PAPER – 7: DIRECT TAX LAWS

Working notes should form part of the answer.

Question No.1 is compulsory.

*Answer any **five** questions from the remaining **six** questions.*

All questions relate to Assessment Year 2016-17, unless stated otherwise in the question.

Question 1

(a) Sona Ltd., a resident company, earned a profit of ₹ 15 lakhs after debit/credit of the following items to its Statement of Profit and Loss for the year ended on 31/03/2016:

(i) Items debited to Statement of Profit and Loss:

No.	*Particulars*	*₹*
1.	*Provision for the loss of subsidiary*	*70,000*
2.	*Provision for doubtful debts*	*75,000*
3.	*Provision for income-tax*	*1,05,000*
4.	*Provision for gratuity based on actuarial valuation*	*2,00,000*
5.	*Depreciation*	*3,60,000*
6.	*Interest to financial institution (unpaid before filing of return)*	*1,00,000*
7.	*Penalty for infraction of law*	*50,000*

(ii) Items credited to Statement of Profit and Loss:

No.	*Particulars*	*₹*
1.	*Profit from unit established in special economic zone.*	*5,00,000*
2.	*Share in income of an AOP as a member*	*1,00,000*
3.	*Income from units of UTI*	*75,000*
4.	*Long term capital gains*	*3,00,000*

Other Information:

(i) Depreciation includes ₹ 1,50,000 on account of revaluation of fixed assets.

(ii) Depreciation as per Income-tax Rules is ₹ 2,80,000.

(iii) Balance of Statement of Profit and Loss shown in Balance Sheet at the asset side as at 31/03/2015 was ₹ 10 lakhs which includes unabsorbed depreciation of ₹ 4 lakhs.

(iv) The capital gain has been invested in specified assets under section 54EC.

The Suggested Answers for Paper 7:- Direct Tax Laws are based on the provisions of income-tax law as amended by the Finance Act, 2015, which is relevant for May, 2016 examination. The relevant assessment year is A.Y.2016-17.

(v) *The AOP, of which the company is a member, has paid tax at maximum marginal rate.*

(vi) *Provision for income-tax includes ₹ 45,000 of interest payable on income-tax.*

Compute minimum alternate tax under section 115JB of the Income-tax Act, 1961, for A.Y. 2016-17. *(10 Marks)*

(b) *K and Co. (firm) had sold all its assets and liabilities as a slump sale on 31-03-2016 to SVPC & Co. (firm) for a lump sum consideration of ₹ 600 lakhs.*

The statement of affairs of K & Co. as on 31-03-2016 is as below:

Liabilities	*₹ (in lakhs)*	*Assets*	*₹ (in lakhs)*	
Capital	*1,627*	*Fixed Assets*		
Unsecured Loans	*25*	*Plant & Machinery at WDV*	*250*	
Bank Borrowing	*500*	*Land (At Revalued figure)*	*1,200*	*1,450*
Sundry Creditors	*80*	*Current Assets:*		
		Sundry Debtors	*380*	
		Cash & Bank Balances	*2*	
		Loans & Advances	*150*	
		Closing Stock	*250*	*782*
Total	*2,232*	*Total*		*2,232*

Additional Information:

(1) *Cost of land in March 2005 was ₹ 100 lakhs.*

(2) *WDV of Plant & Machinery u/s 43(6) was ₹ 200 lakhs.*

(3) *Cost Inflation Index for the financial year 2004-05 was 480 and for 2015-16 is 1081.*

(4) *Stock is overvalued by 10%*

Compute capital gain arising from slump sale and tax on such gain. *(10 Marks)*

Answer

(a) Computation of "Book Profit" for levy of MAT under section 115JB for A.Y.2016-17

Particulars	₹	₹
Net Profit as per Statement of Profit and Loss		15,00,000
Add: Net profit to be increased by the following amounts *(Explanation 1* to section 115JB):		
- Provision for the loss of subsidiary *[Clause (d) of Explanation 1 to section 115JB]*	70,000	
- Provision for doubtful debts, being the amount set aside as provision for diminution in the value of any asset *[Clause (i) of Explanation 1 to section 115JB]*	75,000	

-	Provision for income-tax *[Clause (a) of Explanation 1 to section 115JB* *Further, as per* Explanation 2 *to section 115JB, income-tax shall include, inter alia, any interest charged under the Act, therefore, whole of the amount of provision for income-tax including ₹ 45,000 towards interest payable has to be added]*	1,05,000	
-	Depreciation *[Clause (g) of Explanation 1 to section 115JB]*	3,60,000	6,10,000
			21,10,000
Less:	Net profit to be decreased by the following amounts *(Explanation 1* to section 115JB):		
-	Share in income of an AOP as a member *[In a case, where AOP has paid tax on its total income at maximum marginal rate, no income-tax is payable by the company, being a member of AOP, in accordance with the provisions of section 86. Therefore, as per clause (iic) of Explanation 1 to section 115JB, share in income of an AOP on which no income-tax is payable in accordance with the provisions of section 86, would be reduced while computing book profit, since the same has been credited to profit and loss account]*	1,00,000	
-	Income from units in UTI *[As per clause (ii) of Explanation 1 to section 115JB, income from units in UTI shall be reduced while computing the book profits, since the same is exempt under section 10(35)]*	75,000	
-	Depreciation other than depreciation on revaluation of assets (₹ 3,60,000 – ₹ 1,50,000) *[Clause (iia) of Explanation 1 to section 115JB]*	2,10,000	
-	Unabsorbed depreciation or brought forward business loss, whichever is less, as per the books of account. *[As per clause (iii) of Explanation 1 to section 115JB, lower of unabsorbed depreciation ₹ 4,00,000 and brought forward business loss ₹6,00,000 as per books of accounts has to be reduced while computing the book profit]*	4,00,000	7,85,000
	Book Profit		13,25,000

Computation of MAT liability under section 115JB

Particulars	₹
18.50% of book profit	2,45,125
Add: Education cess@2%	4,903
Secondary and higher education cess@1%	2,451
Minimum Alternate Tax liability	2,52,479
MAT liability (rounded off)	2,52,480

Notes:

(1) It is only the specific items mentioned under *Explanation 1* to section 115JB, which can be adjusted from the net profit as per the Statement of Profit and Loss prepared as per the Companies Act for computing book profit for levy of MAT. Since the following items are not specified thereunder, the same cannot be adjusted for computing book profit:

- Interest to financial institution (unpaid before filing of return) and
- Penalty for infraction of law

(2) Provision for gratuity based on actuarial valuation is an ascertained liability *[CIT v. Echjay Forgings (P) Ltd. (2001) 251 ITR 15 (Bom.)]*. Hence, the same should not be added back to compute book profit.

(3) As per proviso to section 115JB(6), the profits from unit established in special economic zone cannot be excluded while computing the book profit, and hence, such income would be liable for MAT.

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

(b) As per section 50B, any profits and gains arising from the slump sale effected in the previous year shall be chargeable to income-tax as capital gains arising from the transfer of capital assets and shall be deemed to be the income of the previous year in which the transfer took place.

If the assessee owned and held the undertaking transferred under slump sale for more than 36 months before slump sale, the capital gain shall be deemed to be long-term capital gain.

In this case, it is assumed that the undertaking was set up in March 2005, being the period in which land was acquired. Hence, the resultant capital gain on slump sale is a

long-term capital gain. However, as per section 50B(2), indexation benefit is not available in case of slump sale.

Computation of Capital Gain arising from slump sale and tax on such gain

Particulars	₹ in lakhs
Slump sale consideration	600.00
Less: Cost of acquisition (net worth) [*See Working Note below*]	454.27
Long-term capital gain	145.73
Income-tax @ 20% (under section 112)	29.146
Add: Surcharge@12%, since total income exceeds ₹ 1 crore.	3.498
	32.644
Add: Education cess@2% and secondary and higher education cess@1%	0.979
Total tax liability	33.623

Working Note: Computation of Net worth of the undertaking

Particulars		₹ in lakhs
WDV of block of assets (Plant & Machinery) as per section 43(6)]		200.00
Book value of non-depreciable assets		
- Land (Revaluation not to be considered)	100.00	
- Sundry Debtors	380.00	
- Cash & Bank Balance	2.00	
- Loans & Advances	150.00	
- Closing Stock (₹ 250 lakhs – ₹ 22.73 lakhs, being the amount of over-valuation i.e., 10/110 × ₹ 250) [See Note below]	227.27	859.27
		1059.27
Less : Liabilities		
- Unsecured Loans	25.00	
- Bank Borrowing	500.00	
- Sundry Creditors	80.00	605.00
Net worth		454.27

Note: Book value of assets (other than depreciable assets) has to be considered for the purpose of arriving at the net worth. Stock has to be valued at lower of cost or net realizable value as per AS 2 and this is the value to be reflected in the Balance Sheet of an entity. For this reason, the effect of over-valuation of stock has been removed while computing the net worth of the undertaking.

Question 2

XYZ Ltd. is engaged in the manufacture of fertilizers since 01-04-2009. Its Statement of Profit & Loss shows a net profit of ₹ 700 lakhs after debit/credit of the following items:

(1) Depreciation calculated on the basis of useful life of assets as per provisions of the Companies Act, 2013 is ₹ 50 lakhs.

(2) Normal Depreciation calculated as per Income-tax Rules is ₹ 80 lakhs.

(3) Employer's contribution to EPF of ₹ 2 lakhs together with the Employees' contribution of ₹ 2 lakhs for the month of March, 2016 was remitted on 8th May 2016.

(4) The company appended a note to its Income Statement that industrial power tariff concession of ₹ 2.5 lakhs was received from the State Government and treated the same as capital receipt.

(5) The company had provided an amount of ₹ 25 lakhs being sum estimated as payable to workers based on agreement to be entered with the workers union towards periodical wage revision once in 3 years. The provision is based on a fair estimation on wage and probable revision.

(6) The company had made a provision of 10% of its debtors towards bad and doubtful debts. Total sundry debtors of the company as on 31-03-2016 was ₹ 200 lakhs.

(7) A debtor who owed the company an amount of ₹ 40 crores was declared insolvent and hence, was written off.

(8) Sundry creditors include an amount of ₹ 50 lakhs payable to A & Co, towards supply of raw materials, which remained unpaid due to quality issues. An agreement has been made on 31-03-2016, to settle the amount at a discount of 75% of the outstanding.

(9) The opening and closing stock for the year were ₹ 200 lakhs and ₹ 250 lakhs, respectively. They were overvalued by 10%.

(10) Provision for gratuity based on actuarial valuation was ₹ 5 crores. Actual gratuity paid was ₹ 3 crores.

(11) Commission of ₹ 1 lakhs paid to a recovery agent for realization of a debt. Tax has been deducted and remitted as per Chapter XVIIB of the Act.

(12) The company has purchased 500 tons of industrial paper as packing material at a price of ₹ 30,000/ton from PQR, a firm in which majority of the directors are partners. PQR's normal selling price in the market for the same material is ₹ 28,000/ton.

Additional Information:

(1) There was an addition to Plant & Machinery amounting to ₹ 50 lakhs on 10-06-2015.

(2) The company had credited a sub-contractor an amount of ₹ 8 lakhs on 31-03-2015 towards repairing a machinery component. The tax so deducted was remitted on 31-10-2015.

(3) The company has collected ₹ 10 lakhs as sales tax from its customers and paid the same on the due dates. However, on an appeal made, the High Court directed the Sales Tax Department to refund ₹ 3 lakhs to the company. The company in turn refunded ₹ 2 lakhs to the customers from whom the amount was collected and the balance of ₹ 1 lakh is still lying under the head "Current Liabilities".

Compute total income and tax payable. Ignore MAT provisions. *(16 Marks)*

Answer

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

Particulars		Amount (₹)	
Profits and Gains from Business and Profession			
Net profit as per profit and loss account			7,00,00,000
Add: Items debited but to be considered separately or to be disallowed			
(a)	Depreciation as per Companies Act, 2013 disallowed	50,00,000	
(b)	Employees contribution to EPF *[See Note 1 below]*	2,00,000	
	[Since employees contribution to EPF has not been deposited on or before the due date under the PF Act, the same is not allowable as deduction as per section 36(1)(va). Since the same has been debited to profit and loss account, it has to be added back for computing business income].		
(c)	Employers contribution to EPF	Nil	
	[As per section 43B, employers' contribution to EPF is allowable as deduction since the same has been deposited on or before the 'due date' of filing of return under section 139(1). Since the same has been debited to profit and loss account, no further adjustment is necessary]		
(d)	Industrial power tariff concession received from State Government *[See Note 2 below]*	Nil	
	[Any assistance in the form of, inter alia, concession received from the Central or State Government would be treated as income as per section 2(24)(xviii). Since the same has been credited to profit and loss account, no adjustment is required.		
(e)	Provision for wages payable to workers *[See Note 3 below]*	Nil	
	[There has been wage revision every three years. The company was formed in 1999. Since the provision is based on a fair estimation of wages and probable revision, the same can be recognized for the purpose of income computation [CIT v. BHEL Ltd. (2013) 352 ITR 88 (Del)].		

	As the provision has been debited to profit and loss account, no adjustment is required while computing business income]		
(f)	Provision for doubtful debts [10% of ₹ 200 lakhs] *[Provision for doubtful debts is allowable as deduction under section 36(1)(viia) only in case of banks, public financial institutions, state financial corporations and state industrial investment corporations. Such provision is not allowable as deduction in the case of a manufacturing company. Since the same has been debited to profit and loss account, it has to be added back for computing business income]*	20,00,000	
(g)	Bad debts written off *[Bad debts write off in the book of account is allowable as deduction under section 36(1)(vii). Since the same has already been debited to profit and loss account, no further adjustment is required]*	Nil	
(h)	Discount given by Sundry Creditors for supply of raw materials *[See Note 2 below]* *[Discount of 75% given by Sundry Creditors for supply of raw materials is taxable under section 41(1). Since the same has already been credited to profit and loss account, no further adjustment is required]*	Nil	
(i)	Provision for gratuity *[Provision of ₹ 500 lakhs for gratuity based on actuarial valuation is not allowable as deduction as per section 40A(7). However, actual gratuity of ₹ 300 lakhs paid is allowable as deduction. Hence, the difference has to be added back]*	2,00,00,000	
(j)	Commission paid to recovery agent for realization of a debt. *[Commission of ₹ 1 lakh paid to a recovery agent for realisation of a debt is an allowable expense under section 37 as per DCIT v. Super Tannery (India) Ltd. (2005) 274 ITR 338 (All). Since the same has been debited to profit and loss account, no further adjustment is required]*	Nil	
(k)	Purchase of paper at a price higher than the fair market value *[As per section 40A(2), the difference between the purchase price (₹ 30,000 per ton) and the fair market value (₹ 28,000 per ton) multiplied by the quantity purchased (500 tons) has to be added back since the purchase is from a related party, a firm in which majority of the directors are partners, at a price higher than the fair market value]*	10,00,000	

(l)	Sales tax not refunded to customers out of sales tax refund *[The amount of sales tax refunded to the company by the Government is a revenue receipt chargeable to tax under section 41(1). Deduction can be claimed of amount refunded to customers [CIT v. Thirumalaiswamy Naidu & Sons (1998) 230 ITR 534 (SC)]. Hence, the net amount of ₹ 1,00,000 (i.e., ₹ 3,00,000 minus ₹ 2,00,000) would be chargeable to tax]*	1,00,000	
			2,83,00,000
			9,83,00,000
Less: Items credited but to be considered separately / permissible expenditure and allowances			
(m)	Depreciation as per Income-tax Act,1961 already debited in profit and loss account – hence, no adjustment is required *[See Note 2 below]*	Nil	
(n)	Over-valuation of stock [₹ 50 lakhs × 10/110] *[The amount by which stock is over-valued has to be reduced for computing business income. ₹ 50 lakhs, being the difference between closing and opening stock, has to be adjusted to remove the effect of over-valuation]*	4,54,545	
(o)	Additional Depreciation *[See Note 4 below]* *[Additional depreciation@20% is allowable on ₹ 50 lakhs, being actual cost of new plant & machinery acquired on 10.06.2015, assuming that the same is put to use for more than 180 days in the P.Y.2015-16. Since additional depreciation has not been debited to profit and loss account, the same has to be deducted while computing business income]*	10,00,000	
(p)	Payment to a sub-contractor where tax deducted last year was remitted after the due date of filing of return *[See Note 5 below]* *[30% of ₹ 8 lakhs, being payment to a sub-contractor, would have been disallowed under section 40(a)(ia) while computing the business income of A.Y.2015-16, since tax deducted was remitted after the due date of filing of return. However, the same is allowable in A.Y.2016-17, since the remittance has been made on 31.10.2015]*	2,40,000	
			16,94,545
Total Income			9,66,05,455
Total Income (rounded off)			9,66,05,460

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

Particulars	₹
Tax @30% on the above total income	2,89,81,638
Add: Surcharge@7% (since total income exceeds ₹ 1 crore but less than ₹ 10 crore)	20,28,715
	3,10,10,353
Add: Education cess@2%	6,20,207
Secondary and higher education cess@1%	3,10,104
Total tax liability	3,19,40,664
Total tax liability (rounded off)	3,19,40,660

Notes:

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

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

(2) The following items, which are generally given under additional information, have been stated to have been debited/credited to the profit and loss account:

Item No.(2) – Normal Depreciation calculated as per Income-tax Rules ₹ 80 lakhs;

Item No.(4) – Industrial Power Tariff Concession of ₹ 2.50 lakhs received from State Government and treated as a capital receipt.

Item No.(8) - Discount of 75% given on amount of ₹ 50 lakhs payable to A & Co., included in Sundry Creditors.

In the above solution, we have treated the same as given in the question i.e., normal depreciation as per Income-tax Rules, 1962 has been debited to the statement of profit and loss account in addition to depreciation as per Companies Act, 2013, and the industrial power tariff concession and discount on sundry creditors have been credited to the statement of profit and loss; accordingly, no adjustments have been made in respect

of the above amounts credited. Depreciation as per Companies Act, 2013 alone has been added back.

Alternate Answer – Since these items are generally given under additional information, it is also possible to solve the question by considering that such items are given under additional information and not given effect to in the profit and loss account. Accordingly, the difference of ₹ 30 lakhs between depreciation as per the Income-tax Act, 1961 and the Companies Act, 2013 has to be reduced while computing business income. Further, the industrial power tariff concession of ₹ 2.50 lakhs and discount of ₹ 37.50 lakhs to creditors have to be added back while computing business income. The answer would, accordingly, undergo a change.

(3) Since the provision for wages is based on a fair estimation of wages and probable revision, the same can be recognized for the purpose of income computation *[CIT v. BHEL Ltd. (2013) 352 ITR 88 (Del)]*. As the provision has been debited to profit and loss account, no adjustment is required.

Alternate view - Since it is stated in the question that the provision is based on probable revision, it is possible to take a view that ICDS X will apply and hence, the provision is not allowable, since ICDS X requires 'reasonable certainty for recognition of a provision.[1] *If this view is taken, the provision will have to be disallowed.*

(4) ₹ 50 lakhs, being the addition to plant and machinery on 1.6.2015 qualifies for additional depreciation@20% under section 32(1)(iia). Since only the normal depreciation as per Income-tax Rules, 1962, has been debited to profit and loss account, additional depreciation of ₹ 10 lakhs (being 20% of ₹ 50 lakhs) has to be deducted while computing business income.

Alternate Answer – Newly installed capacity in an existing plant for production of fertilizer also qualifies for investment-linked tax deduction under section 35AD. If deduction under section 35AD is provided, no deduction can be allowed under any other provision of the Income-tax Act, 1961 as per section 35AD(4). Consequently, normal depreciation and additional depreciation would not be allowable in respect of such plant and machinery.

(5) The above solution has been worked out by considering the due date mentioned in *Explanation 2* to section 139(1) i.e., 30th September, 2015, as the due date of filing return of income for A.Y.2015-16. Since the tax deducted during the P.Y.2014-15 was remitted only on 31.10.2015, i.e., after the due date of filing of return for A.Y.2015-16, ₹ 2,40,000, being 30% of ₹ 8 lakh would have been disallowed while computing the business income of that year. Since the tax deducted has been remitted on 31.10.2015, ₹ 2,40,000 would be allowed as deduction while computing the business income of the A.Y.2016-17.

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[1] The alternate view may not be relevant in actual practice for A.Y.2016-17, since the applicability of ICDSs has since been postponed. The notified ICDSs which were applicable from A.Y.2016-17, are now being made applicable from A.Y.2017-18.

Alternate Answer - The due date for filing of return of income of A.Y.2015-16 was extended to 31.10.2015, in case of, inter alia, companies. Therefore, if the extended due date of 31.10.2015 is considered, then, there would have been no disallowance under section 40(a)(ia) in the A.Y.2015-16. Consequently, there would be no adjustment in this regard while computing the business income of A.Y.2016-17.

Question 3

(a) M/s. XYZ commenced the business of manufacturing iron rods on 1st April, 2015. It had employed 200 workmen during the year which included the following:

Workman	*No. of persons*	*Salary per month (in ₹)*
Casual Labour	*50*	*5,000*
Workmen employed through contractor	*25*	*7,500*
Skilled labour	*50*	*12,500*
Semi-skilled labour	*50*	*6,000*
Skilled labour employed from 01-10-2015	*25*	*12,500*

Compute deduction available to M/s. XYZ if the profits derived during the financial year 2015-16 is ₹100 lakhs. (6 Marks)

(b) M/s. XYZ was subjected to search and seizure. During the course of search, sales, purchase ledgers and property documents pertaining to Mr. A was found in the premises of M/s. XYZ. What is the procedure to be adopted by the Assessing Officer of M/s. XYZ who has seized the records? (4 Marks)

(c) Discuss the liability of the following receipts, during the year ended 31st March, 2016, in the hands of Ms. Jyoti under the Income-tax Act, 1961:

(i) Gift of ₹60,000 in cash from her father's sister on her birthday.

(ii) Acquired a vacant site from grandfather's younger brother. The stamp duty value of the land was ₹3 lakhs but the consideration paid was ₹2 lakhs.

(iii) Received a car from her friend on payment of ₹2,50,000, the market value of which was ₹3,00,000.

(iv) Interest on enhanced compensation on the order of court, from NHAI in respect of her land which was compulsorily acquired, was received ₹3,50,000 on 12-11-2015 which includes interest of ₹2,00,000 pertaining to previous year 2013-14.

(v) Received cash gift of ₹15,000 each from three of her friends. (4 Marks)

(d) State with reasons whether the provisions of Chapter XVII-B are attracted in the following case and what is the net amount receivable by the payee.

Mr. Sharma is an employee of M/s. ABC Ltd. since 01-04-2013. He has resigned on 31-03-2016 and has withdrawn the amount of ₹ 50,000 being the balance in his EPF account. *(2 Marks)*

Answer

(a) M/s. XYZ is eligible for deduction under section 80JJAA since its gross total income includes profits and gains derived from the manufacture of goods in a factory and it has employed more than 50 new regular workmen in its factory.

"Regular workman" does not include a casual workman or a workman employed through contract labour or any other workman employed for a period of less than 300 days during the previous year.

Computation of deduction under section 80JJAA

Particulars	View I	View II
	₹	₹
Additional Wages paid to new regular workmen in excess of 50:		
View I *[See Note 1 below]*		
₹12,500 × 50 × 12	75,00,000	
₹ 6,000 × 50 × 12	36,00,000	
	1,11,00,000	
View II *[See Note 1 below]*		
₹12,500 × 50 × 12[2]		75,00,000
Deduction under section 80JJAA:		
View I: 30% of ₹ 1,11,00,000	33,30,000	
View II: 30% of ₹ 75,00,000		22,50,000

Notes:

(1) As per clause (i) of the *Explanation* to section 80JJAA, "additional wages" means the wages paid to the new regular workmen in excess of '*50 workmen employed during the previous year*'. There are two possible views as to whether the '*50 workmen employed during the previous year*' would encompass all workmen or only the regular workmen. From a plain reading of the definition of "additional wages", it

[2] It is more beneficial to take into account the additional wages of 50 skilled labour since their wages are higher than that of the 50 semi-skilled labour. Also, it has been assumed that both skilled and semi-skilled labour are employed on the same date i.e., 1.4.2015, being the date of commencement of business of manufacturing iron rods.

is possible to take a view that 50 workmen employed during the previous year can be any category of workmen and not necessarily regular workmen.

The alternative view is that the 50 workmen employed during the previous year refers to 50 regular workmen. In this context, it may be noted that the report under section 80JJAA of the Income-tax Act, 1961 has to be submitted in Form No.10DA by a Chartered Accountant. In Note 1(a) below the Annexure to Form No.10DA, it has been clarified that in case of newly set up unit, the number of new regular workmen should be in excess of 50 regular workmen; hence, the possibility of an alternative view.

Therefore, the question can be solved on the basis of the following two possible views:

I. Number of new regular workmen in excess of 50 workmen employed during the previous year means the number in excess of 50 workmen, who may belong to any category, as it appears from a plain reading of the definition of additional wages in clause (i) of *Explanation* to section 80JJAA.

   If this view is considered, 30% of additional wages paid to 100 new regular workmen would qualify for deduction under section 80JJAA in this case, since there are more than 50 other workmen who are not regular workmen.

II. Number of new regular workmen in excess of 50 workmen employed during the year means the number of new regular workmen in excess of 50 regular workmen employed during the year (as per the view arising out of the language in Note 1(a) below the Annexure in Form 10DA).

   If this view is considered, 30% of additional wages paid to 50 new regular workmen (100 - 50) would qualify for deduction under section 80JJAA in this case.

Number of new regular workmen:

Particulars	No. of workmen			
	View I		View II	
Total number of workmen employed during the year		200		200
Less: Casual labour employed during the year	50		50	
Workmen employed through contract labour	25		25	
Workmen employed for a period of less than 300 days during the P.Y.2015-16 (skilled labour employed from 1.10.2015)	25	100	25	100
Total number of new regular workmen		100		100
Number of new regular workmen in excess of 50		100		50

(2) Since the question states that 200 workmen are employed during the year, it is assumed that all the 200 workmen employed fall within the definition of "workmen" as per section 2(s) of the Industrial Disputes Act, 1947. In particular, it is assumed that the skilled labour employed are not persons who are employed in supervisory capacity.

(3) It is assumed that except for the skilled labour employed from 1.10.2015, all the other workmen are employed from 1.4.2015, being the date of commencement of business of manufacture of iron rods.

(b) As per section 153C(1), where the Assessing Officer is satisfied that any books of account or documents seized or requisitioned pertains to or the information contained therein relates to any person other than the person subjected to search under section 132 or whose books or documents were seized or requisitioned under section 132A, then, the books of accounts or documents seized or requisitioned shall be handed over to the Assessing Officer having jurisdiction over such other person;

That Assessing Officer having jurisdiction over such other person shall issue notice and assess or reassess income of such other person in accordance with the provisions of section 153A subsequent to such transfer of books and records seized or requisitioned, only if he is satisfied that the books of account or documents seized or requisitioned have a bearing on the determination of total income of such other person for the relevant assessment year or assessment years referred to in section 153A(1).

In this case, if Mr. A is subject to the jurisdiction of the same Assessing Officer as that of M/s. XYZ, the said Assessing Officer shall proceed against Mr. A, otherwise, the Assessing Officer of M/s. XYZ should hand over the sales, purchase ledgers and property documents pertaining to Mr. A to the Assessing Officer having jurisdiction over Mr. A, if he is satisfied that the same pertains to Mr. A or any information contained therein relates to Mr. A.

Thus, the same Assessing Officer or the Assessing Officer having jurisdiction over Mr. A, as the case may be, shall proceed against Mr. A and issue notice and assess or reassess the income of Mr. A in accordance with the provisions of section 153A, only if he is satisfied that the books of account and documents have a bearing on the determination of total income of Mr. A for the relevant assessment year or assessment years referred to in section 153A(1).

(c) (i) Gift of ₹ 60,000 in cash received on her birthday would not be taxable in the hands of Ms. Jyoti, since such sum is received from father's sister who is a relative [as per clause (e) of *Explanation* to section 56(2)(vii)].

(ii) As per section 56(2)(vii)(b), where any immovable property is obtained for inadequate consideration from a person (other than relative) and the difference between stamp duty value of the property and the consideration exceeds ₹ 50,000, then such difference is chargeable to tax as income under the head "Income from Other Sources".

In the present case, since the younger brother of grandfather is not a 'relative' [as per clause (e) of *Explanation* to section 56(2)(vii)], and the difference between the stamp duty of land and consideration paid i.e., ₹ 1,00,000 (₹ 3,00,000 – ₹ 2,00,000) exceeds ₹ 50,000, the difference of ₹ 1,00,000 would be chargeable to tax in the hands of Ms. Jyoti under section 56(2)(vii) under the head "Income from Other Sources".

(iii) Since car is not included in the definition of property [as per clause (d) of *Explanation* to section 56(2)(vii)], the difference between fair market value and purchase price of car is not taxable in the hands of Ms. Jyoti under section 56(2)(vii)(c).

In any case, the difference between the fair market value and purchase price does not exceed ₹ 50,000.

(iv) As per section 145A(b), interest received during the year on enhanced compensation shall be deemed to be the income of the year in which such interest is received, irrespective of the method of accounting followed by the assessee.

Hence, the interest of ₹ 3,50,000 (including interest of ₹ 2,00,000 pertaining to previous year 2013-14) received by Ms. Jyoti, is taxable under section 56(2)(viii) in the previous year 2015-16 after allowing deduction @50% under section 57(iv).

Accordingly, ₹ 1,75,000 (₹ 3,50,000 – ₹ 1,75,000), being 50% of ₹ 3,50,000) would be taxable in her hands under the head "Income from Other Sources".

(v) Cash gifts of ₹ 45,000 (₹ 15,000 x 3) received from three of her friends is not taxable under section 56(2)(vii) in the hands of Ms. Jyoti, since its aggregate value does not exceed ₹ 50,000.

(d) As per section 192A, in a case where the accumulated balance due to an employee participating in a recognized provident fund is includible in his total income owing to the provisions of Rule 8 of Part A of the Fourth Schedule not being applicable, the trustees of the Employees Provident Fund Scheme, 1952 or any person authorised under the scheme to make payment of accumulated balance due to employees are required to deduct income-tax@10% at the time of payment of accumulated balance due to the employee. Tax deduction at source has to be made only if the amount of such payment or aggregate amount of such payment of the payee is ₹ 30,000 or more.

Rule 8 of Part A of the Forth Schedule, *inter alia*, provides that only if an employee has rendered continuous service of five years or more with the employer, then accumulated balance in a recognized provident fund payable to an employee would be excluded from the total income of that employee.

In the present case, Mr. Sharma has withdrawn an amount exceeding ₹ 30,000 on his resignation after rendering a continuous service of three years with M/s. ABC Ltd. Therefore, tax has to be deducted at source@10% under section 192A on ₹ 50,000, being the amount withdrawn on his resignation without rendering continuous service of a period of five years with M/s. ABC Ltd.

The net amount receivable by Mr. Sharma is ₹ 45,000 [i.e., ₹ 50,000 – ₹ 5,000, being tax deducted at source].

Note – It is assumed that Mr. Sharma has furnished his permanent account number (PAN) to the person responsible for deducting tax at source. Otherwise, tax would be deductible at the maximum marginal rate.

Question 4

Examine critically any four out of the following problems/issues/cases in the context of provisions contained in the Income-tax Act, 1961 relevant for Assessment Year 2016-17. Support the answers with relevant case laws and workings.

(a) *Mr. Janak is proprietor of M/s. Yash Texnit which is engaged in garment manufacturing business. The entire block of Plant & Machinery chargeable to depreciation @ 15%, has 15 different machinery items as at 31-03-2015. One of the machinery used for packing had become obsolete and was discarded by Mr. Janak in July' 13.*

Assessee filed its return for A.Y. 2015-16 claiming total depreciation of ₹ 40 lacs which includes ₹ 4.00 lacs being the depreciation claimed on the machinery item discarded by Mr. Janak. The A.O. disallowed the claim of depreciation of ₹ 4.00 lacs during the course of scrutiny assessment.

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

(b) *X. Ltd. issued debentures in the previous year 2015-16, which were to be matured at the end of five years. The debenture holder was given an option of one time upfront payment of ₹ 60 per debenture on account of interest which was to be immediately paid by the company. As per the option exercised by the debenture holders, company paid interest upfront to them in the first year itself and the same was claimed as deduction in the return of the company. But in the accounts, the interest expenditure was shown as deferred expenditure to be written off over a period of five years. During the course of assessment, the Assessing Officer spread the upfront interest paid over a period of five year term of debentures and allowed only one fifth of the amount in the previous year 2015-16. Examine the correctness of the action of Assessing Officer.*

(c) *An assessee deducted the tax at the time of making the payment of salaries. However, it delayed depositing the amounts of tax deducted with the revenue. The quantum of tax deducted was deposited with the revenue along with the interest by the assessee on its own before any notice determining the amount or declaring the assessee to be in default was made by the Revenue. The Assessing Officer levied penalty under section 221 of the Income-tax Act, 1961, for failure to pay tax deducted at source within the prescribed time. Is the action of Assessing Officer justified?*

(d) *Ms. Ankisha had filed her return for the relevant assessment year wherein her total income consisted of income from business and profession of ₹ 3.25 lacs and income from short term capital gain of ₹ 2 lacs. During the course of scrutiny, the Assessing Officer interpreted the income of ₹ 2 lacs declared as short term capital gain (STCG) as*

income from her business having regard to the nature of transactions. The Assessing Officer completed the assessment and levied penalty under section 271(1)(c) on the grounds that Ms. Ankisha had furnished inaccurate particulars of her income.

Is the action of Assessing Officer justified in law?

(e) *Bhola & Co., a firm, failed to pay the advance tax as required by the provisions of Income-tax Act, 1961. The assessment was done under section 143(3) and the assessment order issued by the Assessing Officer stated that interest is payable under section 234B of the Income-tax Act, 1961. The order did not contain any direction for the payment of interest, it merely stated that interest is payable. The assessee's contention is that since the direction for payment of interest is absent in the assessment order, it could not be fastened with liability to interest under section 234B. Examine the validity of assessee's contention.* *(4 x 4 = 16 marks)*

Answer

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

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

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

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

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

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

Applying the rationale of the above case, the action of the Assessing Officer in disallowing ₹ 4 lakhs, being the depreciation claim attributable to discarded machinery,

on the ground that the same was not put to use in the relevant previous year, is invalid, since the said machinery was put to use in the earlier previous years.

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

The facts of the case are similar to the facts in *Taparia Tools Ltd. v. JCIT (2015) 372 ITR 605*, wherein the above issue came up before the Supreme Court. In that case, it was observed that under section 36(1)(iii), the amount of interest paid in respect of capital borrowed for the purposes of business or profession, is allowable as deduction.

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

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

Accordingly, the action of the Assessing Officer in spreading the upfront interest paid over the five year term of debentures and restricting the deduction in the P.Y.2015-16 to one-fifth of the upfront interest paid is <u>not</u> correct. The company is eligible to claim the entire amount of interest paid upfront as deduction under section 36(1)(iii) in the P.Y.2015-16.

(c) Penalty under section 221 is attracted when an assessee is in default or is deemed to be in default in making payment of tax.

The issue under consideration in this case is whether the Assessing Officer was justified in levying penalty under section 221 when the assessee had voluntarily remitted the tax deducted at source, though belatedly.

This issue came up before the Bombay High Court in the case of *Reliance Industries Ltd. v. CIT (2015) 377 ITR 74.* The High Court observed that as per section 201, a person is deemed to be an assessee-in-default for failure to deduct tax or after deduction, pay the tax to the credit of the Government within the prescribed time.

In the case on hand, the assessee has deducted the tax but failed to pay the tax so deducted to the credit of the Government within the prescribed time. Hence, it would be deemed to be an assessee-in-default for failure to pay the tax after deduction. Consequently, penalty under section 221 would be attracted.

Further, the assessee would not cease to be liable to penalty under section 221 merely by reason of the fact that before the levy of penalty, he has paid the tax *[Explanation to section 221(1)].*

The action of the Assessing Officer in this case is, therefore, justified.

(d) Under section 271(1)(c), penalty of 100% to 300% of the amount of tax sought to be evaded is leviable for concealment of income or furnishing inaccurate particulars of income.

In the case on hand, the amount in question, namely ₹ 2 lakhs declared as short-term capital gains, was honestly reported by Ms. Ankisha in her return of income. The Assessing Officer assessed the income as business income. Reporting of income under a different head formed the basis of levy of penalty.

The issue under consideration is whether reporting of income under a different head of income can tantamount to furnishing of inaccurate particulars of income to attract penalty under section 271(1)(c).

The facts of the case are similar to the facts in *CIT v. Amit Jain (2013) 351 ITR 74,* in which the Delhi High Court relied upon Supreme Court ruling in *CIT v. Reliance Petro Products Pvt. Ltd. (2010) 322 ITR 158* wherein it was held that merely because the Assessing Officer was of the opinion that the income falls under some other head cannot be reason enough to treat the particulars reported in the return as "inaccurate particulars".

Where there is no finding that any details supplied by the assessee in its return were incorrect or erroneous or false, there is no question of imposing penalty under section 271(1)(c). Mere reporting of income under a different head would not characterize the particulars reported as "inaccurate" to attract levy of penalty under section 271(1)(c).

Therefore, in this case, action of the Assessing Officer in levying penalty under section 271(1)(c) on the ground that Ms. Ankisha had furnished inaccurate particulars of her income on account of mere reporting of income under a different head is, therefore, not justified in law.

(e) The issue under consideration is whether interest liability under section 234B would arise in the absence of specific direction for payment of interest in the assessment order.

Interest under section 234B is attracted for non-payment of advance tax or shortfall payment of advance tax.

As per the provisions of section 234B, the moment an assessee who is liable to pay advance tax has failed to pay such tax or where the advance tax paid by the assessee is less than 90% of the assessed tax, the assessee becomes liable to pay simple interest @1% per month or part of the month.

Levy of interest under section 234B is automatic when the conditions of section 234B are met and the income-tax computation sheet/form is part of the assessment order. It was

so held by the Gauhati High Court in the case of *CIT v. Assam Mineral Development Corporation Ltd. (2010) 320 ITR 149*.[3]

The contention of the firm, Bhola & Co., that it could not be fastened with the liability to interest under section 234B in the absence of the direction for payment of such interest in the assessment order is, therefore, not valid, assuming that interest under section 234B has been computed for determining the tax liability as per the income-tax computation sheet annexed to the assessment order. Interest liability under section 234B would arise, even in the absence of specific direction for payment of interest in the assessment order.

Note – Answers to all sub-parts of question 4 are based on interpretation of case laws. The answers given above are based on particular legal decisions wherein the facts of the case and issue under consideration are similar to the facts given and issue(s) raised in the questions. However, it may also be possible to answer some of these questions on the basis of other case laws wherein the facts and issue(s) are similar.

Question 5

(a) In the context of provisions contained in the Income-tax Act, 1961 examine the correctness of the following:

(i) Liaison Office maintained in India to explore the opportunity of business in India does not constitute business connection.

(ii) Transfer pricing rules shall have no implication where income is computed on the basis of book profits. (3 x 2= 6 Marks)

(b) Discuss the correctness or otherwise of the following with reference to the provisions of Income-tax Act, 1961.

(i) The double taxation avoidance treaties entered into by the Government of India override the domestic law.

(ii) Assessing Officer can complete the assessment of income from international transaction in disregard of the order passed by the Transfer Pricing Officer by accepting the contention of assessee. (4 Marks)

(c) A non-resident aviation company flying an aircraft in India and paid tax under section 44BBA claims that the employees deputed for flying this aircraft shall not be subjected to tax on the remuneration to the extent paid out of such income. Is the claim justified? (3 Marks)

(d) 'X' while making payment "net of tax" to a non-resident for providing technical services on a world bank aided project had deducted tax out of such payments as per rates prescribed but says that the payee is not entitled for the TDS certificate. Examine. (3 Marks)

[3] The Supreme Court, in *CIT v. Bhagat Construction Co. Pvt. Ltd. (2015) 279 CTR 185,* upheld that the levy of interest under section 234B is automatic when the conditions of section 234B are met and the Income-tax computation form is part of the assessment order

Answer

(a) (i) 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 opportunity of business in India, 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 or industrial activity, directly or indirectly, the Liaison Office does not constitute a business connection in this case.

(ii) The statement is correct.

For the purpose of computing book profit for levy of minimum alternate tax, the net profit shown in the profit and loss account prepared in accordance with the Companies Act can be increased/decreased only by the additions and deductions specified in *Explanation 1* to section 115JB.

No other adjustments can be made to arrive at the book profit for levy of MAT, except where:

(a) it is discovered that the profit and loss account is not drawn up in accordance with the relevant Schedule of the Companies Act

(b) incorrect accounting policies and/or accounting standards have been adopted for preparing such accounts; and

(c) the method and rate of depreciation adopted is not correct.

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

(b) (i) The statement is correct.

Section 90(2) provides that where a double taxation avoidance treaty is entered into by the Government, the provisions of the Income-tax Act, 1961 would apply to the extent they are more beneficial to the assessee.

In case of any conflict between the provisions of the double taxation avoidance agreement and the Income-tax Act, 1961, the provisions of the DTAA would prevail over the Act in view of the provisions of section 90(2), to the extent they are more beneficial to the assessee[*CIT v. P.V.A.L. Kulandagan Chettiar (2004) 267 ITR 654 (SC)]*.

(ii) The statement is <u>not</u> correct.

Section 92CA(4) provides that on receipt of the order of the Transfer Pricing Officer determining the arm's length price of an international transaction, the Assessing

Officer shall proceed to compute the total income in conformity with the arm's length price determined by the Transfer Pricing Officer.

The order of the Transfer Pricing Officer is binding on the Assessing Officer. Therefore, the Assessing Officer cannot complete the assessment of income from international transactions in disregard of the order of Transfer Pricing Officer by accepting the contention raised by the assessee.

(c) Section 44BBA provides for deeming 5% of aggregate of amounts received by/paid or payable to a non-resident assessee engaged in the business of operation of aircrafts, for carriage of passengers, livestock, mail or goods, as profits and gains of such business chargeable to tax under the head "Profits and gains of business or profession".

The issue under consideration is whether employees deputed for flying the aircraft in India would be exempt from tax on the remuneration received from the non-resident aviation company to the extent paid out of income which is subject to tax in India on the basis of presumptive taxation provisions under section 44BBA.

This issue came up before the Authority for Advance Rulings in the case *Lloyd Helicopters International Pty Ltd. (2001) 249 ITR 162*, wherein it was observed that as per Article 15 of the DTAA between India and Australia, one of the conditions for exemption of remuneration of employees resident of Australia is that such remuneration should not be deductible in determining the profits chargeable to tax of the non-resident aviation company.

In this regard, the AAR observed that the profits determined under section 44BBA, though arrived at on a statutory basis, cannot be considered to exclude such expenses as non-deductible merely because the statute fixes a percentage in this regard. The fixation of a rate as low as 5% of gross receipts indicates the statutory attempt at estimating and allowing expenses normally likely to be incurred in such business, which includes remuneration of employees.

Therefore, applying the rationale of the AAR ruling, the remuneration paid to employees is deemed to have been deducted while computing the profits chargeable to tax of the employer i.e., the non-resident aviation company under section 44BBA. Accordingly, the said remuneration paid to non-resident employees shall not be exempt from tax in India.

The claim of the non-resident aviation company is, therefore, not justified.

Note – The question is silent about the country of residence of the employees of the aviation company. Employees may be resident or non-resident in India. In case the remuneration is paid to resident employees, the same is taxable in their hands.

Also, the aviation company can be incorporated in a country with which India has no treaty. Therefore, it is possible to answer the question on the basis of the provisions of section 9(1) alone. Since the services were rendered in India, salary of the employees shall be deemed to accrue or arise in India and therefore, the same attracts tax liability in

India, irrespective of the fact that remuneration was paid out of income of the non-resident company chargeable to tax in India as per the provisions of section 44BBA.

(d) As per section 198, any sum deducted in accordance with the provisions of Chapter XVII-B of the Income-tax Act, 1961 is deemed to be income received while computing the income of the payee.

As per section 203, every person deducting tax at source shall furnish to the payee a certificate in the prescribed form within the prescribed time.

Even in a case where 'X undertakes to pay the tax on the grossed up amount, the non-resident shall be entitled for issue of certificate for tax deducted at source in respect of payment made 'net of tax' in terms of section 195A. This has been clarified vide CBDT Circular No.785 dated 24.11.1999.

Therefore, X has a legal obligation to issue TDS certificate to the non-resident, even if he has made payment of income "net of tax" to him.

Question 6

(a) Mr. Shyam had e-filed his income-tax return for A.Y.2015-16 within the due date declaring a total income of ₹ 9,50,000. Such total income, inter alia, includes dividend from Indian companies of ₹ 50,000 and long term capital gains on sale of shares of ₹ 2,00,000. However, Mr. Shyam correctly disclosed both such incomes in the schedule of exempt income. Consequently, the said return got processed under section 143(1) denying both the above exemptions and intimation was served on Mr. Shyam raising a demand of tax. After receipt of said intimation, assessee filed a revised return but time limit of filing revised return under section 139(5) had lapsed and such revised return was held invalid. Assessee filed for rectification under section 154 which was also rejected by Assessing Officer.

Decide the correctness of action of the Assessing Officer. (4 Marks)

(b) M/s. A Ltd. has received a notice under section 148 for the Assessment Year 2012-13 on 02-02-2016. They also anticipate similar notices for the Assessment Years 2010-11 and 2011-12 for which they have already furnished return of income. On examination of the books of account produced, you have noticed huge amounts of concealed income. As a consultant, what is your advice to A Ltd.? (4 Marks)

(c) Mr. Ravi has gifted his only house property to his wife, Mrs. Ravi, and his married daughter, Mrs. Divya. The Assessing Officer has served a notice of demand on Mr. Ravi for payment of tax for the income derived from the said house property. Examine the validity of the Assessing Officer's action. (2 Marks)

(d) Sachin settled 1/4th share of his property under a trust for the education and maintenance of his minor daughter, Pallavi. Under the terms of the trust deed, the income accruing to the trust, after meeting the expenses of maintenance and education of Pallavi, was to be accumulated and paid over to her on attaining majority. The Assessing Officer assessed

the income arising from 1/4th share of the property, settled for the benefit of Pallavi, in the hands of Sachin.

Can the Assessing Officer do so? *(6 Marks)*

Answer

(a) The facts of the case are similar to the facts in *Sanchit Software and Solutions Pvt. Ltd. v. CIT (2012) 349 ITR 404*, wherein the Bombay High Court observed that the entire object of administration of tax is to secure the revenue for the development of the country and not to charge the assessee more tax than which is due and payable by the assessee.

An error was initially committed by the assessee while e-filing his return. Incomes which were exempt ought not to have been shown as part of his total income. However, the assessee had shown the impugned amounts as exempt, in the schedule of exempt income. While processing such return under section 143(1)(a), the system could not have detected this error and hence was processed, accepting the income returned by the assessee. The Assessing Officer, however, cannot take advantage of a mistake committed by the assessee.[4]

In the case on hand, since there is an error on the face of the intimation under section 143(1), the rectification filed under section 154, obviously within the stipulated time limit, cannot be rejected by the Assessing Officer.

Hence, the action of the Assessing Officer is not correct.

(b) As per section 245C, an assessee may, at any stage of a case relating to him, make an application in the prescribed form and manner to the Settlement Commission.

"Case" means any proceeding for assessment which may be pending before an Assessing Officer on the date on which such application is made.

A proceeding for assessment or reassessment or recomputation under section 147 is deemed to have commenced from the date of issue of notice under section 148. Where a notice under section 148 is issued for any assessment year, a proceeding under section 147 shall be deemed to have commenced on the date of issue of such notice and the assessee can approach the Settlement Commission for other assessment years as well, even if notice under section 148 for such other assessment years have not been issued but could have been issued on that date. However, a return of income for such other assessment years should have been furnished under section 139 or in response to notice under section 142.

In the case on hand, M/s A Ltd. has received a notice under section 148 for the A.Y.2012-13 and also anticipates similar notices for the A.Y.2010-11 and A.Y.2011-12, for which return of income has been furnished. Thus, a proceeding for assessment is

[4] CBDT Circular dated 11th April, 1955

pending before an Assessing Officer i.e., the basic condition for approaching Settlement Commission is satisfied.

Moreover, since after examination of the books of account, huge amount of concealed income is also noticed, it is presumed that the second condition that the additional amount of income-tax payable on the income disclosed in the application should exceed ₹ 10 lakhs has also been satisfied.

Based on these facts, assuming that the necessary conditions are fulfilled, our advice as consultant to M/s A Ltd. would be to approach the Settlement Commission to have his case settled and apply for grant of immunity from penalty and prosecution.

(c) As per section 27(i), an individual who transfers otherwise than for adequate consideration any house property to his spouse, not being a transfer in connection with an agreement to live apart, or to a minor child not being a married daughter shall be deemed to be the owner of the house property so transferred.

Mr. Ravi, in this case, would be the deemed owner only in respect of the share of house property transferred to his wife Mrs. Ravi without consideration and not for the share of the house property transferred to his married daughter Mrs. Divya, even if she is a minor.

Since Mr. Ravi is the deemed owner of the share of house property transferred to his wife without consideration, the income derived from the house property, to the extent attributable to the share of property transferred to his wife without consideration, would be taxable in his hands under the head "Income from house property".

As per section 65, the notice of demand can, however, be served on Mrs. Ravi for payment of that portion of tax levied on Mr. Ravi attributable to the income derived [by virtue of section 27(i)], from the share of house property transferred to Mrs. Ravi, and standing in her name.

However, the income derived from house property, attributable to the share of property transferred to his married daughter without consideration, would be taxable in the hands of his daughter. Such income would not be taxable in the hands of Mr. Ravi. Mr. Ravi will not be responsible for the payment of tax attributable to aforesaid share of income of daughter from house property.

Thus, the action of the Assessing Officer in serving notice of demand on Mr. Ravi for payment of tax for the entire income derived from the said house property is not valid.

(d) As per section 64(1A), the income of a minor child should be included in the total income of that parent, whose total income before such inclusion is higher.

In the case of *CIT v. M.R. Doshi (1995) 211 ITR 1*, the Supreme Court held that where the income from the trust was to be accumulated until the child attained majority, the clubbing provisions would not get attracted; this is so since no benefit (in such accumulated funds) accrues to the minor child during the period when such child is a minor.

However, in this case, the minor daughter Pallavi is eligible for the benefits during the period when she is a minor, since income from the trust is being used for meeting her education and maintenance expenses.

Only the remaining income is to be accumulated and paid over to her on her attaining majority. Therefore, since benefit under the terms of the trust deed is accruing, even though to a limited extent, to the minor daughter Pallavi during the period when she is a minor, the clubbing provisions under section 64(1A) will get attracted.

Applying the rationale of the above ruling, the stand taken by the Assessing Officer to tax the income arising from 1/4th share in the house property, settled for the benefit of Pallavi, in the hands of Sachin is incorrect.

Only so much of income as is used for meeting the education and maintenance expenses of Pallavi during the current year should be clubbed in the hands of Sachin after providing for an exemption of ₹ 1,500 under section 10(32) assuming that Sachin's total income is greater than his spouse's total income.

Question 7

(a) State the rate at which the tax either is to be deducted or collected under the provisions of the Act in the following cases:

(i) A partnership firm making sales of the timber which was procured and obtained under a forest lease.

(ii) Payment of income on investments in the securities to the Foreign Institutional Investor.

(iii) A nationalized bank receiving professional services from a registered society made provision on 31-03-2016 of an amount of ₹ 25 lacs against the service charges bills to be received.

(iv) Payment of ₹ 5 lacs made to Mr. Phelps who is an athlete by a manufacturer of a swim wear for brand ambassador. (4 Marks)

(b) Discuss the liability for tax deduction at source in the following cases for the assessment year 2016-17:

(i) Wings Ltd. has paid amount of ₹ 15 lacs during the year ended 31-3-2016 to Airports Authority of India towards landing and parking charges.

(ii) Omega Ltd., an event management company, organized a concert of international artists in India. In this connection, it engaged the services of an overseas agent Mr. John from UK to bring artists to India. He contacted the artists and negotiated with them for performance in India in terms of the authority given by the company. He did not take part in event organized in India. The company made the payment of commission of ₹ one lac to the overseas agent.

(iii) Ramesh gave a building on sub-lease to Mac Ltd. with effect from 1-7-2015 on a rent of ₹ 15,000 per month. The company also took on hire machinery from Ramesh with effect from 1-11-2015 on hire charges of ₹ 10,000 per month. The rent of building and hire charges of machinery for the year 2015-16 were credited by the company to the account of Ramesh in its books of account on 31-3-2016.

(iv) ₹ 1,95,000 paid to Mr. X on 01-02-2015[5] by Karnataka State Government on compulsory acquisition of his urban land. What would be your answer if the land is agriculture land? *(8 Marks)*

(c) Ravinder, a non-resident, had maintained his permanent house both in U.A.E. and in India during the previous year ended on 31-3-2016 but was having his habitual abode in U.A.E. because of employment. He had income in India from dividend, interest and capital gains during the previous year ended on 31-3-2016 which are not subject to tax under any law in force in U.A.E. There exists a DTAA between India and U.A.E. Ravinder claims that none of the income earned by him in India shall be subject to tax in India because of the benefits available to him under DTAA.

Is the contention of Ravinder correct? *(4 Marks)*

Answer

(a) Applicable Rate of TDS/TCS

Situation	TCS/TDS	Rate	Note
(i) Partnership firm selling timber obtained under forest lease	TCS	2.5%	1
(ii) Payment of income on investments in the securities to the Foreign Institutional Investors	TDS	20.6%	2
In case the securities are Government securities		5.15%	
(iii) Professional services rendered by a registered society to a nationalised bank	TDS	10%	3
(iv) Payment by a manufacturer of swim wear to its brand ambassador Mr. Phelps, an athlete	TDS		4
If Mr. Phelps is a resident		10%	
If Mr. Phelps is a non-resident		20.6%	

Notes:

(1) As per section 206C(1), tax has to be collected at source@2½% by the partnership firm, being a seller, at the time of debiting of the amount payable by the buyer to the account of the buyer or at the time of receipt of such amount, whichever is earlier.

[5] To be read as 01-02-2016

(2) As per section 196D, tax has to be deducted at source @ 20.6% (20% plus cess@3%) by any person who is responsible for paying to a Foreign Institutional Investor, any income by way of interest on securities at the time of credit of such income to the account of the payee or at the time of payment of such income, whichever is earlier.

Alternatively, if the said securities are assumed to be government securities, tax is deductible@5.15% (i.e., 5% plus cess@3%) under section 194LD.

(3) Tax has to be deducted at source@10% under section 194J, by the nationalized bank at the time of credit of fees for professional services to the account of the registered society (i.e., on 31.3.2016), even though payment is to be made after that date.

(4) Tax has to be deducted at source@10% under section 194J[6] in respect of income of ₹ 5 lacs paid to Mr. Phelps, athlete, for advertisement, on the inherent presumption that Mr. Phelps is a resident.

Alternatively, if Mr. Phelps is assumed to be a non-resident, who is not a citizen of India, tax has to be deducted at source@20.6% (20% plus cess 3%) under section 194E in respect of income of ₹ 5 lacs paid to Mr. Phelps, an athlete, for advertisement referred under section 115BBA.

(b) (i) TDS on landing and parking charges: The landing and parking charges which are fixed by the Airports Authority of India are not merely for the "use of the land". These charges are also for services and facilities offered in connection with the aircraft operation at the airport which include providing of air traffic services, ground safety services, aeronautical communication facilities, installation and maintenance of navigational aids and meteorological services at the airport. *[Japan Airlines Co. Ltd. v. CIT / CIT v. Singapore Airlines Ltd. (2015) 377 ITR 372 (SC)]*.

Hence, tax is deductible @2% under section 194C by the airline company, Wings Ltd., on payment of ₹ 15 lacs made towards landing and parking charges to the Airports Authority of India for the previous year 2015-16.

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

Since commission income for contacting and negotiating with artists by Mr. John, a non-resident, who remains outside India is not subject to tax in India[7], consequently, there is no liability for deduction of tax at source. It is assumed that the commission of ₹ 1 lakh was remitted to Mr. John outside India.

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[6] CBDT Circular No.715 dated 8.8.1995

[7] In spite of withdrawal of Circular No.786 dated 7.2.2000 by means of Circular No.7 dated 22.10.2009

(iii) TDS on rent for building and machinery: Tax is deductible on rent under section 194-I, if the aggregate amount of rental income paid or credited to a person exceeds ₹ 1,80,000. Rent includes payment for use of, *inter alia*, building and machinery.

The aggregate payment made by Mac Ltd. to Ramesh towards rent in P.Y.2015-16 is ₹ 1,85,000 (i.e., ₹ 1,35,000 for building and ₹ 50,000 for machinery). Hence, Mac Ltd. has to deduct tax @10% on rent paid for building and tax @ 2% on rent paid for machinery.

(iv) TDS on compensation for compulsory acquisition: Tax is deductible at source @10% under section 194LA, where payment is made to a resident as compensation or enhanced compensation on compulsory acquisition of any immovable property (other than agricultural loan).

However, no tax deduction is required if the aggregate payments in a year does not exceed ₹ 2 lakh.

Therefore, no tax is required to be deducted at source on payment of ₹ 1,95,000 to Mr. X, since the aggregate payment does not exceed ₹ 2 lakh.

Since the definition of immovable property specifically excludes agricultural land, no tax is deductible at source on compensation paid for compulsory acquisition of agricultural land.

(c) As per section 90(1), the Central Government is empowered to enter into an agreement with the Government of any country outside India for avoidance of double taxation of income under the Indian law and the corresponding law of that country. Section 90(2) provides that where the Central Government has entered into an agreement with the Government of any other country for granting relief of tax or for avoidance of double taxation, then, in relation to the assessee to whom such agreement applies, the provisions of the Income-tax Act, 1961 shall apply to the extent they are more beneficial to that assessee.

Mr. Ravinder shall be deemed to be resident of that country with which he has closer personal and economic relations. Since Mr. Ravinder has a permanent home in UAE and he also has a habitual abode in that country due to his employment in UAE, he shall be deemed to be resident of UAE for A.Y. 2016-17.

However, in order to claim relief under the double taxation avoidance agreement (DTAA), Mr. Ravinder has to obtain a certificate [Tax Residency Certificate (TRC)] declaring his residence of UAE from the Government of that country. Further, he also has to provide such other documents and information, as may be prescribed [Section 90(4)].

As regards dividend income from an Indian company, the same is in any case exempt in the hands of the recipient under section 10(34), since the Indian company is liable to

dividend distribution tax in respect of such income. Therefore, the same would be exempt in the hands of Ravinder by virtue of the provisions of the Income-tax Act, 1961.

As regards, interest income and capital gains, if a concessional rate of tax is provided under the DTAA with UAE, such income would be subject to tax at such concessional rate in the hands of Mr. Ravinder. If the concessional rates provided under the Income-tax Act, 1961 in respect of interest and capital gains are more beneficial than the rates provided under the DTAA, the income would be subject to tax at such concessional rates in India. Further, if long-term capital gains have arisen on account of sale of listed shares in recognized stock exchange, the same would be exempt in the hands of the non-resident under section 10(38) as per the provisions of the Income-tax Act, 1961.

Therefore, the contention of Mr. Ravinder is not entirely correct, since the DTAA does not provide for exemption from income-tax in India, of all such income earned in India, in totality.

Note – Articles 10, 11 and 13 of the DTAA between India and UAE deal with dividend, interest and capital gains, respectively.