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SUGGESTED SOLUTION

CS PROFESSIONAL

Subject – Advanced Tax

Topic – Direct Tax

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Answer to Q1.A.

(i) Incorrect : As per section 188A of the Income tax Act, 1961, Every person who was, during the previous year, a partner of a firm, and the legal representative of any such person who is deceased, shall be jointly and severally liable along with the firm for the amount of tax, penalty or other sum payable by the firm for the assessment year to which such previous year is relevant, and all the provisions of this Act, so far as may be, shall apply to the assessment of such tax or imposition or levy of such penalty or other sum.

(ii) Incorrect : As per section 245Q of the Income tax Act, 1961, the application before the authority for seeking Advance Ruling shall be made in Quadruplicate and to be accompanied by a fee of Rs.10000 or such fee as may be prescribed in this behalf, whichever is higher.

(iii) Correct : As per section 92BA of the Income tax Act, 1961, "specified domestic transaction" in case of an assessee means any business transactions between the assessee and other person as referred to in section 80-IA(10) of the Income Tax Act, 1961 and where the aggregate of such transactions entered into by the assessee in the previous year exceeds Rs. 20 crore.

(iv) Correct : As per section 96 of the Income tax Act, 1961, any arrangement which directly or indirectly resulted in the misuse or abuse of the provisions of the Act is an impermissible avoidance arrangement where GAAR provision shall apply.

(v) Correct : Tax avoidance cannot be same as Tax Evasion. Azadi Bachao Andolan, (2003), 263 ITR 706 (SC) Supreme court held that citizen is free to carry on his business within the four corners of the law and that mere tax planning, without any motive to evade taxes through colourable devices is not frowned upon.

(5 marks)

Answer to Q1.B.

Computation of Tax payable by Mr. X for AY 2021-22

Computation of Normal Tax

Particulars	**Amount (Rs. In lakh)**
Tax liability under the normal provisions of the Income-tax Act, 1961	22.125
Add: Health & Education Cess @4%	0.885
Total Tax Liability	23.01

Computation of Alternate Minimum Tax

Particulars	**Amount (Rs. In lakh)**

Adjusted Total Income	80.00
Add : Deduction under section 35AD	70.00
Less : Depreciation under section 32	(7.00)
Adjusted Total Income	143.00
AMT @18.5%	26.455
Surcharge @ 15% (since adjusted total income> Rs. 100 lakh)	3.968
Tax	30.423
Add: Health & Education cess @4%	1.216
Total tax Liability	31.639

Since, the regular income tax payable is less than the AMT payable, the adjusted total income of Rs. 143 lakhs shall be deemed to be the total income of Mr. X and tax is payable @18.5% thereof plus surcharge @ 15% and cess @4%. Therefore, tax liability is 31.639 lakhs. However, Mr. X would be eligible for credit in 15 subsequent years to the extent of difference between the AMT and Normal Tax i.e. Rs. 8.629 lakhs.

(5 marks)

Answer to Q1.C.

<u>Specific Anti Avoidance Rules 'SAAR'</u>

- These are specific and help reduce time and costs involved in tax litigation
- These provide certainty to any tax payer while formalising specific arrangements These don't provide any discretion to the tax authorities
- There is always a possibility that the tax payers find loopholes and circumvent these limited application, specific provisions

<u>General Anti Avoidance Rules 'GAAR'</u>

- These involve necessarily granting the discretion to the tax authorities to invalidate the arrangements as impermissible tax avoidance
- They have a far broader application and hence interpreted in a more extensive manner
- GAAR has the potential to counter more effectively and outsmart the tax payers in their "out of the box thinking" and their approach in devising new means of tax avoidance

(5 marks)

Answer to Q1.D.

The treatment to be given to the various Income derived/earned by Mr. Thomas, resident but not ordinarily resident (RNOR) during the previous year relevant to Assessment Year 2020-21 as per provisions of the Income Tax Act, 1961 shall be as under:

a) Agricultural income of Rs. 35,000 derived from the land used for cultivating the crop of grapes situated in Nasik, Maharashtra, India is exempt from tax u/s 10(1) since covered under the definition of Agriculture Income u/s 2(1A) of the Income tax act, 1961.
b) Income received by way of dividend of Rs. 55,000 in respect of Units of a Mutual Fund specified u/s 10(23D) is exempt from tax u/s 10(35) of the Income tax Act, 1961.
c) Any income accrued or received from a business controlled or a profession set up in India is taxable as income for RNOR u/s 5 of the Income tax Act, 1961 and therefore income of Rs. 1,25,000 of the cosmetics business shall be subject to tax.
d) All gifts from the relatives specified in section 56(2) and those received at the time of marriage from any person are not taxable. Therefore, total amount of gifts of Rs. 72,000 [21000+51000] received on the occasion of the marriage from the brother and friends are exempt from tax.
e) Any profits of earlier years whether taxed or not when remitted to India are not taxable in the year of receipt. Therefore, past untaxed profits of Rs. 2,50,000 lying in bank account maintained in Singapore and remitted during the previous year to India is not taxable.

(5 marks)

Answer to Q2.A.

The location where company's Board of Directors (BOD) regularly meets and makes decisions may be the company's Place of Effective Management (POEM) provided the Board:
1. Retain and exercises its authority to govern the company: and
2. Does, in substance, make the key management and commercial decisions necessary for the conduct of the company's business as a whole.
In given case the board meetings are held in UK, but the same formalise the decisions taken by the committee at Delhi. Hence Place of Board meeting held at UK cannot be POEM, as power is delegated to committee which is based at Delhi. Guiding factors when Board Delegating Authorities to Committee are as under:
If Board of Director had delegated some or all of its major authorities to one or more committees consisting senior management, then POEM shall be at the place where:
1. Members of executive committee are based and
2. Where committee develops and formulate key decisions for formal approval by Board.
Hence in given case, POEM of XYZ Ltd. will be Delhi, as discussed above.

(3 marks)

Answer to Q2.B.

i. The investment of Rs.1 lakh in PPF account so as to reduce his total income from Rs.6 lakh to Rs. 5 lakh is considered as Tax Planning because the same is carried out within the framework of law by availing the deductions permitted by law and thereby minimising the tax liability.
ii. Premium paid on life insurance policy of minor son is allowed as deduction under section 80C of the Income tax Act, 1961. Therefore, Rs. 55,000 paid, by Mr. Kunal

Sharma, as premium on life insurance policy of his minor son is an act of Tax Planning.

iii. Claiming depreciation on motor car being used for personal purpose is not allowed under section 32 of the Income Tax Act, 1961. Therefore, the depreciation claimed by the company on the motor car which is being used by the director for personal purpose is an act of Tax Evasion.

(3 marks)

Answer to Q2.C.

The facts of the case are similar to that of the Mascon Technical Services Ltd. v. CIT (2013) 358 ITR 545, where the Madras High Court observed that the assessee had taken steps to go in for a public issue and incurred share issue expenses. However, it could not go in for the public issue by reason of the orders issued by the SEBI just before the proposed issue. The High Court observed that though the efforts were aborted, the fact remains that the expenditure incurred was only for the purpose of expansion of the capital base. The capital nature of the expenditure would not be lost on account of the abortive efforts. Thus, the expenditure incurred by Sukriti Ltd. constitutes capital expenditure.

(3 marks)

Answer to Q2.D.

The statement is incorrect as, the minimum alternate tax (MAT) is attracted under section 115JB, on account of tax on total income being less than 15% of book profit. Chapter XII-B is a self contained code for computation of book profit.

The net profit as per the profit and loss account for the relevant previous year prepared in accordance with the provisions of Companies Act, 2013, as increased/reduced by the specified adjustments provided for in Explanation 1 to section 115JB would be the book profit for levy of MAT under section 115JB.

The rate of MAT has been reduced from 18.5% to 15% vide amendment in sub-section (1) of section 115JB by the Taxation Laws (Amendment) Act applicable for FY 2019-20 onwards.

(3 marks)

Answer to Q2.E.

Two enterprises shall be deemed to be Associated Enterprises, if a loan advanced by one enterprise to other constitutes not less than 51% of the book value of total assets of other enterprise.

In the given case:-

Total book value of Pit Ltd. is Rs. 57,25,000/-

51% of Rs. 57,25,000/- = Rs. 29,19,750/- Loan given by the UK company = Rs. 30,00,000/-

Since, the loan amount is more than 51% of the book value of the total assets of the Indian company, Brat Inc. and Pit Ltd. are deemed to be Associated Enterprises.

(3 marks)

Answer to Q3.A.

Computation of Tax Liability of Lal Ltd.

Particulars	Amount (lakh Rs.)
Consideration for Buy-Back	18.000
Less : Amount received on Issue of shares	(11.000)
Distributed income	7.000
Tax @ 20%	1.400
Surcharge @ 12% of Rs. 1.4 lakhs	0.168
Total tax and surcharge	1.56800
Health & Education Cess @ 4% of Rs. 1.568 lakhs	0.06272
Tax Liability	1.63072

The additional income-tax was payable on or before 31st August, 2020. However, the same was paid only on 7th November, 2020. Thus, interest under section 115QB is attracted @1% for every month or part of the month on the amount of tax not paid or short paid for the period beginning from the date immediately after the last date on which such tax was payable and ending with the date on which the tax is actually paid.

In this case, the period for which interest @1% per month or part of a month is leviable is calculated as under for 3 months (September-November):

Interest = Rs. (1,63,072 x 1/100 x 3) = Rs. 4,892.

(5 marks)

Answer to Q3.B.

(i) Roll back provisions in relation to Advance Pricing Agreement (APA) can be applied only for any previous year, falling within the period not exceeding four previous years, preceding the first of the five consecutive previous years stated in the APA. The first of the five consecutive previous years specified in the APA is the P.Y. 2019-20 relevant for A.Y. 2020-21. Therefore, P.Y. 2015-16 to 2018-19 relevant for A.Y. 2016-17 to 2019-20 are the years for which roll back provisions under the APA can be applied. As a consequence, the Assessing Officer cannot apply the roll back provisions for the AY 2012-13 to A.Y. 2015- 16.

(ii) Assumption : The solution has been made based on the assumption that Janak Poly Fibers Ltd. (Indian Company) was making sales to John Stuart LLP (Non-Resident) Singapore base company.

Rollback provisions cannot be applied where the same would result in reduction of Income. In the given situation, when the APA is applied for the A.Y. 2016-17 and 2017-18, the ALP per MT will be lower by Rs. 500 per MT (as taken in these years at Rs. 14000 per MT whereas under APA is 13,500 per MT) which when be applied on 2 lakh MT, the income would be lower by Rs 10 crores. Hence rollback cannot be applied for AY 2016-17 and AY 2017-18. However, for all other years being AY 2018-19 and AY 2019-20 it has to be mandatorily applied

Alternative (OR)

Assumption : The solution has been made based on the assumption that Janak Poly Fibers Ltd. (Indian Company) was Purchasing from John Stuart LLP (Non-Resident) Singapore base company. Rollback provisions cannot be applied where the same would result in reduction of Income. In the given situation, when the APA is applied for the A.Y. 2016-17 and 2017-18, the ALP per MT will be lower by Rs. 500 per MT (as taken in these years at Rs. 14000 per MT whereas under APA is 13,500 per MT) which when be applied on 2 lakh MT, the income would be higher by Rs 10 crores. Hence rollback is to be applied for AY 2016-17 and AY 2017-18. However, for all other years being AY 2018-19 and AY 2019-20 it cannot be applied.

(iii) Completed Assessments : The AO will reassess or re-compute the income adopting the ALP as per the APA entered into whenever for which year the same is applicable. Pending Assessments: The pending assessments for the AY 2018-19 and AY 2019-20 will be completed in the light of the ALP as per the APA entered into between the assesse and Johan Stuart LLP.

(5 marks)

Answer to Q3.C.

Computation of book profit for AY 2021-22 and remuneration allowed under section 40(b) of Income-Tax Act, 1961

Particulars	**Amount (Rs.)**	**Amount (Rs.)**
Net Profit as per Profit and Loss Account		1,00,000
Add: Remuneration to Partners	4,00,000	
Add: Municipal Tax of House Property	5,000	4,05,000
Total		5,05,000
Less : Rent received on House Property		(50,000)
Book Profit as per section 40(b)		**4,55,000**

Remuneration allowed is lower of the amount as per partnership deed (Rs. 4,00,000) or amount actually paid (Rs. 4,00,000) or the amount computed as under:

Maximum amount deductible on account of payment of remuneration to partners

Particulars	**Amount**
First Rs. 300000 @ 90%	2,70,000

Balance of Rs.155000@ 60%	93,000
Total	3,63,000

Lower of above i.e. Rs. 363000 is the maximum remuneration permissible u/s 40(b).

(5 marks)