Book No. 1 (containing 36 pages)

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA

CA Final Examination

Group No. II. Paper No. 7.

Subject Direct Tax Laws.

Number of Answer Books used 1 + 2 = 3

For use by ICAI only

622890

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Q. No.	Please put ✓ against the Questions answered	Marks Awarded (to be filled by Examiner)					
		a	b	c	d	e	Total
1	✓	7½	10				17½
2	✓						13
3	✓	9	3	1½			13½
4	✓	–	3	3	3	2	11
5	✓	5	3	2½	2		12½
6	✓	2½	2	3	6		13½
7							–
8							
9							
10							
Total							80½ say 81

MAY 2017

1 5 MAY 2017

1 4 MAY 2017

AVOID RED PEN.

Total Marks awarded

0 8 1

Total Marks awarded (in words) Eighty one

Examiner's Signature

Checker

Q24 Computation of the ~~Total Income~~ Tax Liability of Preetam Motors limited for AY 2017-18

		(₹) in lakhs.
Income from Business and Profession [Part A].		127.103.
Less: deduction u/s 80JJA [15 X 30%].		(4.5)
Total Income		122.603.
(X) Tax @ 30%	36.7809.	
Tax on dividend income on gross basis [12 X 15%].	1.8	
Tax on long term gain [3.98 X 20%]	0.796	39.3769
(+) Surcharge @ 7%		2.7563.
(+) cess and higher education cess		1.2639
Tax Payable		43.3971.

Computation of Total Income

	(₹) in lakhs.
Income from Business (Part A)	127.103.
~~Income from~~ (-) dedn u/s 80JJA	(4.5)
	122.603.
Income from other sources (Part B)	12
Income from under capital gains (Part C).	3.98
	138.583

Part A: Computation of Income from Business and Profession

Particulars		₹ [in lakhs]	
Net Profit as per Profit and loss account			150
add: Amounts to be disallowed / considered seperately:			
(i) One time license fees to foreign company.	1.	20.	
(ii). Amount to earn dividend	2	0.5	
(iii). Technological advancement (Research expenses) for existing business abandoned	3	NIL.	
(iv) Payment to railways.	4.	2.	
(v). Contribution to approved research association	5	1.	
(vi) Depreciation	6	20.	
(vii) Payment in cash by two seperate vouchers.	7	0.3.	
(viii) legal fees for defending title of premises	8	3.	
(ix) Payment to additional workers	9	NIL.	
(x). Provision for warranty on scientific basis	10	NIL.	
(xi) Overvaluation of opening and closing stock	11	2	48.8.

less: amounts credited but not allowed / not considered to be considered.			
(xi) Dividend Income.	2	12	
(xii) Depreciation under income tax.	6	35.447	
(xiii) Contribution to approved association u/s 35(1)(iii).	5	1.25	
(xiv) ~~Overvaluation~~ of ~~opening and closing stock~~.			
(xv) Profit on hedging contract.	12	3	
(xv) Profit on sale of land. Cont	13	20	71.697
Income from Business and Profession			127.103.

Part B : Income under the head Income from other sources

			(₹) in lakhs
Dividend received from a foreign company	2		12
			12

Part C : Income under the head capital Gains

	(₹) in lakhs
Sale consideration (stamp duty value is not considered since the sale consideration is more).	70
less:	
Indexed cost of acquisition $\left[50 \times \frac{1125}{852}\right]$	66.02
	3.98

4. Payment to railways is covered u/s 43B. ie to be eligible for deduction the payment ought to have been made before the
½ due date for filing return u/s 139(1). Here the payment was made on in December ∴ It is disallowed.

5. Contribution to approved ~~scientific~~ statistical research association is eligible
½ for deduction @ 125%.

6. Depreciation

	(₹) in lakhs
(i) Depreciation as per the Income Tax rules.	– 22
(ii) depreciation on licence fees @ 25% [20 X 25%].	– 5
(iii) Additional depreciation on new imported machinery ½ [90 (–) 3 = 87 (X) 20% X 50%]	8.7
(iv) ~~excess~~ depreciation to to ~~on account~~ extent of profit to be reversed [3 X 15% X 50%] ½	(0.225)
	35.447

The profit is to be reduced from the WDV of the asset.

Working Notes :-

1) One time licence fees is a capital expenditure. The license obtained is an intangible asset ~~so~~ that is eligible for depreciation u/s 32 @25% (Refer WN-6)
½

2) Dividend Income received is chargeable under Income from other sources. The expenses are ~~also~~ therefore added back.
Further as per special taxation regime where Indian company receives dividend from foreign company in which it holds >=26% shares; then dividend ~~is~~ + tax is @15% on gross basis.
∴ No expenses are allowed.
½

3. Where the project pertained to the existing business and failed was consequently abandoned, then shall not ipso facto ~~no~~ preclude the expenses on feasibility studies. since it was for an existing business
∴ It is eligible.

Since the machine was used for less than 180 days (∵ purchased on 20.12.2016); ∴ the depreciation and additional depreciation are restricted to 50%.
½

7. Since payment is made other than by account payee cheque/draft for an amount exceeding 20000 ∴ the disallowance u/s 40A(3) is attracted.
½

9). Payment to additional workers is allowed. The deduction u/s 80JJA is available from the gross total income.
½

10). Warranty on scientific basis is an eligible business expenses, hence nothing has been added.

8) Legal fees for defending title is a capital expenditure since the benefit is expected to flow over the life of the company.

11). Overvaluation of opening stock exceeds closing stock and hence it increase the Profit.
½

12) Profit on hedging contract would be reduced from the cost of machine.

Yes — It is a business income and not speculative

13) Profit on sale of land is considered under capital gains

Q6)
(a) Discussion of arms length character of Borrowing rate :-

1. EF Limited is an Indian company, 74% shares of whom are held by EF Inc. Accordingly, EF Inc and EF limited are associated enterprises (AEs) u/s 92A by virtue of control over voting power.

½C

2. Since the EF limited and EF Inc are AEs the transaction entered into between them shall form part be an international transaction u/s 92B. ∴ The loan transaction is an international transaction

3. As per 92C the arms length price of an international transaction has to be decided with respect to the most appropriate method which inter alia include "comparable uncontrolled price" method. [CUP]

½

4. As per CUP method the price charged in an uncontrolled transaction is adjusted for any differences

between the two controlled and uncontrolled transaction to arrive at the arms length price

5). In the given case RP Ltd borrows funds at LIBOR (+) 150 basis points i.e. 4 + 1.5 = 5.5%
½ (LIBOR being 4%).

6) The External commercial borrowing guidelines under FEMA stipulate a rate
½ of LIBOR (+) 2000 basis points i.e. 4 + 2 = 6%

7). However ∴ There is a variation between the transfer price (5.5%) and arms length price (6%)

8) However, the transfer pricing machinery would not apply
½ in cases where the application of the same would reduce the tax base in India which would happen if 6% would be adopted.
∴ The borrowing by RP Ltd at 5.5% is at arms length price

2½

Q6.

(C) ~~The Asse As~~ per section 133B the assessing officer can enter the business premises of the assessee over whom he excercises jurisdiction.

1 However care must be taken that such entry is during the business hours.

The Assessing officer can make enquiries and collect information for the purposes of the act.

In The present case the hotelier cannot claim that the assessing officer cannot enter the premises after sunset

1/2 This is because the Assessing officer has entered at 8pm and normal business hours are until 9pm

1/2 The second question ~~so~~ is with respect to the contention of the assessing officer to impound the books. In this regard there is a specific prohibition u/s 133B whereby the assessing officer cannot impound any books.

1/2 Therefore the assessing officer cannot impound books at the hotel.

1/2

3

Q67. (c)

(c). The Interest under section 234A.

In the given case IA Consulting (P) Ltd has furnished his return of Income on 15 October 2017.
However the due date for the furnishing the return of Income is 30/9/2017.
∴ There is a ~~da~~ delay of 15 days.
There shall be levied ~~penalty~~ interest u/s 234A
½ @1% for every month / part of month for such delay.
Amount on which ~~pen~~ interest leviable

	(₹)	
Tax on Total Income (315000 + 3%)	~~1050000~~	324450 ~~315000~~
½ less: advance tax	(267000)	
Tax deducted	(24450)	
Tax on doubly taxed Income	(10000)	(301450)
	~~748500~~	~~13550~~
½		23000

∴ Interest = ~~13550~~ 23000 ~~748500~~ X 1% X 1 month
½ = ~~₹7485.5~~ ~~135.5~~ 230
~~rounded off to~~
= ~~₹500~~

Q6)

(b) Maintainability of Prosecution proceedings -

In the given case the assessing officer ('AO'). lodged prosecution proceedings u/s 276 CC for failure to furnish the return of Income by firm M/s Emerald.

½ The issue under consideration is where the commissioner of income-tax (Appeal). has ~~redu~~ determined the tax payable by the assessee at ₹ 1000 v/s a v/s ₹ 60,000 (determined by the AO). If in such a case the prosecution is maintainable

The answer is that the prosecution u/s 276CC is maintainable notwithstanding the fact that the CIT(A) passed an order against revenue, which the revenue did not appeal against.

½ However since the tax payable by assessee has been determined at ₹ 1000 which is lower than ₹3000 ∴ the by virtue of this fact the prosecution proceedings are not maintainable.

½ ½

2

Interest under 234B.

Interest u/s 234B is leviable if the advance tax payable is paid is less than 90% of the advance tax payable.

		(₹)
Tax on Total Income	~~315000~~ ~~1050000~~	324450
(−) Tax deducted	(24450)	
(−) Tax on doubly taxed Income	(10000)	
	~~1015450~~	
	~~280550~~	290000
(X) 90%	282495 · 261000	

Since the advance tax paid ie 261000 is more than 90% therefore no interest u/s 234B is payable

Interest u/s 234C

290000 (X) min%.

Date	Advance Tax	Minimum	(₹)	Shortfall
15-06	40000	12%	34800	—
15-09	105000	36%	87000	—
15-12	205000	75%	217500	12500 (X) 1% X 3 month = 375
15-03	267000	100%	290000	23000 X 1% X 3 month 690

Interest u/s 234C is not payable ~~on~~ for quarter ended 15/06 & 15/09 since amount paid is more than what is required.

(f) Tax on Total Income

= 1050000 × 30% + 3%

= (₹) 324450

6

Q5Y.

aY.

(i) The treatment in the question is correct.

This is because the amount of TDS paid u/s 194C for warehousing has been paid by the payer viz. Recepient ie. ABC warehousing charg.

∴ The Assessing officer cannot recover the difference from the assessee viz Avatar limited.
The assessee has no obligation to deduct tax at source where the recepient has furnished his return of income and included such income and paid tax thereon to the credit of the government.

The assessee shall however be liable to pay interest on the amount of the difference amount of TDS.
∴ The contention of M/s Avatar limited is correct.

Q6
05Y
(a)(ii) K Ltd an event management company does not have to deduct tax on the commission paid to the overseas agent.

The overseas agent does not have any income that accrues in India, since he negotiates with the foreign artists outside India.
Also the amount of commission is also remitted out of India. ∴
No part of the income is received in India.

In view of the above K Ltd need not deduct tax at source on ₹ 5 lakh worth commission.

Q6)
(b)
(iii) The given case will attract Tax deducted at source u/s 194-I.
The rent payable on machinery building. is [20000 x 10] = ₹200 000 since it is given from 1/6/16.

The machinery is hired from 1/10/16 ie 6 months ie 90 000 is payable

1 Since the aggregate of rent exceeds ₹180 000. The provisions u/s 194-I. are attracted.

Accordingly, Ram should deduct. 2% on rent building ie 200000 x 2% ie → ₹ 4000
X and 10% on machinery ie 9000.

∴ TDS payable is ₹ 13000

5

There will be an adjustment of ₹ 62500000 to total Income of N ltd

- No deduction u/ch VI-A or 10AA would be allowed
- No corresponding adjustment would be made to total income of M ltd

3

Q5.

(b). Determination of ALP

1) Since N ltd is a subsidiary of M ltd; the two are associated enterprises (AEs)

2) The international transaction is purchase/sale of computer monitors by the AE to N ltd

3) Since the AE also sells such computer to K ltd an unrelated enterprise, ∴ the comparable uncontrolled price method can be used.

4) Adjustment to the uncontrolled price would be made for warranty charges of 3 months, handled by K ltd M ltd vis a vis in case of transaction with N ltd, warranty is handled by N ltd

Arms length Price	(₹).
Price to uncontrolled entity	10000
(-) warranty [1000×3/12]	(250)
arms length price	9750
Transfer price	11000
Difference (adjustment).	1250
(×) units	50000
	6,25,00,000

Q5

(b) Penalties

(i) Failure to audit books u/s 44AB-

The penalty leviable is 0.5% of the total turnover/gross receipts or ₹150 000 whichever is higher.

(ii). Directions u/s 142(2A) - Penalty of ₹10 000

1

(iii). Failure to furnish report from an accountant u/s 92E would attract a flat penalty of ₹ 100.000

1

2

Q 5)

(d) The issue under consideration is regarding the conclusivity of the order of the settlement commission

The order of the settlement commission should clearly state :-

1/2 a) the terms of settlement

b) the fact that the order would be void if it is found that order was obtained by fraud or misrepresentation of facts

Further the determination of whether the order is void or not can is done by the settlement commission. But there is no bar on the representation being made by the revenue

Further section 245-I says that the order of settlement commission is final and conclusive. But ~~this~~ is notwithstanding

1/2 the same, the settlement commission can declare its order void if found to be obtained by fraud

Since the Mr Musari has alledgedly misrepresented facts as discovered by the revenue; the settlement Commission shall examine the same ~~the~~

If the fraud/misrepresentation is discovered the order shall be void.

1. The contention of Mr Musari is incorrect

Q4.
(a) Determination of shareholding pattern of Vaamana Private Ltd.

	A	B	C	D	E	F
31.3.2015	–	–	25	25	25	25
31.3.16	25	–	~~25~~ –	25	25	25
31.3.17	25	25	–	–	25	25

Determination of the Business Profits for PY 2015-16 and PY 16-17

AY 16-17	(₹)
~~Income~~ Profit before depreciation	800 000
1 (–) current year depreciation	(100 000)
Total Income	700 000
1 less: brought forward business loss	(600 000)
	100 000
1 (–) unabsorbed depreciation	(100 000)
Total Income	NIL

AY .

AY 2017-18	(₹)
Profit before depreciation	1 500 000
1 (–) depreciation	(150 000)
	1350 000
(–) brought fo. unabsorbed depreciation	(1200 000)
$1 \times 3 = 3$ Total Income	150 000

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Notes :-

1) The given question ~~is also~~ deals with section 79.

2). In order to claim set off of brought forward losses the condition is that shareholders holding atleast 51% of share capital should be the same in the year in which set off is to be claimed.

3) In ~~2016~~ - 2015-16, the shareholding condition is satisfied, hence brought forward business losses have been set off. [D, E, F hold 75%].

4) However in 2016 - 17, the above condition gets violated. However, this does not govern unabsorbed depreciation as that is covered u/s 32(2). Therefore in PY 2016-17, the unabsorbed depreciation has been setoff.

1

1

9

Q3.

(b) The ~~Act~~ its held in case laws as well as guidelines, the Income tax is machinery is to secure revenue for the land of India. It is not to ~~se~~ exploit the assessees.

The Income tax officers should do everything in their power to provide guidance to the assessees to claim relief.

The remedies available to Mr D. are as follows:-

~~a~~ (i) He can file an appeal to the commissioner of income tax (appeals) u/s 246A in 30 days from receipt of order u/s 143(3).

1

(ii) He can also file a rectification application u/s 154. The time limit is 4 years from end of year in which order to be rectified has passed.

1

(iii) Alternatively, he can also file a revision petition to the commissioner u/s 264.

1 The time limit is 1 year from the end of the year in which order to be revised was ~~fas~~ received.

3

1

Q3.

(C)

(i). Damage of machines is deemed to be transfer u/s 2(47).
Since section 2(47) defines a transfer to ~~be a de~~ inter-alia include ~~dis-or~~ 'destruction' of any capital asset.

1/2

(ii). The amounts received by the assessee from the insurance company are to be treated as consideration for transfer and chargeable under capital gains

1/2

(iii). Yes there will be an impact on ~~money~~ written down value.
~~As per~~ 43(6) written down value means actual cost of the asset as reduced by money payable and ~~Money~~ depreciation.
Money payable means amount actually received.
Hence ₹500 000 is to be reduced from the written down value of the machines.

1/2

(V)

Q17. MAT liability of Vinay Exports Ltd.
(a) Computation of Book Profit u/s 115JB.

PARTICULARS	(₹)	(₹).
Net Profit as per Profit and loss A/c.		9500000
add: items to be disallowed by virtue of explanation 1 to section 115JB		
½ (a) Provision for income tax. (even ₹ 50,000 interest is to be disallowed).	500000	
½ (b) Sales tax liability	NIL.	
½ (c) Depreciation	900000.	
½ (d) Interest to financial institution unpaid before 139(1) date.	NIL	
½ (e) Reserves for currency exchange	130000	
½ (f). Penalty for infraction of laws	NIL	1030000
Less: items credited to Profit & loss account but not allowed as per explanation 1 to 115JB		
½ (a). Dividend received	140000	
½ (b). Long term profit on sale of rural agricultural land	1000000	
½ (c) Profit on unit in SEZ.	NIL.	
½ (d). Net agricultural income	600000	

4c	(e) Royalty from Patents	4060000	
4c	(f) Depreciation (400000 - 190000)	210000	
4c	(g) ~~Net~~ Debit Balance of Profit and loss account	60000	(6010000)
	Book Profit		4420000
4c	MAT liability @ 18.5%	817700	
	(+) education and higher education cess @ 3%	24531	
		842231	
4c	rounded off	842230	

Notes:

1) Rectification of Net Book Profit

Net Profit → 9500000

(-) interest on borrowed capital not recorded (100000) 9400000

2) Provision for income tax includes interest tax which is disallowed u/s explanation 1 to 115JB.

3) The following are not to be included from MAT liability

- sales tax
- interest not paid till due date of return of income

- Penalty for for infraction of law
- Profit on SEZ units

4) Any reserve created is to be disallowed
∴ Currency fluctuation reserve is added back

5) Depreciation as per income tax is irrelevant.
Depreciation as per books of account to the extent they do not represent revaluation is allowed

6) Lower of following is allowed
a) unabsorbed depreciation - 410000
b) debit balance of P&L a/c 60000
∴ 60000 has been considered

7) Income exempt u/s 10 - are to be excluded. So the following have been excluded:-
a) dividend
b) profit on transfer of rural agricultural land.
c) net agricultural income

87 As per ~~FA~~ finance act 2016, a new section 115 BBF was introduced in order to encourage & the development of patents and research in India. A special taxation regime is in place wherein the royalty income is taxed at 10%.
Therefore the same has been excluded from Book Profits.

1/2

Addl. Book No. 1.

15 MAY 2017

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA
ADDL. BOOK

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Q.1)(b)

(i) Slump sale u/s 50B

Computation of ~~as~~ to tax liability

Since the unit I was set up in April 2012. Accordingly it is a long term capital asset since it was held for more than 36 months.

1

- The benefit of indexation is however not available.

1

		(₹)	(₹)
	Sale consideration		300 00 000
	(-) cost of acquisition (refer note 1)		(100 00 000)
1	Long term capital gain		200 00 000
1	Tax @ 20% u/s 112	40 00 000	
½+½	(+) surcharge @ 7%	280 000	
½	(+) education and senior and higher education cess @ 3%	128400	~~4408400~~
	Tax Payable		4408400

Computation of the
Net Worth / cost of acquistion
of Unit 2.

		₹
½	Written down value of fixed assets	750
½	Debtors	6800
½	Inventories	2200
½	Liabilities	(15000
	cost of acquisition	10000

(ii). Restructuring - Tax Planning -

a). Alpha ltd already owns 85% of share capital of Beta ltd. It should acquire 15% of Beta ltd so that Beta ltd becomes its wholly owned subs. Then by virtue of sec 47(iv) the transfer would be an exempt transfer. The only stipulation is Beta ltd should be an Indian co. and Alpha ltd should hold shares for 8 years.

b). Alternatively, if Alpha ltd ~~cannot~~ does not wish to acquire Beta ltd's share, it can opt for demerger option u/s which is exempt u/s 47(vib)

1½

1½

10

Q47.

(b). The issue under consideration is whether the consideration for supply in of software embedded in hardware is 'Royalty'

As per provision of section 9(1)(vi) Royalty income inter-alia includes consideration for payment of so software licenses.

However the said case the software is embedded in the hardware. The said issue was squarely covered by a landmark judgement wherein the supreme court of India held that the consideration software embedded in the hardware did not represent royalty.

<u>This is because:-</u>

a) The software formed an integral part of the hardware

b) The ~~software~~ hardware could not be sold without the software since the software was integral to the hardware

c) The software did not have an independent existence of its own.

In view of the above the apex court held that the transaction represented a sale transaction and therefore the consideration could not be regarded as royalty.

1/2

3

15 MAY 2017

Addl. Book No. 2

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA
ADDL. BOOK

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Q4
(c) The issue under consideration deals with the powers of the commissioner to invoke the statutory revisionary powers of 263.

½

As per section 263, the commissioner has the power to call for any records and examine the same. If it is of the opinion that the interest of the revenue have been prejudiced then the commissioner can invoke revisionary powers.

1

The assessing officer has conducted enquiries and upon being satisfied has accepted declared income of the assessee.

There is nothing on record to show that the enquiry was not proper. Only where the enquiries are blatantly

Q4(a) The issue under consideration is whether the assessing officer is correct in initiating penalty proceedings u/s 271D.

½

The 271D can be initiated where 269SS has been violated ie where a company assessee accepts loan in cash for an amount exceeding the specified limit from another person

1

However in the present case the firm has accepted the loans from its partner who cannot be regarded as a seperate legal entity.

The contention that the firm has paid interest to its partners does is in line with section 40(b) whereby the firm can pay an amount of capital.

1

This does not ipso facto prove that the assessee and its partners are seperate persons.

In view of the above, section 269SS is not violated. Therefore ~~prosecution~~ penalty proceedings under 271D is not maintainable ∴ The action of the assessing officer is not tenable in law

½

3

Q4)(c) The issue under consideration is whether the assessing officer can tax the amount of capital as unexplained cash credit ~~in~~ in hands of the firm.

The ~~unexplained cash credit~~ partners have not been able to explain the source of their capital contribution.

~~Ho~~

However, the firm can offer an explanation that amounts ~~represent~~ capital of partner which is also confirmed by partners.

In view of the same, the assessing officer should not ~~initiate~~ treat the amounts as unexplained cash credit in hands of the firm.

The assessing officer can however ~~treat the~~ conduct an enquiry against the partners for determining the source of their unexplained income.

Therefore the action of the assessing officer is not valid in law.