

VGFNLM2
DIRECT TAX
TEST PAPER - 2 MAY 19 EXAM - HINT-ANSWERS

Division A – Multiple Choice Questions

1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20
d	b	d	c	c	d	d	c	c	d	b	C	c	b	b	b	c	d	c	C

Division B – Descriptive Questions

Answer to Q. No. 1(a) 10 Marks

Particulars		\	\
Net Profit as per Profit & Loss Account			2,00,00,000
Add: Net Profit to be increased by the following amounts as per Explanation 1 to section 115JB			
Income-tax paid or payable or provision therefor			
Provision for income-tax	\ 17,00,000		
Dividend distribution tax	\ 3,00,000	20,00,000	
Provision for deferred tax		12,00,000	
Transfer to General Reserve		5,00,000	
Provision for diminution in the value of investment		3,00,000	
Dividend paid or proposed			
Proposed dividend	6,00,000		
Preference dividend	4,00,000	10,00,000	
Expenditure to earn income exempt u/s 10			
Expenditure to earn agricultural income [Exempt u/s 10(1)]		1,00,000	
Depreciation		22,00,000	73,00,000
Less: Net Profit to be reduced by the following amounts as per Explanation 1 to section 115JB			2,73,00,000
Amount credited to profit and loss account from Special Reserve		2,00,000	
Depreciation (excluding depreciation on account of revaluation of fixed assets) (i.e., \ 22,00,000 – \ 6,00,000)		16,00,000	

Amount credited to profit and loss account from revaluation reserve (to the extent of depreciation on revaluation)	6,00,000	
Brought forward business loss or unabsorbed depreciation as per books of account, whichever is less taken on cumulative basis	5,00,000	
Income exempt u/s 10		
Agricultural Income [since it is exempt under section 10(1)]	4,00,000	33,00,000
Book Profit		2,40,00,000
Computation of tax liability of Phi Ltd. for A.Y.2019-20		
18.5% of book profit		44,40,000
Add: Surcharge@7% (since total income > ` 1 crore but less than ` 10 crore)		3,10,800
		47,50,800
Add: HEC @ 4%	190,032	
Tax liability on book profit under section 115JB		49,40,832
Total income computed as per the provisions of the Income-tax Act, 1961	1,30,00,000	
Tax payable @ 30%		39,00,000
Add: Surcharge@7%		<u>2,73,000</u>
Add: HEC @ 4%	166,920	41,73,000
Tax Payable as per the Income-tax Act, 1961		43,39,920

Answer to Q. No. 1(b) 4 Marks

Computation of interest to be disallowed in the computation of income under the head profits and gains of business or profession of A Ltd.

Particulars	Rs.
EBITDA	10,00,00,000
Interest paid or payable by A Ltd.	9,00,00,000
lower of the following would be disallowed	
Interest paid or payable in excess 30% of EBITDA	6,00,00,000
- interest paid or payable to non-resident AE	9,00,00,000
Interest to be disallowed as deduction	6,00,00,000

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

Ascertainment of tax liability of Beta Limited from slump sale of software unit

Particulars	(in lacs)
Sale consideration for slump sale of Software Unit	700
Less: Cost of acquisition being the net worth of Software Unit	<u>195</u>
Long term capital gains arising on slump sale	<u>505</u>
(The capital gains is long-term as the Software Unit is held for more than 36 months)	
<u>Tax liability on LTCG</u>	
Under section 112@20% on ` 505 lacs	101.00
Add: Surcharge@7%	<u>7.07</u>
	108.07
Add: Education cess@2% and SHEC@1%	<u>4.32</u>
	<u>112.39</u>

Working Note: Computation of net worth of Software Unit

Particulars	(in lacs)
(1) Book value of non-depreciable assets	
(i) Land (Revaluation not to be considered)	40
(ii) Debtors	110
(iii) Inventories	35
(2) Written down value of depreciable assets under section 43(6)	
	<u>100</u>
Aggregate value of total assets	285
Less: Current liabilities of software unit	<u>90</u>
Net worth of software unit	<u>195</u>

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

Computation of tax liability of Anuradha for the A.Y. 2019-20

Particulars	
Indian Income	6,00,000
Foreign Income	1,00,000
Gross Total Income	7,00,000
Less: Deduction under Chapter VI-A	
Under section 80C	

Deposit in PPF	1,50,000	
Under section 80CCC		
Contribution to approved Pension Fund of LIC	25,000	
	1,75,000	
Under section 80CCE		
The aggregate deduction under section 80C, 80CCC and 80CCD(1) has to be restricted to	1,50,000	
₹ 1,50,000		
Under section 80D		
Medical insurance premium is allowable as deduction under section 80D. Since she is a resident senior citizen, the deduction is allowable to a maximum of ₹ 50,000	32,000	
Medical insurance premium of ₹ 31,000 paid for mother aged 79 years. Since her mother is non-resident in India, she will not be entitled for the higher deduction of ₹ 30,000 eligible for a senior citizen, who is resident in India. Hence, the deduction will be restricted to maximum of ₹ 25,000.	25,000	2,07,000
Total Income		4,93,000
Tax on Total Income		
Income-tax	10,036	
Average rate of tax in India (i.e. ₹ 10,036 / ₹ 4,93,000 × 100)	2.04%	
Average rate of tax in foreign country (i.e. ₹ 10,000 / ₹ 1,00,000 × 100)	10%	
Rebate under section 91 on ₹ 1,00,000 @		
2.04% (lower of average Indian-tax rate or average foreign tax rate)		2,045
Tax payable in India (₹ 10,036 - ₹ 2,045)		7,991

Answer to Q. No. 2(c) 3 Marks

The interest income received by Mr. Kumar, a non-resident, from a notified infrastructure debt fund would be subject to a concessional tax rate of 5% under section 115A on the gross amount of such interest income. Therefore, the tax liability of Mr. Kumar in respect of such income would be ₹ 20,800 (being 5% of ₹ 4 lakhs plus health and education cess@4%).

Under section 194LB, tax is deductible @5% (plus health and education cess@4%) on interest paid by such fund to a non-resident. However, since Mr.

Kumar is a resident of a NJA, tax would be deductible@30% (plus health and education cess@4%) as per section 94A, and not @5% specified under section 194LB. This is on account of the provisions of section 94A(5), which provides that "Notwithstanding anything contained in any other provision of this Act, where a person located in a NJA is entitled to receive any sum or income or amount on which tax is deductible under Chapter XVII-B, the tax shall be deducted at the highest of the following rates, namely–

- at the rate or rates in force;
- at the rate specified in the relevant provision of the Act;
- at the rate of thirty per cent."

Mr. Kumar can, however, claim refund of excess tax deducted along with interest.

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

A.	Share of each of the Associates in the Value of the Order	3,00,000
	Share of BIL [Given]	1,00,000
	Share of PCI [Given]	90,000
	Share of NBR [Amount Retained = 3,00,000 - 1,00,000 - 90,000]	1,10,000
B.	Share of each of the Associates in the Profit of the Order	1,00,000
	Combined Total Profits	40,000
	Share of BIL [Contribution of 40% × Total Profit Euro 1,00,000]	30,000
	Share of PCI [Contribution of 30% × Total Profit Euro 1,00,000]	30,000
	Share of NBR [Contribution of 30% × Total Profit Euro 1,00,000]	
C.	Computation of Incremental Total Income of BIL	
	Total Cost to BIL Ltd	80,000
	Add: Share in the Profit to BIL (from B above)	40,000
	Revenue of BIL on the basis of Arm's Length Price	1,20,000
	Less: Revenue Actually received by BIL	1,00,000
	Increase in Total Income of BIL	20,000

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

The Assessing Officer's power is restricted to examining whether the books of account are certified by the authorities under the Companies Act, 1956 as having been properly maintained in accordance with the Companies Act, 1956. Thereafter, he only has the limited power of making additions and deductions as provided for in Explanation I below section 115JB.

- The Supreme Court in the case of Apollo Tyres Ltd. V CIT (2202) 255 ITR 273 held that the Assessing Officer does not have the jurisdiction to go behind the net profit shown in the audited and loss account except to the extent provided in Explanation I below section 115JB. Hence, no adjustment is required for prior period expenses which have to be shown separately in

the profit and loss account as per AS in view of the specific requirement under section 115JB(2) read with section 211 of the Companies Act, 1956 [CIT v Khaitan Chemicals & Fertilizers Ltd (2208) 307 ITR 150 (Del)]. Further, prior period expense is not an item which can be adjusted in terms of any of the clauses covered in Explanation I below section 115JB. The action of the Assessing Officer is therefore not correct.

- (ii) As per Schedule XIV to the Companies Act, 1956, depreciation has to be provided on pro rata basis in respect of additions made to any asset during the year. Accordingly, depreciation has to be calculated only for 90 days at the rate prescribed in Schedule XIV in respect of car purchased on 1.1.2019. Since depreciation for the whole year has been debited to profit and loss account, the excess depreciation has to be added back, since the same is not in accordance with the requirements of Schedule XIV to the Companies Act, 1956. The action of the Assessing officer is correct.

Answer to Q. No. 3(c) 2 Marks each

- (i) By the above arrangement, the tax payer has obtained a tax benefit and created rights or obligations which are not ordinarily created between persons dealing at arm's length. Since transactions of purchase and sale of shares of a closely held company at a price other than the fair market value are covered under section 56 of the Act, GAAR may not be invoked as section 56, being SAAR, is applicable. However, if SAAR is not applicable considering the limited scope of section 56 to the shares of closely held companies only, then GAAR may be invoked.
- (ii) The above facts reflect the following possibilities:
- A. Z Ltd. misrepresents the facts by showing on paper that everything is done outside India and therefore, nothing is taxable in India. This would be case of tax evasion and not GAAR; OR
- B. Z Ltd. Represents that certain operations relating to A, its subsidiary, are carried out in India but it is not table under the relevant DTAA as these operations do not constitute a permanent establishment (PE) in India. This is not a case of tax avoidance but of determination of facts to ascertain whether there is a PE or not.

Again, the investigation should reveal if it is a case of correct reporting of facts or a mis-representation. If the latter, it would be tax evasion. Further, if any activity is being carried out by Z Ltd for A Ltd, then Z Ltd is required to be compensated at arm's length price which would be covered by specific anti-avoidance rules. Hence, it is not a fit case for invoking GAAR

Answer to Q. No. 4(a) 7 Marks

Computation of Total income of Massy incorporated for assessment year 2019-20			
P & G under the head Business & Profession	Rs.	Rs.	Rs.
Business in India:			
Sale	30,00,000		
Less: Expenses under sections 28 to 44C	28,00,000	2,00,000	
Royalty	3,00,000		
Less: Expenses	Not allowed	3,00,000	5,00,000
P & G under the head Business & Profession:			
Income under the head capital gain			
Short-term capital gain referred to in section 1111-A		2,40,000	
Long-term capital gain from sale of shares sold through recognized stock exchange	6,00,000		
LESS; Cost of acquisition (FMV on 31.1.2018)	4,10,000	1,90,000	4,30,000
Income from other sources:			
Interest on loan	11,00,000		
Less; Expenses	Not allowed	11,00,000	
Interest on loan in Indian currency	4,00,000		
Less; Collection charges	5,000	3,95,000	
Income from units		Exempt	14,95,000
Gross total income			24,25,000
Less: Deduction under section 80G (limited to royalty income, business income & interest income from loan given in Indian currency included in G.T.I. It is not allowed from interest on loan)			8,95,000
Taxable income			15,30,000
Tax on long-term capital gain exceeding Rs. 1,00,000 i.e. on Rs. 90,000 @ 10%			9,000
Tax on Rs. 2,40,000 @ 15%			36,000
Tax on 11,00,000 @ 20%			2,20,000
Add: Surcharge (as the total income does not exceed Rs. 1 crore)			Nil
			2,65,000
Add: H&EC@ 4%			10,600
Total tax			2,75,600
Case B:			

G.T.I. as computed above		23,25,000
Less: Deduction under section 80G		7,95,000
Total income		15,30,000
Tax on Rs. 2,40,000 @15%		36,000
Tax on long-term capital gain Rs. 90,000@ 10%		9,000
Tax on 11,00,000 @ 20%		2,20,000
Tax on Rs. 1,00,000 @ 10% (royalty income)		10,000
		2,75,000
Add: Surcharge)		Nil
		2,75,000
Add: H&EC @ 4%		11,000
Tax Payable		2,86,000

If we claim deduction under section 80G first from royalty income and then from other income, the other income of Rs. 1,00,000 would have been taxable @ 40%

Not- Although, surcharge in case of a foreign company is 2%/5% but it is leviable only if its total income exceeds Rs. 1 crore or 10 crores as the case may be

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

- (i) As per section 153A, the notices for post search assessment can be issued for Assessment Year 2013-14 to 2018-19.
- (ii) As per section 153A, the pending assessments for Assessment Year 2016-17 and 2017-18 and pending reassessment for Assessment Year 2015-16 shall abate
- (iii) If the post search assessment orders are annulled by the Income Tax Appellate Tribunal (ITAT), then the abated assessments and reassessments shall revive. The revival shall take place from the date the order of ITAT is received by the Commissioner of Income-Tax.

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

Pramod is deemed to have under-reported his income since he has not filed his return of income and his assessed income exceeds the basic the exemption limit of Rs. 2,50,000. Hence, penalty under section 270A is leviable in his case

Computation of penalty leviable under section 270A		
Particulars	Rs.	Rs.
Total income assessed	14,00,00	
(-) Basic exemption limit	2,50,000	
Under-reported income:		11,50,000

Tax payable on total income assessed	2,32,500	
Add: Health & Education cess @ 4%	9,300	
Total tax payable		2,41,800
Penalty leviable @ 50% of tax payable		1,20,900

Answer to Q. No. 5(a) 2 Marks each

- (i) Commission paid to doctors for referring the patients not to be allowed as deduction: Vide CBDT Circular No. 5/2012 dated 1.8.2012, it has been stated that the Indian Medical Council had imposed a prohibition on medical practitioners taking any freebies and hence, expenditure incurred in providing such freebies is to be regarded as incurred "for a purpose which is either an offence or prohibited by law" and disallowed under Explanation to section 37(1). This was upheld by the Punjab & Haryana High Court in the case of CIT v Kap Scan & Diagnostic Centre Pvt. Ltd. (2012) 344 ITR 476 (P&H) wherein commission given to the private doctors for referring the patients for various medical tests was treated to be a trade practice which could not be termed to be illegal and therefore, the same was disallowed under section 37(1). Applying the rationale and considering the purpose of Explanation to section 37(1), the assessee would not be entitled to deduction of payment made in contravention of law. Similarly, payments which are opposed to public policy being in the nature of unlawful consideration cannot also be claimed as deduction. The assessee cannot take a plea that business men are entitled to conduct their business even contrary to law and claim deduction of certain payments as business expenditure, notwithstanding that such payments are illegal or opposed to public policy or have pernicious consequences to the society as a whole. Thus action of the A.O. in disallowing the referral fee paid by XYZ co. to doctors is correct. The fact that the tax has been deducted at source u/s 194H is of no compliance.
- (ii) As per section 194J, any person, who is responsible for paying to a resident, any sum by way of fees for professional services, or fees for technical services or royalty or non-compete fees referred to in section 28(va) is required to deduct tax at source. The obligation to deduct tax under section 194J arises whether if the non-compete fee is payable in cash or kind as section 28(va) states that non-compete fee whether paid in cash or kind shall be taxable. If it is paid in kind then it will be the responsibility of the payer to recover the amount of tax deductible from the recipient of the non-compete fee in kind. Therefore, the Assessing officer is correct in disallowing expenditure on account of non-complete fee under section 40(a)(ia) but it will be

- disallowed to the extent of 30% of such expenditure. Further, he can, levy penalty u/s 271C and charge interest under section 201(1A).
- (iii) The facts of the above case are similar to facts in the case of CIT v Yamaha Motor India Pvt. Ltd. (2010) 328 ITR 297, wherein the Delhi High Court observed that the expression "used for the purpose of the business" in section 32 when used with respect to discarded machinery would mean the use in the business, not only in the relevant financial year/previous year, but also in the earlier financial years. The discarded machinery may not be actually used in the relevant previous year but depreciation can be claimed as long as it was used for the purposes of business in the earlier years provided the block continues to exist in the relevant previous year. Therefore, the condition for claiming depreciation in respect of the discarded machine would be satisfied if it was used in the earlier previous years for the business. Further, for the purpose of section 43(6), "moneys payable" means the sale price, in case of sale, or insurance, salvage or compensation in respect of the asset. In this case, the machinery has not been sold as machinery or scrap or disposed off, and it continues to exist. Hence, there is no "moneys payable" in this case, which alone is deductible while computing the WDV of the block to which it belongs. Applying the rationale of the above case and the provisions of section 43(6), the action of the Assessing Officer in disallowing Rs. 4 lakhs, being the depreciation claim attributable to discarded machinery, on the ground that the same was not put to use in the relevant previous year, is invalid, since the said machinery was put to use in the earlier previous years.

Answer to Q. No. 5(b) 2 Marks each

- (i) The dividend income earned by 'A' Ltd. on the shares held as investment is exempt under the provisions of section 10(34). As per section 14A, no expenditure is allowable in respect of income which does not form part of total income. The interest paid on borrowed capital is an expenditure incurred in respect of shares purchased for investment. Since the dividend income received on shares is exempt and does not form part of total income of 'A' Ltd, the interest expenditure is not allowable as deduction.
- (ii) A transaction in derivatives, in which underlying asset is shares, is exempt from the purview of the speculative transaction, in terms of clause (d) of the proviso to section 43(5). As per the said clause, an eligible transaction in respect of trading in derivatives carried out in a recognized stock exchange shall not be deemed to be a speculative transaction. Accordingly, in the given case, if the transaction falls within the meaning "eligible transaction" as defined in the Explanation there in, then the loss would be treated as an ordinary business loss eligible for set-off loss as per normal set-off provisions. On the other hand, if the transaction does not

fall within the meaning of "eligible transaction", the loss would be treated as a speculation loss and can be set-off only against speculative income

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

[Hindustan Aeronautics Ltd v. CIT (2000) 243 ITR 898 (SC)] Section 264 provides that the Principal Commissioner or Commissioner has no power to revise any order which has been made the subjects matter of an appeal to the Commissioner (Appeals), even if the relief claimed in the petition is different from the relief claimed in appeal. The concept of total merger would apply in the case of section 264.

Section 154 provides that where any matter had been considered and decided in any proceeding by way of appeal or revision relating to an order, Assessing Officer may amend the order for rectification of mistake apparent from the record, in relation to a matter other than the matter which has been considered and decided. The concept of partial merger would apply in the case of section 154.

In the present case, since the order passed by the Assessing Officer in respect of the addition of unexplained cash credit of Rs. 8 lakhs became the subject matter of an appeal to the Commissioner (Appeals), the assessee, AUM Enterprise cannot apply for revision under section 264 even if the subject matter of revision i.e., addition of Rs. 3 lakhs under section 40(a)(ia) is different from the subject matter of appeal.

However, AUM Enterprise can apply to the Assessing Officer for rectification of the order in respect of addition of Rs. 3 lakh under section 40(a)(ia), as the matter has not been considered and decided in any proceeding by way of appeal or revision. In the view of above, the assessee, AUM Enterprise should seek rectification under section 154.

Answer to Q. No. 6(a) 7 Marks

Short-term capital gain on depreciable assets:	Rs.	Rs.
(i) Plant & Machinery (Rs. 30,00,000-21,00,000)	9,00,000	
(ii) Buildings (Rs. 40,00,000-12,00,000)	28,00,000	
(iii) Furniture & Fixture (Rs. 60,000-50,000)	10,000	37,10,000
Long term capital gain on industrial land:		
Sale Consideration	38,00,000	
Less: Indexed cost of acquisition – Rs. $10,90,000 \times 280/100$	30,52,000	7,48,000
Total Capital gain		44,58,000
Less: Exemption under section 54G		
(Rs. 17,00,000+31,60,000) but restricted to Rs. 44,48,000		44,48,000
Short-term capital gain (on furniture)		10,000
Capital gain furniture and fixture is not eligible for exemption under section 54G.		

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

Computation of total income and tax payable by R for the assessment year 2019-20			
		Rs.	Rs
Income under head "Salaries"			
Gross salary		5,00,000	
Less: Standard deduction		40,000	4,60,000
Long-term capital gain			
(a) From shares			
Sold through recognised stock exchange			
Selling price		4,00,000	
Cost of acquisition (see Note below)		2,70,000	
		1,30,000	
Long-term capital gain/loss from gold ornaments:			
Consideration Price	5,50,000		
Less: Indexed cost of acquisition – Rs. 2,00,000×280/100	5,60,000	(-) 10,000	1,20,000
Total Income			5,80,000
Tax on Rs. 5,80,000			
LTCG u/s 112A in excess of Rs. 1,00,000 i.e. 10% of Rs. 20,000			2,000
Tax on balance total income Rs. 4,60,000			10,500
			12,500
Add: Health and Education cess @ 4%			500
Tax Payable			13,000

Determination of cost of acquisition

Higher of the following:

- (i) Cost of acquisition i.e. Rs. 40,000 OR
- (ii) Lower of the following:
 - a) FMV on 31.1.2018. i.e. Rs. 2,70,000
 - b) Sale price of the shares i.e. Rs. 4,00,000

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

If any expenditure is incurred by an assessee in any financial year in respect of which he is not able to offer explanation about the source of such expenditure or the explanation offered by him is not satisfactory in the opinion of the Assessing Officer, then the amount of such unexplained expenditure may be deemed as income of the assessee for such financial year as per section 69C. Therefore, in this case, the expenditure of Rs. 20 lakhs incurred by Mr. X on the

wedding of his daughter may be deemed as income of Mr. X as per section 69C. Further, such unexplained expenditure which is deemed as the income of Mr. X shall not be allowed as deduction under any head of income Where the total income of Mr. X includes such unexplained expenditure of Rs. 20 lakhs, which is deemed as his income under section 69C, such deemed income would be taxed at the maximum marginal rate of 30% as per section 115BBE (plus education cess@ 2% and secondary and higher education cess @ 1%)

Further, no basic exemption or allowance or expenditure shall be allowed to Mr. X under any provision of the Income-tax Act, 1961 in computing such deemed income. Therefore, penalty under section 271(1)(c) shall be levied for concealment of income

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

The facts of case given in the question are similar to the case CIT v Madhukant M. Mehta (2001) 247 ITR 805, where the Supreme Court has held that if the business is succeeded by inheritance, the legal heirs are entitled to the benefit of carry forward of the loss of the predecessor. Even if the legal heirs constitute themselves as a partnership firm, the benefit of carry forward and set off the loss of the predecessor would be available to the firm.

May 19, 2019 CA Vijay Gaurav



CA FINAL REGULAR

NOV 2019/MAY 2020 EXAM



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