

Mock Test Paper - Series II: April, 2024

Date of Paper: 8 April, 2024

Time of Paper: 2 P.M. to 5 P.M.

**FINAL COURSE: GROUP II****PAPER – 4: DIRECT TAX LAWS & INTERNATIONAL TAXATION****SOLUTIONS****Division A – Multiple Choice Questions**

MCQ No.	Most Appropriate Answer	MCQ No.	Most Appropriate Answer
1.	(d)	9.	(d)
2.	(b)	10.	(d)
3.	(a)	11.	(b)
4.	(b)	12.	(b)
5.	(a)	13.	(c)
6.	(b)	14.	(c)
7.	(d)	15.	(a)
8.	(a)		

**Division B – Descriptive Questions**

1. **Computation of total income and tax liability of Fun Limited for A.Y.2024-25 under regular provisions of the Act**

Particulars	₹	₹	₹
<b>Profits and gains of business or profession</b>			
Net profit as per statement of profit and loss		1,47,50,000	
<b>Add: Items debited but to be disallowed</b>			
- Depreciation as per books of account	34,00,000		
- <b>Consideration for designs &amp; models</b> [Consideration for designs & models of Mixer grinder is in the nature capital expenditure and hence, is an intangible asset which is eligible for depreciation as per section 32. Since lumpsum consideration	36,00,000		

has been debited to statement of profit and loss, the same has to be added back while computing business income]				
- <b>Purchased raw material at a price higher than the fair market value</b> [As per section 40A(2), the difference between the purchase price (₹ 96 lakhs) and the fair market value (₹ 82 lakhs) has to be added back since the purchase is from a related party, i.e., Gold Ltd., a company in which directors of Fun Limited have substantial interest and at a price higher than the fair market value]	14,00,000			
- <b>Legal expenses for issue of bonus shares</b> [There is no fresh inflow of funds or increase in capital employed on account of issue of bonus shares and there is only reallocation of the company's fund. Consequently, since there is no increase in the capital base of the company, legal expenses of ₹ 6 lakhs in connection with issue of bonus shares is a revenue expenditure and is hence, allowable as deduction <sup>1</sup> ]	Nil			
- <b>Legal expenses for issue of right shares</b> [Expenses incurred in relation to rights issue are of capital in nature <sup>2</sup> . Hence, not allowed as	<u>8,00,000</u>			

<sup>1</sup> It was held by Apex Court in case of CIT vs. General Insurance Corpn. (2006) 286 ITR 232

<sup>2</sup> It was held by Karnataka High Court in case of CIT Vs Motor Industries Ltd (1998) 229 ITR 137

deduction from business income. Since, it is already debited in statement of profit and loss, the same has to be added back while computing business income]			
		<u>92,00,000</u>	
		2,39,50,000	
<b>Less: Items credited but to be considered separately</b>			
- Short term capital gains on equity shares [Not taxable under this head]	15,00,000		
- Cash Subsidy [Subsidy from State Government on acquisition of asset is reduced from the actual cost of the asset. Hence, such subsidy is not the income of Fun Limited. Since, subsidy is already credited in the statement of profit and loss, the same has to be reduced while computing business income]	15,00,000		
		<u>30,00,000</u>	
		2,09,50,000	
<b>Less: Depreciation as per Income-tax Rules</b>			
- Depreciation	36,00,000		
- Depreciation on New Plant and machinery [₹ 50 lakhs x 15%, since it has been put to use for more than 180 days during the year] [Any expenditure for acquisition of any asset in respect of which payment or aggregate of payment made to a person in a day, otherwise than by an a/c payee cheque/ bank draft or use of ECS or	7,50,000		

<p>through prescribed electronic mode, exceeds ₹ 10,000, such expenditure would not form part of actual cost of such asset.</p> <p>Further, where any part of the cost of asset acquired has been met directly or indirectly, <i>inter alia</i>, by State Government, then, so much of the cost as relates to subsidy would not be included in the actual cost. Hence, ₹10 lakhs paid by bearer cheque and ₹ 15 lakhs of cash subsidy received by State Government for acquisition of asset would not be included in the actual cost of plant and machinery.]</p>			
- Additional depreciation on New Plant and machinery [₹ 50 lakhs x 20%, since it has been put to use for more than 180 days during the year]	10,00,000		
- Depreciation on Intangible asset, being designs & models of mixer grinder [₹ 36 lakhs x 25% x 50%, since put to use for less than 180 days during P.Y. 2023-24]	4,50,000		
		<u>58,00,000</u>	1,51,50,000
<b>Capital Gains</b>			
- Short term capital gains on transfer of listed equity shares		15,00,000	
- Short term capital gains on transfer of unlisted equity shares [Since not held for more than 24 months]			
Full value of consideration	22,00,000		
Less: Cost of acquisition	<u>12,00,000</u>		
		<u>10,00,000</u>	
			<u>25,00,000</u>
<b>Total Income</b>			<b><u>1,76,50,000</u></b>

<b>Computation of tax liability</b>			
Tax u/s 111A on Short-term capital gains on transfer of listed equity shares on which STT is paid [₹ 15 lakhs x 15%]		2,25,000	
Tax on other income [₹ 1,61,50,000 x 25%]		40,37,500	
			42,62,500
Add: Surcharge @7% since total income exceeds ₹ 1 crore but does not exceed ₹ 10 crores			<u>2,98,375</u>
			45,60,875
Add: HEC@4%			<u>1,82,435</u>
<b>Tax liability</b>			<b>47,43,310</b>

**Computation of tax liability of Fun Limited for the A.Y. 2024-25 under section 115JB**

Particulars	₹
Minimum Alternate Tax @15% on book profit of ₹ 3,20,00,000	48,00,000
Add: Surcharge@7%, since the book profit of the company > ₹ 1 crore but ≤ ₹ 10 crores	<u>3,36,000</u>
	51,36,000
Add: Health and Education cess@4%	<u>2,05,440</u>
<b>Tax liability under section 115JB</b>	<b>53,41,440</b>
Since the regular income-tax payable is less than the minimum alternate tax, book profit of ₹ 3,20,00,000 would be deemed to be the total income of Fun Limited and it has to pay tax of ₹ 53,41,440. It would be eligible for MAT credit of	
MAT liability	53,41,440
Tax liability under the regular provisions of the Income-tax Act, 1961	<u>47,43,310</u>
<b>MAT credit</b>	<b><u>5,98,130</u></b>
<b>Note –</b> Since Fun Limited set up and registered on or after 1.10.2019 and has commenced operations before 31.3.2024, and engaged in manufacturing business, it is eligible for concessional tax regime under section 115BAB. In case Fun Limited opted for concessional tax regime u/s 115BAB, it would not be eligible to claim additional depreciation u/s 32 on plant and machinery. In that case, its total income and tax liability would be -	

Particulars	₹	₹
<b>Total Income under regular provisions of the Act</b>		1,76,50,000
<b>Add:</b> Additional depreciation [No additional depreciation is allowable under section 32(1)(ia)]		<u>10,00,000</u>
<b>Total Income</b>		<b><u>1,86,50,000</u></b>
<b>Computation of tax liability under section 115BAB</b>		
Tax u/s 115BAB on business income [₹ 1,61,50,000 x 15%]	24,22,500	
Tax u/s 111A on Short-term capital gains on transfer of listed equity shares on which STT is paid [₹ 15 lakhs x 15%]	2,25,000	
Tax u/s 115BAB on short term capital gains on transfer of unlisted equity shares [₹ 10 lakhs x 22%]	<u>2,20,000</u>	
		28,67,500
<b>Add:</b> Surcharge @10%		<u>2,86,750</u>
		31,54,250
<b>Add:</b> HEC@4%		<u>1,26,170</u>
<b>Tax liability</b>		<b><u>32,80,420</u></b>
<b>Suggestion to Fun Limited</b>		
Fun Limited should opt for section 115BAB, since the tax liability under section 115BAB is lower than the tax liability under the regular provisions of the Act and section 115JB.		

2. (a) **Computation of Total Income of Heros and Sons, a partnership firm, for the A.Y. 2024-25**

	Particulars	Amount (in ₹)	
I	<b>Profits and gains of business and profession</b>		
	Net profit as per profit and loss account		80,00,000
	<b>Add: Items debited but to be considered separately or to be disallowed</b>		
	(1) <b>Interest to partners on capital</b>	1,00,000	
	[As per section 40(b), interest to partners authorized by the partnership deed is allowable as		

deduction subject to a maximum of 12% p.a.] [₹ 7,00,000 x 2%/14%]		
<b>(2) Interest on loan taken from partner</b> [As per section 40(b), interest to partners authorized by the partnership deed is allowable as deduction subject to a maximum of 12% p.a., whether it is interest on partner's capital or loan] [₹ 90,000 x 3%/15%]	18,000	
<b>(3) Depreciation as per books of account</b>	1,02,000	
	<hr/>	<u>2,20,000</u>
		82,20,000
<b>Less: Items credited but chargeable to tax under other head/expenses allowed but not debited</b>		
<b>1. Interest on bank fixed deposits made out of surplus fund</b> [Interest received from bank on fixed deposits made out of surplus funds is assessable under the head 'Income from other sources'. Since the same has been credited to profit and loss account, it has to be deducted while computing business income]	25,000	
<b>2. Profit on sale of building</b> [Capital gain on sale of building is taxable under the head "Capital Gains". Since such gains has been credited to profit and loss account, the same has to be deducted while computing business income]	53,55,000	
	<hr/>	<u>53,80,000</u>
		28,40,000
<b>Less: Depreciation as per Income-tax Rules, 1962</b>		
- Depreciation other than on motor car and mobile phones	14,000	
- Depreciation on Motor car [₹ 6,80,000 x 15%]	1,02,000	

	- Mobile phone [₹ 20,000 x 15% x 50%, since purchased and put to use for less than 180 days]	<u>1,500</u>	
	<b>Book Profit</b>		<u>1,17,500</u>
	<b>Less:</b> Salary to working partners		27,22,500
	(i) As per limits given under section 40(b)		
	On first ₹ 3,00,000 @90%	2,70,000	
	On the balance of ₹ 24,22,500 @ 60%	<u>14,53,500</u>	
		17,23,500	
	(ii) Salary actually paid to working partners [₹ 20,000 x 12 x 2]	4,80,000	
	Deduction allowed being (i) or (ii) whichever is less		<u>4,80,000</u>
			22,42,500
<b>II</b>	<b>Capital Gains</b>		
	<b>Short term capital gain on sale of building forming part of block of asset</b> [Since building was the only asset in the block]		
	Full value of consideration	90,00,000	
	<b>Less:</b> Cost of acquisition [WDV as on 1.4.2023]	<u>36,45,000</u>	
		53,55,000	
	<b>Less:</b> Exemption under section 54EC [Investment in bonds of NHAI, the maximum deduction u/s 54EC would be ₹ 50 lakhs]	<u>50,00,000</u>	3,55,000
	[Available against depreciable asset, being a building held for more than 24 months and the payment for bonds has been made within six months from the date of transfer, exemption u/s 54EC would be available even if the allotment of bonds was made after the expiry of the six months <sup>3</sup> ]		
<b>III</b>	<b>Income from Other Sources</b>		
	Interest from bank on fixed deposits		25,000
	<b>Gross Total Income</b>		<u><b>26,22,500</b></u>

<sup>3</sup> Hindustan Unilever Ltd. v. DCIT (2010) 325 ITR 102 (Bom.)



<b>Less: Deduction under section 10AA</b> [₹ 7,50,000 x 40,00,000/ ₹ 1,20,00,000 x 100] [Unit in SEZ is eligible for deduction u/s 10AA since it obtained the letter of approval on or before 31 <sup>st</sup> March, 2020 and started operations before 31.3.2021]		2,50,000
<b>Total Income</b>		<b>23,72,500</b>

**(b) Computation of Total income of Mr. Albert for the A.Y. 2024-25**

Particulars	₹	₹
<b>Salary</b> [Salary deemed to accrue or arise in India, since it is paid for services rendered in India as per section 9(1)(ii). Hence, it is taxable in the hands of Mr. Albert. Exemption u/s 10(6)(vi) would not be available to him, though he stayed in India for a period of not exceeding 90 days during the previous year since he is receiving salary from an American company which is engaged in business and trade in India through a PE in India and such salary is borne by Indian PE]	25,00,000	
Less: Standard deduction u/s 16(ia)	50,000	24,50,000
<b>Capital Gains</b> Transfer of 1200 equity shares of Shine Pvt. Ltd. [Taxable in India, since shares are situated in India] Sale Consideration (1200 x ₹ 63 per share/91, being average of ₹ 90 (TTBR) + ₹ 92 (TTSR)/2 on 20.8.2023)	\$ 830.77	
Less: Cost of acquisition (1200 x ₹ 35 per share/69, being average of ₹ 68 (TTBR) + ₹ 70 (TTSR)/2 on 31.12.2018)	\$ 608.70	
	<b>\$ 222.07</b>	
Long-term capital gain [\$ 222.07 x ₹ 90, being TTBR on 20.08.2023]		19,986
<b>Transfer of 2000 Equity shares of YoC Inc.</b> [Not taxable in India, since shares of foreign company do not derive its value		Nil

substantially from assets located in India as value of Indian assets do not exceed ₹ 10 crores]		
<b>Income from Other Sources</b>		
Dividend received in India from YoC Inc. [taxable in India, since dividend is received in India]		1,32,000
<b>Gross Total Income/total income</b>		<b>26,01,986</b>
<b>Total income (rounded off)</b>		<b>26,01,990</b>

3. (a) (i) Voluntary contribution of ₹ 150 lakhs received with a specific direction that it will form part of corpus of the trust would be exempt from tax only if it is invested in any of the modes specified under section 11(5) specifically maintained for such corpus. If the same is not so invested, then, it would not be exempt under section 11(1)(d) for P.Y.2023-24.
- Investment in shares of private company is not a specified mode under section 11(5). Hence, ₹ 150 lakhs received by Healthy Wealthy Foundation would not be exempt under section 11.
- (ii) Yoga is included in the definition of “charitable purpose” under section 2(15).
- Accordingly, voluntary contributions of ₹ 80 lakhs and fees towards providing Yoga classes of ₹ 50 lakhs would be income from property held for charitable purposes and eligible for unconditional exemption of 15% under section 11.
- Exemption will be available under section 11 subject to the fulfilment of the necessary conditions.
- (b) As per section 13(6), UVX Trust shall not be denied the benefit of exemption under section 11 in respect of its entire income merely due to the reason that the benefit of medical facilities have been provided to Mr. Umesh, son of Mr. Shyam, being the specified person. Accordingly, the registration of UVX Trust cannot be cancelled by the Income-tax authorities on this basis.
- As per section 12(2), the value of medical facilities provided to Mr. Umesh, being the specified person, at a concessional rate would be deemed to be the income of the trust and such income would not be eligible for exemption under section 11. Hence, ₹ 1,30,000, being the concessional value of medical services would be deemed to be the income of UVX Trust.
- The remaining income would be eligible for benefit of section 11.
- (c) Mr. Sarthak is a resident in India for A.Y.2024-25, since his stay in India in the P.Y.2023-24 is for 305 days which exceeds the minimum required stay of 182 days in that previous year. Also, his stay in India must be more than 730 days in the immediately preceding seven years, and he

must be resident in 7 years (P.Y.2013-14 to P.Y.2019-20) out of 10 years immediately preceding P.Y.2023-24, since he left India for the first time on 1<sup>st</sup> April, 2020.

Hence, he is resident and ordinarily resident in India for A.Y.2024-25. Accordingly, his global income would be subject to tax. He would, however, be entitled for deduction under section 91 in respect of doubly taxed income earned in Country Y.

#### Computation of total income of Mr. Sarthak for A.Y.2024-25

Particulars	₹	₹
<b>Income from House Property</b> <b>[Residential property in Country Y]</b>		
Annual Value <sup>4</sup> (\$ 32,000 x ₹ 75, exchange rate on 31.3.2024)	24,00,000	
Less: Deduction under section 24 – 30% of NAV	7,20,000	
		16,80,000
<b>Profits and Gains of Business or Profession</b>		
Income from business in India		6,20,000
<b>Income from Other Sources</b>		
Dividend from Indian company [₹2,25,000 x 100/90]	2,50,000	
Interest on savings bank account with SBI	13,500	2,63,500
<b>Gross Total Income</b>		<b>25,63,500</b>
<b>Less: Deduction under Chapter VIA</b>		
<b>Under section 80TTA</b> – Interest on savings bank account (actual interest of ₹ 13,500 or ₹ 10,000, whichever is lower)		10,000
<b>Total Income</b>		<b>25,53,500</b>

#### Computation of net tax liability of Mr. Sarthak for A.Y.2024-25

Particulars	₹
Tax on total income [30% of ₹ 15,53,500 + ₹ 1,12,500]	5,78,550
Add: Health and Education cess@4%	23,142
	6,01,692

<sup>4</sup> Rental Income has been taken as GAV in the absence of other information relating to fair rent, municipal value etc.

Less: Deduction under section 91 ( <b>See Working Note below</b> )	2,41,500
Net Tax Liability	3,60,192
Net Tax liability (rounded off)	<b>3,60,200</b>

**Working Note: Calculation of deduction under section 91**

Particulars	₹	₹
Average rate of tax in India [i.e., ₹ 6,01,692/₹ 25,53,500x100]	23.56%	
Average rate of tax in country Y [20% of \$ 23,000 (\$ 32,000 - \$ 9,000) = \$ 4,600/\$ 32,000 x 100 = 14.375%	14.375%	
<b>Doubly taxed income</b>		
Income from house property	16,80,000	
Deduction u/s 91 on ₹16,80,000 @14.375% (being the lower of average Indian tax rate (23.56%) and foreign tax rate (14.375%)]		2,41,500

4. (a) (i) By virtue of section 206C(1A), Mr. Bharat is not required to collect tax at source under section 206C(1), since Mr. Amit has furnished a declaration to Mr. Bharat that the scrap purchased by 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. Amit, since his turnover in the immediately preceding financial year i.e., F.Y.2022-23 exceeds ₹ 10 crores and he has purchased goods of the value or aggregate of such value exceeding ₹ 50 lakhs in the F.Y.2023-24. 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. Amit is required to deduct tax at source @ 0.1% of ₹ 15,00,000, being the amount exceeding ₹ 50 lakhs (₹ 49,00,000, being the payment made *plus* ₹ 16 lakhs, being the amount credited to the account of Mr. Bharat).

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

- (ii) Mr. Ashok, a resident, is entering into an agreement with Cloud Ltd., a real estate developer, to develop a high-rise apartment complex on his land for a consideration of ₹ 6.5 crore and 6 flats in the apartment. This is a specified agreement under section 45(5A).

As per section 194-IC, Cloud Ltd. is required to deduct tax at source @ 10% on ₹ 6.5 crores, being the consideration paid other than consideration in kind, under a specified agreement to Mr. Ashok.

Tax is to be deducted at the time of credit of such sum or payment, whichever is earlier.

Tax u/s 194-IC would be = ₹ 6.5 crore x 10% = ₹ 65 lakhs

- (iii) State Government is required to collect tax at source @ 2% u/s 206C(1C) on ₹ 12 crores, being the charges for lease of coal mine.

TCS = 2% x ₹ 12 crores = ₹ 24,00,000

M/s Maple Co. Ltd. is required to collect tax at source @ 1% u/s 206C(1) on sale of coal to M/s DL (P) Ltd.

TCS = 1% of ₹ 1 crore = ₹ 1,00,000.

- (b) Two enterprises are deemed to be associated enterprises where one enterprise, directly or indirectly, holds shares carrying not less than 26% of the voting power in the other enterprise.

In this case, since Aster Ltd., a foreign company, holds 30% equity shares in Bhuvan Ltd., an Indian company, Aster Ltd. and Bhuvan Ltd. are deemed to be associated enterprises. Since the transaction of developing software and providing related support service by Bhuvan Ltd. to Aster Ltd. is an international transaction between associated enterprises, the provisions of transfer pricing would be attracted in this case.

#### Computation of Arm's Length Price as per Cost Plus Method

Particulars	%	%
Gross Profit mark-up on cost in case of Gaurav Ltd. Ltd. [an unrelated party]		40%
<b>Less:</b> Adjustments for functional and other differences		
- Value of technology support [Aster Ltd. provides technology support, but Gaurav Ltd. does not provide such support. Therefore, value of technology support shall be adjusted] [15% of 40%, being gross profit]	6%	
- Quantity discount to Aster Ltd. [Quantity discount is allowed to Aster Ltd. as it gives business in large volumes, but the same is not	4%	

provided to Gaurav Ltd. Therefore, it shall be adjusted] [10% of 40%, being gross profit]		
- Risk and cost associated with marketing [Bhuvan Ltd. has to bear all the risk and costs associated with the marketing function in case of Gaurav Ltd., while there is no such risk in case of services to Aster Ltd. Therefore, market risk and cost shall be adjusted] [20% of 40%, being gross profit]	8%	<u>18%</u>
		22%
<b>Add:</b> Cost of credit to Aster Ltd. [Bhuvan Ltd has provided credit of 1 month to Aster Ltd. but not to the unrelated party. Therefore, adjustment for the cost of such credit has to be carried out to arrive at the ALP] [(5% of 40%, being gross profit]		<u>2%</u>
<b>Arm's length gross profit mark up to cost</b>		<u>24%</u>
Cost incurred by Bhuvan Ltd. for executing Aster Ltd.'s work		4,52,000
<b>Add:</b> Adjusted gross profit (₹ 4,52,000 x 24%)		<u>1,08,480</u>
<b>Arm's length billed value</b>		<b>5,60,480</b>
<b>Less:</b> Actual Billed Income from Aster Ltd. (₹ 2,700 x 150 man hours)		<u>4,05,000</u>
<b>Total Income of Bhuvan Ltd to be increased by</b>		<b><u>1,55,480</u></b>

5. (a) (i) **Issue Involved:** The issue under consideration is whether the High Court is justified in not framing any substantial question of law itself and adjudicating merely on the questions put forth by the appellant.

**Relevant provision of law:** Section 260A(1) provides that an appeal shall lie to the High Court from every order passed in appeal by the Appellate Tribunal, if the High Court is satisfied that the case involves a substantial question of law. As per section 260A(3) and 260A(4), if the High Court is so satisfied, it shall formulate that question and the appeal shall be heard only on the question so formulated.

**Analysis & Conclusion:** There lies a distinction between the questions proposed by the appellant for admission of the appeal to the High Court and the questions framed by the High Court. The questions, which are proposed by the appellant, fall under section 260A(2)(c) whereas the questions framed by the High Court fall under section 260A(3). Section 260A(4) provides that the appeal is to be heard on merits only on the questions formulated by the High Court under section 260A(3) and not on the questions proposed by the appellant.

In case the High Court is of the view that the appeal did not involve any substantial question of law, it should have recorded a categorical finding to that effect that the questions proposed by the appellant either do not arise in the case or/and are not substantial questions of law so as to attract the rigour of section 260A for its admission and accordingly, should have dismissed the appeal at the preliminary stage itself. However, this was not done in this case. Instead, the appeal was heard only on the questions urged by the appellant u/s 260A(2)(c).

The High Court was, therefore, not justified since it did not decide the appeal in conformity with the mandatory procedure prescribed in section 260A.

**Note** – *The facts given in the question are similar to the facts in CIT v. A.A. Estate Pvt. Ltd. [2019] 413 ITR 438, 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.*

- (ii) **Issue Involved:** The issue under consideration is whether the provisions of section 14A can be invoked in disallowing the expenditure incurred in respect of the income for which deduction is claimed under Chapter VI-A.

**Provisions applicable:** As per section 14A, expenditure incurred in relation to income which does not form part of the total income under the Act, will not be allowed in computing the total income of the assessee.

**Analysis:** Deduction under section 80P covered in Chapter VIA is different from the exclusions/exemptions provided under Chapter III. Section 14A is applicable only if an income is not included in the total income as per the provisions of Chapter III of the Income-tax Act, 1961

Income which qualifies for deductions under section 80C to 80U has to be first included in the gross total income of the assessee and then allowed as a deduction.

Therefore, no disallowance can be made u/s 14A in respect of income included in total income in respect of which deduction is allowable u/s 80C to 80U.

**Conclusion:** Accordingly, the action taken by the Assessing Officer in disallowing the expenditure incurred with respect to income for which deduction under Chapter VI-A is claimed, by invoking the provisions of section 14A is, therefore, **not tenable in law**.

**Note** – *The facts given in the question are similar to the facts in CIT v. Kribhco (2012) 349 ITR 0618, wherein the issue came up before the Delhi High Court. The above answer is based on the rationale of the Delhi High Court in the said case.*



- (iii) **Issue Involved:** The issue under consideration is whether bonus shares received by shareholders would be taxable under the head 'Income from other sources' as per the provisions of section 56(2)(x), as they are received without consideration.

**Provision Applicable:** Section 56(2)(x) brings to tax any sum of money or value of property received by any person without consideration or for inadequate consideration from any person.

**Analysis:** The issue of bonus shares by capitalization of reserves is merely a reallocation of the company's funds. There is no inflow of fresh funds or increase in the capital employed, which remains the same. Thus, there is no addition or alteration to the profit-making apparatus and the total funds available with the company remain the same.

On the other hand, when a shareholder gets bonus shares, the value of the original shares held by him goes down and the market value as well as intrinsic value of the two shares put together will be the same or nearly the same as the value of original share before the issue of bonus shares.

Thus, any profit derived by the assessee shareholder on account of receipt of bonus shares is adjusted by depreciation in the value of equity shares originally held by him.

**Conclusion:** Accordingly, the action of the Assessing Officer in including the fair value of bonus shares as Income from other sources of M Sudarshan is incorrect.

**Note** – The facts given in the question are similar to the facts in *PCIT v. Dr. Ranjan Pai (2021) 431 ITR 250*, wherein the issue came up before the Karnataka High Court. The above answer is based on the rationale of the Karnataka High Court in the said case.

- (b) In digital economy transactions like sale, purchase, payment, rendering services are performed through digital or virtual mode. In the digital domain, business does not actually occur in any physical location but instead takes place in "cyberspace."

### **Taxation issues in e-commerce**

The typical taxation issues relating to e-commerce are:

- (i) the difficulty in characterizing the nature of payment and establishing a nexus or link between taxable transaction, activity and a taxing jurisdiction,
- (ii) the difficulty of locating the transaction, activity and identifying the taxpayer for income tax purposes.

The following are OECD recommendations under Action Plan 1 dealing with digital economy:



- (1) **Modifying the existing permanent establishment** rule to provide for whether an enterprise engaged in fully de-materialized digital activities would constitute a PE, if it maintained a significant digital presence in another country's economy.
- (2) **a virtual fixed place of business in the concept of permanent establishments** i.e., creation of a PE when the enterprise maintains a website on a server of another enterprise located in a jurisdiction and carries on business through that website.
- (3) **Imposition of a final withholding tax on certain payments** for digital goods or services provided by a foreign e-commerce provider **or imposition of equalisation levy** on consideration for certain digital transactions received by a non-resident from a resident or from a non-resident having permanent establishment in other contracting state.

## 6. (a) Applicability of GAAR

- (i) In case of investment made prior to 1.4.2017, income arising from transfer thereof would not be subject to GAAR. Accordingly, income from transfer of shares acquired on 1.4.2016 by Right Inc. would not attract GAAR.

If the original shares are acquired before 1.4.2017, but bonus shares are issued after that date, GAAR provisions would not be attracted on transfer of such bonus shares also.

- (ii) An impermissible avoidance arrangement means an arrangement, the main purpose or one of the main purposes of which is to obtain a tax benefit and also, *inter alia*, lacks commercial substance or is deemed to lack commercial substance. An arrangement is deemed to lack commercial substance if it involves, *inter alia*, round tripping of funds.

In this case, the arrangement of routing money through wholly owned subsidiary Company C in Country X, a low tax jurisdiction, to an Indian company (C Ltd.) involves round tripping of funds even though funds emanating from D Ltd. are not traced back to D Ltd. The alternate course available in this case is direct advance to C Ltd. an Indian company, in which case the interest income would have been chargeable to tax in the hands of D Ltd.

Therefore, the agreement is deemed to lack commercial substance as it involves round tripping of funds. Also, its main purpose is to obtain tax benefit and there is no other activity in Company C.

However, if the tax benefit in the relevant assessment year arising, in aggregate, to all the parties to the arrangement does not exceed ₹ 3 crore, then, GAAR provisions would not be invoked.

- (b) (i) Form 15CB is a certificate of an accountant wherein he certifies that he has examined the agreement between the remitter and the beneficiary requiring such remittance as well as the relevant

documents and books of account required for ascertaining the nature of remittance and for determining the rate of deduction of tax at source. The chartered accountant certifying the form undertakes to have verified the agreement between the remitter and the beneficiary as well as the relevant documents and books of account to ascertain the nature of remittance and determine the rate of TDS. In this case, however, the chartered accountant mentioned that he had only verified KYC of signatory to invoice and the invoices thereof. He had not only failed to justify as to how verification of invoices was considered as sufficient compliance for certifying the forms but also failed to bring on record the said invoices. Thus, he failed to provide any basis on which he relied for issuing Form 15CB certificates to the company.

On account of such failure, clauses (7) and (8) of Part I of the Second Schedule to the Chartered Accountants Act, 1949 for failure to exercise due diligence in discharging his professional responsibilities and failure to obtain sufficient information may be invoked.

- (ii) As per section 44AB, every person carrying on business or profession is required to get his accounts audited before the “specified date” by a Chartered Accountant, if the total sales, turnover or gross receipts in business exceeds ₹ 1 crore in any previous year.

However, tax audit is not required in case of such person carrying on business whose total sales, turnover or gross receipts in business  $\leq$  ₹ 10 crore in the relevant previous year (P.Y.), if:-

- aggregate cash receipts including amount received for sales, turnover, gross receipts in the relevant previous year  $\leq$  5% of such receipts; **and**
- aggregate cash payments including amount incurred for expenditure in the relevant P.Y.  $\leq$  5% of such payments or

In this case, the turnover of XYZ & Co. exceeds ₹ 1 crore but does not exceed ₹ 10 crore. Accordingly, it has to be seen whether cash receipts exceed 5% of aggregate receipts and cash payments exceed 5% of aggregate payments, to determine whether tax audit is compulsory.

In this case, the percentage of cash receipts of ₹ 19 lakhs to aggregate receipts of ₹ 456 lakhs is 4.16% and the percentage of cash payments to aggregate payments is 15.97%.

Since the cash payments made during the year exceed 5% of aggregate payments, the firm is required to get its accounts audited under section 44AB and furnish audit report before the specified

date, irrespective of the fact that its turnover does not exceed ₹ 10 crores and its cash receipts do not exceed 5% of total receipts.

- (c) (i) The statement is **not** correct.

An applicant who is aggrieved by any ruling pronounced by the Board for Advance Rulings may appeal to the High Court against such ruling or order of the Board of Advance Rulings. He has to do so within sixty days from the date of the communication of that ruling, in the prescribed form and manner.

Therefore, Mr. Rakul may appeal to the High Court against such order within sixty days from the date of the communication of that order.

- (ii) The statement is **not** correct.

A resident falling within any class or category of persons as notified by the Central Government i.e., a public sector undertaking can seek advance ruling even if question raised is pending before the Appellate Tribunal.