

PAPER – 7 : DIRECT TAX LAWS

Working notes should form part of the respective answers.

Question No.1 is compulsory.

Answer any five questions from the remaining six questions.

All questions relate to the assessment year 2016-17, unless stated otherwise in the question.

Question 1

(a) KDS Realty Trust., a business trust registered under SEBI (Real Estate Investment Trusts) Regulations, 2014 provides the following particulars of its income for the previous year 2015-16:

- (i) Rental income ₹ 3 crore, from the directly owned real estate assets;
- (ii) Short term capital gain ₹ 1.5 crore, on sale of listed shares of Brahma Ltd., an Indian company in which KDS Realty Trust holds controlling interest through holding 60% of the shareholding of Brahma Ltd.
- (iii) Short term capital gain ₹ 2 crore, on sale of development properties;
- (iv) Interest ₹ 1 crore, received from investments in unlisted debentures of real estate companies;
- (v) Dividend ₹ 3.5 crore from Brahma Ltd.

Other Information:

KDS Realty Trust has distributed ₹ 10 crore to its unit holders in the previous year 2015-16.

Discuss the tax implications (including TDS implications) based on the above income earned by KDS Realty Trust, both in the hands of KDS Realty Trust and its unit holders in the previous year 2015-16. (10 Marks)

(b) Mr. Raghu purchased 10,000 equity shares of AB Avenues Private Limited on 25-05-2004 for ₹ 1,20,000. The company went into liquidation on 31-07-2015. The following is the summarized financial position of the company as on 31-7-2015.

Liabilities	₹	Assets	₹
60,000 equity shares of ₹ 10 each	6,00,000	Agricultural lands in urban area	22,00,000
General reserve	40,00,000	Cash at bank	32,14,305
Liability for income tax	<u>8,14,305</u>		<u> </u>
	54,14,305		54,14,305

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 November, 2016 examination. The relevant assessment year is A.Y.2016-17.

The assets remaining after discharging liability for income tax were distributed to the shareholders in the proportion of their shareholding. The market value of agricultural land as on 31-07-2015 is ₹ 60,00,000.

The agricultural land received as above was sold by Mr. Raghu on 28-02-2016 for ₹ 15,00,000.

Discuss the tax implications in the hand of the company and Mr. Raghu.

The cost inflation indices are F.Y. 2004-05: 480 and F.Y. 2015-16: 1081. (10 Marks)

Answer

(a)

	Particulars	Tax treatment in the hands of	
		KDS Realty Trust (REIT)	Unit Holders
(1)	(2)	(3)	(4)
(i)	Rental income of ₹ 3 crores of REIT from directly owned real estate assets	Any income of a business trust, being a REIT, by way of renting or leasing or letting out any real estate asset owned directly by such business trust is exempt in its hands as per section 10(23FCA). Consequently, the rental income is exempt in the hands of the REIT.	The distributed income or any part thereof, received by a unit holder from the REIT, which is in the nature of income by way of renting or leasing or letting out any real estate asset owned directly by such REIT is deemed income of the unit holder as per section 115UA(3). Therefore, such income is taxable in their hands. The component of rental income received from REIT in the hands of each unit holder would be determined in the proportion of 3/11 by virtue of section 115UA(1).

		As per section 194LBA, REIT to deduct tax@10% in case of distribution of such rental income component to a resident unit holder and at rates in force in case of distribution to a non-resident unit holder.	
(ii)	Short-term capital gains of ₹ 1.5 crore on sale of listed shares of Brahma Ltd.	As per section 115UA(2), the total income of a business trust shall be chargeable to tax at the maximum marginal rate, subject to the provisions of sections 111A and 112. Accordingly, KDS Realty Trust is liable to tax@15% under section 111A in respect of short-term capital gains on sale of listed shares of special purpose vehicle i.e., Brahma Ltd.¹ No tax is deductible at source on the short-term capital gain component of income distributed by the REIT to the unit holders.	Any distributed income referred to in section 115UA, to the extent it does not comprise of interest referred to in section 10(23FC) and rental income referred to in section 10(23FCA), received by unit holders is exempt in their hands under section 10(23FD). Hence, the short-term capital gain component of income will not be taxable in the hands of the unit holders.
(iii)	Short-term capital gains of ₹ 2 crore on sale of developmental properties	Further, the short-term capital gains of ₹ 2 crore on sale of developmental properties is taxable at maximum marginal rate ² , in the hands of the KDS	There would be no tax liability on the short-term capital gain component of income distributed to unit holders by virtue of the

¹ Since Brahma Ltd. is an Indian company in which the KDS Realty trust holds controlling interest and 60% of shareholding, it is a special purpose vehicle (SPV). It is presumed that Brahma Ltd. fulfills the other conditions specified in the regulations to qualify as an SPV.

² Maximum Marginal rate is 34.608%

		Realty trust as per section 115UA(2). No tax is deductible at source on the short-term capital gain component of the income distributed by the REIT to the unit holders.	exemption contained in section 10(23FD).
(iv)	Interest of ₹ 1 crore received in respect of investment in unlisted debentures of real estate companies	Interest income received in respect of investment in unlisted debentures of real estate companies is taxable at the maximum marginal rate³, in the hands of the KDS Realty trust as per section 115UA(2) No tax is deductible at source when on the interest component of the income is distributed to the unit holders by the REIT.	No tax liability on interest component of income distributed to unit holders in their hands by virtue of section 10(23FD).
(v)	Dividend income of ₹ 3.50 crore from Brahma Ltd.	There would be no tax liability in the hands of the business trust since dividend is subject to dividend distribution tax in the hands of Brahma Ltd; Hence, the dividend income is exempt in the hands of the business trust under section 10(34). No tax is deductible at source on the dividend component of the income is distributed to the unit holders by the REIT.	No tax liability on the dividend component of income distributed to unit holders in their hands by virtue of section 10(23FD).

(b) Tax implications in the hands of the company

Distribution of capital assets amongst the shareholders on liquidation of the company is not regarded as “transfer” in the hands of the company. Consequently, there will be no capital gains in the hands of the company as per section 46(1).

Any distribution made to the shareholders of a company on its liquidation, to the extent to which distribution is attributable to the accumulated profits of the company immediately before its liquidation would be deemed as dividend under section 2(22)(c). Therefore,

³ Maximum Marginal rate is 34.608%

distribution made to shareholders to the extent of ₹ 40,00,000, being the amount of general reserves on the date of liquidation would be deemed as dividend.

Company is liable to pay dividend distribution tax @15% plus surcharge @ 12% plus education cess and secondary and higher education cess @3% on such deemed dividend of ₹ 40,00,000. Dividend Distribution tax would be computed as follows:

Particulars	₹
Net distributed profits to the extent of accumulated profits	40,00,000
Add: Increase for the purpose of grossing up (40,00,000x15/85)	<u>7,05,882</u>
Gross Dividend	<u>47,05,882</u>
Additional income-tax payable under section 115-O	7,05,882
Add: Surcharge@12%	<u>84,706</u>
	7,90,588
Add: Education cess@2% and SHEC@1%	<u>23,718</u>
Dividend Distribution tax payable	<u>8,14,306</u>

Note: As per sub-section (1B) of section 115-O, for the purpose of grossing up, the rate specified in sub-section (1) has to be considered. The rate specified in sub-section (1) is 15%.

However, it is also possible to take a view that grossing up should be done at the rate of 17.304% (that is, 15% plus surcharge@12% plus education cess and SHEC@3%), which is the effective rate of dividend distribution tax.

Tax implications in the hands of Mr. Raghu (shareholder)

(i) On liquidation (31.07.2015)

As per section 46(2), where a shareholder on the liquidation of a company receives any money or other assets from the company, he shall be chargeable to income-tax under the head "capital gains" in respect of the money so received or the market value of the other assets on the date of the distribution, as reduced by the amount assessed as dividend under section 2(22)(c) and the sum so arrived at shall be deemed to be the full value of consideration for the purpose of section 48.

Particulars	₹
Mr. Raghu holds 1/6 th of the shareholding of the company	
Market value of agricultural land received (₹ 60 Lakhs x 1/6 th)	10,00,000
Cash at bank [1/6 th of (₹ 32,14,305 – ₹ 8,14,305)]	
The tax liability ascertained at ₹ 8,14,305 has to be reduced from bank balance while computing full value of consideration under section 46(2).	<u>4,00,000</u>
	14,00,000

Less: Deemed dividend under section 2(22)(c) - 1/6 th of ₹ 40,00,000	<u>6,66,667</u>
Consideration for computing Capital Gain	7,33,333
Less: Indexed cost of acquisition of Shares (₹ 1,20,000 x 1081/480)	<u>2,70,250</u>
Long term capital gains	<u>4,63,083</u>

Dividend under section 2(22)(c) amounting to ₹ 6,66,667 will be exempt under section 10(34).

(ii) On sale of agriculture land

Where the capital asset became the property of the assessee on the distribution of the capital assets of a company on its liquidation and the assessee has been assessed to capital gains in respect of that asset under section 46, the cost of acquisition means the fair market value of the asset on the date of distribution as per section 55(2)(b)(iii). Hence, the **short-term capital gains** in the hands of Mr. Raghu (shareholder) at the time of sale of urban agricultural land should be computed as follows:

Particulars	₹
Sale consideration	15,00,000
Less: Fair market value of the agricultural land on the date of distribution	<u>10,00,000</u>
Short term capital gain	<u>5,00,000</u>

Question 2

Statement of Profit & Loss of BM Private Ltd., a resident company engaged in manufacturing, shows net profit of ₹90,00,000 for the financial year ended on 31st March, 2016 after debit/credit of the following items.

A. Credited to the Statement of Profit and Loss:

- (i) Rent received from vacant land ₹1,20,000
- (ii) Rent received (gross) from a commercial property owned by the company ₹2,50,000 (Tax deducted by tenant @ 10%)
- (iii) Interest received on income tax refund ₹1,00,000
- (iv) Profit on sale of unused land ₹10,00,000.

B. Debited to the Statement of Profit and Loss:

- (i) Depreciation charged to the Statement of Profit and Loss ₹12,00,000.
- (ii) Donation of ₹1,00,000 paid to Swachh Bharat Kosh.

- (iii) Contribution to Political Party amounting to ₹ 2,00,000 paid in cash.
- (iv) Payment made to transporter ₹ 1,00,000 by account payee cheque, but no tax has been deducted at source. (Transporter is having PAN and furnished declaration that he is covered under section 44AE and not having more than 10 goods carriages at any time during the previous year).
- (v) Bonus to employees ₹ 2,00,000 provided. However, payment was made on the occasion of Diwali festival on 18th October, 2016.
- (vi) Provision made for income tax ₹ 3,00,000 (including interest of ₹ 50,000 thereon)
- (vii) Contribution of ₹ 1,00,000 to a University approved and notified under section 35(1)(ii)
- (viii) Loss of ₹ 2,50,000 incurred by way of trading in futures and options (derivatives) in stocks in a recognized stock exchange.

Additional information:

- (1) Depreciation as per Income-tax Act, 1961 ₹ 20,00,000. However, while calculating such depreciation, rate applicable to computers has been adopted for (i) accessories like printers and scanners, and (ii) EPABX. The written down value of these items as on 01.04.2015 is given below:
 - (a) Printers and Scanners ₹ 3,00,000
 - (b) EPABX ₹ 5,00,000
- (2) Additional depreciation on plant and machinery purchased for ₹ 20,00,000 on 15th October, 2015 has not been considered while calculating depreciation as per Income-tax Act, 1961 as above.
- (3) Provision for audit fee ₹ 1,00,000 was made in the books for the year ended on 31st March, 2015 without deducting tax at source.
Such fee was paid to auditors in September 2015 after deducting tax at source under Section 194J and tax so deducted was deposited on 6th October, 2015.
- (4) The company during the financial year 2013-14 made a provision for an outstanding bill of ₹ 1,00,000 for purchase of raw material. Out of such outstanding amount, the company has paid ₹ 50,000 in cash on 15th September, 2015.
- (5) During the year, the company has issued 1,00,000 equity shares of face value of ₹ 10 each at premium of ₹ 90 each. The fair market value is ₹ 60 per share at the time of issue of shares.
- (6) Unused land which was sold during the year for ₹ 50,00,000 was acquired by the company in the financial year 2012-13 for ₹ 40,00,000.
- (7) Cost Inflation Index – FY 2012-13: 852; FY 2015-16: 1081

(16 Marks)

Compute total income of the company for the Assessment Year 2016-17 stating reasons for treatment of each item. Ignore provisions relating to Minimum Alternate Tax. (16 Marks)

Answer

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

	Particulars	Amount (₹)	
I	Income from house property [Rental income from commercial property] Gross Annual Value ⁴ /Net Annual Value ⁵ Less: Deduction under section 24(a) 30% of Net Annual Value	2,50,000 <u>75,000</u>	1,75,000
II	Profits and gains of business and profession Profits from manufacturing business [See Working Note below] Less: Set-off of losses from trading in derivatives in a recognized stock exchange [allowed to be set-off against profits from the business of manufacturing as per section 70(1) since it is not speculative in nature [See Note 2 below]	77,50,000 <u>2,50,000</u>	75,00,000
III	Capital Gains [See Note 1 below] Sale consideration Less: Indexed Cost of Acquisition [₹ 40,00,000 × 1081/852] Long-term capital loss to be carried forward to A.Y.2017-18 for set-off against long-term capital gains, if any, in that year	50,00,000 <u>50,75,117</u> (75,117)	
IV	Income from Other Sources Rent received from vacant land Interest received on income-tax refund	 1,20,000 1,00,000	

⁴ Rent received has been taken as the Gross Annual Value(GAV) in the absence of information relating to Municipal Value, Fair Rent and Standard rent.

⁵ Since the question does not contain information about municipal taxes paid, the net annual value is the same as the GAV.

Excess of issue price of shares over the fair market value of shares is taxable as per section 56(2)(viib) in the case of BM Pvt. Ltd., not being a company in which public are substantially interested [₹ 40 (i.e., ₹ 100 – ₹ 60) × 1,00,000 shares]	40,00,000	42,20,000
Gross Total Income		1,18,95,000
Less: Deductions under Chapter VI-A		
Deduction under section 80G Donation to Swachh Bharat Kosh ⁶ [qualifies for 100% deduction – assuming that the same has not been spent in pursuance of corporate social responsibility under section 135(5) of the Companies Act, 2013]	1,00,000	
Deduction under section 80GGB Contribution to Political Party [Not allowable as deduction since the contribution is made in cash]	Nil	1,00,000
Total Income		1,17,95,000

Working Note:

Computation of profits and gains from the business of manufacturing

Particulars	Amount (₹)	
Profits and Gains from Business and Profession		
Net profit as per profit and loss account		90,00,000
Add: Items debited but to be considered separately or to be disallowed		
B(ii) Donation paid to Swachh Bharat Kosh, considered separately [not an expenditure incurred wholly and exclusively for the manufacturing business. Hence, not allowable under section 37]	1,00,000	
B(iii) Contribution to political party [not an expenditure incurred wholly and exclusively for the manufacturing business. Hence, not allowable under section 37]	2,00,000	
B(iv) Payment to transport contractor [As per section 194C(6), no tax is required to be deducted at source since the payment is to a transport contractor not having more than 10 goods carriages at any time during the	-	

⁶ Assumed to be paid by a mode other than cash

previous year and he has given a declaration to that effect along with his PAN. Hence, disallowance under section 40(a)(ia) for non-deduction of tax at source is not attracted. Also, since payment is made by account payee cheque, no disallowance under section 40A(3) is attracted].		
B(v) Bonus to employees [Since the payment is made after the due date of filing return of income, disallowance under section 43B is attracted]	2,00,000	
B(vi) Provision for income-tax (including interest of ₹ 50,000 thereon) [Not allowable as deduction. Disallowance under section 40(a)(ii) is attracted]	3,00,000	
B(viii) Loss from trading in futures and options (derivatives) in stock in a recognized stock exchange (See Note 2 below) [Since loss from trading in futures and options in stock is not related to the business of manufacturing, the same is not incurred wholly and exclusively for this business, and hence, is not allowable as deduction under section 37 while computing profits from the business of manufacturing]	2,50,000	
		10,50,000
Add: Cash Payment for purchase of raw material deemed as income		1,00,50,000
AI(4) [Since the provision for outstanding bill for purchase of raw material has been allowed as deduction during the P.Y.2013-14, cash payment in excess of ₹ 20,000 against such bill in the P.Y.2015-16 would be deemed as income of P.Y.2015-16 as per section 40A(3A)]		50,000
		1,01,00,000
Less: Expenditure to be allowed		
B(i) & AI(1) Depreciation [Difference between the normal depreciation of ₹ 17.75 lakhs as per Income-tax Act, 1961 [See Note below] and depreciation charged to the statement of profit and loss of ₹ 12 lakhs].	5,75,000	

Note – ⁷Printers and scanners form an integral part of the computer system and they cannot be used without the computer. Hence, they are part of the computer system, they would be eligible for depreciation at the higher rate of 60% applicable to computers including computer software. However, EPABX is not a computer and is, hence, not entitled to higher depreciation@60%⁸

Particulars	₹
Depreciation computed as per Income-tax Act, 1961	20,00,000
Less: Depreciation@60% wrongly provided in respect of EPABX = 60% of ₹ 5,00,000	<u>3,00,000</u>
	17,00,000
Add: Depreciation@15% on EPABX = 15% of ₹ 5,00,000	<u>75,000</u>
Correct Depreciation as per Income-tax Act, 1961	<u>17,75,000</u>

AI(2) Additional depreciation on new plant and machinery

Since plant and machinery was purchased only on 15.10.2015, it was put to use for less than 180 days during the year. Hence additional depreciation is to be restricted to 10% (i.e., 50% of 20%) of ₹ 20 lakhs.⁹

2,00,000

AI(3) Audit Fees relating to P.Y.2014-15

[₹ 30,000, being 30% of audit fees of ₹ 1,00,000 provided for in the books of account of F.Y.2014-15 would have been disallowed due to non-deduction and deposit of tax at source. Since tax has been deducted in September, 2015 and paid on 6.10.2015, the amount of ₹ 30,000 is deductible while computing business income of P.Y.2015-16].

30,000

B(vii) Contribution to University

[Contribution to a University approved and notified under section 35(1)(ii) would qualify for weighted deduction@175%. Since ₹ 1,00,000 has already been debited to the statement of profit and loss, the balance ₹ 75,000 has to be deducted while computing business income]

75,000

8,80,000

⁷ CIT v. BSES Yamuna Powers Ltd (2013) 358 ITR 47 (Delhi)

⁸ Federal Bank Ltd. v. ACIT (2011) 332 ITR 319 (Kerala)

⁹ Balance additional depreciation of ₹ 2 lakhs can be claimed in the next year i.e., A.Y.2017-18

		92,20,000
Less: Items credited to statement of profit and loss, but not includible in business income.		
A(i) Rent received from vacant land [Chargeable to tax under the head "Income from other sources"]	1,20,000	
A(ii) Rent received from commercial property owned by the company [Chargeable to tax under the head "Income from house property"]	2,50,000	
A(iii) Interest received on income tax refund [Chargeable to tax under the head "Income from other sources"]	1,00,000	
A(iv) Profit on sale of unused land [Chargeable to tax under the head "Capital Gains"]	10,00,000	
		14,70,000
Profits and gains from the business of manufacturing		77,50,000

Notes:

- (1) In case of unused land sold during the year, the financial year of purchase has been given as 2012-13 and the year of sale is the current financial year i.e. F.Y.2015-16. The date/month of purchase and sale is not given in the question. In our solution, we have assumed the unused land to be a long-term capital asset and accordingly, the resultant long-term capital loss has to be carried forward to A.Y.2017-18 for set-off against long-term capital gains in that year. If the same is considered to be a short-term capital asset, the short term capital gains computed would be ₹ 10 lakhs. In such a case, his gross total income would be ₹ 1,28,95,000 and total income would be ₹ 1,27,95,000.
- (2) As per section 43(5), an eligible transaction of trading in derivatives in stocks in a recognized stock exchange is not a speculative transaction.

In this case, the company is engaged in the business of manufacturing and hence, the loss on account of trading in derivatives is not incurred wholly and exclusively in relation to such business and hence, has to be disallowed while computing profits from the business of manufacturing. Trading in derivatives in stocks is also not incidental to the business of manufacturing. Therefore, it has to be assumed that the company is also carrying on the business of trading in derivatives in stocks in addition to its manufacturing business.

In this case, the loss has to be disallowed at the first instance while computing income from the business of manufacturing since it is not wholly and exclusively incurred for the said business and thereafter, loss from trading in derivatives has to be set-off against the profits from manufacturing business applying the provisions of section 70(1) permitting inter-source set-off of losses.

Question 3

- (a) As per agreement between S Limited, a company incorporated in Korea and Bharti Motors Limited, an Indian company, S limited rendered both off-shore and on-shore technical services to Bharti Motors Limited for setting up a car manufacturing plant in Gujarat. S Limited rendered off-shore services and on-shore services at a fee of ₹ 2 crore and ₹ 3 crore, respectively. S Limited claims that it is not liable to tax in India in respect of fee of ₹ 2 crore as it is for rendering services outside India. Is the view taken by S Limited correct? (4 Marks)
- (b) Keeping in view that Yoga is the present focus area and has been granted international recognition by the United Nations Organisation (UNO), an institution called "Hindustan Mahan" having 'Yoga' as its main object was registered under section 12AA. For the previous year 2015-16, the total receipts of the institution are ₹135 lakhs including ₹ 26.5 lakhs from business activity.
- (i) State with reasons whether the institution will continue to retain its "Charitable Status" and be eligible for exemption under section 11 for the Assessment Year 2016-17.
- (ii) What would have been the effect, had the main object of the institution been "advancement of any other object of general public utility" and it had applied its receipts from business activities towards such main object? (6 Marks)
- (c) During the previous year 2015-16, Ms. Indu, a citizen of India is a resident of both India and a foreign country with which India has a Double Tax Avoidance Agreement (DTAA), which provides that "the income would be taxable in country where it is earned and not in other country, but would be included for computation of tax rate in such other country". Her income is ₹ 3,25,000 from business in India and ₹ 6,00,000 from business in foreign country. In foreign country, the rate of tax is 20%. During the year, she paid a premium of ₹ 32,000 to insure the health of her mother, a non-resident, aged 82 years, not dependent on her, through her credit card.
- (i) Compute the tax payable by Ms. Indu in India for the A.Y. 2016-17.
- (ii) Also, show the tax payable by Ms. Indu in India, had there been no DTAA with such foreign country. (6 Marks)

Answer

- (a) As per section 9(1)(vii), income by way of fees for technical services payable by a person who is a resident would be deemed to accrue or arise in India except where the fees are payable in respect of services utilized in 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.

As per Explanation below section 9(2), income by way of, *inter alia*, fees for technical services from services utilized in India would be deemed to accrue or arise in India under

section 9(1)(vii) in case of a non-resident and be included in his total income, whether or not such services were rendered in India.

In this case, the technical services rendered by the foreign company, S Ltd., were for setting up a car manufacturing plant in Gujarat by Bharti Motors Ltd., an Indian company. Therefore, the services were utilized in India.

Consequently, the fee of ₹ 5 crore for technical services rendered by S Ltd. (both off-shore and on-shore services) to Bharati Motors Limited is deemed to accrue or arise in India and includible in the total income of S Ltd.

Therefore, the view of S Ltd. that it is not liable to tax in India in respect of fee of ₹ 2 crore (as it is for rendering services outside India) is **not correct**.

- (b) (i) As per section 2(15), “Charitable purpose” includes relief of the poor, education, *yoga*, medical relief, preservation of environment etc. or objects of artistic or historic interest and the advancement of any other object of general public utility.

Since *yoga* has been specifically included in the definition of “charitable purpose” it would no longer fall under the residual clause “advancement of any other object of general public utility”.

Therefore, “Hindustan Mahan” an institution having yoga as its main object would not be subject to the restriction which is applicable to the “advancement of any other object of general public utility”, namely, that it should not carry on any activity in the nature of trade, commerce or business. Hence, such institution would continue to retain its “charitable” status and be eligible for exemption under section 11 for A.Y. 2016-17, even if it derives income from an activity in the nature of trade.

- (ii) As per the proviso to section 2(15), the “advancement of any other object of general public utility” shall not be a charitable purpose, if the institution is carrying on any activity in the nature of trade, commerce or business, or any activity of rendering any service in relation to any trade, commerce or business, for a cess or fee or any other consideration, irrespective of the nature of use or application, or retention, of the income derived from such activity unless -

- such activity is undertaken in the course of actual carrying out of such advancement of any other object of general public utility; and
- the receipts from such activity does not exceed 20% of the total receipts in that year.

In the present case, since the receipts of ₹ 26.50 lakhs from such activity does not exceed ₹ 27 lakhs, being 20% of total receipts of ₹ 135 lakhs, the institution “Hindustan Mahan” will not lose its charitable status and will be eligible for tax exemption under section 11 or 12 in the P.Y.2015-16, presuming that the activity is undertaken in the course of actual carrying out of such advancement of any other object of general public utility.

(c) (i) India has a DTAA with the Foreign Country

Computation of Tax Payable by Ms. Indu for A.Y. 2016-17

Particulars	₹
Income from business in India	3,25,000
Less: Deduction under Chapter VI-A	
- Deduction under section 80D in respect of medical premium for her mother to be restricted to (Ms. Indu would not be entitled for deduction of ₹ 30,000 even if her mother is 82 years old, since the higher limit of deduction of ₹ 30,000 is available in respect of an individual who is of the age of 60 years or more and resident in India during the previous year)	<u>25,000</u>
Total Income	3,00,000
Income from business in the foreign country	<u>6,00,000</u>
	<u>9,00,000</u>
Tax on Total Income	₹
- Upto ₹ 2,50,000	Nil
- 2,50,000 to ₹ 5,00,000 @ 10%	25,000
- 5,00,000 to ₹ 9,00,000 @ 20%	<u>80,000</u>
	1,05,000
Add: Education cess and SHEC @3%	<u>3,150</u>
Tax Payable	1,08,150
Average tax rate in India (1,08,150 x 100/9,00,000)	12.017%
Tax liability	
As per DTAA with the foreign country, the income earned in foreign country would not be taxable in India, but it has to be included in the total income only for computation of tax rate. Accordingly, Ms. Indu would only be liable to pay tax on income earned in India @ 12.017% and not on the foreign income.	
Indian Income included in total income = ₹ 3,25,000 – 25,000 = ₹ 3,00,000.	
Tax@12.017% of ₹ 3,00,000 (rounded off)	36,050

Note : In the above solution, the average rate of income-tax has been determined by dividing the amount of income-tax computed on total income (including both Indian Income and foreign income), by such total income. Thereafter, the said rate has been applied on the Indian income included in total income for computing the tax liability of Ms. Indu.

However, on a plain reading of the language of the DTAA as stated in the question, it is possible to take a view that the foreign income should be included for rate purposes for computing tax on Indian income in the manner specified in section 2(2) of the Finance Act, 2015 for computation of tax on non-agricultural income by including agricultural income for rate purposes alone. If this view is taken, the tax liability has to be computed as given hereunder :

Particulars	₹
Tax on Total Income of ₹ 9,00,000 (Indian Income ₹ 3,00,000 + Foreign Income ₹ 6,00,000)	
- Upto ₹ 2,50,000	Nil
- 2,50,000 to ₹ 5,00,000 @ 10%	25,000
- 5,00,000 to ₹ 9,00,000 @ 20%	<u>80,000</u>
	1,05,000
Less: Tax on basic exemption limit + Foreign Income [i.e., ₹ 2,50,000 + ₹ 6,00,000]	
Tax on ₹ 8,50,000	<u>95,000</u>
	10,000
Add: Education cess @ 3%	<u>300</u>
Tax liability	10,300

(ii) India has no DTAA with the Foreign Country

Computation of Tax Payable by Ms. Indu for A.Y. 2016-17	₹
Tax on both Foreign and Indian Income (as computed in (1)(i) above)	1,08,150
Less: Relief under section 91 on foreign income of ₹ 6,00,000 @ 12.017% [lower of (average) Indian-tax rate (12.017%) or foreign tax rate (20%)] would be allowed	<u>72,102</u>
Tax Payable	<u>36,048</u>
Tax Payable (rounded off)	36,050

Note: Where India does not have a DTAA with the foreign country, then an assessee shall be allowed relief under section 91 provided all the following conditions are fulfilled:-

- The assessee is a resident in India during the relevant previous year.
- The income accrues or arises to him outside India during that previous year.
- Such income is not deemed to accrue or arise in India during the previous year.

- (d) *The income in question has been subjected to income-tax in the foreign country in the hands of the assessee and the assessee has paid tax on such income in the foreign country.*
- (e) *There is no agreement under section 90 for the relief or avoidance of double taxation between India and the other country where the income has accrued or arisen.*

In case (ii) above where India does not have a DTAA with the foreign country, Ms. Indu would be eligible for deduction under section 91, since all the above conditions are satisfied.

Question 4

Answer any four out of the following five cases.

- (a) *Mr. Ankit sold a plot during the financial year 2015-16 and invested the sale proceeds in purchase of a new house in the name of his wife by the end of the financial year i.e., by 31st March, 2016. He claimed deduction under section 54F in respect of the new house purchased by him in the name of his wife. The Assessing Officer, while making assessment for the Assessment Year 2016-17, denied such deduction on the ground that in order to avail benefit under section 54F, it is necessary to invest the sale proceeds in the name of the assessee.*

Comment on the validity of action taken by the Assessing Officer.

- (b) *Bahubali Co-operative Housing Society is a registered co-operative housing society. It is formed with the objective of maintaining the property owned by it. It effects repairs and maintenance of the common property of the members and confers the usual rights and privileges to its members. During the year ended 31st March, 2016, Mr. X transferred his membership to Mr. Y for which the society received transfer fees of ₹ 5.50 lakhs each from Mr. X and Mr. Y. Mr. Y was not a member of the society at the time of transfer. In course of assessment of the society under section 143(3), the Assessing Officer charged transfer fees to tax under the head "Profits and gains of business of profession".*

Is the action of the Assessing Officer correct?

- (c) *MNO Ltd., a listed company, wanted some credit facilities from the bank for its business purpose. The bank insisted on personal guarantee of the directors as a precondition for providing financial assistance to the company. The directors were employees of the company who were drawing salary from the company. A resolution was passed for paying commission to the directors and a sum of ₹ 24.50 lakhs each was paid as commission calculated at the rate of 1.5% of the principal sum, in respect of which personal guarantee was furnished by the directors to the bank.*

The assessee claimed the expenses as business expenditure. But applying section 36(1)(ii), the Assessing Officer held that if the amount was not paid to them as commission, the same would have been payable as dividend and contended that the assessee avoided dividend distribution tax under section 115-O which was otherwise payable.

Is the action of the Assessing Officer valid?

- (d) *Wellcare Warehousing Ltd. is engaged in the business of warehousing, handling and transport along with the relevant auxiliary services like pest control, rodent control, fumigation and security etc. Statement of profit and loss of company shows that the main source of income is storage charges and maintenance or user charges. The substantial part of expenses relate to salaries of employees engaged in maintenance and upkeep of warehouses. The company has filed return of income showing income from letting out of buildings and godown space as "Income from Business". The Assessing Officer rejected the view of the assessee and assessed the same as "Income from house Property".*

Comment on the validity of action taken by Assessing Officer.

- (e) *ST & Co., a partnership firm, was dissolved and as per the dissolution deed of the partnership firm, with effect from 18th September, 2004, S, one of the partners of erstwhile firm took over the entire business of the partnership firm in his individual capacity including fixed assets, current assets and liabilities and the other partner was paid his dues. He then continued the business as a sole proprietor with effect from that date. The assessee, relying upon section 78(2), claimed the set-off of the losses suffered by the erstwhile partnership firm against his income earned as an individual proprietor, considering the case as inheritance of business. The claim of the assessee was disallowed by the Assessing Officer.*

Examine the correctness of the action of the Assessing Officer. (4 × 4 = 16 Marks)

Answer

- (a) The issue under consideration in this case is whether exemption under section 54F can be denied to Mr. Ankit if sale proceeds of a long term capital asset¹⁰ are invested in a new residential house within the stipulated time limit but the said house is purchased in the name of his wife and not in his name.

This issue came up before the Delhi High Court in *CIT v. Kamal Wahal (2013) 351 ITR 4*, wherein it was observed that section 54F requires purchase or construction of a residential property within the specified period. It does not require purchase of new residential house property in the name of the assessee himself.

The Delhi High Court decided that having regard to the rule of purposive construction and the object of enactment of section 54F, the assessee is entitled to claim exemption under section 54F in respect of utilization of sale proceeds of plot of land for investment in residential house property in the name of his wife

In this case, Mr. Ankit had not purchased the new house in the name of a stranger or somebody who is unconnected with him, but had purchased it in the name of his wife. The entire investment for purchase of new residential house had come out of the sale proceeds of the plot belonging to Mr. Ankit and there was no contribution from his wife.

¹⁰ It is assumed that the plot is a long-term capital asset

Therefore, applying the rationale of the above Delhi High Court ruling in this case, the action of the Assessing Officer in denying the claim for deduction under section 54F in the hands of Ankit due to the reason that he had invested the sale proceeds in purchasing a new residential house in the name of his wife rather than in his name, is not valid.

- (b) The issue under consideration is whether the transfer fees received by a co-operative housing society from its incoming and outgoing members is taxable or exempt.

This issue came up before the Bombay High Court in *Sind Co-operative Housing Society v. ITO (2009) 317 ITR 47*, wherein the High Court observed that any transfer fee received by a co-operative housing society, whether from outgoing or from incoming members, is not liable to tax in the hands of the co-operative society on account of the principle of mutuality, since the predominant activity of such co-operative society is maintenance of property of the society and there is no taint of commerciality, trade or business.

Under the bye-laws of the society, charging of transfer fees had no element of trading or commerciality. Both the incoming and outgoing members have to contribute to the common fund of the assessee. The amount paid was to be exclusively used for the benefit of the members as a class.

Further, section 28(iii), which provides that income derived by a trade, professional or similar association from specific services performed for its members shall be treated as business income, can have no application in this case since the co-operative housing society is not a trade or professional association.

Therefore, applying the rationale of the Bombay High Court ruling to the case on hand, the action of the Assessing Officer, in bringing to tax the transfer fees under the head "Profits and gains of business or profession" in the hands of Bahubali Co-operative Housing Society is not correct.

- (c) The issue under consideration in this case is whether guarantee commission paid by a company to its employee directors is deductible as its business expenditure, where such guarantee was given by the employee directors to the bank for enabling credit facility to the company, and whether it can be contended that the same would have been payable as dividend had it not been paid as commission.

In the absence of any specific disallowance, an expenditure incurred wholly and exclusively for the purpose of business has to be allowed under section 37. It has also to be seen whether such payment was a device used to outwit the provisions of section 115-O, which requires payment of dividend distribution tax.

The directors of the company are employees of the company and are entitled to remuneration for the services rendered as employees. In this case, they also provided personal guarantee to banks, since it was a pre-condition laid down by the bank to provide financial assistance to the company. This act of providing personal guarantee was clearly beyond the scope of their services as employees of the company.

The assessee-company, in its commercial wisdom, had passed a resolution resolving that the directors be paid commission for providing their personal guarantees for the financial assistance availed by the assessee-company from the bank. In such a case, the Assessing Officer only has to determine whether the transactions are real and genuine.

Further, as regards section 36(1)(ii), the recipient directors were not entitled to receive the amount as commission in lieu of dividend. Dividend is paid to all the shareholders and the recipient directors were not the only shareholders of the company. The payment of commission, hence, cannot be taken as payment of dividend, since payment of dividend would result in payment to all the shareholders and not to select shareholders.¹¹

It was so held by the Delhi High Court, in *Controls & Switchgear Contractors Ltd v. Dy. CIT (2014) 365 ITR 312*.

Therefore, the action of the Assessing Officer, holding that if the amount was not paid to them as commission, the same would have been payable as dividend, and contending that the company avoided dividend distribution tax under section 115-O which was otherwise payable, is **not valid**.

- (d) The issue under consideration is whether income from letting out of godowns and provision of warehousing services is taxable under the head “Income from house property” or “Profits and gains of business or profession”.

In this case, the company's activity was not merely letting out of warehouses but storage of goods with provision of several auxiliary services such as pest control, rodent control and fumigation service to prevent the goods stored from being affected by vagaries of moisture and temperature. Further, service of security and protection was also provided to the goods stored. There is, therefore, no dispute that the company carries on the warehousing activity in an organised manner. These activities are more than mere letting out of the godown for tenancy.

The statement of profit and loss of the assessee-company shows that its main source of income is storage charges and maintenance or user charges. Even substantial part of the expenses also relate to the salaries of employees engaged in the maintenance and upkeep of the godowns and warehouses.

Based on these facts, it is evident that the income earned by the assessee from letting out of godowns and provision of warehousing services is chargeable to tax under the head “Profits and gains of business or profession” and not under the head “Income from house property”.

It was so held by the Madras High Court in *CIT v. NDR Warehousing P Ltd (2015) 372 ITR 690*.

Accordingly, the action of the Assessing Officer in bringing to tax such income under the head “Income from house property”, in this case, is **not valid**.

¹¹ It is assumed that the directors are also the shareholders of the company

- (e) The issue under consideration in this case is whether the loss suffered by an erstwhile partnership firm, which was dissolved, can be carried forward for set-off by the individual partner who took over the business of the firm as a sole proprietor, considering the succession as a succession by inheritance

Section 78(2) deals with carry forward of losses in case of succession of business. It provides that only the person who has incurred the losses, and no one else, would be entitled to carry forward the same and set it off. An exception provided thereunder is in the case of succession by inheritance.

Upon dissolution, the partnership firm, ST & Co. ceased to exist. Also, the partnership firm, ST & Co. and the sole proprietorship concern are two separate and distinct units for the purpose of assessment. The income earned by the sole proprietor would include his share of loss as an individual but not the loss suffered by the erstwhile partnership firm in which he was a partner.

The exception given in section 78(2), permitting carry forward of losses by the successor in case of inheritance, is not applicable in the present case since the partnership firm was dissolved and ceased to continue. Taking over of business by a partner cannot be considered as a case of inheritance due to death as per the law of succession.

It was so held by the Delhi High Court in *Pramod Mittal v. CIT* (2013) 356 ITR 456.

Therefore, the action of the Assessing Officer in disallowing the claim of set-off of losses suffered by the erstwhile partnership firm ST & Co. against the income earned as an individual proprietor is correct.

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) ABC Private Ltd. was converted into a limited liability partnership (LLP) called ABC LLP on 01-07-2015. You are provided with the following particulars of ABC Private Limited as on 31-03-2015:

- (i) Unabsorbed depreciation ₹ 13 lakhs.
- (ii) Business loss ₹ 10 lakhs (relating to previous year 2007-08).
- (iii) Unadjusted MAT credit under section 115JAA ₹ 8 lakhs.
- (iv) Written down value of the assets as per section 43(6) of the Income-tax Act.
 - Plant and Machinery (15%) ₹ 10 lakhs (market value ₹ 15 lakhs)
 - Plant and machinery ₹ 50 lakhs (Cost) - deduction claimed under section 35AD

Building (10%) ₹ 20 lakhs (market value ₹ 30 lakhs)

- (v) *Cost of land (acquired in year 2000) ₹ 50 lakhs (market value ₹ 100 lakhs)*
- (vi) *Expenditure on voluntary retirement incurred by the company during the previous year 2013-14 is ₹ 25 lakhs. The company has been allowed deduction of ₹ 5 lakhs each year for the previous year 2013-14 and previous year 2014-15 under section 35DDA.*

Explain the tax treatment of each item stated above in the hands of LLP, assuming that the conversion satisfies all the conditions laid down in section 47(xiiib). (8 Marks)

- (b) *Chennai Co-operative Society derives income during financial year 2015-16 from the following sources:*

(i)	<i>Income from processing with the aid of power</i>	<i>₹ 20,000</i>
(ii)	<i>Income from collective disposal of labour of its members</i>	<i>₹ 30,000</i>
(iii)	<i>Interest from another co-operative society</i>	<i>₹ 15,000</i>
(iv)	<i>Income from house property</i>	<i>₹ 90,000</i>
(v)	<i>Income from other business</i>	<i>₹ 60,000</i>
(vi)	<i>Income by way of dividend from another co-operative society</i>	<i>₹ 25,000</i>

Determine its total income for Assessment Year 2016-17. (5 Marks)

- (c) *After completion of regular assessment on February 22, 2014, Mr. Anshul received a notice on October 12, 2015 under section 148 for Assessment Year 2013-14 on the ground that excess depreciation was allowed on certain assets. The Assessing Officer recorded the reason for re-opening. In the course of reassessment proceedings, the Assessing Officer also disallowed certain expenses incurred in relation to dividend and tax-free interest, without recording the reasons for applying section 147 for disallowance of such expenses. The Assessing Officer passed the order disallowing the excess depreciation and certain expenses under section 14A.*

Mr. Anshul seeks your opinion on the correctness of action of the Assessing Officer. Advise him. (3 Marks)

Answer

- (a) **Tax implications on conversion of company into LLP**

(i)	As per section 72A(6A), ABC LLP would be able to carry forward the unabsorbed depreciation of ABC Pvt. Ltd. as on 31.3.2015 indefinitely for set-off against its income.
(ii)	As per section 72A(6A), ABC LLP would be able to carry forward and set-off the business loss of ABC Pvt. Ltd. as on 31.3.2015. The business loss, is eligible for set-off against business income of the LLP in the A.Y.2016-17. Such accumulated loss can be carried forward for fresh period of 8 years.

(b) Computation of total income of Chennai Co-operative Society for A.Y.2016-17

Particulars	₹	₹
I Income from house property [assumed as computed]		90,000
II Profits and gains of Business or Profession		
From processing with the aid of power	20,000	
From collective disposal of labour	30,000	
From other business	<u>60,000</u>	
		1,10,000
III Income from other sources		
Interest received from another co-operative society	15,000	
Dividend received from another co-operative society	<u>25,000</u>	
		<u>40,000</u>
Gross Total Income		2,40,000
Less: Deduction under section 80P		
Interest and dividend from another co-operative society [₹ 15,000 + ₹ 25,000] - fully deductible under section 80P(2)(d)	40,000	
Income from collective disposal of labour – fully deductible under section 80P(2)(a)(vi), assuming that the stipulated conditions are fulfilled.	30,000	
Income from other business ₹ 60,000, deduction restricted to ₹ 50,000 under section 80P(2)(c)(ii)	<u>50,000</u>	
		<u>1,20,000</u>
Total Income		<u>1,20,000</u>

Note: Since the gross total income exceeds ₹ 20,000, in case of a co-operative society engaged in manufacturing operations with the aid of power, income from house property is not eligible for deduction under section 80P(2)(f).

- (c) As per section 147, the Assessing Officer may assess or reassess such income and also any other income chargeable to tax which has escaped assessment and which comes to his notice in the course of proceedings under that section.

As per *Explanation 3* to section 147, the Assessing Officer can assess or reassess the income in respect of any issue which has escaped assessment and such issue comes to his notice subsequently in the course of proceedings under section 147, even though the reason for such issue does not form part of the reasons recorded under section 148.

Therefore, in the instant case, the Assessing Officer has the power to disallow expenses under section 14A in addition to disallowing excess depreciation for which notice under section 148 was issued even though the reason for issue relating to disallowance under section 14A was not recorded under section 148(2). Hence, the action of the Assessing Officer is correct in law.

Question 6

- (a) *NANO Inc., a German Company, holds 45% of equity in Hitech Ltd., an Indian Company. Hitech Ltd. is engaged in development of software and maintenance of the same for customers across the globe. Its clientele includes NANO Inc.*

During the financial year 2015-16, Hitech Ltd. had spent 2400 man hours for developing and maintaining software for NANO Inc. with each hour being billed at ₹ 1,300. Cost incurred by Hitech Ltd. for executing work for NANO Inc. amounts to ₹ 20 lakhs.

Hitech Ltd. had also undertaken developing software for Modi Industries, for which Hitech Ltd. had billed at ₹ 2,700 per man hour. The persons working for Modi Industries and NANO Inc. were part of the same team and were of matching credentials and calibre. Hitech Ltd. made a gross profit of 60% on Modi Industries work. Hitech Ltd.'s transactions with NANO Inc. are comparable to transactions with Modi Industries, subject to the following differences:

- (i) NANO Inc. gives technical knowhow support to Hitech Ltd., which can be valued at 8% of the normal gross profit. Modi Industries does not provide any such support.*
- (ii) Since the work for NANO Inc. involved huge number of man hours, a quantity discount of 14% of normal gross profits was given.*
- (iii) Hitech Ltd. had offered 90 days credit to NANO Inc., the cost of which is measured at 2% of the normal billing rate. No such discount was offered to Modi Industries.*

Compute arm's length price as per cost plus method and the amount of increase in total income of Hitech Ltd. (6 Marks)

- (b) *Discuss the tax implications under section 56(2) in respect of each of the following transactions:*

- (i) Mr. Anaimudi received a painting by Raja Ravi Verma worth ₹ 65,000 from his nephew by way of gift on his 25th wedding anniversary.*
- (ii) Dodabetta's son transferred shares of Pir Panjal Ltd. to Dodabetta HUF without any consideration. The fair market value of the shares is ₹ 3 lakhs.*
- (iii) ABC Private Ltd. purchased 8,000 equity shares of Satarupas Private Ltd. at ₹ 72 per share from Ms. Yamuna. The fair market value per share on the date of transaction is ₹ 90.* (2 x 3 = 6 Marks)

- (c) Share of member of an AOP/BOI in the income of the AOP/BOI is to be reduced from net profit for computing “book profit” for levy of minimum alternate tax with effect from Assessment Year 2016-17. Explain the rationale behind the amendment. (4 Marks)

Answer

- (a) Computation of Arm's Length Price as per Cost Plus Method

Particulars		₹
Gross Profit Mark up in case of Modi Industries [an unrelated party]	60.0%	
Less: Differences to be adjusted		
- Value of technical know-how (8% of 60%)	4.8%	
- Quantity discount to Nano Inc. (14% of 60%)	<u>8.4%</u>	
	46.8%	
Add: Cost of credit to Nano Inc., an associated enterprise ¹² (2% of 100%)	<u>2.0%</u>	
Arm's length gross profit mark up	<u>48.8%</u>	
Cost incurred by Hitech Ltd. for executing Nano Inc's work. [100% - 48.8% = 51.2%]		20,00,000
Add: Adjusted gross profit (₹ 20,00,000 x 48.8/51.2)		<u>19,06,250</u>
Arm's length billed value		39,06,250
Less: Actual Billed Income in the case of Nano Inc (₹ 1300 x 2400 man hours)		<u>31,20,000</u>
Total Income of Hitech Ltd to be increased by		<u>7,86,250</u>

- (b) Tax Implications under section 56(2)

- (i) Under section 56(2)(vii), where an individual received any property other than immovable property without consideration, the aggregate fair market value of which exceeds ₹ 50,000, such value of property would be chargeable to tax under the head “Income from other sources”.

As per clause (d) of *Explanation* to section 56(2)(vii), paintings are included in the definition of “property”.

Therefore, ₹ 65,000, being the fair market value of painting, would be taxable in the hands of Mr. Anaimudi, since he received such painting without any consideration from his “nephew”, who is not included in the definition of “relative” as per clause (e)

¹² Since Nano Inc. holds shares carrying not less than 26% of the voting power of Hitech Ltd.

of *Explanation* to section 56(2)(vii) thereunder, and its fair market value exceeds ₹ 50,000.

- (ii) Any property received without consideration by a HUF from its relative is not taxable under section 56(2)(vii).

Since Dodabetta's son is a member of Dodabetta HUF, he is a "relative" of the HUF.

Therefore, if Dodabetta HUF receives any property (shares, in this case) from its member, i.e., Dodabetta's son, without consideration, then, the fair market value of such shares will not be chargeable to tax in the hands of the HUF even though its fair market value exceeds ₹ 50,000, since such shares are received from a "relative".

- (iii) Where a closely held company receives in any previous year from any person any property, being shares of another closely held company for inadequate consideration, then the difference between the aggregate fair market value of shares and the consideration paid for purchase of such shares is deemed as income in the hands of the purchasing company under section 56(2)(viiia), if the difference exceeds ₹ 50,000.

Accordingly, in this case, the difference of ₹ 1,44,000 [i.e., (₹ 90 – ₹ 72) × 8,000] is taxable under section 56(2)(viiia), in the hands of ABC Private Ltd, being the recipient closely held company, since it purchased shares of Satarupas Private Ltd., another closely held company, for inadequate consideration and the difference between the fair market value and purchase price exceeds ₹ 50,000.

- (c) Under section 86, no income-tax is payable on the share of a member of an AOP/BOI in the income of the AOP/BOI in certain circumstances. A company which is a member of an AOP is also not required to pay tax in respect of its share in the income of the AOP/BOI in such cases.

However, under section 115JB, a company which is a member of an AOP/BOI was liable to pay Minimum Alternate Tax (MAT) on such share, since such income was not excluded from the book profit while computing the MAT liability of the member, being a company upto A.Y.2015-16.

It may be noted that in the case of a partner of a firm, the share in the profits of the firm is exempt in the hands of the partner as per section 10(2A) and no MAT is payable by the partner on such profits, since income in respect of which any provision of section 10 [other than section 10(38)] applies, has to be reduced for computing book profit for levy of MAT.

In order to ensure equity, with effect from A.Y.2016-17, it has been provided that, as per clause (iic) inserted in *Explanation 1* to section 115JB, the share of a member of an AOP or BOI, in the income of the AOP or BOI, on which no income-tax is payable in accordance with the provisions of section 86, should be reduced while computing book profit for levy of MAT, if any such amount is credited to profit and loss account.

Question 7

(a) Examine the applicability of provisions relating to deduction of tax at source and compute the liability, if any, for deduction of tax at source in the following cases for the financial year ended 31-03-2016:

- (i) ₹ 80,000 towards interest on compensation credited to the account of the payee by Motor Accidents Claim Tribunal on 30-11-2015.
- (ii) ₹ 2,50,000 paid on 30-09-2015 as consideration to Mr. B, a resident in India, on account of compulsory acquisition of his residential building acquired for laying railway tracks.
- (iii) Ravi Kumar, aged 67 years, derived ₹ 6,00,000 as salary from his employer, XYZ Ltd. for the year ended 31-03-2016. The following details are provided by him to the employer:

Particulars	₹
Loss from self-occupied house property at Mumbai	2,00,000
Net loss from let-out property	2,00,000
Net loss from business activity	1,00,000
Interest income from bank	3,20,000

(3 x 2 = 6 Marks)

(b) Answer the following in context of provisions of the Income-tax Act, 1961:

- (i) Consequences of non-compliance of notice under section 143(2).
- (ii) Circumstances under which the advance ruling becomes void.
- (iii) Can the Income Tax Appellate Tribunal impose penalty for concealment of income?

(3 x 2 = 6 Marks)

(c) "Orders of the Settlement Commission are binding in nature" Explain the binding character of orders of the Settlement Commission in the context of the provisions contained in the Income-tax Act, 1961.

(4 Marks)

Answer

(a) Applicability of TDS provisions

		Amount of TDS (₹)
(i)	As per section 194A, tax has to be deducted at source @10% from interest on the compensation amount awarded by the Motor Accidents Claims Tribunal at the time of payment, if the amount of interest payment or the aggregate amount of such interest payments during the financial year exceeds ₹ 50,000.	Nil

	In the present case, since the amount of ₹ 80,000 towards interest on compensation is only credited to the account of the payee by the Motor Accidents Claims Tribunal, no tax is deductible at source.																																														
(ii)	As per section 194LA, tax has to be deducted @10% on any sum paid to a resident in respect of compensation on account of compulsory acquisition of any immovable property (other than agricultural land), where the amount of payment or aggregate amount of such payments during the financial year exceeds ₹ 2,00,000. Thus, in the present case, tax is deductible@10% on ₹ 2,50,000, being the amount paid to Mr. B, a resident in India, on account of compulsory acquisition of residential building for laying railway tracks.	25,000																																													
(iii)	As per section 192(2B), XYZ Ltd is required to deduct tax at source at the time of payment of income under the head "Salaries" after considering the information furnished by Ravi Kumar for the financial year 2015-16 in respect of income under any other head of income but not loss, except loss from house property. Therefore, XYZ Ltd. is not required to take into account the loss of ₹ 1 lakh from business activity for determining the TDS liability. <table><tr><th colspan="2">Particulars</th><th>₹</th></tr><tr><td colspan="2">Income under the head Salaries</td><td>6,00,000</td></tr><tr><td colspan="2">Less: Loss from house property</td><td></td></tr><tr><td>Loss from self-occupied house at Mumbai</td><td>2,00,000</td><td></td></tr><tr><td>Loss from let out property</td><td><u>2,00,000</u></td><td><u>4,00,000</u></td></tr><tr><td colspan="2"></td><td>2,00,000</td></tr><tr><td colspan="2">Add: Interest income from Bank</td><td><u>3,20,000</u></td></tr><tr><td colspan="2">Gross Total Income</td><td>5,20,000</td></tr><tr><td colspan="2">Less: Deduction under section 80TTA (It is assumed that at least ₹ 10,000 out of interest income represents interest from saving bank account)</td><td><u>10,000</u></td></tr><tr><td colspan="2">Total Income</td><td><u>5,10,000</u></td></tr><tr><td colspan="2">Tax on Total Income:</td><td>₹</td></tr><tr><td colspan="2">Upto ₹ 3,00,000</td><td>Nil</td></tr><tr><td colspan="2">3,00,000 to 5,00,000 @ 10%</td><td>20,000</td></tr><tr><td colspan="2">5,00,000 to 5,10,000 @ 20%</td><td><u>2,000</u></td></tr><tr><td colspan="2"></td><td>22,000</td></tr></table>	Particulars		₹	Income under the head Salaries		6,00,000	Less: Loss from house property			Loss from self-occupied house at Mumbai	2,00,000		Loss from let out property	<u>2,00,000</u>	<u>4,00,000</u>			2,00,000	Add: Interest income from Bank		<u>3,20,000</u>	Gross Total Income		5,20,000	Less: Deduction under section 80TTA (It is assumed that at least ₹ 10,000 out of interest income represents interest from saving bank account)		<u>10,000</u>	Total Income		<u>5,10,000</u>	Tax on Total Income:		₹	Upto ₹ 3,00,000		Nil	3,00,000 to 5,00,000 @ 10%		20,000	5,00,000 to 5,10,000 @ 20%		<u>2,000</u>			22,000	
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		22,000																																													

	Add: Education cess and SHEC @3%		<u>660</u>	
	Tax liability on the income liable for TDS		<u>22,660</u>	
	However, since the tax deductible on bank interest@10% of Rs.3,10,000 is more than the tax liability of Rs.22,660 on the total income on which tax is deductible at source by the employer, no tax is deductible on salary income.			

Note – The solution can also be worked out without providing for deduction under section 80TTA while computing total income, since interest on savings bank account has not been separately mentioned in the question.

(b) (i) Consequences of non-compliance of section 143(2):

- (1) The Assessing Officer can make a best judgment assessment under section 144 and determine the sum payable by the assessee after giving him an opportunity of being heard.
- (2) Penalty of ₹ 10,000 is leviable under section 271(1)(b)

(ii) Circumstances under which advance ruling becomes void:

As per section 245T, an advance ruling can be declared to be *void ab initio* by the Authority for Advance Ruling if:

- on a representation made to it by the Principal Commissioner or Commissioner or otherwise,
- it finds that the ruling has been obtained by the applicant by fraud or misrepresentation of facts.

(iii) Power of Appellate Tribunal to impose penalty for concealment of income:

As per section 271(1)(c), only the Assessing Officer or the Commissioner (Appeals) or the Principal Commissioner or Commissioner can impose penalty for concealment of income, if he is satisfied that any person has concealed the particulars of his income or furnished inaccurate particulars of such income.

Therefore, an Appellate Tribunal is **not** empowered to impose penalty for concealment of income.

- (c) As per section 245-I, every order of settlement passed under section 245D(4) shall be conclusive as to the matters stated therein and no matter covered by such order, shall, unless expressly provided in Chapter XIX-A, be reopened in any proceeding under the Income-tax Act, 1961 or under any other law for the time being in force.

However, the settlement shall be void, if it is subsequently found by the Settlement Commission that it has been obtained by fraud or misrepresentation of facts

Further, the order of the Settlement Commission is not appealable before Commissioner (Appeals) or Appellate Tribunal.

However, the High Court's power of judicial review would remain unaffected irrespective of the scope of powers of the Settlement Commission and the relevant provision of law that the decision of the Settlement Commission is final and conclusive. In spite of such power of High Court, the decision of the Settlement Commission could be interfered with only where there are grave procedural defects or violation of rules of natural justice. The High Court cannot interfere either with an error of fact or error of law alleged to have been committed by the Settlement Commission.¹³

Further, the order that the Settlement Commission may pass though is binding between the parties, does not lay down a ratio or a precedent.

¹³ *N. Krishnan v. Settlement Commission and Others* (1989) 180 ITR 585 (Kar.)