Paper-7 Direct Taxation

Time Allowed: 3 hours **Full Marks: 100**

All the questions relate to the assessment year 2015-16, unless stated otherwise.

Working notes should form part of the answers.

Section A

[Answer all the Questions]

(1) Answer the following sub-divisions briefly in the light of the provisions of the Income-tax Act, 1961: (1×20)

(i) Amit, resident individual having business income, is required to audit his books of accounts under the Income Tax Act. What is the due date by which Amit is required to file his return?

Answer:

The due date of filing of return is 30th September of the Assessment Year for Amit, as his books of accounts is required to be audited under the Income Tax Act.

(ii) Calculate the amount of tax payable by Mr. Samik, a resident individual, who has taxable Long Term Capital Gains of ₹55,000 and income from other sources ₹1,70,000 during the previous year 2014-15.

Answer:

As the amount of total income i.e. ₹2,25,000 (55,000+1,70,000) does not exceed the exemption limit of ₹2,50,000, no tax is payable by Mr. Samik for the previous year 2014-15.

(iii) XYZ Ltd. paid Excise Duty for the previous year 2014-15 on 07.10.2015. In which assessment year, will it be allowed?

Answer:

XYZ Ltd. paid tax after the due date for filling return of income, deduction will be allowed only in the year of actual payment i.e. previous year 2015-16 relevant to assessment year 2016-17.

(iv) The assessee claims the set-off of unabsorbed depreciation of ₹75,000 of a discontinued business against the profits of another business. Can he do so? Justify.

Answer:

As per section 32(2) unabsorbed depreciation of a discontinued business can be set-off against the profits of any other business and thereafter against the income of any other head.

Hence, in the given case, the set-off of unabsorbed depreciation of ₹75,000 of a discontinued business is allowable.

(v) Can an LLP be understood as body corporate, independent of its partners?

Answer:
Yes. Section 2(d) of Limited Liability Partnership Act, 2008 understands the LLP as body corporate.

(vi) Where the private trust is charged at the maximum marginal rate u/s 164(1), whether basic exemption is to be allowed?

Answer:
No. The tax should be levied at the maximum marginal rate as laid down in the Act itself, without allowing the basic exemption as laid down in the Finance Act.

(vii) Where a co-operative society is eligible for relief u/s 80-IA as well as u/s 80P, which relief will have precedence?

Answer:
Relief u/s 80-IA will be first given and balance will be reckoned for relief u/s 80P.

(viii) Can an Assessing Officer assess the income below the returned income or assess the loss higher than the returned loss?

Answer:
The Assessing Officer cannot assess income under section 144 for an assessment below the returned income or cannot assess the loss higher than the returned loss.

(ix) What are the consequences if a person fails to comply with the provisions of Sec. 139A i.e. quoting of PAN?

Answer:
As per Sec. 272B(2), if a person fails to comply with the provisions of Sec. 139A, the Assessing Officer may direct that such person shall have to pay, by way of penalty, a sum of ₹10,000.

(x) Does tax planning have any effect on the rate of tax?

Answer:
Yes. As dispersal of income over different taxable entities, slab rate can be reduced.

(xi) Could a road in a factory building, used exclusively for industrial purpose, be treated as a plant for purposes of depreciation?

Answer:
Road could not be treated as a plant, but only as a building for purposes of depreciation.

(xii) How is income to be computed, if part of a property is let out and part is self-occupied?

Answer:

It has to be treated as two residential units and income from each unit has to be computed according to law by allocating common outgoings on a basis proportionate to area of occupation.

(xiii) Is commission paid to a property agent for acquiring property deductible from "Income from Other Sources"?

Answer:

Since income from the property is assessable only under the head "Income from House Property", such commission is not deductible from "Income from Other Sources".

(xiv) Mr. More gifted a piece of land to his daughter in law after obtaining approval of the authorities constructed 5 shops as at and let out the same. The value of shops on valuation date 31.03.2015 is ₹50,00,000. In whose hand it is taxable?

Answer:

The asset transferred to daughter-in-law without adequate consideration is deemed to be the asset of the transferor provided it is in the form of taxable asset. In the given case, shops are not assets as per section 2(ea) and hence not included in the wealth of Mr. More.

(xv) Mohit, while computing net wealth, wants to claim deduction of outsourcing income tax and wealth tax liabilities of preceding years of ₹2,75,000. Can he do so?

Answer:

Income tax and wealth tax liabilities are not deductible while computing net wealth.

(xvi) Can the transfer price ignore dumping, R&D expenses and start-up cost in judging the arm's length price?

Answer:

Such matters like dumping, R&D expenses and start-up cost are commercial realities, which cannot be ignored.

(xvii) Under Transfer Pricing Study, in the Annexure to which form is the statement of particulars to be furnished?

Answer:

Under Transfer Pricing Study, the statement of particulars is to be furnished in the Annexure to Form No. 3CEB for the Income Tax Act, 1961.

(xviii) What do you mean by Residual Profit Split?

Answer:

Residual Profit Split is the residual profit which is apportioned to each party based on ownership of non-routine intangibles (i.e. network reach, efficiency of Sales & Marketing team, etc).

(xix) Can the Board enter in Advance Pricing Agreement?

Answer:
Section 92CC empowers the Board with the approval of the Central Government to enter into an Advance Pricing Agreement with any person.

(xx) Who can enter into an APA?

Answer:
Any person, who –
(i) has undertaken an international transaction; or
(ii) is contemplating to undertake an international transaction,
shall be eligible to enter into an APA.

2. Answer any four Questions [4 × 13 = 52]

(a)(i) 'U' was born in 1977 in India. His parents were also born in India in 1948. His grandparents were, however, born in England. 'U' was residing in India till 15.3.2012. Thereafter, he migrated to England and took the citizenship of that country on 15.3.2014. He visits India during 2014-15 for 90 days. Determine the residential status of 'U' for assessment year 2015-16. [5]

Solution:

In this case, U is neither a citizen of India nor a person of Indian origin, because neither he nor his parents nor his grandparents were born in undivided India.

Although in this case, he does not satisfy the first condition of category A but he satisfies the second condition as he was in India for more than 60 days during the relevant previous year and his stay in the four preceding previous years was as under:

	₹
2013 – 14	Nil
2012 – 13	Nil
2011 – 12	349 days
2010 - 11	365 days
	714 days

He is therefore, resident in India.

For determining whether he is "ordinarily resident in India", he has to satisfy both the conditions of category B. He is resident for more than one previous year in the preceding 10 years and the second condition is also satisfied as he is in India for 730 days or more in the 7 preceding previous years. Hence, he is resident and ordinarily resident in India.

(a)(ii) A sole proprietary concern, whose written down value of the block of assets as on 1.04.2014 carrying 15% rate of depreciation was ₹5,00,000, purchased another asset of the same block on 1.04.2014 for ₹2,00,000. The said concern was succeeded by the company on 1.09.2014. After the succession, the company purchased another asset of the same block on 1.1.2015 for ₹1,60,000. Compute the depreciation available to the proprietary concern and the company for the assessment year 2015-16. [8]

Solution:

As there is a succession of the proprietary concern during the previous year, it will be first assumed as if no succession had taken place and the depreciation will be calculated as under:

	₹
Written down value at the beginning of the year	5,00,000
Additions during the year for 180 days or more	2,00,000
W.D.V. for the purpose of charging depreciation	7,00,000
Depreciation on ₹7,00,000 @ 15%	1,05,000

Apportionment between the predecessor and successor

(1) Depreciation allowed to sole proprietary concern (predecessor) (Number of days assets used by the concern i.e. April 1 to 31st August = 153 days) 1,05,000 × $\frac{153}{365}$	44,014
(2) Depreciation allowable to company (Successor) (i) assets which were used by both the assessee: Number of days asset used by the company (01.09.14 to 31.03.15) 1,05,00 × $\frac{212}{365}$	60,986
(ii) asset which was used by company assessee only Depreciation on ₹1,60,000 @ 7.5% (50% of the normal rate as it is acquired and put to use for less than 180 days)	12,000
	72,986

(b)(i) ABC Ltd an Indian company has received the following dividend from its subsidiary companies:

1. **₹ 10,00,000 on 5.08.2014 from S Ltd. a subsidiary company in India.**
2. **₹20,00,000 on 09.07.2014 from T Ltd., a specified company in Germany in which ABC Ltd. holds 60% shares.**

ABC Ltd. wishes to declare dividend of ₹1 crore to its shareholders.

Determine the amount of dividend distribution tax payable by ABC Ltd.

Also determine the tax payable on dividend received from T Ltd. assuming the total income of ABC Ltd. including the above dividend is ₹80,00,000.

What shall be your answer if ABC Ltd. holds 36% shares in T Ltd. [10]

Solution:

	₹	₹
Total dividend proposed to be declared		1,00,00,000
Less: Dividend received from		
S Ltd.	10,00,000	
T Ltd.	20,00,000	30,00,000
Balance amount which DDT is payable		70,00,000
Amount of DDT payable		
Net dividend to be gross up (₹70,00,000/85 x 100)	82,35,294	
DDT payable on ₹82,35,294@16.995%	13,99,588	
Tax payable by ABC Ltd. on its total income		
- On ₹20,00,000 received from T Ltd. @ 15%	3,00,000	
- Balance total income 60,00,000 @ 30%	18,00,000	
	21,00,000	
Add: Education cess & SHEC @ 3%	63,000	
	21,63,000	

Second part -
Since ABC Ltd hold 36% shares in T Ltd., it is not subsiding company although T Ltd. is a specified company. Hence, dividend received from T Ltd. shall not be deductible while computing DDT payable by ABC Ltd.

	₹
Total dividend proposed to be declared	1,00,00,000
Less: Dividend received from S Ltd.	10,00,000
Balance	90,00,000
Amount of DDT payable	
Net dividend to be gross up (₹90,00,000/85 x 100)	1,05,88,235
DDT payable on ₹1,05,88,235@16.995%	17,99,471

(b)(ii) X is a 50% partner in XY and Co., a partnership firm, from which his wife Mrs. X is getting salary of ₹ 1,20,000 p.a. The Total Income of X (before clubbing) is ₹3,60,000 while the Total Income of Mrs. X (exclusive of such salary), is ₹4,50,000. Compute the total income of Mr & Mrs. X. [3]

Solution:

The clubbing provisions will be applicable and Total Income-of X and Mrs. X will be determined as under:

	₹	₹
Mr. X Other Income	3,60,000	
Income from salary (salary of Mrs. X)	1,20,000	4,80,000
Mr. X Total Income		4,50,000

It may be noted that clubbing in the above case is mandatory, even if such clubbing in some case results into benefit to the assesses and loss to revenue.

(c) Determine the Gross Total Income of X and his wife from the following particulars for the year ending 31.3.2015:

(i) X and his wife are partners in a firm carrying on cloth business, their respective shares of profit being ₹78,000 and ₹60,000.

(ii) Their 16 years old son has been admitted to the benefits of another firm, from which he received ₹80,000 as his share of profit in the firm and ₹90,000 as interest on capital. The capital was invested out of the minor's own funds amounting to ₹9,00,000.

(iii) A house property in the name of X was transferred to his wife on 1.12.2014 for adequate consideration. The property has been let at a rent of ₹30,000 p.m

(iv) Debentures of a company of ₹1,40,000 and ₹1,12,000 purchased two years ago are in the names of X and his wife respectively, on which interest is receivable at 10% p.a. His wife had in the past transferred ₹70,000 out of her income to X for the purchase of the debentures in X's name.

(v) X had transferred ₹50,000 to his wife in the year 2010 without any consideration which was given as a loan by her to Y. She earned ₹20,000 as interest during the earlier previous years which was also given on loan to Y. During the financial year 2014-15, she received interest at 10% p.a. on ₹70,000.

(vi) X transferred ₹75,000 to a trust, the income accruing from its investment as interest amounted to ₹7,500, out of which ₹5,000 shall be utilised for the benefit of his son's wife and ₹2,500 for the benefit of his son's minor child. **[13]**

Solution: Computation of Gross Total Income of X for the assessment year 2015-16

		₹	₹
(1)	Income from House Property:		
	Rental value for 8 months (i.e., before transfer) (8 × 30,000)	2,40,000	
	Less: 30% as statutory deduction	72,000	1,68,000
(2)	Profit from Business:		
	(i) Share from firm (exempt)	Nil	
	(ii) Minor Son's share in another firm (Exempt)	Nil	
	(iii) Interest on minor's capital with firm (₹90,000 – Exemption u/s 10(32) ₹1,500)	88,500	88,500
(3)	Income from other Sources:		
	(i) Interest @ 10% on ₹70,000 Debentures (only one-half of ₹1,40,000 were bought by own funds)	7,000	
	(ii) Interest received by his wife @ 10% on ₹50,000 (being transferred without any consideration)	5,000	

	(iii) Interest on ₹50,000 from his trust (Interest income utilized for the benefit of son's wife)	5,000	17,000
	Gross Total Income		2,73,500

Computation of Gross Total Income of Mrs. X for the assessment year 2015-16

Income from House Property:	₹	₹
Rental value for 4 months (i.e., after transfer) (30,000 × 4)	1,20,000	
Less: 30% as statutory deduction	36,000	84,000
Income from business:		
Share from firm (Exempt)	Nil	
Income from other Sources:		
(i) Interest on ₹ 1,12,000 10% Debentures	11,200	
(ii) Interest on ₹70,000 10% Debentures in husband's name but funds invested by her	7,000	
(iii) Interest on ₹20,000 @ 10% (This interest is on accrued income of ₹50,000, which have been transferred to her by the husband and interest on such accrued income is treated as the income of the transferee, although the income on the transferred amounts is treated as the income of the transferor as it was transferred without any consideration.)	2,000	20,200
Gross Total Income		1,04,200

Note:

1. Shares of profit from a firm, which is assessed as such, is fully exempt u/s 10(2A) in the hands of the partners; although husband and wife may be partners in the same firm. Even in a case where one spouse gifts some amount to the other spouse to be invested as capital in the firm, the clubbing provisions though applicable, it will not affect the Total Income since the share of the profit is itself exempt. However, if interest on capital contribution is received, it will be clubbed to the extent of the amount invested as capital contribution out of the transfer made without adequate consideration.
2. Similarly, the minor son's income though clubbed, but as the share of the profit from the firm is exempt, will not affect the Total Income. However, if interest on capital contribution is received, it will be clubbed to the extent of the amount invested as capital contribution out of the transfer made without adequate consideration.
3. Where the asset is transferred to a Trust for the benefit of son's wife, the income from such asset is taxable in the hands of the transferor. However, income utilised for the benefit of son's minor son shall be clubbed in the hands of that parent of the son's minor son, whose income is greater. It shall, therefore, not be clubbed in the hands of the transferor *i.e.* X.

(d)(i) Anu purchased 5,000 shares of S Ltd. @ ₹200 per share on 5.7.2014. S Ltd. declares a dividend of ₹10 per share. The record date is fixed as 4.9.2014. Anu received the dividend immediately after the record date. The above shares were sold by Anu on 5.11.2014 for:

(a) ₹175 per share

(b) ₹192 per share

(c) ₹205 per share

Compute the income/loss in each case. [9]

Solution:

As the shares have been acquired within 3 months prior to the record date and sold within 3 months after the record date, section 94(7) shall be applicable.

Situation I

Dividend of ₹50,000 shall be exempt in the hands of Anu.

Short term capital loss on shares

₹8,75,000 - ₹ 10,00,000 = (-) ₹ 1,25,000

Dividend received = ₹50,000

Loss to the extent of dividend claimed as exempt shall not be allowed to be carried forward

Therefore, capital loss of ₹75,000 (₹1,25,000 - ₹50,000) shall be allowed to be carried forward.

Situation II

Dividend of ₹50,000 shall be exempt in the hands of Anu.

Short term capital loss on shares

₹9,60,000 – ₹10,00,000 = (-) ₹40,000

Dividend received = ₹50,000

Therefore, capital loss of ₹40,000 on shares shall not be allowed to be carried forward.

Situation III

Dividend of ₹50,000 shall be exempt in the hands of Anu.

Short term capital gain on shares

₹10,25,000 – ₹10,00,000 = ₹25,000

As there is capital gain instead of capital loss, section 94(7) is not applicable and such capital gain shall be taxable.

(d)(ii) Q, a resident of India, aged 81 years, submits the following information for the previous year 2014-15:

		₹
(1)	**Income from salary**	**4,86,000**
(2)	**Interest on Fixed Deposits with Banks (gross)**	**49,000**
(3)	**Long-term capital gains**	**1,10,000**
(4)	**Short-term capital gains on the sale of equity shares on which securities**	**10,000**

He pays ₹5,000 as Life Insurance Premium on a policy of ₹40,000 and deposits ₹22,000 in Public Provident Fund account.
Compute the tax payable by Q for the assessment year 2015-16. [4]

Solution:

		₹
Step 1	Gross Total Income (without LTCG and STCG)	5,35,000
Step 2	Less: Deduction permissible u/s 80C	27,000
	Total income (without LTCG and STCG)	5,08,000
Step 3	Tax on ₹5,08,000 (20% on amount in excess of ₹5,00,000)	1,600
Step 4	Tax on long-term capital gain (20% of ₹ 1,10,000)	22,000
Step 5	Tax on short-term capital gain (15% of ₹ 10,000)	1,500
Step 6	Total tax payable	25,100
	Add: Education cess & SHEC - @ 3%	753
	Total tax payable	25,853
	Tax rounded off	25,850

(e) R, S, G are three members of an AOP sharing profit and losses in the ratio of 2:2:1. The profit and loss account of the AOP for year ending 31.3.2015 is as follows:

	₹		₹
Cost of good sold	**52,00,000**	**Sales**	**63,00,000**
Interest to members @ 24%		**Long-term capital gain**	**1,60,000**
R	**48,000**		
S	**72,000**		
G	**24,000**		
Salary to members			
R	**90,000**		
G	**40,000**		
Other expenses	**3,80,000**		
Net Profit	**6,06,000**		
	64,60,000		**64,60,000**

Other Information:

1. **The AOP gives a donation of ₹40,000 to a public charitable trust (not debited to P/L A/c) which is eligible u/s 80G.**
2. **Out of other expenses ₹20,000 are not deductible by virtue of section 43B.**

Other incomes and particulars of the members are given below.

	Amount ₹	Nature of Income	Deduction u/s 80D	PPF contribution ₹
R	**1,22,000**	**Saving bank Interest**	**₹3,000 medical**	**12,000**
S	**1,16,000**	**Saving bank Interest**		**4,000**
	10,000	**Dividend from U.T.I**		
G	**1,10,000**	**Interest on company Deposits**	**₹4,000 medical insurance premium**	**5,000**

Find out the liability of the AOP and members for the assessment year 2015 –16. [13]

Solution:

A. Computation of Total Income of AOP

1. Profits & gains	₹	₹	₹
Net Profit as per P and L A/c		6,06,000	
Add: Disallowed expenses			
Interest to members			
R	48,000		
S	72,000		
G	24,000		
Salary to members			
R	90,000		
G	40,000		
Other expenses not allowed u/s 43B	20,000	2,94,000	
		9,00,000	
Less: Income not taxable under this head			
Long-term capital gain		1,60,000	
Business Income		7,40,000	
2. Capital gains			
Long-term capital gain		1,60,000	
Gross Total Income		9,00,000	
Deduction u/s 80G			
Donation ₹40,000 @ 50%		20,000	
Total Income		8,80,000	

A. Computation of Tax of AOP

As no member of AOP has income exceeding the maximum exemption limit nor any member is taxable at a rate higher than the maximum marginal rate, the tax shall be charged on the total income of AOP at the rate applicable to individuals.

Tax on first ₹2,50,000	Nil
Next ₹2,50,000@10%	25,000
Next ₹2,20,000 @ 20%	44,000
Long-term capital gain ₹ 1,60,000 @ 20%	32,000
Total Tax	1,01,000
Add: Education cess & SHEC @ 3%	3,030
	1,04,030

B. Allocation of AOP's total income

	R	S	G
Interest on capital	48,000	72,000	24,000
Salary	90,000	-	40,000
Share [2:2:1] (8,80,000 - 1,60,000 (LTCG) - 2,74,000)	1,78,400	1,78,400	89,200
Business income	3,16,400	2,50,400	1,53,200
Long-term capital gain	64,000	64,000	32,000
Share of profit of each member	3,80,400	3,14,400	1,85,200

Member R

	₹	₹
Business income	3,16,400	
Long-term capital gain	64,000	
Share from AOP		3,80,400
Other Income: Bank Interest		1,22,000
Gross Total Income		5,02,400
Deductions		
(i) U/s 80C	12,000	
(ii) U/s 80D	3,000	
(iii) U/s 80TTA	10,000	25,000
Total Income		4,77,400
Tax on ₹2,50,000 of total income	Nil	
On next 1,63,400 of total income @ 10%	16,340	
Tax on Long-term capital gain ₹64,000 @ 20%	12,800	29,140
Less: Rebate u/s 86 [₹29,140 × 3,80,400/4,77,400]		23,219
Net tax		5,921
Less: Rebate u/s 87A		2,000
		3,921
Add: Education cess & SHEC @ 3%		118
Tax rounded off		4,040

Member S

Share from AOP	₹	₹
Business income	2,50,400	
Long-term capital gain	64,000	3 ,14,400
Other Income: Bank interest		1,16,000
Dividend from UTI		Exempt
Gross Total Income		4,30,400
Deduction u/s 80C	4,000	
Deduction u/s 80TTA	10,000	14,000

Total Income		4,16,400
Tax on ₹3,52,400	10,240	
Tax on long-term capital gain ₹64,000 @ 20%	12,800	23,040
Less: Rebate of tax u/s 86 [₹23,040 × 3,14,400/4,16,400]		17,396
		5,644
Less: Rebate u/s 87A		2,000
		3,644
Add: Education cess & SHEC @ 3%		109
Tax rounded off		3750

Member G

Share from AOP	₹	₹
Business income	1,53,200	
Long-term capital gain	32,000	1,85,200
Other income: Interest on deposits		1,10,000
Gross total income		2,95,200
Less: Deduction u/s 80C	5,000	
Deduction u/s 80D	4,000	9,000
Taxable Income		2,86,200
Tax on ₹4,200	420	
Tax on long-term capital gain ₹32,000 @ 20%	6,400	6,820
Less: Rebate u/s 86 [6,820 × 1,85,200/2,86,200]		4,413
Net Tax Payable		2,407
Less: Rebate u/s 87A		2,000
		407
Add: Education cess and SHEC @ 3%		12
Tax rounded off		420

Section B

3. Answer any two Questions [1 × 8 = 8]

(a) (i) S. Kumar has the following assets on 31st March, 2015:

Asset	Market Value (₹)	Loan Outstanding (₹)
Gold	**87,00,000**	**10,00,000**
Residential House at Pune	**45,00,000**	**2,00,000**
Residential House at Andheri	**90,00,000**	**27,00,000**
Residential House at Mahape (Let out though out the year)	**65,00,000**	**11,00,000**

Commercial House at Thane used for his own business	**1,15,00,000**	**50,00,000**
Shares	**25,00,000**	**5,00,000**
Boat	**1,50,000**	**2,50,000**
Motor Car	**9,00,000**	**3,00,000**
Bank deposit	**58,00,000**	**Nil**
Commercial complex at Andheri having 25 offices	**2,50,00,000**	**1,55,00,000**

Besides above mentioned loans, S. Kumar took a loan of ₹1,00,000 from his bank for his brother's marriage. Moreover, out of loan of ₹2,50,000 taken for boat, he utilized ₹50,000 for financing expenses on his foreign visit.
Determine his Net Wealth. [6]

Solution:
Net wealth of S. Kumar shall be determined as under:

Asset	Market Value (₹)	Loan outstanding (₹)
Gold	87,00,000	10,00,000
Residential House at Pune	45,00,000	2,00,000
Residential House at Andheri [exempt u/s 5(vi)]	—	—
Residential House at Mahape (Let out though out the year) [not an asset]	—	—
Commercial House at Thane used for his own business [not an asset]	—	—
Shares [not an asset]	—	—
Boat	1,50,000	2,00,000
Motor Car	9,00,000	3,00,000
Bank deposit [not an asset]	—	—
Commercial complex at Andheri having 25 offices [not an asset]	—	—
Total	**1,42,50,000**	**17,00,000**

Net Wealth = Market value of assets – Loan outstanding
= ₹(1,42,50,000 – 17,00,000) = ₹1,25,50,000

Note: Loan for brother's marriage and loan utilised for foreign visit are not deductible.

(a)(ii) Manoj, Karta of HUF, out of HUF funds gifted to his nephew an amount of ₹3,00,000 on 01.01.2015. The coparceners of the HUF challenged the gifts and as a consequence gifts were held to be void. Discuss whether the amount of ₹3,00,000 is taxable as wealth of Manoj HUF for the valuation dated 31.03.2015. [2]

Solution:
As the amount actually gifted by the HUF, the provisions of Sec. 4(5A) are not attracted. As on the valuation date 31.03.2015, the said amount of ₹3,00,000 does not belong to the HUF. Therefore, the same cannot be charged to Wealth Tax in the hands of Manoj HUF. Hence, in the case, challenging by the coparceners is of no consequence.

(b)(i) Alok owns a residential house property. It is given by him as rent free house to his general manager Jitendra who looks after the business of Alok. Annual salary of Jitendra is ₹4,80,000. Alok claims that since the house is used for business purposes, it comes in section 2(ea)(i) and it is not an asset. Is the claim tenable in law? Justify. [3]

Solution:

The house owned by Alok is a residential house. A residential house is covered by section 2(ea)(i)(1) and since it is not owned by a company, the benefit of exemption is not available and it is an asset.

As the house is used for business purposes, one may argue that it is covered by the exception given u/s 2(ea)(i)(3) and it is not an asset.

In the case of a residential house, section 2(ea)(i)(1) is a special provision. According to judgment of the case Union of India vs. Indian Fisheries (P.) Ltd. [1965] 57 ITR 331 (SC), if there is an apparent conflict between two independent provisions of law, the special provision must prevail. The general provision, however, controls the cases where the special provision does not apply as the special provision is applicable to the extent of its scope. In other words, a special rule controls or cuts down the general provision.

Consequently, section 2(ea)(i)(1) covers a residential house and section 2(ea)(i)(3) covers a house used for carrying on a business or profession but other than a residential house.

In the given case, the house owned by Alok is an asset as the condition of section 2(ea)(i)(1) does not satisfied.

(b)(ii) Akhtar owns three cars and silver furniture (value of cars being ₹25,00,000 and of silver furniture being ₹35,00,000 of 31.03.2015). He take loan of ₹4,70,000 by pledging there to invest in shares. You are requested by Akhtar to calculate amount of wealth tax payable by him for the assessment year 2014-15. [4]

Solution:

Assessee: Akhtar **Valuation Date: 31.03.2015** **Assessment Year: 2015-16**

Calculation of Net Wealth

Particulars	Amount (₹)
Car	25,00,000
Silver Furniture	35,00,000
Shares (not an asset)	Nil
Gross Wealth	60,00,000
Less: Debt (loan of ₹4,70,000 is not deductible as it is taken to purchase shares which are not assets)	Nil
Net Wealth	**60,00,000**
Less: Basic Exemption	30,00,000
Net Taxable Wealth	**30,00,000**
Tax @ 1%	**30,000**

(b)(iii) Mrs. Suman Yadav received jewellery from her father at the time of her marriage in 1956 was of the value of ₹25,50,000 on 31st March, 2015. Is this included in the net wealth of Mrs. Suman Yadav? [1]

Answer:

Since the jewellery received in 1956 is outside the purview of section 4. Therefore, it will be included in the net wealth of Mrs. Suman Yadav.

Section C

4. Answer any two Questions [2 × 10 = 20]

(a)(i) When can Profit Split Method (PSM) be used for determination of Arm's Length Price in an international transaction? [4]

Answer:

The Indian TPR affirms that the PSM may be applicable mainly in the following cases:

(1) Transactions involving transfer of unique intangibles;

(2) Multiple inter-related international transactions which cannot be evaluated separately for determining the ALP of any one transaction.

I. The extent of economies of backward and forward integration, the existence of intangibles on both sides of the transaction, and complex functional and transactional structures may limit the use of standard approaches to economic analysis for transfer pricing purposes (i.e. performing comparable company searches to apply the TNMM). In those circumstances, the arm's length nature of transactions may be better evaluated by considering the transaction from an end-to-end perspective, and thus PSM can be applied.

II. This method can be used in situations where economies of integration differentiate the tested party from the comparables, provided these are taken into account in the principle for allocating profits. The method enables accounting for valuable intangibles being developed on both sides of the transaction.

III. The allocation of profit can be calculated based on principles that take into account the contribution of intangibles in the industry's or the group's value creation process.

IV. This method is also well suited to complex transactions where several entities are involved in the same functions and it is not possible to define precisely the scope of functions and responsibilities. While this method has not been widely used, it has been somewhat popular in the financial services industry.

(a)(ii) Essol LLP of France and Sushma Ltd. of India are associated enterprises. Sushma Ltd. imports 3,000 compressors for Air Conditioners from Essol at ₹7,500 per unit and these are sold to Paharpur Cooling Solutions Ltd. at a price of ₹11,000 per unit. Sushma Ltd. had also imported similar products from Cold Ltd and sold outside at a Gross Profit of 20% on Sales. Essol offered a quantity discount of ₹1,500 per unit. Cold could offer only ₹500 per unit as Quantity Discount. The freight and customs duty paid for imports from France had cost Sushma Ltd. ₹1,200 per piece. In respect of purchase from Cold Ltd, Sushma Ltd. had to pay ₹200 only as freight charges.
Determine the Arm's Length Price and the amount of increase in Total Income of Sushma Ltd. [6]

Solution:

Computation of Arm's Length Price of Products bought from Essol, France by Sushma Ltd.

Particulars	₹	₹
Resale Price of Goods Purchased		11,000
Less: Adjustment for differences		
Normal gross profit margin @ 20% of sale price [20% × ₹11,000]	2,200	
Incremental Quantity Discount by Essol [₹1,500 – ₹500]	1,000	
Difference in Purchase related Expenses [₹1,200 – ₹200]	1,000	4,200
Arms Length Price		6,800

Computation of Increase in Total Income of Sushma Ltd.

Particulars	
Price at which actually bought from Essol LLP of France	₹7,500
Less : Arms Length Price per unit under Resale Price Method	₹ (6,800)
Decrease in Purchase Price per Unit	₹700
No. of Units purchased from Essol	3,000 units
Increase in Total Income of Sushma Ltd. [3,000 Units × ₹700]	₹21,00,000

(b)(i) An arrangement whose main purpose (or one of the main purposes) is to obtain a tax benefit (and which also satisfies at least one of the four tests), can be declared as an "impermissible avoidance arrangements" — what are these four tests? [2]

Answer:

The four tests are —

(1) The arrangement creates rights and obligations, which are not normally created between parties dealing at arm's length.
(2) It results in misuse or abuse of provisions of tax laws.
(3) It lacks commercial substance or is deemed to lack commercial substance.
(4) It is carried out in a manner, which is normally not employed for bona fide purpose.

(b)(ii) Describe in short the procedure to deal with requests for bilateral or multilateral advance pricing agreements. [5]

Answer:

(I) Where a person has made request for a bilateral or multilateral advance pricing agreement in an application filed in Form No. 3 CED in accordance with rule 10-I, the request shall be dealt with subject to provisions of this rule.

(II) The process for bilateral or multilateral advance pricing agreement shall not be initiated unless the associated enterprise situated outside India has initiated process of advance pricing agreement with the competent authority in the other country.

(III) The competent authority in India shall, on intimation of request of the applicant for a bilateral or multilateral agreement, consult and ascertain willingness of the competent authority in other country or countries, as the case may be, for initiation of negotiation for this purpose.

(IV) In case of willingness of the competent authority in other country or countries, as the case may be, the competent authority in India shall enter into negotiation in this behalf and endeavour to reach a set of terms which are acceptable to the competent authority in India and the competent authority in the other country or countries, as the case may be.

(V) In case of an agreement after consultation, the competent authority in India shall formalise a mutual agreement procedure arrangement with the competent authority in other country or countries, as the case may be, and intimate the same to the applicant.

(VI) In case of failure to reach agreement on such terms as are mutually acceptable to parties mentioned in sub-rule 4, the applicant shall be informed of the failure to reach an agreement with the competent authority in other country or countries.

(VII) The applicant shall not be entitled to be part of discussion between competent authority in India and the competent authority in the other country or countries, as the case may be; however the applicant can communicate or meet the competent authority in India for the purpose of entering into an advance pricing agreement.

(VIII) The applicant shall convey acceptance or otherwise of the agreement within thirty days of it being communicated.

(IX) The applicant, in case the agreement is not acceptable, may at its option continue with process of entering into an advance pricing agreement without benefit of mutual agreement process or withdraw application in accordance with rule 10J.

(b)(iii) How can you classify the methods for determining arm's length price in international transactions? [3]

Answer:

In order to ensure that a transfer price meets the arm's length standard, the OECD (Organization for Economic Co-operation and Development) guidelines have indicated five transfer pricing methods that can be used. These methods fall in two categories:

(1) Traditional Transaction Methods;
(2) Transactional Profit Methods.

As per Sec.92C of the Income Tax Act, 1961, the methods for determining Arm's Length Price may be represented as under:

(1) Comparable Uncontrolled Price Method,
(2) Resale Price Method,
(3) Cost Plus Method,
(4) Profit Split Method,
(5) Transactional Net Margin Method,
(6) Such other method as may be prescribed by the Board

Traditional Transaction Methods	Transactional Profit Methods
Comparable Uncontrolled Price Method Resale Price Method Cost Plus Method	Profit Split Method Transactional Net Margin Method

(c)(i) Elaborate whether adjustment is required in the context of transfer pricing provisions where the transfer price adopted for an international transaction concluded is ₹36 Lakhs whilst the Arm's Length Price determined using most appropriate method are ₹32 Lakhs and ₹42 Lakhs. [4]

Answer:

Arithmetical Mean: Where more than one price is determined by the most appropriate method, the Arm's Length Price (ALP) shall be taken to be arithmetical of such prices.

Deemed ALP: If the variation between the ALP and the price at which the international transaction has been undertaken does not exceed the notified % of the actual price, then the Actual Price at which the international transaction has been undertaken shall be deemed to be ALP.

Analysis and Conclusion:

(a) Since in the given case, there are 2 prices of ₹32 Lakhs and ₹42 Lakhs determined by the most appropriate method, the average price of ₹37 Lakhs [(32 + 42) ÷ 2] shall be considered as ALP.

(b) But, as the variation between the average price (₹37 Lakhs) and the actual price (₹36 Lakhs) is less than 3% of the actual price (i.e. 1 Lakhs < 1.11 Lakhs = 37 Lakhs x 3%), the actual price of ₹36 Lakhs shall be considered as the Arm's Length Price.

(c)(ii) Briefly explain Profit Split Method in determining Arm's Length Price. [6]

Answer:

Profit Split Method is mainly applicable in international transactions involving transfer of unique intangibles or in multiple international transactions which are so inter-related that they cannot be evaluated separately for the purpose of determining the Arm's Length Price of any one transaction.

Step I: Determine the combined net profit of the associated enterprises arising from the international transaction in which they are engaged.

Step II: Determine the relative contribution made by each of the associated enterprises to the earning of such combined net profit. This is determined on the basis of the functions performed, assets employed and risks assumed by each enterprise and on the basis of reliable external market data which indicates how such contribution would be determined by unrelated enterprises performing comparable functions in similar circumstances.

Step III: Split the combined net profit amongst the enterprises on the basis of reasonable returns and in proportion to their relative contributions, as determined in Step II. (Note below)

Step IV: Arm's Length Price = Profit apportioned to the assessee under Step III + Cost incurred during the transaction.

Note: Combined Net Profit shall be split as under:

III.A. First Split = Reasonable Return: Allocate an amount to each enterprise so as to provide it with a basic return appropriate for the type of international transaction with reference to market returns achieved in similar types of transactions by independent enterprises.

III.B. Second Split = Contribution Ratio: Allocate the residual net profit amongst the enterprises in proportion to their relative contribution.

III.C. Total Profit: Share of profit of each enterprise = Step III.A + III.B