VGFNLM1
DIRECT TAX
TEST PAPER - 1 MAY 19 EXAM - HINT-ANSWERS

Answer to Q. No. 1(1 Mark each)

i	ii	iii	iv	v	vi	vii	viii	ix	x
a	a	a	a	b	c	b	b	b	c
xi	**xii**	**xiii**	**xiv**	**xv**	**xvi**	**xvii**	**xviii**	**xix**	**xx**
d	d	d	b	b	c	a	c	d	c
xxi	**xxii**	**xxiii**	**xxiv**	**xxv**	**xxvi**	**xxvii**	**xxviii**	**xxix**	**xxx**
d	b	a	d	b	b	d	c	c	c

Answer to Q. No. 2(a) (10 Marks)

Net Profit	1120000
Add 2500+19500+55000+10000+15000+12000=114000 **Less** 50000+22000+17500+15000+8000+50000=162500	
Other Income	32500
Total	1104000
Less	15000
Income	**1089000**

Answer to Q. No. 2(b) (6 Marks)

(1) As per section 72A, the LLP would be able to carry forward and set-off the unabsorbed depreciation and business loss of A Pvt. Ltd. as on 31.03.2018. However, if in any subsequent year, say previous year 2019-20, the LLP fails to fulfill any of the conditions mentioned in section 47, the set-off of loss or depreciation so made in the previous year 2018-19 would be deemed to be the income chargeable to tax of P.Y.2019-20.

(2) As per section 115JAA, the credit for MAT paid by A Pvt. Ltd. cannot be availed by the successor LLP.

(3) The aggregate depreciation for the P.Y.2018-19 would be –

Particular	**Amount**
Plant & Machinery (15% of Rs. 60 lakh)	Rs. 9 lakh
Building (10% of Rs. 90 lakh)	Rs. 9 lakh
Furniture (10% of Rs. 10 lakh)	Rs. 1 lakh

In this case, since the conversion took place on 1.4.2018, the entire depreciation is allowable in the hands of the LLP. Had the conversion taken place on any other date, say 1.7.2018, the depreciation shall be apportioned between the company and the LLP in proportion to the number of days the assets were used by them. In such a case, the depreciation allowable in the hands of A Pvt. Ltd. and the LLP would be calculated as given below -

Particular	**In the hands of A Ltd. (for 91 days)**	**In the hands of the LLP (274 days)**
Plant and machinery Transferor 91/365 x 9,00,000 Transferee 274/365 x 9,00,000	2,24,384	6,75,616
Building Transferor 91/365 x 9,00,000 Transferee 274/365 x 9,00,000	2,24,384	6,75,616
Furniture Transferor 91/365 x 1,00,000 Transferee 274/365 x 1,00,000	24,932	75,068

(4) The cost of acquisition of land in the hands of the LLP would be the cost for which A Pvt. Ltd. acquired it, i.e., Rs. 50 lakh.

(5) The LLP would be eligible for deduction of Rs. 10 lakh each for the P.Y.2018-19 P.Y.2019-20 and P.Y.2020-21 and under section 35DDA.

Answer to Q. No. 2(c) (4 Marks)

Commission paid outside India is neither accrue nor arise in India hence not taxable in India. Hence, no requirement to deduct TDS.

Answer to Q. No. 3(a) (5 Marks)

Mr. Ganesh In this case, the cost of acquisition of equity share of A Ltd. would be Rs. 2,000, being higher of actual cost i.e., Rs. 1,000 and Rs. 2,000 (being the lower of FMV of Rs. 2,000 as on 31.1.2018 and actual sale consideration of Rs. 2,500). Thus, the long-term capital gain would be (Rs. 2,500 – Rs. 2,000) x 1,000 shares.	LTCG 500000/-
Mr. Rajesh In this case, the cost of acquisition of equity shares of B Ltd. would be Rs. 5,000, being higher of actual cost i.e., Rs. 3,000 and Rs. 5,000 (being the lower of FMV of Rs. 6,500 as on 31.1.2018 and actual sale consideration of Rs. 5,000). In other words, actual cost of acquisition (i.e., Rs. 3,000) is less than the FMV of Rs. 6,500 as on 31.1.2018. However, the sale value of Rs. 5,000 is also less than the FMV of Rs. 6,500 as on 31.1.2018. Accordingly, the sale value of Rs. 5,000 will be taken as the cost of acquisition. The long-term capital gains would be Nil (Rs. 5,000 – Rs. 5,000) x 2,000 shares.	Nil

Mr. Sridhar In this case, the cost of acquisition of equity shares of C Ltd. would be **Rs.** 2,000, being higher of actual cost i.e., **Rs.** 2,000 and **Rs.** 1,500 (being the lower of FMV of **Rs.** 1,500 as on 31.1.2018 and actual sale consideration of **Rs.** 3,000). In other words, the FMV of equity shares of C Ltd. on 31.1.2018 (i.e., **Rs.** 1,500) is less than **Rs.** 2,000, being the actual cost of acquisition of equity shares, and therefore, the actual cost of **Rs.** 2,000 would be taken as cost of acquisition. Accordingly, the long-term capital gains would be (**Rs.** 3,000 – **Rs.** 2,000) x 3,000	LTCG 3000000/-
Mr. Vaibhav In this case, the cost of acquisition of equity shares of D Ltd. would be **Rs.** 4,000, being higher of actual cost i.e., **Rs.** 4,000 and **Rs.** 2,500 (being the lower of FMV of **Rs.** 6,000 as on 31.1.2018 and actual sale consideration of **Rs.** 2,500). In other words, the actual cost of acquisition of equity shares D Ltd. (i.e., **Rs.** 4,000) is less than the FMV of **Rs.** 6,000 as on 31.1.2018. However, the sale value of **Rs.** 2,500 is also less than the FMV of **Rs.** 6,000 as on 31.1.2018 and also the cost of acquisition. Accordingly, the actual cost of **Rs.** 4,000 will be taken as the cost of acquisition. The long-term capital loss would be **Rs.** 6,00,000 (**Rs.** 2,500 – **Rs.** 4,000) x 4,000 shares.	LTCL 6000000/-

Answer to Q. No. 3(b) (5 Marks)

Section 206C(1F) provides for collection of tax at source@1% by the seller from the buyer, at the time of receipt of consideration for sale of motor vehicle, the value of which exceeds Rs. 10 lakhs. CBDT Circular No.22/2016 dated 8.6.2016 clarifies that this section has been inserted to cover all transactions of retail sales and accordingly, it will not apply to sale of motor vehicles by manufacturers to dealers. Hence, car manufacturers are not liable to collect tax at source under section 206C(1F).

In respect of sale of premium model cars (of value ranging above Rs. 10 lakhs and upto Rs.25 lakhs) by dealers to retail customers, tax has to be collected at source@1% under section 206C(1F), even if no part of the consideration is received in cash.

As regards small cars of value ranging from Rs. 5 lakhs upto Rs. 10 lakhs, there is no requirement to collect tax at source.

Answer to Q. No. 4(a) (5 Marks)

(i) As per the third proviso to section 147, the Assessing Officer may assess or reassess such income, other than the income involving matters which are the subject matters of any appeal, reference or revision, which is chargeable to tax and has escaped assessment. Therefore, even when an appeal is pending before Commissioner (Appeals), the Assessing Officer can initiate reassessment proceedings in respect of income chargeable to tax which has escaped assessment, provided such income is not the subject matter of the appeal before the Commissioner (Appeals) i.e., such income which has escaped assessment does not form part of the additions of Rs.22 lakhs to the returned income, which is the subject matter of appeal.

(ii) As per section 154(1A), the Assessing Officer can pass an order under 154(1) to rectify a mistake apparent from the record, provided the rectification is in relation to a matter, other than the matter which has been considered and decided in the appeal before Commissioner (Appeals). Since the issue under consideration in this case relates to rectification of a mistake in respect of a matter which is not the subject matter of appeal, the Assessing Officer can pass an order under section 154 for rectification of the same provided the same is a mistake apparent from the record.

(iii) As per section 264(4), the Principal Commissioner or Commissioner shall not revise any order under section 264, where such order has been made the subject of an appeal to the Commissioner (Appeals). Therefore, under section 264, the Principal Commissioner or Commissioner cannot revise an order which is pending before the Commissioner (Appeals), even if the revision pertains to a matter, other than the matter(s) covered in the appeal.

(iv) As per section 263, the Commissioner has the power to revise an order prejudicial to the interests of revenue, even if the order is the subject matter of appeal before Commissioner (Appeals). However, the power of the Commissioner under section 263 shall extend to only such matters as had not been considered and decided in such appeal. In a case where the appeal is pending but not yet decided, the Commissioner cannot exercise his revisionary jurisdiction in respect of those issues which are the subject matter of appeal [CWT v. Sampathmal Chordia (2002) 256 ITR 440 (Mad.)].

Answer to Q. No. 4(b) (3 Marks)

(i) Incorrect

As per section 249(3) of the Income-tax Act, 1961, the Commissioner (Appeals) may admit an appeal after the expiry of the period of 30 days specified in section 249(2), if he is satisfied that the appellant had sufficient cause for not presenting the appeal within the prescribed time.

(ii) Incorrect

Section 254(2A) provides that the Appellate Tribunal, where it is possible, may hear and decide an appeal within a period of four years from the end of the financial year in which such appeal is filed. The Appellate Tribunal may, on merit, pass an order of stay in any proceedings relating to an appeal. However, such period of stay cannot exceed 180 days from the date of such order. The Appellate Tribunal has to dispose of the appeal within this period of stay. Where the appeal has not been disposed of within this period and the delay in disposing the appeal is not attributable to the assessee, the Appellate Tribunal can further extend the period of stay originally allowed. However, the aggregate of period originally allowed and the period so extended should not exceed 365 days even if the delay in disposing of the appeal is not attributable to the assessee. The Appellate Tribunal is required to dispose off the appeal within this extended period. If the appeal is not disposed of within such period or periods, the order of stay shall stand vacated after the expiry of such period or periods.

Answer to Q. No. 4(c) (2 Marks)

"Significant Economic Presence" means-

a) transaction in respect of any goods, services or property carried out by a non-resident in India including provision of download of data or software in India, if the aggregate of payments arising from such transaction or transactions during the previous year exceeds the prescribed amount; or
b) systematic and continuous soliciting of business activities or engaging in interaction with such prescribed number of users in India through digital means.

Further, the above transactions or activities shall constitute significant economic presence in India, whether or not,—

(i) the agreement for such transactions or activities is entered in India;
(ii) the non-resident has a residence or place of business in India; or
(iii) the non-resident renders services in India:

However, where a business connection is established by reason of significant economic presence in India, only so much of income as is attributable to the transactions or activities referred to in (a) or (b) above shall be deemed to accrue or arise in India. This provision has been inserted in the Income-tax Act, 1961 in line with "BEPS Action Plan 1 Addressing the challenges of the digital economy" to take care of new business models such as digitized businesses, which do not require physical presence of itself or any agent in India. Such businesses can now be covered within the scope of section 9(1)(i)

Answer to Q. No. 5(a) (5 Marks)

Where Xylo Inc., a US company, has a PE in India and rendering technical services is effectively connected with the PE in India.

Since Xylo Inc. carries on business through a PE in India, in pursuance of an agreement with Alpha 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 as per section 44DA, such income shall be computed under the head "Profits and gains of business or profession" in accordance with the provisions of the Income-tax Act, 1961.

Accordingly, expenses of Rs. 23 lakhs (Rs. 8 lakhs + Rs. 15 lakhs) incurred for earning fees for technical services of Rs. 6 crore (Rs. 2 crore + Rs. 4 crore) is allowable as deduction therefrom. However, expenditure of Rs. 6 lakhs which is not incurred wholly and exclusively for the business of the PE and the amount of Rs. 12 lakhs paid by the PE to the Head Office is **not** allowable as deduction.

Xylo 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.

Answer to Q. No. 5(b) (5 Marks)

As per provisions of section 9(1)(vi), royalty will be deemed to accrue or arise in India when it is payable by:

a) The Central Government or any State Government; or
b) A person who is resident in India. However, the same shall not be deemed to accrue or arise in Indian when royalty is payable in respect of nay right, property or information used or services utilized for the purpose of :
   - Business or profession carried on by such person outside India; or
   - Earning any income from any source outside India.

In the above example, the amount paid by X Ltd., a resident to Y Inc., a non-resident for right to use the ONE UP technology falls under the definition of royalty as per the Indian income Tax Act. However, the same is not taxable in India as it is utilized for a business carried on by X Ltd., a resident outside India.

Answer to Q. No. 6(a) (4 Marks)

There are two different tax consequences that will have to be examined in this case. First, in the hands of Company A and second in the hands of Company B. In the hands of Company A, the interest payments received will be taxable under the provisions of the Act as well as under the India Singapore DTAA. Under the Act, Section 9(1)(v) provides that income by way of interest payable by a person who is a resident, except where the interest is payable in respect of any debt incurred, or moneys borrowed and used, for the purposes of business or profession carried on by such person outside India or earning income from any source outside India; shall be deemed to accrue or arise in India. Since Company A has revenues only from business activities carried on in India, the interest income will be taxable under the provisions of the Act. The applicable rates that will apply for such withholding will be restricted to 5 per cent due to the application of section 194LC. Under the provisions of the India Singapore DTAA, Article 11 para 2 also provides a right to the source state, provided that the tax so charged shall not exceed 10 per cent of the gross amount of interest payable if the interest is paid on a loan granted by a bank or similar financial institution and 15 per cent in other cases.

In the hands of Company B, apart from withholding tax implications, the thin capitalization provisions will also be relevant. Section 94B has been inserted to provide for thin capitalization rules in India. As per the provisions, where an Indian company pays more than one crore which is deductible in computing income under the head 'profits and gains of business or profession' in respect of debt issued by a non-resident, being an associated enterprise of such borrower, the interest shall not be deductible in computation of income under the said head to the extent it arises from excess interest. Excess interest has been defined under Section 94B to mean an amount of total interest paid or payable in excess of 30% of EBIDTA of the borrower in the previous year or interest paid or payable to the associate enterprise, whichever is less. Company A and Company B will qualify as associated enterprises. Therefore, any interest in excess of 90 crores (300*30/100) shall be treated as excess interest and shall not be available deduction in the hands of the Company B. Company B can however carry forward the excess interest for a period of up to 8 years and offset the same in future years.

Answer to Q. No. 6(b) (3 Marks)

Income of XYZ Co. out of Income from ABC Co. could be only that income which it is entitled to receive from ABC Co. ABC Co. has declared 5 million as interim dividend. XYZ Co. holds 75% shares of ABC Co. & hence is entitled to 75% of said interim dividend declared by ABC Co. which is 75% of Rs. 5 million & Income of XYZ Co. attributable is Rs.3.75 million.

Answer to Q. No. 6(c) (3 Marks)

Section 94A has been introduced in Finance Act 2011, empowering the government to notify any country which does not help Indian in Tax Information Exchange as a Notified Jurisdictional Area ('NJA') under the above section.

Section 94A is an anti-avoidance measure to curb the generation and circulation of black money. The government has entered into several Tax Information Exchange Agreements with various countries for sharing information with respect the money held by Indian residents outside India. However, certain countries have not been cooperative with respect to sharing of such information and India still does not have an effective tax information exchange system with such countries. To discourage transactions with such countries which don't have an effective tax information exchange system with India, section 94A has been introduced. India blacklisted Cyprus as a NJA in 2013 for not sharing tax information vide issuing a Notification. Per the Notification, any payments made to Cyprus attracted a withholding tax at a rate of 30 per cent and Indian entities receiving money from there were required to disclose the source of funds. Subsequently, India and Cyprus signed revised bilateral treaty under which capital gains will be levied on sale of shares on investments made after April 01, 2017. The new DTAA also provided for exchange of banking information and allows the use of such information for purposes other than taxation with prior approval of competent authorities of the country. Accordingly, India removed Cyprus from the list of NJA vide publication in official gazette of India on December 15, 2016.

Answer to Q. No. 7(a) (3 Marks)

ABC Ltd, the Indian company and XYZ Inc., the French company are deemed to be associated enterprises as per section 92A(2)(a), since XYZ Inc. holds shares carrying not less than 26% of the voting power in ABC 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.

Particular	Rs. in Lacs
Amount by which total income of ABC Ltd. is enhanced on account of adjustment in the value of international transactions:	
(i) Difference in price of tie @ $ 1 each for 50,000 pieces sold to XYZ Inc. ($ 1 x 50,000 x 64)	32.00
(ii) Difference for excess payment of guarantee fee to XYZ Inc. for loan borrowed from foreign lender ($ 2,000 x 64)	1.28
(iii) Difference for excess payment for services to XYZ Inc. ($ 4,000 x 64)	2.56
	35.84

ABC Ltd. cannot claim deduction under section 10AA in respect of Rs. 35.84 lakhs, being the amount of income by which the total income is enhanced by virtue of the first proviso to section 92C(4).

Answer to Q. No. 7(b) (3 Marks)

Since Mr. X does not own more than 10 vehicles at any time during the previous year 2018-19, he is eligible to opt for presumptive taxation scheme under section 44AE. Rs. 1,000 per ton of gross vehicle weight or unladen weight per month or part of the month for each heavy goods vehicle and Rs. 7,500 per month or part of month for each goods carriage other than heavy goods vehicle, owned by him would be deemed as his profits and gains from such goods carriage. Heavy goods vehicle means any goods carriage, the gross vehicle weight of which exceeds 12,000 kg. The presumptive income of Mr. X under section 44AE for A.Y.2019-20 would be - **Rs. 6,82,500** i.e., 55 × Rs. 7,500, being for other than heavy goods vehicle + 18 x Rs. 1,000 x 15 ton being for heavy goods vehicle. The answer would remain the same even if the two vehicles purchased in April, 2018 were put to use only in July, 2018, since the presumptive income has to be calculated per month or part of the month for which the vehicle is owned by Mr. X.

Working Notes

(1)	(2)	(3)	(4)
Number of Vehicles	**Date of purchase**	**No. of months for which vehicle is owned**	**No. of months × No. of vehicles [(1) × (3)]**
Heavy goods vehicle			
2	29.08.18	8	16
1	23.02.19	2	2
		Total	**18**
Goods vehicle other than heavy goods vehicle			
2	10.04.2018	12	24
1	15.03.2019	1	1
3	16.07.2018	9	27
1	02.01.2019	3	3
		Total	**55**

Answer to Q. No. 7(c) (2 Marks)

The Finance (No.2) Act, 2014 introduced the rollback provisions under the Advance Pricing Agreement (APA) program. The roll back provisions were made applicable to the APAs signed or applied post 1 October 2014. The rules have been notified on 14 March 2015 by CBDT vide Notification No. S.O.758 (E) of 2015,setting out the applicability and the requirement for applying rollback.

Some of the salient features of the rollback rules are as highlighted below:

- The international transaction proposed to be covered under the rollback is to be the same as covered under the main APA;
- The rollback provisions shall be applied for all the rollback years in which the relevant international transaction has been undertaken;
- The manner in which Arm's length price has been determined in relation to an international transaction shall be consistent for all the years covered under the APA including the rollback years
- To be eligible for the applicability of the rollback provisions, the applicant should have filed Return of Income and Form No. 3CEB (Accountants Report) on or before the statutory due date;
- The rollback provision will not be applicable for a particular year where the Income Tax Appellate Tribunal has passed an order disposing off the appeal prior to the date of signing of the APA;
- In case the application of the rollback provisions would result in reduction of the income offered to tax or increasing the loss as declared in the Return of Income for a particular year, the rollback provision will not be applicable for that year;

Answer to Q. No. 7(d) (2 Marks)

(i) The statement is **incorrect**.

Prior to 1.6.2016, under section 253(2A), the Principal Commissioner or Commissioner may, if he objected to any direction issued by the Dispute Resolution Panel (DRP) under section 144C(5) in pursuance of which the Assessing Officer has passed an order completing the assessment or reassessment, direct the Assessing Officer to appeal to the Appellate Tribunal against such order.vFurther, section 253(3A) provided that every appeal under section 253(2A) shall be filed within 60 days of the date on which the order sought to be appealed against is passed by the Assessing Officer in pursuance of the directions of the DRP under section 144C(5). However, in order to minimise litigation, sub-sections (2A) and (3A) of section 253 have been omitted by the Finance Act, 2016 with effect from 1st June, 2016. Thus, the provision for filing of appeal by the Assessing Officer against the order of the DRP has now been done away with.

(ii) The statement is **incorrect**.

With effect from 1st June, 2016 to provide that the Appellate Tribunal may rectify any mistake apparent from the record in its order at any time within six months from end of the month in which order is passed

Answer to Q. No. 8(a) (4 Marks)

Leena to Poorna
Leena - STCG 15 Lac, Poorna- Section 56 shall not apply

Sale by Poorna
STCG 12 Lac

Answer to Q. No. 8(b) (3 Marks)

Computation of total income of Mysore Co-operative Society for A.Y.2019-20

Particulars		Rs.	Rs.
I	**Income from house property**		75,000
II	**Profits and Gains of Business or Profession**		
	From processing with the aid of power	40,000	
	From collective disposal of labour	20,000	
	From other business	72,000	1,32,000
III	**Income from Other Sources**		
	Interest received from another co-operative society	12,000	
	Dividend received from another co-operative society	15,000	27,000
Gross Total Income			**2,34,000**
***Less:* Deduction under section 80P**			
	Interest and dividend from another co-operative society [Rs. 12,000 + Rs. 15,000] - fully deductible under section 80P(2)(d)	27,000	
	Income from collective disposal of labour – fully deductible under section 80P(2)(a)(vi), assuming that the stipulated conditions are fulfilled.	20,000	
	Income from other business Rs. 72,000, deduction restricted to Rs. 50,000 under section 80P(2)(c)(ii)	50,000	97,000
Total Income			**1,37,000**

Note: Since the gross total income exceeds Rs. 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)

Answer to Q. No. 8(c) (3 Marks)

The issue under consideration in this case is, whether omission to issue notice under section 143(2) is a defect not curable in spite of section 292BB. This issue came up before the Apex Court in *Asstt. CIT v. Hotel Blue Moon (2010) 321 ITR 362,* wherein it was held that without the statutory notice under section 143(2), the Assessing Officer could not assume jurisdiction. In that case, the Assessing Officer recorded his inability to generate a notice due to certain reasons. Such defect cannot be cured subsequently, since it is not procedural but one that goes to the root of the jurisdiction. Even though the assessee had participated in the proceedings, in the absence of mandatory notice, section 292BB cannot help the Revenue officers who have no jurisdiction, to begin with. Section 292BB helps Revenue in countering claims of assessees who have participated in proceedings once a due notice has been issued. Applying the rationale of the Supreme Court ruling to the case on hand, the failure to issue notice under section 143(2) would vitiate the assessment proceedings notwithstanding the assessee's participation in the proceedings. Section 292BB would not come to the rescue of the Revenue Authority if they omit to issue notice under section 143(2).