

**MOCK TEST PAPER**  
**FINAL (NEW) COURSE: GROUP – II**  
**PAPER – 7: DIRECT TAX LAWS & INTERNATIONAL TAXATION**  
**SOLUTIONS**

**Division A – Multiple Choice Questions**

| MCQ No. | Sub-part | Most Appropriate Answer |
|---------|----------|-------------------------|
| 1.      | (i)      | (c)                     |
|         | (ii)     | (b)                     |
|         | (iii)    | (c)                     |
|         | (iv)     | (c)                     |
| 2.      | (i)      | (b)                     |
|         | (ii)     | (a)                     |
|         | (iii)    | (a)                     |
|         | (iv)     | (c)                     |

| MCQ No. | Most Appropriate Answer |
|---------|-------------------------|
| 3.      | (a)                     |
| 4.      | (a)                     |
| 5.      | (b)                     |
| 6.      | (b)                     |
| 7.      | (d)                     |
| 8.      | (c)                     |
| 9.      | (b)                     |
| 10.     | (a)                     |

**Division B – Descriptive Questions**

**1. Computation of Total Income of KMP Construction Ltd. for the A.Y.2020-21**

|          | Particulars   | Amount (₹) |           |
|----------|---|------------|-----------|
| <b>I</b> | <b>Profits and gains of business and profession</b>   |            |           |
|          | Net profit as per the statement of profit and loss  |            | 85,00,000 |
|          | <b>Add: Items debited but to be considered separately or to be disallowed</b>   |            |           |
|          | (a) <b>Interest to public financial institution paid on 20.12.2020</b>  | 3,00,000   |           |
|          | [Disallowance under section 43B would be attracted for A.Y.2020-21, since the interest is paid on or after 30.11.2020, being the due date of filing of return]  |            |           |
|          | (b) <b>Fees for technical services paid to non-resident without deduction of tax at source</b>  | 6,00,000   |           |
|          | [Disallowance of 100% of the amount towards fees for technical services to a non-resident, would be attracted under section 40(a)(i) during the previous year 2019-20 since tax was deducted and paid during the subsequent previous year i.e., P.Y. 2020-21] |            |           |
|          | (c) <b>Damages paid to State Government for defects in construction of flyover</b>  | -          |           |

|   |           |             |
|---|-----------|-------------|
| <p>[Payment of damages as per the terms of the contract for defects in construction is compensatory in nature and incurred in the normal course of construction business, and hence, such expenditure is deductible under section 37.</p> <p>Since such payment is debited to the statement of profit and loss, no further adjustment is required]</p>  |           |             |
| <p>(e) <b>Marked to market losses</b></p> <p>[As per ICDS I, marked to market losses cannot be recognized unless the recognition of such loss is in accordance with the provisions of any other ICDS. Since such losses have been debited to the statement of profit and loss, they have to be added back for computing business income]</p>  | 6,00,000  | 15,00,000   |
| <p><b>Less: Items credited to statement of profit and loss, but not includible in business income</b></p>   |           | 1,00,00,000 |
| <p>(f) <b>Profit on sale of land to wholly owned subsidiary</b></p> <p>[Income is chargeable to tax under the head “Capital Gains”. Since the same has been credited to statement of profit and loss, it has to be reduced while computing business income]</p>   | 10,00,000 |             |
| <p>(g) <b>Retention money</b></p> <p>[Section 43CB read with ICDS III requires recognition of contract revenue, including retention money, on percentage of completion method.</p> <p>Since such amount has been credited to the statement of profit and loss, no adjustment is required]</p>   | -         |             |
| <p>(h) <b>Interest on bank fixed deposit</b></p> <p>[Since the fixed deposit has been made with a bank as margin money for obtaining a guarantee required by a State Government for a particular contract, interest income of such deposit is inextricably linked to the business of the assessee and hence, has to be treated as business income and not as income from other sources [CIT v. K and Co. (2014) 364 ITR 93 (Del)]</p> <p>Since the same has been credited to the statement of profit and loss, no adjustment is required]</p> | -         |             |
| <p>(i) <b>Income received from REIT</b></p> <p>Short-term capital gain component of ₹ 6 lakhs is taxable in the hands of REIT and hence, exempt in the hands of the unit holder under section 10(23FD). Since ₹6 lakhs has been credited to the statement of profit and loss, the same has to be deducted for computing business income</p>   | 6,00,000  |             |
| <p><b>Rental income component distributed by REIT</b></p> <p>As per section 115UA(3), such income would be deemed as income in the hands of unit holder. By</p>   | -         | 16,00,000   |

|    |   |                  |                  |
|----|---|------------------|------------------|
|    | <p>virtue of section 115UA(1), income distributed by REIT to a unit holder would be deemed to be of the same nature and same proportion in the hands of the unit holder as it had been received by or accrued to the REIT.</p> <p>Accordingly, rental income component would be taxable under the head "Profits and gains of business and profession" as per the Supreme Court decision in <i>Chennai Properties and Investments Ltd. (2015) 373 ITR 673</i>, since REIT is engaged in the business of letting out real estate properties<sup>1</sup>.</p> <p>Since ₹ 4 lakhs has been credited to the statement of profit and loss, no adjustment is required]</p>   |                  |                  |
|    | <p><b>Less: Permissible deduction</b></p> <p>Depreciation</p> <p>Depreciation of ₹ 25 lakh computed as per Income-tax Rules, 1962 is allowable as deduction u/s 32. However, depreciation of ₹ 20 lakh has only been charged in the statement of profit and loss. Therefore, the difference of ₹ 5 lakh has to be deducted for computing business income]</p>   |                  | 84,00,000        |
|    |   |                  | 5,00,000         |
|    | <p><b>Profits and gains from business and profession</b></p>  |                  | 79,00,000        |
| II | <p><b>Capital Gains</b></p> <p>Full value of consideration under section 50C</p> <p>[Stamp duty value of ₹ 50 lakh would be deemed as full value of consideration since it is higher than 105% of actual consideration of ₹ 40 lakh (i.e., Cost of ₹ 30 lakh + Profit of ₹ 10 lakh)]</p> <p>Less: Indexed Cost of Acquisition [₹ 30,00,000 × 289/254]</p> <p><b>[Note - Even though KMP Construction Ltd. holds 100% of shareholding of N Inc., transfer of land by KMP Construction Ltd. to N Inc. would be regarded as a transfer for the purpose of levy of capital gains, since N Inc. is not an Indian company].</b></p> <p><b>Long-term capital gain [Since held for a period of more than 24 months]</b></p> | 50,00,000        |                  |
|    |   | <u>34,13,386</u> |                  |
|    | <p><b>Gross Total Income</b></p>  |                  | 94,86,614        |
|    | <p><b>Less: Deduction under Chapter VI-A</b></p> <p>Deduction u/s 80JJAA [See Working Note below]</p>   |                  | 12,96,000        |
|    | <p><b>Total Income</b></p>  |                  | <b>81,90,614</b> |
|    | <p><b>Total Income (rounded off)</b></p>  |                  | <b>81,90,610</b> |

<sup>1</sup>As per SEBI (REIT) Regulations, 2014, not less than 80% of value of the REIT assets shall be invested in completed and rent generating properties

**Working Note: Computation of deduction u/s 80JJAA**

- (i) Since casual employees do not participate in recognized provident fund, they do not qualify as additional employees. Further, 25 regular employees employed on 1.5.2019 also do not qualify as additional employees since their monthly emoluments exceed ₹ 25,000. Also, 10 regular employees employed on 1.9.2019 do not qualify as additional employees for the P.Y.2019-20, since they are employed for less than 240 days in that year.

Therefore, only 15 employees employed on 1.4.2019 qualify as additional employees, and the total emoluments paid or payable to them during the P.Y.2019-20 is deemed to be the additional employee cost. Additional employee cost = ₹ 24,000 × 15 × 12 = ₹ 43,20,000

Deduction under section 80JJAA = 30% of ₹ 43,20,000 = ₹ 12,96,000.

- (ii) As regards 10 regular employees employed on 1.9.2019, they would be treated as additional employees for previous year 2020-21, if they continue to be employees in that year for a minimum period of 240 days. Accordingly, 30% of additional employee cost in respect of such employees would be allowable as deduction under section 80JJAA during the A.Y. 2021-22.

**2. (a) Computation of total income of XYZ LLP for A.Y. 2020-21**

| Particulars  | ₹ (in lacs)       |
|--|-------------------|
| Profit from Unit X [₹ 502 lakhs + ₹ 24 lakhs, being disallowance u/s 43B]  | 526               |
| Profit from Unit Y [₹ 753 lacs + ₹ 47 lacs, being disallowance u/s 40A(3)] | <u>800</u>        |
|  | 1326              |
| Less: Deduction under section 10AA [See Working Note below]                | <u>348</u>        |
| <b>Total Income</b>  | <b><u>978</u></b> |
| Tax on total income@30%  | 293.40            |
| Add: Surcharge@12%, since total income > ₹ 1 crore                         | <u>35.21</u>      |
|  | 328.61            |
| Add: Health and Education cess @4%   | <u>13.14</u>      |
| <b>Tax liability (as per normal provisions)</b>                            | <b>341.75</b>     |

**Computation of Adjusted total income and Alternate Minimum tax of XYZ LLP as per the provisions of section 115JC for A.Y. 2020-21**

| Particulars  | ₹ (in lakh)          |
|--|----------------------|
| Total income as per the normal provisions                      | 978                  |
| Add: Exemption under section 10AA                              | <u>348</u>           |
| Adjusted Total Income  | <u>1326</u>          |
| Tax@18.5% of Adjusted Total Income                             | 245.31               |
| Add: Surcharge @12% as the adjusted total income is > ₹1 crore | <u>29.44</u>         |
|  | 274.75               |
| Add: Health and Education cess @4%                             | <u>10.99</u>         |
| <b>Alternate Minimum Tax as per section 115JC</b>              | <b><u>285.74</u></b> |

Since the tax payable as per the normal provisions of the Act is more than the alternate minimum tax payable, XYZ LLP is liable to pay tax as per normal provisions of the Income-tax Act. Accordingly, the tax payable for A.Y. 2020-21 would be ₹ 341.75 lakhs.

**Working Note:****Computation of deduction under section 10AA in respect of Unit X located in a SEZ**

| Particulars   | ₹ (in lacs)       |
|---|-------------------|
| <b>Total turnover of Unit X =</b><br>(₹ 1200 lacs + ₹ 200 lacs) – ₹ 200 lacs, being freight and insurance included therein. Since freight and insurance has been excluded from export turnover, the same has to be excluded from total turnover also <sup>2</sup> | 1200              |
| <b>Export Turnover of Unit X</b>  |                   |
| Export sale proceeds received in India  | 1040              |
| Less: Insurance and freight not includible in export turnover   | <u>140</u>        |
|   | <b><u>900</u></b> |
| <b>Profit “derived from” Unit X</b>   |                   |
| Net profit for the year   | 502               |
| Add: Disallowance under section 43B   | <u>24</u>         |
|   | 526               |
| <b>Less: Items of business income which are in the nature of ancillary profits and hence, do not constitute profit ‘derived from’ business for the purpose of exemption under section 10AA<sup>3</sup></b>  |                   |
| Duty drawback   | 38                |
| Profit on sale of import entitlement  | <u>24</u>         |
|   | <u>62</u>         |
|   | <b><u>464</u></b> |
| <b>Deduction under section 10AA</b>   |                   |
| Export turnover of Unit X   |                   |
| Profit derived from Unit X    x    -----    x 100%  |                   |
| Total turnover of Unit X  |                   |
| <b>= 464 x 900/1200 x 100% =</b>  | <b>348</b>        |

- (b) (i) Subject to the provisions of Rule 10MA, the agreement may provide for determining the arm’s length price or specifying the manner in which arm’s length price shall be determined in relation to the international transaction entered into by the person during the rollback year.

The relevant limb of the rule mandates that the applicability of rollback provision, in respect of an international transaction, has to be requested by the applicant for all the rollback years in which the said international transaction has been undertaken by the applicant

As per *Circular No.10/2015 dated 10.06.2015* issued by the CBDT, the applicant does not have the option to choose the years for which it wants to apply for rollback in application filed under rule 10MA(2)(iv) of Income-tax Rules, 1962. The applicant has to either apply for all the four years or not apply at all.

However, if the covered international transaction(s) did not exist in a rollback year or there is some disqualification in a rollback year, then, the applicant can apply for rollback for less than four years.

<sup>2</sup> CIT v. Dell International Services India P. Ltd. (2012) 206 Taxman 107 (Karnataka)

<sup>3</sup> CIT v. Orchev Pharma P. Ltd. (2013) 354 ITR 227 (SC)

Accordingly, if the covered international transaction(s) were not in existence during any of the rollback years, the applicant can apply for rollback for the remaining years.

Similarly, if in any of the rollback years for the covered international transaction(s), the applicant fails the test of the rollback conditions contained in various provisions, then, it would be denied the benefit of rollback for that rollback year. However, for other rollback years, it can still apply for rollback.

- (ii) As per section 5(2), the total income of a non-resident would include all income which is, *inter alia*, deemed to accrue or arise to him in India in that previous year.

In case of a non-resident, being a person engaged in the business of banking, any interest payable by the Permanent Establishment (PE) in India of such non-resident to the head office or any PE or any other part of such non-resident outside India, shall be deemed to accrue or arise in India [*Explanation* to section 9(1)(v)].

In the present case, the Indian branch, being a fixed place of business, is the PE in India of Texo Bank Ltd., being a non-resident engaged in the banking business, since such business is carried on in India through the Indian branch [Clause (iia) of section 92F].

Accordingly, the interest of ₹ 35 lakhs paid to its head office in California and ₹ 15 lakhs paid to the other branch office in Sydney by the Indian branch [being the PE in India of Texo Bank Ltd, a non-resident engaged in the business of banking] shall be deemed to accrue or arise in India and shall be liable to tax in India in the hands of head office and Sydney branch, respectively, in addition to any income attributable to the PE in India.

3. (a) **Computation of total income of Sarv Mangal Charitable Trust for the A.Y.2020-21**

| Particulars   | ₹         | ₹                |
|---|-----------|------------------|
| Gross receipts from Hospital  |           | 2,00,00,000      |
| Add: Anonymous donations [to the extent not chargeable to tax@30% under section 115BBC(1)(i)] [ <b>See Note 1 &amp; 2</b> ]   |           | <u>3,00,000</u>  |
|   |           | 2,03,00,000      |
| Less: 15% of income eligible for being set apart without any condition <sup>4</sup>   |           | <u>30,45,000</u> |
|   |           | 1,72,55,000      |
| Less: Amount applied for charitable purposes  |           |                  |
| - <b>On revenue account</b> – Administrative expenses   | 75,00,000 |                  |
| [Expenditure on Repair and maintenance for which payment was made in cash would be disallowed by virtue <i>Explanation 3 to section 11(1)</i> read with section 40A(3). Therefore, ₹ 2,00,000 would be disallowed out of ₹ 77,00,000] |           |                  |
| - <b>On capital account</b> – Land & Building [Section 56(2)(x) is not attracted in respect of value of property received by a trust or institution registered u/s 12AA for inadequate consideration]                                 | 80,00,000 |                  |
| - <b>Corpus donation to “Serve the Poor” Trust registered</b>   |           |                  |

<sup>4</sup> As per the Supreme Court ruling in *CIT v. Programme for Community Organisation (2001) 116 Taxman 608*, 15% of gross receipts would be eligible for accumulation under section 11(1)(a). However, as per the plain reading of section 11(1)(a), only 15% of income would be eligible for accumulation under section 11(1)(a).

|  |   |                         |
|--|---|-------------------------|
| u/s 12AA – not allowable even if it is out of current year income of the trust             | - | <u>1,55,00,000</u>      |
| <b>Total income [other than anonymous donation taxable@30% under section 115BBC(1)(i)]</b> |   | <b>17,55,000</b>        |
| Add: Anonymous donation taxable @30% u/s 115BBC(1)(i) [See Note 1]                         |   | <u>9,00,000</u>         |
| <b>Total Income of the trust (including anonymous donation taxable@30%)</b>                |   | <b><u>26,55,000</u></b> |

**Computation of tax liability of the trust for the A.Y. 2020-21**

| Particulars   | ₹               | ₹                      |
|---|-----------------|------------------------|
| <b>Tax on total income of ₹ 17,55,000 [Excluding anonymous donations]</b> |                 |                        |
| Upto ₹ 2,50,000   | Nil             |                        |
| ₹ 2,50,001 – ₹ 5,00,000 [₹ 2,50,000 x 5%]                                 | 12,500          |                        |
| ₹ 5,00,001 – ₹ 10,00,000 [₹ 5,00,000 x 20%]                               | 1,00,000        |                        |
| > ₹ 10,00,000 [₹ 7,55,000 x 30%]  | <u>2,26,500</u> |                        |
|   | 3,39,000        |                        |
| Tax on anonymous donations taxable@30% [₹ 9,00,000 x 30%]                 | 2,70,000        | 6,09,000               |
| Add: Health and education cess @4%  |                 | 24,360                 |
| <b>Total tax liability</b>  |                 | <b><u>6,33,360</u></b> |

**Notes:**

|   |             |             |
|---|-------------|-------------|
| (1) Anonymous donations taxable @30%                | ₹           | ₹           |
| Anonymous Donations received (lakhs)                |             | 12.00       |
| 5% of total donations received, i.e. 5% of 60 lakhs | 3.00        |             |
| Monetary limit                                      | <u>1.00</u> |             |
| Higher of the above                                 |             | <u>3.00</u> |
| Anonymous donations taxable@30%                     |             | <u>9.00</u> |

- (2) The provisions of section 13(7) have been interpreted in a manner that it excludes only anonymous donations subject to tax@30% under section 115BBC(1)(i). All taxable income of the trust [excluding anonymous donations taxable@30% u/s 115BBC(1)(i)] falls under section 115BBC(1)(ii), and are subject to tax at normal rates and eligible for benefit of unconditional accumulation u/s 11(1). Anonymous donation of ₹ 3,00,000 taxable at normal rates also falls under section 115BBC(1)(ii) and hence, like other taxable income of the trust falling within the scope of this clause, the same would also be eligible for the benefit of unconditional accumulation under section 11(1). The above solution has been worked out on the basis of this interpretation of section 13(7). Accordingly, in the above solution, the benefit of unconditional accumulation upto 15% under section 11(1) has been given in respect of anonymous donation of ₹ 3,00,000 subject to tax at normal rates.

However, an alternative view is also possible on the basis of the plain reading of section 13(7), as per which anonymous donation referred to in section 115BBC has to be excluded from the purview of exemption under sections 11 and 12. As per this view, even the anonymous donations of ₹ 3,00,000 subject to tax at normal rates would not be eligible for unconditional accumulation of upto 15%.



- (3) Corpus donations, whether received by way of cheque or cash, are not includible in the total income of the trust by virtue of section 11(1)(d).
- (4) Since the trust follows cash system of accounting, fees not realized from patients would not form part of gross receipts. Therefore, there is no need of applying the provisions of *Explanation 1* to section 11(1) to exclude such income.
- (5) Where the cost of assets is claimed as application, no deduction for depreciation on such assets would be allowed in determining income for the purposes of application. Therefore, since cost of assets of the trust has been claimed as application of income in earlier years, no depreciation would be allowed on these assets while determining income for the purposes of application.

**(b) (i) Principle of *Contemporanea Expositio***

A treaty's terms are normally to be interpreted on the basis of their meaning at the time the treaty was concluded. However, this is not a universal principle.

In *Abdul RazakA. Meman's* (2005) 276 ITR 306, the AAR observed that "there can be little doubt that while interpreting treaties, regard should be had to material *contemporanea expositio*. This proposition is embodied in article 32 of the Vienna Convention and is also referred to in the decision of the Hon'ble Supreme Court in *K. P. Varghese v. ITO* [1981] 131 ITR 597.

**(ii) Purposive Interpretation**

In this approach the treaty is to be interpreted so as to facilitate the attainment of the aims and objectives of the treaty. This approach is also known as the 'objects and purpose' method.

In case of *Union of India v. AzadiBachaoAndolan* 263 ITR 706, the Supreme Court observed that "the principles adopted for interpretation of treaties are not the same as those in interpretation of statutory legislation. The interpretation of provisions of an international treaty, including one for double taxation relief, is that the treaties are entered into at a political level and have several considerations as their bases."

One instance is where the Apex Court agreed with the contention of the Appellant that "the preamble to the Indo-Mauritius DTAA recites that it is for 'encouragement of mutual trade and investment' and this aspect of the matter cannot be lost sight of while interpreting the treaty.

- 4. (a) (i) Tax is deductible under section 194-I on rent, if the aggregate amount of rental income paid or credited to a person exceeds ₹ 2,40,000. Tax is deductible at the time of payment or credit, whichever is earlier. Rent includes payment under any lease or sub-lease for use of, *inter alia*, building and machinery.

The aggregate amount credited by MT Ltd. to the account of Raghav in its books of account on 31.3.2020 towards rent for the P.Y.2019-20 is ₹ 2,90,000 [i.e., ₹ 2,00,000 (₹ 20,000 × 10) for building and ₹ 90,000 (₹ 15,000 × 6) for machinery]. Hence, MT Ltd. has to deduct tax @10% on rent credited for building and tax @ 2% on rent credited for machinery.

- (ii) In the present case, TDS under section 194J would not be attracted in respect of fees for professional services even though the turnover from the business exceeds ₹ 100 lakhs during the preceding financial year or aggregate amount of fees for professional services paid to a resident during the financial year exceed ₹ 30,000, since such sum is paid exclusively for personal purposes. TDS provisions u/s 194M would, however, be attracted, since TDS is not required to be deducted under section 194J on account of being paid for personal services and the amount of fees of professional services exceed the threshold limit of ₹ 50,00,000.



Accordingly, Mr. Sarthak is required to deduct tax @5% under section 194M on the amount of ₹ 54,00,000, being the fees for professional services paid to the architect for furnishing his residential house.

- (b) As per the first proviso to section 201(1), any person (including the principal officer of the company) who fails to deduct the whole or any part of the tax on the amount credited or payment made to a payee shall not be deemed to be an assessee-in-default in respect of such tax if such payee has included the warehouse charges for computing its income, paid tax thereon and filed its return of income under section 139.

Thus, the difference amount of TDS cannot be recovered from A Ltd., since MNO Warehousing has paid tax on the entire amount of warehousing charges.

However, A Ltd. has to pay interest under section 201(1A)(i) i.e., @1% p.m. or part of month, from the date on which such tax was deductible to the date of furnishing of return of income by such payee i.e., MNO Warehousing.

- (c) S Ltd, an Indian company and B Inc., France based company are deemed to be associated enterprises as per section 92A(2)(a), since B Inc. holds shares carrying not less than 26% of the voting power in S Ltd.

As per *Explanation* to section 92B, the transactions entered into between these two companies for sale of product, lending or guarantee and provision of services relating to market research are included within the meaning of "international transaction".

Accordingly, transfer pricing provisions would be attracted and the income arising from such international transactions have to be computed having regard to the arm's length price. In this case, from the information given, the arm's length price has to be determined taking the comparable uncontrolled price method to be the most appropriate method.

| Particulars   | ₹ in lakhs          |
|---|---------------------|
| Amount by which total income of S Ltd. is enhanced on account of adjustment in the value of international transactions: |                     |
| (i) Difference in price of shirt @ \$ 1 each for 45,000 pieces sold to Breek Inc. (\$ 1 x 45,000 x 70)                  | 31.50               |
| (ii) Difference for excess payment of guarantee fee to B Inc. for loan borrowed from foreign lender (\$ 2,000 x 70)     | 1.40                |
| (iii) Difference for excess payment for services to B Inc. (\$ 1,000 x 70)  | <u>0.70</u>         |
|   | <b><u>33.60</u></b> |

S Ltd. cannot claim deduction under section 10AA in respect of ₹ 33.60 lakhs, being the amount of income by which the total income is enhanced by virtue of the first proviso to section 92C(4).

5. (a) (i) Under section 268A(1), the CBDT is empowered to issue orders, instructions or directions to the other income-tax authorities, fixing such monetary limits, as it may deem fit, to regulate filing of appeal or application for reference by any income-tax authority.

Under section 268A(2), where an income-tax authority has not filed any appeal or application for reference on any issue in the case of an assessee for any assessment year, due to above-mentioned order/instruction/direction of the CBDT, such authority shall not be precluded from filing an appeal or application for reference on the same issue in the case of the same assessee for any other assessment year or any other assessee for the same or any other assessment year. Further, in such a case, it shall not be lawful for an assessee to contend that the income-tax authority has acquiesced in the decision on the disputed issue by not filing an appeal or application for reference in any case.

In view of above provision, it would be in order for the Income-tax Department to move an appeal to the Tribunal against the orders of the CIT(A) in respect of A.Y.2020-21 both for Sarita and Sagar, if it meets the criterion laid down vide CBDT Circular.

- (ii) Section 276CC provides for prosecution for wilful failure to furnish a return of income within the prescribed time, in a case where tax would have been evaded had the failure not been discovered. Since the amount of tax which would have been evaded does not exceed ₹ 25 lakh, the imprisonment would be for a term of 3 months to 2 years. In addition, fine would also be attracted.

However, in a case where the return of income is not filed within the due date, prosecution proceedings will not be attracted if the tax payable by a person, other than a company, on the total income determined on regular assessment, as reduced by the advance tax, if any, paid and any tax deducted at source, does not exceed ₹ 10,000.

In this case, even though the tax liability of the firm as per the original order of assessment exceeded ₹ 10,000, however, as a result of the order of the Commissioner (Appeals), it got reduced to ₹ 2,750, which is less than ₹ 10,000. Therefore, since the tax liability of the firm on final assessment was determined at ₹ 2,750, the prosecution proceedings are not maintainable.

In *Guru Nanak Enterprises v. ITO (2005) 279 ITR 30*, where the facts were similar, the Supreme Court held that prosecution was unwarranted.

- (iii) This issue came up before the Supreme Court in *K. Lakshmansa and Co. v. Commissioner of Income-tax and Anr [2017] 399 ITR 657*. The Supreme Court observed that the right to claim refund is automatic once the statutory provisions have been complied with. The statutory obligation to refund, being non-discretionary, carries with it the right to interest. Section 244A is clear and plain – it grants a substantive right of interest and is not procedural.

Under section 244A, it is enough if the refund becomes due under the Income-tax Act, 1961, in which case, the assessee shall, subject to the provisions of that section, be entitled to receive simple interest. The expression “due” only means that a refund becomes due pursuant to an order under the Act which either reduces or waives tax or interest. It does not matter that the interest being waived is discretionary in nature; the moment that discretion is exercised and refund becomes due consequently, a concomitant right to claim interest springs into being in favour of the assessee.

Applying the rationale of the Supreme Court ruling to the case on hand, the action of the Settlement Commission in refusing to grant interest on refund is **not correct**.

**(b) (i) Where Tyrax Inc., a US company, does not have a PE in India**

In this case, Tyrax Inc. would be eligible for a concessional rate of tax@10% of ₹ 1.5 crore under section 115A on the fees for technical services received from ATP Ltd., an Indian company, since the same is in pursuance of an agreement entered into after 31.3.1976, which has been approved by the Central Government. No deduction, however, would be allowed in respect of expenditure of ₹ 7.2 lakhs incurred to earn such income. Also, Tyrax Inc. has to file its return of income in India under section 139, hence, there is no exemption in this regard.

- (ii) Where Tyrax Inc., a US company, has a PE in India and rendering technical services is effectively connected with the PE in India.**

Since Tyrax Inc. carries on business through a PE in India, in pursuance of an agreement with ATP Ltd. or other Indian companies entered into after 31.3.2003, and the income by way of fees for technical services is effectively connected with the PE in India, such income

shall be computed under the head “Profits and gains of business or profession” in accordance with section 44DA of the Income-tax Act, 1961.

Accordingly, expenses of ₹ 17 lakhs (₹ 5 lakhs + ₹ 12 lakhs) incurred for earning fees for technical services of ₹ 7.3 crore (₹ 2.5 crore + ₹ 4.8 crore) is allowable as deduction therefrom. However, expenditure of ₹ 6.3 lakhs which is not incurred wholly and exclusively for the business of the PE and the amount of ₹ 12.7 lakhs paid by the PE to the Head Office is **not** allowable as deduction.

Tyrax Inc. is required to maintain books of account under section 44AA and get the same audited under section 44AB and furnish report along with the return of income under section 139.

6. (a) The right of membership is not a private asset and it is merely a personal privilege granted to the member. It is non-transferable and incapable of alienation by the member or his legal representative except to the limited extent provided in the rules and regulations of the stock exchange and subject to the fulfillment of conditions prescribed by the stock exchange. The nomination, even if permitted, is subject to the rules and is not automatic. The right of nomination is vested in the stock exchange absolutely in the case of death of or default of a member.

Thus, the membership card is not the property of the assessee and therefore cannot be attached under section 281B. It has been so held by the Apex Court in the case of *Stock Exchange Ahmedabad vs. ACIT (2001) 248 ITR 209*.

**(b) Tax Planning / Tax Management / Tax Evasion**

|       | <b>Answer</b> | <b>Reason</b>  |
|-------|---------------|--|
| (i)   | Tax planning  | Depositing money in PPF and claiming deduction under section 80C is as per the provisions of law. Hence, it is a legitimate tax planning measure which enables her to reduce her tax liability by claiming a deduction permissible under the Income-tax Act, 1961.   |
| (iii) | Tax evasion   | An air conditioner fitted at the residence of a director as per the terms of his appointment would be a furniture qualifying for depreciation@10%, whereas an air conditioner fitted in a factory would be a plant qualifying for a higher depreciation@15%. The wrong treatment unjustifiably increases the amount of depreciation and consequently, reduces profit and consequent tax liability. Treatment of air-conditioner fitted at the residence of a director as a plant fitted at the factory would tantamount to furnishing of false particulars with an attempt to evade tax. |

- (c) (i) The issue under consideration in this case is whether consideration for supply of software embedded in hardware would tantamount to ‘royalty’ for attracting deemed accrual of income under section 9(1)(vi).

As per section 9(1)(vi), income by way of royalty payable by a person who is a resident in India would be deemed to accrue or arise in India. However, where it is payable for the transfer of any right or the use of any property or information or for the utilization of services for the purposes of a business or profession carried on by such person outside India or for the purposes of making or earning any income from any source outside India, the amount payable by way royalty would not be deemed to accrue or arise in India, in the hands of non-resident.

For this purpose, 'royalty' includes transfer of all or any right for use or right to use a computer software irrespective of the medium through which such right is transferred.

The facts of the case are similar to the facts in *CIT v. Alcatel Lucent Canada (2015) 372 ITR 476*, wherein the above issue came up before the Delhi High Court. The Court observed that the software supply is an integral part of GSM mobile telephone system and is used by the cellular operators for providing cellular services to its customers. Where payment is made for hardware in which the software is embedded and the software does not have independent functional existence, no amount could be attributed as 'royalty' for software in terms of section 9(1)(vi).

In this case, since the software that was loaded on the hardware and embedded in the system does not have any independent existence, there could not be any independent use of such software. Therefore, the rationale of the Delhi High Court ruling can be applied to the case on hand. Accordingly, the action of the Assessing Officer in treating the consideration for supply of software embedded in hardware as royalty under section 9(1)(vi) is **not** correct.

- (ii) The Calcutta High Court in *Indcom v. CIT (TDS)(2011) 335 ITR 485* has held that 'match referee' would not fall within the meaning of "sportsmen" to attract the provisions of section 115BBA. Therefore, although the payments made to non-resident 'match referee' are "income" which has accrued and arisen in India, the same are not taxable under the provisions of section 115BBA. They are subject to the normal rates of tax.

| Particulars   | ₹             |
|---|---------------|
| Tax@30% under section 115BB on winnings of ₹30,000 from horse races   | 9,000         |
| <b>Tax on ₹ 8,30,000 at normal rates of tax</b> [Since he is a non-resident, he is not eligible for higher basic exemption limit of ₹ 3,00,000 even if he of the age of 60 years or more] |               |
| Upto ₹ 2,50,000   | Nil           |
| 2,50,001 – 5,00,000 @5%   | 12,500        |
| 5,00,001 – 8,30,000 @ 20%   | 66,000        |
|   | 87,500        |
| Add: Health and Education cess@4%   | 3,500         |
| <b>Tax liability</b>  | <b>91,000</b> |