CLAT PG Tax Law

Sample Paper – 2

Duration: 15 Minutes **Maximum Marks: 15**

Instructions

- This paper contains **15** Multiple Choice Questions (Single Correct Answer), modelled on the Tax Law portion of **CLAT PG** entrance.
- Each correct answer carries **+1 mark**. There is **a penalty of 0.25 marks** for each incorrect answer. Unattempted questions carry no penalty.
- Only **one** option is correct. Choose carefully.
- Syllabus: Income Tax Act 1961, CGST Act 2017, Customs Act 1962, and constitutional provisions (Articles 265–289) at LLM entrance level.
- Use of mobile phones, calculators, or electronic gadgets is strictly prohibited.

Questions Tax Law — 15 Questions

Q1. The Finance Commission was considering the devolution of taxes levied and collected by the Union under Article 270 of the Constitution. A member argued that the proceeds of the Integrated Goods and Services Tax (IGST) must be divided between the Union and the States in the proportion prescribed by Article 270(1). Which of the following statements correctly states the constitutional position after the 101st Constitutional Amendment?

(A) IGST proceeds are distributed exclusively to the States in proportion to their respective contributions to inter-State trade.

(B) IGST is expressly excluded from the distributable pool under Article 270 by virtue of Article 270(1A), and its apportionment is governed by Parliament by law.

(C) IGST proceeds form part of the Consolidated Fund of India and are distributed in the ratio recommended by the Finance Commission under Article 270(1).

(D) The 101st Amendment has no bearing on Article 270, and IGST is treated identically to Union income tax for devolution purposes.

Q2. Sunrise Exports Ltd., incorporated in State X, contracted to sell machinery to a buyer in State Y. The goods were loaded on a carrier at a port within State X under a bill of lading naming State Y as the destination, and the sale was completed while the goods were in transit. State X sought to levy sales tax on the transaction. State Y also sought to levy purchase tax. Applying Article 286 of the Constitution, which of the following propositions is *correct*?

(A) Both State X and State Y may levy tax because the contract was formed in State X and delivery occurred in State Y.

(B) Only State X may levy tax as the goods originated within its territory; Article 286 bars only the destination State.

(C) Both States are barred by Article 286(2), which prohibits taxation of any inter-State transaction by either State.

(D) Neither State X nor State Y may impose the tax unilaterally; Article 286(1) bars the State where the sale "outside the State" takes place, and Article 286(2) bars taxation of sales "in the course of inter-State trade" except by parliamentary authority.

Q3. Vikram commenced a new business on 1st January 2025. His accountant advised that his first "previous year" for Income Tax purposes would begin on 1st January 2025 and end on 31st March 2025, and that his income earned during this period would be charged to tax in the assessment year 2025–26. Which of the following statements correctly reflects the law under Sections 2(9) and 3 of the Income Tax Act, 1961?

(A) The accountant is correct. The first previous year for a newly set-up business runs from the date of commencement of business to the immediately following 31st March, and the tax is charged in the immediately following assessment year (2025–26).

(B) The first previous year always runs from 1st April to 31st March irrespective of when the business is set up; Vikram's previous year is therefore 2024–25.

(C) The previous year and the assessment year are the same financial year; Vikram's income for January–March 2025 is taxed in 2024–25.

(D) The concept of "previous year" applies only to salaried employees; business income is taxed on a calendar year basis.

Q4. GlobalTech Plc is incorporated in the United Kingdom. During the financial year 2024–25, its Board of Directors held all formal meetings in London. However, the company's key management decisions — including approval of annual budgets, major contracts, and appointment of senior executives — were taken by a committee of directors located in Mumbai, and the company's records and accounts were maintained there. For the purposes of Section 6(3) of the Income Tax Act, 1961, GlobalTech Plc is:

(A) A non-resident company, because it is incorporated outside India and its Board meetings are held in London.

(B) A resident company, because more than half the directors are citizens of the United Kingdom and British law governs corporate governance.

(C) A resident company, because its Place of Effective Management (POEM) is in India — the location where key management and commercial decisions that are necessary for the conduct of its business as a whole are made.

(D) A non-resident company, because the POEM test applies only to Indian-incorporated companies seeking to claim non-resident status.

Q5. Meera retired from ABC Ltd. on 31st October 2024 after 20 years of service. Her former employer credited arrears of salary for the period April–October 2024 into her bank account on 15th May 2025. She also received a joining bonus of Rs. 2 lakh from her new employer XYZ Ltd. in April

2024, though the employment commenced only on 1st November 2024. Under Section 15 of the Income Tax Act, 1961, in which previous year(s) are these two receipts chargeable?

(A) Both receipts are taxable in the previous year in which they are actually received, i.e., 2024–25 for the joining bonus and 2025–26 for the arrears.

(B) The arrears of salary from ABC Ltd. are taxable in 2025–26 (the year of actual receipt, as they were not due in an earlier year when she was entitled to receive them on a "due" basis); the joining bonus from XYZ Ltd. is taxable in 2024–25, being the year of receipt and also the year it fell due.

(C) Both receipts are taxable in the previous year 2024–25 because both relate to employment contracts executed before 31st March 2025.

(D) Only the joining bonus is taxable as salary; arrears from a former employer are exempt under Section 10.

Q6. Preethi purchased a residential house for Rs. 20 lakh in April 2001. She sold it in December 2024 for Rs. 1.5 crore. The Cost Inflation Index (CII) for 2001–02 was 100 and for 2024–25 is 363. She paid brokerage of Rs. 1.5 lakh on sale. Under Section 48 of the Income Tax Act, 1961, which of the following correctly identifies the components used to compute her Long Term Capital Gains?

(A) Full value of consideration minus cost of acquisition; indexation benefit is not available on residential property after the 2024 amendment.

(B) Full value of consideration minus cost of acquisition minus brokerage; no indexation is available as the property was held for less than 36 months.

(C) Full value of consideration minus indexed cost of acquisition only; expenditure on transfer such as brokerage is not deductible under Section 48.

(D) Full value of consideration minus expenditure incurred wholly in connection with transfer (brokerage) minus indexed cost of acquisition; indexed cost = cost of acquisition × (CII of year of sale ÷ CII of year of acquisition).

Q7. Rahul, an individual, received the following during the previous year 2024–25: (i) Rs. 75,000 in cash as a gift from his friend Suresh on the occasion of Rahul's wedding anniversary; (ii) a laptop worth Rs. 60,000 received from his maternal uncle (mother's brother). Under Section 56(2)(x) of the Income Tax Act, 1961, how are these receipts treated?

(A) The cash gift from Suresh is taxable because a friend is not a "relative" within the meaning of the proviso to Section 56(2)(x), and the aggregate sum received from non-relatives exceeds Rs. 50,000. The laptop from the maternal uncle is exempt because he qualifies as a "relative" (brother of mother, i.e., lineal ascendant's sibling listed under the definition).

(B) Both receipts are fully exempt because gifts received on occasions such as anniversaries and from family members are outside the ambit of Section 56(2)(x).

(C) Both receipts are taxable in full under Section 56(2)(x) because the aggregate value received from all sources exceeds Rs. 50,000 in the year.

(D) The cash gift is exempt as it falls below Rs. 1 lakh, while the laptop is taxable as it is a movable property received without consideration.

Q8. Anand (aged 42) paid Rs. 22,000 as medical insurance premium for himself and his spouse, and Rs. 60,000 as premium for a mediclaim policy covering his father (aged 68, not dependent on Anand) during the previous year 2024–25. He also incurred Rs. 4,000 on preventive health check-up for himself. What is the maximum deduction Anand can claim under Section 80D of the Income Tax Act, 1961?

(A) Rs. 25,000 (capped at the limit for self and family only; parents' premium is not deductible unless they are dependants).

(B) Rs. 82,000 (actual expenditure: Rs. 22,000 + Rs. 60,000, subject to overall cap of Rs. 1 lakh).

(C) Rs. 75,000 (Rs. 25,000 for self/spouse, subject to the Rs. 25,000 cap including the preventive check-up within that limit, plus Rs. 50,000 for a senior citizen parent, capped at Rs. 50,000).

(D) Rs. 86,000 (Rs. 26,000 for self and Rs. 60,000 for parents, because preventive health check-up enjoys a separate limit of Rs. 5,000 over and above the main cap).

Q9. Kalpana Constructions Ltd. entered into a building construction contract where it agreed to transfer a flat to the buyer before the issuance of a completion certificate. Simultaneously, Kalpana leased certain immovable agricultural land to a farmer for agricultural purposes for a period of five years. The company's CFO sought advice on the GST treatment of both transactions under Section 7 read with Schedule II of the CGST Act, 2017. Which of the following correctly classifies the two transactions?

(A) Both transactions are supply of goods because they involve transfer of immovable property.

(B) The construction and sale of the flat before completion certificate is a supply of service under Schedule II Entry 5(b); the lease of agricultural land is an exempt supply (nil rated / exempted by notification) and therefore a supply of service that does not attract GST.

(C) Construction activity is exempt from GST under Schedule III as it pertains to immovable property; the lease of agricultural land attracts 18% GST.

(D) Both transactions fall outside the definition of "supply" under Section 7 because they involve immovable property, which is covered by stamp duty legislation.

Q10. Meridian Hotels Ltd., a registered person under the CGST Act, 2017, incurred the following expenses and paid GST thereon: (i) purchase of a motor vehicle (seating capacity: 6 persons) for carrying hotel guests; (ii) provision of food and beverages to its employees in the hotel canteen; (iii) purchase of a dishwasher machine exclusively used in the hotel kitchen for the taxable restaurant supply. Under Section 17(5) of the CGST Act, 2017, which of the following correctly identifies the blocked credits?

(A) Input tax credit is blocked on the motor vehicle (seating ≤ 13 persons for non-transport purposes) and on food and beverages provided to employees; ITC on the dishwasher is available as it is used in the course of making taxable restaurant supplies.

(B) ITC is fully available on all three items because Meridian Hotels is in the hospitality sector and all inputs relate to its taxable business activity.

(C) ITC on food and beverages and the dishwasher is blocked; the motor vehicle ITC is available because it is used for transporting customers.

(D) All three credits are blocked under Section 17(5) because they relate to personal consumption or the hospitality sector.

Q11. A registered taxpayer under CGST makes the following supplies during a tax period: (i) fresh vegetables (nil-rated supply); (ii) services of a funeral, burial or cremation (non-taxable supply under Schedule III); (iii) healthcare services by a clinical establishment (exempt supply by notification). The taxpayer's chartered accountant advised that the ITC reversal obligation under Section 17(2) applies equally to all three categories. Is this advice correct, and what is the correct legal position?

(A) The advice is correct; all three categories are treated identically and the taxpayer must reverse ITC proportionately for all three.

(B) Only the nil-rated supply and the exempt supply require ITC reversal; Schedule III activities are not "supplies" at all and therefore do not require reversal.

(C) Only the exempt supply requires ITC reversal; nil-rated and Schedule III activities are outside the GST net entirely and ITC on inputs used for them may be retained.

(D) The advice is incorrect. Section 17(2) requires reversal for inputs used in "exempt supplies," which by definition under Section 2(47) includes nil-rated supplies and supplies wholly exempt by notification, but Schedule III activities are not supplies at all and therefore do not trigger a reversal obligation on their own — though in practice the CGST rules aggregate exempt supplies for the reversal formula.

Q12. Indus Imports Ltd. presented a bill of entry for clearance of a consignment of industrial chemicals. The customs officer was unable to determine the correct classification of the chemicals pending a technical report from a government laboratory. The importer was keen to take delivery immediately for use in an ongoing production process. Under Section 17 of the Customs Act, 1962, which of the following procedures governs this situation?

(A) The customs officer must detain the goods until final assessment is complete; provisional clearance is not permissible under the Customs Act.

(B) The importer must pay the maximum possible duty under any classification and claim a refund after final assessment; no bond or security is required.

(C) The proper officer may make a provisional assessment of duty, allow clearance of goods upon execution of a bond (with or without surety or security) for payment of the difference between the duty provisionally assessed and the duty finally assessed, and issue a final assessment order after the laboratory report is received.

(D) Provisional assessment under Section 17 is available only for goods whose tariff value has not yet been fixed by the Central Government; it does not apply to classification disputes.

Q13. The Income Tax Department sought to invoke GAAR provisions against Aryaman Ltd. for the following arrangements: (i) a merger of two wholly-owned subsidiaries of Aryaman Ltd. carried out solely to avail of a tax benefit under Section 72A (carry-forward of accumulated business loss of an amalgamating company); (ii) a genuine commercial restructuring where Aryaman Ltd. divested a loss-making division to reduce operational risk, which incidentally also resulted in a tax benefit. Under Section 97 of the Income Tax Act, 1961, which arrangement(s) cannot be treated as an "impermissible avoidance arrangement"?

(A) Both arrangements are impermissible avoidance arrangements because in each case a tax benefit accrues to the taxpayer and the arrangement lacks commercial substance.

(B) Only arrangement (ii) is specifically protected under Section 97(d), which provides that an arrangement shall not be deemed impermissible solely because it results in a tax benefit, provided there is a bona fide commercial purpose. Arrangement (i) may still be examined on the basis that it was entered into solely for tax benefit with no genuine commercial activity between unrelated parties.

(C) Both arrangements are safe harbours under Section 97; GAAR cannot apply if the taxpayer demonstrates any commercial rationale whatsoever.

(D) GAAR provisions under the Income Tax Act do not apply to restructuring or merger transactions; such transactions are exclusively governed by the Companies Act, 2013.

Q14. Anika, a tax resident of Germany, received royalty income from an Indian company. Under the India–Germany Double Taxation Avoidance Agreement (DTAA), the treaty rate for royalties is 10%. Under the domestic Income Tax Act, 1961, the applicable rate (as per Section 115A) is 20% (plus surcharge and cess). Anika's Indian tax advisor argued that she must pay the higher domestic rate. Which of the following correctly states the legal position under Section 90 and Section 90A of the Income Tax Act, 1961?

(A) The advisor is correct; domestic law always overrides treaty provisions in India because parliamentary legislation has supremacy over executive agreements.

(B) The DTAA rate of 10% applies automatically, but only if the taxpayer produces a Tax Residency Certificate; without a TRC the domestic rate of 20% applies mandatorily.

(C) The taxpayer has no choice; whichever rate is specified in the DTAA prevails, even if it is higher than the domestic rate.

(D) Section 90(2) of the Income Tax Act expressly provides that the provisions of the Act shall apply to the extent they are more beneficial to the assessee; accordingly, Anika may elect to be governed by the DTAA rate of 10%, which is lower than the domestic rate of 20%.

Q15. During a Transfer Pricing audit, the Assessing Officer found that Bharat Tech Ltd. had entered into an international transaction involving the provision of software development services to its Associated Enterprise (AE) in Singapore. The taxpayer had used the Comparable Uncontrolled Price (CUP) method to determine the Arm's Length Price (ALP). The AO contended that the Transactional Net Margin Method (TNMM) was more appropriate. Under Section 92C of the Income Tax Act, 1961, which of the following correctly states the legal framework for selection of the most appropriate method?

(A) Section 92C requires the taxpayer to use the "most appropriate method" from among the prescribed methods (CUP, RPM, CPM, TNMM, PSM, and such other method as may be prescribed), selected on the basis of the nature of the transaction, availability of reliable data, and degree of comparability; the AO may reject the taxpayer's chosen method only if he demonstrates that an alternative method gives a more reliable measure of the ALP.

(B) Section 92C mandates a hierarchical order of methods; the CUP method is always the primary method and must be used first; any other method can be used only after demonstrating unavailability of CUP data.

(C) The taxpayer has an absolute right to choose any of the prescribed methods and the AO has no power to substitute a different method, provided the taxpayer's method was applied consistently in prior years.

(D) Section 92C allows only two methods — CUP and TNMM — for transactions involving intangibles and services; all other methods are applicable only to goods.

Detailed Solutions Tax Law — Sample Paper 2

Sol.1.

Solution

Concept — Article 270 and the 101st Amendment: Article 270(1) distributes taxes levied and collected by the Union between the Union and the States. The 101st Constitutional Amendment (which introduced GST) inserted Article 270(1A), expressly providing that the tax levied and collected under Article 246A(1) — i.e., CGST and IGST (to the extent of the Union share) — shall *not* form part of the divisible pool under Article 270(1). Instead, the apportionment of IGST proceeds is governed by Parliament by law (the IGST Act, 2017), and the State share is credited directly to the respective State on the basis of consumption/destination principle.

Step 1 — Effect of Article 270(1A): IGST is excluded from the Finance Commission's recommended sharing formula under Article 270(1). The Finance Commission therefore has no role in determining the Union–State split of IGST; Parliament prescribes this by law.

Step 2 — Correct option identified: Option B correctly states that IGST is expressly excluded from the distributable pool under Article 270 by virtue of Article 270(1A), and that its apportionment is governed by Parliament by law.

Why other options are wrong:

- Option A: IGST is not distributed "exclusively" to the States; the Union retains its share and the State share is credited on a destination/consumption basis, not a contribution basis.
- Option C: Incorrect, because Article 270(1A) specifically removes IGST from the Finance Commission's distributable pool.
- Option D: The 101st Amendment directly modified the constitutional scheme under Article 270 by inserting clause (1A); this option incorrectly treats IGST as equivalent to income tax for devolution.

Final Answer: IGST is excluded from the Article 270 distributable pool by Article 270(1A); Parliament governs its apportionment by law $\Rightarrow \boxed{\text{B}}$

Answer: (B) Go Back to Q1

Sol.2.

Solution

Concept — Article 286 restrictions on State taxation: Article 286(1) prohibits any State from imposing a tax on the sale or purchase of goods where such sale or purchase takes place (a) *outside* that State, or (b) *in the course of import or export* of goods into/out of India. Article 286(2) restricts the power of State legislatures to tax sales or purchases that take place *in the course of inter-State trade or commerce*, except insofar as Parliament by law otherwise provides.

Step 1 — Analysis of the transaction: The goods moved from State X to State Y across a State boundary; the sale was completed while goods were in transit. This is quintessentially an inter-State sale within the meaning of the Central Sales Tax Act (enacted under Article 286(2) parliamentary authority).

Step 2 — Application to each State: State X cannot tax this as an "outside State" sale under Article 286(1)(a) from State Y's perspective, and neither State can unilaterally tax an inter-State sale without parliamentary sanction under Article 286(2). Option D correctly captures both limbs.

Why other options are wrong:

- Option A: The fact that the contract was formed in State X does not make it an intra-State sale; the movement of goods across the State border determines it as an inter-State transaction.
- Option B: Article 286 does not bar only the destination State; it restricts both States through Articles 286(1) and 286(2).
- Option C: Article 286(2) does not categorically bar all taxation; it allows Parliament to authorise such taxation (which it has done through the CST Act).

Final Answer: Article 286(1) and 286(2) together bar unilateral State taxation of inter-State sales; Parliamentary law governs the levy $\Rightarrow \boxed{\text{D}}$

Answer: (D) Go Back to Q2

Sol.3.

Solution

Concept — Section 2(9) "assessment year" and Section 3 "previous year": Under Section 3, the "previous year" for a person commencing a new business or profession is the period beginning on the date of commencement and ending on the 31st March immediately following. The "assessment year" under Section 2(9) is the 12-month period beginning on 1st April immediately after the previous year.

Step 1 — Applying Section 3 to Vikram's facts: Vikram commenced business on 1st January 2025. His first previous year runs from 1st January 2025 to 31st March 2025 (a short year of approximately 3 months). The immediately following assessment year is 2025–26 (1st April 2025 to 31st March 2026).

Step 2 — Confirming Option A: The accountant's advice is correct. Section 3 creates a flexible first previous year for new businesses rather than insisting on a full April–March year.

Why other options are wrong:

- Option B: This is the rule for *existing* sources; for a *new* business, Section 3 provides a shorter first previous year from the date of commencement.
- Option C: The previous year and the assessment year are always different periods under the Act; income earned in the previous year is taxed in the next year (the assessment year).
- Option D: The concepts of previous year and assessment year apply universally to all sources of income; there is no calendar year basis under the Income Tax Act for business income.

Final Answer: First previous year for a new business = date of commencement to 31st March; taxed in the immediately following assessment year $\Rightarrow \boxed{\text{A}}$

Answer: (A) Go Back to Q3

Sol.4.

Solution

Concept — Section 6(3) and POEM (Place of Effective Management): Prior to the Finance Act 2016 amendment, a foreign company was resident in India only if its control and management was "wholly" in India. After the amendment, Section 6(3)(ii) provides that a company is resident in India if its Place of Effective Management (POEM) is in India. POEM is defined in Circular 6/2017 as "a place where key management and commercial decisions that are necessary for the conduct of the business of an entity as a whole are in substance made."

Step 1 — Applying POEM to GlobalTech Plc: Although formal Board meetings are in London, the substance of key management and commercial decisions (budget approval, major contracts, senior appointments) is made from Mumbai. The CBDT guidelines look through formal meeting structures to identify where real decisions are taken. Mumbai is therefore the POEM.

Step 2 — Consequence: GlobalTech Plc is resident in India for the financial year 2024–25 because its POEM is in India, making Option C correct.

Why other options are wrong:

- Option A: Mere place of incorporation and formal Board meeting location are not determinative under the POEM test; substance prevails over form.
- Option B: Directors' citizenship is irrelevant to the POEM test under Section 6(3).
- Option D: The POEM test under Section 6(3)(ii) specifically targets foreign-incorporated companies to determine whether they are resident in India; it does not apply to Indian companies.

Final Answer: Key management decisions made from Mumbai $\Rightarrow$ POEM in India $\Rightarrow$ GlobalTech Plc is a resident company $\Rightarrow$ $\boxed{\text{C}}$

Answer: (C) Go Back to Q4

Sol.5.

Solution

Concept — Section 15 salary: due vs receipt basis: Under Section 15, salary is chargeable to tax on the earlier of the following: (a) when it is due (i.e., when the right to receive accrues), or (b) when it is actually received. Arrears of salary from a former employer are taxable in the year of receipt if not taxed in the year of accrual.

Step 1 — Joining bonus from XYZ Ltd.: The joining bonus of Rs. 2 lakh was received in April 2024 (previous year 2024–25). Even though employment commenced in November 2024, the amount was received and also fell due (under the terms of the offer letter) in April 2024. It is taxable in 2024–25.

Step 2 — Arrears from ABC Ltd.: The arrears relate to April–October 2024 but were credited into Meera's account in May 2025 (previous year 2025–26). Under Section 15, if salary becomes due but has not been received in the earlier year, it is taxable when due. However, "arrears" typically implies amounts not previously taxed on a due basis; they are taxable in the year of receipt, i.e., 2025–26.

Why other options are wrong:

- Option A: The joining bonus is taxable in 2024–25 both on receipt and due basis; Option A correctly states 2024–25 for the joining bonus but Option B provides the more precise legal basis.
- Option C: Simply because both contracts were executed before 31st March 2025 does not consolidate their taxability into a single year; Section 15 applies transaction by transaction.
- Option D: Arrears from a former employer are fully taxable under Section 15 (with relief under Section 89); there is no general exemption under Section 10.

Final Answer: Joining bonus taxable in 2024–25 (year of receipt/due); arrears from former employer taxable in 2025–26 (year of actual receipt) $\Rightarrow \boxed{\text{B}}$

Answer: (B) Go Back to Q5

Sol.6.

Solution

Concept — Section 48 computation of Long Term Capital Gains: Section 48 provides that capital gains = Full Value of Consideration (FVC) – Expenditure wholly and exclusively in connection with transfer – Cost of Acquisition (CoA) – Cost of Improvement. For long-term capital assets (other than those in proviso to Section 48), the indexed cost of acquisition may be substituted for CoA.

Step 1 — Identifying components for Preethi's case:

- FVC = Rs. 1,50,00,000
- Expenditure on transfer (brokerage) = Rs. 1,50,000
- Indexed CoA = Rs. 20,00,000 $\times$ (363 $\div$ 100) = Rs. 72,60,000
- LTCG = Rs. 1,50,00,000 – Rs. 1,50,000 – Rs. 72,60,000 = Rs. 75,90,000

Step 2 — Correct option: Option D correctly identifies all three components: FVC, transfer expenditure (brokerage), and indexed CoA with the correct formula.

Why other options are wrong:

- Option A: The 2024 Finance Act amended the indexation benefit but did not eliminate it for properties acquired before 2001 (grandfathering); and the question assumes standard pre-2024 amendment applicability for clarity.
- Option B: The property was acquired in April 2001 and sold in December 2024, making it a long-term capital asset (held > 24 months for immovable property); indexation is available.
- Option C: Brokerage is expressly deductible as an expenditure "wholly in connection with transfer" under Section 48; Option C incorrectly excludes it.

Final Answer: LTCG = FVC – brokerage – indexed CoA (CoA $\times$ CII of sale year $\div$ CII of acquisition year) $\Rightarrow \boxed{\text{D}}$

Answer: (D) Go Back to Q6

Sol.7.

Solution

Concept — Section 56(2)(x) gifts and the definition of "relative": Section 56(2)(x) taxes any sum of money received by an individual (from a non-relative) without consideration exceeding Rs. 50,000 in aggregate during the year. The proviso exempts amounts received from "relatives," defined in the Explanation to Section 56(2)(vii) (applicable to Section 56(2)(x) by reference) to include, among others, any lineal ascendant or descendant of the individual and spouse thereof, and brother or sister of the individual or their spouse.

Step 1 — Suresh (friend): A friend is not a "relative" within the statutory definition. The cash gift of Rs. 75,000 from Suresh exceeds Rs. 50,000 and is fully taxable as income from other sources under Section 56(2)(x).

Step 2 — Maternal uncle (mother's brother): The definition of "relative" in the Explanation includes "brother or sister of the *individual*" but also "any lineal ascendant or descendant." Mother's brother (maternal uncle) qualifies as a "relative" because the Explanation includes "brother or sister of either of the parents of the individual" in the extended definition under the Finance Act, 2012 amendment. The laptop (movable property) received from a relative is exempt.

Why other options are wrong:

- Option B: There is no blanket exemption for gifts received on anniversaries from non-relatives; only wedding gifts from relatives enjoy exemption under the proviso.
- Option C: The aggregate threshold rule applies per donor category; Suresh's gift alone exceeds Rs. 50,000, making it taxable, but the maternal uncle's gift is separately exempt as from a relative.
- Option D: There is no Rs. 1 lakh cash gift threshold under Section 56(2)(x); the threshold is Rs. 50,000.

Final Answer: Friend's cash gift $>$ Rs. 50,000 is taxable; maternal uncle is a "relative," laptop is exempt $\Rightarrow \boxed{\text{A}}$

Answer: (A) Go Back to Q7

Sol.8.

Solution

Concept — Section 80D deduction limits: Section 80D allows deduction for medical insurance premium paid. For individuals below 60 years: Rs. 25,000 (including up to Rs. 5,000 for preventive health check-up). For senior citizen parents (60 years or above): Rs. 50,000. The preventive health check-up limit is subsumed within the main limit, not additional.

Step 1 — Anand's own/spouse premium + preventive check-up:

- Premium paid = Rs. 22,000; preventive check-up = Rs. 4,000; total = Rs. 26,000.
- But the overall cap for self/family (Anand is 42, below 60) is Rs. 25,000 (preventive check-up up to Rs. 5,000 is within this Rs. 25,000 cap).
- Allowable deduction for self/spouse = Rs. 25,000.

Step 2 — Father's premium:

- Father is 68 (senior citizen). Premium paid = Rs. 60,000. Cap for senior citizen parent = Rs. 50,000.
- Allowable deduction for father = Rs. 50,000 (capped; dependence on Anand is not required for parents' premium under Section 80D).

Total deduction: Rs. 25,000 + Rs. 50,000 = Rs. 75,000. Option C is correct.

Why other options are wrong:

- Option A: Parents' premium is deductible under Section 80D regardless of whether they are financially dependent; Option A incorrectly restricts the deduction.
- Option B: The deductions are subject to statutory caps; actual expenditure is irrelevant beyond those caps.
- Option D: The preventive health check-up limit (Rs. 5,000) is subsumed within the Rs. 25,000 cap; it is not a separate addition over and above the cap.

Final Answer: Self/spouse cap Rs. 25,000 + senior citizen father cap Rs. 50,000 = Rs. 75,000 $\Rightarrow \boxed{\text{C}}$

Answer: (C) Go Back to Q8

Sol.9.

Solution

Concept — Section 7 CGST and Schedule II: Section 7(1)(d) of the CGST Act treats activities or transactions listed in Schedule II as supply of goods or supply of services. Schedule II, Entry 5(b) specifically provides that construction of a complex, building, or civil structure intended for sale to a buyer is a supply of services, where the supply takes place *before issuance of completion certificate* by the competent authority (or first occupation, whichever is earlier).

Step 1 — Construction and sale of flat before completion certificate: Kalpana's supply of the flat before the completion certificate falls squarely within Schedule II Entry 5(b). It is treated as a supply of service and attracts GST (at the applicable rate for under-construction property).

Step 2 — Lease of agricultural land for agricultural purpose: Leasing of land is generally a supply of service. However, services by way of renting of agricultural land for use in agriculture are exempted under Notification No. 12/2017-CT(Rate). The supply exists but is exempt (nil tax); Option B correctly identifies both positions.

Why other options are wrong:

- Option A: Under-construction flat sale is a supply of service (Schedule II Entry 5(b)); it is not a supply of goods.
- Option C: Construction activity is not in Schedule III; Schedule III lists activities that are neither supply of goods nor services (e.g., actionable claims other than lottery).
- Option D: Immovable property transactions are not automatically outside "supply"; Section 7 and Schedule II specifically bring several immovable property-related activities within the GST net.

Final Answer: Under-construction flat = supply of service (Sch. II Entry 5(b)); agricultural land lease = exempt supply $\Rightarrow \boxed{\text{B}}$

Answer: (B) Go Back to Q9

Sol.10.

Solution

Concept — Section 17(5) blocked credits ("ineligible ITC"): Section 17(5) of the CGST Act lists categories of supplies on which input tax credit is *not* available. Key blocked categories include: (a) motor vehicles for transportation of persons with seating capacity ≤ 13 (including driver), unless used for specified purposes; (b) food and beverages, outdoor catering, health services, etc., unless the same category of outward supply is being made or it is obligatory under a statute. Credits on goods and services used in the course of making taxable outward supplies are generally available.

Step 1 — Motor vehicle (seating capacity 6): A vehicle with 6 seats (below 13) is a blocked credit unless used for: transport of passengers (as a principal supply), imparting training in driving/flying/navigating such vehicles, or as stock-in-trade. Carrying hotel guests is not one of the specified exceptions. ITC is *blocked*.

Step 2 — Food and beverages to employees: ITC on food and beverages supplied to employees is blocked under Section 17(5)(b)(i) unless the taxpayer itself makes an outward taxable supply of food. A hotel may make such supply, but the provision to *employees* in the canteen (as opposed to guests) is still blocked. ITC is *blocked*.

Step 3 — Dishwasher for kitchen (taxable restaurant supply): The dishwasher is a capital good exclusively used in the course of making a taxable supply (restaurant services). ITC is *available* under Section 16.

Why other options are wrong:

- Option B: Not all inputs used in a hotel are eligible; Section 17(5) operates as a specific override.
- Option C: The dishwasher is not blocked; it is used for taxable restaurant supplies, not for personal consumption.
- Option D: Not all hospitality-related inputs are blocked; only those specifically listed in Section 17(5) are blocked.

Final Answer: ITC blocked on motor vehicle and employee food/beverages; ITC available on dishwasher used for taxable restaurant supply $\Rightarrow \boxed{\text{A}}$

Answer: (A) Go Back to Q10

Sol.11.

Solution

Concept — Exempt supply, nil-rated supply, and non-taxable supply: Under the CGST Act: (a) **Nil-rated supply** — goods/services attracting 0% GST by tariff/schedule (e.g., fresh vegetables); (b) **Exempt supply** — as defined in Section 2(47): any supply exempt from GST, including nil-rated and wholly exempt by notification; (c) **Non-taxable supply** (Section 2(78)) — supply not leviable to GST at all (e.g., petroleum crude, alcohol); (d) **Schedule III** activities — not a supply at all (e.g., services by an employee to employer, funeral services, court fees).

Step 1 — ITC reversal under Section 17(2): Section 17(2) requires reversal of ITC attributable to "exempt supplies" as defined in Section 2(47), which *includes* nil-rated and notification-exempt supplies. Rule 42/43 of the CGST Rules aggregate these for the reversal formula.

Step 2 — Schedule III activities: Funeral/burial/cremation services are listed in Schedule III, meaning they are *not a supply* at all. Technically, they do not trigger the Section 17(2) reversal obligation on their own. However, CGST Rule 42 includes "non-taxable supply" in the reversal formula, which has led to interpretational complexity. Strictly, Schedule III activities are not supplies and do not generate a reversal obligation.

Step 3 — Correct option: Option D is the most legally precise: Section 17(2) covers nil-rated and notification-exempt supplies as "exempt supplies"; Schedule III activities are not supplies at all and do not strictly trigger reversal, though the Rules extend the formula in practice.

Why other options are wrong:

- Option A: Schedule III activities are not "supplies," so reversal is not strictly required under Section 17(2) for them.
- Option B: Nil-rated supplies are included within "exempt supply" under Section 2(47) and therefore do require reversal; Option B is incorrect to exclude them.
- Option C: Nil-rated supplies fall within the definition of exempt supply in Section 2(47) and attract ITC reversal; Option C is incorrect.

Final Answer: Section 17(2) reversal applies to nil-rated and notification-exempt supplies; Schedule III activities are not supplies and do not strictly trigger reversal $\Rightarrow \boxed{\text{D}}$

Answer: (D) Go Back to Q11

Sol.12.

Solution

Concept — Section 17 Customs Act, 1962: Provisional Assessment: Section 17 of the Customs Act provides for self-assessment by importers/exporters. Where the proper officer is unable to make final assessment owing to pending inquiries (such as a laboratory test, production of a document, or classification reference), Section 18 (provisional assessment) enables clearance on a provisional basis.

Step 1 — Procedure under Section 18: The proper officer may order that the duty be assessed provisionally. The importer must execute a bond (with or without surety or security in such form as may be prescribed) undertaking to pay the difference between the duty provisionally assessed and the duty finally assessed. After the pending inquiry (laboratory report in this case) is complete, final assessment is made and the differential duty is recovered or refunded.

Step 2 — Correct option: Option C correctly describes the Section 18 Customs Act provisional assessment mechanism — bond execution, conditional clearance, and subsequent final assessment.

Why other options are wrong:

- Option A: Detention of goods pending final assessment is not mandated; provisional clearance exists precisely to prevent commercial hardship from delayed assessments.
- Option B: There is no requirement to pay the maximum possible duty; the provisional assessment is made at the best estimate of the officer, secured by a bond.
- Option D: Section 18 provisional assessment is not restricted to tariff value disputes; it applies to any situation where the proper officer cannot make a final assessment immediately, including classification disputes.

Final Answer: Provisional assessment under Section 18 Customs Act — bond execution + conditional clearance + subsequent final assessment $\Rightarrow \boxed{\text{C}}$

Answer: (C) Go Back to Q12

Sol.13.

Solution

Concept — Section 97 ITA: Arrangements not treated as impermissible under GAAR: Section 97 of the Income Tax Act lists specific arrangements that shall not be deemed to be an impermissible avoidance arrangement (IAA). Section 97(1)(d) provides that an arrangement shall not be treated as an IAA solely because it results in a tax benefit, if the arrangement does not lack commercial substance and the main purpose (or one of the main purposes) is not to obtain a tax benefit (i.e., genuine commercial transactions).

Step 1 — Arrangement (i) — Merger solely for Section 72A benefit: This is entered into "solely" for the tax benefit of carry-forward of accumulated business loss. Where the *sole* purpose is tax avoidance and there is no genuine commercial rationale between independent parties beyond tax savings, GAAR may apply. Section 97 protection does not automatically apply merely because it is a merger.

Step 2 — Arrangement (ii) — Genuine commercial restructuring: The divestment of a loss-making division is driven by commercial rationale (operational risk reduction). The tax benefit is incidental. Section 97(d) provides safe harbour for arrangements with genuine commercial purposes where the tax benefit is not the *main* purpose. Option B correctly identifies this distinction.

Why other options are wrong:

- Option A: Arrangement (ii) has genuine commercial purpose; GAAR cannot be invoked simply because a tax benefit results from a bona fide commercial restructuring.
- Option C: The safe harbour is not unlimited; it requires that obtaining a tax benefit is *not* the main purpose. Arrangement (i) may not qualify.
- Option D: GAAR under Chapter X-A of the ITA applies to restructurings and mergers; the Companies Act is not a shield against GAAR where tax avoidance is the dominant purpose.

Final Answer: Arrangement (ii) with genuine commercial purpose is protected under Section 97(d); arrangement (i) (sole purpose = tax benefit) remains open to GAAR scrutiny $\Rightarrow \boxed{\text{B}}$

Answer: (B) Go Back to Q13

Sol.14.

Solution

Concept — Section 90(2) treaty override and beneficial rule: Section 90(1) of the Income Tax Act empowers the Central Government to enter into agreements (DTAAs) for avoidance of double taxation. Section 90(2) expressly provides that where the Central Government has entered into a DTAA, the provisions of the Act shall apply to the assessee *to the extent they are more beneficial to that assessee*. This is the foundational "beneficial rule" in Indian treaty law. Section 90A extends similar treatment to adopted agreements.

Step 1 — Applying Section 90(2) to Anika: The DTAA rate (10%) is lower than the domestic rate (20%). Because Section 90(2) applies the law that is more beneficial to the assessee, Anika is entitled to elect the lower DTAA rate of 10%.

Step 2 — TRC requirement: A valid Tax Residency Certificate is a prerequisite to claim treaty benefits (Section 90(4)), but the question of TRC is a procedural compliance issue, not the core legal principle asked about in this question.

Why other options are wrong:

- Option A: India follows a "treaty override" principle through Section 90(2), which allows treaty rates to prevail over domestic law when they are more beneficial; parliamentary supremacy does not override Section 90(2) within the Act itself.
- Option B: While a TRC is required, the question asks about the *legal principle* governing the applicable rate; Section 90(2) unambiguously applies the more beneficial provision.
- Option C: The beneficial rule cuts both ways — if the treaty rate were higher than the domestic rate, the taxpayer would be entitled to the lower domestic rate.

Final Answer: Section 90(2) mandates application of the more beneficial provision (DTAA rate 10% vs domestic 20%); Anika may elect the DTAA rate $\Rightarrow \boxed{\text{D}}$

$\boxed{\textbf{Answer: (D)}}$ Go Back to Q14

Sol.15.

Solution

Concept — Section 92C: Most Appropriate Method (MAM) rule: Section 92C(1) of the Income Tax Act provides that the arm's length price (ALP) of an international transaction shall be determined by any of the following methods: Comparable Uncontrolled Price (CUP), Resale Price Method (RPM), Cost Plus Method (CPM), Profit Split Method (PSM), Transactional Net Margin Method (TNMM), or any other method as prescribed. The method most appropriate to the facts and circumstances of the transaction shall be applied (the "Most Appropriate Method" or MAM rule).

Step 1 — MAM Rule: Rule 10C of the Income Tax Rules prescribes the factors for selecting the MAM: nature and class of transaction, class of associated enterprise, functions performed (with assets and risks), availability and reliability of data, degree of comparability, extent of reliable adjustments. The AO may reject the taxpayer's chosen method only by demonstrating that an alternative method provides a more reliable measure of the ALP.

Step 2 — No rigid hierarchy: Unlike the pre-2001 OECD approach (which had a strict priority order), Indian law does not prescribe a rigid hierarchy. CUP is not automatically the "primary" method. The most reliable method for the facts governs.

Why other options are wrong:

- Option B: India's Section 92C does not impose a rigid hierarchical order; the most appropriate method for the specific transaction is selected based on Rule 10C factors.
- Option C: The taxpayer has no absolute right to insist on its chosen method; the AO can substitute a more appropriate method if he establishes it is a more reliable measure of ALP.
- Option D: Section 92C does not restrict methods for services/intangibles to only CUP and TNMM; all prescribed methods are available for any transaction type.

Final Answer: Section 92C mandates the Most Appropriate Method (MAM) from among all prescribed methods, based on reliability and comparability; AO may substitute if he demonstrates greater reliability $\Rightarrow \boxed{\text{A}}$

Answer: (A) Go Back to Q15

Answer Key Tax Law — Sample Paper 2

Q.No	Ans		Q.No	Ans		Q.No	Ans		
1	B	2	D	3	A	4	C	5	B
6	D	7	A	8	C	9	B	10	A
11	D	12	C	13	B	14	D	15	A

Q.No	Ans		Q.No	Ans	

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