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PAPER – 7 : DIRECT TAX LAWS

Working notes should form part of the answer.

Question No.1 is compulsory.

*Answer any **five** questions from the remaining **six** questions.*

All questions relate to the assessment year 2014-15, unless stated otherwise in the question.

Question 1

(a) Victory Polyfibres, a partnership firm, has earned a gross total income of ₹ 300 lacs for the year ended 31-3-2014. There are no international transactions.

The above includes a profit of ₹ 220 lacs from an industrial undertaking having a turnover of ₹ 80 crores. This is the fifth year and deduction under section 80-IB of the Income-tax Act, 1961 is available to the extent of ₹ 200 lacs.

There are some grey areas in the taxation workings and hence, the assessee is contemplating to file the return of income on 7.12.2014, after seeking clarifications from tax experts.

Advise the assessee-company by working out the total income and tax payable, where the return is filed on 31-10-2014 and when the same is filed on 7-12-2014.

What is the practical solution as regards obtaining clarifications, which might or might not have an impact on the total income? (10 Marks)

(b) Examine with brief reason whether following are to be regarded as assets while calculating the net wealth as on 31-03-2014: (1 x 10 = 10 Marks)

(i) House given to a part-time employee of a company who has substantial interest in the company and whose gross salary is ₹ 50 lakhs per annum.

(ii) Commercial property let out for 300 days.

(iii) Jeep of the company given to the Director for official use.

(iv) Land held as stock in trade. (Acquired on 30-04-2005)

(v) Urban land lying vacant with incomplete building.

(vi) Yachts owned by a political party.

(vii) Bullions held by the Reserve Bank of India.

(viii) Gold deposit bonds held by the company, not being a company registered under section 25 of the Companies Act,1956.

(ix) ₹ 49,999 unrecorded cash held by a company.

(x) Helicopter owned by the assessee and used exclusively for business purposes.

[Mere conclusion, without any brief reasoning, will not receive any credit.]

Status may be taken as individual, unless indicated otherwise in the sub-division.

The Suggested Answers for Paper 7:- Direct Tax Laws are based on the provisions applicable for A.Y.2014-15, which is the assessment year relevant for May, 2014 examination.

Answer

(a) As per section 80AC, where in computing the total income of an assessee of a previous year *(P.Y.2013-14, in this case)* relevant to any assessment year *(A.Y.2014-15, in this case),* any deduction is admissible, *inter alia,* under section 80-IB, no such deduction shall be allowed unless it furnishes a return of its income for such assessment year on or before the due date as per section 139(1).

Since the turnover of the partnership firm has exceeded 100 lacs rupees in the previous year 2013-14, it would be subject to audit under section 44AB, in which case the due date of filing its return of income for A.Y.2014-15 would be 30th September, 2014 as per section 139(1).

Whether the firm files its return on 30-10-2014 or 7-12-2014, it would be a belated return under section 139(4). Consequently, as per section 80AC, deduction under section 80-IB would not be available.

In such circumstances, the gross total income of ₹ 300 lacs would be the total income of the firm.

The tax liability would be : -

	₹ in lacs
Income-tax@30% of ₹ 300 lacs	90.00
Add: Surcharge@10% (since total income exceeds ₹ 100 lacs)	9.00
Income-tax (plus surcharge)	99.00
Add: Education cess@2% and secondary and higher education cess@1%	2.97
Total tax liability	101.97

Practical solution regarding obtaining clarifications

The practical solution regarding obtaining clarifications would be to file the return of income under section 139(1) on or before the due date 30.9.2014 and claim deduction under section 80-IB. In such a case, the firm can claim deduction of ₹ 200 lacs under section 80-IB. Thereafter, consequent to the clarifications obtained, if any change is required, it can file a revised return under section 139(5) within 31.3.2016 (i.e., within one year from the end of A.Y.2014-15) which would replace the original return filed under section 139(1). A return filed under section 139(1) [i.e., on or before the due date of filing return of income] can only be revised under section 139(5). A belated return filed under section 139(4) cannot be revised.

If the firm files the return of income under section 139(1) on or before 30.9.2014, its tax liability would stand reduced to ₹ 62.88 lacs *(See Working Note below)*, as against ₹ 101.97 lacs to be paid if return is furnished after due date. Further, it would also be eligible for tax

credit for alternate minimum tax under section 115JD to the extent of ₹ 31.98 lacs. Therefore, the firm is advised to file its return of income on or before 30.9.2014.

Working Note – Computation of tax liability of the firm had it filed its return on or before 30.9.2014, being the due date of filing of return

Particulars	₹ in lacs
Gross Total Income	300.00
Less: Deduction under section 80-IB	200.00
Total Income	100.00
Tax liability@ 30%	30.00
Add: Education cess@2% and secondary and higher education cess@1%	0.90
Regular income-tax payable	30.90
Computation of Alternate Minimum Tax payable	
Total Income	100.00
Add: Deduction under section 80-IB	200.00
Adjusted Total Income	300.00
Alternate Minimum Tax (AMT) @ 18.5% on ₹ 300 lacs	55.50

Since the regular income-tax payable by the firm is less than the alternate minimum tax payable, the adjusted total income shall be deemed to be the total income of the firm for P.Y.2013-14 and it shall be liable to pay income-tax on such total income@18.5% [Section 115JC(1)]. Therefore, the tax payable for the A.Y.2014-15 would be:

	₹ in lacs
Tax @ 18.5% on ₹ 300 lacs (Adjusted total income)	55.50
Add: Surcharge@10% (Since adjusted total income > ₹ 1 crore)	5.55
	61.05
Add: Education cess@2% and secondary and higher education cess@1%	1.83
Total tax payable (AMT)	62.88

Tax credit for Alternate Minimum Tax [Section 115JD]	₹ in lacs
Total tax payable for A.Y.2014-15 (Alternate Minimum Tax)	62.88
Less: Regular income-tax payable	30.90
To be carried forward for set-off against regular income-tax payable (upto a maximum of ten assessment years).	31.98

Notes:

(1) If it is assumed that the firm has entered into specified domestic transactions and aggregate of such transactions entered into by the firm in the previous year exceeds ₹ 5 crore, then, the firm would have to file a report under section 92E, in which case, the due date of filing of return would be 30.11.2014. In such a case, the return filed on 31.10.2014 would be a return filed before the due date. If such an assumption is made, the computation of tax liability as given in the Working Note above would form the first part of the answer vis-à-vis computation of tax liability had the return been filed on 7.12.2014.

(2) It is assumed that the industrial undertaking is situated in the state of Jammu & Kashmir, due to which it is eligible for deduction@100% of its eligible profits for the first five years.

(b)

	Particulars	Reason for inclusion or exclusion as asset for wealth tax
(i)	House given to a part-time employee of a company whose gross salary is ₹ 50 lakhs p.a.	Yes, it is an asset under section 2(ea). The exclusion from the definition of asset under item (1) of section 2(ea)(i) is only in respect of a house allotted by a company to an employee or an officer or a director who is in whole-time employment, having a gross annual salary of less than ₹ 10 lakhs.
(ii)	Commercial property let out for 300 days.	No, it is not an asset under section 2(ea) It is excluded from asset as per item (5) of section 2(ea)(i), whether or not it is let out. The condition of letting out for a minimum period of 300 days is applicable only for exclusion of let-out residential house property from the definition of asset as per item (4) of section 2(ea)(i).
(iii)	Jeep of the company given to Director for official use	Yes, it is an asset under section 2(ea). In the Wealth-tax Act, 1957, the term "Motor Car" is meant to be an inclusive term encompassing all vehicles (other than heavy vehicles) which can be regarded as "motor car" in a broad sense. Hence, "Motor Car" includes a Jeep. Since the jeep is not used for the business of running on hire or as stock-in-trade, it is an asset as per section 2(ea)(ii). *[Southern Roadways Ltd. v. CWT (2001) 251 ITR 213 (Mad.) supports this view]*

(iv)	Land held as stock-in-trade (acquired on 30.4.2005)	No, it is not an asset under section 2(ea). Urban land does not include a land held by the assessee as stock-in-trade for a period of ten years from the date of its acquisition by him. Since the ten year period has not expired on 31.3.2014, it does not constitute an asset as per section 2(ea)(v) read with clause (b) of *Explanation 1*.
(v)	Urban land lying vacant with incomplete building	<u>First view (based on taxability of urban land, on which building is under construction)</u> Yes, it is an asset under section 2(ea). Urban land excludes only land occupied by any completed building which has been constructed with the approval of the appropriate authority. Therefore, value of land on which construction is in progress as on the valuation date would not be excluded from the definition of urban land. Hence, it is an asset chargeable to wealth-tax on the valuation date 31.3.2014 as per section 2(ea)(v). *[This view was taken by the Karnataka High Court in CWT vs. Giridhar G. Yadalam (2010) 325 ITR 223].* <u>Second view (based on taxability of an incomplete building)</u> No, it is not an asset under section 2(ea). A building under construction is not a completed building. An incomplete building would neither fall within the meaning of a building nor within the purview of "urban land" under section 2(ea) and hence, it is not an asset chargeable to wealth-tax. Thus, as on the valuation date 31.3.2014, wealth-tax liability does not arise in respect of the building under construction. *[This view was upheld by the Punjab and Haryana High Court in CIT vs. Neena Jain (2011) 330 ITR 157].*
(vi)	Yachts owned by political party	Even though yacht is an asset as per section 2(ea)(iv), wealth-tax is not leviable in the case of a political party by virtue of section 45.
(vi)	Bullions held by Reserve Bank of India	Although bullion is an asset as per section 2(ea)(iii), no tax shall be levied in respect of the net wealth of Reserve Bank of India as per section 45.

(viii)	Gold deposit bonds held by a company, not being a company registered under section 25 of the Companies Act, 1956	No, it is not an asset under section 2(ea). Although jewellery is an asset as per section 2(ea)(iii), *Explanation 2* to section 2(ea) clarifies that "jewellery" does not include Gold Deposit Bonds issued under the Gold Deposit Scheme, 1999 notified by the Central Government.
(ix)	₹49,999 unrecorded cash held by a company	Yes, it is an asset under section 2(ea). In case of persons other than individuals and HUFs, any amount of cash not recorded in the books of account is an asset as per section 2(ea)(vi).
(x)	Helicopter owned by the assessee and used for business purposes	No, it is not an asset under section 2(ea). Helicopter is an aircraft. Use for business purposes can be construed as use for commercial purposes, and hence the same is excluded from the definition of asset as per section 2(ea)(iv). *[This view was upheld in case of Wall Ropes Ltd. vs. Additional CIT (2004) 89 ITD 221 (Mum)]*

Question 2

XYZ Ltd. is engaged in the business of manufacturing fertilizers. Its profit and loss account shows a net profit of ₹ 500 lakhs for the year ended 31-03-2014 after debiting and crediting the following items:

- *Depreciation provided in accounts as per straight line basis is ₹ 30 lakhs.*

  Normal depreciation allowable is ₹ 28 lakhs. The company has made addition to machinery during the year to the extent of ₹ 100 lakhs, in June, 2013.

- *The company has made cash payments for purchases and expenditure as below:*

  On 04-06-2013 ₹ 5 lakhs (Due to strike by bank staff)

  On 05-06-2013 ₹ 7 lakhs (Due to cash demanded by the supplier)

  On 30-09-2013 ₹ 10 lakhs (Half yearly closing for bank; a bank holiday)

  Payment made to transport operator for hiring of lorry as follows:

  07-05-2013 ₹ 50,000; 08-01-2014 ₹ 75,000; 02-03-2014 ₹ 32,000.

- *₹ 5 lakhs contribution to a University approved and notified under section 35(1)(ii).*

- *Sales tax of ₹ 1.45 lakhs, pertaining to the year ended 31-03-2013, was paid on 10-12-2013.*

- *Rent paid and professional charges to a consultant including service tax was ₹ 5,61,800 and ₹ 2,24,720 respectively. Tax was not deducted on the service tax portion for both the payments.*

- *The company has imported 1000 kgs raw materials from a supplier in US at the rate $75/kg on 29-03-2013. The exchange rate was ₹ 59/$ when the imports were made. The payment to the supplier was made on 20-01-2014 when the exchange rate was ₹ 62/$. The company had not entered into a forward contract to hedge the risk.*
- *The company has also purchased goods of ₹ 55 lakhs from M/s. ABC Ltd. in which Directors have substantial interest. The market value of the goods is ₹ 54 lakhs.*
- *The company has incurred legal expenses for the following:*

  Issue of Bonus shares ₹ 10 lakhs.

  Alteration of Memorandum of Association ₹ 2 lakhs (in connection with increase of authorized capital).
- *Donation paid to a political party is ₹ 25 lakhs.*

Compute the total income and tax payable by the company for the assessment year 2014-15. Ignore MAT provisions. *(16 Marks)*

Answer

Computation of Total Income of XYZ Ltd. for the A.Y.2014-15

Particulars	Amount (₹)	
Profits and Gains from Business and Profession		
Net profit as per profit and loss account		5,00,00,000
Add: Items debited but to be considered separately or to be disallowed		
Depreciation provided on straight line basis (Note 1)	30,00,000	
Disallowance under section 40A(3) for payment exceeding ₹ 20,000 made in cash for purchases and expenditure (Note 2)	7,00,000	
Disallowance under section 40A(3) for cash payment exceeding ₹ 35,000 in a day to transport operators for hiring of lorry (Note 3)	1,25,000	
Contribution to University (considered separately for weighted deduction) (Note 4)	5,00,000	
Sales tax of P.Y.2012-13 paid on 10.12.2013 (Note 5)	-	
Rent and Professional charges paid to consultant, on which tax has not been deducted on the service tax component (Note 6)	-	
Foreign exchange loss actually incurred on payment to a supplier of raw material (Note 7)	-	
Disallowance under section 40A(2) for excess payment to related person (Note 8)	1,00,000	

Legal expenses for issue of bonus shares (Note 9)	-	
Legal expenses for alternation of memorandum of association (Note 9)	2,00,000	
Donation to political party (Note 10)	25,00,000	71,25,000
		5,71,25,000
Less: Items credited but to be considered separately or to be allowed		
Depreciation allowable under the Income-tax Act, 1961 (Note 1)	48,00,000	
Weighted deduction @ 175% in respect of contribution of ₹ 5 lakhs to a University approved and notified under section 35(1)(ii) (Note 4)	8,75,000	56,75,000
Gross Total Income		5,14,50,000
Less: Deduction under Chapter VI-A		
Under section 80GGB [Donation to political party] (Note 10)		25,00,000
Total Income		4,89,50,000

Computation of tax liability of XYZ Ltd. for A.Y.2014-15

Particulars	₹
Tax@30% on total income of ₹ 4,89,50,000	1,46,85,000
Add: Surcharge@5% (since total income exceeds ₹ 1 crore but does not exceed ₹ 10 crores)	7,34,250
Tax payable including surcharge	1,54,19,250
Add: Education cess@2% and secondary and higher education cess@1%	4,62,578
Total tax payable	1,58,81,828

Notes:

(1) Depreciation provided in the accounts on straight line basis (i.e., ₹ 30 lakhs) has to be added back and depreciation calculated as per Income-tax Rules, 1962 (i.e. ₹ 28 lakhs) is allowable as deduction under section 32.

Further, as per section 32(1)(iia), additional depreciation is allowable in the case of any new machinery or plant acquired and installed by an assessee engaged in, *inter alia*, the business of manufacture or production of any article or thing, at the rate of 20% of the actual cost of such machinery or plant. In this case, since the new machinery costing ₹ 100 lakhs is purchased in June 2013, additional depreciation @ 20% is allowable, as

the machinery was put to use for more than 180 days during the P.Y.2013-14[1]. Therefore, the total depreciation allowable is ₹ 48 lakhs [i.e., ₹ 28 lakhs + ₹ 20 lakhs].

(2) Cash payments exceeding ₹ 20,000 a day attracts disallowance under section 40A(3). However, Rule 6DD provides for certain exceptions, which includes, *inter alia,* payments which are required to be made on a day on which the banks were closed either on account of holiday or strike. Therefore, cash payment of ₹ 5 lakhs made on the day of strike by bank staff and cash payment of ₹ 10 lakhs made on a bank holiday would not attract disallowance under section 40A(3), assuming such payments were required to be made on those specific dates. However, cash payment of ₹ 7 lakhs made on 5-6-2013 due to demand of supplier would attract disallowance under section 40A(3), since the same is not covered under any of the exceptions laid out in Rule 6DD.

(3) In respect of cash payments to transport operators, a higher limit of ₹ 35,000 per day is permissible. Therefore, cash payment of ₹ 32,000 on 2-3-2014 would not attract disallowance under section 40A(3). However, cash payments of ₹ 50,000 and ₹ 75,000 on 7.5.2013 and 8.1.2014, respectively, would attract disallowance under section 40A(3) since the same exceeds ₹ 35,000 per day.

(4) Contribution to a university approved and notified under section 35(1)(ii) qualifies for weighted deduction@175%. Hence, the contribution of ₹ 5 lakhs is first added back and thereafter, deduction of ₹ 8.75 lakhs (i.e.,175% of ₹ 5 lakhs) has been provided under section 35(1)(ii).

(5) Sales tax liability of ₹ 1.45 lakhs pertaining to P.Y.2012-13 would have been disallowed under section 43B while computing business income of A.Y.2013-14, since it was paid only on 10.12.2013 (i.e., after the due date of filing return of income of that year). It would be allowed in the year of payment (i.e., P.Y.2013-14). Since it is already debited to profit and loss account, no further adjustment is required.

(6) Rent and professional charges have been debited to profit and loss account. It is stated that tax has not been deducted on the service tax component of rent and professional charges.

As per *CBDT Circular No. 4/2008 dated 28.4.2008*, service tax paid by a tenant does not partake the nature of income of the landlord. Hence, tax is to be deducted at source under section 194-I on rent paid without including service tax.

In respect of professional charges, if in terms of the agreement/contract between the payer and the payee, the service tax component comprised in the amount payable to a resident is indicated separately, tax shall be deducted at source on the amount paid/payable without including such service tax component. It was so held in *CIT v. Rajasthan Urban Infrastructure (2013) (31) STR 642 (Raj.)*[2]

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[1] *It is assumed that the machinery is put to use immediately after purchase in June, 2013.*

[2] *The view taken in CIT v. Rajasthan Urban Infrastructure (2013) (31) STR 642 (Raj.) has also been incorporated in the CBDT Circular No.1/2014 dated 13.1.2014.*

Assuming that, in this case, the service tax component is indicated separately in the agreement/contract between the company and the consultant, tax is required to be deducted at source on the professional charges without including such service tax component. Therefore, no disallowance is attracted for non-deduction of tax at source on the service-tax component.

(7) Where the assessee regularly follows accrual system of accounting and provides for loss suffered on account of foreign exchange difference according to Accounting Standard 11 and not with a view to reduce incidence of taxation, such loss is an item of expenditure allowable under section 37(1). It has been so held in *CIT vs. Woodward Governor India Pvt. Limited (2009) 312 ITR 254 (SC).*

In this case, the foreign exchange loss of ₹ 2,25,000 (1,000 kgs × $ 75 × ₹ 3) has accrued and actually been incurred during the P.Y.2013-14. Hence, the same is allowable as deduction in the A.Y.2014-15. Since the same has already been debited to profit and loss account, no adjustment is required.

Note : It is assumed that XYZ Ltd. follows mercantile system of accounting and therefore, it can be presumed that the amount of ₹ 44,25,000 (1,000 kgs × $ 75 × ₹ 59) was debited to the profit and loss account in the year P.Y.2012-13. Further, it is also assumed that the rate of exchange on 31.3.2013 was the same as on 29.3.2013 and hence, no further loss was provided for in P.Y.2012-13.

(8) ABC Ltd. is a related person under section 40A(2), since the directors of the XYZ Ltd. have substantial interest in ABC Ltd. Therefore, excess payment of ₹ 1 lakh to ABC Ltd. for purchase of goods would attract disallowance under section 40A(2).

(9) There is no fresh inflow of funds or increase in capital employed on account of issue of bonus shares and there is only reallocation of the company's fund. Consequently, since there is no increase in the capital base of the company, legal expenses of ₹ 10 lakhs in connection with issue of bonus shares is a revenue expenditure and is hence, allowable as deduction. It has been so held by Apex Court in case of *CIT vs. General Insurance Corpn. (2006) 286 ITR 232.*

However, ₹ 2 lakhs, being legal expenses in relation to alternation of memorandum in connection with increase in Authorised Capital is directly related to expansion of the capital base of the company and is, hence, a capital expenditure. Therefore, the same is not allowable as deduction. It has been so held in *Punjab State Industrial Development Corporation Ltd. vs. CIT (1997) 225 ITR 792 (SC).*

Note : A view can also be taken that legal expenses in relation to alternation of memorandum of association in connection with enhancement of authorized capital is allowable as deduction, if the enhancement of capital was for the purpose of issuance of bonus shares.

(10) Donation paid to a political party is not an allowable expenditure under section 37 since it is not laid out wholly or exclusively for the purposes of business or profession. Hence, the same has to be added back while computing business income. However, donation made by a company to a political party is allowable deduction under section 80GGB from

gross total income, subject to the condition that payment is made otherwise than by way of cash. It is assumed that such donations are made otherwise than by way of cash to a political party registered under section 29A of the Representation of the People Act, 1951.

Question 3

(a) *VKS Internationals Ltd., the assessee, has sold goods on 12-1-2014 to L Ltd., located in a notified jurisdictional area (NJA), for ₹ 10.5 crores. The sale price of identical goods sold to an unfamiliar customer in New York during the year was ₹ 11.5 crores. While the second sale was on CIF basis, the sale to L Ltd. was on F.O.B. basis. Ocean freight and insurance amount to ₹ 20 lacs.*

India has a Double Taxation Avoidance Agreement with the U.S.A.

The assessee has a policy of providing after-sales support services to the tune of ₹ 14 lacs to all customers except L Ltd.

The ALP worked out as per Cost plus method for identical goods is ₹ 12.1 crores.

You are required to compute the ALP for the sales made to L Ltd., and the amount of consequent increase, if any, in profits of the assessee company. *(8 Marks)*

(b) *Vishwa Textiles Ltd. has convened a meeting of top management in which the Taxation Manager and Finance Manager are also present. As Tax Auditor, you have also been convened to the meeting for the session relating to tax audit under section 44AB of the Income-tax Act, 1961.*

The company plans to start a subsidiary for doing Chit Fund business.

The Managing Director asked the Taxation Manager, "How are gross receipts/turnover calculated for the purposes of section 44AB, relating to Chit Fund business?" The Taxation Manager replied that it was based on the total chit collections during the year in question.

The Sales Manager pointed out in the meeting that sales return relating to a sale effected in March, 2013 had been debited to the sales account in the current year. He wanted to know how this should be dealt with, in the particulars to be furnished in Form No. 3CD of the current year, i.e., assessment year 2014-15.

The Finance Manager had a different view relating to an item in Tax Audit Report of the assessment year 2013-14 and wanted some changes in Form No. 3CA of that year.

The company has received a subsidy of ₹ 10 lakh from the State Government during the year for a machinery purchased in 2010-11 The WDV of the block as on 1-4-2013 was ₹ 12 lakhs. The Chairman asked the forum "How will this subsidy be reported in Form No.3CD?"

As Tax Auditor of the Company, you are required to

(i) *Identify the various issues raised relating to section 44AB and requirements of particulars for Form No. 3CD, and* *(2 Marks)*

(ii) *Suggest your views relating to the said issues.* *(6 Marks)*

Answer

(a) A transaction where one of the parties thereto is a person located in a notified jurisdictional area (NJA) would be deemed to be an international transaction and all parties to the transaction would be deemed as associated enterprises under section 92A. The transaction of sale to L Ltd. located in a NJA, has a bearing on the profit/income/ loss/assets of the assessee company, and hence, the same shall be deemed to be an international transaction within the meaning of section 92B. Accordingly, all the provisions of transfer pricing would be attracted in case of such a transaction. However, the benefit of permissible variation between the ALP and the transfer price *[provided for in the second proviso to section 92C(2)]* based on the rate notified by the Central Government would not be available in respect of such transaction.

Arm's length price (ALP) means a price which is applied or proposed to be applied in a transaction between persons other than associated enterprises in uncontrolled conditions.

Section 92C provides that the ALP shall be determined by any of the prescribed methods, being the most appropriate method, having regard to the nature of transaction or other relevant factors.

From the information given in the question, ALP can be computed by applying Comparable Uncontrolled Price (CUP) method. The ALP worked out as per Cost Plus Method (CPM) is also given in the question.

Assuming that the CUP method is the most appropriate method, the ALP of the transaction with L Ltd. located in NJA, would be: -

Particulars	₹ in crores
Sale price of identical goods (on CIF basis)	11.50
Less: Ocean freight and insurance	0.20
	11.30
Less: Cost of after-sales support services	0.14
Arm's length price (ALP) of the transaction with NJA	11.16
Less: Actual Transfer Price (of the transaction with NJA)	10.50
Increase in profits of VKS International Ltd.	0.66

Thus, if CUP method is taken as the most appropriate method, the ALP would be ₹ 11.16 crores and the increase in profits of VKS International Ltd. would be ₹ 66 lakhs.

Notes:

(1) The first proviso to section 92C(2) states that where more than one price is determined by the most appropriate method, the ALP shall be taken to be the arithmetical mean of such prices. Thus, the first proviso to section 92C(2) would be attracted only in a case where more than one ALP is determined by applying the most appropriate method. From the facts given in the question, only one ALP can

be determined using the most appropriate method, i.e., CUP Method, as assumed in this case. Therefore, the question of computing arithmetical mean does not arise. The ALP of ₹ 12.10 crores as per Cost Plus Method (CPM) for identical goods cannot be used for determining the arithmetical mean since it is the ALP worked out by a method, other than the CUP method.

(2) As per the Guidance Note on Report under section 92E of the Income-tax Act, 1961, issued by ICAI, CUP Method may be adopted as the most appropriate method in respect of, inter alia, a transaction involving transfer of goods. Further, the Guidance Note also mentions that CPM is normally used only where raw materials or semi-finished goods are sold or where joint facility agreements or long-term buy-and-supply arrangements, or provision of services are involved. Accordingly, the above solution has been worked out taking CUP Method to be the most appropriate method, since the transaction in this case involves transfer of goods. It is assumed that the goods mentioned in the question are finished goods.

Alternatively, since the exact nature of goods transferred is not given, the question may be solved by assuming CPM as the most appropriate method. Even in such a case, the question of determining arithmetical mean does not arise due to the reason mentioned in (1) above.

(b) (i) The various issues raised relating to section 44AB and the requirements of particulars for Form 3CD are as follows -

(1) The manner of computation of gross receipts/turnover of chit fund business – whether on total chit collection basis or on any other basis.

(2) The manner of dealing with sales return relating to sales effected in the earlier previous year (P.Y.2012-13) in Form 3CD of A.Y.2014-15.

(3) Whether changes can be made in Form 3CA of A.Y.2013-14, consequent to a different view expressed by the Finance Manager relating to an item in Tax Audit Report.

(4) The manner of reporting, in Form 3CD, subsidy of ₹ 10 lakhs received from the State Government during the P.Y.2013-14, in respect of machinery purchased in an earlier previous year (P.Y.2010-11), the written down value (WDV) of which on 1.4.2013 is ₹ 12 lakhs.

(ii) The views of the tax auditors on the above issues, based on the Guidance Note on Tax Audit under section 44AB issued by ICAI, are as under: -

(1) In case of chit fund business, commission, brokerage, service and other incidental charges received would constitute gross receipts in business.[3]

The taxation manager's view that the gross receipt is based on total chit collections during the year is not correct.

[3] Para 5.14 on page 25 of the Guidance Note on Tax Audit under section 44AB

(2) The price of goods returned should be deducted from the figure of turnover for P.Y.2013-14, even if the returns are from the sales made during P.Y.2012-13.[4]

The quantity of goods returned should be reduced from the quantity of sales and the net sales quantity should be disclosed under clause 28(a) of Form 3CD, if the company is a trading concern or under clause 28(b) of Form 3CD, if the company is a manufacturing concern.

Further, in Part B of Annexure I to Form 3CD, the figure of Gross turnover/gross receipts should indicate the amount as reduced by the price of goods returned.

(3) Report under section 44AB (in Form 3CA, in this case) should not normally be revised.[5] However, sometimes, the tax audit report may be required to be revised on grounds such as:

(i) Revision of accounts of a company after its adoption in annual general meeting;

(ii) Change of law, for example, on account of a retrospective amendment.

(iii) Change in interpretation, for example, on account of CBDT Circular, judgement of courts etc.

Assuming that the difference in view of the Finance Manager relating to an item in the tax audit report is on account of any of the above reasons, Form 3CA can be revised.

(4) *Explanation 10* to section 43(1) provides that where a portion of the cost of an asset acquired by the assessee has been met directly or indirectly by the Central or State Government, in the form of subsidy, then so much of the cost as is relatable to such subsidy shall not be included in the actual cost of the asset to the assessee.

Subsidy coming within the scope of *Explanation 10* to section 43(1) in respect of asset acquired in any earlier year and received during the year has to be deducted from the written down value (WDV) of such assets in the year of receipt.[6] Accordingly, in this case, the subsidy of ₹ 10 lakhs has to be reduced from the written down value of ₹ 12 lakhs on 1.4.2013.

In Form 3CD, the subsidy has to be reported in clause 14(d) Deductions during the year. The depreciation allowable [Clause 14(e)] would be on ₹ 2 lakhs (i.e., ₹ 12 lakhs – ₹ 10 lakhs) and the written down value at the end of the year [clause 14(f)] would accordingly, stand reduced.

In addition, the capital subsidy should also be disclosed as a capital receipt in clause 13(e) of Form 3CD.

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[4] Para 5.9 on page 22 of the Guidance Note on Tax Audit under section 44AB

[5] Para 13.10 on page 56 of the Guidance Note on Tax Audit under section 44AB

[6] Para 26.18 in page 104 of the Guidance Note on Tax Audit under section 44AB

Question 4

Answer any four from the following five sub-divisions:

(a) X & Co. Diagnostic Centre P Ltd. has claimed referral fee paid to doctors as revenue expenditure for the assessment year 2014-15. Tax has been deducted under section 194H of the Income-tax Act, 1961 for the said payments. The Assessing Officer proposes to disallow such expenditure.

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

(b) Discuss whether tax has to be deducted at source under the provisions of the Income-tax Act, 1961 in the following situations, which have taken place during the year ended 31-3-2014:

(i) M/s. Jiva & Co., a partnership firm, pays a sum of ₹ 43,000 as interest on loan borrowed from Indian branch of a foreign bank.

(ii) Above firm has paid ₹ 14,000 as interest on capital to partner Mr. A, a resident in India, and ₹ 22,000 as interest on capital to partner Mr. B, a non-resident. (2 x 2 = 4 Marks)

(c) Mrs. Priya, a resident individual, sold on 30-6-2013, depreciable assets held for more than 36 months and invested the proceeds on 30-9-2013 in a residential house property to claim exemption from capital gains. Examine the validity of the order of the Assessing Officer in denying her the exemption under section 54F of the Income-tax Act, 1961. Mrs. Priya does not own any other residential house. (4 Marks)

(d) X & Co Ltd. had made an application to the Settlement Commission. The issue in the said application related to cash credits in the books of account. The Commission passed an order making addition to the income on the basis of difference in gross profit rate adopted, which was neither an issue in the application nor in the report of the Commissioner of Income-tax. Discuss the validity of the order of the Settlement Commission. (4 Marks)

(e) A foreign company seconded some employees to the assessee, an Indian collaborator. The assessee had not deducted tax at source on the home salary/special allowance/s (education allowance or retention allowance) payments made by foreign company/HO to its employees (expatriated to India) outside India in foreign currency. The Revenue authorities, holding the assessee as an 'assessee-in-default' under section 201 of the Income-tax Act, 1961, levied interest and penalty on it. Is the same justified? (4 Marks)

Answer

(a) As per *Explanation* to section 37(1), any expenditure incurred by an assessee for any purpose which is an offence or which is prohibited by law shall not be deemed to have been incurred for the purpose of business and profession and no deduction or allowance shall be made in respect of such expenditure.

As per the Indian Medical Council (Professional Conduct, Etiquette and Ethics) Regulations, 2002, no physician shall give, solicit, receive or offer to give, solicit or receive any gift, gratuity, commission or bonus in consideration of a return for referring any patient for medical treatment.

The demand as well as payment of such referral fee is bad in law. It is not a fair practice and is opposed to public policy. Applying the rationale and considering the purpose of *Explanation* to section 37(1), the assessee would not be entitled to deduction of such payments made in contravention of law or opposed to public policy or have pernicious consequences to the society as a whole. This view has been upheld by the Punjab & Haryana High Court in *CIT vs. Kap Scan and Diagnostic Centre P Ltd. (2012) 344 ITR 476*.

Thus, the action of the Assessing Officer in disallowing the referral fee paid by X & Co. Diagnostic Centre P. Ltd. to doctors is correct. The fact that tax has been deducted under section 194H is of no consequence.

(b) (i) Section 194A requires deduction of tax on any income by way of interest, other than interest on securities, credited or paid to a resident, at the rates in force.

However, it specifically excludes from its scope, income credited or paid to any banking company to which the Banking Regulation Act, 1949 applies.

An Indian branch of a foreign bank, transacting the business of banking in India is a banking company to which the Banking Regulation Act, 1949 applies. Therefore, interest payment to such bank will not attract TDS provisions under section 194A.

Consequently, no tax is required to be deducted at source under section 194A on interest of ₹ 43,000 paid by M/s. Jiva & Co., a partnership firm, on loan borrowed from an Indian branch of a foreign bank.

Note: The Banking Regulation Act, 1949 applies to every banking company i.e., any company which transacts the business of banking in India. "Company", for this purpose, includes a foreign company within the meaning of section 591 of the Companies Act, 1956 i.e., a company incorporated outside India which has established a place of business within India. Therefore, an Indian branch of a foreign bank falls within the definition of a banking company to which the Banking Regulation Act, 1949 applies.

(ii) Section 194A requiring deduction of tax at source on any income by way of interest, other than interest on securities, credited or paid to a resident, excludes from its scope, income credited or paid by a firm to its partner. Therefore, no tax is required to be deducted at source under section 194A on interest on capital of ₹ 14,000 paid by the firm to Mr. A, a resident partner.

However, section 195, which requires tax deduction at source on interest payments to non-residents, does not provide for such exclusion. Therefore, tax has to be deducted under section 195 at the rates in force in respect of interest on capital of ₹ 22,000 paid to partner Mr.B, a non-resident, unless Mr.B makes an application to the Assessing Officer in the prescribed form for grant of certificate authorising him to receive such interest without deduction of tax and he has been granted such certificate.

(c) Exemption under section 54F would be available where an individual or HUF transfers a long-term capital asset, other than residential house, and purchases a residential house

within one year before or two years after the date of transfer. Another condition to be satisfied for availing the benefit of exemption is that the individual/HUF should not own more than one residential house (other than the new residential house purchased) on the date of transfer of the original asset.

The deeming fiction created by section 50 that the capital gain arising on transfer of a depreciable asset shall be treated as capital gain arising on transfer of short-term capital asset is only for the purpose of sections 48 and 49 and not for the purpose of any other section.

Section 54F being an independent section will not be bound by the provisions of section 50. The nature of capital asset, whether short-term or long-term, has to be determined applying the provisions of section 2(42A). The depreciable asset, if held for more than 36 months, shall be a long-term capital asset.

It was so held by the Delhi High Court in the case of *CIT vs. Rajiv Shukla (2011) 334 ITR 138* following the decision of Bombay High Court in the case of *CIT vs. Ace Builders Pvt. Ltd.(2006) 281 ITR 210*.

In this case, since a depreciable asset held for more than 36 months is transferred and the proceeds are invested within a span of 3 months (i.e., within the prescribed time limit of two years after the date of transfer) in a residential house property, exemption under section 54F cannot be denied to Mrs. Priya.

Mrs. Priya does not own any other residential house. Hence, she also satisfies the condition of not owning more than one residential house on the date of transfer.

Therefore, the action of the Assessing Officer in denying her exemption under section 54F is not valid.

(d) The issue under consideration is whether the Settlement Commission can pass an order making addition to the income on the basis of difference in gross profit rate adopted, which was neither an issue in the application nor in the report of the Commissioner of Income-tax.

Section 245D(4) provides that the Settlement Commission, after examination of records and the report of the Commissioner and after examining such further evidence as may be placed before it or obtained by it, may, in accordance with the provisions of the Act, pass such order as it thinks fit.

Further, section 245D(5) provides that the materials brought on record before the Settlement Commission shall be considered by the Members of the concerned Bench before passing any order under section 245D(4).

"Consideration" means independent examination of the evidence and material brought on record before the Settlement Commission by the members and application of mind thereto with a view to independently assess the materials and evidence, whether adduced by the applicant or by the Commissioner, and come to a conclusion by themselves.

This view has been upheld in case of *Supreme Agro Foods P Ltd. v. Income-tax Settlement Commission (2013) 353 ITR 385 (P & H)*

The Settlement Commission, therefore, has to consider the material brought on record before it and "consideration" means independent examination of the evidence and material on record.

In this case, since the material was available before the Settlement Commission and such material has been taken into consideration for returning a finding which is relevant for determining the undisclosed income of the applicant, the addition made on the basis of difference in gross profit rate adopted is justified.

Therefore, the order of the Settlement Commission is valid.

(e) Section 9(1)(ii) provides that any income which falls under the head "salaries" is deemed to accrue or arise in India, if it is earned in India. The *Explanation* thereto further clarifies that income payable for services rendered in India shall be regarded as income earned in India.

Section 192(1) requires the person responsible for paying any income chargeable under the head "Salaries" to deduct income-tax, at the time of payment, at the average rate of income-tax computed on the basis of the rates in force for the financial year on the amount payable.

Since the TDS provisions relating to payment of income chargeable under the head "Salaries" form an integrated code alongwith the charging and computation provisions under the Act, section 192(1) has to be read with section 9(1)(ii) and the *Explanation* thereto. Therefore, if any payment under the head "Salaries" falls within section 9(1)(ii), then TDS provisions under section 192 gets attracted. Consequently, the Indian tax deductor assessee is duty bound to deduct, from the portion of salary paid by it, tax at source under section 192(1) on the entire salary paid to the employee, including home salary/special allowance paid abroad to the employee by the foreign company.

It was so held by the Apex Court in *CIT, New Delhi v. Eli Lilly & Co. (India) P. Ltd. (2009) 312 ITR 225.*

If the tax due on home salary/special allowance is paid by the recipient-employees (assuming that they are resident in India), then, the employer-assessee would not be treated as an assessee-in-default under section 201(1), if the resident-employees have furnished a return of income under section 139 on or before the due date of filing return of income, disclosing such income, and have also furnished a certificate to this effect from an accountant in the prescribed form. However, interest under section 201(1A)@1% per month or part of month shall be payable by the employer-assessee from the date on which such tax was deductible to the date of furnishing of return by such resident employee.

In cases where the tax has not been paid by the recipient employee, the Assessing Officer can proceed under section 201(1) to recover the shortfall in payment of tax and interest thereon under section 201(1A).

However, no penalty under section 271C would be attracted, if the tax deductor assessee was under the genuine and *bona fide* belief that it was not under any obligation to deduct tax at source from the home salary paid by the foreign company. This is provided for under section 273B.

Question 5

(a) The regular assessment of MNO Ltd. for the assessment year 2012-13 was completed under section 143(3) on 13th April, 2013. There was an audit objection by the Revenue Audit team that interest on loan should be partly disallowed as there was diversion of borrowed fund to sister concern without charge of interest.

Based on the above facts:

(i) State, with reasons, whether the Assessing Officer can issue notice under section 148 (on 12th March, 2014) on the basis of audit objection of the Revenue Audit team. (4 Marks)

(ii) If the action stated in (i) above is not permitted, what is the option open to the Revenue Department to deal with the said audit objection? (4 Marks)

(b) An assessee, who is aggrieved by all or any of the following orders, is desirous to know the available remedial measures and the time limit against each, under the Income-tax Act, 1961:

(i) Passed under Section 143(3) by Assessing Officer,

(ii) Passed under Section 263 by the Commissioner of Income-tax,

(iii) Passed under Section 272A by the Director General, and

(iv) Passed under Section 254 by the Income Tax Appellate Tribunal.

Advise him suitably. (2 x 4 = 8 Marks)

Answer

(a) (i) Section 147 states that if the Assessing Officer has reason to believe that any income chargeable to tax has escaped assessment for any assessment year, he may assess or reassess such income and also any other income chargeable to tax which has escaped assessment and which comes to his notice subsequently in the course of the proceedings under this section.

The Assessing Officer should, therefore, have reason to believe that income chargeable to tax has escaped assessment. The belief should be that of the Assessing Officer and not of the revenue audit team.

Further, the Income-tax Act, 1961 does not confer jurisdiction on the Assessing Officer to change its opinion on the interpretation of a particular provision earlier adopted by it. If the issue had already been considered earlier during the course of scrutiny assessment and the Assessing Officer had come to a conclusion that no disallowance of interest paid by the assessee is required, even though loans had been given to sister concern without any interest, the same issue cannot be the basis of reassessment, merely because the revenue audit team takes a different view.

Therefore, the Assessing Officer cannot issue notice under section 148 on the basis of audit objection of the Revenue Audit team.

(ii) Option available to the Revenue Department

The option open to the Revenue is initiation of proceedings under 263, by the jurisdictional Commissioner. He has the power to call for and examine the records, if he is of the opinion that the order passed by the Assessing Officer under section 143(3) is erroneous in so far as it is prejudicial to the interests of the Revenue.

However, where the Assessing Officer has considered the issue in the original assessment and come to a conclusion that no disallowance of interest is called for, the Commissioner cannot initiate revisionary proceedings, merely because he holds a different view. Only where the view taken by the Assessing Officer is unsustainable in law, the Commissioner will be justified in initiating the revisionary proceedings under section 263. It was so held in *CIT vs. Sohana Woollen Mills (2008) 296 ITR 238 (P & H).*

Mere audit objection and possibility of a different view are not sufficient to conclude that the order of the Assessing Officer is erroneous or prejudicial to the interest of revenue.

(b) (i) An assessee, aggrieved by the order passed under section 143(3) by the Assessing Officer, can file an appeal before the Commissioner of Income-tax (Appeals) under section 246A(1) within 30 days of the date of service of the notice of demand relating to the assessment.

However, where the assessee does not want to prefer an appeal, then he can move a revision petition before the Commissioner of Income-tax under section 264 within a period of one year from the date of on which the order was communicated to him or the date on which he otherwise came to know of it, whichever is earlier.

(ii) An assessee, aggrieved by the order passed under section 263 by the Commissioner of Income-tax, can file an appeal to Income-tax Appellate Tribunal under section 253(1)(c) within 60 days of the date on which the order sought to be appealed against is communicated to the assessee.

(iii) An assessee, aggrieved by the order passed under section 272A by the Director General, can file an appeal before the Income-tax Appellate Tribunal under section 253(1)(c) within 60 days of the date on which the order sought to be appealed against is communicated to the assessee.

(iv) An assessee, aggrieved by the order passed under section 254 by the Income-tax Appellate Tribunal, can file an appeal before the High Court under section 260A within 120 days from the date of receipt of order of Income-tax Appellate Tribunal, only where the order gives rise to a substantial question of law.

Question 6

(a) Compute the quantum of depreciation available under section 32 of the Income-tax Act, 1961 and any other benefit available in respect of the following items of Plant and Machinery purchased by PQR Textile Ltd., which is engaged in the manufacture of textile fabrics, during the year ended 31-3-2014:

	(₹ In crores)
New machinery installed on 1-5-2013	*84*
New Windmill purchased and installed on 18-6-2013.	*22*
Items purchased after 30th November 2013:	
Lorries for transporting goods to sales depots	*3*
Fork-lift-trucks, used inside factory	*4*
Computers installed in office premises	*1*
Computers installed in factory	*2*
New imported machinery	*12*

The new imported machinery arrived at Chennai port on 30-03-2014 and was installed on 3-4-2014. All other items were installed during the year ended 31-3-2014.

The company was newly started during the year.

Also, compute the WDV of the various blocks of assets.

Will your answer be different if the above assessee were a partnership firm? (8 Marks)

(b) Examine the taxability or allowability or otherwise in the following cases while computing income under the head "Profits and Gains from Business or Profession" to be declared in the return of income for the assessment year 2014-15:

(i) Amount received towards power subsidy with a stipulation that the same is to be adjusted in the electricity bills.

(ii) Donations received by a person in the course of carrying on vocation, from his followers.

(iii) Profit derived by an assessee engaged in carrying the business as dealers in shares, on exchange of the shares held as stock in trade of one company with the shares of other company.

(iv) The amount of margin money forfeited by a bank on the failure of its constituents of not taking the delivery of the shares purchased by such bank on their behalf. (8 Marks)

Answer

(a) Computation of depreciation allowance under section 32 for the A.Y. 2014-15

Particulars	Normal Depreciation [u/s 32(1)(ii)] (₹ in crores)	Additional Depreciation [u/s 32(1)(iia)] (₹ in crores)
(A) Plant and Machinery (15% block) (Put to use for 180 days or more)		
- New machinery installed on 01.05.2013	84.00	84.00
- New windmill purchased and installed on 18.06.2013	22.00	22.00
	106.00	106.00
Normal Depreciation@15% & additional deprecation @20%	15.90	21.20
(B) Plant and Machinery (15% block) (Put to use for less than 180 days – hence, depreciation is restricted to 7.5%, being 50% of 15%)		
- Lorries for transporting goods to depots	3.00	-
- Fork-lift trucks, used inside a factory	4.00	4.00
	7.00	4.00
Normal Depreciation @ 7.5% & additional depreciation @10%	0.53	0.40
Total Depreciation on plant and machinery (15% block) (A) + (B)	16.43	21.60
(C) Plant and Machinery (60% block) (Put to use for less than 180 days, hence depreciation restricted to 30%, i.e., 50% of 60%)		
- Computers installed in office premises	1.00	-
- Computers installed in factory	2.00	2.00
	3.00	2.00
Normal depreciation@30% & additional depreciation@10%	0.90	0.20
Total depreciation and additional depreciation [(A) + (B) + (C)]	17.33	21.80
Depreciation available under section 32 = ₹ 39.13 crores		

Computation of Written Down Value (WDV) as on 01.04.2014

Particulars		Plant & Machinery	
		15%	60%
		(₹ in crores)	
WDV as on 01.04.2013 (assumed as Nil in the absence of information in the question)		Nil	Nil
Add: Plant and Machinery acquired during the year			
- New Machinery installed on 01.05.2013	84.00		
- New Windmill purchased and installed on 18.6.2013	22.00		
- Lorries for transporting goods to sales depots	3.00		
- Fork-lift trucks, used inside factory	4.00		
- New imported machinery	12.00	125.00	-
- Computers installed in office premises		-	1.00
- Computers installed in factory		-	2.00
		125.00	3.00
Less: Asset sold during the year		Nil	Nil
WDV as on 31.3.2014 (before charging depreciation)		125.00	3.00
Less: Depreciation for the P.Y.2013-14			
- Normal depreciation		16.43	0.90
- Additional depreciation		21.60	0.20
WDV as on 1.4.2014		86.97	1.90

Computation of deduction under section 32AC for the A.Y.2014-15

(See Notes 1 to 4 below)

Particulars	(₹ in crore)
Plant and Machinery acquired and installed during the previous year	
- New Machinery installed on 01-05-2013	84.00
- New Windmill purchased and installed on 18.06.2013	22.00
- Fork-lift trucks, used inside factory	4.00
- Computers installed in factory	2.00
	112.00
15% of ₹ 112 crore, being aggregate investment in new plant and machinery acquired and installed during the P.Y.2013-14	16.80

If the assessee is a partnership firm instead of a company

Yes, the answer would be different in respect of deduction under section 32AC, since this deduction is available only to an assessee, being a company engaged in the business of manufacture or production of any article or thing. Therefore, a partnership firm would not be eligible for deduction under section 32AC.

However, depreciation and additional depreciation computed under section 32(1)(ii) and 32(1)(iia), respectively, and the written down of the block of assets would remain the same, even if the assesee is a firm.

Notes:

(1) For the A.Y.2014-15, the company would be entitled for deduction under section 32AC since the investment in new plant and machinery acquired and installed during the P.Y.2013-14 is ₹ 112 crores (i.e., more than ₹ 100 crores). The deduction under section 32AC would be in addition to the depreciation allowable under section 32 for that year. However, such deduction would not go to reduce the written down value of plant and machinery.

(2) New imported machinery was not installed during the previous year 2013-14. Hence, it would not be eligible for deduction under section 32AC and additional depreciation for A.Y.2014-15. It would also not be eligible for normal depreciation for A.Y.2014-15, since it was not put to use in the P.Y.2013-14, being the year of acquisition.

(3) It may be noted that investment in the following plant and machinery would neither be eligible for deduction under section 32AC nor for additional depreciation under section 32(1)(iia):

   (a) Lorries for transporting goods to sales depots, being vehicles/road transport vehicles; and

   (b) Computers installed in office premises.

(4) As per section 2(28) of the Motor Vehicles Act, 1988, the definition of a "vehicle" excludes, *inter alia*, a vehicle of special type adapted for use only in a factory or in any enclosed premises. Therefore, fork-lift trucks used inside factory would not fall within the definition of "vehicle". Hence, it is eligible for additional deprecation under section 32(1)(iia) and deduction under section 32AC.

(b) Taxability of the following receipts/income while computing income under the head "Profits and gains of business or profession"

(i) Power subsidy received by the assessee is revenue in nature as it goes towards reduction of the electricity bills. Therefore, the subsidy is taxable as business income. It was so held by the Supreme Court in *CIT vs. Rajaram Maize Products (2001) 251 ITR 427*.

(ii) Donations received by a person from his followers in the course of carrying on vocation for the furtherance of the objects of his vocation were receipts arising from the carrying on of his vocation and not casual or non-recurring receipts. The Supreme Court, in *Dr. K. George Thomas vs. CIT (1985) 156 ITR 412,* held that such donations are taxable as a business income as there is a direct nexus between the vocation carried on by the assessee and the receipt of such donation.

(iii) The difference between the price of shares of the first company and the market value of shares of the new company on the date of such exchange has to be treated as profit derived by the dealer in shares (on exchange of shares held as stock-in-trade of first company with the shares of the new company) in the normal course of his business, and hence such profit is taxable as business income. It was so held by the Supreme Court in *Orient Trading Co. Ltd. vs. CIT (1997) 224 ITR 371*.

(iv) Since the bank is purchasing shares on behalf of the constituents, the forfeiture of margin money by the bank from the constituents for not paying the balance amount of purchase price and not taking delivery of shares purchased by the bank on their behalf is in the normal course of its banking business and hence, the forfeited amount is assessable as business income of the bank. The forfeited amount being revenue in nature cannot be adjusted against the purchase price of the shares. The Supreme Court has, in the case of *CIT vs. Lakshmi Vilas Bank Ltd. (1996) 220 ITR 305,* confirmed this view.

Question 7

(a) The following are the particulars of income earned by Miss Vivitha, a resident Indian aged 25, for the assessment year 2014-15:

	(₹ In lacs)
Income from playing snooker matches in country L	*12.00*
Tax paid in country L	*1.80*
Income from playing snooker tournaments in India	*19.20*
Life Insurance Premium paid	*1.20*
Medical Insurance Premium paid for her father aged 62 years (paid through credit card)	*0.25*

Compute her total income and tax payable by her for the assessment year 2014-15. There is no Double Taxation Avoidance Agreement between India and country L. (8 Marks)

(b) "Come Air Ltd." has paid a sum of ₹ 12 lacs during the year ended 31-3-2014 to Airports Authority of India towards landing and parking charges. Is the company required to deduct any tax at source from such payment? If so, what is the rate of TDS? (4 Marks)

(c) Mr. Vasudevan gifted a sum of ₹ 6 lakhs to his brother's wife on 14-6-2013. On 12-7-2013, his brother gifted a sum of ₹ 5 lakhs to Mr. Vasudevan's wife. The gifted amounts were

invested as fixed deposits in banks by Mrs. Vasudevan and wife of Mr. Vasudevan's brother on 01-8-2013 at 9% interest. Discuss the consequences of the above under the provisions of the Income-tax Act, 1961 in the hands of Mr. Vasudevan and his brother. (4 Marks)

Answer

(a) Computation of total income and tax liability of Miss Vivitha for the A.Y. 2014-15

Particulars		₹	₹
Indian Income [Income from playing snooker tournaments in India]			19,20,000
Foreign Income [Income from playing snooker matches in country L]			12,00,000
Gross Total Income			31,20,000
Less: Deduction under Chapter VIA		₹	
Deduction under section 80C			
Life insurance premium of ₹ 1,20,000 paid during the previous year deduction is restricted to overall limit of ₹ 1 lakh.		1,00,000	
Deduction under section 80D			
Medical insurance premium of ₹ 25,000 paid for her father aged 62 years. Since her father is a senior citizen, the deduction is allowable to a maximum of ₹ 20,000 (assuming that her father is also a resident in India). Further, deduction is allowable where payment is made by any mode other than cash. Here payment is made by credit card hence, eligible for deduction.		20,000	1,20,000
Total Income			30,00,000
Tax on Total Income			
Income-tax		7,30,000	
Add : Education cess @ 2%		14,600	
Add: Secondary and higher education cess @ 1%		7,300	7,51,900
Average rate of tax in India (i.e. ₹ 7,51,900/₹ 30,00,000 × 100)	25.06%		
Average rate of tax in foreign country (i.e. ₹ 1,80,000/₹ 12,00,000 ×100)	15.00%		
Rebate under section 91 on ₹ 12 lakh @ 15% (lower of average Indian-tax rate or average foreign tax rate)			1,80,000
Tax payable in India (₹ 7,51,900 – ₹ 1,80,000)			5,71,900

Note : Miss Vivitha shall be allowed deduction under section 91, since the following conditions are fulfilled:-

(a) She is a resident in India during the relevant previous year.

(b) The income accrues or arises to her outside India during that previous year and such income is not deemed to accrue or arise in India during the previous year.

(c) The income in question has been subjected to income-tax in the foreign country L in her hands and she has paid tax on such income in the foreign country L.

(d) There is no agreement under section 90 for the relief or avoidance of double taxation between India and country L where the income has accrued or arisen.

(b) The issue under consideration in this case is whether "Come Air Ltd" is required to deduct tax at source from the sum of ₹ 12 lacs paid towards landing and parking charges to Airports Authority of India and if so, at what rate.

This issue was addressed by the Delhi High Court in *CIT vs. Japan Airlines Co. Ltd. (2010) 325 ITR 298* and *United Airlines v. CIT (2006) 287 ITR 281* and the Madras High Court in *CIT vs. Singapore Airlines Ltd. (2013) 358 ITR 237.* While the Delhi High Court held that the landing and parking charges paid by the airline company to Airports Authority of India is in the nature of rent within the meaning of section 194-I, the Madras High Court expressed a contrary view.

Delhi High Court's view in *CIT vs. Japan Airlines Co. Ltd. (2010) 325 ITR 298* and *United Airlines v. CIT (2006) 287 ITR 281*

The definition of "rent" under section 194-I has a wider meaning than "rent" in common parlance. It includes any payment under any agreement or arrangement for use of, *inter alia*, land.

When the wheels of the aircraft coming into an airport touch the surface of the airfield, use of the land of the airport immediately begins. Similarly, for parking the aircraft in that airport, again, there is use of the land. Therefore, the landing and parking fee were "rent" within the meaning of the provisions of section 194-I as they were payments for the use of the land of the airport.

Since the payment of landing and parking charges are in the nature of rent, the provisions of tax deduction at source under section 194-I would be attracted, if the aggregate rental income during the year is more than ₹ 1,80,000.

Based on the view expressed by the Delhi High Court, Come Air Ltd. has to deduct tax@10% on ₹ 12 lacs under section 194-I, since the aggregate payment exceeds ₹ 1,80,000.

Madras High Court's view in *CIT vs. Singapore Airlines Ltd. (2013) 358 ITR 237*

The Madras High Court observed that the charges of landing and take-off are with reference to a number of facilities provided by Airports Authority of India in compliance with the international protocols and the charges are not made for any specified land usage or area allotted.

The charges are governed by various considerations including offering facilities to meet the requirement of passenger's safety and for safe landing and parking of aircraft. Thus, the charges levied are, at the best, in the nature of fees for the services offered rather than in the nature of rent for the use of the land.

Therefore, mere use of land for landing and charge of payment, which is in the nature of maintenance of the various services provided by the Airports Authority, including the technical services involving navigation, would not automatically bring the transaction and the charges within the meaning of either lease or sub-lease or tenancy or any other agreement or arrangement of the nature of lease or tenancy to fall within the definition of "rent" as per section 194-I. With regard to the runway usage by an aircraft, it could be no different from the analogy of a road used by any vehicle or any other form of transport.

Thus, the Madras High Court held that, going by the nature of services offered by the Airports Authority of India in respect of landing and parking and the charges collected from the assessee, there is no ground to accept that the payment would fit in with the definition of 'rent' as given under section 194-I. Since landing and parking charges paid are in the nature of charges for maintenance of various services provided by Airport Authority of India, the provisions of tax deduction at source under section 194C would be attracted.

Based on the view expressed by the Madras High Court, Come Air Ltd. has to deduct tax @2% of ₹ 12 lacs under section 194C.

(c) In the given case, Mr. Vasudevan gifted a sum of ₹ 6 lakhs to his brother's wife on 14.06.2013 and simultaneously, his brother gifted a sum of ₹ 5 lakhs to Mr. Vasudevan's wife on 12.07.2013. The gifted amounts were invested as fixed deposits in banks by Mrs. Vasudevan and his brother's wife. These transfers are in the nature of cross transfers. Accordingly, the income from the assets transferred would be assessed in the hands of the deemed transferor because the transfers are so intimately connected to form part of a single transaction and each transfer constitutes consideration for the other by being mutual or otherwise.

If two transactions are inter-connected and are part of the same transaction in such a way that it can be said that the circuitous method was adopted as a device to evade tax, the implication of clubbing provisions would be attracted. It was so held by the Apex Court in *CIT vs. Keshavji Morarji (1967) 66 ITR 142*.

Accordingly, the interest income arising to Mrs. Vasudevan in the form of interest on fixed deposits would be included in the total income of Mr. Vasudevan and interest income arising in the hands of his brother's wife would be taxable in the hands of Mr. Vasudevan's brother as per section 64(1).

This is because both Mr. Vasudevan and his brother are the indirect transferors of the income to their respective spouses with an intention to reduce their burden of taxation.

Note : In the hands of Mr. Vasudevan's brother, interest income earned by his spouse on fixed deposit of ₹ 5 lakhs alone would be included and not the interest income on the entire fixed deposit of ₹ 6 lakhs, since the cross transfer is only to the extent of ₹ 5 lakhs.