

**MOCK TEST PAPER 1**  
**FINAL COURSE: GROUP – II**  
**PAPER – 7: DIRECT TAX LAWS & INTERNATIONAL TAXATION**  
**SOLUTIONS**

**Division A – Multiple Choice Questions**

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

**Division B – Descriptive Questions**

1. (a) **Computation of Total Income of Lambda Ltd. for the A.Y. 2023-24**

	Particulars	Amount (₹)	
I	<b>Profits and gains of business and profession</b>		
	Net profit as per the statement of profit and loss		7,50,00,000
	<b>Add: Items debited but to be considered separately or items of expenditure to be disallowed</b>		
	(a) <b>Depreciation as per Companies Act</b>	52,00,000	
	(c) <b>Provision for wages payable to workers</b>	-	
	[Since the provision is based on a fair estimate of wages payable with reasonable certainty, the provision is allowable as deduction. ICDS X requires a reliable estimate of the amount of obligation and 'reasonable certainty' for recognition of a provision, which is present in this case.		
	As the provision of ₹ 18 lakhs has been debited to statement of profit and loss, no adjustment is required while computing business income]		
	(e) <b>Loss due to destruction of machinery by fire</b>	17,00,000	
	[Loss of ₹ 17 lakhs due to destruction of machinery caused by fire is not deductible since it is capital in nature.		
	Since the loss has been debited to statement of profit and loss, the same is required to added back while computing business income]		

<p>(f) <b>Provision for gratuity</b>  [Provision of ₹ 320 lakhs for gratuity based on actuarial valuation is not allowable as deduction. However, actual gratuity of ₹ 160 lakhs paid is allowable as deduction.  Hence, the difference has to be added back to income [₹ 320 lakhs (-) ₹ 160 lakhs]</p>	1,60,00,000
<p>(g) <b>Advertisement in souvenir of a political party</b>  [Advertisement charges paid in respect of souvenir published by a political party is not allowable as deduction from business profits of the company. Since the expenditure has been debited to statement of profit and loss, the same has to be added back while computing business income]</p>	2,30,000
	2,31,30,000
	<b>9,81,30,000</b>
<b>Add: Income taxable but not credited to statement of profit and loss</b>	
<p>AI(ii) <b>GST not refunded to customers out of GST refund received from State Govt.</b>  [The amount of GST refunded to the company by the Government is a revenue receipt chargeable to tax. Out of the refunded amount of ₹ 3 lakhs, the amount of ₹ 2 lakh stands refunded to customers would not be chargeable to tax.<sup>1</sup>  The balance amount of ₹ 1,00,000 lying with the company would be chargeable to tax]</p>	1,00,000
	9,82,30,000
<b>Less: Items credited to statement of profit and loss, but not includible in business income/ permissible expenditure and allowances</b>	
<p>(b) <b>Industrial power tariff concession received from State Government</b>  [Any assistance in the form of, <i>inter alia</i>, concession received from the Central or State Government would be treated as income. Since the same has been credited to statement of profit and loss, no adjustment is required]</p>	-
<p>(d) <b>Dividend received from US company</b>  [Dividend received from foreign company is taxable under "Income from other sources". Since the same has been credited to the statement of profit and loss, it has to be deducted while computing business income]</p>	12,00,000

<sup>1</sup>CIT v. Thirumalaiswamy Naidu & Sons (1998) 230 ITR 534 (SC)

(e) <b>Scrap value of machinery</b> [Scrap value of machinery, being capital in nature, has to be reduced from WDV of machinery. Since the same has been credited to the statement of profit and loss, it has to be deducted while computing business income]	3,00,000	
(h) <b>Long term capital gains on sale of equity shares</b> [The taxability or otherwise of long-term capital gain on sale of equity shares has to be considered while computing income under the head "Capital Gains". Since such capital gains has been credited to statement of profit and loss, the same has to be reduced to arrive at the business income.]	3,00,000	
<b>AI(i) Depreciation as per Income-tax Rules, 1961</b>	71,00,000	89,00,000
<b>Profits and gains from business and profession</b>		<b>8,93,30,000</b>
<b>II Income from Other Sources</b>		
<b>Dividend received from foreign company</b> [Dividend received from a foreign company is chargeable to tax under the head "Income from other sources"]		12,00,000
<b>III Capital Gains</b>		
<b>Long term capital gain on sale of equity shares</b> [Long term capital gains in excess of ₹ 1 lakh (i.e., ₹ 2 lakh, being ₹ 3 lakh – ₹ 1 lakh) on sale of equity shares on which STT is paid at the time of acquisition and sale would be taxable@10% u/s 112A, without indexation benefit.]		3,00,000
<b>Gross Total Income</b>		<b>9,08,30,000</b>
<b>Less: Deduction under Chapter VI-A</b> Under section 80GGB [Contribution by a company to a registered political party is allowable as deduction, since payment is made otherwise than by cash. Expenditure incurred by an Indian company on advertisement in souvenir published by such political party tantamounts to contribution to such political party.]		2,30,000
<b>Total Income</b>		<b>9,06,00,000</b>

**Computation of tax liability of Lambda Ltd. for A.Y.2023-24**

<b>Particulars</b>	<b>₹</b>
Tax @10% on long term capital gains in excess of ₹ 1 lakh (i.e., ₹ 2 lakh, being ₹ 3 lakh – ₹ 1 lakh)	20,000
Tax @30% on balance income of ₹ 9,03,00,000 (i.e., ₹ 9,06,00,000 - ₹ 3,00,000) (since the turnover exceeded ₹400 crore in the P.Y. 2020-21)	2,70,90,000
	2,71,10,000
<b>Add: Surcharge @ 7% (since total income exceeds ₹1 crore but less than ₹ 10 crore)</b>	18,97,700
	<b>2,90,07,700</b>

Add: Health and Education cess @ 4%	11,60,308
Total tax liability	<b>3,01,68,008</b>
Total tax liability (Rounded off)	<b>3,01,68,010</b>

2. (a) **Computation of total income & tax liability of XYZ Co-operative Society for A.Y.2023-24 (under the regular provisions of the Act)**

Particulars	₹	₹
Profits and gains of business or profession		65,00,000
Income from other sources – Interest on bank fixed deposits		<u>30,00,000</u>
<b>Gross Total Income</b>		<b>95,00,000</b>
<i>Less: Deductions under Chapter VI-A</i>		
<b>Deduction u/s 80JJAA</b> [30% of ₹ 22,000 x 10 employees x 11 months]	7,26,000	
<b>Deduction u/s 80P</b> [XYZ Co-operative society is entitled for deduction under section 80P on the whole of the amount of profits and gains of business attributable to the activity of marketing of agricultural produce grown by its members]	<u>65,00,000</u>	
		<u>72,26,000</u>
<b>Total Income</b>		<b><u>22,74,000</u></b>
<b>Tax liability:</b>		
Upto ₹ 10,000 – 10%	1,000	
₹ 10,000 – ₹ 20,000 – 20%	2,000	
₹ 20,000 – ₹ 22,74,000 – 30%	<u>6,76,200</u>	
		6,79,200
Add: Health and education cess@4%		<u>27,168</u>
<b>Tax liability</b>		<b><u>7,06,368</u></b>
<b>Tax liability (Rounded off)</b>		<b><u>7,06,370</u></b>
<b>Alternate Minimum Tax</b>		
<b>Total Income</b>		22,74,000
Add: Deduction under section 80JJAA		<u>7,26,000</u>
<b>Adjusted Total Income</b>		<b><u>30,00,000</u></b>
Alternate Minimum Tax@15% of ₹ 30,00,000		4,50,000
Add: Health and education cess@4%		<u>18,000</u>
<b>Alternate Minimum Tax</b>		<b><u>4,68,000</u></b>
<b>Since AMT is lower than the tax payable under the regular provisions of the Act, the tax liability of the co-operative society would be ₹ 7,06,370.</b>		

**Computation of total income & tax liability of XYZ Co-operative Society under section 115BAD for A.Y.2023-24**

Particulars	₹	₹
Profits and gains of business or profession		65,00,000
Income from other sources – Interest on bank fixed deposits		<u>30,00,000</u>
<b>Gross Total Income</b>		<b>95,00,000</b>
<b>Less: Deductions under Chapter VI-A</b>		
Deduction u/s 80JJAA [30% of ₹ 22,000 x 10 employees x 11 months]	7,26,000	
Deduction u/s 80P [Not allowable where the co-operative society opts for section 115BAD]	-	
		<u>7,26,000</u>
<b>Total Income</b>		<b><u>87,74,000</u></b>
<b>Tax liability</b>		
22% of ₹ 87,74,000		19,30,280
Add: Surcharge@10%		<u>1,93,028</u>
		21,23,308
Add: Health and education cess@4%		<u>84,932</u>
<b>Tax liability</b>		<b><u>22,08,240</u></b>

Since the tax liability under section 115BAD is higher than the tax liability under the regular provisions of the Act, XYZ Co-operative Society should not opt for section 115BAD.

(b) **Computation of Total income of Mr. Charles for the A.Y. 2023-24**

Particulars	₹	₹
<b>Salary</b>	28,00,000	
[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. Charles.		
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 a German company which is engaged in business and trade in India through a PE in India and such salary is borne by Indian PE]		
Less: Standard deduction u/s 16(ia)	50,000	27,50,000
<b>Capital Gains</b>		
Transfer of 1200 equity shares of B (P) Ltd. [Taxable in India, since shares are situated in India]		
Sale Consideration (1200 x ₹ 43 per share/75, being average of ₹ 74 (TTBR) + ₹ 76 (TTSR)/2 on 23.6.2022)	\$ 688	
Less: Cost of acquisition (1200 x ₹ 15 per share/60, being average of ₹ 59 (TTBR) + ₹ 61 (TTSR)/2 on 28.11.2015)	\$ 300	
	<b>\$ 388</b>	
Long-term capital gain [\$ 388 x ₹ 74, being TTBR on 23.06.2022]		28,712

<b>Transfer of 2000 Equity shares of Aribitz GmbH (AG)</b> [Not taxable in India, since shares of foreign company do not derive its value substantially from assets located in India as value of Indian assets do not exceed ₹ 10 crores]		Nil
<b>Income from Other Sources</b> Dividend received in India from Aribitz GmbH [taxable in India, since dividend is received in India]		1,11,000
<b>Gross Total Income/total income</b>		<b>28,89,712</b>
<b>Total income (rounded off)</b>		<b>28,89,710</b>

3. (a) (i) The contention of the institution is **not** correct. Since the institution has receipts from a university specified under section 10(23C)(iiiad) and a hospital specified under section 10(23C)(iii ae), and the combined receipts of ₹ 6 crore exceed the threshold receipt of ₹ 5 crore, the institution would **not** be eligible for exemption under sections 10(23C)(iiiad) and 10(23C)(iii ae) [Explanation below section 10(23C)(iii ae)]. The institution has to make an application to the Principal Commissioner or Commissioner within the prescribed time limit for grant of approval for claiming exemption under section 10(23C)(vi) and (via).
- (ii) The proposed action of the trust is **not** correct. As per Explanation 5 to section 11(1), with effect from A.Y.2022-23, no set off or deduction or allowance of any excess application of any of the year preceding the previous year shall be made in computation of income required to be applied or accumulated during the previous year. Accordingly, excess application of ₹ 27 lakhs in the P.Y.2021-22 cannot be set-off while computing income required to be applied or accumulated during the P.Y.2022-23.
- (iii) The proposed claim of the trust is **not** correct. As per clause (ii) of Explanation 4 to section 11(1), application for charitable purposes from a loan or borrowing shall not be treated as application of income for charitable purposes. However, the amount not so treated as application, or part thereof, would be treated as application for charitable purposes in the previous year in which the loan is repaid from the income of that year and to the extent of such repayment.
- Accordingly, the trust cannot claim ₹ 40 lakhs as application of income of A.Y.2023-24, since the amount is spent out of loan taken from SBI. However, it can treat the amount of ₹ 5 lakhs repaid to SBI during the P.Y.2022-23 as application of income in that year.
- (b) (i) **The statement is correct.**
- Under section 245U, the Authority for Advance Rulings shall have all the powers vested in the Civil Court under the Code of Civil Procedure, 1908 as are referred to in section 131.
- Accordingly, the Authority for Advance Rulings shall have the same powers as are vested in a court under the Code of Civil Procedure, 1908, when trying a suit in respect of the following matters, namely -
- (1) discovery and inspection;
  - (2) enforcing the attendance of any person, including any officer of a banking company and examining him on oath;
  - (3) compelling the production of books of account and other documents; and
  - (4) issuing commissions.
- Therefore, the Authority for Advance Ruling has the powers of compelling the production of books of account.

- (ii) Chapter VIII of the Finance Act, 2016, "Equalisation Levy", provides for an equalisation levy of 6% of the amount of consideration for specified services received or receivable by a non-resident not having permanent establishment in India, from a resident in India who carries out business or profession, or from a non-resident having permanent establishment in India.

**"Specified Service"** means

- (1) online advertisement;
- (2) any provision for digital advertising space or any other facility or service for the purpose of online advertisement and
- (3) any other service as may be notified by the Central Government.

However, equalisation levy shall **not** be levied-

- where the non-resident providing the specified services has a permanent establishment in India and the specified service is effectively connected with such permanent establishment.
- the aggregate amount of consideration for specified service received or receivable during the previous year does not exceed ₹ 1 lakh.
- where the payment for specified service is not for the purposes of carrying out business or profession.

Equalization levy@2% would be chargeable on the amount of consideration received or receivable by an e-commerce operator from e-commerce supply or services made or provided or facilitated by it—

- (1) to a person resident in India; or
- (2) to a non-resident in the specified circumstances as provided below; or
- (3) to a person who buys such goods or services or both using internet protocol address located in India.

The equalization levy shall not be charged—

- (1) where the e-commerce operator making or providing or facilitating e-commerce supply or services has a permanent establishment in India and such e-commerce supply or services is effectively connected with such PE;;
- (2) where the equalization levy is leviable under section 165; or
- (3) sales, turnover or gross receipts, as the case may be, of the e-commerce operator from the e-commerce supply or services made or provided or facilitated is less than ₹ 2 crore during the previous year.

**Meaning of "specified circumstances":**

- (1) sale of advertisement, which targets a customer, who is resident in India or a customer who accesses the advertisement through internet protocol address located in India; **and**
- (2) sale of data, collected from a person who is resident in India or from a person who uses internet protocol address located in India.

Equalisation levy would not be attracted in the present case since MNO Inc., a non-resident service recipient does not have a permanent establishment in India. Therefore, the MNO Inc. is not required to deduct equalisation levy @ 6% on ₹ 5 lakhs, being the amount paid towards online advertisement services to PQR Inc.

However, equalisation levy @2% under section 165A is attracted on ₹ 5 lakhs, being the amount of consideration received by PQR Inc, an e-commerce operator from e-commerce

services provided by it to MNO Inc., a non-resident in the specified circumstance, namely, sale of advertisement, which targets a customer, who is resident in India, since the gross receipt of PQR Inc. in the P.Y. 2022-23 exceeds ₹ 2 crores.

4. (a) (i)	₹
Gross salary, allowances and monetary perquisites	7,30,000
Non-Monetary perquisites	<u>1,20,000</u>
	8,50,000
Less: Standard deduction under section 16(ia)	<u>50,000</u>
	<b><u>8,00,000</u></b>
Tax Liability	75,400
Average rate of tax (₹ 75,400 / ₹ 8,00,000 × 100)	9.425%

The company can deduct ₹ 75,400 at source from the salary of the General Manager at the time of payment.

Alternatively, the company can pay tax on non-monetary perquisites as under –

Tax on non-monetary perquisites = 9.425% of ₹ 1,20,000 = ₹ 11,310

Balance to be deducted from salary = ₹ 64,090

If the company pays tax of ₹ 11,310 on non-monetary perquisites, the same is not a deductible expenditure as per section 40(a)(v). The amount of tax paid towards non-monetary perquisite by the employer, however, is not chargeable to tax in the hands of the employee as per section 10(10CC).

- (ii) As per section 194LB, tax would be deductible @5% on gross interest paid/credited by a notified infrastructure debt fund, eligible for exemption under section 10(47), to a foreign company.

In the first case, since the payment is to a foreign company, health and education cess @4% has to be added to the applicable rate of TDS. Therefore, the tax deductible under section 194LB would be ₹ 26,000 (i.e., 5.20% of ₹ 5 lakhs).

However, in case the notified infrastructure debt fund pays interest to a person who is a resident of a notified jurisdictional area, section 94A will apply. Accordingly, tax would be deductible @30% (plus health and education cess@4%) under section 94A, even though section 194LB provides for deduction of tax at a concessional rate of 5%. Therefore, the tax deductible in respect of payment of ₹ 3 lakh to Mr. X, who is a resident of a notified jurisdictional area, would be ₹ 93,600, being 31.2% of ₹ 3,00,000

- (iii) The definition of “work” under section 194C includes manufacturing or supplying a product according to the requirement or specification of a customer by using material purchased from such customer or its associate. In the instant case, Mini Limited manufactures the product as per the specification given by Max Limited by using the raw materials purchased from Max Limited. Therefore, it falls within the definition of “work” under section 194C. Consequently, tax is to be deducted on the invoice value excluding the value of material purchased from such customer if such value is mentioned separately in the invoice. If the material component is not mentioned separately in the invoice, tax is to be deducted on the whole of the invoice value.



- (iv) Provisions for deduction of tax at source under section 194J are attracted in respect of payment of fees for professional services, if the amount of such fees exceeds ₹ 30,000 in the relevant financial year. The service rendered by a commentator in relation to sports activities has been notified by the CBDT as a professional service for the purposes of section 194J vide its *Notification No. 88 dated 21st August, 2008*. Therefore, tax is required to be deducted @10% from the fee of ₹ 5 lakhs payable to the former cricketer.
- (b) Any income arising from an international transaction, where two or more “associated enterprises” enter into a mutual agreement or arrangement, shall be computed having regard to arm’s length price as per the provisions of Chapter X of the Act.

Section 92A defines an “associated enterprise” and sub-section (2) of this section speaks of the situations when the two enterprises shall be deemed to associated enterprises. Applying the provisions of section 92A(2)(a) to (m) to the given facts, it is clear that “Anush Motors Ltd.” is associated with :-

- (i) Rida Ltd. as per section 92A(2)(a), because this company holds shares carrying more than 26% of the voting power in Anush Motors Ltd.;
- (ii) Kyoto Ltd. as per section 92A(2)(g), since this company is the sole owner of the technology used by Anush Motors Ltd. in its manufacturing process;
- (iii) Dorf Ltd. as per section 92A(2)(c), since this company has financed an amount which is more than 51% of the book value of total assets of Anush Motors Ltd.

The transactions entered into by Anush Motors Ltd. with different companies are, therefore, to be adjusted accordingly to work out the income chargeable to tax for the A.Y. 2023-24.

Particulars		₹ (in crores)
Income of Anush Motors Ltd. as computed under Chapter IV-D, prior to adjustments as per Chapter X		300.00
<i>Add:</i>	Difference on account of adjustment in the value of international transactions:	
(i)	Difference in price of car @ \$ 200 each for 10,000 cars (\$ 200 x 10,000 x ₹ 63)	12.60
(ii)	Difference for excess payment of royalty of \$ 30,00,000 (\$ 30,00,000 x ₹ 63) [See Note below]	18.90
(iii)	Difference for excess interest paid on loan of EURO 1000 crores (₹ 84*1000*1/100)	840.00
<b>Total Income</b>		<b>1,171.50</b>

The difference for excess payment of royalty has been added back presuming that the manufacture of cars by Anush Motors Ltd is wholly dependent on the use of know-how owned by Kyoto Ltd.

**Note:** It is presumed that Anush Motors Ltd. has not entered into an Advance Pricing Agreement or opted to be subject to Safe Harbour Rules.

5. (a) The action of the Commissioner in issuing the second notice is not justified. The term “record” has been defined in clause (b) of *Explanation 1* to section 263(1). According to this definition “record” shall include and shall be deemed always to have included all records relating to any proceeding under the Act available at the time of examination by the Commissioner. In other words, the information, material, report etc. which were not in existence at the time the assessment was made and came into existence afterwards can be taken into consideration by the Commissioner for the purpose of invoking his jurisdiction under section 263(1). However, at

the same time, in view of the express provisions contained in clause (b) of the *Explanation 1* to section 263(1), such information, material, report etc. can be relied upon by the Commissioner only if the same forms part of record when the action under section 263 is taken by the Commissioner, Issuance of a notice under section 263 succeeds the examination of record by Commissioner. In the present case, the Commissioner initially issued a notice under section 263, after the examination of the record available before him. The subsequent second notice was on the basis of material collected under section 133A, which was totally unrelated and irrelevant to the issues sought to be revised in the first notice. Accordingly, the material on the basis of which the second notice was issued could not be said to be “record” available at the time of examination as emphasized in clause (b) of the *Explanation 1* to section 263(1).

- (b) The powers under section 131(1A) deal with power of discovery and production of evidence. They do not confer the power of seizure of cash or any asset. The Director General, for the purposes of making an enquiry or investigation relating to any income concealed or likely to be concealed by any person or class of persons within his jurisdiction, shall be competent to exercise powers conferred under section 131(1), which confine to discovery and inspection, enforcing attendance, compelling the production of books of account and other documents and issuing commissions. Thus, the power of seizure of unaccounted cash is not one of the powers conferred on the Director General under section 131(1A).

However, under section 132(1), the Director General has the power to authorize any Additional Director or Additional Commissioner or Joint Director or Joint Commissioner etc. to seize money found as a result of search [Clause (iii) of section 132(1)], if he has reason to believe that any person is in possession of any money which represents wholly or partly income which has not been disclosed [Clause (c) of section 132(1)]. Therefore, the proper course open to the Director General is to exercise his power under section 132(1) and authorize the Officers concerned to enter the premises where the cash is kept by Mr. Mogambo and seize such unaccounted cash.

(c) **Computation of tax liability of Ms. Rajni for the A.Y. 2023-24**

Particulars	₹	₹
<b>Income from house property</b>		
Gross annual value <sup>2</sup> [CMD 25000 x 69, being conversion rate as on 31.3.2023 – Rule 115]	17,25,000	
Less: Municipal taxes [CMD 200 x 69]	<u>13,800</u>	
	17,11,200	
Less: Deduction u/s 24@30%	<u>5,13,360</u>	
		11,97,840
<b>Profits and gains of business or profession</b>		
From concerts held in India	15,00,000	
From concerts held in Country M [CMD 10,120 x 69 (being conversion rate as on 31.3.2023 – Rule 115)]	<u>6,98,280</u>	
		21,98,280

<sup>2</sup> Rental income assumed to be gross annual value, in absence of information regarding standard rent, fair rent and municipal value.

<b>Income from Other Sources</b>		
Income from bank fixed deposits in her name	4,20,000	
Income from savings bank account	<u>15,000</u>	<u>4,35,000</u>
<b>Gross Total Income</b>		<b>38,31,120</b>
<b>Less: <u>Deduction under section 80C</u></b>		
Deposit in PPF	1,50,000	
Five year fixed deposit in the name of her son (does not qualify for deduction under section 80C)	-	
<b><u>Under section 80D</u></b>	50,000	
Medical insurance premium to insure her health and health of spouse (₹ 61,000, restricted to ₹ 50,000, being the maximum allowable for senior citizens)		
<b><u>Under section 80TTB :</u></b>		
Interest on bank FD and savings bank account restricted to	<u>50,000</u>	<u>2,50,000</u>
<b>Total Income</b>		<b><u>35,81,120</u></b>
<b><u>Tax on Total Income</u></b>		
Income-tax		8,84,336
Add: Health and Education Cess @4%		<u>35,373</u>
		9,19,709
Average rate of tax in India (i.e., ₹ 9,19,709/ ₹ 35,81,120 × 100)	25.682%	
Rate of tax in Country M	20%	
Doubly Taxed Income	18,96,120	
₹ 11,97,840 (income from house property) + ₹ 6,98,280 (income from concerts)		
Lower of Indian rate of tax and Rate of tax in Country M	20%	
<b><u>Deduction under section 91</u></b>		
20% of doubly taxed income of ₹ 18,96,120		<u>3,79,224</u>
<b>Net tax payable</b>		<b><u>5,40,485</u></b>
<b>Net tax payable (rounded off)</b>		<b>5,40,490</b>

6. (a) (i) There is no violation of section 269SS at the time of acceptance of the first deposit of ₹ 15,000 by bearer cheque on 1.5.2019, since it is not in excess of the threshold limit of ₹ 20,000. However, violation under section 269SS is attracted at the time of acceptance of the second deposit in cash on 30<sup>th</sup> June, 2022, since as on that date, there is already an outstanding deposit of ₹ 15,000 and another cash deposit of ₹ 15,000 would take the aggregate to ₹ 30,000, which exceeds the threshold limit of ₹ 20,000. Therefore, penalty under section 271D of a sum equal to the amount of deposit taken from Mr. A is attracted for failure to comply with the provisions of section 269SS.

- (ii) In this case, there is a violation of the provisions of section 269T at the time of first repayment by bearer cheque on 23<sup>rd</sup> March, 2023, since on that date, the aggregate amount of deposits held by Mr. A with the non-banking company (together with interest payable on such deposits) is more than ₹ 20,000. Therefore, penalty under section 271E equal to the amount of deposit so repaid will be attracted for failure to comply with the provisions of section 269T.

However, the second repayment of ₹ 15,500 on 25<sup>th</sup> March, 2023 in cash cannot be considered as a violation of section 269T, since neither the amount of deposit with interest thereon nor the aggregate amount of deposits held by Mr. A on that date together with interest exceeds the threshold limit of ₹ 20,000.

- (b) The following are certain principles enunciated by the Courts on the question as to whether it is the form or substance of a transaction, which will prevail in income-tax matters:
- (i) **Form of transaction is to be considered in case of genuine transactions** - It is well settled that when a transaction is arranged in one form known to law, it will attract tax liability whereas, if it is entered into in another form which is equally lawful, it may not. Therefore, in considering whether a transaction attracts tax or not, the form of the transaction put through is to be considered and not the substance. **However, this rule applies only to genuine transactions.** [*CIT v. Motor and General Stores (P) Ltd. v. CIT (1967) 66 ITR 692(SC)*]. Moreover, with General Anti Avoidance Rules coming into force with effect from A.Y.2017-18.
- (ii) **True legal relation is the crucial element for taxability** - It is open for the authorities to pierce the corporate veil and look behind the legal facade at the reality of the transaction. The taxing authority is entitled as well as bound to determine the true legal relation resulting from a transaction. The true legal relation arising from a transaction alone determines the taxability of a receipt arising from the transaction [*CIT v. B.M. Kharwar (1969) 72 ITR 603 (SC)*]
- (iii) **Substance (i.e. actual nature of expense) is relevant and not the form –**
- (a) In the case of an expenditure, the mere fact that the payment is made under an agreement does not preclude the department from enquiring into the actual nature of the payment [*Swadeshi Cotton Mills Co. Ltd. v. CIT (1967) 63 ITR 57(SC)*].
- (b) In order to determine whether a particular item of expenditure is of revenue or capital nature, the substance and not merely the form should be looked into. [*Assam Bengal Cement Co. Ltd. v. CIT (1955) 27 ITR 34 (SC)*].
- (c) A wide range of extrinsic material is permitted to be used in interpretation of tax treaties. According to Article 32 of the Vienna Convention, the supplementary means of interpretation include the preparatory work of the treaty and the circumstances of its conclusion.

According to Prof. Starke, one may resort to following extrinsic aids to interpret a tax treaty provided that clear words are not thereby contradicted:

- (i) Interpretative Protocols, Resolutions and Committee Reports, setting out agreed interpretations;
- (ii) A subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions [Art. 31(3) of the VCLT];
- (iii) Subsequent conduct of the state parties, as evidence of the intention of the parties and their conception of the treaty;
- (iv) Other treaties, in *pari materia* (i.e., relating to the same subject matter), in case of doubt.

### **Provisions in Parallel Tax Treaties**

If the language used in two tax treaties (say treaties: X and Y) are same and one treaty is more elaborative or clear in its meaning (say treaty X) can one rely on the interpretation/explanations provided in a treaty X while applying provisions of a treaty Y? Though the interpretation or explanations in treaty X would not be binding while interpreting the treaty Y, however, if the language is similar between the two treaties, one can make a reference to treaty X for understanding the intention of the Contracting parties.

The views of the Indian Judiciary are, however, not consistent in this respect. There are contradictory judgments by Indian courts/Tribunal in this regard.

### **International Articles/Essays/Reports**

Like in the direct tax cases, Courts many a times refer to the Commentaries of Kanga Palkhiwala and Sampath Iyengar for interpretation as they are considered authoritative source. Also under the International taxation, various authors like Phillip Baker and Klaus Vogel's commentary are considered as classic sources of interpretation for understanding the tax treaties. International Article/Essays/Reports are referred as extrinsic aid for interpretation of tax treaties. Like, in case of *CIT v. Vishakhapatnam Port Trust (1983) 144 ITR 146 (AP)*, the High Court obtained "useful material" through international articles.

### **Protocol**

Protocol is like a supplement to the treaty. In many treaties, in order to put certain matters beyond doubt, there is a protocol annexed at the end of the treaty, which clarifies borderline issues.

A protocol is an integral part of a tax treaty and has the same binding force as the main clauses therein.

Protocol to India France treaty contains the Most Favoured Nation(MFN) Clause. Thus, one must refer to protocol before arriving at any final conclusion in respect of any tax treaty provision .

### **Preamble**

Preamble to a tax treaty could guide in interpretation of a tax treaty. As mentioned above, in case of *Azadi Bachao Andolan*, the Apex Court observed that 'the preamble to the Indo-Mauritius Double Tax Avoidance Treaty recites that it is for the 'encouragement of mutual trade and investment' and this aspect of the matter cannot be lost sight of while interpreting the treaty'. These observations are very significant whereby the Apex Court has upheld 'economic considerations' as one of the objectives of a Tax Treaty. Further, now after the BEPS Action Plan 6 recommendation and Multi-lateral Instrument (MLI), the new text has been added to the Preamble to reflect that the treaties are not intended for creating opportunities for double-non taxation and treaty shopping arrangements. This will play a key-role in interpreting the treaties post MLI.

### **Mutual Agreement Procedure [MAP]**

MAP helps to interpret any ambiguous term/provision through bilateral negotiations. MAP is more authentic than other aids as officials of both countries are in possession of materials/documents exchanged at the time of signing the tax treaty which would clearly indicate the object or purpose of a particular provision. Successful MAPs also serve as precedence in case of subsequent applications.