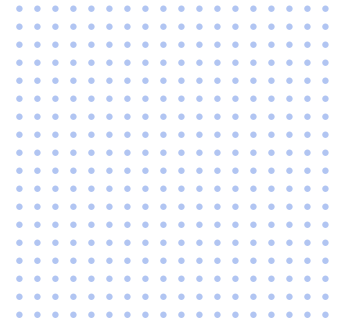




FOR CA FINAL EXAM PREPARATION

CA Final 2023 Suggested Answers · Paper 7 Direct Tax Laws and International Taxation (Old Scheme)

EXAM	YEAR	TYPE
CA Final	2023	Suggested Answers

SUBJECT	DATE
Paper 7 Direct Tax Laws and International Taxation (Old Scheme)	May 2023

PAPER – 7: DIRECT TAX LAWS & INTERNATIONAL TAXATION**Part - II**

Question No.1 is compulsory.

Answer any **four** questions out of the remaining **five** questions.

Working notes should form part of the answer

All questions relate to Assessment Year 2023-24, unless stated otherwise in the question.

Question 1

X Ltd. is engaged in the manufacture and sale of textiles goods. Its net profit for the year ending March 31, 2023 after debit/ credit of the following items to the profit and loss account was ₹ 1,25,00,000.

- (i) Advertisement expenditure includes a sum of ₹ 1.60 lakhs paid in cash to sister concern of a director of the company. The Fair market value of such expenditure in the market is ₹ 52,000.
- (ii) Repairs of plant and machinery include ₹ 1.80 lakhs towards replacement of worn out parts of machineries.
- (iii) The company used to include interest cost in valuation of its finished stock upto the financial year 2021-22. During the financial year 2022-23, the company changed its accounting policy to comply with the requirements of accounting standard issued by the ICAI and excluded interest cost in valuation of finished stock. This has resulted in a decrease in the current year's profit by ₹ 10.70 lakhs.
- (iv) An executive Mr. Q, while on business trip abroad, died and the company voluntarily paid gratuity to his family amounting to ₹ 2.00 lakhs.
- (v) Capital Expenditure of ₹ 1.80 lakhs incurred for the purpose of promoting family planning amongst its employees debited in the Profit and Loss account.
- (vi) Retrenchment compensation paid to employees of one of the unit of the company which was closed down during the year amounted to ₹ 14 lakhs.
- (vii) ₹ 4 lakhs, being amounts waived by a co-operative bank out of principal and ₹ 1 lakh being amount waived by the bank on arrears of interest, respectively, in one-time settlement. The loan was obtained for meeting working capital requirement four years back.
- (viii) Contribution towards Employees' pension scheme notified by the Central Government u/s 80CCD for a sum of ₹ 3 lakhs calculated at 12% of basic salary and Dearness Allowance (forming part of retirement benefits) payable to the employees.

The Suggested Answers for Paper 7: Direct Tax Laws and International Taxation are based on the provisions of direct tax laws as amended by the Finance Act, 2022, which are relevant for May, 2023 examination. The relevant assessment year is A.Y.2023-24.

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- (ix) Marked to market loss amounting to ₹ 6 lakhs in respect of an unsettled derivative contract. The contract was settled in May, 2023 with a gain of ₹ 1 lakh.
- (x) Provision for gratuity based on actuarial valuation was ₹ 4 lakhs. Actual gratuity paid debited to gratuity provision account was ₹ 2.75 lakhs. The gratuity paid to Mr. Q is debited separately and not included in Provision for gratuity or Actual gratuity paid mentioned here.

The company furnishes following additional information relating to it:

- (i) The company has obtained a loan of ₹ 4 lakhs from ABC Private Limited in which it holds 16% voting rights. The accumulated profit of ABC Private Limited on the date of receipt of loan was ₹ 1 lakh.
- (ii) The company has given 1 phone Mobile sets to 5 distributors as incentive costing ₹ 60,000 each on 28.10.2022 on the occasion of Diwali. The accountant of the company debited the same amount to Business Promotion Expenses, being business expenditure and did not deduct any tax at source.
- (iii) The company during the financial year 2022-23 has contributed a sum of ₹ 3,50,000 to an approved Electoral trust by an RTGS directly to the account of the Trust.

You are required to compute the Total Income of X Ltd. for the A.Y. 2023-24 assuming that the company has not opted for Section 115BAA/115BAB under the Income-tax Act, 1961.

(14 Marks)

Answer

Computation of Total Income of X Ltd. for the A.Y. 2023-24			
	Particulars	Amount (in ₹)	
I	Profits and gains of business and profession		
	Net profit as per profit and loss account		1,25,00,000
	Add: Items debited but to be considered separately or to be disallowed		
	(i) Payment of advertisement expenditure of ₹ 1,60,000	1,60,000	
	[Sister concern of a director of X Ltd. falls under specified person u/s 40A(2). ₹ 1,08,000, being the excess payment to a specified person is disallowed u/s 40A(2). Since the payment is made in cash and since the remaining amount of ₹ 52,000 exceeds ₹ 10,000, the same would be disallowed u/s 40A(3). Since ₹ 1,60,000 has been debited to profit and loss account, the same has to be added back.]		

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<p>Note – Alternatively, the entire sum of ₹ 1,60,000 can be disallowed u/s 40A(3).</p>		
<p>(ii) Repair of plant and machinery [As per ICDS V on Tangible Fixed Assets, only an expenditure that increases the future benefits from the existing asset beyond its previously assessed standard of performance has to be added to the actual cost. Since expenditure on replacement of worn out parts does not bring in any new asset into existence, such replacement is in the nature of current repairs, which is allowable as deduction. Since the same has been debited to profit and loss account, no adjustment is required.]</p>	-	
<p>(iii) Interest cost in valuation of finished stock [X Ltd. has excluded interest cost in valuation of finished stock as it has changed its accounting policy to comply with the requirements of accounting standard, which is a <i>bona fide</i> reason and would be followed consistently in future. The change in the method of valuation of stock, being a genuine reason, no further adjustment is required, as the said interest cost has been already excluded and consequently profit has been reduced.]</p>	-	
<p>(iv) Payment of gratuity to Mr. Q's family [Payment of gratuity ₹ 2.00 lakhs on account of death of an executive while on business trip is allowable as deduction¹. Since it has already been debited to the profit and loss account, no further adjustment is required.]</p>	-	
<p>(v) 4/5th capital expenditure for promoting family planning [Capital expenditure incurred for the purpose of promoting family planning amongst employees is deductible over a period of 5 years as per the first proviso to section 36(1)(ix). Hence, only ₹ 36,000 is deductible in the current year in respect of such</p>	1,44,000	

¹ CIT vs. Laxmi Cement Distributors (P) Ltd. (1976) 104 ITR 711 (Gujarat)

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expenditure incurred by the company. Since ₹ 1,80,000 has been debited to the profit and loss account, ₹ 1,44,000, being 4/5 th capital expenditure has to be added back.]		
(vi) Retrenchment compensation to employees on closure of unit [Retrenchment compensation paid to employees at the time of closure of one of the units of the company is allowable as deduction ² . Since the same has already been debited to the profit and loss account, no further adjustment is required.]	-	
(viii) Contribution towards NPS in excess of 10% of salary disallowed [Contribution to the extent of 10% of salary (basic salary + dearness allowance, if it forms part of pay for retirement benefits) is allowable as deduction under section 36(1)(iva). In this case, 2%, which is in excess of 10% i.e., ₹ 3,00,000 x 2/12, would be disallowed.]	50,000	
(ix) Marked to market losses [Marked to market loss or other expected loss as computed in accordance with the ICDS would be allowed as deduction u/s 36(1)(xviii). As per ICDS I, marked to market losses cannot be recognized unless the recognition of such loss is in accordance with the provisions of any other ICDS. Marked to market loss in respect of an unsettled derivative contract is not allowable as deduction. Since such losses have been debited to the profit and loss A/c, they have to be added back for computing business income.]	6,00,000	
(x) Provision for gratuity [Provision of ₹ 4 lakhs for gratuity based on actuarial valuation is not allowable as deduction as per section 40A(7). However, actual gratuity of ₹ 2.75 lakhs paid is allowable as deduction. Hence, the difference has to be added back]	1,25,000	
A(ii) Incentive to distributor without deducting tax at source [30% x ₹ 60,000 x 5]	90,000	

² Allahabad High Court in *CIT v. JK Cotton Spinning & Weaving Co. Ltd.* (2005) 145 Taxman 591

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	<p>[Mobile phone to distributors is a perquisite or benefit provided to the distributors and X Ltd. is liable to deduct tax at source under section 194R on such benefit or perquisite. Disallowance @30% would be attracted under section 40(a)(ia) for non-deduction of tax at source on such benefit or perquisite]</p>		<p>11,69,000</p> <p>1,36,69,000</p>
	<p>Less: Items credited but not taxable or chargeable to tax under another head</p>		
	<p>(vii) Waiver of principal on bank loan</p> <p>[Waiver of principal amount of loan taken for trading activity is a benefit in respect of a trading-liability by way of remission or cessation thereof and is, hence, taxable u/s 41(1)³. Since the loan is for meeting working capital requirement, it is logical to assume that is taken for trading activity. Since the loan waiver has already been credited to profit and loss account, no adjustment is required.]</p>	-	
	<p>(vii) Waiver of interest on bank loan</p> <p>[As per section 43B, since interest is allowable only on actual payment, deduction in respect of interest due on loan would not have been allowed as deduction in any previous year. Therefore, waiver of such interest cannot be brought to tax by invoking section 41(1). Since such interest has now been credited to profit and loss account, the same has to be deducted while computing business income.]</p>	1,00,000	
			1,00,000
			1,35,69,000
II	<p>Income from Other Sources</p> <p>Deemed dividend under section 2(22)(e)</p> <p>[Loan of ₹ 4 lakhs by ABC Pvt. Ltd., being a company</p>		1,00,000

³ Solid Containers vs. DCIT (2009) 308 ITR 417 (Bom)

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in which the public are not substantially interested, to X Ltd., being a shareholder who is holding 16% of voting rights of the ABC Pvt. Ltd. will be deemed to be dividend in the hands of X Ltd. to the extent of the accumulated profits i.e., ₹ 1 lakh.]	
Gross Total Income	1,36,69,000
Less: Deduction under Chapter VI-A	
Under section 80GGB [Contribution by a company to an approved Electoral trust is allowable as deduction, since payment is made through RTGS.]	3,50,000
Total Income	1,33,19,000

Question 2

- (a) (i) Mr. A, aged 34 years, is a salaried employee with TKM Limited. He has furnished the following details for the previous year 2022-23:

Sr. No.	Particulars	Amount in ₹
1.	Gross Salary	23,00,000
2.	Business Loss from a new part time business of trading in Mobiles	(4,50,000)
3.	Short Term Capital Loss on sale of Property (computed)	(3,60,000)
4.	Mr. A purchased 1000 Bibcoins, a virtual digital currency on 01.04.2022 for ₹ 1,000 per coin, which he sold on 15.02.2023 for ₹ 1,300 per coin. Commission for transfer of Bibcoins is 2% of the sale value.	

You are required to compute the total income of Mr. A, assuming that he has not opted for section 115BAC for the Assessment year 2023-24 as per the provisions of the Income-tax Act, 1961.

(4 Marks)

- (ii) L, M and N are three partners of M/s. L & G Associates, a partnership firm established on 01.04.1995. L retires from the firm on July 27, 2022 and after his retirement, business of the firm will be operated by M and N. Capital account balance of L as on July 27, 2022 is ₹ 20 Lakhs, (there is no revaluation of assets in books of the firm at any time after 2003-04 when L joined the firm as a partner).

The firm gives to L the following to settle his account:

- (i) Cash payment of ₹ 1,00,000
(ii) Stock in trade (Fair market value on July 27, 2022 is ₹ 2,00,000).

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This stock was purchased on April 15, 2022 for ₹ 1,20,000.

- (iii) *Plot of Land at Kota (Fair market value of plot as on July 27, 2022 is ₹ 17,00,000)*

Book value of plot is ₹ 17,00,000. It was acquired during 1998-99 for ₹ 60,000. Fair market value of the plot as on April 1, 2001 is ₹ 1,10,000.

You are required to calculate the Taxable Income as per the provisions of Income-tax Act, 1961 for L & G Associates for A.Y. 2023-24.

Cost Inflation index for F.Y. 2022-23 is 331 and for F.Y. 2001-02 is 100. (4 Marks)

- (b) *M/s ABC Inc., a company incorporated in Korea, entered into an agreement with XYZ Ltd., an Indian company, for providing assistance to the latter in setting-up a power plant in Gujarat. The scope of work includes -*

- (i) *offshore services in the nature of drawing and design of Electrical and networking work; and*
- (ii) *onshore services in respect of installation of such machinery.*

The consideration for aforesaid scope of work was agreed to be ₹ 3 crores for offshore services and ₹ 2 crores for onshore services. The consideration was discharged as under:

- *₹ 3 crores, in respect of offshore services, was paid in ABC's bank account in Korea on 1st July 2022;*
- *6% debentures for ₹ 2 crores were issued on 1st September, 2022 in consideration for onshore services.*

Discuss tax implications in India in respect of above transactions in the hands of M/s ABC Inc. under the provisions of the Act for AY. 2023-24. For the purpose of your answer, you may assume that activities of ABC Inc. do not constitute any business connection in India.

Ignore the provisions of tax treaty and DTAA.

(6 Marks)**Answer**

- (a) (i) **Computation of total income of Mr. A for A.Y. 2023-24**
(under the regular provisions of the Income-tax Act, 1961)

	Particulars	Amount (in ₹)	Amount (in ₹)
I	Salaries		
	Gross Salary	23,00,000	
	Less: Standard deduction under section 16(ia)	<u>50,000</u>	
			22,50,000

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II	Profit and gains from business or profession		
	Business loss from part time business	(4,50,000)	
	Loss from business cannot be set off against salary income. No set off of business loss is allowed against any capital gain from virtual digital assets. Business loss of ₹ 4,50,000 has to be carried forward to A.Y. 2024-25.		
III	Capital Gains		
	Short term capital loss on sale of property [Short term capital loss cannot be set off against any income other than Capital gains. Short term capital loss of ₹ 3,60,000 has to be carried forward to A.Y. 2024-25]. It is not eligible for set off against capital gain arising from transfer of virtual digital asset.	(3,60,000)	
IV	Capital Gains		
	Income from transfer of virtual digital assets [(₹ 1,300 - ₹ 1,000) x 1,000 bib coins] [No deduction in respect of any expenditure other than cost of acquisition is allowed]		3,00,000
	Total Income		25,50,000

(ii) Computation of taxable income for M/s. L & G Associates for A.Y. 2023-24

Particulars	Amount (in ₹)	Amount (in ₹)
Profits and gains of business or profession		
Deemed transfer on receipt of stock in trade by Mr. L from L & G associates		
Receipt of stock in trade by Mr. L from L & G associates in connection with		

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reconstitution of L & G associates would be deemed to be transfer of stock in trade by L & G associates to Mr. L and would be taxable in the P.Y. 2022-23 u/s 9B		
Full value of consideration of stock in trade [FMV as on 27.7.2022, being the date on which stock in trade is received by Mr. L]	2,00,000	
Less: Purchase cost	<u>1,20,000</u>	
Profits and gains from business		80,000
Capital Gains		
Deemed transfer on receipt of plot of Land by Mr. L from L & G associates		
Receipt of plot of land by Mr. L from L & G associates in connection with reconstitution of L & G associates would be deemed to be transfer of plot of land by L & G associates to Mr. L and would be taxable in the P.Y. 2022-23 u/s 9B		
Full value of consideration of plot of land [FMV as on 27.7.2022, being the date on which capital asset is received by Mr. L]	17,00,000	
Less: Indexed cost of acquisition [Higher of cost of acquisition (₹ 60,000) and FMV as on 1.4.2001 (₹ 1,10,000) i.e., ₹ 1,10,000 x 331/100]	3,64,100	
Capital Gains		13,35,900
Deemed income on receipt of cash and plot of land by Mr. L from L & G associates		
Profits and gains arising on receipt of cash and plot of land by Mr. L from L & G associates in connection with reconstitution of L & G associates would be deemed to be the income of L & G associates and would be taxable in the P.Y. 2022-23 under section 45(4)		
Cash payment	1,00,000	
FMV of plot of land as on 27.7.2022	<u>17,00,000</u>	
	18,00,000	

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Less: Amount of balance in capital account [See Working Note below]	19,25,724	
Since, income chargeable is negative, it would be deemed to be zero	(1,25,724)	-
Taxable Income		14,15,900
<u>Working Note</u>		
Amount of balance in capital account for section 45(4) = Capital balance as on date 27.7.2022 as increased / reduced by share in book profit/loss arising on account of deemed transfer		
Book profit after income-tax on account of deemed transfer u/s 9B		
Book profit on transfer on land = Nil (₹ 17,00,000 – ₹ 17,00,000)		
Book profit on transfer on stock in trade = 80,000 (₹ 2,00,000 – ₹ 1,20,000)		
Tax on capital gains on transfer of land as per section 9B = ₹ 13,35,900 x 20.8% = ₹ 2,77,867		
Tax on business income on transfer of stock in trade under section 9B = ₹ 80,000 x 31.2% = ₹ 24,960		
Profit as per books as reduced by Income-tax on transfer u/s 9B ₹ 80,000 – ₹ 2,77,867 – ₹ 24,960 = (₹ 2,22,827)		
Share of loss of Mr. L = ₹ 2,22,827/3 = ₹ 74,276		
Capital account balance before adjustment	20,00,000	
Less: Share of loss	74,276	
Amount of balance in capital account on 27.7.2022	19,25,724	

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(b) Payment for offshore services in the nature of drawing and design of Electrical and networking work:

In this case, ₹ 3 crores, being the consideration towards offshore services of drawings and designs are in the nature of fee for technical services⁴.

Income by fees for technical services payable by a resident in India for the purpose of business or profession carried on in India is deemed to accrue or arise in India under section 9(1)(vii), whether or not the non-resident has a residence; or place of business; or business connection in India; or whether or not the non-resident has rendered services in India.

Therefore, in the present case, even if drawing and design services are offshore services provided by M/s ABC Inc., a Korean company, the consideration of ₹ 3 crore payable by XYZ Ltd. would be deemed to accrue or arise in India since it is for setting up a power plant in India. Hence, the consideration would be chargeable to tax in India.

Payment for onshore service in respect of installation of such machinery:

₹ 2 crores, being the value of debentures issued by an XYZ Ltd., an Indian company in consideration of providing technical services i.e., onshore services for installation of machinery for setting up a power plant in Gujarat, is in the nature of fee for technical services and would be deemed to accrue or arise in India to M/s ABC Inc. under section 9(1)(vii). Hence, it is taxable in India.

Payment of interest on debentures of ABC Ltd:

As per section 9(1)(v), income by way of interest payable by a person who is a resident of India is deemed to accrue or arise in India except where the interest is payable for debt incurred or money borrowed and used for the purpose of business carried on outside India and for making or earning any income from any source outside India.

Therefore, interest income of ₹ 7 lakhs ($₹ 2 \text{ crores} \times 6\% \times 7/12$) from debentures of XYZ Ltd., an Indian company is deemed to accrue or arise in India in the hands of M/s ABC Inc. by virtue of section 9(1)(v). Hence, it is taxable in India.

Question 3

- (a) (i) *A public company has created a charitable trust exclusively for the benefit of the public. The trust has granted interest free loans, inter alia, to some of the company's employees in order to enable their children to pursue higher studies, as per the objects of the trust. The Assessing Officer considers this benefit as being covered under section 13(3) and proposes to withdraw the exemption from tax granted to the*

⁴ Aeg Aktiengesellschaft v. CIT (2004) 267 ITR 209 (Kar.)

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trust. Comment upon the correctness or otherwise of the view of the Assessing Officer.

- (ii) Leeladhar Memorial Trust runs an educational institution, which is engaged solely in education, received annual receipts during F.Y. 2022-23 amounting to ₹ 2.40 crores. The trust also runs a hospital for treatment of persons suffering from mental defectiveness solely for philanthropic purposes. The total receipts for the hospital during F.Y. 2022-23 amounted to ₹ 2.50 crores.

Leeladhar Memorial Trust is not registered under the Income-tax Act, 1961 for tax exemption u/s. 11, 12 or any other such clause. The consultant of the trust told them they are not required to pay any tax even not given Registration under the Act, Examine the consultants' view discussing the relevant provisions of Income-tax Act, 1961. **(4 x 2 = 8 Marks)**

- (b) Mr. Rizvi, an Indian resident, aged 35 years, works in the Welly Oilfields, Country S as a Superintendent in charge at an emolument of AED 9,500 per month. In order to look after his ailing mother residing in Mumbai, India, he shifted with his family on 1st July, 2022 and started his consultancy business in India. Before shifting to India, he let out his house property in Country S @ 3,250 AED from the same month. The details of his income in INR for the year ended 31st March, 2023 are as follows:

Profit from the consultancy business	₹ 8,65,000
Fixed Deposit interest from the bank of Country S	₹ 45,500
Savings bank interest from SBI, Mumbai	₹ 18,250
Dividend income from XYZ Ltd., an Indian company	₹ 7,750

Rate of income tax in Country S is 23%.

During the previous year, Mr. Rizvi paid ₹ 48,000 as medical insurance premium for himself and ₹ 60,000 as medical insurance premium to insure the health of his father, a non-resident aged 66 years, who is not dependent on him.

You are required to compute the total income and tax liability of Mr. Rizvi for assessment year 2023-24 assuming that India has not entered into double taxation avoidance agreement with Country S and he has not opted for the provisions of Section 115BAC. You may consider (1 AED = 23 INR) **(6 Marks)**

Answer

- (a) (i) (1) The benefit of section 11 would **not** be available to a public charitable trust, if any part of its income enures directly or indirectly for the benefit of any person to in section 13(3).

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- (2) The persons referred to in section 13(3) include an –
- (i) author or trustee of the trust,
 - (ii) person who has made contribution exceeding ₹ 50,000 to the trust upto the end of the relevant previous year,
 - (iii) where the author or trustee or person mentioned above is a HUF, a member of the HUF
 - (iv) relative of such author, trustee or member
 - (v) person or a concern in which any person mentioned above has substantial interest
- (3) The list of prohibited persons in section 13(3), however, does not include employees of the company.
- (4) Therefore, the proposed action of the Assessing Officer to withdraw the exemption from tax granted to the trust on account of interest-free loans granted to company's employees to pursue higher education as per the objects of the trust, is incorrect.

Note – Section 13(3) includes relative of an author or trustee. However, a person having relationship pursuant to a contract like that of an employer and an employee cannot be said to be a relative. "Relative" means a person connected by birth or marriage with another person. This line of reasoning is based on the Patna High Court ruling in *CIT v. Tata Steel Charitable Trust (1993) 203 ITR 764*.

- (ii) The condition of approval or registration is not required in the following cases –
- An educational institution existing solely for educational purposes whose aggregate annual receipts do not exceed ₹ 5 crore is eligible for exemption under section 10(23C)(iiia);
 - A hospital for treatment of persons suffering from mental defectiveness existing solely for philanthropic purposes whose aggregate annual receipts do not exceed ₹ 5 crore is eligible for exemption under section 10(23C)(iiiae);

A trust running an educational institution and a hospital or both would be eligible for exemption under section 10(23C), without the condition of approval or registration, if the combined aggregate annual receipts from the educational institution and hospital does not exceed ₹ 5 crore.

In this case, Leeladhar Memorial Trust's combined receipts of ₹ 4.90 crores from educational institution (₹ 2.40 crores) and hospital (₹ 2.50 crores), does not exceed ₹ 5 crores.

Therefore, the consultant's view that the trust is not required to pay tax even if it is not registered under section 11 or 12 or any other clause is correct.

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Note – The question can also be answered in the following manner -

Exemption under the first regime is available under section 10(23C), where the trust is required to fulfil the prescribed conditions and be approved by the Principal Commissioner/Commissioner in certain cases.

Exemption under the second regime under section 11 is available to a trust registered under section 12AB and fulfilling the prescribed conditions. However, in case of a trust whose combined receipts from educational institution and hospital established solely for education and philanthropic purposes, respectively, do not exceed ₹ 5 crores, neither approval of Principal Commissioner / Commissioner nor registration is required.

Therefore, the consultant's view that the trust is not required to pay tax even if it is not registered under section 11 or 12 or any other clause is correct.

(b) Computation of total income and tax liability of Mr. Rizvi for A.Y.2023-24

Particulars	₹	₹
Salaries		
Salary income from Welly Oilfields, Country S (9500 AED x 3 x ₹ 23)	6,55,500	
Less: Standard deduction	50,000	
		6,05,500
Income from house property		
Annual Value of house property in Country S (3,250 AED x ₹ 23 x 9 months)	6,72,750	
Less: Deduction u/s 24(a) 30% of Annual Value	2,01,825	
		4,70,925
Profits and Gains of Business or Profession		
Profits from the Consultancy business in India		8,65,000
Income from Other Sources		
Fixed deposit interest from the bank of Country S	45,500	
Savings bank interest from SBI Mumbai	18,250	
Dividend income from XYZ Ltd., an Indian company	7,750	71,500
Gross Total Income		20,12,925

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Less: Deductions under Chapter VI-A		
Under section 80D		
Mediclaime premium for self ₹ 48,000 restricted to	25,000	
Mediclaime premium for father ₹ 60,000 restricted to	25,000	
(Since father is a non-resident, even though he is of the age of 66 years)		
	50,000	
Under section 80TTA		
Interest on savings bank account ₹18,250, restricted to	10,000	
		60,000
Total Income		19,52,925
Total Income (rounded off)		19,52,930
Tax liability on ₹ 19,52,930		
Tax on total income [30% of ₹ 9,52,930 + ₹ 1,12,500]		3,98,379
Add: Health and Education cess@4%		15,935
		4,14,314
Less: Deduction u/s 91 (See Working Note below)		2,38,016
Net tax liability		1,76,298
Net tax liability (Rounded off)		1,76,300

Working note – Calculation of deduction under section 91	
Particulars	₹
Doubly Taxed Income	
Salaries	6,05,500
Income from house property	4,70,925
FD interest in Country S	45,500
	11,21,925
Indian rate of tax = $4,14,314/19,52,930 \times 100 = 21.215\%$	
Rate of tax in Country S = 23%	
Lower of the above = 21.215%	
Deduction u/s 91 [21.215% x ₹ 11,21,925]	2,38,016

Note – The question mentions that Mr. Rizvi is an Indian resident working in Country S. The facts given therein indicate the intent to test the application of the provisions of section 91. Accordingly, the main solution has been worked out considering **Mr. Rizvi as a resident and ordinarily resident.**

Alternate Solution

The question specifically mentions that Mr. Rizvi who was residing in Country S and was in employment there, has shifted with his family to India on 1st July, 2022 and started his consultancy business here. No information relating to his stay in India in the earlier previous years is given. He is a resident in P.Y.2022-23 since the period of his stay in this year is 182 days or more. However, since he has been ordinarily residing in Country S so far and has shifted to India only on 1st July, 2022, he would be resident but not ordinarily resident in India for A.Y.2023-24, in which case, the income earned by him in Country S in the P.Y.2022-23 would not be chargeable to tax in India. Accordingly, on this basis, an alternate solution is worked out below –

Computation of total income and tax liability of Mr. Rizvi for A.Y.2023-24

Particulars		₹
Income from Salaries		
Salary income from Welly Oilfields Country S (not taxable, since the income accrues or arises outside India. Since the services are rendered outside India, such income is not deemed to accrue or arise in India)		-
Income from house property		
Income from house property in Country S (income accruing or arising outside India is not taxable since Mr. Rizvi is a RNOR)		-
Profits and Gains of Business or Profession		
	₹	₹
Profits from the Consultancy business		8,65,000
Income from Other Sources		
Fixed deposit interest from the bank of Country S (income accruing or arising outside India not taxable since Mr. Rizvi is a RNOR)		-
Savings bank interest from SBI Mumbai	18,250	
Dividend income from XYZ Ltd., an Indian company	7,750	
		<u>26,000</u>
Gross Total Income		8,91,000

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Less: Deductions under Chapter VI-A		
Under section 80D		
Mediclaime premium for self ₹ 48,000 restricted to	₹ 25,000	
Mediclaime premium for father ₹ 60,000 restricted to	₹ 25,000	
(Since father is a non-resident, even though he is of the age of 66 years)		
	50,000	
Under section 80TTA		
Interest on savings bank account ₹ 18,250, restricted to	10,000	
		60,000
Total Income		8,31,000
Tax liability on ₹ 8,31,000		
Tax on total income [20% of ₹ 8,31,000 + ₹ 12,500]		78,700
Add: Health and Education cess@4%		3,148
Tax liability		81,848
Tax liability (Rounded off)		81,850

Note – While working out the question on the basis that Mr. Rizvi is a RNOR, it may be assumed that income from house property in Country S or FD interest from bank of Country S or both is received in India, since effect of deduction under section 91 can be given only when such assumption(s) is made. The figures of doubly taxed income, deduction under section 91 and net tax liability would differ depending on the assumption made.

Question 4

- (a) (i) During the previous year 2022-23, Mr. A purchased scrap of ₹ 55 lakhs from Mr. B for the purpose of his manufacturing unit. Mr. A also furnished a certificate to Mr. B that the scrap shall be utilized for manufacturing process carried on by Mr. A and shall not be used for trading purposes. Mr. A made the payment of ₹ 45 lakhs during F.Y 2022-23 to Mr. B. Assume turnover of both Mr. A and Mr. B from the business carried on by them exceeds ₹ 10 crores in the financial year 2021-22. Comment upon TDS/ TCS implication in the above case. **(3 Marks)**
- (ii) Mr. P provides technical consultancy to its various clients who deduct tax u/s 194-J of the Act. Mr. P applies for lower tax deduction certificate u/s 197 from the TDS officer in respect of his receipts from consultancy. During the previous year 2022-23, Mr. P was issued the lower tax deduction certificate allowing him to receive the consultancy payments after deduction of tax@1%. Mr. P forwarded this

certificate to his client Mr. Q asking him to deduct tax@1% on the payments of ₹ 15 lakhs to be made to Mr. P.

Mr. Q has approached you to advise on the amount of tax to be deducted from the payment to be made to Mr. P. You gathered the information that Mr. P is not filing his ITRs for the last two Assessment years and TDS credit in his 26AS is more than ₹ 1 lakh in each last two years i.e. A.Y. 2021-22 and 2022-23. What would be your advice to Mr. Q? **(3 Marks)**

- (iii) Ms. Roshni sold her house property at Delhi to Ms. Shalini for a consideration of ₹ 60 lakhs on 1.8.2022. She has purchased the house property on 1.4.2015 for ₹ 36 lakhs. The Stamp duty value of the property on the date of sale i.e., 1.8.2022 is ₹ 82 lakhs.

Determine the TDS implications in the hands of Ms. Shalini as per the Income-tax Act, 1961, assuming both Roshni and Shalini are resident individuals. **(2 Marks)**

- (b) Shahi Pvt. Ltd., a domestic company, located in Special Economic Zone (SEZ) since November 2013.

The company is engaged in manufacturing of consumables goods. The manufacturing is wholly dependent on raw material which is imported from Sumi Inc. of Japan.

The following details are furnished in respect of the financial year 2022-23:

- (i) Shahi Pvt. Ltd. imported goods for ₹ 30 crores from Sumi Inc.
- (ii) Sumi Inc. supplied similar raw materials to unrelated parties with a mark-up of 10%, whereas for Shahi Pvt. Ltd. it earned a mark-up of 20%.
- (iii) Shahi Pvt. Ltd. was allowed to use the brand name of Sumi Inc. without any payment and whereas the unrelated parties cannot use such brand name in India. The annual cost of brand value is ₹ 90 lakhs.
- (iv) The Assessing Officer referred the matter to the Transfer Pricing Officer (TPO) for determination of Arm's Length Price (ALP).

You are required to answer the following:

- (a) Compute the arm's length price of the transaction and adjustments to be made to the income of Shahi Pvt. Ltd while discussing the relevant provisions.
- (b) If Transfer Pricing Officer (TPO) had enhanced the income of Shahi Pvt. Ltd. by ₹ 2 crores, will that enhanced amount of income be eligible for deduction u/s 10AA?
- (c) Will Shahi Pvt. Ltd. become liable for penalty for under-reporting of income based on the report of the Transfer Pricing Officer (TPO)? **(6 Marks)**

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Answer

- (a) (i) By virtue of section 206C(1A), Mr. B is not required to collect tax at source under section 206C(1), since Mr. A has furnished a certificate to Mr. B that the scrap purchased from him is for manufacturing process carried on by him and not for trading purposes.

However, as clarified vide *Circular no. 13/2021 dated 30.6.2021 and Circular No. 20/2021 dated 25.11.2021*, TDS under section 194Q will be attracted in the hands of the buyer in such cases covered under section 206C(1A), if the conditions specified under section 194Q are fulfilled.

In this case, tax is required to be deducted at source under section 194Q by the buyer, Mr. A, since his turnover in the immediately preceding financial year i.e., F.Y.2021-22 exceeds ₹ 10 crores and he has purchased goods of the value or aggregate of such value exceeding ₹ 50 lakhs in the F.Y.2022-23. TDS u/s 194Q would be 0.1% of the sum exceeding ₹ 50 lakhs and the same has to be deducted at the time of payment or credit of such sum to the account of resident seller, whichever is earlier.

Therefore, in the present case, Mr. A is required to deduct tax at source @ 0.1% of ₹ 5,00,000, being the amount exceeding ₹ 50 lakhs (₹ 45,00,000, being the payment made plus ₹ 10 lakhs, being the amount credited to the account of Mr. B).

Note: It may be noted that section 206C(1H) would not apply where section 194Q is applicable.

- (ii) As per section 194J, Mr. Q is required to deduct tax at source @2% on ₹ 15 lakhs in respect of payment for technical consultancy to Mr. P. However, since Mr. P has furnished lower tax deduction certificate issued under section 197 specifying lower rate of 1% to Mr. Q, tax would be deducted at such lower rate of 1%.

However, as per section 206AB, since Mr. P has not furnished his return of income for A.Y.2021-22 / A.Y.2022-23 relevant to the P.Y. 2020-21/P.Y.2021-22, respectively, and the aggregate of TDS and TCS in his case is ₹ 1 lakh in the said previous year, which is more than the threshold of ₹ 50,000, Mr. Q is required to deduct tax at source on payment of fees for technical consultancy to Mr. P, at higher of *inter alia* the following rates –

- (i) at twice the rate prescribed in the relevant provisions of the Act i.e., 4% [being twice the rate of 2% applicable under section 194J] [Alternatively, since tax is deductible as per lower tax deduction certificate issued under section 197, rate of 2% may be mentioned in the answer];
- (ii) at 5%

Accordingly, Mr. Q is required to deduct tax at source @5% on ₹ 15 lakhs, being the amount paid as technical consultancy fees.

Note - The above answer is on the basis that receipts from technical consultancy represents fees for technical services attracting TDS@2%. It may be noted that "technical consultancy" is also covered under the definition of "Professional Services" under section 194J. The rate of TDS for Fees for professional services is 10%. If receipts from technical consultancy is treated as fees for professional services, the TDS rate applying section 206AB would be 20%, being the higher of 5% or twice the applicable rate of 10%. This is an alternate view possible since technical consultancy is also included in the definition of "Professional Services" under section 194J.

- (iii) In the case of transfer of any immovable property and the transferor is a resident, where the consideration or the stamp duty value, whichever is higher, exceeds ₹ 50 lakhs, tax is deductible at source @1%.

As per section 194-IA, Ms. Shalini, being a resident transferee paying ₹ 60 lakhs to Ms. Roshni, a resident transferor, as consideration for transfer of house property at Delhi, is required to deducted tax at source @1% on ₹ 82 lakhs, being the higher of Stamp duty value of ₹ 82 lakhs or consideration of ₹ 60 lakhs.

Therefore, tax to be deducted = ₹ 82,00,000 x 1% = ₹ 82,000.

- (b) (a) Shahi Pvt. Ltd, an Indian company and Sumi Inc. of Japan, are deemed to be associated enterprises as per section 92A(2), since Shahi Ltd.'s manufacturing is wholly dependent on raw material⁵ imported from Sumi Inc. Further, the transaction of purchasing raw material falls within the meaning of "international transaction" u/s 92B. Hence, transfer pricing provisions would be attracted in this case.

Computation of Arm's length price and adjustment to be made	₹ in crores
Price of imported goods charged by Sumi Inc. from Shahi Pvt. Ltd.	30.00
Less: Mark up earned @ 20% [₹ 30 crores x 20/120] from Shahi Pvt. Ltd.	<u>5.00</u>
	25.00
Add: Mark up earned in uncontrolled comparable transaction @10%	<u>2.50</u>
	27.50
Add: Adjustment on account of brand value [Annual cost of brand value]	<u>0.90</u>
Arm's length price of raw material purchase	28.40
Less: Price at which raw material was imported by Shahi Pvt. Ltd. from Sumi Inc.	<u>30.00</u>
Adjustment to be made to the income of Shahi Pvt. Ltd.	<u>1.60</u>

⁵ Assuming the prices and terms of supply are decided by the Sumi Inc.

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- (b) Shahi Pvt. Ltd. cannot claim deduction under section 10AA in respect of ₹ 2 crores, being the amount of income by which the total income is enhanced by the TPO, by virtue of the first proviso to section 92C(4).
- (c) No, Shahi Pvt. Ltd. would not be liable for penalty for under reporting of income based on the report of the TPO, since the amount of under-reported income represented by any addition made in conformity with the arm's length price determined by the Transfer Pricing Officer would not be included within the scope of under-reported income under section 270A, assuming Shahi Pvt. Ltd. has maintained information and documents, as prescribed under section 92D, declared the international transactions under Chapter X and disclosed all material facts relating to the transaction.

Question 5

- (a) Answer any **two** out of the following three sub-parts, viz. (i), (ii) and (iii).

Your answer should cover:

- (a) Issue involved
 - (b) Provisions applicable
 - (c) Analysis and Conclusion
- (i) M/s Risky Construction Pvt. Ltd. is engaged in the construction of bridges and flyovers. During the previous year 2022-23, it made payment to various parties and deducted tax amounting to ₹ 1.60 crores. However, the company failed to deposit the said amount with the income-tax department within the time prescribed under the Act. The company submitted that it is facing financial hardship since a large sum of money has been stuck-up with its debtors and also with the income-tax department in the form of tax refunds. It is further submitted that in spite of financial crisis, the company has suo-moto deposited the TDS amount along-with interest u/s 201(1A) of the Act, before receiving any notice from the income-tax department in this regard. However, Tax officer initiated prosecution proceedings under Section 276B of the Act against the company and its directors. The company has approached you to advise in the matter.
- (ii) XYZ Limited entered into a contract for purchase of software with M/s. Delta Inc, a non-resident company based in Sweden. It filed an application u/s 195(2) before the Assessing Officer to make payment to the non-resident company for purchase of software without deducting tax at source.

The assessee, XYZ Limited, contended that said non-resident company had no Permanent Establishment in India and in terms of the DTAA between India and Sweden, no tax was to be deducted in India on same. The AO rejected the assessee's application on grounds that consideration for software licensing constituted royalty u/s 9(1)(vi) and was liable to be taxed in India and, accordingly,

assessee was directed to deduct tax at source at rate of 10% on said royalty payment.

On Appeal, the Commissioner (Appeals) passed an order in favour of the assessee. On further appeal, the Tribunal upheld the order passed by the Assessing Officer on grounds that payments made for purchase of software were in nature of royalty and tax at source to be deducted on such payment.

The assessee company filed a miscellaneous application for rectification under Section 254(2) before the Tribunal. The assessee had also filed an appeal before the High Court.

Tribunal allowed said application in exercise of his powers under section 254(2) and reheard entire appeal on merits and recalled its original order and passed an order in favour of the assessee. Thereafter, the writ petition filed by the assessee with High Court was also withdrawn. Is Tribunal justified in recalling its original order? Please state your answer on the basis of latest provisions of the Act and Supreme Court rulings.

- (iii) The assessee, MPV Ltd, being a branch office of US Company, MPV Inc, was engaged in contract research activities and cultivation of parent seeds in India. It had been claiming exemption by treating its entire income as agricultural income.

On Scrutiny assessment for the period from year 2010 to 2015, the Assessing Officer treated entire income of the assessee as "Business Income" and attributed deemed income from research activity holding the assessee company to be a Permanent Establishment (PE) of MPV Inc. However, the assessee company disputed the matter for resolution under Mutual Agreement Procedure (MAP) under the DTAA agreement between India and USA. The MAP was culminated in the year 2020. The assessment was finalized and taxes alongwith interest were paid by the assessee u/s 220.

However, the assessee disputed the amount of interest u/s.220(2) for the period from 2015 to 2020.

Thereafter the assessee company filed an application before Jurisdictional Commissioner of Income-tax under section 220(2A) for waiver of interest levied u/s 220(2). Commissioner dismissed application of the assessee.

The assessee company is a part of MPV Inc, a global conglomerate which had in 2020 ₹ 94,000 crores in net sales and ₹ 12,000 crores as operating profit. The amount paid by it towards interest u/s.220(2) of the Act was 2.50 crores.

On the basis of the above facts and as per the latest ruling of the Supreme Court, whether the Commissioner of Income-tax is justified in rejecting the claim of Assessee or not.

(4 x 2 = 8 Marks)

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- (b) Kiwi Inc., a company based in USA, is engaged in manufacturing and selling of mobile phones, globally. It sells each mobile phone for USD 2,000. Alpha Inc., another company based in USA, owns and manages a website which acts as a marketplace for buying and selling of goods and also hosts advertisements. Gama LLC, a company incorporated in UK, is engaged in manufacturing and selling of printers.

During the previous year 2022-23, Kiwi Inc. sold 80,000 mobile phones, as under-

Platform through which the mobile phones are sold	Customer to whom the mobile phones are sold	Number of mobile phones sold
Through Alpha Inc.	Persons who are resident in India	15,000
Through Alpha Inc.	Persons who are not resident in India, sitting in U.K.	25,000
Through Kiwi Inc.'s own website	Persons who are resident in India	7,000
Through Kiwi Inc.'s own website	Persons who are not resident in India, using Internet in U.K.	12,000
Through Kiwi Inc.'s physical store in US	Persons who are resident in India	<u>21,000</u>
Total		<u>80,000</u>

Gama LLC enters into a contract with Alpha Inc. for publishing its advertisement on the website of Alpha Inc., for the period from 1st March 2023 to 31st March 2023. Gama LLC paid USD 50,000 for hosting advertisement in India for Indian customers and USD 20,000 for hosting advertisement in UK for UK customers. Kiwi Inc., Alpha Inc. and Gama LLC do not have any Permanent Establishment in India.

Discuss the India tax implications in the above scenario as per Income-tax Act, 1961. You may assume that sale of mobile phones was evenly distributed throughout the year and the rate of 1 USD is equal to ₹ 80. **(6 Marks)**

Answer

- (a) (i) **Issue Involved:** The issue under consideration is whether prosecution proceedings can be initiated where tax deducted has been deposited by the assessee *suo moto*, after the time prescribed under the Act but before receiving notice from the income-tax department, along with interest under section 201(1A) and the assessee has shown reasonable cause for such delay.

Provisions Applicable: Prosecution proceedings are attracted under section 276B, if a person fails to pay to the credit of the Central Government, the tax deducted at source by him as required under the provisions of the Act.

Section 278AA provides that no person would be punishable for such failure if he proves that there was reasonable cause for the same.

Analysis and Conclusion: In this case, the company has reasonable and sufficient cause since it was facing financial hardship on account of large sum of money stuck up with the debtors and also with the income-tax department on account of refunds. In spite of the financial crisis, the company has *suo moto* deposited the TDS along with interest under section 201(1A) of the Act, before receiving any notice from the income-tax department in this regard.

Since it has deposited the TDS along with interest *suo moto* before receiving any notice from the department and it has also shown reasonable cause for such delay in deposit, the company cannot be punishable for the delay in deposit of TDS. The initiation of prosecution proceedings under section 276B against the company and the directors is, therefore, **not** correct.

- (ii) **Issue Involved:** The issue under consideration is whether the powers under section 254(2) can be exercised by the Tribunal to recall an order and rehear the entire appeal on merits.

Provisions applicable: Section 254(1) empowers the Appellate Tribunal to pass such order thereon as it thinks fit, after giving both the parties to the appeal an opportunity of being heard.

Under section 254(2), the Appellate Tribunal, may amend an order passed by it u/s 254(1) with a view to rectifying any mistake apparent from the record.

Analysis and Conclusion: The power u/s 254(2) is limited to rectification of a mistake apparent on record and therefore, the Tribunal must restrict itself within those parameters.

A detailed order was passed by the Tribunal upholding the order passed by the Assessing Officer. While allowing the application u/s 254(2) and recalling its earlier order, the Tribunal had reheard the entire appeal on the merits as if the Tribunal was deciding the appeal against the order passed by the Commissioner (Appeals). The subsequent order passed by the Tribunal recalling its earlier order was beyond the scope and ambit of the powers u/s 254(2) and is not tenable in law.

Note – The facts given in the question are similar to the facts in *Reliance Telecom Ltd./Reliance Communications Ltd. (2022) 440 ITR 1 (SC)* wherein the issue came up before the Supreme Court. The above answer is based on the rationale of the Supreme Court in the said case.

- (iii) **Issue Involved:** The issue under consideration is whether pendency of dispute resolution under MAP is a valid ground for waiver of interest under section 220(2A).

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Provisions Applicable: Section 220(2) provides for levy of simple interest for delay in paying the sum specified in the notice of demand within the period specified thereunder.

Section 220(2A) provides for reduction or waiver of interest payable under section 220(2) if, *inter alia*, the Commissioner is satisfied that payment of such amount has caused or would cause genuine hardship to the assessee.

Analysis and Conclusion: Merely raising the dispute before any authority cannot be a ground for waiver of interest under section 220(2A). Otherwise, each and every assessee may raise a dispute and thereafter, may contend that since the litigation was *bona fide*, no interest is leviable.

Further, in this case, the assessee is a part of a global conglomerate which had in the 2020 ₹ 94,000 crores in net sales and ₹ 12,000 crores as operating profit. In comparison to the profitability over the years, the amount paid by it towards interest under section 220(2) was merely ₹ 2.50 crores. This fact is relevant in concluding that no 'genuine hardship' can be said to have been caused to the assessee on account of payment of interest.

The Commissioner of Income-tax is, therefore, justified in rejecting the claim of assessee.

Note – The facts given in the question are similar to the facts in *Pioneer Overseas Corporation USA (India Branch) v. CIT (International Taxation) (2022) 449 ITR 186*, wherein the issue came up before the Supreme Court. The above answer is based on the rationale of the Supreme Court in the said case.

(b) Tax implications in the hands of Kiwi Inc./Alpha Inc.

(1)		(2)
Transaction entered into by Kiwi Inc.		Tax implications in the hands of Kiwi Inc./ Alpha Inc.
(i)	Sale of 15,000 mobile phones through Alpha Inc. to persons who are resident in India	<p>Alpha Inc, the e-commerce operator, has to pay equalisation levy@2%, since the e-commerce supply is to persons resident in India, the consideration for which exceeds ₹ 2 crore.</p> <p>Consideration = 15,000 x 2,000 x ₹ 80 = ₹ 240 crores</p> <p>EL payable by Alpha Inc = 2% x ₹ 240 crores = ₹ 4.80 crores</p> <p>There would be no income-tax liability in the hands of Kiwi Inc on account of exemption u/s 10(50).</p> <p>Note – This view is taken since EL is leviable on the gross sale consideration even though Alpha Inc. is only facilitating sale of phones by Kiwi Inc. in this case. Accordingly, Kiwi Inc. can avail benefit of</p>

		<p>exemption u/s 10(50), since the transaction has already been subject to equalization levy in the hands of Alpha Inc.</p> <p>Alternatively, it is possible to take a view that exemption u/s 10(50) would not be available to Kiwi Inc since equalization levy is paid by Alpha Inc. If this view is taken, then the income attributable to this transaction would be subject to income-tax in the hands of Kiwi Inc. on account of significant economic presence of Kiwi Inc. in India leading to business connection in India.</p>
(ii)	Sale of 25000 mobile phones through Alpha Inc. to persons who are not resident in India, sitting in UK	<p>Equalisation levy is not attracted in the hands of Alpha Inc. on sale of mobile phones to non-residents based outside India.</p> <p>Income-tax liability is also not attracted in the hands of Kiwi Inc. since the income accrues and arises outside India and is received outside India by a non-resident, i.e., Kiwi Inc.</p>
(iii)	Sale of 7,000 phones through Kiwi Inc's own website to persons resident in India	<p>Equalisation levy@2% is attracted in the hands of Kiwi Inc, since it has effected e-commerce supply to persons resident in India, the consideration for which exceeds ₹ 2 crores.</p> <p>Consideration = 7,000 x 2,000 x ₹ 80 = ₹ 112 crores</p> <p>EL payable by Kiwi Inc. = 2% x ₹ 112 crores = ₹ 2.24 crores</p> <p>There would be no income-tax liability in the hands of Kiwi Inc. on account of exemption u/s 10(50).</p>
(iv)	Sale of 12,000 phones through Kiwi Inc's own website to persons who are not resident in India, using internet in UK	<p>Equalisation levy is not attracted in the hands of Kiwi Inc. on sale of mobile phones to non-residents based outside India using internet protocol address outside India.</p> <p>Income-tax liability is also not attracted in the hands of Kiwi Inc. since the income accrues and arises outside India and is received outside India by a non-resident, i.e., Kiwi Inc.</p>
(v)	Sale of 21,000 phones through Kiwi's physical store in US to persons resident in India.	<p>Since the sale has taken place outside India, no income is deemed to accrue or arise in the hands of Kiwi Inc.</p>

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USD 50,000 received from Gama LLC by Alpha Inc. for hosting advertisement for Indian Customers

Amount of USD 50,000 paid by Gamma Inc., a non-resident, to Alpha Inc, another non-resident, being an e-commerce operator, would be subject to EL @2% in the hands of Alpha Inc, since the same is for hosting advertisement in India which is a specified circumstance.

EL payable by Alpha Inc. = 2% x USD 50,000 x ₹ 80 = ₹ 80,000.

USD 20,000 received from Gama LLC by Alpha Inc. for hosting advertisement in UK for UK customers

No equalization levy is attracted in respect of the sum of USD 20,000 paid since it is not for targeting Indian customers.

No income-tax liability is attracted since no income accrues or arises or is deemed to accrue or arise in India to Alpha Inc.

Note – The question requires the candidates to discuss the India tax implications in the given scenario **as per the Income-tax Act, 1961**. Since majority of the transactions listed therein is through a non-resident e-commerce operator, it becomes imperative to first consider the equalisation levy implications. If the transaction is subject to equalisation levy, then, it would be exempt u/s 10(50) of the Income-tax Act, 1961. Otherwise, it has to be examined whether the income from the transaction is deemed to accrue or arise in India to attract chargeability of income-tax u/s 9 of the Income-tax Act, 1961. The main answer given above has been prepared on these lines.

However, due to the specific reference to “as per the Income-tax Act, 1961” in Q.5(b), an alternate answer is given below ignoring the provisions of equalisation levy, since the levy itself is through Chapter VIII of the Finance Act, 2016 and not through the Income-tax Act, 1961:

Tax implications under the Income-tax Act, 1961 ignoring equalisation levy		
(1)		(2)
Transaction entered into by Kiwi Inc.		Tax implications in the hands of Kiwi Inc.
(i)	Sale of 15,000 mobile phones@ USD 2,000 through Alpha Inc. to persons who are resident in India	Significant economic presence of Kiwi Inc in India arises in these cases [transactions referred to in (i) and (iii)] since these transactions are with persons in India in respect of which the aggregate payments in the P.Y.2022-23 exceeds ₹ 2 crores.

(iii)	Sale of 7,000 phones@ USD 2,000 through Kiwi Inc's own website to persons resident in India	Hence, business connection is constituted and income attributable to such transactions shall be deemed to accrue or arise in India and would be chargeable to income-tax in the hands of Kiwi Inc.
(ii)	Sale of 25000 mobile phones through Alpha Inc. to persons who are not resident in India, sitting in UK	Income-tax liability is not attracted in the hands of Kiwi Inc. in respect of transactions referred to in (ii) and (iv) since the income accrues and arises outside India and is received outside India by a non-resident, i.e., Kiwi Inc.
(iv)	Sale of 12,000 phones through Kiwi Inc's own website to persons who are not resident in India, using internet in UK	No business connection is established in this case, and hence, no income is deemed to accrue or arise in India in the hands of Kiwi Inc.
(v)	Sale of 21,000 phones through Kiwi's physical store in US to persons resident in India.	Since the sale has taken place outside India, no income is deemed to accrue or arise in the hands of Kiwi Inc.
USD 50,000 received from Gama LLC by Alpha Inc. for hosting advertisement in India for Indian Customers		
Income attributable to operations carried out in India which is deemed to accrue or arise in India would include income from advertisement which targets customers residing in India. Accordingly, income of USD 50,000 received from Gama LLC by Alpha Inc. for hosting advertisement in India for Indian customers would be chargeable to income-tax in the hands of Alpha Inc.		
USD 20,000 received from Gama LLC by Alpha Inc. for hosting advertisement in UK for UK customers		
No income-tax liability is attracted since no income accrues or arises or is deemed to accrue or arise in India to Alpha Inc.		

Question 6

- (a) (i) *Comment whether the following transactions, undertaken during the financial year 2022-23, are required to be reported under the Statement of Financial Transaction or Reportable Account as required u/s 285BA of the Income-tax Act, 1961. Please give your answer alongwith suitable reasons and Category of Reporting Person.*
- (a) *Mr. A purchased five bank drafts of ₹ 3 lakh each from his current A/c with State Bank of India, Jaipur;*

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(b) Ms. Q made two time deposits with Canara Bank, Jaipur - (a) a time deposit of ₹ 7 lakhs made on 07-08-2022 and (b) Renewal of Time deposit of ₹ 5 lakhs originally made on 1.1.2022 and renewed on 1.1.2023;

(c) Ms. C made following payments in respect of credit card payments-

• For the months of April to July, 2022	-	₹ 19,500 for each month, in cash
• For the months of Aug. to Dec., 2022	-	₹ 59,500 for each month, through bank A/c
• For the months of Jan to Mar, 2023	-	₹ 13,300 for each month, in cash

(d) Mr. Z purchased garments of ₹ 2 lakhs in cash from M/s Arora Designers on the occasion of his marriage. M/s Arora Designers is liable for audit u/s 44AB of the Income-tax Act, 1961. **(4 Marks)**

(ii) Doctrine of precedence would be applicable in case of tax laws. In light of the Doctrine of Precedence, comment on the correctness or otherwise of the following statements alongwith reasons for your answers:

(a) The ratio decendi (the rationale for deciding a case) of a Supreme Court decision is absolutely binding on all lower courts, Tribunals and authorities. However, the lower courts, Tribunals and authorities are not bound by the obiter dicta (additional remarks or things said by the way) of Supreme Court decisions.

(b) Where there are two irreconcilable decisions of two Benches of similar strength of the Supreme Court, the decision with more detailed discussion on the subject shall prevail.

(c) Lower courts are bound by the decisions of Supreme Court. The only exception to this principle is the judgments passed by the Supreme Court per incuriam (i.e. without referring the statutory provision).

(d) Lower authorities may deviate from the decision of the High Court within whose jurisdiction they function, only in a situation to keep the issue alive where the Department has not accepted the said decision and has taken the matter to the Supreme Court. **(4 Marks)**

(b) (i) What is the "General Rule of Interpretation" of tax treaty as provided under Vienna Convention on Law of Treaties? **(2 Marks)**

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- (ii) Explain the following terms "*Pacta Sunt Servanda* (in good faith)" in view of Principles enunciated in the Vienna Convention on law of treaties. **(1 Mark)**
- (iii) Explain the term "*Mutual Agreement Procedure*" as per Article 25 of Model Tax Conventions under OECD model and UN Model. **(3 Marks)**

Answer

- (a) (i) (a) State Bank of India, Jaipur, is **not** required to report value of bank drafts purchased by Mr. A, even though aggregate value of such bank drafts i.e., ₹ 15 lakhs, exceed ₹ 10 lakhs in the F.Y.2022-23, since such bank drafts are purchased from his current A/c and not in cash.
- (b) Canara Bank, Jaipur is **not** required to report time deposits made by Ms. Q, since the value of time deposits other than time deposit renewed on 1.1.2023 is only ₹ 7 lakhs, and hence, does not aggregate to ₹ 10 lakhs or more in the F.Y.2022-23.
- (c) The bank or institution issuing credit card is required to report cash payment made by Ms. C in respect of credit card, since aggregate cash payments of ₹ 1,17,900 (₹ 19,500 x 4 + ₹ 13,300 x 3) exceeds ₹ 1 lakh in the F.Y.2022-23.
- However, payment of ₹ 59,500 for each month from August 2022 to December 2022 need **not** be reported by such bank or company or institution since, aggregate value of such transactions, being ₹ 2,97,500, is less than ₹ 10 lakhs.
- (d) Payment of ₹ 2 lakhs by Mr. Z is not required to be reported by M/s Arora Designers, since receipt of cash payment against sale of garments from Mr. Z does not exceed ₹ 2 lakhs.
- (ii) **Doctrine of precedence**
- (a) **Incorrect** - Not only the *ratio decidendi* (the rationale for deciding a case), but also *obiter dicta* (additional observations, remarks, and opinions given while deciding a case) of the Supreme Court are binding on all the Courts.
- (b) **Incorrect** - When there are two irreconcilable decisions of two Benches of similar strength of Supreme Court, the decision later in time shall prevail.
- (c) **Incorrect** - The Supreme Court judgments cannot be ignored by the lower courts though such judgments are *per incuriam* (i.e., without referring the statutory provisions).

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- (d) **Incorrect** - Lower authorities cannot pass orders which are inconsistent with the decisions of the High Court within whose jurisdiction they function, even for the purpose of keeping the issue alive.
- (b) (i) General Rule of Interpretation implies that a treaty shall be interpreted –
- in good faith;
 - in accordance with the ordinary meaning to be given to the terms thereof; and
 - in the context and in the light of its object and purpose.
- (ii) *Pacta Sunt Servanda* (in good faith) implies that every treaty in force-
- is binding upon the parties; and
 - must be followed by them in good faith.
- (iii) There may be a situation wherein a tax payer may believe that the treatment accorded by either or both Contracting States is not in accordance with the provisions of the tax treaty.

In such a case, there is a need for dispute resolution which is addressed by Article 25 of Model Tax Convention under OECD Model and UN Model. This Article requires competent authorities of both countries to endeavor to resolve the conflict by engaging in bilateral negotiations.

The UN Model Convention provides two alternatives - Alternative A and Alternative B, for the article on Mutual Agreement Procedure. Under OECD Model Convention, the taxpayer may make a request to either Contracting State while UN Model (Alternative A) contemplates taxpayer going to Residence State or the country of his nationality. Alternative B of UN Model Article 25 contemplates reference to an arbitration process as part of the Mutual Agreement Procedure.