CA FINAL (May 2026)

GROUP II – PAPER 4

DIRECT TAX LAWS & INTERNATIONAL TAXATION

SUGGESTED ANSWERS

(Series 3)

PART – I (MCQs)

MCQ – 2 marks each														
1.	**2.**	**3.**	**4.**	**5.**	**6.**	**7.**	**8.**	**9.**	**10.**	**11.**	**12.**	**13.**	**14.**	**15.**
D	D	D	B	D	C	A	B	A	C	D	A	D	D	B

PART – II (Descriptive Answers)

Answer 1

Implication on conversion of company into LLP

Transfer of capital asset or intangible asset by a private company or unlisted public company to a LLP or any transfer of share held by shareholder to LLP in a **conversion of private company into an LLP is not regarded as transfer** under section 47 provided the conditions specified therein are satisfied.

Accordingly, transfer of capital asset by Binu Ltd., Delhi to M/s Soumya LLP is not regarded as transfer since the conditions specified in section 47(xiiib) as stated in the question stand satisfied and fulfilled.

Computation of Total Income in the hands of M/s Soumya LLP

Particulars	Amount (₹)		
Profits and gains of business and profession			
Net profit as per the profit and loss account		25,40,000	
Add: Items debited but to be considered separately or to be disallowed			
(i) Salary to Binu, working partner (to be considered separately) [₹ 55,000 x 12]	6,60,000		
(ii) Salary paid to Mr. Ayushman, an employee [Under section 40A(3), disallowance is attracted in respect of expenditure for which cash payment exceeding ₹ 10,000 is made on a day to a person. Payment of ₹ 3,45,000 to Mr. Ayushman, an employee, is covered by exception under Rule 6DD since, TDS has been deducted, employee is temporarily posted in Mumbai and does not have a bank account in Mumbai. Since the same has been debited to profit and loss account, no adjustment	–		

is required]			
(iii) Penalty for non-fulfilment of delivery conditions of a contract for sale [Penalty for non-fulfilment of delivery conditions of a contract for sale is not on account of infraction of law. Penalty for breach of contract is business or commercial loss and would be allowable expenditure under section 37. Since the same has been debited to profit and loss account, no adjustment is required]	–		
(iv) Provision for wages payable to workers [The provision is based on fair estimate of wages and reasonable certainty of revision, and thus is allowable as deduction, as ICDS-X requires 'reasonable certainty for recognition of a provision, which is present in this case. As the provision has been debited to profit and loss account, no adjustment is required while computing business income]	–		
(v) Depreciation as per books of account	5,40,000		
(vi) Provision for gratuity [Provision of ₹ 6,50,000 for gratuity based on actuarial valuation is not allowable as deduction as per section 40A(7). However, actual gratuity of ₹ 4,00,000 paid is allowable as deduction. Hence, the difference is to be added back being of ₹ 2,50,000 (₹ 6,50,000 – ₹ 4,00,000)]	2,50,000		
(viii) Repair to plant and machinery given on lease [Lease rent from factory building along with plant and machinery and furniture is chargeable to tax under the head income from other sources, since the main business of the M/s Soumya LLP is manufacturing of metro rail seats and not letting out the properties. Therefore, repairs to such plant and machinery to be deducted from lease income taxable under the head "Income from Other Sources. Since the same has been debited to profit and loss account, it has to be added back]	59,000		
(ix) Factory licence fee paid [Factory licence fee in respect of leased out factory building is to be deducted from lease income taxable under the head "Income from Other Sources". Since the same has been debited to profit and loss account, it has to be added back]	15,000		
(x) Legal fee to advocate for drafting and registering lease agreement [Legal fee to advocate for drafting and registering lease agreement to be deducted from lease income taxable under the head "Income from Other Sources". Since the same has been debited to profit and loss, it has to be added back]	26,000		
***Add:* Amount taxable but not credited to profit and loss account**			
AI(4) Profit on sale of import entitlements [Profit on sale of import entitlements is chargeable to tax under the head "Profits and gains from business and profession" under section 28. Since the same has not been credited to profit and loss account, it has to be added]	1,50,000	17,00,000	

		42,40,000	
***Less:* Items credited to profit and loss account, but not includible in business income / permissible expenditure and allowances**			
(i) Profit on sale of shares of M/s Toyo Ltd. [Taxable under the head "Capital Gains". Since the same has been credited to profit and loss account, it has to be reduced from business income]	1,27,500		
AI(a)Voluntary Retirement Scheme expenditure [₹ 20 lakh/5] [One fifth deduction is available in respect of payment for voluntary retirement scheme for five years. Where a private company or unlisted company is succeeded by a LLP fulfilling the conditions laid down in section 47(xiiib), then, deduction in respect of voluntary retirement scheme is available to the LLP for the balance years from the year of succession. Hence, deduction of ₹ 4,00,000 is allowable in P.Y. 2025-26 to M/s Soumya LLP being for 3rd year]	4,00,000		
AI(1) Interest paid during the year [Conversion of unpaid interest into loan shall not be construed as payment of interest for the purpose of section 43B. The amount of unpaid interest converted into a new loan will be allowable as deduction only in the year in which such converted loan is actually paid. Since ₹ 3 lakhs has been paid in the P.Y. 2025-26, the same is allowable as deduction]	3,00,000		
AI(2) Depreciation on motor car exclusively used for business purpose [Depreciation on motor car bought and used exclusively for the purposes of business is allowable though not registered in the name of the firm.]	15,000		
AI(3) Depreciation as per Income-tax Rules [₹ 8,10,000 – ₹ 90,000] [Depreciation on leased out asset to be deducted from lease income taxable under the head "Income from Other Sources. Since the same has been included in depreciation of ₹ 8,10,000, it has to be reduced from it]	7,20,000	15,62,500	
Book Profit		26,77,500	
***Less:* Remuneration to Mr. Binu, a working partner [Subject to limit specified in section 40(b)** [On first ₹ 6,00,000 of book profit, 90% of book profit or ₹ 3,00,000, whichever is higher and on the balance of book profit, 60% of balance book profit] [₹ 17,86,500 (5,40,000, being 90% of ₹ 6,00,000 + ₹12,46,500, being 60% of ₹ 20,77,500) restricted to actual remuneration paid to Binu.		6,60,000	
Profits and gains from business and profession			**20,17,500**

Capital Gains			
Sale consideration [150 x ₹ 2,750 per share]		4,12,500	
Less: Cost of acquisition [150 x ₹ 2,500 per share] [Indexation benefit would not be available] [Higher of (i) ₹ 1,900, actual cost, being the cost of acquisition to Binu Ltd. as per section 49] (ii) ₹ 2,500, being the lower of - Fair market value as on 31.1.2018 [₹ 2,500 per share] - Full value of consideration [₹ 2,750 per share]		3,75,000	
Long term Capital gains since shares held for more than 12 months [Period of holding of Binu Ltd. is also included]			**37,500**
Income from Other Sources			
Lease rent [₹ 50,000 x 12]		6,00,000	
Less: Deduction under section 57			
Repair of leased out plant and machinery		59,000	
Factory licence fee in respect of leased out factory building		15,000	
Legal fee for drafting and registering lease agreement		26,000	
Depreciation of assets given on lease		90,000	
			4,10,000
Gross Total Income/ Total Income			**24,65,000**

Answer 2A

Computation of total income of Siddarth Ltd. for A.Y. 2026-27

Particulars	₹	₹
Profits and gains of business or profession		
Unit X (See Note 4)	63,81,000	
Less: Deduction under section 10AA (See Working below)	17,72,500	46,08,500
Unit Y (See Note 4)		36,54,000
Total Income		**82,62,500**

Deduction under section 10AA in respect of Unit X (See Notes 1, 2 & 3)

$$= \text{Profit of Unit in SEZ (Unit X)} \times \frac{\text{Export turnover of Unit in SEZ}}{\text{Total turnover of Unit in SEZ}} \times 50\%$$

$$= ₹\ 63,81,000 \times \frac{₹\ 1,00,00,000}{₹\ 1,80,00,000} \times 50\% = \textbf{₹ 17,72,500}$$

Notes:

(1) Deduction under section 10AA is available in respect of units established in Special Economic Zones which begin to manufacture or produce articles or things or provide any services during the previous year relevant to A.Y.2006-07 or thereafter. Under section 10AA(1), 100% of the profits and gains derived from export of such articles or things or from services is allowable as deduction for a period of five consecutive assessment years beginning with the assessment year

relevant to the previous year in which the Unit begins to manufacture or produce such articles or things or provide services, as the case may be.

Therefore, in this case, the profits from Unit X, located in a SEZ, will be eligible for deduction of 50% of the profits and gains derived from export, since P.Y.2025-26 is the sixth year of its operations. It is assumed that Unit X has fulfilled all the specified conditions for claim of deduction. Unit Y is, however, not eligible for deduction under section 10AA in respect of the exports made by it since it is located in a Free Trade Zone.

(2) Export turnover, for the purpose of section 10AA, means the consideration received in respect of export by the unit in SEZ. Therefore, in this case, the amount of ₹ 20,00,000 which has become irrecoverable due to bankruptcy of one of the foreign buyers in Unit X will not be included in its export turnover.

Therefore, export turnover of Unit X (in SEZ) = ₹ 1,20,00,000 – ₹ 20,00,000 = ₹ 1,00,00,000.

(3) Profits and gains from on site development of computer software outside India shall be deemed to be the profits and gains derived from export of computer software outside India. Since the same has already been included in the figure of export sales, no further adjustment is required.

(4) Computation of unit-wise profits of the business

Particulars	**Unit X**	**Unit Y**	**Total**
	(₹)	**(₹)**	**(₹)**
Profit earned [after claim of bad debts under section 36(1)(vii) in Unit X]	63,00,000	36,00,000	99,00,000
Add: Depreciation calculated on SLM basis and charged in the proportion of sales (3:2)	5,40,000	3,60,000	9,00,000
	68,40,000	39,60,000	1,08,00,000
Less: Depreciation calculated @15% on WDV basis and charged in the proportion of sales (3:2) **(See Note 5)**	4,59,000	3,06,000	7,65,000
Profits of the business	**63,81,000**	**36,54,000**	**1,00,35,000**

(5) Depreciation as per the Income-tax Rules, 1962 for A.Y.2026-27 has to be calculated as follows:

Particulars	**₹**
Actual cost of plant and machinery (₹ 9,00,000 / 15%)	60,00,000
Less: Depreciation @15% for P.Y.2024-25 (It is logical to assume that the assets were put to use for more than 180 days during the year.)	9,00,000
Written down value as on 1.4.2025	51,00,000
Depreciation @15% on WDV for P.Y.2025-26 (₹ 51,00,000 × 15%)	**7,65,000**

Answer 2B

(i) If a **Liaison Office** is maintained solely for the purpose of carrying out activities which are **preparatory or auxiliary** in character, and such activities are approved by the Reserve Bank of India, then, **no business connection** is established.

In this case, had the liaison office's activities been restricted to forwarding of trade inquiries to ABC Ltd., a Dubai based company, its activities would not have constituted business connection. However, the activities of the liaison office extends to also **negotiating and entering into**

contracts on behalf of ABC Ltd. with the customers in India, on account of which **business connection is established.**

(ii) As per the opening sentence in Explanation 2, to section 9(1)(i) "business connection" shall include any business activity carried out through a person in India acting on behalf of the non-resident. Accordingly, in this case, since the **branch office is carrying out a business activity** by purchasing raw materials in India for XYZ Inc. and selling finished product manufactured by XYZ Inc. to customers in India and providing sales related services to them on behalf of XYZ Inc., **business connection is established.**

It may be noted that as per clause (a) of Explanation 2, in the case of a non-resident, no business connection would be established if the activities of the person acting on behalf of the non-resident were limited to the purchase of goods or merchandise for the non-resident.

In the present case, however, business connection would be established, since the branch set up at Hyderabad by XYZ Inc. is not solely engaged in purchase of raw materials for XYZ Inc. for manufacturing its products but is also engaged in selling such manufactured products to customers in India and providing sales related services to them on behalf of XYZ Inc.

(iii) 'Business connection' shall include any business activity carried out through a person acting on behalf of the non-resident. For a business connection to be established, the person acting on behalf of the non-resident –

a. must have an authority which is habitually exercised in India to **conclude contracts** on behalf of the non-resident or;

b. in a case where he has no such authority, but habitually **maintains in India a stock** of goods or merchandise from which he regularly delivers goods or merchandise on behalf of the non-resident, or

c. habitually **secures orders in India**, mainly or wholly for the non-resident.

In the present case, business connection would not be established, since Mr. Rajesh does not have the authority to accept or conclude orders in India on behalf of PQR Inc. Moreover, all the orders were directly received, accepted and after receipt of the price/value, the delivery of goods was also given by PQR Inc. outside India. Hence, **no business connection is established in this case.**

Answer 3A

Computation of total income of Trust

Particulars	₹ in crores	₹ in crores
Gross receipts from students towards admission fees, tuition fees, development fees etc.		145.000
Dividend received on units of mutual funds		12.000
Government Grant		9.500
Corpus Donations [does not form part of total income]		Nil
Normal Donations other than anonymous donations of ₹ 2.5 crores		9.000
		175.500
Add: Anonymous donations [to the extent not chargeable to tax @30% under section 115BBC(1)(i)] [See Note 1 & 2]		1.000
		176.500
Less: 15% of income eligible for being set apart without any condition		26.475

		150.025
Less: Amount applied for charitable purposes		
- **On revenue account** – Administrative expenses:	87.75	
For schools (Out of ₹ 92.25 crores, ₹ 4.5 crores, being 30% of ₹ 15 crores, would be disallowed, since tax is not deducted u/s 192 & 194C on such amount paid to resident doctors & contractors)		
- **On capital account** – Purchase of computer and laboratory equipment	18.50	
- Corpus Donation to a trust registered under section 10(23C) out of current year income is not permissible.	-	
- Repayment of loan taken earlier for construction of school building	10.00	116.25
Less: Excess of expenditure over income in the P.Y. 2024-25 not allowable as application for the current previous year		Nil
Total income [other than anonymous donation and deemed income taxable@30% u/s 115BBC and 115BBI]		**33.775**
Add: Anonymous donation taxable @30% u/s 115BBC [**See Note 1]**		1.500
Add: ₹ 13 crores remaining unutilized out of accumulated income would be deemed as income of the current previous year and taxable @30% u/s 115BBI [i.e., ₹ 35 crores, being the amount set apart for acquiring and developing a plot of land for construction of a new school for a period of 2 years less ₹ 22 crores utilised on acquisition of land]		13.000
Total Income of the trust		**48.275**

Notes:

(1) As per section 115BBC(1)(i), the anonymous donations in excess of the higher of the following would be subject to tax@30%;

- ₹ 1 crore, being 5% of the total donations received i.e., 5% of ₹ 20 crore [Corpus donations ₹ 8.5 crore (+) Normal donations ₹ 9 crore (+) Anonymous donations ₹ 2.5 crore]; or
- ₹ 1 lakh

Therefore, anonymous donations of ₹ 1.5 crores (₹ 2.5 crores – ₹ 1.0 crore) would be subject to tax@30% under section 115BBC(1)(i).

Such anonymous donations which are subject to tax@30% are not eligible for the benefit of exclusion from total income under sections 11 and 12

Answer 3B

Computation of total income of Mr. S

Particulars	₹	₹
Income from House Property in India		
Gross Annual Value [Rent received is taken as GAV] [₹ 30,000 p.m. x 12 months]	3,60,000	
Less: Municipal taxes	-	
Net Annual Value (NAV)	3,60,000	
Less: Deduction u/s 24 @30%	1,08,000	

Profits and Gains of Business or Profession		2,52,000
Income from music performances in India	5,00,000	
Income from Country A	5,00,000	
Income from Country B [Income earned during July 2025 and January 2026 is taxable in India in P.Y. 2025-26]	4,00,000	14,00,000
Gross Total Income		**16,52,000**
Less: Deduction under Chapter VIA		
Under section 80C – Contribution to PPF		1,50,000
Total Income		**15,02,000**

Computation of tax liability of Mr. S		
Particulars		**₹**
Tax on total income [₹1,50,600 (i.e., 30% of ₹ 5,02,000) plus ₹ 1,12,500 (Tax on income of ₹ 10 lakh)]		2,63,100
Add: Health and education cess @4%		10,524
Tax Liability		2,73,624
Average rate of tax in India [i.e., ₹ 2,73,624/₹ 15,02,000 x 100]	18.217%	
Foreign Tax credit		
For Country A (with which India does not have a DTAA)		
Doubly taxed income	5,00,000	
Deduction under section 91 on ₹ 5,00,000 @18.217% [being the lower of Indian rate of tax (18.217%) and Country A tax rate (20%)]		91,085
For Country B (with which India has a DTAA)		
Doubly taxed income [Credit shall be allowed for foreign tax paid by Mr. S in Country B in respect of income which is chargeable to tax in India in P.Y. 2025-26 i.e., for income of ₹ 4,00,000]	4,00,000	
Deduction under section 90:		
Lower of:		
Tax Payable under the Income-tax Act, 1961 i.e., ₹ 72,868, being 18.217% of ₹4,00,000; and		
Tax paid in Country B i.e., ₹ 40,000, being 10% of ₹ 4,00,000		40,000
Tax Payable		**1,42,539**
Tax Payable (Rounded off)		1,42,540

Answer 4A

(i) **In respect of tips** collected by the company from the guests and distributed to the employees, the **person responsible for paying the employee was not the employer at all, but a third person, namely the guest.**

The **payments of collected tips** included and paid by way of a credit cards, UPI or Net Banking in the bills by guest, **would not be payments made "by or on behalf of" an employer.**

The contract of employment not being the proximate cause for the receipt of tips by the employee from a guest, such payments would be outside the scope of sections 15 and 17.

There is **no employer-employee relationship between customers and employees** of Raj

Keshri Hotels and Resorts Ltd. and therefore such payments do not fall in the nature of salary.

On account of such tips being received from guests and not from employer, **section 192 would not get attracted at all in hands of Raj Keshri Hotels and Resorts Ltd.** Thus, the **company is not responsible for deducting tax at source** from disbursement of tips to its employees.

(ii) **Lalit is required to deduct TDS under section 194C** for contract payments and under section 194-I for rent paid for office premises during the previous year 2025-26 **since Lalit's turnover** for the previous year 2024-25 **exceeded ₹ 1 crore.**

Thus, tax deduction under section 194C would be ₹ 5,000, being 1% of ₹ 5 lakhs.

Mr. Lalit is also required to deduct tax at source @10% u/s 194-I on the rent paid for office premises and for furniture, fixtures and vacant land appurtenant to office to Mr. Hemant, since aggregate of rent per month i.e., ₹ 52,000 (₹ 46,000 + ₹ 6,000) paid exceeds the threshold limit of ₹ 50,000 per month.

The tax deduction under section 194-I would be ₹ 62,400, being ₹ 52,000 x 10% x 12.

(iii) As per section 194-O, **ABC Limited, an e-commerce operator is required to deduct tax at source @0.1% on ₹ 4,90,000, being the gross amount of sale** of products 'R' of XY and Co., a partnership firm, an e-commerce participant, since such sale of goods is facilitated by ABC Limited through its digital facility.

The gross amount of sales is ₹ 4,90,000 of which ₹ 4,30,000 was paid to e-commerce operator and balance of ₹ 60,000 is directly paid to the XY and Co. by one of the buyers (Mr. Rai).

ABC Ltd. is required to deduct tax@0.1% on the entire amount of ₹ 4,90,000. **Thus, ABC Ltd. is required to deduct tax of ₹ 490, being 0.1% of ₹ 4,90,000.**

Answer 4B

(1) BlueOrbit Systems Inc. held 30% voting power in TechMitra Solutions Ltd. which is not less than 26% of the voting power in BlueOrbit Systems Inc. Hence, **BlueOrbit Systems Inc. and TechMitra Solutions Ltd. are deemed to be associated enterprises**. Therefore, provision of system support services by TechMitra Solutions Ltd., an Indian company, to BlueOrbit Systems Inc., a foreign company, is an international transaction between associated enterprises, and consequently, the **provisions of transfer pricing are attracted** in this case.

System support services falls within the definition of **"software development services"**, and hence, is an **eligible international transaction**. Since, TechMitra Solutions Ltd. is providing software development services to a non-resident associated enterprise and has exercised a valid option for safe harbour rules, it is an eligible assessee.

Since the **value** of international transactions entered **does not exceed ₹ 100 crore**, TechMitra Solutions Ltd. **should have declared an operating profit margin of not less than 17%** in relation to operating expense, to be covered within the safe harbour rules. However**, since TechMitra Solutions Ltd. has declared an operating profit margin of only 16% (i.e. 8/50 x 100),** the same is not in accordance with the circumstance mentioned in Rule 10TD. Hence, it is **not binding on the income-tax authorities to accept the transfer price declared by TechMitra Solutions Ltd.**

(2) Since **NeuroCore Technologies Inc.**, is a foreign subsidiary of **NextEra Systems India Ltd.**, an Indian company, both **are associated enterprises**. Data processing services with the use of information technology falls within the definition of **"information technology enabled services"**, and is hence, an **eligible international transaction**. Since NextEra Systems India Ltd. is providing data processing services to a non-resident associated enterprise and has exercised a

valid option for safe harbour rules, it is an eligible assessee.

Since the aggregate **value** of transactions entered **exceeds ₹ 100 crore but does not exceed ₹ 300 crore,** NextEra Systems India Ltd. **should have declared an operating profit margin of not less than 18%** in relation to operating expense, to be covered within the scope of safe harbour rules. In this case, **since NextEra Systems India Ltd. has declared an operating profit margin of 20% (i.e. 45/225 x 100),** the same is in accordance with the circumstance mentioned in Rule 10TD. Hence, the **income-tax authorities shall accept the transfer price declared by NextEra Systems India Ltd.** in respect of such international transaction.

(3) Stratosphere Innovations., a foreign firm holds 12% interest in Pragati & Co., an Indian firm. Therefore, condition of one enterprise, being a foreign firm, holding not less than 10% interest in another enterprise, being an Indian firm, is satisfied. Hence, **Stratosphere Innovations. and Pragati & Co. are deemed to be associated enterprises.** Therefore, provision of contract R & D services relating to development of internet technology by Pragati & Co., an Indian firm, to Stratosphere Innovations, a foreign firm, is an international transaction between associated enterprises, and consequently, the **provisions of transfer pricing are attracted** in this case.

Development of internet technology falls within the meaning of **"contract R&D services wholly or partly relating to software development"**, and hence, is an **eligible international transaction**. Since Pragati & Co., an Indian firm is providing contract R & D services to a non-resident associated enterprise and has exercised a valid option for safe harbour rules, it is an eligible assessee.

Since the **value** of the international transaction **does not exceed ₹ 300 crore**, Pragati & Co. **should have declared an operating profit margin of not less than 24%** in relation to operating expense, to be covered within the safe harbour rules. However, **since Pragati & Co. has declared an operating profit margin of only 20% (50/250 x 100),** the same is not in accordance with the circumstance mentioned in Rule 10TD. Hence, it is **not binding on the income-tax authorities to accept the transfer price declared by Pragati & Co.**

The **safe harbour rules shall not apply in respect of eligible international transactions entered into with an associated enterprise located in a notified jurisdictional area**. Therefore, if in any of the cases mentioned above, the foreign entity is located in a NJA, the safe harbour rules shall **not be applicable, irrespective of the operating profit margin declared by the assessee**.

Answer 5A

(i) Taxability of interest from deposits made out of borrowed funds:

Issue involved:

The issue under consideration is whether the interest income of ₹ 2 lakhs on short-term fixed deposits made out of the unspent amount of term loan disbursed to BSL Ltd., would be a capital receipt not chargeable to tax or a revenue receipt chargeable to tax.

Provisions applicable:

Interest which is chargeable to tax under the Income-tax Act, 1961 would be assessable under the **head "Income from Other Sources",**

(i) if such income is **not exempt**, and

(ii) is **not chargeable to tax under any other head** including "Profits and gains of business or profession.

Analysis of the issue:

Interest earned by the assessee is clearly its income and unless it can be shown that there is exemption under any provision of the Act, like section 10, such income will be taxable.

The fact that the source of income was borrowed money does not detract anything from the revenue character of the receipt.

The interest payable on funds borrowed for the business prior to commencement of such business can be capitalized. However, such interest payable cannot be adjusted against interest received on investment of surplus funds assessable under section 56 under the head "Income from Other Sources".

In this case, since the assessee had deposited the amount of surplus funds available with it prior to commencement of business with the bank solely for the purpose of earning interest, **such interest, in the absence of specific exemption in respect thereof, is chargeable to tax under the head "Income from Other Sources".**

Conclusion:

Accordingly, the **action of the AO is legally valid/ justified.**

(ii) Issue involved:

The issue under consideration in this case is whether the AO is justified in rejecting the claim for exemption u/s 10(23C), on the ground that the assessee-institution does not exist solely for educational purposes.

Provisions applicable:

Section 10(23C)(iiiad) postulates three requirements, namely,

(i) the education institution **must exist solely for educational** purposes;

(ii) it should **not be for purposes of profit**; and

(iii) the **aggregate annual receipts of such institution should not exceed the amount** as may be prescribed.

Analysis of the issue:

The following tests would apply for determining whether an educational institution exists solely for education purposes and not for purposes of profit:

(i) Where an educational institution carries on the activity of education primarily for educating persons, the fact that it makes a surplus does not lead to the conclusion that it ceases to exist solely for educational purposes and becomes an institution for the purpose of making profit;

(ii) The predominant object test must be applied - the purpose of education should not be submerged by a profit making motive;

(iii) A distinction must be drawn between the making of surplus and an institution being carried on "for profit". Merely because imparting of education results in making a profit, it cannot be inferred that it becomes an activity for profit;

(iv) If after meeting expenditure, surplus arises incidentally from the activity carried on by the educational institution, it will not cease to be one existing solely for educational purposes.

The ultimate test is whether on an overall view of the matter in the concerned assessment year, the object is to make profit as opposed to educating persons.

Conclusion:

Therefore, the **action of the Assessing Officer**, rejecting the claim for exemption u/s 10(23C) **not valid.**

Answer 5B

In order **to complete tax cases,** a country **may require certain information** which may be available **with the treaty partner.**

Article 26 provides for the information which may be exchanged and the manner in which such a request has to be made.

The OECD and UN Model Conventions are similar with respect to this Article.

Importance of Article 26

- **facilitates effective exchange** of information between Contracting States.
- **curtails** cross-border **tax evasion and avoidance**.
- **curtails the capital flight** that is often accomplished through tax evasion & avoidance. This is particularly relevant in the perspective of developing countries.

Answer 6A

In clause 34(a) of Form 3CD, the tax auditor is required to **report whether the assessee is required to deduct or collect tax** as per the provisions of Chapter XVII-B or Chapter XVII-BB, and if yes, to furnish the details mentioned thereunder. While answering the issue of applicability of the provisions of Chapter XVII-B and/or XVII-BB, a number of debatable issues may arise before the assessee as well as the tax auditor. The tax auditor may have a difference of opinion with regard to the applicability of the provisions of TDS/TCS on a particular payment. In such a case, the tax auditor has to **report the difference of opinion** appropriately as an observation in para 3 of Form 3CA. This requirement is contained in the Guidance Note on Tax Audit.

Also, in clause 21(b)(ii) of Form 3CD, the **amount inadmissible under section 40(a)(ia) has to be mentioned**.

In case the tax auditor does not comply with the reporting requirements under these clauses and fails to mention the difference of opinion appropriately as an observation in para 3 of Form 3CA, **clause (7) of Part I of the Second Schedule to the Chartered Accountants Act, 1949 for not exercising due diligence may be invoked**.

Answer 6B

GAAR may, prima facie, apply, when the following twin conditions are satisfied:

- Main purpose of the arrangement being tax benefit, and
- Existence of tainted benefit.

As per the tax treaty between India and Country "A", there is no tax on capital gains either in the Source country or in Country "A". Consequently, the capital gains arising to Y Ltd is not taxable in India.

The arrangement of routing investment through Country "A" would result in a tax benefit. Since there is no business purpose in incorporating a company Y Ltd (100% subsidiary of YAN Ltd) in Country "A", it can be said that the **main purpose of the arrangement is to obtain a tax benefit.**

On the question of whether the arrangement has any tainted element, it is evident that there **is no commercial substance** in incorporating Y Ltd as it **does not have any effect on the business risk of YAN Ltd or cash flow of YAN Ltd.**

Additionally, the fact that all rights of shareholders of Y Ltd (designated as Permitted Transferee) are

being exercised by YAN Ltd instead of Y Ltd, indicates that Y Ltd lacks commercial substance.

As the twin conditions of main purpose being tax benefit and existence of a tainted element are satisfied, **GAAR may be invoked in this case.**

Answer 6C

The statement is correct.

Under section 245U, the Board 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 BAR 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 and examining him on oath;

(3) **compelling the production of books** of account and other documents; and

(4) **issuing commissions.**

Therefore, Board for Advance Ruling has the powers of compelling production of books of account.