FINAL EXAMINATION

June 2018

P–16(DTI)
Syllabus 2016

Direct Tax Laws and International Taxation

Time Allowed: 3 Hours

Full Marks: 100

The figures in the margin on the right side indicated full marks.

Wherever required the candidate may make suitable assumption(s) and state the same clearly in the Answer.

Working notes should form part of the relevant answer.

All questions relate to the Income-tax Act, 1961.

All the questions relate to Assessment Year 2018-19, unless otherwise stated.

Answer Question No.1 *which is compulsory and* any five *from* Question No. 2 *to* Question No. 8.

Section–A

1. Choose the most appropriate alternative and give justification in brief / brief working for your answer: 2×10=20

(i) When Mr. Hari engaged in manufacturing acitivity with turnover of ₹ 125 lakhs has realized sale proceeds through banking channel of ₹ 90 lakhs and balance by cash, his income under section 44AD would be

(A) ₹ 10 lakhs

(B) ₹ 7·50 lakhs

(C) ₹ 8·20 lakhs

(D) Not eligible for presumptive income under section 44AD

(ii) When a company engaged in the business of bio-technology incurs (i) expenditure on scientific research towards land and building ₹ 20 lakhs; (ii) other capital expenditures ₹ 10 lakhs and (iii) revenue expenditure of ₹ 8 lakhs. The quantum of deduction under section 35 (2AB) shall be

(A) Nil

(B) ₹ 16 lakhs (200% of revenue expenditure)

(C) ₹ 27 lakhs (150% of total expenditure other than cost of land and building)

(D) ₹ 38 lakhs (100% of capital expenditure including cost of land and building)

(iii) Mr. Malik received a notice under section 148 for the assessment year 2013-14 in March, 2018. He wants to make application to the Settlement Commission. The additional amount of income-tax payable on the income disclosed in the application to the Settlement Commission must exceed _________.

(A) ₹ 5 lakhs

(B) ₹ 10 lakhs

(C) ₹ 25 lakhs

(D) ₹ 50 lakhs

(iv) ABC & Co. Ltd. earned ₹ 15 lakhs by way of transfer of carbon credit. The tax liability in respect of carbon credit is

(A) Nil

(B) ₹ 1,54,500 (@10·3%)

(C) ₹ 4,63,500 (@30·9%)

(D) ₹ 2,31,750 (@15·45%)

(v) When Mr. Atul doing business has gross total income of ₹ 9 lakhs, the maximum amount he can claim deduction in respect of the pension scheme of the Central Government under section 80CCD would be

(A) ₹ 50,000 (monetary limit)

(B) ₹ 90,000 (10% of gross total income)

(C) ₹ 1,00,000 (monetary limit)

(D) ₹ 1,80,000 (20% of gross total income)

(vi) When interest paid by an Indian company to a foreign company being an associated enterprise, such interest must not exceed _________ % of the Indian company's earnings before interest, taxes, depreciation and amortization (EBITDA).

(A) 10

(B) 20

(C) 30

(D) 40

(vii) Secondary adjustment has to be made when the primary adjustment exceeds _______.

(A) ₹ 50 lakhs

(B) ₹ 100 lakhs

(C) ₹ 300 lakhs

(D) ₹ 500 lakhs

(viii) When Mr. Singhania having total income exceeding ₹ 10 lakhs files the return of income for the assessment year 2018-19 in January, 2019, the fee payable under section 234F for the delayed filing of return would be

(A) ₹ 1,000

(B) ₹ 5,000

(C) ₹ 10,000

(D) ₹ 20,000

(ix) When Mr. Gautam doing business paid hall rent of ₹ 80,000 for 3 days for doing Diwali sale, the amount of tax deductible at source under section 194-IB would be

(A) ₹ 8,000 @ 10%

(B) ₹ 16,000 @ 20%

(C) Nil

(D) ₹ 4,000 @ 5%

(x) When an Indian company pays ₹ 5 lakhs to a foreign company for online advertisement of its products, it has to deduct

(A) tax at source @ 2%

(B) tax at source @ 10%

(C) equalization levy @ 6%

(D) equalization levy @ 8%

Section–B

2. (a) PQR Co. Ltd. engaged in manufacturing activity reports a Net Profit of ₹ 15 lakhs for the year ended 31.03.2018. The below said items are debited / credited to statement of profit and loss. 12

(i) CSR expenditure incurred during the year ₹ 5 lakhs.

(ii) Non-compete fee paid to DEF Ltd for not marketing their products in North-Eastern States ₹ 10 lakhs. The non-complete agreement bars DEF Ltd for a period of 5 years ending 31.03.2022. No tax was deducted at source on the said payment.

(iii) A building was constructed on the leasehold land for ₹ 30 lakhs and it was completed on 30.11.2017. The lease agreement is for 3 years and after the lease period, the building must be handed over to the lessor.

(iv) The company during the year paid donation of ₹ 1 lakh to Dalmia Research Centre Ltd. which is engaged in approved scientific research.

(v) The company introduced VRS scheme during the financial year 2014-15 and paid ₹ 60 lakhs as VRS compensation. The company transferred the entire unamortized amount of ₹ 24 lakhs to statement of profit and loss.

(vi) Paid ₹ 2 lakhs to Registrar of Companies as fee for issue of bonus shares.

(vii) It incurred ₹ 25 lakhs towards feasibility study for new product manufacture which eventually was aborted.

(viii) Cost of EPABX and mobile phones acquired on 01.06.2017 for use by executives ₹ 10 lakhs. Depreciation @ 60% was charged in the books.

(ix) Compounding fee paid for violation of municipal laws in construction of buildings ₹ 1,20,000.

(x) Depreciation debited ₹ 24,60,000.

(xi) Royalty from patent developed by the company credited to Statement of profit and loss ₹ 22 lakhs.

(xii) Dividend received from foreign company in which the assessee company holds 26% shares ₹ 8 lakhs.

Additional Information:

Eligible depreciation ₹ 32,30,000 under section 32 without considering item (iii) and (viii) given above.

You are required to compute the total income and income tax liability of PQR Ltd for the assessment year 2018-19.

Note: Your answer must be supported by reasons for treatment of each item. Ignore MAT provisions.

(b) A partnership firm with three equal partners authorized payment of monthly salary of ₹ 1 lakh each to all the partners w.e.f. 01.04.2017. Earlier, the partnership deed authorized payment of monthly salary of ₹ 50,000 each to all the partners. The business of the firm has more than doubled during the financial year 2017-18 and the partners anticipating such increase in business/profit have changed accordingly the condition for working partner salary.

The profit of the firm was ₹ 50 lakhs for the year ended 31.03.2018 and the corresponding profit was ₹ 20 lakhs for the year ended 31.03.2017. The partners of the firm want to know whether increase in payment of salary to working partners would be subjected to disallowance under section 40A(2)(a). 4

3. (a) S Limited, an Indian Company supplied billets to its holding company, G Limited, Germany during the previous year 2016-17. S Limited also supplied the same product to another German-based company, Z Limited, an unrelated entity. The transactions with G Limited are priced at Euro 500 per MT (FOB), whereas the transactions with Z Limited are priced at Euro 900 per MT (CIF). Insurance and Freight amounts to Euro 300 per MT. Compute the arm's length price for the transaction with G Limited.

During the year, 10,000 MT were supplied to G Limited. What will be the effect of the change in the ALP on the profits of S Limited? Assuming that its export profits are covered by exemption u/s 10AA (seventh year), will there be any increase in the quantum of exemption u/s 10AA? Assume an exchange rate of 1 Euro = 90 INR. 8

(b) Enumerate the consequences that would ensue if the Assessing Officer makes adjustment to arm's length price in international transactions of the assessee resulting in increase in total income of the assessee. What are the remedies available to an assessee to dispute such adjustment made? 4

(c) When is a transaction treated as an international transaction for the transfer pricing provisions as per section 92CB? 4

4. (a) Mahavishnu Tea Pvt. Ltd., is engaged in the business of tea as well as development of infrastructural facility (covered by section 35 AD).

The company has brought forward business loss of 3 lakhs from tea business and ₹ 4 crores from the business of infrastructural facility, relating to the AY 2017-18.

During the year ended 31.03.2018, the company has shown a net profit of ₹ 82 lakhs from business of tea in its books, before current depreciation of ₹ 12 lakhs.

From the infrastructural facility business, it has earned profit of ₹ 2·2 crores.

The company has credited a sum of ₹ 30 lakhs in the share application money on 28-2-2018, for which it is unable to explain the source satisfactorily.

Compute the total income of the company for the assessment year 2018-19. 8

(b) Lakshmi Fertilizers Ltd. set up an industrial unit for manufacturing fertilizers in notified backward area in the State of Bihar, on 11.05.2016.

The following details of investment in plant and machinery are made available to you:

Date of investment/ installation	**Type of assets purchased**	**Amount (₹ in crores)**
21-7-2017	Plant and machinery (including second hand machinery ₹ 2 crores)	32
1-12-2017	Plant and machinery	10

All the assets were put to use immediately. Excepting the machinery for ₹ 2 crores, all other assets are new.

Compute the depreciation allowable under section 32 of the Income-tax Act, 1961 and the WDV of the relevant block of assets.

Is the assessee entitled for any other benefit in respect of aforesaid investments? If so, what is the benefit available?

Would your answer be different where such manufacturing unit is set up by a partnership firm?

Append suitable notes, wherever required. 8

5. (a) Fried pepper Inc (FPI), a foreign company, is supplying frozen chicken to several Indian concerns, including LMN & Co. FPI has made an application to the AAR for determination of the rate of tax to be applied on its total income arising from the said operations in India.

LMN & Co, has made an application to the ITO, TDS Ward for determination of the rate of tax to be deducted at source from payments to be made to FPI.

The AAR wants to reject the application of FPI on the ground that the matter is already pending before the income-tax authority. Is this stand tenable in law? 6

(b) Anupam Gulati, a resident in India, is a famous badminton player, who plays in several tournaments. For the year ended 31-03-2018, he has derived income from playing in tournaments outside India and also share income from a firm, from nations with which no DTAA exists.

The summarized results of the income earned during the year are as under:

	₹
Income from tournaments in India	32,50,000
Income from tournaments outside India (as converted into INR)	16,00,000
Share of loss from a partnership firm abroad (Set off permitted in that nation)	2,00,000
Residential house property purchased at Colombo (including registration and stamp duty for ₹ 1,80,000)	4,00,00,000

On the foreign income, he has paid tax of ₹ 3,50,000.

You are required to compute the tax payable by the assessee. 6

(c) India Telephones Ltd. paid ₹ 15 lakhs per annum to Bharat Mobiles Ltd. for each of the mobile towers used by it. During the financial year 2017-18, India Telephones Ltd. paid ₹ 435 lakhs to Bharat Mobiles Ltd. It deducted tax at source under section 194C and whereas the Assessing Officer claimed that the assessee must have deducted tax at 10% under section 194-I. Decide the correctness of the action of assessee *vis a vis* the Assessing Officer. 4

6. (a) Search under section 132 was conducted in the premises of Mr. Balaji on 15.12.2017. Incriminating materials such as unaccounted sale deed dated 08.10.2009 for ₹ 60 lakhs and company deposits dated 05.07.2006 for ₹ 30 lakhs were found in addition to unaccounted transactions of his business by name Balaji Traders which commenced from 01.04.2013. The assessment under section 143(3) for the assessment year 2016-17 is pending and reassessment proceeding for the assessment year 2015-16 was also pending on the date of search.

(i) State the assessment years for which notice can be issued for making post search assessments.

(ii) What will happen to regular assessment under section 143(3) and reassessment under section 147 because of search?

(iii) Can the unaccounted company deposits be subjected to tax in case Mr. Balaji is a non-resident? 6

(b) Monohar & Hari LLP is engaged in multiple business activities. The following information is furnished for the year ended 31.03.2018:

(i) Net profit as per Profit and Loss Account ₹ 52 lakhs.

(ii) Working partner salary debited to profit and loss account ₹ 40,20,000 as authorized by the LLP agreement.

(iii) Interest on capital paid to partners @ 15% ₹ 15,75,000. This is authorized by the LLP agreement.

(iv) Depreciation debited to profit and loss account ₹ 8,10,000.

(v) Eligible depreciation under section 32 ₹ 10,35,000.

(vi) The Net Profit includes profit from under taking located in SEZ (4th year) ₹ 20 lakhs. The total turnover is ₹ 200 lakhs and the export turnover is ₹ 150 lakhs.

(vii) The unit has earned income from generation of power and the eligible deduction under section 80-IA amounts to ₹ 8 lakhs.

You are required to compute the total income of the firm and also the alternative minimum tax (AMT) and decide the final tax liability of the firm for the assessment year 2018-19. 10

7. (a) Kite & Co. (firm) had sold all its assets and liabilities on 31.03.2018 to ABC Co. (P) Ltd. for a lump sum consideration of ₹ 500 lakhs.

The Balance Sheet of Kite & Co. as on 31.03.2018 is as below:

Liabilities	**₹ in lakhs**	**Assets**	**₹ in lakhs**	
Capital	1,500	*Fixed Assets*:		
Unsecured loans	100	Plant & Machinery at WDV	300	
Bank borrowing	700	Land (At revalued figure)	1,200	
Sundry Creditors	200			1,500
		Current Assets:		
		Sundry Debtors	500	
		Cash & Bank balance	50	
		Loans & Advances	340	
		Closing stock	110	
				1,000
	2,500			2,500

Additional Information:

(1) The land was acquired in March, 2006 for ₹ 200 lakhs.

(2) WDV of plant & machinery under section 43(6) was ₹ 250 lakhs.

(3) Cost inflation index for the financial year 2005-06 was 117 and for 2017-18 is 272.

(4) Stock is overvalued by 10%.

(5) Loans and advances include ₹ 150 lakhs due from ABC Co. (P) Ltd.

Compute capital gain arising from slump sale and tax liability on such gain. 7

(b) Mr. Prasoon acquired a vacant land at Cuttack in April, 2000 for ₹ 2 lakhs. He went out of India for employment in USA in June 2004. He contemplated return to India and begin a start-up business in the manufacture of medicines. In October, 2017 he entered into an agreement for sale of land for ₹ 100 lakhs to Mr. Rahul. The sale took place in March, 2018. The fair market value as on 01.04.2001 was ₹ 5 lakhs.

Mr. Prasoon wants to start a company for manufacture of medicine by using the sale proceeds besides availing loan from financial institutions. He wants to know the conditions of section 54 GB which are to be satisfied for the purpose of availing exemption under section 54 GB and the conditions for availing tax holiday under section 80-IAC for the new business. Advise him with brief points the conditions to be satisfied for optimum tax benefit. 9

8. In the light of decided case laws, answer ***any four*** of the following [Your answer should be under the following heads: (i) Issue involved (ii) Brief discussion on provisions applicable to the issue (iii) Analysis of the issue involved and (iv) Conclusion (*Citation of the case law is NOT required*)]: 4×4=16

(a) Bharathi Co-operative Housing Society collects fees at the time of transfer of flat, from the outgoing member, as well as the incoming member. As per the bye-laws, the receipts are used for meeting the various expenses of the society. During the year ended 31-03-2018, the society has collected a sum of ₹ 5 lakhs as transfer fees from outgoing members and like amount from the incoming members. The Assessing Officer (AO) has brought to tax the entire receipts of ₹ 10 lakhs. Is his action valid in law?

(b) Kaushiba Logistics Pvt. Ltd., borrowed a sum of ₹ 50 lakhs from a bank for business purposes. For the sanction of the bank loan, two directors gave guarantee to the bank. The assessee paid guarantee commission of ₹ 80,000 to the two directors in this regard and claimed the same as business expenditure. The AO has disallowed the same on the ground that this is an indirect payement of dividend to the two directors. Is this correct?

(c) A, B and C were partners in the firm RR & Co. B died on 31-03-2017. The firm was dissolved and the business was continued in the same name by A. The firm had unabsorbed losses to the tune of ₹ 10 lakhs. Against the individual business income earned by A, the losses of the erstwhile firm were set off. This has been disallowed by the AO. Is this disallowance justified?

(d) Saravanan & Co., a firm, had borrowed moneys for its windmills, on which interest of ₹ 23 lakhs had been paid by the firm. The income from the generation and distribution of electricity by the windmills was subject to 100% deduction u/s 80-IA. The Assessing Officer wants to disallow the interest of ₹ 23 lakhs, invoking section 14A. Is he justified?

(e) Saipriya Charities had applied for registration of the trust u/s 12AA on 01-04-2017. No order was passed in this regard by the Commissioner of Income-tax/Director (Exemptions). Hence the trust took the view that its application was accepted and proceeded to file its return of income. Is this view of the trust correct in law?