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SUGGESTED SOLUTION

CA FINAL

SUBJECT- DIRECT TAX LAWS

Test Code – 7416

BRANCH - () (Date :)

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- NOTES:** (1) WORKING NOTES SHOULD FORM PART OF ANSWERS.
 (2) INTERNAL WORKING NOTES SHOULD ALSO BE CONSIDERED BY PAPER CHECKER.
 (3) NEW QUESTION SHOULD BE ON NEW PAGE

Division A – Multiple Choice Questions

1. (i) (C) (1 Mark)
 (ii) (C) (1 Mark)
 (iii) (D) (1 Mark)
 (iv) (C) (1 Mark)
 (v) (D) (1 Mark)
2. (C) (1 Mark)
3. (D) (1 Mark)
4. (A) (1 Mark)
5. (D) (1 Mark)
6. (A) (1 Mark)
7. (D) (2 Marks)
8. (C) (2 Marks)
9. (C) (2 Marks)
10. (A) (2 Marks)
11. (A) (2 Marks)
12. (B) (2 Marks)
13. (D) (2 Marks)
14. (B) (2 Marks)
15. (D) (2 Marks)
16. (B) (2 Marks)

DIVISION B

ANSWER : 1

Step 1 : Computation of Book Profit

	Particulars	Rs.	Rs.
	Net Profit as per Profit & Loss		19,99,000
Add :	Positive Adjustments		
	Depreciation	5,17,000	
	Provision for Bad and doubtful Debts	16,000	
	Interest for late filing of income tax return	2,000	
	Provision for unascertained liabilities	75,000	
	Loss of subsidiary company	39,000	
	Provision for Income Tax	2,25,000	
	Proposed Dividend	64,350	9,38,350
Less :	Negative Adjustments		
	Profit on buy back of shares of closely held Indian Company	(1,00,000)	
	Deferred Tax	(25,000)	
	Income by way of share in income of AOP (which is not subject to tax)	(41,100)	
	Depreciation (excluding depreciation on account of revaluation)	(5,00,000)	
	Brought forward loss or unabsorbed depreciation whichever is lower (as per books of accounts)	(6,000)	(6,72,100)
	Book Profit		22,65,250

Step 2 : Computation of MAT Liability

Particulars	Rs.
MAT @ 15% of Book Profit (Rs. 22,65,250)	3,39,788
Add : Health & Education Cess : (4%)	13,592
MAT Liability	3,53,380

Step 3 :

Particulars	Rs.
Income Under head PGBP	
Net Profit as per profit and loss account	19,99,000
Less : Interest on Fixed Deposit (to be considered under "IFOS")	(1,54,900)
Less : Profit on buy back of shares of closely held Indian Company (Exempt)	(1,00,000)
Less : Differed Tax	(25,000)
Less : Share from AOP(Not taxable)	(41,100)
Less : Depreciation	5,17,000
Add: Provision for bad and doubtful debts	16,000
Add : Penalty under Income Tax Act	10,000
Add : Interest for late filing of return	2,000
Add: Wealth Tax (P.Y. 2014 – 15)	15,000
Add : Custom Duty (Assuming that it has not paid before due date of filing return)	21,000
Add : Provision for unascertained liability	75,000
Add : Losses of subsidiary	39,000
Add : Provision for Income Tax	2,25,000
Add : Proposed Dividend	64,350
Sub – total	26,62,350
Less : Depreciation as per Income Tax	(5,36,000)
Balance	21,26,350
Less : brought forward Business Loss	(13,52,000)
Balance	7,74,350
Less : unabsorbed depreciation	(13,000)
Income Under the head PGBP	7,61,350
Add : Income from Other Sources (FD interest)	1,54,900
Gross Total Income	9,16,250
Less : Deduction under section 80IB (30% of PGBP)	2,28,405
Total Income	6,87,845

Step 4: Computation of Regular Tax Liability

Particulars	Rs.
Regular tax @ 25% of Total Income	1,71,961
Add : Health & Education Cess : (4%)	6,878
Regular tax liability	1,78,839

Step 5 : Final Tax payable

Particulars	Rs.
MAT Liability as per Step 2	3,53,380
Regular Tax Liability as per Step 4	1,78,839
Whichever is higher	3,53,380

ANSWER : 2

(A) In this practical aspect, trust has purchased small office. Therefore, trust has two options :

Option I : To claim investment in office as application of income and therefore, cannot claim depreciation in view of section 11(6)

Option II : Not to claim investment in office as application of income and to avail depreciation in respect of such office.

Considering the above two options, answer is as under :

Option I

	Income from property held under trust	9,00,000
Add :	Voluntary Contribution received from public	8,00,000
Add :	Corpus Donations are an income	Nil
Add :	LTCG on buy back of unlisted shares (Exemption u/s 10 (34A) not available)	3,00,000
Add :	Income from Agricultural Operations(Exemption u/s 10(1) is available to trust)	Nil
		20,00,000
Less :	15% Set apart	(3,00,000)
	Balance	17,00,000
Less :	Applied for the objects of Trust	(11,60,000)
Less :	Applied for purchase of Office	(5,00,000)
	Total Income	40,000

Option II

	Income from property held under trust	9,00,000
Add :	Voluntary Contribution received from public	8,00,000
Add :	Corpus Donations are an income	Nil
Add :	LTCG on buy back of unlisted shares (Exemption u/s 10 (34A) not available)	3,00,000
Add :	Income from Agricultural Operations(Exemption u/s 10(1) is available to trust)	Nil
		20,00,000
Less :	Depreciation in respect of Office (10% of Rs. 5,00,000)	(50,000)
		19,50,000
Less :	15% set apart	(2,92,500)
	Balance	16,57,500
Less :	Applied for the objects of Trust	(11,60,000)
	Total Income	4,97,500

(8 MARKS)**ANSWER : 2(B)**

- (i) Section 194A required deduction of tax on any income by way of interest, other than interest on securities, credited or paid to a resident, at the rates in force.
However, it specifically excludes from its scope, income credited or paid to any banking company to which the Banking Regulation Act, 1949 applies. Therefore, interest payment to such bank will not attract tax deduction under section 194A.
Consequently, no tax is required to be deducted at source under section 194A on interest of Rs. 43,000 paid by M/s. Jiva & Co., a partnership firm.

(ii) Section 194A requiring deduction of tax at source on any income by way of interest, other than interest on securities, credited or paid to a resident, excludes from its scope, income credited or paid by a firm to its partner. Therefore, no tax is required to be deducted at source under section 194A on interest on capital of Rs. 12,000 paid by the firm to Mr. A, a resident partner.

On the other hand, section 195, which requires tax deduction at source on payments to non – residents, does not provide for any exclusion in respect of payment of interest by a firm to its non – resident partner. Therefore, tax has to be deducted under section 195 at the rates in force in respect of interest on capital of Rs. 24,000 paid to partner Mr. B, a non – resident.

(iii) Under section 195, if no sum is chargeable to tax in India, then there is no liability on payer to deduct tax at source. As per section 10(2A), share of profit received by a partner from the total income of the firm is exempt from tax. Therefore, the share of profit paid to non – resident partner is not subject to tax deduction at source.

However, section 195(6) provides that the person responsible for paying any sum, whether or not chargeable to tax, to a non – corporate non – resident or to a foreign company, shall be required to furnish the information relating to payment of such sum in the prescribed form and manner.

(6 MARKS)

ANSWER : 3(A)

Step 1 : Compute Total income ignoring AMT provisions

Particulars	Rs.
Income from business A under head PGBP (Eligible for 100% deduction u/s 80IC)	22,20,300
Loss from business B (Set up on 10 th April of previous year) under head PGBP (After claiming deduction of Rs. 50 lac for building under section 35AD) [NOTE]	(18,18,000)
Income from business C under the head PGBP	12,15,000
Income under head "PGBP"	34,35,300
Less : Income under the head "Income from other sources"	(10,000)
Gross Total Income	34,25,300
Less : Deduction under 80C to 80U	
- Under Section 80 G	(10,000)
- Under section 80IC	(22,20,300)
Total Income	11,95,000

Note : Business "B" is a specified business under section 35AD therefore, loss of Business "B" cannot be set off against profits of non – specified business. Such loss of Rs. 18,18,000 shall be carried forward for indefinite period.

Step 2 : Compute Regular Tax payable by LLP on Step I income

Particulars	Rs.
Total income	11,95,000
Tax Rate @ 30%	3,58,500
Add : Health & Education Cess 4%	14,340
Regular Tax Liability	3,72,840

Step 3 : Compute Adjusted total income as per section 115JC

Particulars	Rs.
Total income (as per Step I)	11,95,000
Add : Deduction under section 80IC	22,20,300
Add: Deduction under section 10AA	Nil
Add : Deduction under section 35AD	
Cost of building	50,00,000
Less : Depreciation	5,00,000
Adjusted Total Income	79,15,300

Step 4 : Compute AMT @ 18.5% on step 3

Particulars	Rs.
Adjusted Total income	79,15,300
Tax Rate @ 18.5%	14,64,330
Add : Health @ Education Cess 4%	58,573
Alternate Minimum Tax (AMT)	15,22,903

Step 5 : Final tax liability of LLP (Higher of Step 2 or Step 4]

Final Tax Liability = Higher of Rs. 3,72,840 or Rs. 15,22,903
= Rs. 15,22,903

Note : Ding Dong LLP is eligible to carry forward AMT Credit of Rs. 11,50,063 (Rs. 15,22,903 – 3,72,840) for next 15 assessment years.

(8 MARKS)**ANSWER : 3(B)****A. Computation of Arm's Length Price of Products bought from MNO Ltd.**

Particulars	Rs.
Resale Price of Goods Purchased from MNO Ltd.	55,000
Less : Adjustment for differences	
(a) Normal gross profit margin @ 20% of sale price [20% × Rs. 55,000]	(11,000)
(b) Incremental Quantity Discount by MNO Ltd. [Rs. 1,500 – Rs. 500]	(1,000)
(c) Difference in Purchase related Expenses (Rs. 1,500 – Rs. 500]	(1,000)
Arms Length Price	42,000

B. Computation of Income in Total Income of Rani Ltd.

Particulars	Rs.
Price in which actually bought	50,000
Less : Arm's Length Price per unit under Resale Price Method	(42,000)
Decrease in Purchase Price per bik	8,000
No. of Units purchased	3,000
Increase in Total Income of Rani Ltd. [3,000 Units × Rs. 8,000]	2,40,00,000

(6 MARKS)

ANSWER : 4(A)

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

Further, such unexplained expenditure which is deemed as the income shall not be allowed as deduction under any head of income.

Therefore, in this case, since the Assessing Officer is not satisfied with the explanation offered by Mr. Gopal, the expenditure of Rs. 30 lakh incurred by him in the financial year **2020 – 21** may be deemed as his income for P.Y. **2020 – 21** as per section 69C and same shall not be allowed as deduction even though they were incurred for the purpose of business.

(4 MARKS)**ANSWER : 4(B)**

This issue came up before the Supreme Court in Balakrishnan V. Union of India & Others (2017) 391 ITR 178 (SC). The Apex Court observed that the acquisition process was initiated under the Land Acquisition Act, 1894. The assessee entered into negotiation only for securing the market value of the land without having to go to the Court. Merely because the compensation amount is agreed upon, the character of acquisition will not change from compulsory acquisition to a voluntary sale. The Court also drew attention to a recently enacted legislation titled, Right to Fair Compensation and Transparency in Land Acquisition, Rehabilitation and Resettlement Act, 2013, which empowers the Collector to pass an award with the consent of the parties. Despite the provision for consent, the acquisition would continue to be compulsory.

Accordingly, the Supreme Court held that when proceedings were initiated under the Land Acquisition Act, 1894, even if the compensation is negotiated and fixed, it would continue to remain as compulsory acquisition.

Applying the rationale of the Supreme Court ruling to the case on hand, the denial of exemption by the assessing officer is not tenable in law.

(4 MARKS)**ANSWER : 4(C)****Computation of Capital Gains**

Particulars	Rs.
Long term capital gain (WN 1)	9,42,820
Less : Exemption under section 115F (Rs. 9,42,820 × 32,02,100/ 64,04,200)	4,71,410
Taxable Capital Gain	4,71,410

Working Note I :

Period of Holding : 02.12.2004 to 25.07.2020	
Nature of capital Asset : Long term	

Particulars	Indian Currency	Conversion Rule	Foreign Currency (\$)
Sale Consideration	64,78,000	Average Rate on Date of Transfer I\$ = Rs. 74.40	87,069.89
Less : Expenses	(73,800)	Average Rate on Date of Transfer I\$ = Rs. 74.40	(991.94)
Less : Cost of Acquisition	(34,44,000)	Average Rate on Date of Acquisition I\$ = Rs. 47	(73,276.60)
Long Term Capital Gain	NA		12,801.35

Long Term Capital Gain in Indian Currency = \$ 12,801.35 × Buying Rate on the date of transfer
= \$ 12,801.35 × Rs. 73.65
= Rs. 9,42,820

Working Note 2: Computation of Net Consideration

Particulars	Indian currency (Rs.)
Sale Consideration	64,78,000
Less : Expenses	(73,800)
Net Consideration	64,04,200

(6 MARKS)

ANSWER : 5(A)

Arjun Ltd. is eligible for deduction under section 80JJAA since it is subject to tax audit under section 44AB for A.Y. 2021 – 22, as its total turnover from business exceeded Rs. 1 crore and it has employed “additional employees” during the P.Y. 2020 – 21.

Additional employee cost = Rs. 20,000 × 12 × 25 [Refer working Note] = Rs. 60,00,000

Deduction under section 80JJAA = 30% of Rs. 60,00,000 = Rs. 18,00,000.

Working Note :

Number of additional employees

Particulars	No. of employees	
Total number of employees employed during the year		200
Less : Employees who do not participate in recognized provident fund	50	
Less : Employees who total monthly emoluments exceed Rs. 25,000	75	
Less : Employees employed less than 240 days in the P.Y. 2020 – 21 (See Note given below)	50	(175)
Number of “additional employees”		25

Note : In view of the second proviso to clause (ii) of Explanation to section 80JJAA, Arjun Ltd. shall be entitled to claim deduction under section 80JJAA treating such 50 employees (employed on 1.9.2020) as additional employees for the previous year 2021 – 22 as if they were employed in the previous year 2021 – 22.

(6 MARKS)

ANSWER : 5(B)

The issue under consideration is whether delay in filing appeal under section 260A can be condoned under section 14 of the Limitation Act, 1963, where the stated reason for delay is the pursuance of an alternate remedy by way of filing an application before the ITAT u/s 254(2) for rectification of mistake apparent on record.

This issue came up before the Supreme Court in **Spinacom India (P.) Ltd. v.CIT [2018] 258 Taxman 128**. The supreme Court rejected the question of invoking section 14 of the Limitation Act 1963 which allows condonation of delay on demonstration of sufficient cause. The Apex Court did not accept the submission that the application before the ITAT under section 254(2) was an alternate remedy to filing of the application under section 260A. The former is an application for rectifying a 'mistake apparent from the record' which is much narrower in scope than the latter. Under section 260A, an order of the ITAT can be challenged on substantial questions of law. The Court stated that the appellant had the option of filing an appeal under section 260A while also mentioning in the Memorandum of Appeal that its application under section 254(2) was pending before the ITAT. The Supreme Court, therefore, held that the time period for filing an appeal under section 260A does not get suspended on account of the pendency of an application before the ITAT under section 254(2).

Accordingly, applying the rationale of the above Supreme Court ruling to the facts of this case, the delay in filing appeal under section 260A due to pursuance of an alternate remedy by way of filing an application before the ITAT under section 254(2) cannot be condoned.

(4 MARKS)**ANSWER : 5(C)**

(a)	If no appeal is filed by the assessee.	(i) On or before the expiry of the financial year in which assessment proceedings are completed. [31.3.2022] OR (ii) 6 months from the end of the month in which action for imposition of penalty have been initiated. [30.11.2021]	Whichever is Later i.e., 31.03.2021
(b)	If Appeal has been filed by the assessee.	(i) On or before the expiry of the financial year in which assessment proceedings are completed [31.03.2022] OR (ii) 1 year form the end of financial year in which order of CIT(A) is received by CIT. [31.03.2024]	Whichever is Later i.e., 31.03.2024

(4 MARKS)

ANSWER : 6(A)

- The issue under consideration is whether the Settlement Commission can pass an order making addition to the income on the basis of difference in gross profit rate adopted, which was neither an issue in the application nor in the report of the Commissioner of Income – Tax.
- Section 2454(4) provides that the Settlement Commission, after examination of records and the report of the commissioner and after examining such further evidence as may be placed before it or obtained by it, may , in accordance with the provisions of the Act, pass such order as it thinks fit.
- Further, section 245D(5) provides that the materials brought on record before the Settlement Commission shall be considered by the Members of the concerned Bench before passing any order u/s 245D(4).
- The Settlement Commission, therefore, has to consider the material brought on record before it and “consideration” means independent examination of the evidence and material on record.
- In this case, since the material was available before the settlement Commission and such material has been taken into consideration for determining the undisclosed income of the applicant, the addition made on the basis of difference in gross profit rate adopted is justified. Therefore, the order of the Settlement Commission is valid.
- This view has been upheld in case of Supreme Agro Foods P Ltd. v. ITSC (2013) 353ITR 385(P & H).

(4 MARKS)

ANSWER : 6(B)

- In the above case no application had been filed by the applicant (foreign company) before any income – tax authority / Appellate Tribunal/ Court, raising the question raised in the application filed with Aar.
- One of the Indian companies, however, had raised the question before the assessing Officer, not on the applicant’s behalf or with a view to benefit the applicant, but only to safeguard its own interest, as it had a statutory duty to deduct the proper amount of tax from payments made to a non – resident u/s 195(2) of the Act. Although the question raised pertains to one of the payments made or to be made to the non – resident applicant, it was not one pending determination before any income – tax authority in the applicant’s case.
- Therefore, as held by the AAR in Ericsson Telephone Corporation India AB v. CIT (1997) 224ITR 203, the application filed by the Indian company before the Assessing Officer cannot be treated to have been filed by applicant (foreign company).
- Hence, it would not be proper to reject the application of the foreign company.

(4 MARKS)

ANSWER : 6(C)

- Section 143(3) provides that
 - (i) The Assessing Officer shall take into account all relevant material gathered by him and also the evidence produced by the assessee.
 - (ii) On the basis, he shall make an assessment of the total income or loss of the assessee.

(iii) On the basis of such assessment, he shall determine the sum payable by the assessee or refund due to him.

- As per provisions of section 153 of the Act, the above order has to be passed within the time frame of 12 months from the end of relevant assessment year. (i.e. **31.03.2023**)
- A look at the provision of section 143(3) of the Act makes it clear that the determination of tax payable by the assessing officer is as much mandatory as the determination of income and that too within the time frame given under section 153 of the Act.
- **Gujarat High Court in case of CIT V. Purushottmdas T. Patel 209 ITR 52(1994)** held that where the order determining the total income is passed within the prescribed time limit (31.3.2023 in this case) but the tax payable is not determined within the prescribed time limit *(07.04.2023 in this case), the entire assessment would be barred by limitation.
- Thus, the order passed by assessing officer is barred by limitation.

(4 MARKS)

ANSWER : 6(D)

- Under section 90(2), where the Central Government has entered into an agreement for avoidance of double taxation with the Government of any country outside India or specified territory outside India, as the case may be, then, in relation to the assessee to whom such agreement applies, the provisions of the Income – tax Act, 1961 shall apply to the extent they are more beneficial to the assessee. Thus, in view of paragraph 2 of the Article 24(Non – discrimination of the Double Taxation Avoidance Agreement (DTAA)), it appears that the Indian branch of Cosmos Limited, incorporated in Mauritius, is liable to tax in India at the rate applicable to domestic company (30%), which is lower than the rate of tax applicable to a foreign company (40%).
- However, Explanation I to Section 90 clarifies that the charge of tax in respect of a foreign company at a rate higher than the rate at which a domestic company is chargeable, shall not be regarded as less favourable charge or levy of tax in respect of such foreign company. Therefore, in view of this Explanation, the action of the Assessing Officer in levying tax @ 40% on the Indian branch of Cosmos Ltd. is in accordance with law.

(2 MARKS)