

NATIONAL LAW UNIVERSITY, JODHPUR

End Term Examination-Jan-May- 2025

UG-VIII Semester

Subject- Direct Taxation (Compulsory)

Time: Three Hours

Marks. 100

Instructions:

1. Attempt any five questions... Marks have been indicated against each question.
2. No clarifications can be sought during the examination.
3. Bare Act is not allowed.

Q.1) In May 2020 Ms. Nirmala Sitaram, an Indian resident, from Mumbai, had applied to "America's Got Talent," which was a State-owned entity as a production assistant. She was informed that she had also cleared the competitive exam. But she was subsequently never offered a job. On enquiry she found that a number of female applicants who had applied to the show had not been offered jobs even after clearing the competitive test. Thus, all the similar situated female applicants along with Ms. Nirmala filed a class action suit in the District Court of Utah against the State claiming discrimination in employment on the basis of sex and race.

The matter went from the District Court of Utah right up to the United States Supreme Court. While the case was still being heard in the United States Supreme Court, the United States Government offered a settlement proposal to the women who had brought the class action suit. The offer to all the women in the class action suit was for \$620 million as a compensation for the loss of their job to settle the entire suit. It is to be noted that US labour laws require payment of 15% of potential salary offered in case job is denied due to sexual or racial discrimination (this would have amounted to \$100 million in toto).

The settlement proposal was subsequently accepted by all the women and a consent decree was approved by the District Court of Utah on 15 December 2023. Ms. Nirmala received \$6 million as part of the settlement on the same day.

In the previous year 2023-24 Ms. Nirmala came back to India on 15 of July, 2023 and stayed back here in India till 31st October 2023. Ms. Nirmala had visited India at many occasions from 2019 to 2024 to attend some family functions and other related issues. She is maintaining some bank accounts in India and earning the interest income from this. She is also receiving the dividend income from various Indian Companies. Total Income from Indian sources was 15 Lakh in the relevant Previous Year. She was present in India in the last 4 years amounting in all more than 365 days.

Ms. Nirmala came to US for the first time on November 1, 2023, and was there 31 consecutive days (from November 1 through December 1, 2023). She stayed in the United States for the rest of the year. During the following year (2024), she was a resident of the United States under the substantial presence test. She opts for the first-year choice for 2023 because she was in the United States in 2023 for a period of 31 days in a row (November 1 through December 1) and for at least 75% of the days following (and including) the first day of that 31-day period (46 total days of presence in the United States divided by 61 days in the period from November 1

through December 31 equals 75.4%). Thus, she is a resident for both countries and accordingly, relevant provisions of US-India Double Tax Avoidance Treaty apply.

The Indian Income Tax Department wanted to classify the settlement as 'income' and tax the same. Ms. Nirmala on the other hand contended that the settlement amount constituted a 'capital receipt.' The Commissioner of Income Tax (Appeals) found that the said amount could be classified under the head of 'Salary' from employer as a profit in lieu of salary and hence was income of the Assessee which could be taxed. She has also contended before the authority that she is non-resident in the relevant year and because income had accrued outside India, she is not liable here. Discuss It.

(Marks,20)

Q.2) TechPro India Pvt. Ltd. (TechPro), an Indian company, purchases software from SoftGlobal Inc., a company incorporated in the United States. The software is a pre-packaged, off-the-shelf product that is sold to multiple customers without any customization. Under the distribution agreement between TechPro and SoftGlobal Inc., TechPro is granted the right to reproduce and resell the software to Indian customers, with an additional right to modify it based on client needs. However, TechPro does not acquire any ownership rights over the software it reproduces or modifies, as all intellectual property (IP) rights remain vested with SoftGlobal Inc. Further, an End User License Agreement (EULA) governs the software's use by Indian clients.

Indian clients can acquire the software in two ways:

1. Through TechPro – purchasing either the standard version or a modified version.
2. Directly from SoftGlobal's website – purchasing the unmodified, pre-packaged version.

For the financial year (FY) 2020-2021, TechPro and the direct buyers remitted INR 1,50,00,000/- (Indian Rupees One Crore Fifty Lakhs Only) to SoftGlobal without deducting tax at source (TDS) under Section 195 of the Income Tax Act, 1961.

The Indian Income Tax Department, however, issues a demand notice, contending that the payments constitute royalties under Section 9(1)(vi) of the Income Tax Act and the India-USA DTAA, and are thus subject to Tax Deducted at Source (TDS). The department relies on the 2012 Amendment to the Income Tax Act, which expanded the definition of "royalty" to include payments for the use of computer software. While the Appellant content that the payments should be classified as sale of goods, not royalties, because there is no transfer of copyright as a right, leading to no requirement for TDS. Further, they state that 2012 amendment cannot override the DTAA.

The Appellant has appealed from this order of the Commissioner of Income Tax (Appeals) before the Income Tax Appellate Tribunal (ITAT), Delhi. Argue the case on following key issues:

1. Whether TechPro and the direct buyers required to deduct TDS under Section 195 before remitting payments to SoftGlobal?



2. Whether the payments made to SoftGlobal amounts to royalty under Section 9(1)(vi) of the Income Tax Act and the India-USA DTAA?
3. What the explanations to Section 9(1)(vi), introduced by the 2012 amendment, override the provisions of the India-USA DTAA?

(Marks,20)

Q.3) Nuns & Sisters, Priests or Fathers, who also rendering their Services as Teachers in the School run by Missionaries, receive Grant in aid from State Government, to the extent of their salary as per scheme formulated by Govt. They claimed that they are bound by canon law for their vows of poverty to the Christ and that they cannot be taxed in respect of the salary received from the State Govt. by respective school, as the receipt of salary in their hand entirely belong to the institution, Church or Religion as diversion by an overriding title, and having taken such vows of poverty in their Canon Law, they have suffered a civil death and renounced the world and therefore cannot be subjected to tax under Income Tax Act. Decide the validity of the arguments of the Assessee with relevant case laws.

(Marks,20)

Q.4) "It was only for the good of his subjects that he collected taxes from them, just as the sun draws moisture from the earth gives it back a thousand-fold." In the light of this statement discuss the cardinal principles of taxation and their application under Income Tax Act.

(Marks,20)

Q.5) The appellant-firm, namely, Akshay Construction and Investment Co., is a firm engaged in the business of real estate development. Since the assessment year 1995-96, the appellant-company is engaged in the construction of a multi-flat housing complex known as "Akshay Dham", in Jodhpur. For this project the appellant-company has entered into an agreement on November 1, 2020, with Bhatia Housing Co-operative Society Ltd., which was engaged in implementation of the said housing complex for residential and commercial purposes. Under the agreement, the appellant-firm agreed to provide a plot of land measuring 3,44,816 sq. ft. and to build thereon in the form of buildings/flats/structures, etc. The structures required to be constructed on the area measuring 3,16,710 sq. ft. for a composite consideration of Rs. 27,07,67,001 including the cost of the land. Under the contract, the project was required to be completed within a period of 3 (three) years from the date of agreement. The appellant-company further entered into an agreement dated November 20, 2020, with Arihant Architect Services pvt. Ltd., for payment of consultancy and supervision charges of the aforesaid project. One of the directors of Appellant company was also the director of Arihant Architect co. ltd. Under this agreement, the consultancy firm has to provide all kinds of consultancy and supervision services including getting prepared the structural planning, designing and details of all civil works and also to supervise the day-to-day progress of the work at all stages and the consultancy firm was to be paid, in lieu of the services rendered, three per cent of the payment received by the appellant-company against the construction work through cash only because of prevalent market customs. As per the appellant, during the year of assessment 21-22, a sum of Rs. 8, 70,518 was paid by the appellant-company to Arihant Architect Services pvt. ltd., as consultancy charges and the appellant-company claimed the deduction as business expenditure of this amount which has been paid to the consultancy firm. The assessing authority disallowed

the consultancy charges whereas the Commissioner (Appeals) allowed the charges but the Tribunal accepting the findings of the Commissioner of Income-tax (Appeals) disallowed the charges of consultancy partly. Discuss this issue with relevant provisions and cases on the point.

(Marks,20)

Q.6) Write short note on the followings.

(Marks, 5*4=20)

- (i) Concept of Business Income under Income Tax Act, 1961
- (ii) Business Expenditure under Section 37 of Income Tax Act, 1961
- (iii) Procedure of Assessment Under Income Tax Act, 1961
- (iv) Residential Status and Incidence of Tax

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Q.1). The taxpayer Alkatel Corp. was incorporated in U.K. and was a wholly owned subsidiary of Techsoft U.K. The Tax treaty between India and U.K. considers a company as tax resident of U.K. The main business of the taxpayer is the supply of the hardware and software which is used in the business of rendering telecommunication services and for this purpose it undertakes project of supply of the telecommunication equipment on a turnkey basis. In telecommunication projects, the activities involved are supply of hardware and embedded software, installation and commissioning of the telecommunication equipment and it's after sales service. It also supplies some software on a CD disk to the operators in India for use in turnkey projects. The operators have a right to make a copy of software for certain other purposes relating to business.

During the year under consideration (2022-23), the taxpayer entered into contract with 10 cellular operators in India for supply of hardware and software (equipment) for which installation and testing in India was done by its group entities. The contract was signed in Singapore.

The Swan Corp. Ltd another U.K. company and the taxpayer assessee group entity, had a branch in India. Alkanet Communication Ltd, (Mumbai) an Indian entity, was another company belonging to same group. These entities were in the business of the installation of equipment and provided marketing support to the tax payer. Indian Entity has right to modify the hardware and software as per customer requirements. During the year under consideration, for the first Four months, the work of installation and marketing support was carried out by Swan Corp. and for remaining eight months the same work was assigned to Alkanet Communication, the Indian associate. The incomes of these entities were separately offered to tax in India. As per the terms of the supply contract between the taxpayer and the cellular operators the equipment supplied was not to be accepted till it passed an acceptance test, which was carried out in India.

The tax authority passed an order and issued the show cause notice in which it held that the tax payer had a business connection in India and its income was, accordingly, held to be taxable in India. Further, it held that as the tax payer had provided software to the cellular operator under a license, the part of consideration specified separately in respect of software was taxable as royalty as per the provision of Income tax law as well as India-U.K. DTAA. Decide the validity of claim made by the department. (Marks, 20)

Q.2) The Contract of Employment of Mr. Mohan Joshi was terminated by the employer and he was not given his dues during the relevant previous year. He filed a suit for the recovery of his dues. Subsequently, after a prolonged litigation and upon a decree by the court the due amount along with interest paid by the employer. Discuss the taxability of the amount with relevant provisions and cases if any.

(Marks, 20)

Q.3) Swiss & co. (Assessee) obtained a working capital facility of Rs. 50 lakhs from a bank in October 23. The partners of the firm having another sister concern named Swede & Co. The partners of Swiss & Co. decided that a sum of Rs. 20 Lakhs shall be given as interest free loan to sister concern Swede & Co. For the year ended 31-03-24 bank interest on working capital facility was Rs 5 lakhs in respect of Swiss & Co. and they paid the interest and claimed as deduction under Section 36 (1) (iii), but assessing officer has not allowed it. For the previous year 2024-25, they did not make a payment and become a defaulter than bank has converted the interest into loan or borrowing. The Swiss & Co. again claimed the deduction of unpaid interest which has been converted into loan for the accounting year 2024-25. Discuss the validity of claim of the Assessee for both previous years.

(Marks, 20)

Q.4) Mittal & co. is engaged in marketing of sugar in certain towns of Rajasthan. The assessee in order to ward of competition entered into an agreement with Vipul & Co. (another assessee engaged in marketing of sugar in Rajasthan). The agreement envisaged that the assessee Mittal & co. would pay Rs. 11 crores to Vipul & Co. for the reason that the Vipul & Co. will not market any sugar & sugar product for a period of 8 years in the state of Rajasthan. The assessee Mittal & Co. claims the payment made as revenue expenditure for the reason that no asset of enduring nature was obtained by making the payment. Similarly, the recipient Vipul & Co. claims the receipt as capital receipt in lieu of source of income. Decide this issue with help of suitable provisions.

(Marks, 20)

Q.5) Sterling & Pierce LLP (S&P) is a Limited Liability Partnership incorporated in the United States, providing legal and business consultancy services to multinational clients, including those with operations in India. S&P specializes in regulatory compliance, corporate structuring, and tax advisory, often assisting clients with cross-border transactions. **Consider that in US, partners are liable for tax and not the partnership**, therefore, partnership firm is not a resident under US. For rest, provisions of DTAA apply as is.

S&P does not maintain a permanent office in India. However, its consultants, including senior partners, occasionally visit India for client meetings, due diligence, and negotiations, amounting to 91 days in total. Further, the invoices are in name of the firm, not partners. When they come to India, they stay for the 91 days in a hotel in Mumbai.

For the Assessment Year 2017-18, S&P earned revenue amounting to USD 2 million from services rendered in connection with Indian business engagements. The firm claims that they are not liable to any tax in India, but the Assessing Officer (AO) classified this income as "Fees for Technical Services" (FTS) under Section 9(1)(vii) of the Indian Income Tax Act, 1961, thereby deeming it taxable in India. The Commissioner of Income Tax (Appeals) upheld the order of AO.

S&P contends that its services should not be categorized as FTS, and that it is entitled to benefits under the India-US Double Taxation Avoidance Agreement (DTAA).



The Appellant has appealed from this order of the Commissioner of Income Tax (Appeals) before the Income Tax Appellate Tribunal (ITAT), Mumbai. Decide the case on following key issues: -

1. Whether S&P, as an LLP registered in the US, qualifies as a resident under the India-US DTAA and is therefore entitled to treaty benefits?
2. Whether the consultancy and legal advisory services provided by S&P qualify as "Fees for Technical Services" (FTS) under Section 9(1)(vii) of the Income Tax Act, 1961 or Business Income?
3. Are there any other legal or factual grounds that justify or negate the taxation of S&P's income in India? (Marks, 20)

Q.6) Write short note on the followings. (Marks, 5*4=20)

- (i) Concept of Agricultural Income under Income Tax Act, 1961.
- (ii) Concept of Transfer under Capital Gain.
- (iii) Diversion of Income by an Overriding Title
- (iv) Concept of Income Under the Income Tax Act, 1961