CLAT PG Tax Law

Sample Paper – 6

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

Q.1. The State Legislature of Rajasthan demands that the entire revenue from stamp duty on promissory notes executed within the state be credited exclusively to the state exchequer. Parliament contests this, asserting that stamp duties on promissory notes are a Union subject and the proceeds vest in the Consolidated Fund of India. A constitutional dispute has arisen regarding the fiscal authority over stamp duty on promissory notes. Which constitutional provision correctly governs the levy and collection of stamp duties on promissory notes, and what is the legal position regarding the distribution of their proceeds?

(A) Art. 268 of the Constitution provides that stamp duties on bills of exchange, cheques, and promissory notes are levied by the Union but collected and appropriated by the states in which such duties are respectively leviable; the state's claim to the entire revenue from stamp duty on promissory notes executed within its territory is therefore constitutionally correct under Art. 268.

(B) Parliament has the exclusive authority to levy and collect stamp duties on promissory notes under Entry 91 of List I, and the entire revenue vests in the Consolidated Fund of India without any share being assigned to the states.

(C) Stamp duties on promissory notes are a state subject under Entry 63 of List II; a state legislature may independently levy and collect them without any role for Parliament in the determination of rates or distribution of proceeds.

(D) Art. 270 of the Constitution governs all taxes on commercial instruments including promissory notes; the proceeds must be shared between the Union and the states in the ratio recommended by the Finance Commission.

Q.2. The Municipal Corporation of a state enacted a by-law imposing an annual property tax on all buildings situated within its limits. The by-law was applied to a multi-storey building owned by the Central Government and occupied exclusively by a Union ministry for official governmental functions. The Central Government challenged the levy, invoking constitutional immunity. The state argued that since taxation of immovable property is a state subject under Entry 49 of List II, the tax is valid and the Union must pay it like any other property owner. Is the state property tax on the Central Government building constitutionally valid?

(A) A state may levy property tax on any building situated within its territory regardless of the ownership of the building, since taxation of immovable property falls under Entry 49 of List II and the Central Government's ownership does not create any constitutional immunity.

(B) Art. 285 of the Constitution exempts Union property from state taxation only where the building is used for defence purposes; buildings used for civilian administrative governmental functions may be validly taxed by a state or municipal authority.

(C) Art. 285(1) of the Constitution provides that property of the Union shall be exempt from all taxes imposed by a state or by any authority within a state; a state law or municipal by-law levying property tax on a building owned by the Central Government and used exclusively for governmental purposes is constitutionally invalid as it directly contravenes Art. 285.

(D) The immunity under Art. 285 is operative only if Parliament has, by a separate statute, declared the property exempt; in the absence of such a parliamentary declaration, the general state taxation law validly applies to Union property.

Q.3. Sunaina, a senior officer in the Indian Administrative Service, retires after 30 years of continuous government service. Her employer (the Central Government) pays her Rs. 25 lakh as retirement gratuity in accordance with the applicable Central Civil Services rules. Sunaina's tax adviser tells her that the entire amount is exempt from income tax without any monetary ceiling. The assessing officer disputes this, contending that the exemption for gratuity is subject to a ceiling of Rs. 20 lakh applicable to all employees. Which statement correctly states the tax treatment of Sunaina's gratuity under the Income Tax Act, 1961?

(A) Government employees are fully taxable on the entire gratuity received; the exemption under Sec 10(10) of the Income Tax Act, 1961 is available only to private-sector employees covered by the Payment of Gratuity Act, 1972.

(B) The exemption under Sec 10(10) is subject to a uniform ceiling of Rs. 20 lakh for all categories of employees including government employees; Sunaina's gratuity exceeds this limit and the excess Rs. 5 lakh is chargeable as salary income.

(C) Sunaina's gratuity is exempt only up to Rs. 20 lakh under Sec 10(10)(ii), which applies to employees of establishments covered by the Payment of Gratuity Act; the excess Rs. 5 lakh is taxable because government gratuity rules are not a substitute for statutory coverage.

(D) Under Sec 10(10)(i) of the Income Tax Act, 1961, any death-cumretirement gratuity received by a government employee (Central Government, State Government, or local authority employee) is wholly exempt from income tax without any monetary ceiling; Sunaina's entire Rs. 25 lakh retirement gratuity is therefore fully exempt, and the assessing officer's contention is incorrect.

Q.4. Prakash owns a self-occupied residential house in Chennai. In order to construct the house, he obtained a housing loan of Rs. 30 lakh from a bank at an annual interest rate of 9 per cent; the loan was taken after 1 April 1999 and the construction was completed within three years of the loan being taken. The total interest paid by Prakash during the previous year is Rs. 2,70,000. He also claims the standard deduction under Sec 24(a). What is the maximum deduction Prakash can claim for interest on borrowed capital under Sec 24(b) of the Income Tax Act, 1961 in respect of the self-occupied house property?

(A) The entire interest of Rs. 2,70,000 is deductible under Sec 24(b) because no monetary ceiling applies where the loan was taken for construction of residential property from a recognised financial institution.

(B) The maximum deduction for interest on borrowed capital under Sec 24(b) for a self-occupied property is capped at Rs. 2,00,000 per annum where the loan was taken after 1 April 1999 for construction completed within five years; even though Prakash actually paid Rs. 2,70,000 in interest, the permissible deduction is limited to Rs. 2,00,000.

(C) The interest deduction under Sec 24(b) is restricted to Rs. 30,000 per annum for self-occupied property, irrespective of when the loan was taken or the purpose of the borrowing; the higher limit applies only to let-out properties.

(D) Interest paid on a loan taken for construction of a self-occupied property is not deductible under Sec 24(b); the provision permits interest deduction only on loans taken for outright purchase of property.

Q.5. Omega Ltd., a pharmaceutical company, paid Rs. 50 lakh as a one-time, lump-sum non-compete fee to Dr. Rao, its former Research Director, under a binding agreement that prevents Dr. Rao from joining or assisting any competitor company for a period of three years. Omega Ltd. claimed the Rs. 50 lakh as a deductible business expenditure under Sec 37(1) of the Income Tax Act, 1961, asserting that it was paid wholly and exclusively for the purpose of its business to protect its trade secrets and customer relationships. The Assessing Officer disallowed the deduction. Is the deduction allowable?

(A) The one-time non-compete fee of Rs. 50 lakh is capital expenditure — it secures an enduring advantage (the right to operate for three years free from the former director's competition) rather than being an outgoing on day-to-day business operations; accordingly, it does not qualify as revenue expenditure "wholly and exclusively" incurred for business purposes and is not deductible under Sec 37(1).

(B) The fee is fully deductible under Sec 37(1) as a revenue expenditure because it was paid exclusively to protect Omega Ltd.'s current business interests; a restriction for only three years is short-term and does not confer a capital benefit on the company.

(C) Non-compete fees paid to former directors are deductible under Sec 36(1)(ii) as remuneration or compensation paid in connection with employment, subject only to the condition that such payments are not excessive or unreasonable relative to the services rendered.

(D) Non-compete fees paid to an individual are governed by Sec 28(va) of the Income Tax Act; the payer company may fully deduct such fees from its business income without restriction, provided the payment is made under a legally enforceable agreement.

Q.6. Sigma Ltd., a manufacturing company, accrued Rs. 6 lakh as employer's contribution to its employees' Provident Fund for the financial year. The due date for depositing employer's contribution under the Employees' Provident Funds and Miscellaneous Provisions Act, 1952 was 15 May. Sigma Ltd. deposited the contribution on 20 June — after the EPF Act due date, but before the due date for filing its income-tax return under

Sec 139(1) of the Income Tax Act, 1961. Sigma Ltd. claimed the Rs. 6 lakh as a deduction in computing its business income for that financial year. Is the deduction allowable for that year?

(A) The contribution is deductible in full for the current year because Sec 43B of the Income Tax Act, 1961 permits deduction of employer's provident fund contributions if actually paid before the due date of filing the income-tax return, irrespective of whether the EPF Act's own deposit deadline was missed.

(B) Employer's contribution to the Employees' Provident Fund is deductible only when the employee's own contribution is also deposited within 15 days of the due date; Sigma's failure to deposit in time means neither contribution is deductible.

(C) The Finance Act 2021 amended Sec 43B of the Income Tax Act, 1961 to provide that employer's contribution to employees' provident fund or ESIC is deductible only if actually paid by the due date specified under the EPF Act (or ESIC Act, as the case may be); payment after the EPF Act's prescribed due date — even if before the income-tax return's due date under Sec 139(1) — denies the deduction for that year, and the deduction is available only in the year of actual payment.

(D) The Supreme Court has held that employer's statutory contributions to provident funds must be allowed as deductions in the year of accrual regardless of the actual date of payment; any amendment by the Finance Act purporting to link deductibility to the date of deposit under the EPF Act is constitutionally suspect and cannot be applied.

Q.7. Arjun, a reputed art collector, holds several valuable ancestral paintings as personal capital assets. In April of the previous year he decided to start an art dealership business and converted his ancestral painting (valued at Rs. 40 lakh on the date of conversion; original cost nil as inherited) into the stock-in-trade of his newly commenced art business. He sold the painting through his dealership in February of the next financial year for Rs. 55 lakh. Under the Income Tax Act, 1961, when does the capital gain arising on the conversion become chargeable to tax, and on what basis is it computed?

(A) Capital gains arising on conversion of a capital asset into stock-in-trade are chargeable in the year of conversion itself; the business sale price subsequently received is irrelevant to the capital gains computation, which is finalised at the time of conversion.

(B) Converting a personal capital asset (an ancestral painting used for personal enjoyment) into business stock-in-trade is not a "transfer" under Sec 2(47) of the Income Tax Act, 1961 and does not attract capital gains tax at any stage; only the business profits on the eventual sale are taxable.

(C) Conversion of a capital asset into stock-in-trade is a deemed sale at cost of acquisition under Sec 45(2); the capital gain is computed on the difference between the cost and the cost of acquisition, and is chargeable in the year of conversion.

(D) Under Sec 45(2) of the Income Tax Act, 1961, when a capital asset is converted by the owner into, or treated as, stock-in-trade of a business, the capital gain is not chargeable in the year of conversion; it becomes chargeable to tax only in the year in which the stock-in-trade is actually sold or otherwise transferred. The fair market value of the asset on the date of its conversion is treated as the full value of consideration for computing the capital gain at that point.

Q.8. Delta Ltd. is engaged in both regular business activities and speculative trading. In Assessment Year (AY) Year 1, it incurred a speculation loss of Rs. 2 lakh and a non-speculation business loss of Rs. 5 lakh; both losses were duly returned. In AY Year 3 (within the eight-year carry-forward window), Delta Ltd. earned speculation income of Rs. 3 lakh and had no other income from business, profession, salary, or any other source. How may Delta Ltd. set off its carried-forward losses against the speculation income in AY Year 3?

(A) Both the speculation loss (Rs. 2 lakh) and the non-speculation business loss (Rs. 5 lakh) can be fully set off against the speculation income of Rs. 3 lakh in AY Year 3, since Sec 72 of the Income Tax Act, 1961 permits set-off of all brought-forward business losses against any income under the head "Profits and Gains of Business or Profession."

(B) The speculation loss of Rs. 2 lakh from AY Year 1 can be set off only against speculation income and may be fully set off against the Rs. 3 lakh speculation income in AY Year 3; the non-speculation business loss of Rs. 5 lakh cannot be set off against speculation income and must be carried forward; it remains eligible for set-off against non-speculation business income for up to eight assessment years from the year it was incurred.

(C) Speculation losses lapse after four assessment years from the year of incurrence; since AY Year 3 is within four years, both the speculation loss and non-speculation loss can be freely set off against speculation income without restriction.

(D) A non-speculation business loss takes priority and is set off first against speculation income; accordingly, Rs. 3 lakh of the Rs. 5 lakh non-speculation loss is set off against the speculation income in Year 3, and the balance Rs. 2 lakh non-speculation loss plus Rs. 2 lakh speculation loss are carried forward.

Q.9. Meridian Consulting Pvt. Ltd., a registered supplier of management consulting services, completed a comprehensive consulting assignment for a corporate client on 1 March. It issued the tax invoice for Rs. 10 lakh only on 15 April — 45 days after the service was rendered. The GST department issued a notice stating that the invoice was not issued within the prescribed time under Sec 31 of the CGST Act, 2017 and that Meridian may be liable for interest and penalty. Meridian contends there is no mandatory time limit for service invoices under the CGST Act. What is the correct legal position?

(A) Sec 31(2) of the CGST Act, 2017 requires a registered person supplying services to issue a tax invoice within 30 days from the date of supply of service (45 days for banking companies and financial institutions); issuing the invoice 45 days after completion of the consulting services violates this statutory requirement; the time of supply under Sec 13 remains the earlier date, and Meridian is liable for interest on delayed tax payment and may also be subject to a general penalty under Sec 125 of the CGST Act.

(B) There is no mandatory time limit for issuing a tax invoice for services under the CGST Act, 2017; a supplier of services may issue the invoice at any time before the close of the financial year in which the service was provided, without any consequence for time of supply or tax liability.

(C) A delay in issuing a tax invoice for services resets the time of supply to the date of the invoice; the GST liability arises only from the date of the invoice, and no interest is payable for the period between the date of service completion and the date of invoice.

(D) Issuing a belated invoice for services under the CGST Act does not attract any penalty; the only consequence is that the recipient cannot avail Input Tax Credit until the invoice is actually received and reflected in GSTR-2B.

Q.10. Sunrise Traders, a registered supplier, supplied goods to a buyer in March 2023 and collected GST accordingly. Owing to a commercial dispute, the parties agreed to a post-supply price reduction and Sunrise Traders issued a credit note reflecting the reduced price. However, Sunrise Traders declared this credit note in its GSTR-1 only in November 2023 (i.e., for the return period October 2023). The GST department disallowed the reduction in output tax liability on the ground that the credit note was declared beyond the permissible time limit under Sec 34 of the CGST Act, 2017. Is the department correct?

(A) A credit note may be issued and declared in GSTR-1 at any point within the same financial year in which the supply was made; since the supply was in March 2023 (financial year 2022-23) and the declaration was in November 2023 (financial year 2023-24), the credit note is admittedly beyond the year of supply but the CGST Act provides a liberal three-year window.

(B) The CGST Act does not impose any time limit on the issuance of credit notes; the only condition under Sec 34 is that the credit note must relate to a valid taxable supply for which GST was correctly charged; the November 2023 declaration is therefore fully valid.

(C) A credit note may be declared within two years from the end of the financial year of supply; since the supply was in March 2023 and the declaration in November 2023 is well within two years, the department is incorrect in disallowing the reduction.

(D) Sec 34(2) of the CGST Act, 2017 provides that a supplier may not reduce its output tax liability in respect of a supply unless the credit note is declared in the return for the period not later than the September following the end of the financial year in which the supply was made, or the date of filing the annual return for that year, whichever is earlier; the March 2023 supply falls in financial year 2022-23, so the credit note had to be declared by September 2023 (or the annual return filing date, whichever is earlier); declaration in November 2023 exceeds this deadline and the department is correct in disallowing the reduction in output tax liability for that year.

Q.11. During a routine GST audit, the proper officer of the GST department discovers that a registered taxpayer availed Input Tax Credit (ITC) amounting to Rs. 12 lakh in respect of inward supplies that were not eligible for ITC — specifically, supplies used for personal consumption of the proprietor. There is no allegation of fraud, wilful misstatement, or suppression of facts; the wrong claim appears to be the result of an inadvertent error in classification. The officer proposes to issue a demand for recovery of the wrongly availed ITC with interest. Which provision governs this demand, and what is the applicable limitation period?

(A) The demand must be raised under Sec 74 of the CGST Act, 2017 because availing ineligible ITC is inherently a deliberate act, and the statute does not distinguish between "fraudulent" and "erroneous" ITC claims for the purpose of determining the applicable provision;

the limitation period is five years.

(B) The proper officer must invoke Sec 122 of the CGST Act, 2017 for wrongful availing of ITC; Secs 73 and 74 relate exclusively to non-payment or short-payment of output tax and do not extend to erroneous ITC claims; no limitation period applies to Sec 122 demands.

(C) Where a taxpayer has wrongly availed ITC without any fraud, wilful misstatement, or suppression of facts, Sec 73 of the CGST Act, 2017 governs the demand; the proper officer must issue a show cause notice within three years from the due date of filing the annual return for the financial year in which the tax was not paid or ITC was wrongly availed, and the taxpayer is liable to pay the tax and interest (with a reduced penalty opportunity under Sec 73(5) and (8)).

(D) The demand for wrongly availed ITC based on an inadvertent error is exclusively governed by Sec 16(4) of the CGST Act, 2017; the proper officer must reverse the ITC administratively without any show cause notice and without reference to Secs 73 or 74.

Q.12. Lakshmi Imports Pvt. Ltd. paid customs duty of Rs. 8 lakh on an import consignment in January 2022. Subsequently, the company realised it had inadvertently paid Rs. 2 lakh in excess — due to a computational error in self-assessment. It filed an application for refund of the excess duty in March 2023, which was 14 months after the date of payment. The Assistant Commissioner of Customs rejected the refund claim on the ground of limitation. Lakshmi Imports contended that the one-year limit is directory and not mandatory. What is the correct legal position under Sec 27 of the Customs Act, 1962?

(A) The refund claim is valid and must be sanctioned; Sec 27(1) of the Customs Act, 1962 prescribes a time limit of two years from the date of payment of duty for filing a refund application, and 14 months is well within this period.

(B) The refund claim is time-barred; Sec 27(1) of the Customs Act, 1962 mandates that an application for refund of customs duty must be made within one year from the date of payment of such duty (or, in the case of duty paid provisionally, one year from the date of final assessment); Lakshmi Imports filed its claim 14 months after payment, which exceeds the statutory one-year limitation, and the Assistant Commissioner's rejection is legally correct.

(C) The one-year limitation under Sec 27(1) is directory, not mandatory; courts have held that where excess duty was paid by a bona fide error and the department has no prejudice, the claim can be entertained beyond one year in the interest of justice.

(D) Customs duty refunds for excess payment made in self-assessment are not governed by Sec 27; they are governed by the re-assessment provisions under Sec 17(4) of the Customs Act, 1962, under which the importer must file a request for re-assessment within 30 days; Lakshmi Imports missed this window and cannot claim a refund at all.

Q.13. During search and seizure proceedings against Rajan, a business taxpayer, the Assessing Officer (AO) discovered evidence suggesting Rajan was in the process of disposing of immovable property and transferring funds abroad in a manner that could defraud the revenue. The AO issued an order under Sec 281B of the Income Tax Act, 1961 provisionally attaching Rajan's primary bank account and a commercial property. Rajan challenged the order on multiple grounds: (i) no prior approval was obtained from any superior authority; (ii) the attachment of a bank account is not permissible under Sec 281B; and (iii) the order does not specify any duration. What are the legal requirements for a valid provisional attachment under Sec 281B?

(A) Provisional attachment under Sec 281B of the Income Tax Act, 1961 does not require prior approval from any authority; the AO may order provisional attachment unilaterally at any stage of proceedings under the Act on forming a reasonable belief, and the attachment continues indefinitely until the assessment is completed.

(B) Provisional attachment under Sec 281B can be ordered only after the final assessment order is passed and the tax demand is raised; attaching assets during the pendency of search and assessment proceedings is impermissible as no tax liability has yet been crystallised by order.

(C) Sec 281B of the Income Tax Act, 1961 applies only to immovable property, shares, and securities; the provisional attachment of a bank account is outside its scope, and the AO must obtain a court injunction to freeze a bank account during pending proceedings.

(D) For a valid provisional attachment under Sec 281B of the Income Tax Act, 1961, the following conditions must be satisfied: (i) proceedings for assessment or reassessment must be pending against the assessee; (ii) the Assessing Officer must have reason to believe that allowing the assessee to retain control of the property would be prejudicial to the interests of the revenue; (iii) prior approval of the Principal Commissioner of Income Tax or Commissioner of Income Tax is mandatory before issuing the attachment order; and (iv) the order of provisional attachment remains in force for six months, extendable in specified circumstances up to a total of two years. Bank accounts may also be attached under Sec 281B.

Q.14. TechVision Inc., a company incorporated in the United States, licences its proprietary enterprise resource planning (ERP) software to Falcon Enterprises Ltd., an Indian company, for exclusive internal operational use (the software is not sub-licensed or resold). Falcon pays TechVision a licence fee of USD 1,00,000 per annum. Falcon's tax team must determine whether to withhold tax under Sec 195 of the Income Tax Act, 1961 and, if so, at what rate under the India-USA Double Taxation Avoidance Agreement (DTAA). The US company argues that the payment is business income ("Other Income") and not royalty because software is a commercial product. How is the licence fee classified under Art. 12 of the India-USA DTAA?

(A) Under Art. 12 of the India-USA DTAA, "royalties" are defined to include payments of any kind received as consideration for the use of, or right to use, any copyright of a literary, artistic, or scientific work, including computer software; India's domestic law (Explanation 2 to

Sec 9(1)(vi) of the Income Tax Act, 1961, as amended) also treats payments for use of computer software as royalty; accordingly, the annual licence fee paid by Falcon to TechVision for internal use of the ERP software is classifiable as royalty under Art. 12 of the India-USA DTAA, and Falcon is obligated to withhold tax under Sec 195 at the applicable treaty rate.

(B) The payment is classifiable as business income ("Other Income") under Art. 7 of the India-USA DTAA because the software licensing transaction is a commercial arms-length arrangement; it can be taxed in India only if TechVision has a Permanent Establishment in India, which is absent in this case.

(C) The annual licence fee is classifiable as "fees for included services" or "fees for technical services" under Art. 12 of the India-USA DTAA because the licensor provides technical support, patches, and software updates alongside the licence; this attracts a different withholding tax rate than pure royalties.

(D) Payments for computer software are excluded from the definition of "royalty" under both the India-USA DTAA and Indian domestic law because software is treated as "goods" under the Information Technology Act, 2000; no withholding obligation under Sec 195 arises on the licence fee payment.

Q.15. Alpha Ltd., an Indian company engaged in the manufacture and export of auto components, entered into international transactions with its German associated enterprise (AE), selling components at Rs. 800 per unit. The Transfer Pricing Officer (TPO) determined the Arm's Length Price (ALP) at Rs. 1,050 per unit using the Comparable Uncontrolled Price (CUP) method. Alpha Ltd. argued that since it was already reporting an overall business loss of Rs. 15 crore for the year, an upward ALP adjustment of Rs. 250 per unit would only reduce the loss and would not result in any additional tax liability; therefore, Sec 92 should not be applied. The TPO nevertheless proposed the ALP adjustment. Is the TPO's action legally permissible?

(A) Sec 92 of the Income Tax Act, 1961 applies only where the international transaction results in assessable income to the Indian company; where the company is reporting an overall loss, there is no "income arising from the international transaction" and hence no ALP adjustment can be made.

(B) Transfer pricing provisions under Secs 92 to 92F apply only where the associated enterprise is resident in a jurisdiction with a tax rate lower than India's; since Germany has a tax rate comparable to India, the TP provisions are not attracted and the TPO's action is without jurisdiction.

(C) Sec 92(1) of the Income Tax Act, 1961 mandates that any income arising from an international transaction between associated enterprises shall be computed having regard to the arm's length price; the obligation to compute income at ALP is not conditional on the company being profitable — it applies regardless of whether the company is in an overall loss position. The TPO's proposal to add back the shortfall between ALP (Rs. 1,050) and the actual transaction price (Rs. 800) is therefore legally permissible and must be carried out even though Alpha Ltd. is otherwise at a loss.

(D) Where an ALP adjustment would reduce a loss rather than create a positive taxable income, the adjustment may be made only with the prior approval of the Transfer Pricing Dispute Resolution Panel (DRP); the TPO alone does not have authority to make such an adjustment, and any order passed without DRP approval is without jurisdiction.

Detailed Solutions

Sol.1.

Solution

Concept — Article 268 of the Constitution: Art. 268 of the Constitution of India deals with duties levied by the Union but collected and appropriated by the states. Specifically, Art. 268(1) provides that such duties as are mentioned in the Union List but are levied and collected by the states — particularly stamp duties on bills of exchange, cheques, promissory notes, bills of lading, letters of credit, insurance policies, and transfer of shares — shall be assigned to the states within which such duties are respectively leviable. Parliament legislates the rates, but the collection and appropriation rest entirely with the states.

Step 1 — Entry 91, List I and Art. 268: Under Entry 91 of List I of the Seventh Schedule, Parliament has the power to legislate on rates of stamp duty in respect of bills of exchange, cheques, promissory notes, and other listed instruments. However, Art. 268(1) provides that the proceeds of such stamp duties shall not form part of the Consolidated Fund of India but shall be assigned to the states in which they are leviable; accordingly, the entire revenue from stamp duty on promissory notes executed in Rajasthan is assigned to Rajasthan.

Step 2 — Role of the state: The states are responsible for collecting stamp duties on the instruments specified in Art. 268 and for retaining the entire proceeds. Rajasthan's claim to the complete revenue from stamp duty on promissory notes within its territory is therefore constitutionally correct under Art. 268.

Why other options are wrong:

- Option B: The proceeds from stamp duties under Art. 268 do not vest in the Consolidated Fund of India; they are assigned entirely to the states. Parliament only legislates rates.
- Option C: Stamp duties on promissory notes are not a state subject under Entry 63 of List II; they appear in List I (Entry 91) but with collection and appropriation assigned to states under Art. 268 — a distinct constitutional mechanism.
- Option D: Art. 270 deals with taxes levied and collected by the Union and distributed between the Union and states on Finance Commission recommendations; it does not govern stamp duties on promissory notes, which fall under the Art. 268 regime.

Final Answer: Art. 268 provides that stamp duties on promissory notes are levied by the Union but collected and appropriated entirely by the states; Rajasthan's claim to the full proceeds is constitutionally correct. $\Rightarrow \boxed{A}$

Answer: (A) Go Back to Q1

Sol.2.

Solution

Concept — Article 285(1) Immunity of Union Property: Art. 285(1) of the Constitution provides that the property of the Union shall, save in so far as Parliament may by law otherwise provide, be exempt from all taxes imposed by a State or by any authority within a State. This is an absolute constitutional immunity that protects Union property from any state or local taxation, irrespective of the head of tax (property tax, entry tax, octroi, etc.).

Step 1 — Scope of the immunity: The immunity under Art. 285(1) extends to all forms of taxation by states or local authorities (including municipal corporations). There is no distinction based on the purpose for which Union property is used (defence vs. civilian administration); the text of Art. 285(1) is unqualified and comprehensive.

Step 2 — Application to the facts: The building is owned by the Central Government (Union property) and used exclusively for official governmental functions of a Union ministry. The municipal by-law imposing annual property tax on this building directly targets Union property and is therefore constitutionally invalid under Art. 285(1). No parliamentary enactment has authorised the state or municipal authority to levy this tax.

Why other options are wrong:

- Option A: Entry 49 of List II does not override Art. 285; constitutional immunity provisions take precedence over legislative entries in the Seventh Schedule.
- Option B: Art. 285 does not restrict the immunity to defence-related buildings; the constitutional text covers all Union property without a purpose-based exception.
- Option D: The immunity under Art. 285(1) is self-executing; it does not require Parliament to enact a separate statute declaring each property exempt. Parliament's power under Art. 285(1) is to abrogate or limit the immunity, not to create it.

Final Answer: Art. 285(1) provides an absolute constitutional immunity of Union property from state taxation; the municipal by-law levying property tax on the Central Government building is invalid. $\Rightarrow \boxed{C}$

Answer: (C) Go Back to Q2

Sol.3.

Solution

Concept — Section 10(10)(i): Gratuity exemption for government employees: Sec 10(10) of the Income Tax Act, 1961 provides three separate clauses for the exemption of gratuity: (i) Sec 10(10)(i) covers government employees (Central/State Government and local authority employees) — the entire gratuity is exempt without any monetary ceiling; (ii) Sec 10(10)(ii) covers non-government employees covered by the Payment of Gratuity Act, 1972 — exempt up to the least of: actual gratuity, 15 days' salary for each completed year of service, or Rs. 20 lakh; (iii) Sec 10(10)(iii) covers other non-government employees — exempt up to half-month's average salary for each completed year, subject to Rs. 20 lakh.

Step 1 — Sunaina's category: Sunaina is a government employee (IAS officer, Central Government service). She falls squarely within Sec 10(10)(i). The exemption under this sub-clause is unconditional and without a monetary ceiling; the entire amount of her retirement gratuity is exempt.

Step 2 — AO's contention is incorrect: The Rs. 20 lakh ceiling applies under Secs 10(10)(ii) and 10(10)(iii) — not under Sec 10(10)(i). The AO's application of the ceiling to Sunaina is a legal error; government employees are treated differently precisely because their gratuity is regulated by statutory service rules rather than the Payment of Gratuity Act.

Why other options are wrong:

- Option A: Government employees are not taxable on gratuity; Sec 10(10)(i) specifically exempts government gratuity in full. The statement is factually and legally incorrect.
- Option B: The Rs. 20 lakh ceiling does not apply to government employees; applying it to Sunaina is a misapplication of Sec 10(10)(ii)'s ceiling to Sec 10(10)(i)'s beneficiaries.
- Option C: Sec 10(10)(ii) covers non-government employees under the Payment of Gratuity Act; Sunaina, as a government employee, is governed by Sec 10(10)(i), not Sec 10(10)(ii).

Final Answer: Under Sec 10(10)(i), a government employee's retirement gratuity is wholly exempt without any monetary ceiling; Sunaina's entire Rs. 25 lakh is exempt. $\Rightarrow \boxed{\text{D}}$

Answer: (D) Go Back to Q3

Sol.4.

Solution

Concept — Section 24(b): Interest deduction for self-occupied property: Sec 24 of the Income Tax Act, 1961 provides for deductions from income under the head "Income from House Property." Sec 24(a) allows a standard deduction of 30% of the Net Annual Value (NAV). Sec 24(b) allows a deduction for interest paid on capital borrowed for acquisition, construction, repair, renewal, or reconstruction of property. For a self-occupied property, where the NAV is taken as nil, the deduction for interest on capital borrowed for construction (or purchase) after 1 April 1999, where construction is completed within five years from the end of the financial year in which the loan was taken, is capped at Rs. 2,00,000 per annum.

Step 1 — Self-occupied property cap: Since Prakash's house is self-occupied, its Annual Value is nil under Sec 23(2). The deduction for interest is therefore subject to the Rs. 2,00,000 statutory ceiling under the proviso to Sec 24(b). The actual interest paid (Rs. 2,70,000) exceeds this ceiling. The maximum permissible deduction is Rs. 2,00,000.

Step 2 — Standard deduction on NAV: Since the NAV of a self-occupied property is taken as nil, the standard deduction of 30% under Sec 24(a) is also nil; only the interest deduction under Sec 24(b), capped at Rs. 2,00,000, is available for a self-occupied property.

Why other options are wrong:

- Option A: No unlimited interest deduction is available for self-occupied property; the Rs. 2,00,000 ceiling is a statutory limitation that applies regardless of the nature of the institution from which the loan is taken.
- Option C: The Rs. 30,000 ceiling applies where the loan was taken before 1 April 1999 or where construction was not completed within five years; in Prakash's case, the loan was taken after 1 April 1999 and construction was completed within three years, so the Rs. 2,00,000 ceiling applies.
- Option D: Sec 24(b) covers interest on loans for both purchase and construction of property; the restriction to purchase loans only is incorrect.

Final Answer: The maximum interest deduction for a self-occupied property under Sec 24(b) (post-1 April 1999 loan, construction within five years) is Rs. 2,00,000; Prakash can claim only Rs. 2,00,000. $\Rightarrow \boxed{B}$

Answer: (B) Go Back to Q4

Sol.5.

Solution

Concept — Section 37(1): Revenue vs. capital expenditure: Sec 37(1) of the Income Tax Act, 1961 allows a deduction for any expenditure (not being expenditure of a capital nature or personal expenditure) laid out or expended wholly and exclusively for the purposes of the business or profession. The critical distinction is between capital and revenue expenditure. Expenditure that creates or acquires a capital asset, enduring advantage, or benefit of a permanent/durable nature is capital and is not deductible under Sec 37(1).

Step 1 — Nature of the non-compete fee: A one-time non-compete payment to a former director secures the right to carry on business without competition from that person for a fixed period. Indian courts and the Income Tax Appellate Tribunal have consistently held that such payments, particularly large lump-sum amounts for multi-year restrictions, create an enduring advantage for the payer's business — akin to acquiring a business protection right — and are therefore capital in nature. The expenditure is not incurred as part of day-to-day trading activities.

Step 2 — Disallowance under Sec 37(1): Since the payment is capital, it falls outside the scope of Sec 37(1). Omega Ltd. cannot claim it as a revenue deduction. The AO's disallowance is therefore legally correct. (Note: The sum may qualify for depreciation if capitalised as an intangible asset under Sec 32, but that was not the claim before the AO.)

Why other options are wrong:

- Option B: The "wholly and exclusively for business" test is a necessary but not sufficient condition for deductibility under Sec 37(1); the expenditure must also be of a revenue nature. A three-year restriction creating a lasting competitive benefit is still capital even if it serves a business purpose.
- Option C: Sec 36(1)(ii) covers bonuses and commissions to employees for services rendered; it does not cover non-compete payments to a former director, who is no longer an employee.
- Option D: Sec 28(va) taxes non-compete fees in the hands of the recipient as business income; it does not create an automatic deduction right for the payer under that section. The payer's deduction is governed by Sec 37(1), subject to the capital/revenue distinction.

Final Answer: The one-time non-compete fee is capital expenditure creating an enduring advantage; it is not deductible under Sec 37(1), and the AO's disallowance is correct. $\Rightarrow \boxed{\text{A}}$

Answer: (A) Go Back to Q5

Sol.6.

Solution

Concept — Section 43B (as amended by Finance Act 2021): Employer's PF contribution: Sec 43B of the Income Tax Act, 1961 originally allowed deduction of employer's contribution to PF/ESI if paid before the due date of filing the income-tax return under Sec 139(1), even if the specific fund's own due date was missed. The Finance Act 2021 amended Sec 43B by adding a specific proviso: employer's contribution to any provident fund or superannuation fund or gratuity fund or any other fund for the welfare of employees is deductible only if it is paid by the due date specified in the relevant law governing such fund (e.g., the EPF Act), not merely before the ITR due date.

Step 1 — Pre-amendment position (overridden): Prior to Finance Act 2021, several courts and the Supreme Court (in CIT v. Alom Extrusions) held that employer's PF contributions paid before the ITR due date were deductible. Parliament responded by overruling this through a specific amendment to Sec 43B.

Step 2 — Post-amendment position: After the Finance Act 2021 amendment (effective from AY 2021-22 onwards), the deduction for employer's contribution to PF is allowable only if the payment is made by the due date prescribed under the EPF Act (15th of the following month, or as specified). Sigma's payment on 20 June is after the EPF Act due date; accordingly, the deduction is not available for the current year and shifts to the year of actual payment.

Why other options are wrong:

- Option A: This represented the pre-Finance Act 2021 position; it was specifically overridden by Parliament's amendment to Sec 43B and is no longer the correct legal position.
- Option B: The deductibility of employer's contribution is not linked to the timing of the employee's own contribution; both are independent; Option B misstates the statutory conditions.
- Option D: No court has declared the Finance Act 2021 amendment unconstitutional; the amendment has been upheld as a valid exercise of Parliament's taxing power. The statement in Option D is factually incorrect.

Final Answer: Post Finance Act 2021 amendment, employer's PF contribution paid after the EPF Act due date is deductible only in the year of actual payment; Sigma's deduction for the current year is disallowed. $\Rightarrow \boxed{C}$

Answer: (C) Go Back to Q6

Sol.7.

Solution

Concept — Section 45(2): Conversion of capital asset into stock-in-trade: When a taxpayer converts a capital asset into stock-in-trade of his business, two tax events arise: (i) a capital gains event, and (ii) a business income event on the ultimate sale of the stock. Sec 45(2) of the Income Tax Act, 1961 specifically addresses the timing of the capital gains charge and the basis of computation.

Step 1 — Deferral of capital gains: Sec 45(2) provides that profits and gains arising from the conversion of a capital asset into stock-in-trade shall be chargeable to tax as capital gains of the *previous year in which such stock-in-trade is sold or otherwise transferred*, not in the year of conversion. This deferral mechanism is the distinguishing feature of Sec 45(2).

Step 2 — Basis of computation: The fair market value (FMV) of the capital asset on the date of its conversion is deemed to be the full value of consideration for the purpose of computing the capital gain. In Arjun's case: FMV on date of conversion = Rs. 40 lakh; cost of acquisition (inherited painting) = nil (or the cost to the previous owner for the purpose of Sec 49); the capital gain becomes chargeable in the year the painting is sold as stock-in-trade (i.e., February of the next financial year). The business profit is computed separately as the difference between the sale price (Rs. 55 lakh) and the FMV at conversion (Rs. 40 lakh, which becomes the opening stock value for business purposes).

Why other options are wrong:

- Option A: The capital gain is *not* chargeable in the year of conversion; Sec 45(2) expressly defers the charge to the year of sale of the stock-in-trade. Option A states the opposite.
- Option B: Conversion of a capital asset into stock-in-trade is specifically deemed a transfer under the Act for capital gains purposes; the claim that no capital gains arise is incorrect.
- Option C: The capital gain is not computed at cost of acquisition under Sec 45(2); it is computed using the FMV on the date of conversion as the full value of consideration, and the charge is deferred to the year of sale of

stock-in-trade.

Final Answer: Under Sec 45(2), capital gains on conversion of a capital asset to stock-in-trade are chargeable in the year of sale of the stock, with FMV at conversion as the full value of consideration. $\Rightarrow \boxed{\text{D}}$

Answer: (D) Go Back to Q7

Sol.8.

Solution

Concept — Section 72 and speculation loss restriction: Under Sec 73 of the Income Tax Act, 1961, a speculation loss (defined under Explanation to Sec 43(5)) can be set off only against speculation income in the same year or, if carried forward, only against speculation income in subsequent years. Sec 73(1) provides that a loss in speculation business shall not be set off except against profits and gains of another speculation business. A non-speculation business loss (governed by Sec 72) can be set off against any income under the head "Profits and Gains of Business or Profession" (other than speculation income, unless the assessee also has non-speculation profits).

Step 1 — Speculation loss set-off (Year 3): The Rs. 2 lakh speculation loss (AY Year 1) can be set off against the Rs. 3 lakh speculation income (AY Year 3) because both are speculation income/loss. After set-off, Rs. 1 lakh surplus speculation income remains taxable.

Step 2 — Non-speculation loss restriction: The Rs. 5 lakh non-speculation business loss (AY Year 1) cannot be set off against speculation income; it can only be set off against non-speculation business income under Sec 72. Since Delta Ltd. has no non-speculation business income in AY Year 3, the Rs. 5 lakh loss must be carried forward to future years (within the 8-year limit from AY Year 1).

Why other options are wrong:

- Option A: Non-speculation losses cannot be set off against speculation income; the two streams are kept separate by Sec 73. Option A incorrectly merges them.
- Option C: Speculation losses are carried forward for up to four assessment years (Sec 73(4)), not eight. Non-speculation business losses have an eight-year carry-forward. Option C also incorrectly states that both losses can be freely set off against speculation income.
- Option D: The order of set-off described in Option D is legally incorrect;

non-speculation losses cannot be set off against speculation income at all.

Final Answer: The Rs. 2 lakh speculation loss is set off against speculation income (Year 3); the Rs. 5 lakh non-speculation loss cannot be set off against speculation income and must be carried forward. $\Rightarrow \boxed{\text{B}}$

Answer: (B) Go Back to Q8

Sol.9.

Solution

Concept — Section 31(2) CGST Act: Time of issue of invoice for services: Sec 31(2) of the CGST Act, 2017 read with Rule 47 of the CGST Rules, 2017 requires a registered supplier of services to issue a tax invoice before or after the provision of service, but not later than 30 days from the date of supply of service (45 days for banking companies, financial institutions, and non-banking financial companies). The time of supply of services under Sec 13 of the CGST Act is determined by the earliest of: (i) date of issue of invoice (if issued within 30 days); (ii) date of receipt of payment; or (iii) date of supply of service.

Step 1 — Violation of Sec 31(2): Meridian issued the invoice 45 days after service completion. The prescribed limit for general service suppliers is 30 days. This is a violation of Sec 31(2) read with Rule 47. The time of supply is determined under Sec 13 based on the date of provision of services (1 March), not the late invoice date (15 April).

Step 2 — Consequences: As the tax should have been paid by the time of supply (1 March / applicable return date), any delay in payment of tax triggers interest liability under Sec 50 of the CGST Act. Additionally, the supplier is exposed to a general penalty under Sec 125 for contravention of provisions of the Act.

Why other options are wrong:

- Option B: Sec 31(2) read with Rule 47 prescribes a mandatory 30-day time limit for issue of service invoices; there is no discretion to issue at any time before year-end.
- Option C: A late invoice does not reset the time of supply; time of supply under Sec 13 is governed by its own rules and is not deferred to the invoice date when the invoice is issued beyond the prescribed period.
- Option D: A belated invoice has consequences beyond ITC availability for the recipient; the supplier is exposed to interest under Sec 50 and may face a general penalty under Sec 125.

Final Answer: Sec 31(2) mandates invoice issuance within 30 days for service suppliers; Meridian's 45-day delay violates this requirement, making it liable for interest and potential penalty. $\Rightarrow \boxed{\text{A}}$

Answer: (A) Go Back to Q9

Sol.10.

Solution

Concept — Section 34(2) CGST Act: Time limit for declaring credit notes: Sec 34(2) of the CGST Act, 2017 allows a registered supplier to issue a credit note for post-supply reduction of price (or return of goods, or deficient services). However, the reduction in output tax liability in respect of a credit note is subject to a strict time limit: the credit note must be declared in the return for the tax period not later than the September following the end of the financial year in which the supply was made, or the date of furnishing the relevant annual return, whichever is earlier.

Step 1 — Financial year of supply: The supply was made in March 2023, which falls in financial year 2022-23. The time limit for declaring the credit note is therefore the earlier of: (i) the return for September 2023 (filed by 20 October 2023); or (ii) the date of filing the annual return for FY 2022-23 (GSTR-9).

Step 2 — November 2023 declaration is beyond the time limit: Sunrise Traders declared the credit note in November 2023, which is after September 2023. Since September 2023 is the outer time limit (assuming annual return was not filed earlier), the credit note is time-barred under Sec 34(2). The department is correct in disallowing the reduction in output tax liability for that year.

Why other options are wrong:

- Option A: A three-year window does not exist under Sec 34; the provision imposes a strict deadline of September following the end of the financial year of supply (or annual return date, whichever is earlier).
- Option B: Sec 34 does not impose any three-year period; the correct time limit is September of the following financial year or annual return date, whichever is earlier.
- Option C: The CGST Act does impose a clear time limit under Sec 34(2); the statement that no time limit exists is incorrect and contrary to the express statutory text.

Final Answer: Sec 34(2) requires credit notes to be declared by September 2023 (for FY 2022-23 supplies); November 2023 declaration is time-barred and the department's disallowance is correct. ⇒ $\boxed{\text{D}}$

Answer: (D) Go Back to Q10

Sol.11.

Solution

Concept — Section 73 vs. Section 74 CGST Act: Demand provisions: Sec 73 of the CGST Act, 2017 governs demands for tax not paid, short paid, erroneously refunded, or ITC wrongly availed or utilised for any reason other than fraud, wilful misstatement, or suppression of facts. Sec 74 applies where such tax non-payment, short payment, refund, or ITC wrong availment is by reason of fraud, wilful misstatement, or suppression of facts. The limitation period under Sec 73 is three years from the due date of filing the annual return; under Sec 74, it is five years.

Step 1 — Determining the applicable section: The scenario states that the ITC was wrongly availed due to an inadvertent error (personal consumption classified as business use) without any fraud, wilful misstatement, or suppression of facts. This falls squarely within the scope of Sec 73. The proper officer must issue a show cause notice under Sec 73(1) within three years.

Step 2 — Penalty implications: Under Sec 73(5), if the taxpayer pays the tax and interest before the show cause notice is issued, no penalty is imposed. Under Sec 73(8), if paid within 30 days of the notice, the penalty is also nil. This is in contrast to Sec 74, where the penalty can be as high as 100% of the tax amount.

Why other options are wrong:

- Option A: Sec 74 requires fraud, wilful misstatement, or suppression; an inadvertent error does not meet this threshold. Treating all wrong ITC claims as deliberate would collapse the distinction between Secs 73 and 74.
- Option B: Secs 73 and 74 expressly cover wrong availment or utilisation of ITC; these provisions are not limited to output tax demands. Option B misreads the scope of the demand provisions.
- Option D: Sec 16(4) deals with the time limit for availing ITC (the annual return time limit); it is not an adjudication provision and does not provide for recovery of wrongly availed ITC without show cause notice. Secs 73/74 are the correct adjudication route.

Final Answer: Wrongly availed ITC without fraud is governed by Sec 73 of the

CGST Act, 2017; the demand must be made within three years from the annual return due date. ⇒ $\boxed{C}$

Answer: (C) Go Back to Q11

Sol.12.

Solution

Concept — Section 27(1) Customs Act, 1962: One-year limitation for refund: Sec 27(1) of the Customs Act, 1962 provides that any person claiming refund of any duty paid by him shall make an application in such form and manner as may be prescribed to the Assistant/Deputy Commissioner of Customs, before the expiry of one year from the date of payment of such duty. This limitation is mandatory and goes to the jurisdiction of the authority to entertain the claim.

Step 1 — Mandatory nature of the time limit: The Supreme Court and various High Courts have consistently held that the one-year limitation period under Sec 27 is mandatory, not directory. The customs authorities have no power to condone delay beyond one year; condonation of delay provisions applicable to court proceedings do not apply to customs refund applications.

Step 2 — Application to Lakshmi Imports: Duty was paid in January 2022. The one-year limitation expired in January 2023. Lakshmi Imports filed the claim in March 2023 — two months after the limitation period expired. The claim is therefore time-barred and the Assistant Commissioner correctly rejected it on the ground of limitation.

Why other options are wrong:

- Option A: The limitation period under Sec 27(1) is one year, not two years; Option A misstates the statutory period.
- Option C: While unjust enrichment is a relevant bar under Sec 27 (refund goes to Consumer Welfare Fund if burden passed on), Option C is a distractor that does not address the threshold issue of limitation; moreover, it does not cure the time-bar problem.
- Option D: Customs refunds for excess duty paid in self-assessment are governed by Sec 27; Sec 17(4) deals with re-assessment of goods at the time of clearance and does not provide the exclusive channel for refund claims based on computational errors post-clearance.

Final Answer: Sec 27(1) prescribes a mandatory one-year limitation; Lakshmi Imports' claim filed 14 months after payment is time-barred and correctly rejected. ⇒ $\boxed{B}$

Answer: (B) Go Back to Q12

Sol.13.

Solution

Concept — Section 281B: Provisional attachment during pending proceedings: Sec 281B of the Income Tax Act, 1961 empowers the Assessing Officer to provisionally attach any property of the assessee during the pendency of any proceeding under the Act. The power is available as a protective measure to safeguard the interests of the revenue where there is reason to believe that the assessee may alienate or dispose of assets.

Step 1 — Statutory requirements: The conditions for a valid provisional attachment under Sec 281B are: (i) any proceeding (assessment, reassessment, search assessment under Sec 153A/153C, etc.) must be pending; (ii) the AO must have "reason to believe" that the assessee is likely to dispose of the property to defraud the revenue; (iii) prior approval of the Principal Commissioner of Income Tax or Commissioner of Income Tax is mandatory — the AO cannot act without this prior approval; and (iv) the order has effect for six months from the date of the order, which may be extended by the Principal Commissioner/Commissioner for reasons recorded in writing, but the total period cannot exceed two years.

Step 2 — Bank accounts are attachable: Sec 281B does not restrict provisional attachment to immovable property, shares, or securities; any "property" of the assessee (including bank accounts) can be provisionally attached. Rajan's challenge that bank accounts cannot be attached under Sec 281B is therefore legally incorrect.

Why other options are wrong:

- Option A: Prior approval of the Principal Commissioner/Commissioner is mandatory; the AO cannot act unilaterally under Sec 281B. Moreover, the attachment has a statutory duration limit, not an indefinite one.
- Option B: Provisional attachment is specifically designed for use during the pendency of proceedings; it is not restricted to the post-assessment period. The entire purpose of Sec 281B is to protect revenue before a demand is crystallised.
- Option C: Bank accounts are attachable under Sec 281B; the provision covers all property. The restriction to immovable property, shares, and securities stated in Option C has no statutory basis.

Final Answer: A valid Sec 281B attachment requires pending proceedings, reason to believe of prejudice to revenue, and mandatory prior approval of the Principal Commissioner/Commissioner; bank accounts are also attachable. ⇒ $\boxed{\text{D}}$

Answer: (D) Go Back to Q13

Sol.14.

Solution

Concept — Article 12 India-USA DTAA: Royalty definition and software: Art. 12 of the India-USA DTAA defines "royalties" to mean payments of any kind received as consideration for the use of, or right to use, any copyright of literary, artistic, or scientific work, including computer software, cinematograph films or films or tapes used for radio or television broadcasting, any patent, trade mark, design, or model. Under India's domestic law, Explanation 2 to Sec 9(1)(vi) of the Income Tax Act, 1961 (as amended by Finance Act 2012, with retrospective effect) expressly includes payments for "use of" or "right to use" computer software within the definition of royalty.

Step 1 — Software licence as royalty: The ERP software licence fee paid by Falcon to TechVision is a payment for the right to use the software (copyright). Under both Art. 12 of the India-USA DTAA and Explanation 2 to Sec 9(1)(vi) of the ITA, this is classifiable as royalty. The fact that the software is used internally (not sub-licensed or resold) does not change the classification; the payment is for the right to use a copyright.

Step 2 — Withholding obligation: Since royalty is sourced in India (the payer is resident in India and the payment arises from use of software in India), the payment is taxable in India under Sec 9(1)(vi) as income accruing in India. Falcon Enterprises is required to withhold tax under Sec 195 at the rate prescribed under Art. 12 of the India-USA DTAA (typically 10–15% depending on the applicable treaty rate and applicable protocol).

Why other options are wrong:

- Option B: Art. 7 (Business Profits) applies only if the income is not classified as royalty under Art. 12; since the payment falls within the Art. 12 royalty definition, Art. 12 as a special provision prevails over Art. 7. Moreover, the specific article governs over the general.
- Option C: "Fees for technical services" under the India-USA DTAA and ITA are distinguishable from royalties; the payment here is for the right to use software (a copyright), which is royalty, not fees for technical services. Technical services involve making available technical knowledge or skill, which

is not the case in a pure software licence.

- Option D: The classification of software as "goods" under the IT Act, 2000 is an e-commerce / sales tax characterisation; it does not override the specific treatment of software payments as royalties under the ITA (Explanation 2 to Sec 9(1)(vi)) and the India-USA DTAA (Art. 12). Sec 195 withholding is mandatory.

Final Answer: Software licence fees for internal use are royalty under Art. 12 of the India-USA DTAA and Explanation 2 to Sec 9(1)(vi) ITA; Falcon must withhold tax under Sec 195. $\Rightarrow \boxed{A}$

Answer: (A) Go Back to Q14

Sol.15.

Solution

Concept — Section 92(1) ITA: ALP mandatory regardless of profit/loss: Sec 92(1) of the Income Tax Act, 1961 mandates that any income arising from an international transaction between associated enterprises shall be computed having regard to the arm's length price. The provision does not contain any exception for cases where the enterprise is in an overall loss position; the obligation to compute income at ALP is unconditional and applies in all cases involving international transactions between associated enterprises.

Step 1 — ALP adjustment when company is at a loss: Transfer pricing provisions are designed to prevent base erosion through non-arm's-length pricing. The objective applies equally where a company is at a loss — because understating revenue in an international transaction reduces taxable income (and increases the loss), thereby eroding the tax base. The TPO's power to make an ALP adjustment under Sec 92C(3) is not contingent on the company having positive taxable income.

Step 2 — Effect of the adjustment: In Alpha Ltd.'s case, the ALP adjustment of Rs. 250 per unit (Rs. 1,050 minus Rs. 800) will increase the computed income from the international transaction. If the company is at a loss, the adjustment will reduce the quantum of the loss (rather than creating a fresh positive income). The TPO is legally correct in making the adjustment; whether it creates a tax demand depends on the overall income computation, but the adjustment itself is mandatory under Sec 92(1).

Why other options are wrong:

- Option A: Sec 92(1) does not limit its application to cases where the international transaction results in income; it applies to all international transactions between associated enterprises. The existence of an overall loss does not exclude the application of Sec 92.
- Option B: The applicability of TP provisions is not determined by whether the AE's jurisdiction has a lower tax rate than India; Secs 92 to 92F apply to all international transactions between associated enterprises as defined in Sec 92A, irrespective of the jurisdiction's tax rate.
- Option D: The Dispute Resolution Panel (DRP) under Sec 144C is available as an alternative remedy for eligible assesses disputing draft assessment orders; it is not a precondition for the TPO to make an ALP adjustment. The TPO has independent statutory authority under Sec 92CA to determine ALP and propose adjustments.

Final Answer: Sec 92(1) mandates ALP computation for all international transactions between associated enterprises regardless of the company's overall loss; the TPO's adjustment is legally permissible. $\Rightarrow \boxed{\text{C}}$

Answer: (C) **Go Back to Q15**

Answer Key

Quick Reference Answer Key

Q.1	Q.2	Q.3	Q.4	Q.5	Q.6	Q.7	Q.8	Q.9	Q.10
A	C	D	B	A	C	D	B	A	D

Q.11	Q.12	Q.13	Q.14	Q.15
C	B	D	A	C

Topic-wise Answer Summary

Q.No.	Topic	Answer
1	Constitutional — Art. 268 (stamp duties: Union levies, states collect)	A
2	Constitutional — Art. 285 (immunity of Union property from state tax)	C
3	Income Tax — Sec. 10(10)(i) (gratuity exemption: government employee)	D
4	Income Tax — Sec. 24(b) (interest deduction: self-occupied property cap)	B
5	Income Tax — Sec. 37(1) (non-compete fee: capital vs. revenue expenditure)	A
6	Income Tax — Sec. 43B (employer PF contribution: Finance Act 2021 amendment)	C
7	Income Tax — Sec. 45(2) (conversion of capital asset to stock-in-trade)	D
8	Income Tax — Sec. 72/73 (carry forward: speculation loss set-off restriction)	B
9	GST — Sec. 31(2) (tax invoice for services: 30-day time limit)	A
10	GST — Sec. 34(2) (credit note: time limit September of following year)	D
11	GST — Sec. 73 (demand without fraud: 3-year limitation period)	C
12	Customs — Sec. 27(1) (refund: mandatory one-year limitation)	B
13	Income Tax — Sec. 281B (provisional attachment: prior approval required)	D
14	DTAA — Art. 12 India-USA (software licence fee as royalty)	A
15	Transfer Pricing — Sec. 92(1) (ALP adjustment even in loss position)	C