payers in their "out of the box thinking" and their approach in devising new means of tax avoidance

Question 7

Exclusion from GAAR ?

Answer:

Exclusions from GAAR

Rule 10U of the Income-tax Rules provides for certain exclusions from the provisions of GAAR, which are discussed below:

a) Monetary Threshold: As discussed above, there is a monetary threshold of INR 3 crores for the applicability of GAAR. The threshold has to be seen with respect to each assessment year. Also, the threshold is not taxpayer-specific and it has to be determined with regard to all the parties to the arrangement.
b) Exemption to Foreign Institutional Investors (FII) and Foreign Portfolio Investors: The Rules provide that the provisions of GAAR are not applicable to an FII
c) Exclusion for P-Notes/Investments in FIIs: The provisions of GAAR shall not apply to a person who is a non-resident in relation to investment made by him by way of offshore derivative instruments or otherwise, directly or indirectly in a FII. The term 'offshore derivative instruments' mainly indicates investments made by way of P-Notes. Further, there is no threshold in respect of this investment. Even de minimis stakes are grandfathered by this clause.

Question 8

Discuss in brief some distinguishing features of General Anti-Avoidance Rules (GAAR) and Specific Anti-Avoidance Rules (SAAR)*?*

Answer:

Distinguishing features of General Anti Avoidance Rules (GAAR)

1. These involve necessarily granting the discretion to the tax authorities to invalidate the arrangements as impermissible tax avoidance.

2. They have a far broader application and hence interpreted in a more extensive manner.

3. GAAR has the potential to counter more effectively and outsmart the tax payers in their "out of box thinking" and their approach in devising new means of tax avoidance.

Distinguishing features of Specific Anti Avoidance Rules (SAAR)

1. These are specific and help reduce to time and cost involved in tax litigation.

2. These provide certainty to any taxpayer while formalising specific arrangements.

3. These don't provide any discretion to the tax authorities. 4. There is always a possibility that the tax payer may find loopholes and circumvent the limited applications of specific provisions.

Circular No. 7 of 2017 - Clarifications on implementation of GAAR provisions under the Income Tax Act, 1961

Question No. 1: Will GAAR be invoked if SAAR applies?

Answer: It is internationally accepted that specific anti avoidance provisions may not address all situations of abuse and there is need for general anti-abuse provisions in the domestic legislation. The provisions of GAAR and SAAR can coexist and are applicable, as may be necessary, in the facts and circumstances of the case.

Question No. 2: Will GAAR be applied to deny treaty eligibility in a case where there is compliance with LOB test of the treaty?

Answer: Adoption of anti-abuse rules in tax treaties may not be sufficient to address all tax avoidance strategies and the same are required to be tackled through domestic anti-avoidance rules. If a case of avoidance is sufficiently addressed by LOB in the treaty, there shall not be an occasion to invoke GAAR.

Question No. 3: Will GAAR interplay with the right of the taxpayer to select or choose method of implementing a transaction?

Answer: GAAR will not interplay with the right of the taxpayer to select or choose method of implementing a transaction.

Question No. 4: Will GAAR provisions apply where the jurisdiction of the FPI is finalised based on nontax commercial considerations and such FPI has issued P-notes referencing Indian securities? Further, will GAAR be invoked with a view to denying treaty eligibility to a Special Purpose Vehicle (SPV), either on the ground that it is located in a tax friendly jurisdiction or on the ground that it does not have its own premises or skilled professional

on its own roll as employees.

Answer: For GAAR application, the issue, as may be arising regarding the choice of entity, location etc., has to be resolved on the basis of the main purpose and other conditions provided under section 96 of the Act. GAAR shall not be invoked merely on the ground that the entity is located in a tax efficient jurisdiction. If the jurisdiction of FPI is finalized based on non-tax commercial considerations and the main purpose of the arrangement is not to obtain tax benefit, GAAR will not apply.

Question No. 5: Will GAAR provisions apply to (i) any securities issued by way of bonus issuances so long as the original securities are acquired prior to 01 April, 2017 (ii) shares issued post 31 March, 2017, on conversion of Compulsorily Convertible Debentures, Compulsorily Convertible Preference Shares (CCPS), Foreign Currency Convertible Bonds (FCCBs), Global Depository Receipts (GDRs), acquired prior to 01 April, 2017; (iii) shares which are issued consequent to split up or consolidation of such grandfathered shareholding?

Answer: Grandfathering under Rule 10U(1)(d) will be available to investments made before 1st April 2017 in respect of instruments compulsorily convertible from one form to another, at terms finalized at the time of issue of such instruments. Shares brought into existence by way of split or consolidation of holdings, or by bonus issuances in respect of shares acquired prior to 1st April 2017 in the hands of the same investor would also be eligible for grandfathering under Rule 1011(1)(d) of the Income Tax Rules.

Question No. 6: The expression "investments" can cover investment in all forms of instrument – whether in an Indian Company or in a foreign company, so long as the disposal thereof may give rise to income chargeable to tax. Grandfathering should extend to all forms of investments including lease contracts (say, air craft leases) and loan arrangements, etc.

Answer: Grandfathering is available in respect of income from transfer of investments made before 1st April, 2017. As per Accounting Standards, 'investments' are assets held by an enterprise for earning income by way of dividends, interest, rentals and for capital appreciation. Lease contracts and loan arrangements are, by themselves, not 'investments' and hence grandfathering is not available.

Question No. 7: Will GAAR apply if arrangement held as permissible by Authority for Advance Ruling?

Answer: No. The AAR ruling is binding on the PCIT / CIT and the Income Tax Authorities subordinate to him in respect of the applicant.

Question No. 8: Will GAAR be invoked if arrangement is sanctioned by an authority such as the Court, National Company Law Tribunal or is in accordance with judicial precedents etc.?

Answer: Where the Court has explicitly and adequately considered the tax implication while sanctioning an arrangement, GAAR will not apply to such arrangement.

Question No. 9: Will a Fund claiming tax treaty benefits in one year and opting to be

governed by the provisions of the Act in another year attract GAAR provisions? An example would be where a Fund claims treaty benefits in respect of gains from derivatives in one year and in another year sets-off losses from derivatives transactions against gains from shares under the Act.

Answer: GAAR provisions are applicable to impermissible avoidance arrangements as under section 96. In so far as the admissibility of claim under treaty or domestic law in different years is concerned, it is not a matter to be decided through GAAR provisions.

Question No. 10: How will it be ensured that GAAR will be invoked in rare cases to deal with highly aggressive and artificially pre-ordained schemes and based on cogent evidence and not on the basis of interpretation difference?

Answer: The proposal to declare an arrangement as an impermissible avoidance arrangement under GAAR will be vetted first by the Principal Commissioner / Commissioner and at the second stage by an Approving Panel, headed by judge of a High Court. Thus, adequate safeguards are in place to ensure that GAAR is invoked only in deserving cases.

Question No. 11: Can GAAR lead to assessment of notional income or disallowance of real expenditure? Will GAAR provisions expand the scope of charging provisions or scope of taxable base and/or disallow the expenditure which is actually incurred and which otherwise is admissible having regard to diverse provisions of the Act?

Answer: If the arrangement is covered under section 96, then the arrangement will be disregarded by application of GAAR and necessary consequences will follow.

Question No. 12: A definite timeline may be provided such as 5 to 10 years of existence of the arrangement where GAAR provisions will not apply in terms of the provisions in this regard in section 97(4) of the IT Act.

Answer: Period of time for which an arrangement exists is only a relevant factor and not a sufficient factor under section 97(4) to determine whether an arrangement lacks commercial substance.

Question No. 13: It may be ensured that in practice, the consequences of a transaction being treated as an ‘impermissible avoidance arrangement’ are determined in a uniform, fair and rational basis. Compensating adjustments under section 98 of the Act should be done in a consistent and fair manner. It should be clarified that if a particular consequence is applied in the hands of one of the participants, there would be corresponding adjustment in the hands of another participant.

Answer: Adequate procedural safeguards are in place to ensure that GAAR is invoked in a uniform, fair and rational manner. In the event of a particular consequence being applied in the hands of one of the participants as a result of GAAR, corresponding adjustment in the hands of another participant will not be made. GAAR is an anti-avoidance provision with deterrent consequences and corresponding tax adjustments across different taxpayers could militate against deterrence.

Question No. 14: Tax benefit of INR 3 crores as defined in section 102(10) may be

calculated in respect of each arrangement and each taxpayer and for each relevant assessment year separately. For evaluating the main purpose to be obtaining of tax benefit, the review should extend to tax consequences across territories. The tax impact of INR 3 crores should be considered after taking into account impact to all the parties to the arrangement i.e. on a net basis and not on a gross basis (i.e. impact in the hands of one or few parties selectively).

Answer: The application of the tax laws is jurisdiction specific and hence what can be seen and examined is the Tax Benefit' enjoyed in Indian jurisdiction due to the 'arrangement or part of the arrangement'. Further, such benefit is assessment year specific. Further, GAAR is with respect to an arrangement or part of the arrangement and therefore limit of Rs. 3 crores cannot be read in respect of a single taxpayer only.

Question No. 15: Will a contrary view be taken in subsequent years if arrangement held to be permissible in an earlier year?

Answer : If the PCIT/Approving Panel has held the arrangement to be permissible in one year and facts and circumstances remain the same, as per the principle of consistency, GAAR will not be invoked for that arrangement in a subsequent year.

Question No. 16: No penalty proceedings should be initiated pursuant to additions made under GAAR at least for the initial 5 years.

Answer: Levy of penalty depends on facts and circumstances of the case and is not automatic. No blanket exemption for a period of five years from penalty provisions is available under law. The assessee, may at his option, apply for benefit u/s 273A if he satisfies conditions prescribed therein.

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Basics of International Taxation

Part I: Transfer Pricing

Question 1

Discuss the meaning of the term 'associated enterprise' as defined under section 92A (1).

Answer

Transfer pricing provision applies only to transaction between associated enterprises.

As per Section 92A(1) an associated enterprise in relation to another enterprise means:

a) An enterprise which participates directly or indirectly or through one or more intermediaries in the management or control or capital of the other enterprise or
b) An enterprise in respect of which one or more persons who participate directly or indirectly or through one or more intermediaries in its management or control or capital are the same persons who participates directly or indirectly or through one or more intermediaries in the management and control or capital of other enterprise.

Further, sub-clause (2) of Section 92A(1) states the purposes of Section 92(A)(1), two enterprises shall be deemed to be associated enterprises if at any time during the previous year any of the conditions prescribed under this sub clause are satisfied. Section 92A(2) enlists 13 situations in which two enterprises shall be deemed to be associated enterprises if the prescribed conditions are satisfied.

Question 2

Discuss the meaning of the term 'deemed associated enterprise' as defined under section 92A (2).

Answer

Two enterprises shall be deemed to be associated enterprises if, at any time during the previous year, any of the conditions prescribed below are satisfied. Section 92A(2) enlists 13 situations in which two enterprises shall be deemed to be associated enterprises as follows:

(a) one enterprise holds, directly or indirectly, shares carrying not less than twenty-six per cent of the voting power in the other enterprise; or

(b) any person or enterprise holds, directly or indirectly, shares carrying not less than twenty-six per cent of the voting power in each of such enterprises; or

(c) a loan advanced by one enterprise to the other enterprise constitutes not less than fifty-one per cent of the book value of the total assets of the other enterprise; or

(d) one enterprise guarantees not less than ten per cent of the total borrowings of the other enterprise; or

(e) more than half of the board of directors or members of the governing board, or one or more executive directors or executive members of the governing board of one enterprise, are appointed by the other enterprise; or

(f) more than half of the directors or members of the governing board, or one or more of the executive directors or members of the governing board, of each of the two enterprises are appointed by the same person or persons; or

(g) the manufacture or processing of goods or articles or business carried out by one enterprise is wholly dependent on the use of know-how, patents, copyrights, trade-marks, licences, franchises or any other business or commercial rights of similar nature, or any data, documentation, drawing or specification relating to any patent, invention, model, design, secret formula or process, of which the other enterprise is the owner or in respect of which the other enterprise has exclusive rights; or

(h) ninety per cent or more of the raw materials and consumables required for the manufacture or processing of goods or articles carried out by one enterprise, are supplied by the other enterprise, or by persons specified by the other enterprise, and the prices and other conditions relating to the supply are influenced by such other enterprise; or

(i) the goods or articles manufactured or processed by one enterprise, are sold to the other enterprise or to persons specified by the other enterprise, and the prices and other conditions relating thereto are influenced by such other enterprise; or

(j) where one enterprise is controlled by an individual, the other enterprise is also controlled by such individual or his relative or jointly by such individual and relative of such individual; or

(k) where one enterprise is controlled by a Hindu undivided family, the other enterprise is controlled by a member of such Hindu undivided family or by a relative of a member of such Hindu undivided family or jointly by such member and his relative; or

(l) where one enterprise is a firm, association of persons or body of individuals, the other enterprise holds not less than ten per cent interest in such firm, association of persons or body of individuals; or

(m) there exists between the two enterprises, any relationship of mutual interest, as may be prescribed.

Question 3

Explain in the following cases whether the entities shall be deemed to be 'associated enterprises' under section 92A(2) of the Income tax Act, 1961 :

(i) Run India Ltd has 12 directors on its Board, out of which 6 directors are appointed by Race Ltd.

(ii) Cane UK Ltd. possesses 25% of the voting power in Bane (India) Pvt. Ltd.

(iii) Joy India's total borrowings amounted to Rs. 1000 crore, out of which guarantee has been given by Chapple India Ltd., for a borrowing of Rs. 400 crore.

Answer

(i) Two enterprises shall be deemed to be Associated Enterprises, if more than half of the directors or members of the board of one enterprise are appointed by other enterprise.

In the given case:-

Race Ltd. has appointed only half (6 out of 12) of the directors on the Board of Run India Ltd. Thus, both are not Associated Enterprises.

(ii) Two enterprises shall be deemed to be Associated Enterprises, if one enterprise holds, directly or indirectly, shares carrying not less than twenty-six per cent of the voting power in the other enterprise.

In the given case, the volume of voting power possessed by Cane UK Ltd. in Bane (India) Pvt. Ltd. is less than 26%, thus they are not Associated Enterprises.

(iii) Two enterprises shall be deemed to be Associated Enterprises, if one enterprise guarantees not less than ten per cent of the total borrowings of the otherenterprise;

Here, as the percentage of borrowings guaranteed by Chapple India Ltd. is 40% (Rs. 400 crore out of Rs 1000 crore) is more than the prescribed limit thus, Joy India Ltd. and Chapple India Ltd., are deemed to be Associated Enterprises.

Question 4

Brat Inc. of U.K. holds 9% shares in Pit Ltd. of India. The total book value of Assets of Pit *Ltd., is Rs. 57,25,000. Brat Inc. of U.K. has given a loan to Pit Ltd. of Rs. 30,00,000. Examine whether Brat Inc and Pit Ltd. are associated enterprises.*

Answer

Two enterprises shall be deemed to be Associated Enterprises, if a loan advanced by one enterprise to other constitutes not less than 51% of the book value of total assets of other enterprise.

In the given case:-

Total book value of Pit Ltd. is Rs. 57,25,000/-

51% of Rs. 57,25,000/- = Rs. 29,19,750/-

Loan given by the UK company = Rs. 30,00,000/-

Since, the loan amount is more than 51% of the book value of the total assets of the Indian company, Brat Inc. and Pit Ltd. are deemed to be Associated Enterprises.

Question 5

Coco Ltd. supplied consumables and raw material of Rs. 300 crore to Parrot Ltd. Total consumables and raw materials consumed by Parrot Ltd. was Rs. 400 crore.

Answer

Two enterprises shall be deemed to be Associated Enterprises, if, 90% or more of the raw materials and consumables required for the manufacture or processing of goods or articles

carried out by one enterprise, are supplied by the other enterprise, or by persons specified by the other enterprise, and the prices and other conditions relating to the supply are influenced by such other enterprise.

Here, Coco Ltd. supplied 75% of the raw material (i.e. raw material worth Rs. 300 crore out of Rs. 400 crore) to Parrot Ltd. Therefore, Coco Ltd. and Parrot Ltd. would not be associated enterprises.

Question 6

Indira Ltd, an Indian Company supplied billets to Charles Ltd. an UK based company which holds 40% of the shares of Indira Ltd., during the previous year 2021-22. Indira Ltd. also supplied the same product to another UK based company, Vales Ltd., an unrelated entity. The transactions with Charles Limited are priced at Euro 400 per MT (FOB), whereas the transactions with Vales Ltd. are priced at Euro 700 per MT (CIF). Insurance and Freight amounts to Euro 200 per MT. Compute the arm's length price for the transaction with Charles. Limited.

Answer

Here, since the foreign company, Charles Ltd., holds more than 26% shares in Indira Ltd., both be deemed to be associated enterprises within the meaning of section 92A.

As Indira Ltd. supplies similar product to an unrelated entity, Vales Ltd. UK, the transactions between Indira Ltd. and Vales Ltd. can be considered as comparable uncontrolled transactions for the purpose of determining the arm's length price of the transactions between Indira Ltd. and Charles Ltd.

Thus, Comparable Uncontrolled Price (CUP) method of determination of arm's length price (ALP) would be applicable in this case.

Transactions with Chalres Ltd. are on FOB basis, whereas transactions with Vales Ltd. are on CIF basis. This difference has to be adjusted before comparing the prices.

Particulars	*Amount (in Euro)*
Price per MT of billets to V Ltd.	700
Less : Cost of insurance and freight per M.T.	(200)
Adjusted price per M.T.	500

Since, the adjusted price for Vales Limited, UK is greater than the price fixed for Charles Ltd., the arm's length price be Euro 500 per MT.

Question 7

Transfer pricing rules shall have no implication where the income is computed on the basis of book profits. Comment.

Answer

The statement is correct. For the purpose of computing book profit for levy of minimum alternate tax, the net profit shown in the profit and loss account prepared in accordance with the companies that can be increased/decreased only by the addition / deductions specified in explanation to section 115JB. No other adjustments can be made to arrive at the book profit for the levy of MAT, except where:

a) it is discovered that the profit and loss account is not drawn up in accordance with the relevant schedule of the Companies Act
b) incorrect accounting policies and or accounting standards have been adopted for preparing such accounts and
c) the method and rate of the depreciation adopted is not correct.

Therefore transfer pricing adjustment cannot be made while computing book profit for levy of MAT.

Question 8

Explain how the arm's length price in relation to an international transaction is computed under 'resale price method' as per rule 10B(1)(b) of the Income-tax Rules, 1962.

Answer

Rule 10B (1) (b) of Income tax Rules, 1962 prescribes Resale Price method under which arm's length price is determined in the following manner:

(a) The price at which property purchased or services obtained by the enterprise from an associated enterprise is resold or are provided to an unrelated enterprise is identified;
(b) Such resale price is reduced by the amount of a normal gross profit margin accruing to the enterprise or to an unrelated enterprise from the purchase and resale of the same or similar property or from obtaining and providing the same or similar services, in a comparable uncontrolled transaction, or a number of such transactions;
(c) The price so arrived at is further reduced by the expenses incurred by the enterprise in connection with the purchase of property or obtaining of services;
(d) The price so arrived at is adjusted to take into account the functional and other differences, including differences in accounting practices, if any, between the international transaction and the comparable uncontrolled transactions, or between the enterprises entering into such transactions, which could materially affect the amount of gross profit margin in the open market;
(e) The adjusted price arrived as under (d) is taken to be an arm's length price in respect of the purchase of the property or obtaining of the services by the enterprise from the associated enterprise.

Example: A sold a machine to B (Associated Enterprise) and in turn B sold the same machinery to C (an independent party) at sale margin of 30% for Rs. 4,00,000 but B has incurred expenses of Rs. 4000 in sending the machine to C. Here Arm's length price would be calculated as:

Sales price to B = Rs. 4,00,000

Less : Gross Margin = Rs. 4,00,000 × 30%= Rs.1,20,000

Less : Expenses incurred by B = Rs.4,000

Arm's length price = Rs. 2,76,000

Question 9

Write a short note on Advance Pricing Agreement (APA).

Answer

"An APA is an agreement between a tax payer and tax authority determining the transfer pricing methodology for pricing the tax payer's international transactions for future years."

Types of APA's

- Unilateral APA: an APA that involves only the tax payer and the tax authority of the country where the tax payer is located.
- Bilateral APA (BAPA): an APA that involves the tax payer, associated enterprise (AE) of the tax payer in the foreign country, tax authority of the country where the tax payer is located, and the foreign tax authority.
- Multilateral APA (MAPA): an APA that involves the tax payer, two or more AEs of the tax payer in different foreign countries, tax authority of the country where the tax payer is located, and the tax authorities of AEs.

Benefits of APA's

- Certainty with respect to tax outcome of the tax payer's international transactions, by agreeing in advance the arm's length pricing or pricing methodology (ies) to be applied to the tax payer's international transactions covered by the APA.
- Removal of an audit threat (minimize rigours of audit), and deliverance of a particular tax outcome based on the terms of the agreement.
- Substantial reduction of compliance costs over the term of the APA.
- For tax authorities, an APA reduces cost of administration and also frees scarce resources.

Procedure for an APA

- An application for a unilateral agreement should be made to the Director General of Income Tax (International Taxation) (DG-IT).
- For BAPA/MAPA, application should be made to the Competent Authority (CA) in India. The CA will send the application to DG-IT who in turn will send it to respective APA teams.
- In the case of BAPA/MAPA, negotiations between the CAs of India and other country (ies) shall be carried out in accordance with the provisions of the tax treaties.

- Further, the process in India will be initiated, only after filing the application with the CAs in the AEs' jurisdiction and evidence to that effect is provided to the Indian CA.

Question 10

Briefly explain the concept of rollback provisions under the Advance Pricing Agreement (APA).

Answer

The Finance (No.2) Act, 2014 introduced the rollback provisions under the Advance Pricing Agreement (APA) program. The roll back provisions were made applicable to the APAs signed or applied post 1st October 2014.

An Advance Pricing Agreement (APA) is an ahead of time agreement between a taxpayer and a taxing authority on an appropriate transfer pricing methodology for some set of transactions at issue over a fixed period of time. The Roll Back provisions allow an APA entered into from April 1, 2013 to be applied to four previous years for the international transactions covered in the APA. Rules/regulations, including the manner in which the Rollback will apply to bilateral APAs have been notified on vide Notification No. S.O. 758 of 2015 (E) dated 14th March 2015.

Question 11

State the consequences that would follow, if the Assessing Officer makes adjustment to arm's length price in international transactions of the assessee resulting in increase in taxable income. What are the remedies available to the assessee to dispute such adjustment?

Answer

In case the Assessing Officer makes adjustment to arm's length price in an international transaction it will results in increase in taxable income of the assesse. Further, the following consequences shall follow:-

(a) No deduction under section 10AA or Chapter VI-A of Income tax Act shall be allowed from the income so increased.

(b) No corresponding adjustment would be made to the total income of the other associated enterprise (in respect of payment made by the assessee from which tax has been deducted or is deductible at source) on account of increase in the total income of the assessee on the basis of the arm's length price so recomputed.

The remedies available to the assessee to dispute such an adjustment are:-

1) In case the assessee is an eligible assessee under section 144C of Income tax Act he can file his objections to the variation made in the income within 30 days [of the receipt of draft order by him] to the Dispute Resolution Panel and Assessing Officer. Appeal against the order of the Assessing Officer in pursuance of the directions of the Dispute Resolution Panel can be made to the Income-tax Appellate Tribunal.

2) In any other case, he can file an appeal under section 246A of the Act to the Commissioner (Appeals) against the order of the Assessing Officer within 30 days of the date of service of notice of demand.

3) The assessee can opt to file an application for revision of order of the Assessing Officer under section 264 within one year from the date on which the order sought to be revised is communicated, provided the time limit for appeal to the Commissioner (Appeals) or the Income-tax Appellate Tribunal has expired or the assessee has waived the right of such an appeal. The eligibility conditions stipulated in section 264 should be fulfilled.

Question 12

Discuss whether adjustment is required in the context of transfer pricing provisions where the transfer price adopted for an international transaction on sale of goods by an Indian company during the financial year 2021-22, is Rs. 25 lakhs whilst the Arm's Length Price determined using appropriate method are Rs. 25 lakhs and Rs. 27 lakhs. Assume that the rate of permissible variation prescribed by the Central Government is 3% of the transfer price for this class of international transaction.

Answer

The proviso to section 92C (2) of Income tax Act, provides that where more than one price is determined by the most appropriate method, the arm's length price (ALP) shall be taken to be the arithmetical mean of such prices. However, if the arithmetical mean, so determined, is within such percentage of the transfer price notified by the central government, then the transfer price shall be deemed to be the arm's length price and no adjustment is required to be made.

Here, the arithmetical mean of the prices =

(Rs. 25 + Rs. 27) / 2 = Rs. 26 lakhs

Permissible variation =

3% of 25 lakhs = 0.75 lakhs

Thus, since the variation between the arm's length price of Rs. 26 lakhs and the transfer price of Rs. 25 lakhs is outside 3% of Transfer Price (i.e., Rs. 0.75 lakhs), adjustment in price is required.

Question 13

List out the method for determination of arm's length price?

Answer:

Computation of arm's length price [Section 92C]

The arm's length price in relation to an international transaction or specified domestic transaction shall be determined by any of the following methods, being the most appropriate method, having regard to the nature of transaction or class of transaction or class of associated persons or functions performed by such persons or such other relevant factors as the Board may prescribe namely:

(a) comparable uncontrolled price method;

(b) resale price method;

(c) cost plus method;

(d) profit split method;

(e) transactional net margin method;

(f) such other method as may be prescribed by the Board.

The most appropriate method referred to in sub-section (1) shall be applied, for determination of arm's length price, in the manner as may be prescribed.

Provided that where more than one price is determined by the most appropriate method, the arm's length price shall be taken to be the arithmetical mean of such prices:

Provided further that if the variation between the arm's length price so determined and price at which the international transaction or specified domestic transaction has actually been undertaken does not exceed such percentage not exceeding three per cent of the latter, as may be notified by the Central Government in the Official Gazette in this behalf, the price at which the international transaction or specified domestic transaction has actually been undertaken shall be deemed to be the arm's length price :

Provided also that where more than one price is determined by the most appropriate method, the arm's length price in relation to an international transaction or specified domestic transaction undertaken on or after the 1st day of April, 2014, shall be computed in such manner as may be prescribed and accordingly the first and second proviso shall not apply.

Question 14

Explain the term 'Specified Domestic Transaction'?

Answer:

Meaning of specified domestic transaction [Section 92BA]

For the purposes of this section and sections 92, 92C, 92D and 92E, "specified domestic transaction" in case of an assessee means any of the following transactions, not being an international transaction, namely:

(i) any transaction referred to in section 80A;

(ii) any transfer of goods or services referred to in sub-section (8) of section 80-IA;

(iii) any business transacted between the assessee and other person as referred to in sub-section (10) of section 80-IA;

(iv) any transaction, referred to in any other section under Chapter VI-A or section 10AA, to which provisions of sub-section (8) or sub-section (10) of section 80-IA are applicable; or

(v) any other transaction as may be prescribed,

and where the aggregate of such transactions entered into by the assessee in the previous year exceeds a sum of twenty crore rupees.

Question 15

Discuss the factors to be considered by the Assessing Officer while selecting the appropriate transfer pricing method*?*

Answer:

Factors to be considered by the Assessing Officer while selecting an appropriate transfer pricing method are as under:

1. The nature and class of the International or Specified Domestic Transaction.

2. The class or classes of Associated Enterprises entering into the transactions and the functions performed by them taking into account assets employed or to be employed and risk assumed by each enterprises.

3. The availability, coverage and reliability of data necessary for application of the method.

4. The degree of comparability existing between the International transaction or Specified Domestic Transaction and the uncontrolled transaction, and between the enterprises entering into such transaction

5. The extent to which reliable and accurate adjustments can be made to account for differences, if any, between the International or Specified Domestic Transaction and the comparable uncontrolled transactions or between the enterprises entering into such transactions.

6. The nature, extent and reliability of assumptions required to be made in the application of the method.

Question 16

Discuss in brief a few benefits derived from the Safe Harbour Rules, relating to the transfer pricing regulations*?*

Answer:

Benefits derived from Safe Harbour Rules are as under:

1. Compliance Simplicity: Safe Harbour Rules tends to substitute requirements in place of existing regulations, thereby reducing compliance burden and associated costs for eligible taxpayers, who would otherwise be obligated to dedicate resources and time to collect, analyze and maintain extensive data to support their inter-company transactions.

2. Certainty and Reduce litigation: Electing Safe Harbours may grant a greater sense of assurance to taxpayers regarding acceptability of their transfer price by the authorities without onerous audits. This conserves administrative and monetary resources for both the taxpayer and tax administration.

3. Administrative Simplicity: Since Tax administration would be required to carry out only a minimal examination in respect of taxpayers opting for safe harbours, they can channelize their efforts to examine more complex and high - risk transactions and high- risk transactions and taxpayers.

Question 17

ABC Ltd. is a foreign subsidiary company of XYZ Ltd. XYZ Ltd. sells refrigerators to ABC Ltd. at a price of Rs. 10,000 each for sale to its dealers in Singapore. In other States, XYZ Ltd. is directly selling to their dealers at Rs. 12,000 with a warranty of one year (Rs. 500 for each fridge). ABC Ltd. does not offer such warranty. Quantity sold to ABC Ltd. is 8000 units and to dealers of XYZ Ltd. is 3000 units.

Discuss the method to be applied to arrive at the arm's length price and compute the ALP.

How is the assessment of XYZ Ltd. going to be affected?

Answer:

ABC Ltd. and XYZ Ltd. are associated enterprise as ABC Ltd is subsidiary of XYZ Ltd. Comparable product (fridge) is sold to dealers (Uncontrolled transactions). Hence in given circumstances Comparable Uncontrolled Price (CUP) Method for determining arm's length price can be applied.

Particulars	Amount
Sale price charged to Dealers of XYZ Ltd.	12,000
Less cost of warranty included in price	(5,00)
Arm length price	11,500
Actual price paid by ABC Ltd. to XYZ Ltd.	10,000
Difference per unit	1,500
Addition required to be made in the computations of the total Income of XYZ Ltd. (1500 x 8000 units)	12,00,0000

No deduction under chapter VI-A would be available in respect of the enhanced Income.

Question 18

Zonik Inc of Canada holds 35% shares of Gama India Ltd. Gama India Ltd. imports 2000 unit of product X from Zonik Inc Canada at a price of Rs. 1,500 per unit and these are sold to Sunil Regency Ltd. at a price of Rs. 1,700 per unit. Gama India Ltd. has bought similar products from Ronak India Ltd. and sold to Vijay Ltd. at a gross profit of 14% on sales. Zonik Inc Canada offers a quantity discount of Rs. 15 per unit whereas Ronak India Ltd. does not offer such quantity discount. Gama India Ltd. incurred freight of Rs. 10 per unit and customs duty of Rs. 30 per unit in case of purchases made from Zonik Inc Canada.

On the basis of these facts explain the method which would be applicable for determination of Arm's Length Price (ALP) under Income Tax Act, 1961.

Determine the Arm's Length Price on the basis of the method as found to be applicable and also determine the effect on the net Profit/Income of Gama India Ltd. (assuming that there is no advance pricing agreement) in the scenario discussed above.

Answer:

Arm's Length Price is determined on the basis of Resale Price Method

Particular	Amounts (Rs.)
Resale price of goods purchased from Zonik Inc Canada (per unit)	1700
Less: Normal Gross Profit Margin @ 14% on Rs. 1700 (per unit)	(238)
Less: Expenses connected with purchases (fright and customs duty i.e. Rs. 10 + Rs. 30)	(40)
Less: Quantity discount allowed by Zonik Inc Canada	(15)
Arm's Length Price (per unit)	1407
Price paid to Zonik Inc Canada (per unit)	1500
Excess price paid per unit (Rs. 1500 – Rs. 1407)	93
Increase in Income of Gama Limited (Rs. 93 * 2000 units)	186000

Question 19

State with reasons, whether Jackson LLC., (incorporated in Japan) and Vijayshree Ltd. a domestic company, are/can be deemed to be associated enterprises for the transfer pricing regulations in the following independent situations :

(a) Jackson LLC. has advanced a loan of Rs. 55 crores to Vijayshree Ltd. on 12th January, 2022. The total book value of assets of Vijayshree Ltd. is Rs. 100 crores. The market value of the assets, however, is Rs. 140 crores. Vijayshree Ltd. repaid Rs. 10 crores before 31st March, 2022.

(b) Total value of raw materials and consumables of Vijayshree Ltd. is Rs. 800 crores. Of this, Jackson LLC supplies to the tune of Rs. 740 crores, at prices mutually agreed upon once in six months and depending upon the market conditions.

Answer:

(a) Jackson LLC (a foreign company, has advanced loan of Rs. 55 crores to Vijayshree Ltd., a domestic company, which amounts to 55% of book value of assets of Vijayshree Ltd. Since the loan advanced by Jackson LLC is not less than 51% of the book value of assets of Vijayshree Ltd., Jackson LLC and Vijayshree Ltd. are deemed to be associated enterprises for the purpose of transfer pricing regulations. The deeming provision would be attracted even if there is a repayment of loan during the same previous year which brings down its percentage below 51%.

(b) The Jackson LLC supplies 92.50% (Rs. 740 crore / Rs. 800 crores *100) of the raw material and consumables required by Vijayshree Ltd. which is more than the specified threshold limit of 90%, however, Jackson LLC and Vijayshree Limited are not deemed to be associated enterprises since the price of supply is not influenced by Jackson LLC but is mutually agreed upon once in six months depending upon prevailing market conditions.

Question 20

What are the practical difficulties in applying Arm's length price?

Answer:

The practical difficulties involved in application of Arm's length price are as follows:

- True comparison difficult in certain cases.
- Availability of data and reliability of available data.
- Absence of market price.
- Absence of comparable market price for "intangible" transactions.
- Administrative burden.
- Time lag.

Question 21

A person fails to furnish audit report under section 92E of the Income Tax Act, 1961. The Income Tax Officer imposes penalty on the assessee. Assessee challenges the penalty stating that there was reasonable cause for not furnishing the report. Can the assessee escape the penalty if the cause was genuine.

Answer:

As per section 271BA of the Income-tax Act, 1961 "the Act", if any person fails to furnish audit report as required under section 92E of the Act, then the assessing officer may direct that such person shall pay, by way of penalty, a sum of Rs. 1 lakh.

However, as per section 273B of the Act, penalty shall not be levied if the assessee proves that there was reasonable cause for such failure.

In this case, as the assessee is able to proves genuine reasonable cause of failure to furnish report u/s 92E, the assessing officer is not justified in imposing the penalty.

Question 22

Mr. Joy has entered into International transactions aggregating to Rs. 75 lakhs and specified domestic transactions aggregating to Rs. 5 crores. He did not mention any document/information relating to transfer pricing nor has filed any report/certificate/document/information with the tax authorities. Discuss penal consequences, if any.

Answer:

Mr. Joy is not required to maintain information and documents since neither the aggregated value of international transactions exceed Rs. 1 crore, nor the aggregated value of specified domestic transactions exceed Rs. 20 Crore. Therefore, no penalty shall be levied for non-maintenance of information and documents.

However, Mr. Joy is required to obtain and furnish the audit report u/s 92E even if the aggregated value of international transactions does not exceed Rs. 1 crore or specified domestic transaction does not exceed Rs. 20 crore. Hence, Mr. Joy was required to obtain and furnish audit report u/s 92E in respect of international transactions aggregating to Rs. 75 lakh and specified domestic transaction aggregating to Rs. 5 crore. He shall be liable to penalty u/s 271BA of Rs. 1,00,000 for such default.

Question 23

Comment on the following independent situations, whether X Ltd. and Y Ltd. constitute associated enterprises under the provisions of Section 92A :

(a) Book value of total assets of X Ltd. is Rupees 100 crores, Y Ltd. has advanced a loan of Rupees 80 crores to its wholly subsidiary A Ltd., A Ltd., in term advanced a loan of Rupees 80 crore to X Ltd.

(b) Y Ltd. is engaged in trading of furniture. During the previous year 2021-22 it purchases furniture of Rupees 50 lakh from X Ltd. Total purchases of Y Ltd. during the year is Rupees 55 lakh.

(c) X Ltd. has two units, Unit A and Unit B, Unit A manufactures industrial equipment using the manufacturing process exclusively owned by Y Ltd. Unit B is engaged in buying and selling of toys.

(d) X Ltd. holds whole of equity share capital of C Ltd. C Ltd. holds 30% equity shares of Y Ltd. X Ltd. also holds 60% of preference share capital of Y Ltd.

(e) Y Ltd. has the right to appoint one of the executive director of X Ltd. However Y Ltd. does not exercise its right and therefore it did not appoint any executive director of X Ltd.

Answer:

(a) X Ltd. and Y Ltd. are not Associated Enterprise. As per section 92A of the Income-tax Act, 1961, two enterprises are deemed to be associated enterprise if loan advanced by one enterprise to another enterprise constitutes not less than 51% of book value of the total asset of the other enterprise. Under this clause, direct loans are covered and loan advanced indirectly is not covered. In this case, Y Ltd. has not directly given loan to X Ltd. and hence they do not qualify as Associated Enterprises.

(b) X Ltd. and Y Ltd. are not Associated Enterprise. As per section 92A of the Income-tax Act, 1961, two enterprises are deemed to be associated enterprises if 90% or more of the raw material required for the manufacture or processing of goods carried out by one enterprise, are supplied by the other enterprise. This clause is applicable only if the purchasing enterprise is engaged in manufacturing or processing of goods. In this case, Y Ltd. is not engaged in manufacturing or processing of goods and hence, X Ltd. and Y Ltd. do not qualify as Associated Enterprises.

(c) X Ltd. and Y Ltd. are not associated enterprises. As per section 92A of the Income-tax Act, 1961, two enterprises are deemed to be associated enterprises if the business carried on by one enterprise is 'wholly' dependent upon the intangible owned by the other enterprise. In this case, X Ltd. is engaged in two businesses, out of which only one business is dependent on Y Ltd. Thus, X Ltd.'s business is not wholly dependent upon Y Ltd. and therefore they do not qualify As associated Enterprises.

(d) X Ltd. and Y Ltd. are Associated Enterprises. As per section 92A of the Income-tax Act, 1961, two enterprises are deemed to be associated enterprises if one enterprise holds, directly or indirectly, shares carrying not less than 26% of voting power in other enterprise. In this case, X Ltd. indirectly (through C Ltd.) holds more than 26% equity shares (i.e. 30%) in Y Ltd. and thus they qualify as associated enterprises.

(e) X Ltd. and Y Ltd. are not associated enterprises. As per section 92A of the Income-tax Act, 1961, two or more enterprises are deemed as associated enterprises if one or more executive director of one enterprise is appointed by other enterprise. In this case, Y Ltd. has actually not appointed any executive director of X Ltd. Merely having a right to appoint is not sufficient. Hence, X Ltd. and Y Ltd. do not qualify as associated enterprises.

Clarifications on Rollback Provisions of Advance Pricing Agreement Scheme

Under rule 10 MA(2)(ii) there is a condition that the return of income for the relevant roll back year has been or is furnished by the applicant before the due date specified in Explanation 2 to sub-section (1) of section 139 of the Income-tax Act (hereinafter referred to as the 'Act'). It is not clear as to whether applicants who have filed returns under section 139(4) or 139(5) of the Act would be eligible for roll back.

Answer:

The return of income under section 139(5) of the Act can be filed only when a return under section 139(1) has already been filed. Therefore, the return of income filed under section 139(5) of the Act, replaces the original return of income filed under section 139(1) of the Act. Hence, if there is a return which is filed under section 139(5) of the Act to revise the original return filed before the due date specified in Explanation 2 to sub-section (1) of section 139, the applicant would be entitled for rollback on this revised return of income.

However, rollback provisions will not be available in case of a return of income filed under section 139(4) because it is a return which is not filed before the due date.

Rule 10MA (2)(i) mandates that the rollback provision shall apply in respect of an international transaction that is same as the international transaction to which the agreement (other than the rollback provision) applies. It is not clear what is the meaning of the word "same". Further, it is not clear whether this restriction also applies to the Functions, Assets, Risks (FAR) analysis.

Answer:

The international transaction for which a rollback provision is to be allowed should be the same as the one proposed to be undertaken in the future years and in respect of which the agreement has been reached. There cannot be a situation where rollback is finalised for a transaction which is not covered in the agreement for future years. The term same international transaction implies that the transaction in the rollback year has to be of same nature and undertaken with the same associated enterprise(s), as proposed to be undertaken in the future years and in respect of which agreement has been reached. In the context of FAR analysis, the restriction would operate to ensure that rollback provisions would apply only if the FAR analysis of the rollback year does not differ materially from the FAR validated for the purpose of reaching an agreement in respect of international transactions to be undertaken in the future years for which the agreement applies.

The word "materially" is generally being defined in the Advance Pricing Agreements being entered into by CBDT. According to this definition, the word "materially" will be interpreted consistently with its ordinary definition and in a manner that a material change of facts and circumstances would be understood as a change which could reasonably have resulted in an agreement with significantly different terms and conditions.

Rule 10MA (2)(iv) requires that the application for rollback provision, in respect of an international transaction, has to be made by the applicant for all the rollback years in which the said international transaction has been undertaken by the applicant. Clarification is required as to whether rollback has to be requested for all four years or applicant can choose the years out of the block of four years.

Answer:

The applicant does not have the option to choose the years for which it wants to apply for rollback. The applicant has to either apply for all the four years or not apply at all. However, if the covered international transaction(s) did not exist in a rollback year or there is some disqualification in a rollback year, then the applicant can apply for rollback for less than four years. Accordingly, if the covered international transaction(s) were not in existence during any of the rollback years, the applicant can apply for rollback for the remaining years. Similarly, if in any of the rollback years for the covered international transaction(s), the applicant fails the test of the rollback conditions contained in various provisions, then it would be denied the benefit of rollback for that rollback year. However, for other rollback years, it can still apply for rollback.

Rule 10 MA(3) states that the rollback provision shall not be provided in respect of an international transaction for a rollback year if the determination of arm's length price of the said international transaction for the said year has been the subject matter of an appeal before the Appellate Tribunal and the Appellate Tribunal has passed an order disposing of such appeal at any time before signing of the agreement. Further, Rule 10 RA(4) provides that if any appeal filed by the applicant is pending before the Commissioner (Appeals), Appellate Tribunal or the High Court for a rollback year, on the issue which is subject matter of the rollback provision for that year, the said appeal to the extent of the subject

covered under the agreement shall be withdrawn by the applicant.

There is a need to clarify the phrase “Tribunal has passed an order disposing of such appeal” and on the mismatch, if any, between Rule 10MA(3) and Rule 10RA(4).

Answer:

The reason for not allowing rollback for the international transaction for which Appellate Tribunal has passed an order disposing of an appeal is that the ITAT is the final fact finding authority and hence, on factual issues, the matter has already reached finality in that year. However, if the ITAT has not decided the matter and has only set aside the order for fresh consideration of the matter by the lower authorities with full discretion at their disposal, the matter shall not be treated as one having reached finality and hence, benefit of rollback can still be given.

There is no mismatch between Rule 10MA(3) and Rule 10RA(4).

Rule 10MA(3)(ii) provides that rollback provision shall not be provided in respect of an international transaction for a rollback year if the application of rollback provision has the effect of reducing the total income or increasing the loss, as the case may be, of the applicant as declared in the return of income of the said year. It may be clarified whether the rollback provisions in such situations can be applied in a manner so as to ensure that the returned income or loss is accepted as the final income or loss after applying the rollback provisions.

Answer:

It is clarified that in case the terms of rollback provisions contain specific agreement between the Board and the applicant that the agreed determination of ALP or the agreed manner of determination of ALP is subject to the condition that the ALP would get modified to the extent that it does not result in reducing the total income or increasing the total loss, as the case may be, of the applicant as declared in the return of income of the said year, the rollback provisions could be applied. For example, if the declared income is Rs. 100, the income as adjusted by the TPO is Rs. 120, and the application of the rollback provisions results in reducing the income to Rs. 90, then the rollback for that year would be determined in a manner that the declared income Rs. 100 would be treated as the final income for that year.

Rule 10RA(7) states that in case effect cannot be given to the rollback provision of an agreement in accordance with this rule, for any rollback year to which it applies, on account of failure on the part of applicant, the agreement shall be cancelled. It is to be clarified as to whether the entire agreement is to be cancelled or only that year for which roll back fails.

Answer:

The procedure for giving effect to a rollback provision is laid down in Rule 10RA. Sub-rules

(2), (3), (4) and (6) of the Rule specify the actions to be taken by the applicant in order that effect may be given to the rollback provision. If the applicant does not carry out such actions for any of the rollback years, the entire agreement shall be cancelled. This is because the rollback provision has been introduced for the benefit of the applicant and is applicable at its option. Accordingly, if the rollback provision cannot be given effect to for any of the rollback years on account of the applicant not taking the actions specified in sub-rules (2), (3), (4) or (6), the entire agreement gets vitiated and will have to be cancelled.

If there is a Mutual Agreement Procedure (MAP) application already pending for a rollback year, what would be the stand of the APA authorities? Further, what would be the view of the APA Authorities if MAP has already been concluded for a rollback year?

Answer:

If MAP has been already concluded for any of the international transactions in any of the rollback year under APA, rollback provisions would not be allowed for those international transactions for that year but could be allowed for other years or for other international transactions for that year, subject to fulfilment of specified conditions in Rules 10MA and 10RA. However, if MAP request is pending for any of the rollback year under APA, upon the option exercised by the applicant, either MAP or application for roll back shall be proceeded with for such year.

Rule 10MA(1) provides that the agreement may provide for determining ALP or manner of determination of ALP. However, Rule 10MA(4) only specifies that the manner of determination of ALP should be the same as in the APA term. Does that mean the ALP could be different?

Answer:

Yes, the ALP could be different for different years. However, the manner of determination of ALP (including choice of Method, comparability analysis and Tested Party) would be same.

Will there be compliance audit for roll back? Would critical assumptions have to be validated during compliance audit?

Answer:

Since rollback provisions are for past years, ALP for the rollback years would be agreed after full examination of all the facts, including validation of critical assumptions. Hence, compliance audit for the rollback years would primarily be to check if the agreed price or methodology has been applied in the modified return.

Whether applicant has an option to withdraw its rollback application? Can the applicant accept the rollback results without accepting the APA for the future years?

Answer:

The applicant has an option to withdraw its roll back application even while maintaining the APA application for the future years. However, it is not possible to accept the rollback results without accepting the APA for the future years. It may also be noted that the fee specified in Rule 10MA(5) shall not be refunded even where a rollback application is withdrawn.

For already concluded APAs, will new APAs be signed for rollback or earlier APAs could be revised?

Answer:

The second proviso to Rule 10MA(5) provides for revision of APAs already concluded to include rollback provisions.

For already concluded APAs, where the modified return has already been filed for the first year of the APA term, how will the time-limit for filing modified return for rollback years be determined?

Answer:

The time to file modified return for rollback years will start from the date of signing the revised APA incorporating the rollback provisions.

In case of merger of companies, where one or more of those companies are APA applicants, how would the rollback provisions be allowed and to which company or companies would it be allowed?

Answer:

The agreement is between the Board and a person. The principle to be followed in case of merger is that the person (company) who makes the APA application would only be entitled to enter into the agreement and be entitled for the rollback provisions in respect of international transactions undertaken by it in rollback years. Other persons (companies) who have merged with this person (company) would not be eligible for the rollback provisions.

To illustrate, if A, B and C merge to form C and C is the APA applicant, then the agreement can only be entered into with C and only C would be eligible for the rollback provisions. A and B would not be eligible for the rollback provisions. To illustrate further, if A and B merge to form a new company C and C is the APA applicant, then nobody would be eligible for rollback provisions.

In case of a demerger of an APA applicant or signatory into two or more companies (persons), who would be eligible for the rollback provisions?

Answer:

The same principle as mentioned in the previous answer, i.e., the person (company) who makes an APA application or enters into an APA would only be entitled for the rollback provisions, would continue to apply. To illustrate, if A has applied for or entered into an APA and, subsequently, demerges into A and B, then only A will be eligible for rollback for international transactions covered under the APA. As B was not in existence in rollback years, availing or grant of rollback to B does not arise.

II
Place of Effective Management

Question 1

How the residential status of a company would be determined under Income Tax Act, 1961.

Answer:

As per Section 6(3) of the Income-tax Act, 1961 (the Act), a company is said to be resident in India in any previous year, if-

(i) it is an Indian company; or
(ii) its place of effective management in that year is in India .

"Place of effective management" is defined in the Act to mean a place where key management and commercial decisions that are necessary for the conduct of the business of an entity as a whole are, in substance, made.

Question 2

ABC Inc., a Swedish company headquartered at Stockholm, not having a permanent establishment in India, has set up a liaison office in Mumbai in April, 2021 in compliance with RBI guidelines to look after its day to day business operations in India, spread awareness about the company's products and explore further opportunities. The liaison office takes decisions relating to day to day routine operations and performs support functions that are preparatory and auxiliary in nature. The significant management and commercial decisions are, however, in substance made by the Board of Director at Sweden. Determine the residential status of ABC Inc. for A.Y.2022-23.

Answer:

Section 6(3) provide that a company would be resident in India in any previous year, if-

(i) it is an Indian company; or

(ii) its place of effective management, in that year, is in India . ,

In this case, ABC Inc. is a foreign company. Therefore, it would be resident in India for P.Y. 2021-22 only if its place of effective management, in that year, is in India.

Explanation to Section 6(3) defines "Place of effective management" to mean a place where key management and commercial decisions that are necessary for the conduct of the business of an entity as a whole are, in substance, made. In the case of ABC Inc., its place of effective management for the PY 2021-22 is not in India, since the significant management and commercial decisions are in substance made by the Board of Directors outside India in Sweden.

ABC Inc. has only liaison office in India through which it looks after routine day to day business operations in India. The place where decisions relating to day to day routine operations are taken and support functions that are preparatory or auxiliary in nature are performed are not relevant in determining the place of effective management.

Hence, ABC Inc. being a foreign company is a non-resident for AY 2022-23 since its place of effective management is outside India in the PY 2021-22.

Example 1

Company A Co. is a sourcing entity, for an Indian multinational group, incorporated in country X and is 100% subsidiary of Indian company (B. Co.). The warehouses and stock in them are the only assets of the company and are located in country X. All the employees of the company are also in country X. The average income wise breakup of the company's total income for three years is:

i) 30% of income is from transaction where purchases are made from parties which are non associated enterprises and sold to associated enterprises;

ii) 30% of income is from transaction where purchases are made from associated enterprises and sold to associated enterprises;

(iii) 30% of income is from transaction where purchases are made from associated enterprises and sold to non-associated enterprises; and

(iv) 10% of the income is by way of interest.

Interpretation: In this case passive income is 40% of the total income of the company. The passive income consists of, -

(i) 30% income from the transaction where both purchase and sale is from/to associated enterprises; and
(ii) 10% income from interest.

The A Co. satisfies the first requirement of the test of active business outside India. Since no assets or employees of A Co. are in India the other requirements of the test is also satisfied. Therefore, company is engaged in active business outside India.

Example 2: The other facts remain same as that in Example 1 with the variation that A Co. has a total of 50 employees. 47 employees, managing the warehouse, storekeeping and accounts of the company, are located in country X. The Managing Director (MD), Chief Executive Officer (CEO) and sales head are resident in India. The total annual payroll expenditure on these 50 employees is of Rs. 5 crore. The annual payroll expenditure in respect of MD, CEO and sales head is of Rs. 3 crore.

Interpretation: Although the first limb of active business test is satisfied by A Co. as only 40% of its total income is passive in nature. Further, more than 50% of the employees are also situated outside India. All the assets are situated outside India. However, the payroll expenditure in respect of the MD, the CEO and the sales head being employees resident in India exceeds 50% of the total payroll expenditure. Therefore, A Co. is not engaged in active business outside India.

Example 3: The basic facts are same as in Example 1. Further facts are that all the directors of the A Co. are Indian residents. During the relevant previous year 5 meetings of the Board of Directors is held of which two were held in India and 3 outside India with two in country X and one in country Y.

Interpretation: The A Co. is engaged in active business outside India as the facts indicated in Example 1 establish. The majority of board meetings have been held outside India. Therefore, the POEM of A Co. shall be presumed to be outside India.

Example 4: The facts are same as in Example 3 but it is established by the Assessing Officer that Although A Co.'s senior management team signs all, the contracts, for all the contracts above Rs. 10 lakh the A Co. must submit its recommendation to B Co. and B Co. makes the decision whether or not the contract may be accepted. It is also seen that during the previous year more than 99% of the contracts are above Rs. 10 lakh and over past years also the same trend in respect of value contribution of contracts above Rs. 10 lakh is seen.

Interpretation: These facts suggest that the effective management of the A Co. may have been usurped by the parent company B Co. Therefore, POEM of A Co. may in such cases be not presumed to be outside India even though A Co. is engaged in active business outside India and majority of board meeting are held outside India.

Example 5: An Indian multinational group has a local holding company A Co. in country X. The A Co. also has 100% downstream subsidiaries B Co. and C Co. in country X and D Co. in country Y. The A Co. has income only by way of dividend and interest from investments made in' its subsidiaries. The Place of Effective Management of A Co. is in India and is exercised by ultimate parent company of the group. The subsidiaries B, C and D are engaged in active business outside India. The meetings of Board of Director of B Co., C Co. and D Co. are held in country X and Y respectively.

Interpretation: Merely because the POEM of an intermediate holding company 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 companies 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.

Question 3

XYZ Ltd., a foreign company, has its head office at USA. The Board of Directors (BOD) meetings are held in USA. However, the Board of Directors has delegated major powers to a committee in Kolkata and the members of this committee are based in Kolkata. The Board of Directors ratified the decisions of the said committee. In the light of above,

(1) Discuss the place of effective management (POEM) of XYZ Ltd.

(2) Discuss the guiding factors of POEM for Board of Directors delegating authorities to Committee

Answer:

The location where company's Board of Directors (BOD) regularly meets and makes decisions may be the company's Place of Effective Management (POEM) provided the Board:

1. Retain and exercises its authority to govern the company: and

2. Does, in substance, make the key management and commercial decisions necessary for the conduct of the company's business as a whole.

In given case the board meetings are held in USA, but the same formalise the decisions taken by the committee at Kolkata. Hence Place of Board meeting held at USA cannot be POEM, as power is delegated to committee which is based at Kolkata.

Guiding factors when Board Delegating Authorities to Committee are as under:

If Board of Director had delegated some or all of its major authorities to one or more committees consisting senior management, then POEM shall be at the place where:

1. Members of executive committee are based and

2. Where committee develops and formulate key decisions for formal approval by Board.

Hence in given case, POEM of XYZ Ltd. will be Kolkata, as discussed above.

***

Tax Treaties

Question 1

Discuss the relief provided to the foreign income of an assessee in following cases:

(a) In case there is bilateral DTAA
(b) In case there is no DTAA.

Answer

Double Taxation Relief is applicable in the case of those assesses whose income is taxed in two or more countries due to residential status or due to source principle. To mitigate the impact of double taxation of income, the provisions for double taxation relief were made.

(a) India has entered into agreement with many countries regarding avoidance of double taxation. In case there is a bilateral Double Taxation Avoidance Agreement ('DTAA' or 'the Treaty') concluded between India and the other country, the assessee can claim relief under section 90 of the Income tax Act, 1961. Foreign tax credit is provided to the assessee who has paid taxes in India as well as in a foreign country. This tax relief is governed by the provisions of respective DTAA. Further, the provision of Income-tax Act, 1961 are applicable to the assessee to the extent they are more beneficial to him.

(b) Where there is no bilateral agreement with a country, under Section 90 of the Income tax Act, section 91 of the Act grants unilateral relief in respect of income which has suffered tax both in India and in a country with which no DTAA exists (i.e. doubly taxed income). This relief is provided in the form of a deduction from the income tax payable in India and is calculated on the doubly taxed income at Indian Tax rate or the tax rate of the foreign country whichever is lower or at Indian rate of tax, if both rates are equal. An assessee shall be allowed deduction under section 91 provided all the following conditions are fulfilled:-

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

(b) The income accrues or arises to him outside India during that previous year.

(c) Such income is not deemed to accrue or arise in India during the previous year.

(d) The income in question has been subjected to income-tax in the foreign country in the hands of the assessee and the assessee has paid tax on such income in the foreign country.

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

Question 2

The Income-tax Act, 1961 provides for taxation of a certain income earned by Shyam. The Double Taxation Avoidance Agreement, which applies to Shyam, excludes the income earned by him from the purview of tax. Will he be liable to pay tax on the income earned by him? Discuss in the light of provisions of Income Tax Act, 1961 and decided case law, if any.

Answer

Section 90(2) makes it clear that where the Central Government has entered into a Double Taxation Avoidance Agreement, then in respect of an assessee to whom such agreement applies, the provisions of the Act shall apply to the extent they are more beneficial to the assessee. This means that where tax liability is imposed by the Act, the Double Taxation Avoidance Agreement may be resorted to for reducing the tax liability.

Further, in *CIT* v. *P.V.A.L. Kulandagan Chettiar* (2004) 267 ITR 654, the Supreme Court has held that in case of any conflict between the provisions of the Double Taxation Avoidance Agreement and the Income-tax Act, 1961, the provisions of the Double Taxation Avoidance Agreement would prevail over those of the Income-tax Act, 1961.

Shyam will, therefore, not be liable to pay tax on such income earned by him.

Question 3

Yogita Kumari, a resident individual, is a freelance dancer deriving income of Rs. 75,000 from shows performed outside India. Tax of Rs. 10,000 was deducted at source in the country where the shows were performed. India does not have any double tax avoidance agreement with that country. Her income in India amounted to Rs. 5,00,000. Compute tax liability of Yogita for the assessment year 2022-23 assuming she has deposited Rs. 10,000 in Public Provident Fund and paid Rs. 20,000 as medical insurance premium in respect of her father (aged 65 years). Assuming assessee has not opted for Section 115BAC of the Income tax Act, 1961.

Answer

Computation of Tax Liability of Ms. Yogita Kumari

	Particulars		*Amount in Rs.*
	Indian Income		5,00,000
	Foreign Income		75,000
A	Gross Total Income		5,75,000
B	*Less* : Deductions under Chapter VIA		
	PPF Contribution	Rs. 10,000	
	Medical Insurance Premium for senior citizen	Rs. 20,000	(30,000)

C	Total Income (A-B)		5,45,000
	Tax on first Rs. 2,50,000	Nil	
	Tax on next Rs. 250000 @ 5%	12,500	
	Tax on next Rs. 45,000 @ 20%	9000	21,500
	Rebate under section 87A		(Nil)
	Health and Education Cess @ 4%		860
D	Total Tax		22,360
	Average rate of Tax in India Rs. (22360/5,45,000 * 100) : 4.1027%		
	Average rate of tax in foreign country Rs. (10,000 /75,000 * 100) : 13.33%		
	Doubly Taxed Income : Rs. 75,000		
E	Relief under section 91 (on Rs. 75,000 @ 4.1027%)		(3077)
F	Tax payable in India (D-E)		19,283

Note:

An assessee shall be allowed Relief under section 91 provided all the following conditions are fulfilled:-

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

(b) The income accrues or arises to him outside India during that previous year.

(c) Such income is not deemed to accrue or arise in India during the previous year.

(d) The income in question has been subjected to income-tax in the foreign country in the hands of the assessee and the assessee has paid tax on such income in the foreign country.

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

In this case, Yogita Kumari is eligible for deduction under section 91 since all the above conditions are fulfilled.

Question 4

The following are the particulars of income earned by Ms. Sunita, a resident Indian aged 25, for the assessment year 2022-23:

Particulars	*Amount in Rs.*
Income from playing basketball match in Netherland	*12,00,000*
Tax paid in Netherland	*1,80,000*
Income from playing basketball match in India	*19,20,000*
Life insurance premium paid	*1,20,000*
Medical Insurance Premium paid through net banking for her father aged 62 years	*25,000*

Compute her total income and tax liability for the assessment year 2022-23. Assume there is no Double Taxation Avoidance Agreement between India and Netherland. Assuming assessee has not opted for Section 115BAC of the Income tax Act, 1961.

Answer

Computation of total income and tax liability of Ms. Sunita for the A.Y 2022-23

	Particulars		*Amount (Rs.)*	*Amount (Rs.)*
A	Indian Income			
	(Income from playing basketball tournaments in India)		19,20,000	
	Foreign Income			
	(Income from playing basketball matches in Netherland)		12,00,000	
	Gross Total Income			31,20,000
B	*Less* : Deduction under chapter VIA			
	Deduction u/s 80C for Life Insurance Premium		1,20,000	
	Deduction u/s 80D for Medical Insurance Premium paid for her father		25,000	(1,45,000)
C	Total Income			29,75,000
D	Tax on total income			
	Tax upto Rs. 10,00,000 -	Rs. 1,12,500		
	Tax on income above Rs. 10,00,000	Rs. 592500	7,05,000	
	Add: Health and Education Cess @ 4%		28200	7,33,200
E	Average rate of tax in India			
	Rs. (7,33,200/ 29,75,000 x 100)	24.65%		

Average rate of tax in foreign country Rs.(1,80,000/12,00,000 X 100) 15%	
Rebate u/s 91 On Rs. 12 lakh @15% (lower of average Indian tax rate or average foreign tax rate)	(180000)
Tax payable in India	5,53,200

Note :

Ms. Sunita shall be allowed Relief under section 91 of Income Tax Act, 1961, since conditions mentioned therein are fulfilled.

Question 5

Sudesh (age 62 years) is a resident and ordinarily resident in India. Details of his Income/ Investment are as under:

Rs. 16,80,000 is income from a business in India

Rs.5,45,000 is income from a business in country A

Rs. 32,000 has been paid as tax on income earned in country A

Rs. 28,000 paid as tuition fee for his daughter studying in India

Rs. 90,000 paid as tuition fee for his son studying outside India

Rs. 48,000 received as interest on Government securities.

Assume there is no Double Taxation Avoidance Agreement:

(i) Find out the tax liability of Sudesh for the Assessment Year 2022-23.

(ii) Does it make any difference, if Sudesh is a non-resident?

Note: Assuming assessee has not opted for Section 115BAC of the Income tax Act, 1961.

Answer

(i) Computation of Tax Liability of Sudesh

For A.Y 2022-23

	Particulars	*Rs.*
	Business Income in India	16,80,000
	Interest on Government Securities	48,000
A	Gross Total Income	17,28,000
B	Deduction u/s 80C For tuition fee (Note 1)	28,000

C	Total Income		17,00,000
	Foreign Income to be included in Indian Income for computation of tax rate		5,45,000
	Total Income for calculating tax rate		22,45,000
D	Tax on 22,45,000		
	Upto Rs. 3,00,000 (in case of senior citizen)		Nil
	From Rs. 3,00,001 to 5,00,000 @ 5%	Rs. 10,000	
	From Rs. 5,00,001 to 10,00,000 @ 20%	Rs. 1,00,000	
	On balance Rs. 12,45,000 @ 30%	Rs. 3,73,500	4,83,500
E	Health and Education Cess (4% of tax)		19,340
F	Tax Payable		5,02,840
G	Average Tax Rate in India 22.40% (Rs.5,02,840/22,45,000 * 100)		
	Tax rate in Foreign Country		
	(32000/545000*100)=5.87%		
	Relief u/s 91 (545000*5.87%)		(32000)
H	Indian Tax Liability		470840
	Rounded off Tax liability		470840

Note:

1. Deduction under Section 80C is not available for tuition fee paid outside India.

(ii) If Sudesh is non-resident, his income taxable in India would be Rs. 17,00,000. Rs. 5,45,000 would not be included in his income as the same is earned outside India and would be taxable in country A.

Further, the tax liability of Sudesh in India would be calculated in following manner:

Particular	*Rs.*	*Rs.*
Total Income		17,00,000
Tax on 17,00,000		
Upto Rs. 2,50,000 (for non-resident)	Nil	
From 2,50,000 to 5,00,000 @ 5%	12,500	

From 5,00,000 to 10,00,000 @ 20%	1,00,000	
On balance 7,00,000 @ 30%	2,10,000	3,22,500
Health & Education Cess @ 4%		12,900
Tax liability in India		3,35,400

Question 6

What is Tax Information Exchange Agreement 'TIEA'?

Answer

A Tax Information Exchange Agreement (TIEA) is an agreement between two jurisdictions and creates for both parties, rights and obligations, which are to be respected. It is not a double taxation avoidance treaty between two states but an agreement between two jurisdictions only for the purpose of exchange of information.

Question 7

Types of Double Taxation Agreement.

Answer:

Comprehensive DTAA: Comprehensive DTAAs are those which cover almost all types of incomes covered by any model convention. Many a time a treaty covers wealth tax, gift tax, surtax etc. too.

Limited DTAA: Limited DTAAs are those which are limited to certain types of incomes only, e.g. DTAA between India and Pakistan is limited to shipping and aircraft profits only.

Foreign nationals of several countries such as USA, Canada and UK are required to declare and pay taxes on their worldwide income. Double taxation avoidance treaties, actually help in either minimizing the tax payable to your home country or in some cases even eliminating further tax liabilities, depending on the tax rates applicable.

Question 8

Need of Double Taxation Agreement

Answer

1. The need for Double Taxation Avoidance Agreement (DTAA) arises because of rules in two different countries regarding chargeability of income based on receipt and accrual, residential status etc.
2. Double taxation is frequently avoided through DTAAs entered into by two countries for the avoidance of double taxation on the same income.
3. The DTAA eliminates or mitigates the incidence of double taxation by sharing revenues arising out of international transactions by the two contracting states of the agreement.
4. As there is no clear definition of income and taxability threreof, which is accepted internationally, an income may become liable to tax in two countries.

5. In such a case, the possibilities are as under:
   - The income is taxed only in one country.
   - The income is exempt in both countries.
   - The income in taxed in both countries, but credit for tax paid in one country is given against tax payable in other country.

If the two countries do not have DTAA then in such a case, the domestic law of the country will apply. In the case of India, the provisions of Section 91 of the Income Tax Act will apply. The CBDT has clarified vide circular no. 333 dated 2nd April, 1982 that in case of a conflict in the provisions of the agreement of Tax Avoidance of double taxation and the Income Tax Act, the provisions contained in the Agreement for Double Tax Avoidance will prevail.

Question 9

Define Tax Treaty. Discuss the principal objectives of Indian Tax Treaties.

Answer:

Tax Treaty: A Tax treaty is a bilateral agreement made by two countries to resolve issues involving double taxation of passive as well as active income Tax treaties generally determine the amount of tax that a country can levy on a taxpayer's income/capital. It is also called a Double Taxation Avoidance Agreement.

Principal objective of India Tax Treaties are as under:

(1) For granting relief in respect of

a. Income on which tax have been paid both under the Income Tax Act, 1961 and Income Tax Act prevailing in the other country ; or
b. Income -tax chargeable under the Income Tax Act, 1961 and under law in force in that country to promote mutual economic relations, trade and investment; or

(2) For the avoidance of double taxation of on income under the Income Tax Act, 1961 and under the corresponding law in force in that country; or

(3) For exchange of information for the prevention of evasion or avoidance of Income Tax chargeable under the Incomes Tax Act, 1961 or under corresponding law in force in that country, or investigation of cases of such evasion or avoidance, or

(4) For recovery of income tax under Income Tax Act, 1961 and under the corresponding law in force in that country.

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Income Tax Implication on specified transactions

Question 1

Distinguish between Slump sale and demerger.

Answer

Slump Sale: As per Section 2(42C) of Income tax Act slump sale means the transfer of one or more undertakings by any means for a lump sum consideration without values being assigned to the individual assets and liabilities in such sales. Any profits or gains arising from the slump sale, affected in the previous year, shall be chargeable to income tax as capital gains and shall be deemed to be the income of the previous year in which the transfer took place. Slump sale can be between any person and consideration is always in cash.

Demerger: As per section 2(19AA) of Income tax Act demerger, in relation to companies, means the transfer, pursuant to a scheme of arrangement under sections 391 to 394 of the Companies Act, 1956. The transfer is ongoing concern basis and all the property and liabilities of the undertaking, being transferred by the demerged company, immediately before the demerger, becomes the property and liabilities of the resulting company by virtue of the demerger. Demerger is between companies only and consideration is in form of shares only.

Question 2

ABC Finance Corp., a finance company had received certain amount from its subsidiary, under a scheme of arrangement sanctioned by the High Court under sections 391 to 394 of the Companies Act, 1956. Can this scheme of arrangement be treated as slump sale to attract capital gains provisions? Discuss in the light of decided case law.

Answer

The facts of the case are similar to that of *SREI Infrastructure Finance Ltd. v. Income-tax Settlement Commission (2012) 207 Taxman 74 of Income tax Act (Delhi), where* the Delhi High Court held that it would be wrong to infer that section 50B is applicable only in case of actual "sale" of assets. Moreover, section 50B of Income tax Act shall be applicable in all types of "transfer" mentioned in section 2(47). When a scheme under sections 391 to 394 of the Companies Act, 1956 is sanctioned by the Court, it is treated as a binding statutory scheme because the scheme has to be implemented and enforced. However, this cannot be a ground for the assessee to escape tax on 'transfer' of a capital asset under the provisions of the Income-tax Act, 1961. The taxability of the said transaction is to be decided as per the provisions of the Income-tax Act, 1961.

Therefore, although the scheme is approved by the court under sections 391 to 394 of the Companies Act, 1956 it shall be treated as slump sale and capital gains provisions would be attracted.

Question 3

XYZ Pvt. Ltd. has converted itself into a Limited Liability Partnership (LLP) on 1.4.2019 and at the time of conversion, all the conditions specified in section 47(xiiib) have been fulfilled. The unabsorbed business loss and depreciation of the company as on the date of conversion were Rs. 40 lakhs and Rs. 27 lakhs respectively. The business profits of the LLP for the previous year 2019-20 were Rs. 75 lakhs. However on 5.9.2020 two partners (who were erstwhile shareholders of XYZ Pvt. Ltd) having in aggregate 51% of the profit sharing in LLP, resigned. Discuss the tax consequences of the conversion of company into LLP and subsequent resignation of partners.

Answer

As per section 72A(6A), the LLP would be able to carry forward and set-off the unabsorbed depreciation and business loss of Rs. 40 lakhs and Rs. 27 lakhs, respectively, of XYZ Pvt. Ltd. since at the time of conversion, all the conditions specified in section 47(xiiib) have been fulfilled. Further, the LLP can set off the unabsorbed depreciation and business loss aggregating to Rs. 67 lakhs against its business profits of Rs. 75 lakhs for A.Y.2020-21.

However, if in any subsequent year, the LLP fails to fulfill any of the conditions mentioned in section 47(xiiib), the business loss or unabsorbed depreciation of the company already set off by the LLP would be deemed to be the income chargeable to tax of the LLP for the year in which it fails to fulfill such conditions.

One of the conditions mentioned in section 47(xiiib) is that the erstwhile shareholders of the company continue to be entitled to receive at least 50% of the profits of the LLP for a period of 5 years from the date of conversion. Since two partners (who were erstwhile shareholders of ABC Pvt. Ltd.) holding in aggregate 51% of the profit-sharing in the LLP have resigned on 5.9.2020, thus the LLP has failed to fulfill this condition.

Therefore, the amount of Rs. 67 lakhs representing unabsorbed depreciation and business losses set-off against profits of the LLP for the A.Y. 2020-21, would deemed to be income of the LLP for the A.Y.2021-22, being the year in which it failed to fulfill the conditions.

Question 4

ABC Ltd. was amalgamated with XYZ Ltd. on 31.03.2021. All the conditions of section 2(1B) were satisfied. ABC Ltd. has the following carried forward losses as assessed till the Assessment Year 2021-22:

Particulars	*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 Limited has computed a profit of Rs. 140 lakhs for the financial year 2021-22 before setting off the eligible losses of ABC Ltd. but after providing depreciation at 15% per

annum on 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, 2021 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 Assessment Year 2022-23.

Answer

Computation of total income of XYZ Ltd. for the A.Y. 2022-23

Particulars		*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 Limited 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)
Income		7.50

Notes:

1. It is presumed that the amalgamation is within the meaning of section 72A of the Income tax Act, 1961.
2. In the case of amalgamation of companies, the unabsorbed losses and unabsorbed depreciation of the amalgamating company shall be deemed to be the loss or unabsorbed depreciation of the amalgamated company for the previous year in which the amalgamation was effected and such business loss and unabsorbed depreciation shall be carried forward and set-off by the amalgamated company for a period of 8 years and indefinitely, respectively.
3. As per section 72A(7), the accumulated loss to be carried forward specifically excludes loss sustained in a speculative business. Therefore, speculative loss of Rs. 4

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.

Question 5

A resident by name Mr. Ram received gifts during the financial year 2021-22 as follows –

a. *Rs. 1,00,000 from his friend residing in USA,*
b. *Rs. 20,000 from his elder brother residing in Lucknow,*
c. *Rs. 50,000 from his friend residing in Mumbai (received on the occasion of birthday of Mr. Ram),*
d. *Shares received from his father, the fair market value(i.e. value as per stock exchange) of the shares on the date of gift was Rs. 2,00,000*
e. *Rs. 50,000 from his friend residing in Mumbai (received on the occasion of marriage of Mr. Ram).*
f. *Jewellery received from his friend, the fair market value of the jewellery is Rs. 84,000.*

We need to advice Mr. Ram with regard to tax treatment of above items in the hands of Mr. Ram.

Answer –

The tax treatment of gifts in the hands of Mr. Ram will be as follows –

a. Rs. 1,00,000 received from his friend will be fully included in income because friend is not covered in the definition of 'relative'.
b. Rs. 20,000 received from elder brother will not be charged to tax because elder brother is covered in the definition of 'relative'.
c. Birthday is not covered in the list of prescribed occasion on which gift is not charged to tax, hence Rs. 50,000 received on the occasion of birthday will be included in income.
d. Nothing will be included in income in respect of shares received from his father,

since father comes under the definition of the term ‘relative’

e. Marriage is covered in the list of prescribed occasion on which gift is not charged to tax, hence Rs.50,000 received on the occasion of marriage will not be taxed.
f. Friend is not covered in the definition of relative and hence, in respect of jewellery received from his friend, the fair market value, i.e., Rs. 84,000 will be included in income.

Question 6

A held 2000 shares in a company ABC Ltd. ABC Ltd amalgamated with another company during the previous year ended 31.03.2022. Under the scheme of amalgamation, A was allotted 1000 shares in the new company. The market value of shares allotted is higher by Rs. 50000 than the value of holding in ABC Ltd.

The assessing officer proposes to treat the transaction as an exchange and to tax Rs. 50000 as capital gains. Is he justified?

Answer:

Assuming that the amalgamated company is an Indian company, the transaction is covered by the exemption u/s 47 and the proposal of the assessing officer to treat the transaction as an exchange is not justified.

Question 7

ABC Limited is an company incorporated under the Companies Act which is having two undertakings engaged in manufacture of cement and steel, decided to hive off cement division to XYZ Limited a company incorporated under the Companies Act, by way of demerger. The net worth of ABC Limited immediately before demerger was Rs. 40,00,00,000/-. The net book value of assets transferred to XYZ Limited was Rs. 10,00,00,000/-. The demerger was made in January 2022. In the scheme of demerger, it was fixed that for each equity share of Rs. 10 each (fully paid up) of ABC Limited, two equity shares of Rs. 10 each (fully paid up) were to be issued.

Mr. Ram. held 25,000 equity shares in ABC Limited which were acquired in the financial year 2003-2004 for Rs. 6,00,000. Mr. Ram received 50,000 equity shares from XYZ Limited consequent to demerger in January 2022. He sold all the shares of XYZ Limited for Rs. 8,00,000 in March, 2022.

Now following are the questions to be answered –

i. *Does the transaction of demerger attract any income tax liability in the hands of above two companies?*

ii. *Would capital gain arise in the hands of Mr. Ram on receipt of shares of XYZ Limited and on sale of shares.*

iii. *Whether the sale of shares by Mr. Ram affect the tax benefits availed by ABC Limited and/or XYZ Limited?*

Also compute the capital gain in hands of Mr.Ram on sale of share of XYZ Ltd.

Answer

(i) No, the transaction of demerger would not attract any income-tax liability in the hands of any of the above companies.

(ii) There would be no capital gains liability in the hands of Mr. Ram on receipt of shares of XYZ Limited, In case he sells these shares than Capital gains would arise.

(iii) No, sale of shares by Mr. Ram would not affect the tax benefits availed by ABC Limited or by XYZ Limited.

(iv) Capital gain in the hands of Mr. Ram on sale of shares of XYZ ltd for AY 2022-23

Period of Holding	*2003-04 to March, 2022 LTCA*
FVC	Rs. 8,00,000
Less ICOA Rs. 6,00,000 x 10,00,000/40,00,000	Rs. 1,50,000
LTCG	Rs. 6,50,000

(We have ignored Section 112A implications while solving capital gains)

Question 8

ABC Ltd. proposes to sell one unit XYZ which was set up in 2010 (out of 10 units) and is not related to company's main line of business. Total consideration for sale of XYZ unit as a going concern by way of slump sale is Rs. 3,50,000. The summarized financial position of XYZ unit as on 31st January, 2022 (Date of Sale) is as under:

Capital and Liabilities	Amount Rs.	Assets	Amount Rs.
Paid up capital	50,000	Fixed assets	70,000
General Reserve	40,000	Debtors	40,000
Revaluation Reserve	30,000	Inventories	40,000
Current liabilities	30,000		
	150000		150000

Additional information as under :

1. Fixed assets includes Land purchased at Rs. 5,000 in May, 2013 revalued at Rs. 50,000.

2. For the remaining fixed assets, their written down value as per the Income-tax Act, 1961 is Rs. 10,000.

Compute the capital gain arising on sale of XYZ unit of ABC Ltd.

Answer:

Computation of long term capital gain on slump sale of XYZ Unit of ABC Ltd.

Particulars	Amount	Amount
Fixed assets at W.D.V.	10,000	
Land at cost price	5,000	
Debtors	40,000	
Inventories	40,000	95,000
Less Current liabilities		(30,000)
Net worth of XYZ Unit Full		65,000
Value of Consideration		3,50,000
Long Term Capital Gain		2,85,000

Note:
1. In slump sale, benefit of indexation is not available.
2. Revaluation Reserve is not to be considered.

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