Test Series: February, 2016

MOCK TEST PAPER – 1

FINAL COURSE: GROUP – II

PAPER – 7: DIRECT TAX LAWS

SUGGESTED ANSWERS / HINTS

1. (a) Computation of total income Sunshine LLP for the A.Y.2016-17

Particulars	Rs.	
Profits and Gains from Business or Profession		
Net profit as per profit and loss account (Rs. 10,25,000 + Rs. 20,50,000)		30,75,000
Add: Items debited to profit & loss account but not allowable as deduction/to be considered separately		
(1) Keyman insurance premium paid (allowable as deduction, since it is incurred wholly and exclusively for the purpose of business – *Circular No.762 dated 18.2.1998*)	-	
(2) Working Partner's salary (to be considered separately)	36,00,000	
(3) Interest on capital payable to partners in excess of 12% disallowed under section 40(b) (Rs. 100 lakhs × 3%)	3,00,000	
(4) Depreciation as per books of account (Rs. 5 lakhs + Rs. 35 lakhs) relating to textile business	40,00,000	
		79,00,000
		1,09,75,000
Less: Depreciation under section 32 of the Income-tax Act, 1961 (relating to textile business) [Rs. 27 lakhs + Rs. 4 lakhs]		31,00,000
Book Profit		78,75,000
Less: Remuneration to working partners [Subject to limits specified in section 40(b)]		
On first Rs. 3,00,000 of book profit — 90% of book profit or Rs.1,50,000, whichever is higher	2,70,000	

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On the balance of book profit Rs. 75,75,000 [Rs. 78,75,000 – Rs. 3,00,000]	60% of balance book profit	45,45,000 48,15,000	
Restricted to actual remuneration paid			36,00,000
Income under the head Profits and gains of business or profession			42,75,000
Income from textile manufacturing business [See Notes 5 & 6]			20,25,000
Income from specified business of operating a warehousing facility for storage of wheat [Rs. 42,75,000 - Rs. 20,25,000]		22,50,000	
Less: Set-off of brought forward loss of specified business under section 73A [See Notes 1 to 4 below]		11,25,000	11,25,000
Total Income			31,50,000

Notes:

(1) Computation of loss of specified business of setting up and operating a warehousing facility for storage of wheat for P.Y. 2014-15 relevant to Assessment Year 2015-16

Particulars	Rs.
Income from warehousing facility [before deduction under section 35AD]	60,00,000
Less: Deduction under section 35AD [150% of Rs. 50,00,000] [See Notes 2 & 3]	75,00,000
Loss of specified business for P.Y.2014-15	15,00,000
Loss to be carried forward as per section 73A read with section 78 [Rs.15,00,000 × ¾] to be set-off against profits of any specified business of the subsequent years [See Note 4 below]	11,25,000

(2) The specified business of setting up and operating a warehousing facility for storage of agriculture produce (wheat is agriculture produce) would be eligible for weighted deduction@150% of the capital expenditure, if the operations are commenced on or after 1.4.2012 [Section 35AD(1A)]. In this case, since the operations have commenced on 1.4.2014, the specified business qualifies for weighted deduction @ 150% of capital expenditure.

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(3) Expenditure of capital nature would, however, not include any expenditure incurred on acquisition of land [Section 35AD(8)(f)]. Therefore, in this case, only cost of Rs. 50 lakhs on construction of building would qualify for deduction under section 35AD, assuming that such expenditure has been capitalized in the books of account as on 1.4.2014 (being the date of commencement of operations), since the same was incurred prior to commencement of operations [Proviso to section 35AD(1)].

(4) Section 78(1) does not permit carry forward of losses pertaining to the share of a retired or deceased partner. Therefore, in this case, since one of the four partners have retired on 31.3.2015, his share of loss (Rs. 3,75,000, being ¼th of Rs.15 lakh) for the previous year 2014-15 (A.Y.2015-16) cannot be carried forward to the previous year 2015-16 (A.Y.2016-17).

(5) Computation of profit from textile manufacturing business

Particulars	Rs.
Profits and Gains from Business or Profession	
Net profit as per profit and loss account	10,25,000
Add: Depreciation as per books of account (Rs. 5 lakhs + Rs. 35 lakhs) relating to textile business	40,00,000
	50,25,000
Less: Depreciation under section 32 of the Income-tax Act, 1961 (relating to textile business)	31,00,000
	19,25,000
Add: Interest on capital of Rs. 3,00,000 disallowed [apportioned in the ratio of net profits of textile business and specified business as per profit and loss account (1:2)] [1/3 × Rs. 3,00,000] [See Note 6 below]	1,00,000
	20,25,000

(6) Loss of specified business can be carried forward indefinitely for set-off only against profits of any specified business. Therefore, it becomes necessary to segregate the income of Rs. 42.75 lakhs computed under the head "Profits and gains of business or profession", so that brought forward loss from specified business relating to P.Y.2014-15 can be set-off against profits of specified business of the P.Y.2015-16.

For this purpose, while computing profits of textile manufacturing business included in the business income of Rs. 42.75 lakhs, the depreciation as per books of account has to be added back and the depreciation as per the Income-tax Act, 1961 has to be reduced from the net profit of Rs. 10.25 lakhs pertaining to textile business, since the depreciation adjustments clearly relate to textile business.

There is no effect of adjustment of partners' remuneration, since the entire

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remuneration which has been added back is allowable as the same is within the limits as per section 40(b)(v).

It is only the interest on capital amounting to Rs. 3 lakhs (which has been added back while computing business income) which has to be apportioned between textile manufacturing business and specified business.

The solution has been worked out apportioning the interest on capital in the ratio of 1:2 between textile manufacturing and specified business, being the ratio of the net profit of these two businesses as per profit and loss account. The solution can also be worked out by apportioning interest on capital on any other logical basis.

(b) (i) The requirement of filing an application for registration under section 12A within one year of creation of the trust has been removed. The application can be filed at any time now. Accordingly, the provisions of sections 11 and 12 would apply from the assessment year relevant to the financial year in which the application is made i.e. the exemption would be available only with effect from the assessment year relevant to the previous year in which the application was filed.

However, where registration has been granted to the trust under section 12AA and on the said date, assessment proceedings relating to earlier assessment years are pending, then, the benefit of sections 11 and 12 shall be available in respect of income derived from property held under trust in those years, provided the objects and activities of the trust remain unchanged.

(ii) No. The application for registration under section 12A cannot be filed before the formation of the trust.

(iii) As per section 12AA(2), every order granting or refusing registration should be passed before the expiry of 6 months from the end of the month in which the application was received under section 12A. The Madras High Court, in *CIT vs. Karimangalam Onriya Pengal Semipu Amaipu Ltd. (2013) 354 ITR 483*, held that there is no automatic or deemed registration if the application under section 12AA is not disposed of within the stipulated period of six months.

(iv) The following are the steps to be taken by the trust to secure exemption from income-tax:

(1) The trust should be registered with the Principal Commissioner or Commissioner of Income-tax under section 12AA.

(2) The accounts of the trust for the previous year must be audited by a Chartered Accountant if its total income without giving effect to the provisions of section 11 and section 12 exceeds the maximum amount which is not chargeable to tax. The audit report in the prescribed form,

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duly signed and verified by the Chartered Accountant, should be furnished along with the return of income of the trust for the relevant assessment year.

(3) At least 85% of the income is required to be applied for the approved purposes.

(4) The unapplied income and the money accumulated or set apart should be invested or deposited in the specified forms or modes, after filing statement in Form 10 on or before the due date of filing return of income specified under section 139(1).

(v) Yes, the certificate of registration can be cancelled by the Commissioner. According to section 12AA, if the Commissioner is satisfied that the activities of the trust are not genuine or are not being carried out in accordance with the objects of the trust, he shall, after giving the trust a reasonable opportunity of being heard, pass an order in writing canceling the registration of the trust.

Further, section 12AA(4) provides that where a trust or an institution has been granted registration, and subsequently it is noticed that its activities are being carried out in such a manner that,—

(i) its income does not ensure for the benefit of general public;

(ii) it is for benefit of any particular religious community or caste;

(iii) any income or property of the trust is applied for benefit of specified persons like author of trust, trustees etc.; or

(iv) its funds are invested in prohibited modes, then, the Commissioner may cancel the registration of such trust or institution. However, if the trust or institution proves that there was a reasonable cause for the activities to be carried out in the above manner, the registration shall not be cancelled.

2. Computation of Total Income of Jupiter Ltd. for the A.Y.2016-17

Particulars	Amount (Rs.)	
Profits and Gains from Business and Profession		
Net profit as per profit and loss account		5,00,00,000
Add: Items debited but to be considered separately or to be disallowed		
Depreciation provided on straight line basis (Note 1)	30,00,000	
Disallowance under section 40A(3) for payment exceeding Rs. 20,000 made in cash for purchases and expenditure (Note 2)	7,00,000	

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Disallowance under section 40A(3) for cash payment exceeding Rs. 35,000 in a day to transport operators for hiring of lorry (Note 3)	1,25,000	
Contribution to University (considered separately for weighted deduction) (Note 4)	5,00,000	
Sales tax of P.Y.2014-15 paid on 07.11.2015 (Note 5)	-	
Rent and Professional charges paid to consultant, on which tax has not been deducted on the service tax component (Note 6)	-	
Disallowance under section 40A(2) for excess payment to related person (Note 7)	1,00,000	
Legal expenses for issue of bonus shares (Note 8)	-	
Legal expenses for alternation of memorandum of association (Note 8)	2,00,000	
Donation to political party (Note 9)	25,00,000	71,25,000
		5,71,25,000
Less: Items credited but to be considered separately or to be allowed		
Depreciation allowable under the Income-tax Act, 1961 (Note 1)	48,00,000	
Weighted deduction @ 175% in respect of contribution of Rs. 5 lakhs to a University approved and notified under section 35(1)(ii) (Note 4)	8,75,000	56,75,000
Gross Total Income		5,14,50,000
Less: Deduction under Chapter VI-A		
Under section 80GGB [Donation to political party] (Note 9)		25,00,000
Total Income		4,89,50,000

Computation of tax liability of Jupiter Ltd. for A.Y.2016-17

Particulars	Rs.
Tax@30% on total income of Rs. 4,89,50,000	1,46,85,000
Add: Surcharge@7% (since total income exceeds Rs. 1 crore but does not exceed Rs. 10 crores)	10,27,950
Tax payable including surcharge	1,57,12,950
Add: Education cess@2% and secondary and higher education cess@1%	4,71,389
Total tax payable	1,61,84,339

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Notes:

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

(2) Cash payments exceeding Rs. 20,000 a day attracts disallowance under section 40A(3). However, Rule 6DD provides for certain exceptions, which includes, *inter alia,* payments which are required to be made on a day on which the banks were closed either on account of holiday or strike. Therefore, cash payment of Rs. 5 lakhs made on the day of strike by bank staff and cash payment of Rs. 10 lakhs made on a bank holiday would not attract disallowance under section 40A(3), assuming such payments were required to be made on those specific dates. However, cash payment of Rs. 7 lakhs made on 25-10-2015 due to demand of supplier would attract disallowance under section 40A(3), since the same is not covered under any of the exceptions laid out in Rule 6DD.

(3) In respect of cash payments to transport operators, a higher limit of Rs. 35,000 per day is permissible. Therefore, cash payment of Rs. 32,000 on 12-2-2016 would not attract disallowance under section 40A(3). However, cash payments of Rs. 50,000 and Rs. 75,000 on 17.7.2015 and 28.1.2016, respectively, would attract disallowance under section 40A(3) since the same exceeds Rs. 35,000 per day.

(4) Contribution to a university approved and notified under section 35(1)(ii) qualifies for weighted deduction@175%. Hence, the contribution of Rs. 5 lakhs is first added back and thereafter, deduction of Rs. 8.75 lakhs (i.e.,175% of Rs. 5 lakhs) has been provided under section 35(1)(ii).

(5) Sales tax liability of Rs. 1.45 lakhs pertaining to P.Y.2014-15 would have been disallowed under section 43B while computing business income of A.Y.2015-16, since it was paid only on 07.11.2015 (i.e., after the due date of filing return of income of that year). It would be allowed in the year of payment (i.e., P.Y.2015-16). Since it is already debited to profit and loss account, no further adjustment is required.

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

As per *CBDT Circular No. 4/2008 dated 28.4.2008*, service tax paid by a tenant does not par take the character of income of the landlord. Hence, tax is to be deducted at source under section 194-I on rent paid without including service tax.

Further, in respect of professional charges, *CBDT Circular No.1/2014 dated 13.1.2014* clarifies that if in terms of the agreement/contract between the payer and the payee, the service tax component comprised in the amount payable to a

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resident is indicated separately, tax shall be deducted at source on the amount paid/payable without including such service tax component.

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

(7) Care Ltd. is a related person under section 40A(2), since the directors of the Jupiter Ltd. have substantial interest in Care Ltd. Therefore, excess payment of Rs. 1 lakh to Care Ltd. for purchase of goods would attract disallowance under section 40A(2).

(8) There is no fresh inflow of funds or increase in capital employed on account of issue of bonus shares and there is only reallocation of the company's fund. Consequently, since there is no increase in the capital base of the company, legal expenses of Rs. 10 lakhs in connection with issue of bonus shares is a revenue expenditure and is hence, allowable as deduction. It has been so held by Apex Court in case of *CIT vs. General Insurance Corpn. (2006) 286 ITR 232.*

However, Rs. 2 lakhs, being legal expenses in relation to alteration of memorandum in connection with increase in Authorised Capital is directly related to expansion of the capital base of the company and is, hence, a capital expenditure. Therefore, the same is not allowable as deduction. It has been so held in *Punjab State Industrial Development Corporation Ltd. vs. CIT (1997) 225 ITR 792 (SC).*

Note: A view can also be taken that legal expenses in relation to alternation of memorandum of association in connection with enhancement of authorized capital is allowable as deduction, if the enhancement of capital was for the purpose of issuance of bonus shares.

(9) Donation paid to a political party is not an allowable expenditure under section 37 since it is not laid out wholly or exclusively for the purposes of business or profession. Hence, the same has to be added back while computing business income. However, donation made by a company to a political party is allowable deduction under section 80GGB from gross total income, subject to the condition that payment is made otherwise than by way of cash. It is assumed that such donations are made to a political party registered under section 29A of the Representation of the People Act, 1951. Since the donation is made by cheque the same is allowed as deduction under section 80GGB.

3. (a) It has been held by the Hon'ble Apex Court in the case of *Hind Wire Industries Ltd. v. CIT (1995) 212 ITR 639* that the order once amended can also be rectified subsequently provided the mistake apparent from record is rectifiable under section 154. The Apex Court enlarged the scope of the words used in that section by stating that it does not necessarily mean the original order. It could be any order including

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the amended or rectified order. The action of the Assessing Officer is therefore, incorrect.

(b) The original return was filed in time and the proceedings were already taken up for assessment under section 143(2). A revised return was filed by the assessee after a period of one year from the end of the relevant assessment year. The action of the Assessing Officer in making the assessment in disregard of the revised return filed on 25.5.2016 is correct because as per the provisions of section 139(5) the assessee can file the revised return only within a period of one year from the end of the relevant assessment year to which the return relates or before completion of the assessment, whichever is earlier.

(c) Chapter XII-DA, comprising of sections 115QA, 115QB and 115QC levies additional income-tax on buyback of unlisted shares by domestic companies. As per section 115QA, the distributed income would be subject to additional income-tax @ 20% (plus surcharge@12% and education cess @ 2% and secondary and higher education cess@1%) in the hands of the domestic company. Distributed income is the consideration paid by the company for buyback of its own unlisted shares which is in excess of the sum received by the company at the time of issue of such shares.

Accordingly, Star Ltd is liable to pay Rs. 1,84,576 as additional income-tax, which is the amount calculated @ 23.072% (20% plus surcharge@12% plus cess @3%) on Rs. 8 lakh, being its distributed income (i.e., Rs. 22 lakh – Rs. 14 lakh).

The additional income-tax was payable on or before 31st October, 2015. However, the same was paid only on 12th January, 2016.

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 -

Period	No. of months/ part of month
1st November – 30th November, 2015 (whole of first month)	1
1st December – 31st December, 2015 (whole of second month)	1
1st January – 12th January, 2016 (part of third month)	1
Total number of months	3

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Interest under section 115QB is payable @ 1% per month for 3 months on the amount of additional tax payable i.e., Rs. 1,84,576. Therefore, interest payable under section 115QB is Rs. 5,537.

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

(d) Section 264(4)(c) provides that the Principal Commissioner or Commissioner shall not revise an order which has been made the subject of an appeal to the Commissioner (Appeals) or Tribunal. This bar remains unaffected by the scope of the appeal to the Tribunal. Therefore, the fact that the relief claimed in the application filed by the assessee under section 264(1) was not the subject matter of appeal to the Appellate Tribunal does not alter the position that the order of assessment was the subject of the appeal.

The Supreme Court has, in *Hindustan Aeronautics Ltd. v. CIT (2000) 243 ITR 808*, held that the Principal Commissioner or Commissioner has no power to revise any order under section 264, if the order has been made subject to an appeal to the Appellate Tribunal, even if the relief claimed in the revision is different from the relief claimed in the appeal.

The word 'order' in section 264(4)(c) refers to the order appealed against and not to the relief claimed in appeal. In view of this, the Principal Commissioner or Commissioner cannot exercise his powers under section 264 to revise the order of assessment and allow the deduction claimed by the assessee in his application.

4. (a) The Apex Court, in *CIT vs. Om Prakash Mittal (2005) 273 ITR 326*, observed that a plain reading of section 245D(6) shows that every order passed under sub-section (4) has to provide for:-

(i) the terms of settlement; and

(ii) that the settlement would become void, if it is subsequently found by the Settlement Commission that it has been obtained by fraud or misrepresentation of facts.

The decision that the order has been obtained by fraud or misrepresentation is that of the Settlement Commission. However, there is no requirement that the action be initiated by the Settlement Commission, *suo moto*. The Revenue can move the Settlement Commission for decision on an issue if it has material to show that the order was obtained by fraud or misrepresentation of facts.

The Supreme Court observed that the foundation for settlement is an application which an assessee can file at any stage of a case relating to him in such form and manner as may be prescribed. The fundamental requirement of the application under section 245C is that there must be full and true disclosure of the income along with the manner in which it has been derived. If an order is obtained by fraud

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or misrepresentation of facts, it cannot be said that there is a full and true disclosure and therefore, the Legislature has prescribed the condition relating to declaration of the order void when it is obtained by fraud or misrepresentation of facts.

The Supreme Court held that merely because section 245-I provides that the order of settlement is conclusive, it does not take away the power of the Settlement Commission to decide where the settlement order has been obtained by fraud or misrepresentation of facts. If the Commissioner is able to establish that the earlier decision was void because of misrepresentation of facts, then it is open for the Settlement Commission to decide the issue. It cannot be called by any stretch of imagination to be a review of the earlier judgment or the subsequent Bench sitting in appeal over the earlier Bench's decision.

Mr. Shalin's contention is, therefore, not correct.

(b) Computation of total income and tax liability of Mrs. Vidya for the A.Y. 2016-17

Particulars		Rs.
Indian Income [Income from stage performances in India]		19,20,000
Foreign Income [Income from stage performances in country M]		12,00,000
Gross Total Income		31,20,000
Less: Deduction under Chapter VIA	Rs.	
Deduction under section 80C		
Life insurance premium of Rs. 1,10,000 paid during the previous year deduction, is within the overall limit of 1.5 lakh. Hence, fully allowable as deduction	1,10,000	
Deduction under section 80D		
Medical insurance premium of Rs. 32,000 paid for her Mother aged 70 years. Since her mother is a senior citizen, the deduction is allowable to a maximum of Rs. 30,000 (assuming that her mother is also a resident in India). Further, deduction is allowable where payment is made by any mode other than cash. Here payment is made by credit card hence, eligible for deduction.	30,000	1,40,000
Total Income		29,80,000
Tax on Total Income		
Income-tax	7,19,000	
Add : Education cess @ 2%	14,380	
Add: Secondary and higher education cess @ 1%	7,190	7,40,570

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Average rate of tax in India (i.e. Rs. 7,40,570 / Rs. 29,80,000 × 100) 24.8513%		
Average rate of tax in foreign country (i.e. Rs. 1,80,000 / Rs. 12,00,000 ×100) 15.00%		
Rebate under section 91 on Rs. 12 lakh @ 15% (lower of average Indian-tax rate or average foreign tax rate)		1,80,000
Tax payable in India (Rs. 7,40,570 – Rs. 1,80,000)		5,60,570

Note: Mrs. Vidya shall be allowed deduction under section 91, since the following conditions are fulfilled:-

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

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

(c) The income in question has been subjected to income-tax in the foreign country M in her hands and she has paid tax on such income in the foreign country M.

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

(c) (i) The scope of the term "intangible property" has been amplified to include, *inter alia*, technical knowhow, which is a technology related intangible asset. Transfer of intangible property falls within the scope of the term "international transaction". Since Arihant Inc. guarantees not less than 10% of the borrowings of Aznara Ltd., Arihant Inc. and Aznara Ltd. are associated enterprises. Therefore, since transfer of technical knowhow by Aznara Ltd., an Indian company, to Arihant Inc., a Canadian company, is an international transaction between associated enterprises, the provisions of transfer pricing are attracted in this case.

(ii) This transaction falls within the meaning of "specified domestic transaction" under section 92BA, since the salary payment has been made to a related person referred to in section 40A(2)(b) i.e., relative (i.e., daughter) of Ms. Niharika, who is a director of Dolls Ltd. However, such a transaction would be treated as a "specified domestic transaction" to attract transfer pricing provisions only if the aggregate of such transactions as specified in section 92BA during the year by Dolls Ltd. exceeds a sum of Rs. 20 crore.

(iii) Unit Light is eligible for deduction@100% of the profits derived from its eligible

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business (i.e., the business of developing an infrastructure facility, namely, a highway project in this case) under section 80-IA. However, Unit Dark is not engaged in any "eligible business". Since Unit Dark has transferred cement to Unit Light at a price lower than the fair market value, it is an inter-Unit transfer of goods between eligible business and other business, where the consideration for transfer does not correspond with the market value of goods. Therefore, this transaction would fall within the meaning of "specified domestic transaction" to attract transfer pricing provisions, if the aggregate value of transactions specified in section 92BA during the year exceeds a sum of Rs. 20 crore.

(iv) The *Explanation* to section 92B amplifies the scope of the term "international transaction". According to the said *Explanation*, international transaction includes, *inter alia*, provision of scientific research services. Starworld Inc. is a specified foreign company in relation to Thrill Ltd. Therefore, the condition of Thrill Ltd. holding shares carrying not less than 26% of the voting power in Starworld Inc is satisfied. Hence, Starworld Inc. and Thrill Ltd. are associated enterprises. Since the provision of scientific research services by Starworld Inc. to Thrill Ltd. is an "international transaction" between associated enterprises, transfer pricing provisions are attracted in this case.

5 (a) Under section 145(1), income chargeable under the heads "Profits and gains of business or profession" or "Income from other sources" shall be computed in accordance with either the cash or mercantile system of accounting regularly employed by the assessee. Section 145(2) empowers the Central Government to notify in the Official Gazette from time to time, income computation and disclosure standards to be followed by any class of assessees or in respect of any class of income. Accordingly, the Central Government has, in exercise of the powers conferred under section 145(2), notified ten income computation and disclosure standards (ICDSs) to be followed by all assessees, following the mercantile system of accounting, for the purposes of computation of income chargeable to income-tax under the head "Profit and gains of business or profession" or " Income from other sources". This notification shall come into force with effect from 1st April, 2015, and shall accordingly apply to the A.Y.2016-17 and subsequent assessment years.

In case of dissolution of a partnership firm or association of persons or body of individuals, Paragraph 24 of ICDS II on Valuation of Inventories requires the inventory on the date of dissolution to be valued at the net realisable value, notwithstanding whether business is discontinued or not.

This requirement in ICDS II is in deviation from the Supreme Court ruling in *Shakti Trading Co. vs. CIT (2001) 250 ITR 871,* where it was held that if the firm is dissolved due to death of a partner and the surviving partners reconstitute the firm

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and continue the business as before, the firm is entitled to adopt cost or market price, whichever is lower.

Therefore, if the firm was dissolved on 31.3.2015, the valuation of inventory would be governed by the Supreme Court ruling in Shakti Trading Company's case. However, if the dissolution takes place on or after 1.4.2015, it would be governed by ICDS II and the inventory has to be valued at the net realizable value, notwithstanding whether business is discontinued or not.

(b) The business of sole proprietary concern was converted into a partnership because of the death of the proprietor. His two sons, who are the legal heirs, continued the business. Section 78(2) provides that in the case of succession by inheritance, the successor can carry forward and set-off the loss of predecessor against his income. The Supreme Court, in the case of *CIT v. Madhukant M. Mehta [2001] 247 ITR* 805, has held that where the legal heirs of a deceased-proprietor enter into partnership and carry on the same business in the same premises under the same trade name, there is succession by inheritance as contemplated in section 78(2) and the assessee-firm is entitled to carry forward and set off the deceased's business loss against its income for subsequent years.

Therefore, the partnership firm formed by the two sons who inherited the business of Mr. Shubhan can set-off the loss of the predecessor i.e. sole-proprietary concern.

(c) Under section 22, the charging section for "Income from house property", the only exception provided is the income derived from property used/occupied by the assessee for his own business. Therefore, income derived from letting out of house property will always be taxable under the head "Income from house property". Even if the business of the assessee is to own and give houses on rent or to trade in houses, the annual value of the houses owned by him during the previous year would be taxable as "Income from house property". It will be so taxable even if property is held by the assessee as stock-in-trade of his business.

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

Note – The Gujarat High Court has, however, expressed an alternate view in CIT v. Neha Builders P. Ltd. (2008) 296 ITR 661, where it was held that in the case of an assessee engaged in construction and sale of buildings, the same would constitute stock-in-trade of the assessee and any income derived from stock would be assessable as business income.

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(d) The issue under consideration is whether penal provisions under section 271(1)(c) would be attracted on the ground that the claim made in the return has been found to be wrong, although the information and details given in the return were correct.

The Supreme Court, in *CIT v. Reliance Petroproducts (P) Ltd (2010) 322 ITR 158*, held that the provisions of section 271(1)(c) would be attracted where there has been a concealment of the particulars of income or furnishing of inaccurate particulars of such income.

There is no concealment of income in the case given in the question. Further, it is also not a case of furnishing of inaccurate particulars since no information/detail given in the return was found to be incorrect or inaccurate. Mere making of an incorrect claim (i.e., a claim which has been disallowed), which is not sustainable in law, would not, by itself, tantamount to furnishing inaccurate particulars.

Where there is no finding that any information or detail supplied by assessee in its return were incorrect or false, there is no question of imposing penalty under section 271(1)(c).

Thus, the Assessing Officer is not correct in applying penal provisions under section 271(1)(c).

6. (a) (i) Section 80-IB(13) provides that the provisions contained in section 80-IA(5) shall, so far as may be, apply to the eligible business under section 80-IB. Accordingly, for the purpose of computing the deduction under section 80-IB, the profits and gains of an eligible business shall be computed as if such eligible business was the only source of income of the assessee.

Therefore, Nayak Limited should claim deduction under section 80-IB on profit from the eligible unit without setting off loss suffered in the other unit. It may be noted that the aggregate deduction under Chapter VIA, however, cannot exceed the gross total income of the assessee.

(ii) Under section 80-IB, where the gross total income of an assessee includes any profits and gains derived from an industrial undertaking referred to in the section, there shall be allowed, in computing the total income of the assessee, a deduction from such profits and gains at the specified percentage and for such number of years as specified in the section. In *CIT vs. Sterling Foods (1999) 237 ITR 579 (SC)* and *Liberty India vs. CIT (2009) 317 ITR 218 (SC),* it was held that sale of import entitlement and duty drawback cannot be construed as income derived from industrial undertaking. Therefore, such income cannot be included in computing income for the purpose of deduction under section 80-IB.

Interest income derived by an undertaking on delayed collection of sale proceeds shall be treated as income derived from the industrial undertaking,

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and therefore, the same would be eligible for deduction under section 80-IB. [*Phatela Cotgin Industries Private Limited vs CIT (2008) 303 ITR 411 (P & H)].*

(b) (i) Computation of depreciation under section 32 for Power Ltd. for A.Y. 2016-17

Particulars		Rs.(in crores)
Plant and machinery acquired on 15.07.2015		30.000
Plant and machinery acquired on 13.01.2016		25.000
WDV as on 31.03.2016		55.000
Less: Depreciation @ 15% on Rs. 30 crore	4.500	
Depreciation @ 7.5% (50% of 15%) on Rs. 25 crore	1.875	
Additional Depreciation@35% on Rs. 30 crore	10.500	
Additional Depreciation@17.5% (50% of 35%) on Rs. 20 crore	3.500	20.375
WDV as on 01.04.2016		34.625

Computation of deduction under section 32AC & 32AD for Power Ltd. for A.Y. 2016-17

Particulars	Rs. (in crores)
Deduction u/s 32AC(1A) @ 15% on Rs. 50 crore (since investment in new plant and machinery acquired and installed in the previous year 2015-16 by X Ltd., a manufacturing company, exceeds Rs. 25 crore)	7.50
Deduction under section 32AD @ 15% on Rs. 50 crore	7.50
Total benefit	15.00

(ii) Yes, the answer would be different, where the manufacturing unit is set up by a firm. The deduction under section 32AC is available only to corporate assesses, and therefore, the deduction of Rs. 7.50 crore under section 32AC would not be available if the manufacturing unit is set up by Power LLP. However, it would be eligible for deduction of Rs. 7.50 crore under section 32AD.

Notes:

(1) As per the second proviso to section 32(1)(ii), where an asset acquired

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during the previous year is put to use for less than 180 days in that previous year, the amount deduction allowable as normal depreciation and additional depreciation would be restricted to 50% of amount computed in accordance with the prescribed percentage.

Therefore, normal depreciation on plant and machinery acquired and put to use on 1.11.2015 is restricted to 7.5% (being 50% of 15%) and additional depreciation is restricted to 17.5% (being 50% of 35%).

(2) As per third proviso to section 32(1)(ii), the balance additional depreciation of Rs. 3.5 crore, being 50% of Rs. 7 crore (35% of Rs. 20 crore) would be allowed as deduction in the A.Y.2017-18.

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

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

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

(c) Computation of "Income from other sources" of Mr. Ayush for the A.Y.2016-17

	Particulars	Rs.
(1)	Cash gift is taxable under section 56(2)(vii), since it exceeds Rs. 50,000	75,000
(2)	Since bullion is included in the definition of property, therefore, when bullion is received without consideration, the same is taxable, since the aggregate fair market value exceeds Rs. 50,000	60,000
(3)	Stamp value of plot of land at Chennai, received without consideration, is taxable under section 56(2)(vii)	5,00,000
(4)	Difference of Rs. 2 lakh in the value of shares of MNO Ltd.	-

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	purchased from Mr. Charan, a dealer in shares, is not taxable as it represents the stock-in-trade of Mr. Ayush. Since Mr. Ayush is a dealer in shares and it has been mentioned that the shares were subsequently sold in the course of his business, such shares represent the stock-in-trade of Mr. Ayush.	
(5)	Difference between the stamp duty value of Rs. 23 lakh on the date of booking and the actual consideration of Rs. 20 lakh paid is taxable under section 56(2)(vii).	3,00,000
Income from Other Sources		9,35,000

Computation of "Capital Gains" of Mr. Ayush for the A.Y.2016-17

Particulars	Rs.
Sale Consideration	7,00,000
Less: Cost of acquisition [deemed to be the stamp value charged to tax under section 56(2)(vii) as per section 49(4)]	5,00,000
Short-term capital gains	2,00,000

Note – The resultant capital gains will be short-term capital gains since for calculating the period of holding, the period of holding of previous owner is not to be considered.

(d) (i) As per section 282(1), the service of notice or summon or requisition or order or any other communication under this Act may be made by delivering or transmitting a copy thereof to the person named therein -

(1) by post or such courier services as approved by the CBDT; or

(2) in such manner as provided in the Code of Civil Procedure, 1908 for the purposes of service of summons; or

(3) in the form of any electronic record as provided in Chapter IV of the Information Technology Act, 2000; or

(4) by any other means of transmission of documents as may be provided by rules made by the CBDT in this behalf.

The CBDT is empowered to make rules providing for the addresses (including the address for electronic mail or electronic mail message) to which such communication may be delivered or transmitted to the person named therein.

(ii) The service of notice in the given cases should be on the persons mentioned hereunder:-

Person	Notice to be addressed and served on
A dissolved firm	Any person (not being a minor) who was a partner

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	immediately before dissolution.
A deceased person	The legal heirs of the deceased.
A partitioned HUF	Last Manager of the HUF, or, if he is dead, then, all adult members of the erstwhile HUF.

7. (a) The issue as to whether the charges fixed by the Airport Authority of India (AAI) for landing and take-off facilities and parking facility for the aircraft are for the "use of the land" by the airline company came up before the Supreme Court in *Japan Airlines Co. Ltd. v. CIT / CIT v. Singapore Airlines Ltd. (2015) 377 ITR 372*.

The Supreme Court observed that the charges which are fixed by the AAI for landing and take-off services as well as for parking of aircrafts are not for the "use of the land". These charges are for services and facilities offered in connection with the aircraft operation at the airport which include providing of air traffic services, ground safety services, aeronautical communication facilities, installation and maintenance of navigational aids and meteorological services at the airport.

There are various international protocols which mandate all authorities manning and managing these airports to construct the airport of desired standards which are stipulated in the protocols. The services which are required to be provided by these authorities, like AAI, are aimed at passengers' safety as well as for safe landing and parking of the aircrafts. Therefore, the services are not restricted to merely permitting "use of the land" of airport. On the contrary, it encompasses all the facilities that are to be compulsorily offered by the AAI in tune with the requirements of the protocol.

The Supreme Court observed that the charges levied on air-traffic includes landing charges, lighting charges, approach and aerodrome control charges, aircraft parking charges, aerobridge charges, hangar charges, passenger service charges, cargo charges, etc. Thus, when the airlines pay for these charges, treating such charges as charges for "use of the land" would tantamount to adopting a totally simplistic approach which is far away from the reality.

The Supreme Court opined that the substance behind such charges has to be considered and when the issue is viewed from this angle, keeping the larger picture in mind, it becomes very clear that the charges are not for use of the land *per se* and, therefore, it cannot be treated as "rent" within the meaning of section 194-I. The Supreme Court, thus, concurred with the view taken by the Madras High Court in *Singapore Airlines* case and overruled the view taken by the Delhi High Court in *United Airlines/Japan Airlines* case.

Applying the rationale of the Supreme Court ruling to the facts of this case, the contention of the Assessing Officer that landing and parking charges are levied for use of the land of airport and hence, the charges are in the nature of rent to attract the provisions of tax deduction at source under section 194-I is <u>not</u> correct.

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

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

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

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

Therefore, on this basis, the Assessing Officer formed a belief that the income has escaped assessment and consequently, issued notice under section 148 for 12 assessment years i.e. from A.Y.2004-05 to A.Y.2015-16.

Hence, the Assessing Officer is justified in invoking reassessment provisions in respect of the earlier assessment years also. However, the extended time limit of 16 years for invoking reassessment proceedings would be available only in respect of A.Y.2006-07 and thereafter, since Sonam first purchased an asset outside India only in July 2005.

Accordingly, in view of the above provisions, the action of the Assessing Officer in issuing notices to Sonam under section 148 for ten assessment years i.e., from A.Y. 2006-07 to A.Y. 2015-16 is in order. However, he cannot issue notice under section 148 for A.Y. 2004-05 and A.Y.2005-06, since the time limit of 4 years or 6 years, as the case may be, has since elapsed.

(c) (i) The statement given is **not** correct. The Supreme Court, in *CIT v. Meghalaya Steels Ltd. (2015) 377 ITR 112*, observed that the power of review would inhere on High Courts, being courts of record under article 215 of the Constitution of India. There is nothing in article 226 of the Constitution to preclude a High Court from exercising the power of review which inheres in every court of plenary jurisdiction to prevent miscarriage of justice or to correct grave and palpable errors committed by it. The Supreme Court further observed that section 260A(7) does not purport in any manner to curtail or restrict the application of the provisions of the Code of Civil Procedure. Section 260A(7) only states that all the provisions that would apply qua appeals in the Code of Civil Procedure would apply to appeals under

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section 260A. The Supreme Court opined that this does not in any manner suggest either that the other provisions of the Code of Civil Procedure are necessarily excluded or that the High Court's inherent jurisdiction is in any manner affected.

(ii) The proposition is not correct. Under section 254(2), the Tribunal may, within four years from the date of the order, rectify any mistake apparent from record if it is brought to its notice either by the Assessing Officer or by the assessee. However, an amendment which has the effect of enhancing an assessment or reducing a refund or otherwise increasing the liability of the assessee shall not be made unless a notice has been given to the assessee of the intention to do so and a reasonable opportunity of being heard has been given. The Tribunal, however, has no inherent power to review its own order.

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