

PAPER-15: DIRECT TAX LAWS AND INTERNATIONAL TAXATION

SUGGESTED ANSWERS

SECTION-A

- 1.
- (i) (D)
- (ii) (B)
- (iii) (C)
- (iv) (A)
- (v) (A)
- (vi) (C)
- (vii) (B)
- (viii) (C)
- (ix) (A)
- (x) (C)
- (xi) (A)
- (xii) (D)
- (xiii) (A)
- (xiv) (D)
- (xv) (C)

SECTION-B

2.

Computation of total income of Derek Pvt Ltd for the Asst. Year 2025-26

Particulars	₹	₹
Net Profit as per the Statement of profit and loss		22,75,000
Add: Items debited to the Statement of profit and loss but not allowable		
i) Interest on loan from the NBFC (not paid within the due date of filing of return of income)		1,85,000
(As per Section 43B, interest on loan from an NBFC is not allowable if not paid within the due date of filing of return of income.)		
ii) Depreciation as per Companies Act		3,70,000
iii) Penalty for infringement of law		60,000
(Penalty for infringement of law is specifically not allowed as deduction as per Section 37)		
iv) Fees to Registrar of Companies for changes in		
Authorised capital		70,000
Memorandum of Association		20,000
Articles of Association		15,000
(All the above are capital expenditure that alters a company's capital base, hence not allowable.)		

v) Provisions		
Deferred tax	50,000	
Doubtful debts	85,000	
Losses of subsidiary	2,40,000	
(Provisions are not allowed as expenses, as per section 37(1))		
		3,75,000
vi) Retrenchment compensation paid to employees on closing down of a unit	NIL	
(Retrenchment compensation paid to employees on closing down of a unit is allowed as expenditure as per section 37)		
vii) Delayed payment to micro enterprise		7,50,000
[100% disallowed under section 43B(h)]		
[Assumption: It is assumed that the amount of ₹ 35.50 lakhs that has been paid up to the end of the year, qualifies the time limits prescribed under section 43B(h)]		
		41,20,000
Less: Items credited to the Statement of profit and loss but not to be considered under PGBP		
i) Profit from SEZ Unit	2,75,000	
(To be considered separately)		
ii) Income from growing and manufacturing of tea	1,00,000	-
(To be considered separately)		
iii) Income tax refund	47,000	
(To be considered separately, since it is not a business income)		
		4,22,000
		36,98,000
Less: Items not debited to the Statement of profit and loss		
i) Depreciation as per the Income-tax Act	4,00,000	
(This amount includes the amount discussed in point ii infra)		
ii) Unabsorbed Depreciation	Nil	
(As per s. 32(2) any brought forward depreciation of an earlier year will be added to current year depreciation and will be treated as current depreciation. Since the depreciation as per Income-tax Act includes the unabsorbed depreciation, no more adjustment is required)		
		4,00,000
Income from manufacturing business		32,98,000
Profit from the SEZ Unit		2,75,000
Income from growing and manufacturing of tea		40,000
(60% agricultural income and 40% non- agricultural income)		
PGBP prior to set off		36,13,000
Less: Brought forward loss from non-speculative business	3,75,000	
(Losses from non-speculative business are allowed to be set off)		
Brought forward loss from speculative business	Nil	
(Losses from speculative business cannot be set off against profit from normal business. Hence, carried forward.)		
		3,75,000
Income from PGBP		32,38,000
Income from Other Sources		

Interest on income tax refund		7,000
Gross total income		32,45,000
Less: Deduction u/s 10AA		2,75,000
(Profit from unit established in special economic zone is exempt @ 100% for first 5 years)		
Total income		29,70,000
Tax @25%		7,42,500
Cess @ 4%		29,700
Total tax payable		7,72,200
Less: Advance tax		5,00,000
Net tax payable		2,72,200

3. (a)

Computation of total income and tax payable of Babloo for the AY 2025-26

Particulars	Default regime ₹	Normal regime ₹
Rent received	1,20,000	
Less: Standard deduction @ 30%	36,000	
Interest on loan	2,20,000	
Loss from house property (Loss is not eligible for set off under default regime)	Nil	(1,36,000)
Income from PGBP		
Net profit as per P/L A/c	51,70,000	
Add: Interest on loan taken for let out property	2,20,000	
Less: Gross rent received, not being business income	(1,20,000)	
Income from Business	52,70,000	52,70,000
Gross total income	52,70,000	51,34,000
Less: Deduction under Chapter VI-A	Nil	
Deduction u/s 80C (restricted to ₹ 1,50,000) (Deposit in PPF is assumed to be made for self, his spouse or any child)		1,50,000
Deduction u/s 80D (restricted to ₹ 25,000) (It is assumed that the premium has been paid by any permissible mode, other than cash)		25,000
Total income	52,70,000	49,59,000
Tax on total income	12,71,000	13,00,200
Add: Surcharge @ 10%	1,27,100	Nil
Add: Cess @ 4%	55,924	52,008
Tax liability	14,54,024	13,52,208
Tax liability (rounded off)	14,54,020	13,52,210
Conclusion: Normal i.e. old regime is beneficial since the tax payable is lower		

3. (b)

Computation of total income of Sara Ltd. for the A.Y. 2025-26

Particulars	Normal provisions ₹	Section 115BAB ₹
Profits and gains from business or profession		
Net profit as per the Statement of Profit and Loss	30,90,000	30,90,000
Add: Items debited but to be considered separately or disallowed		
Depreciation as per the Companies Act	4,50,000	4,50,000
Employer's contribution to EPF – allowed as it was paid before the 'due date' of filing the ROI	Nil	Nil
Employee's contribution to EPF – Not allowed as it was paid after the due date of the relevant Act	11,00,000	11,00,000
Expenses on earning dividend (not allowed under PGBP head)	3,60,000	3,60,000
	50,00,000	50,00,000
Less:		
Normal Depreciation as per the Income-tax Rules	4,90,000	4,90,000
Additional Depreciation as per the Income-tax Act (not allowed under section 115BAB)	1,50,000	Nil
Dividend (taxable under the head 'Income from other sources')	17,00,000	17,00,000
Income from PGBP	26,60,000	28,10,000
Income from other sources		
Dividend	17,00,000	
Less: Expenses (Max 20% allowed) hence, limited to (It is assumed that the expenses relates to the interest expenditure to earn such income)	3,40,000	
Income from other sources	13,60,000	13,60,000
Gross Total Income	40,20,000	41,70,000
Less: Deduction under sec 80M	13,60,000	13,60,000
Inter-corporate dividend up to the amount of dividend received (net of expenses, as per s.80 AB)		
Total income	26,60,000	28,10,000
Tax on total income		
@25% on ₹ 26,60,000	6,65,000	
@15% of 28,10,000		4,21,500
Add: Surcharge@10%		42,150
Add: Cess @4%	26,600	18,546
Tax liability	6,91,600	4,82,196
Tax liability (rounded off)		4,82,200
Conclusion: The assessee should opt of section 115BAB, since the tax liability is lower.		

4. (a)

Tax implications on conversion of firm into company

Transaction not regarded as transfer for the purpose of capital gain [Sec. 47(xiii)]

Any transfer of a capital asset, by a firm to a company as a result of succession of the firm by a company in the business carried on by the firm, shall not be regarded as transfer provided following conditions are satisfied:

- a) All assets and liabilities of the firm relating to the business immediately before the succession become the assets and liabilities of the company.

Here, Anand (P) Ltd. took over all the assets and liabilities of the firm.

- b) All the partners of the firm immediately before the succession became the shareholders of the company in the same proportion in which their capital accounts stood in the books of the firm on the date of succession.

Here, all the three partners became the shareholders in the company. Their capital account balances at the time of succession was in the ratio of 10:8:6 and the shareholdings in the company are also in the ratio of 10:8:6.

- c) The partners of the firm do not receive any consideration or benefit, directly or indirectly, in any form or manner, other than by way of allotment of shares in the company;

All the three partners received only the equity shares in the company as the consideration for transfer.

- d) The aggregate of the shareholding in the company of the partners of the erstwhile firm is not less than 50% of the total voting power in the company and their shareholding continues to be as such for a period of 5 years from the date of succession.

Total share capital of the company after succession is ₹ 44,00,000. Total share capital of the three partners is more than 50% ₹ 24,00,000 i.e. 54.55%

Since all the above conditions are satisfied, the transfer of capital assets by M/s Arihant Motors to Anand (P) Ltd. will not be regarded as 'transfer' and no capital gain will arise.

In case X sells his entire shareholdings to Y

In the hands of Anand Pvt. Ltd.

The condition (d) says, the aggregate of the shareholding in the company of the partners of the firm is not less than 50% of the total voting power in the company and their shareholding continues to be as such for a period of 5 years from the date of succession. Therefore, if X sells his entire shareholdings to Y, then still remaining partners Y and Z are holding not less than 50% of the voting power in the company and no capital gain arises in the hands of Anand Pvt. Ltd.

In the hands of X

Short term capital gain of ₹ 2,00,000, which arises in the hands of X for the assessment year 2025-26 is chargeable to tax.

If the company issues debentures along with the equity shares to the three partners

If the company issues debentures along with the equity shares to the three partners, the above condition (c) gets violated. Hence, the firm will not get the exemption u/s 47(xiii). Capital gain arising from such transfer will be taxable in the hands of the firm.

4. (b)

Computation of total income and tax payable by Zaheer as per Chapter XII-A for the A.Y. 2025-26		₹
Long-term capital gains on transfer of foreign exchange asset		5,67,000
Less: Exemption under section 115F		Nil
Reason: To be eligible for exemption under section 115F, the assessee must invest the sales consideration in the shares of an Indian company within 6 months of the transfer. In the present case, since the investment is done after 6 months from the date of transfer, exemption u/s 115F is not available.		
	Long-term capital gain	5,67,000
Income from other sources		
Interest from notified Government Bonds (Expenses not allowed)	46,000	
Dividend from shares in Indian companies	80,000	
		1,26,000
	Gross total income	6,93,000
Tax payable		
Tax on long-term capital gains 12.5% on (5,67,000-1,25,000)		55,250
Tax on investment income: Interest from notified Government Bonds @ 10% of 46,000		4,600
Tax on dividend from shares in Indian companies @ 20% of ₹ 80,000		16,000
		75,850
Add: Cess @ 4%		3,034
Tax liability		78,884
Tax Liability (Rounded off)		78,880
Less Tax deducted at source		1,20,000
Tax refundable		41,120

5. (a)**Resolving issues of Arun Ltd, Jaipur**

- (i) The view of the tax counsel of the company is incorrect.
When the appeal filed by the assessee does not form part of the subject matter of the revision, the doctrine of total merger would not apply.

Therefore, revision under section 263 is possible in respect of the issues which are not the subject matter of appeal. The concept of partial merger would apply.

In the revision proceedings, the assessee should take defence purely on merits of the case.
- (ii) The view of the tax counsel of the company is incorrect.

As per section 245W, the applicant, if he is aggrieved by any ruling pronounced or order passed by the Board for Advance Rulings, may appeal to the High Court against such ruling or order of the Board for Advance Rulings

within 60 days from the date of the communication of that ruling or order, in such form and manner, as may be prescribed.
- (iii) The view of the tax counsel of the company is incorrect.

Section 264 provides that the CCIT/CIT shall not revise the order of the Assessing Officer if the order has been made subject matter of appeal to the JCIT(A) or CIT(A) or to the Appellate Tribunal.

The doctrine of total merger would apply under section 264, if an appeal is filed to the JCIT(A)/CIT(A) on one or more issues, then revision u/s 264 is not possible on any issue. Therefore, in the present case, the CIT is justified in rejecting the revision application u/s 264.

5. (b)**Interest computation in respect of Surya Ltd, Bhopal**

Total Tax Liability	₹ 15,60,000			
Section 211 of the Income Tax Act mandates that advance tax payments be made in specified instalments throughout the financial year. The due dates and minimum percentages of the total tax liability to be paid by each due date are as follows:				
Calculation of Interest Payable on such short fall				
Due date of Payment	15-6-2024	15-9-2024	15-12-2024	15-3-2025
Rate of advance tax	15%	45%	75%	100%
Advance tax due	2,34,000	7,02,000	11,70,000	15,60,000
Advance tax paid	3,00,000	2,00,000	4,00,000	4,00,000
Cumulative Advance tax paid	3,00,000	5,00,000	9,00,000	13,00,000
Shortfall in advance tax	NIL	2,02,000	2,70,000	2,60,000
Delay in months	0	3	3	1
Total interest payable u/s 234C @1%	-	6,060	8,100	2,600
				16760
Calculation of interest under section 234B				
When assessee fails to pay 90% of advance tax before 31 st March of the previous year, it is liable to pay interest under section 234B @ 1% per month of shortfall from 1 st day of April and up to completion of assessment.				
The total advance tax paid is ₹ 13,00,000 which is less than 90% of the final tax liability of ₹ 15,60,000.				
Therefore, interest @1% per month is payable from 1 st April, 2025 to 31 st October,2025 amounting to ₹ 18,200 (2,60,000 X 1% X 7 months)				

6. (a)**APA and rollback applicability**

The benefit of APA can be applied for the assessment year relevant to the previous year in which the APA was entered into (date of signing of APA) and four subsequent financial years. Thus, it will apply for the FY 2024-25 (date of signing the APA 15th May,2024) and 4 subsequent financial years being F. Ys 2025-26, 2026-27, 2027-28 and 2028-29.

The roll back provisions will apply for four preceding assessment years only, preceding the assessment year 2025-26.

Hence rollback cannot be applied for the AY 2020-21.

Rollback provision shall not be provided in respect of an international transaction for a rollback year, if:

- (i) the determination of arm's length price of the said international transaction for the said year has been subject matter of an appeal before the Appellate Tribunal and the Appellate Tribunal has passed an order disposing of such appeal at any time before signing of the agreement; or
- (ii) the application of rollback provision has the effect of reducing the total income or increasing the loss, as the case may be, of the applicant as declared in the return of income of the said year.

For the assessment year 2021-22, rollback provisions would apply. If any appeal is pending with the High Court for a rollback year, on the issue which is the subject matter of the rollback provision for that year, the said appeal to the extent of the subject covered under the agreement shall be withdrawn by the applicant before furnishing the modified return for the said year.

For the assessment year 2022-23, rollback would not apply if ALP adjustment was reduced to addition of ₹ 150 crores as against addition of ₹ 200 crores originally determined by the TPO.

For the assessment year 2023-24, the rollback provisions would apply since the order has been set aside by the Tribunal for fresh consideration and has not reached the finality.

For the assessment year 2024-25, in respect of which assessment is pending, rollback would apply, since the return of income has been filed before the due date u/s 139(1).

6. (b)

Computation of total income of Hari for the assessment year 2025-2026		
(Normal provisions of the Income-tax Act, 1961)		
Particulars	₹	₹
Profits and gains of business or profession		
Income from profession carried on in India		10,50,000
Royalty income from a literary book from Country SA (net of expenses)	8,00,000	
Less: Business loss in Country SA	2,50,000	
		5,50,000
PGBP income		16,00,000
Income from other sources		
Agricultural income in Country SA [Not exempt u/s 10(1)]	2,65,000	
Dividend from a company incorporated in Country SA	66,000	
		3,31,000
Gross total income		19,31,000
Less: Deduction under Chapter VI-A		
Under section 80QQB -Royalty income of a resident restricted to		3,00,000
Total income		16,31,000
Note: Since the adjusted total income (i.e. ₹ 16,31,000) does not exceed ₹ 20 lakhs, AMT would not be attracted in this case.		
Tax on total income @ slab rate	3,01,800	
Add: Health and education cess @4%	12,072	
Tax Liability		3,13,872
Calculation of Rebate under section 91		
Average rate of tax in India [i.e. ₹ 313872 / ₹ 1631000 X 100)	19.24%	
Average rate of tax in Country SA	15%	
Doubly taxed income pertaining to Country SA		
Agricultural Income		2,65,000
Royalty Income (net of deduction u/s 80QQB) (8,00,000-3,00,000)		5,00,000
Dividend income		66,000
		8,31,000
Less: Business Loss set off		(2,50,000)
Doubly taxed income		5,81,000
Rebate under section 91 (On ₹ 5,81,000 @15% being lower of Indian Tax rate and the tax rate in country SA)		87,150
Net tax liability (3,13,872-87,150)		2,26,722
Net tax liability (Rounded off)		2,26,720

7. (a)

Determination of ALP in the case of Ashish Ltd, Indore

Resale Price Method is the most appropriate method for determination of the Arm's Length Price for import of ACs by Ashish Ltd from Bear LLC. Since Ashish Ltd sold the ACs without any customization or value-addition, Resale Price Method is generally used to test transactions involving distribution function, i.e. when the tested party purchases products/ acquires services from related party and resells the same to independent parties.

The use of RPM is the most appropriate method where the reseller does not add to the value of the product/ services.

Determination of ALP of transaction between Ashish Ltd from Bear LLC by applying Resale Price Method using three independent comparable resale margins.

Particulars	₹ (per unit)
Sale price	40,000
Resale price by Ashish Ltd to third party distributor	40,000
Less: Resale margin of comparable 1 (15% of sales)	6,000
Arm's Length Price using comparable 1	34,000
Resale price by Ashish Ltd to third party distributor	40,000
Less: Resale margin of comparable 2 (23% of sales)	9,200
Arm's Length Price using comparable 2	30,800
Resale price by Ashish Ltd to third party distributor	40,000
Less: Resale margin of comparable 3 (19% of sales)	7,600
Arm's Length Price using comparable 3	32,400
Since there are more than one ALP using Resale Price Method as the most appropriate method and as the dataset has less than 6 entries, Arithmetic mean of all the values would be the Arm's length Price [(34,000+30,800+32,400)/3]	32,400
ALP of 2000 units	6,48,00,000
Total amount billed (₹ 35,000 x 2,000)	7,00,00,000
Since transaction value (billed amount) is higher than the ALP, adjustment is required to be made to the total income of Ashish Ltd. The purchase price excessively paid to AE Bear LLC.	52,00,000

7. (b)

EBITDA

Particulars	₹ in lakhs
Net profit as per books (after tax)	180
Depreciation	60
Interest to AE 1 (Sri Lanka)	90
Interest to AE 2 (Japan)	250
Interest to others (unrelated parties)	100
Amortization	20
Provision for Taxation	80
EBITDA	780

Interest paid to AEs not allowed as deduction

	₹ in lakhs
Interest to AE 1 (Sri Lanka) – less than 100 lakhs hence it is eligible for deduction without any restriction.	NIL
Interest to AE 2 (Japan)	250
Maximum amount allowable is 30% of EBITDA (30% of 780)	234
Amount to be disallowed	16
Note: Disallowance will arise only where the interest to AE is more than ₹ 1 crore. Hence no adjustment is required for AE1.	

Interest allowable as deduction

	₹ in lakhs
Interest to AE 1 (Sri Lanka)	90
Interest to AE 2 (Japan)	234
Interest to others (unrelated parties)	100
Total interest allowable as deduction	424

Carry forward of disallowed interest

Disallowed interest of ₹ 16 lakh is eligible for carry forward to the subsequent 8 assessment years and will be allowed as deduction while computing Profits and gains of business or profession, to the extent it is allowable under section 94B.

8. (a)

Quantum of deduction u/s 80-IA for an industrial undertaking

Issue involved

The issue involved is whether the action of the AO is tenable in law, in restricting the deduction under section 80-IA to the extent of the overall business income, as reduced by loss from any other source

Provisions applicable

As per section 80AB, where the GTI includes any income of nature specified under the heading C, like section 80-IA, then, notwithstanding anything contained in that section, for the purpose of computing the deduction under that section, the amount of income of that nature as computed in accordance with the provisions of the Act (before making any deduction under this Chapter) shall alone be deemed to be the amount of income of that nature which is derived or received by the assessee and which is included in his gross total income.

Section 80A(2) provides that the aggregate amount of the deduction under Chapter VI-A, shall not exceed the “gross total income” of the assessee

Analysis

The import of section 80-IA is that the “total income” of an assessee is computed by taking into account the allowable deduction in respect of the profits and gains derived from the “eligible business” as the “only source of income”.

For the purpose of calculating profit-linked deduction under any section of Chapter VI-A, loss sustained in other division or units cannot be taken into account, as only profits from the eligible business have to be taken into account.

The deduction u/s 80-IA is undertaking-specific and is granted with reference to the impugned undertaking only. It cannot be reduced by loss, if any, from any other undertaking.

Conclusion

The deduction u/s 80-IA for the Hubli unit has to be allowed with regard to its income (₹ 67 lakh) only, and not with reference to the overall business income. Thus, the action of the Assessing Officer is not tenable in law.

8. (b)**Applying The ALP to the transactions with unrelated parties****Issue involved**

The issue involved is whether the action of the AO is valid in law, in applying the ALP determined by the TPO to the transactions with unrelated parties also.

Provisions applicable

Section 92 of the Income-tax Act provides that any income arising from an international transaction shall be computed having regard to the arm's length price.

As per section 92B, international transaction means a transaction, inter alia, between two or more associated enterprises, either or both of whom are non-residents.

The ALP determined by the TPO will be binding on the AO.

Analysis

The ALP can be determined by the TPO, only in respect of international transactions.

Reading section 92B with section 92, it can be said that, arm's length price needs to be computed for international transactions which essentially mean transactions between two or more associated enterprises.

Thus, the ALP, as determined by the TPO, can be applied by the AO, only in respect of transactions with AEs and not with other unrelated parties.

Conclusion

The action of the Assessing Officer is not tenable in law for applying the ALP in respect of transactions with unrelated parties.