Paper-7 – Applied Direct Taxation

The following table lists the learning objectives and the verbs that appear in the syllabus learning aims and examination questions:

	Learning objectives	Verbs used	Definition
LEVEL B	KNOWLEDGE What you are expected to know	List	Make a list of
		State	Express, fully or clearly, the details/facts
		Define	Give the exact meaning of
	COMPREHENSION What you are expected to understand	Describe	Communicate the key features of
		Distinguish	Highlight the differences between
		Explain	Make clear or intelligible/ state the meaning or purpose of
		Identity	Recognize, establish or select after consideration
		Illustrate	Use an example to describe or explain something
	APPLICATION How you are expected to apply your knowledge	Apply	Put to practical use
		Calculate	Ascertain or reckon mathematically
		Demonstrate	Prove with certainty or exhibit by practical means
		Prepare	Make or get ready for use
		Reconcile	Make or prove consistent/ compatible
		Solve	Find an answer to
		Tabulate	Arrange in a table
	ANALYSIS How you are expected to analyse the detail of what you have learned	Analyse	Examine in detail the structure of
		Categorise	Place into a defined class or division
		Compare and contrast	Show the similarities and/or differences between
		Construct	Build up or compile
		Prioritise	Place in order of priority or sequence for action
		Produce	Create or bring into existence

Paper-7 – Applied 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.

Answer all questions.

Question No 1.

(i) Mr. G was born in Lahore in 1946. He has been staying in England since 1972. He came to visit India on 2.10.2014 and left India on 31.3.2015. Determine his residential status for assessment year 2015-16. [2]

Solution:

An Individual is said to be resident in India if he satisfies any one of the following two condition:

(i) He is in India for a period or periods amounting in all to 182 days or more in the relevant previous year; or

(ii) He is in India for 60 days or more during the relevant previous year and has been in India for 365 days or more during 4 previous years immediately preceding the relevant previous year.

During the previous year 2014-15, Mr. G stays in India for 181 days (30 + 30 + 31+ 31+ 28 + 31 i.e. 2.10.2014 to 31.3.2015). He does not satisfy the first condition of 182 days. Further, second condition is not applicable in his case as he is a person of Indian origin (He was born in undivided India) and visits India during the previous year. He is, therefore, a Non-Resident.

(ii) X is an employee of ABC Ltd. getting a salary of ₹ 40,000 per month which is 'due' on the last day of the month but is paid on the 7th of next month. Salary for which months will be taxable for assessment year 2015-16? [2]

Solution:

Income from salary is taxable on receipt or accrual basis, whichever is earlier. Any salary due from an employer to an assessee in the previous year, whether paid in that previous year or not, shall be chargeable to income tax under the head of salaries. If the salary is payable on monthly basis, it normally becomes due at the end of the month although it is paid in the next month. In this case, it will be taxable on 'due' basis because 'due' is earlier than 'receipt'. Therefore, salary is normally taxable from April to March as the salary of March becomes due at the end of the month.

However, in some cases the salary becomes due on the 1st day of the next month. In that case we shall tax the salary from March to February because salary of month of march of current year will be due only in the next financial year and the salary of month of March of last previous year became due only on 1st April of the current year.

In this case, for assessment year 2015-16 the relevant previous year is 2014-15. Therefore, salary will be taxable for the months of April 2014 to March, 2015.

(iii) State the circumstances under which Profit Split Method is applicable for determination of arm's length price under International Transactions. [2]

Solution:

This method is used mainly in International Transactions/Specified Domestic Transactions involving transfer of unique intangibles, or in multiple International Transactions/Specified Domestic Transaction 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.

(iv) What are the limitations in implementation of Transactional Net Margin method while computing the arm's length price of an International Transactions? [1]

Answer:

Limitations in implementation of Transactional Net Margin method

Tax Payers may not have access to enough specific information on the profit attributable to uncontrolled transactions to make a valid application of the method.

(v) What are the steps involved under Cost plus method for determination of Arm's Length Price? [2]

Answer:

Steps involved under Cost plus method for determination of Arm's Length Price

Step	Procedure
I	Determine the Direct and Indirect Costs of production incurred by the Enterprise, in respect of property transferred or services provided to an Associated Enterprise.
II	Determine the Normal GP mark-up to such costs (computed under same accounting norms) arising from the transfer or provision of the same or similar property or services by the Enterprise, or by an Unrelated Enterprise, in a comparable uncontrolled transaction(s).
III	Adjust the Normal GP mark-up referred to in Step II, to take into account the functional and other differences, if any, between the International Transaction / Specified Domestic Transaction and the comparable uncontrolled transactions, or between the Enterprises entering into such transactions, which could materially affect such profit mark-up in the open market or reasonable adjustments can be made to eliminate material effect of such differences.
IV	Arm's Length Price = Step I Add Step III.

(vi) Mr. Jaydeb retires on 4.1.2015 after serving XY Ltd. for a period of 16 years and 11 months. At the time of retirement his basic salary was ₹ 44,000 per month and he was also entitled to Dearness Allowance of ₹ 18,000 per month (50% form part of retirement benefits). On his retirement, he received ₹ 6,00,000 as gratuity. Compute the amount of gratuity exempt from tax and the amount to be included in gross salary. He is not covered under the Payment of Gratuity Act. [2]

Solution:

As per section 10(10)(*iii*) any other gratuity received by an employee on his retirement or on his becoming incapacitated prior to such retirement or on termination of his employment, or any gratuity received by his widow, children or dependants on his death, to the extent it does not, in either case, exceed one-half month's salary for each year of completed service, calculated on the basis of the average salary for the ten months immediately preceding the month in which any such event occurs, subject to such limit as the Central Government may, by notification in the Official Gazette, specify in this behalf having regard to the limit applicable in this behalf to the employees of that Government.

Computation of the amount of gratuity exempt from tax

Computation of Taxable Gratuity

Particulars	**Amount (₹)**	**Amount (₹)**
Amount received as Gratuity		**6,00,000**
Less: Exemption u/s 10(10)(iii)		
Least of the followings: (a) Actual amount received (b) ½ x Average Salary x No. of fully completed years of service [½ x53,000 x 16] (c) Maximum Limit	**6,00,000** **4,24,000** **10,00,000**	**4,24,000**
Taxable Gratuity		**1,76,000**

Therefore ₹4,24,000 shall be exempt from tax and the balance ₹1,76,000 shall be included in the gross salary.

Note:

Salary = 10 months average salary preceding the month of retirement.
= Basic Pay + Dearness Allowance considered for retirement benefits + commission (if received as a fixed percentage on turnover)

Salary for the last 10 months shall have to be considered.

Total Basic Salary for last 10 months	44,000 x 10	4,40,000
Add: D.A. [18,000 × 10 × 50%, forming part of superannuation benefits]		90,000
Salary for 10 months		5,30,000
Average salary = 5,30,000/10		53,000

(vii) The assessee took a loan of ₹ 16,00,000 on 1.4.2012 from a bank for construction of a house on a piece of land he owns in Delhi. The loan carries an interest @ 10% per annum. The construction is completed on 15.6.2014. The entire loan is still outstanding. Compute the interest allowable for the assessment year 2015-16. [2]

Solution:

	Particulars	₹
(i)	Interest for the previous year 2014-15 on ₹ 16,00,000 @ 10%	1,60,000
(ii)	Interest for the pre-construction period i.e. from 1.4.12 to 31.3.14 (1/5th of ₹ 3,20,000)	64,000
	Total Interest allowable subject to maximum ₹ 2,00,000	2,24,000

∴ The amount of interest allowable is ₹ 2,00,000.
Although the property is completed on 15.6.2014, the interest for the entire previous year i.e. 1.4.2014 to 31.3.2015 will be treated as current year's expenditure.

(viii) Rakesh carries two businesses A and B. Business A is a manufacturing business while business B is a speculative business. State whether the loss can be set off in the following two situations:

	Situation I (₹)	Situation II (₹)
Manufacturing business	**(+) 3,00,000**	**(-) 15,00,000**
Speculation business	**(-) 1,40,000**	**(+) 2,00,000**

[2]

Solution:
In situation I, set off is not possible as speculation loss can be set off only against income from speculation business.
In situation II, set off is possible and the manufacturing business loss will have to be set off against income from speculation business to the extent of ₹ 2,00,000.

(ix) XYZ Pvt. Ltd. has three shareholders i.e. X, Y and Z. All the three shareholders have equal shareholding of the company. During the previous year 2013-14 the company incurred a loss of ₹ 1,20,000. On 25.3.2015 X and Y transferred their shareholding to A. On 31.3.2015 the shareholders were.
Z - 1/3rd shareholding
A - 2/3rd shareholding.
Will the company be able to carry forward and set off the loss of ₹1,20,000 to the subsequent year? [1]

Solution:
As per section 79 of the Income Tax Act, 1961, in the case of company, not being a company in which public are substantially interested, where a change in shareholding has taken place in a previous year, then no loss incurred in any year prior to the previous year shall be carried forward and set off against the income of the previous year unless on the last day of that previous year and on the last day of the previous year in which the loss was incurred, the shares of the company carries not less than 51% of the voting power were beneficially held by the same person.
As there has been a change in the shareholding to the extent of more than 49%, the company cannot carry forward and set off the loss to the subsequent year.

(x) The estimated taxable salary of the employee 'Pritam' for the financial year 2014-15 is ₹10,20,000. Determine the amount of tax to be deducted at source every month by the employer. [2]

Solution:

Any person responsible for paying any income chargeable under the head 'salaries' shall at the time of payment, deduct income-tax on the estimated income of the employee under the head "Salaries" for that financial year. The TDS is to be made at the average of income-tax computed on the basis of the rates in force for the financial year in which payment is made. In other words, the total tax to be deducted, on the estimated income of the employee for the financial year, is divided by the number of months of his employment during the financial year. The amount so arrived at is the monthly deduction of tax at source.

	₹
Tax on ₹ 10,20,000	1,31,000
Add: Education cess & SHEC @ 3%	3,930
Tax payable	1,34,930
Amount of tax to be deducted every month (₹ 1,34,930/12)	11,244

(xi) On the occasion of Silver jubilee of A & Co. (a sole proprietary concern), Mr. X an employee, is given a gift of watch whose value is ₹4,500. Is this gift taxable? [2]

SOLUTION:

A gift given in kind or any gift voucher or token in lieu of which such gift may be received shall be tax free perquisite if the value of gift in the aggregate is below ₹5,000 during the previous year.

Question 2. Answer any four questions [4 × 15 = 60]

(a) (i) X earns the following income during the financial year 2014-15:

		₹
(a)	**Interest from an Indian company received in London.**	**1,20,000**
(b)	**Pension from former employer in India received in USA.**	**1,80,000**
(c)	**Profits earned from a business in Paris which is controlled from India, half of the profits being received in India.**	**2,00,000**
(d)	**Income from agriculture in Bhutan and remitted to India.**	**1,25,000**
(e)	**Income from property in England received there.**	**4,00,000**
(f)	**Past foreign income brought to India.**	**10,000**

Compute his income for the assessment year 2015-16 if he is:

I. Resident and ordinarily resident in India.

II. Not ordinarily resident in India.

III. Non-resident in India. [6]

Solution:

	Resident and ordinarily resident (₹)	Not ordinarily resident (₹)	Non-resident (₹)
(1) Income deemed to accrue/arise in India			
Interest from Indian Company	1,20,000	1,20,000	1,20,000
Pension from employer in India.	1,80,000	1,80,000	1,80,000
(2) Income received in India			
50% of profits of business in Paris.	1,00,000	1,00,000	1,00,000
(3) Income earned and received outside India, from a business controlled from India			
50% of profits of business in Paris.	1,00,000	1,00,000	---
(4) Income earned and received outside India other than (3)			
Income from Agriculture in Bhutan.	1,25,000	---	---
Income from Property in England.	4,00,000	---	---
	10,25,000	**5,00,000**	**4,00,000**

Note:

(a) Any income which is either received in India or deemed to be received in India is taxable in India, irrespective of the residential status.

(b) Any income which is either earned in India or is deemed to be earned in India is taxable in India, irrespective of the residential status.

(c) For a Resident in India (for individual & HUF, resident and ordinarily resident in India) all global income, wherever earned/received is taxable ii India.

(d) For a non-resident, an income is taxable only if it is either earned in India or it is received in India.

(e) For not ordinary resident, income earned and received outside India will be taxable, only when it is from a business or profession controlled or set up in India.

(f) Past foreign income is not to be included because it is not the income of the previous year 2014-15.

(ii) Balram furnishes you the following information for the previous year 2014-15.

Basic salary	**₹ 15,000p.m.**
Dearness allowance	**₹ 6,000 p.m. (60% of which is part of salary for retirement benefits)**
Entertainment allowance	**₹ 500 p.m.**
House rent allowance	**₹ 6,000 p.m.**
Actual rent paid for a house in Delhi	**₹ 7,000 p.m.**
Education allowance for 3 children	**₹ 200 p.m. per child**
Transport allowance for commuting from residence to office and back (He spent ₹ 14,000 during the year for such purpose)	**₹ 1,200 p.m.**
Medical allowance (He spent ₹ 5,000 during the year for his medical treatment)	**₹ 1,000 p.m.**

Lunch allowance (He spent ₹ 3,000 during the year for his lunch in the office)	**₹ 200 p.m.**

Compute taxable salary of Balram for the assessment year 2015-16. **[7]**

Solution:

Computation of taxable salary for the assessment year 2015-16

	₹	₹
Basic salary (₹15,000x 12)		1,80,000
Dearness allowance (₹6,000 x 12) – Fully taxable		72,000
Entertainment allowance (₹500 x 12)- Fully taxable to non-Government employee		6,000
Education allowance (₹200 x 12 x 3)	7,200	
Less: Exemption (₹100 x 12 x 2)	2,400	4,800
Transport allowance (₹1,200x 12)	14,400	
Less: Exemption (₹800 x 12)	9,600	4,800
Medical allowance (₹1,000 x 12) – Fully Taxable		12,000
Lunch allowance (₹ 200x 12) – Fully taxable		2,400
House rent allowance (₹ 6,000 x 12)	72,000	
Less: Exemption u/s 10(13A) Rule 2A (See working note)	61,680	10,320
Gross salary		**2,92,320**
Less: Deduction on account of entertainment allowance		Nil
Income under the head salary		**2,92,320**

Working Note

Meaning of salary for HRA

Basic salary + DA 60%

₹ 1,80,000 + 43,200 = ₹ 2,23,200

HRA exempt — Least of following:-

1. Actual HRA received ₹ 72,000
2. Rent paid — 10% of salary (₹ 84,000 – ₹ 22,320) ₹ 61,680
3. 50% of salary of ₹ 2,23,200 ₹ 1,11,600

∴ Amount exempted ₹ 61,680

(iii) For the assessment year 2014-15, Shivam could not file the return within the due date. The Assessing Officer passed the order under section 144 on 31.5.2015 which was received by the assessee on 5.6.2015. The assessee files the return on 2.6.2015. Is the return valid? **[2]**

Solution:

No. The belated return u/s 139(4) can be filed at any time (a) before the expiry of one year from the end of relevant assessment year, or (b) before the completion of the assessment, whichever is earlier. In the above case, the assessment was completed on 31.5.2015 i.e. the date of passing the order (date of service of order is not relevant).

(b) (i) Prabhu owns a house property in Delhi. From the particulars given below compute the income from house property for the assessment year 2015-16.

	₹
Municipal value	**2,00,000**
Fair rent	**2,52,000**
Standard rent	**2,40,000**
Actual rent (per month)	**23,000**
Municipal taxes	**20% of municipal value**
Municipal taxes paid during the year	**50% of tax levied**
Expenses on repairs	**20,000**
Insurance premium	**5,000**
Unrealised rent - conditions of rule 4 satisfied	**12,000**

Prabhu had borrowed a sum of ₹ 12,00,000 @ 10% p.a. on 1.7.2012 and the construction of the property was completed on 28.02.2014. [7]

Solution:

COMPUTATION OF GROSS ANNUAL VALUE

1. Municipal Value	2,00,000
2. Fair Rental Value	2,52,000
3. Higher of (1) and (2)	2,52,000
4. Standard Rent (if applicable)	2,40,000
5. **Reasonable Expected Rent**= Lower of Step (3) and (4)	2,40,000
6. Annual Rent (total rent assuming the property to be let out throughout the Previous Year) (₹ 23,000 x 12)	2,76,000
7. **Deduct:** Unrealized Rent as per Rule 4	12,000
8. **Actual Rent= Step (6) – (7)**	2,64,000
9. **Higher of Reasonable Expected Rent (Step 5) & Actual Rent (Step 8)**	2,64,000
10. **Deduct:** Vacancy Allowance (proportionately on the basis of Annual Rent in Step 6)	-
11. **GROSS ANNUAL VALUE**	2,64,000

COMPUTATION OF INCOME FROM HOUSE PROPERTY

GROSS ANNUAL VALUE	2,64,000
Less: Municipal Taxes paid during the year [50% of (20% of ₹ 2,00,000)]	20,000
NET ANNUAL VALUE (NAV)	2,44,000
Less: Standard Deduction @ 30% of NAV u/s 24(a)	73,200
Less: Interest on Loan u/s 24(b)	1,38,000
Add: Recovery of Unrealized Rent u/s 25AA	-
Income from House Property before considering Arrears of Rent	32,800
Add: Arrears of Rent Received	-
Less: Deduction u/s 25B: 30% of Arrears Received	-
NET INCOME FROM HOUSE PROPERTY	32,800

Notes:-

(1) Interest for pre-construction period

Pre-construction period shall be from 1.7.2012 to 31.3.2013 i.e. 9 months

Interest for 9 months = 12,00,000 x $\frac{10}{100}$ x $\frac{9}{12}$ = 90,000

1/5 of ₹ 90,000	18,000
(2) Interest for previous year (10% of ₹ 12,00,000)	1,20,000
	1,38,000

(3) Interest attributable to the period prior to completion of construction: It may so happen that money is borrowed earlier and acquisition or completion of construction takes place in any subsequent year. Meanwhile interest becomes payable. In such a case interest paid/payable for the period prior to the previous year in which the property is acquired/construction will be aggregated and allowed in five successive years starting from the year in which the acquisition/construction was completed. Interest will be aggregate from the date of borrowing till the end of the previous year prior to the previous year in which the house is completed and not till the date of completion of construction.

(ii) Determine the value of education facility in the following cases:

(1) Three children of Rahman, an employee of XYZ Ltd., are studying in a school, run by XYZ Ltd. School fees is ₹ 3,200 p.m. and hostel fees is ₹ 2,500 p.m. But the employer recovers only ₹ 1,200 p.m. and ₹ 1,000 p.m. respectively. However, a similar school or a hostel around the locality charges ₹ 2,500 p.m. and ₹ 2,000 p.m. respectively. The employer has also reimbursed the school fees of ₹ 1,500 p.m. of his nephew, fully dependent on him after the death of his brother. [3]

(2) Mr. Raghav is the manager of TUR Ltd. His son is a student of Amity International School. School fees of ₹5,000 p.m. and hostel fees of ₹ 3,500 p.m., are directly paid by TUR Ltd. to the school but it recovers from Raghav only 30%. Raghav also joins an advanced course of Marketing Management for 4 months at IIM, Ahmedabad, fees of the course, ₹2,00,000 is paid by TUR Ltd. Determine the taxable value of perquisite related to educational facilities. [3]

Solution:

(1) Computation of Taxable value Perquisite- related to education facility [As per Rule 3(5)]

Particulars	**Taxable value of perquisite Amount (₹)**
1. (a) School fees of his children, studying in a school run by employer : (₹2,500 × 3 × 12) – (₹1,000 × 3 × 12) – (₹1,200 × 3 × 12) (b) Hostel fees: (₹2,500 × 3 × 12) – (₹1,000 × 3 × 12) 2. School fee of nephew (₹1,500 × 12)	 10,,800 54,000 18,000
Total value of Taxable Perquisite	**82,800**

(2) Computation of Taxable value Perquisite- related to education facility [As per Rule 3(5)]

Particulars	**Taxable value of perquisite Amount (₹)**
1.(a) School fees of his child, studying in a school not	42,000

owned/controlled by employer (₹ 5,000 x 12 x 70%) (b) Hostel Fees : (₹ 3,500 x 12 x 70%)	29,400
2. Fees paid for marketing management course for Mr. Raghav (it is fully exempted perquisite)	Nil
Total value of Taxable Perquisite	**71,400**

(iii) Business income of TRP Ltd. Before allowing expenditure of scientific research for the previous year 2014-15 is ₹5,20,000. The company has incurred the following expenditure on scientific research during the previous year 2014-15.

	₹
Revenue expenditure on Scientific Research	**3,60,000**
Capital expenditure on Scientific Research	**4,00,000**

Compute the deduction available on account of Scientific Research assuming the company does not have any other income. [2]

Solution:

	₹
Business Income before claiming expenditure on Scientific Research	5,20,000
Less: (i) Revenue expenditure on Scientific Research	3,60,000
(ii) Capital expenditure on Scientific Research ₹4,00,000	
(Not allowed in this year as there are no profits)	Nil
Business Income	1,60,000

(c) (i) The W.D.V. of the block of assets as on 1.4.2014 was ₹10 crores. Rate of depreciation @15%. An asset of the same block was acquired on 11.5.14 for ₹5 crpres. There was a fire on 18.9.2014 and the assets were destroyed by fire and the assessee received a sum of ₹18 crores from the insurance company.

Compute the Capital Gain assuming:

(a) All the assets were destroyed by fire

(b) Part of the block was destroyed by fire

Would your answer differ if the assessee received ₹8,00,00,000 from insurance company assuming:

(a) All the assets were destroyed by fire

(b) Part of the block was destroyed by fire [7]

Solution :

If Compensation received ₹18,00,00,000

Block of Assets u/s 2(11)

	Particulars	All assets Destroyed (₹)	Part of Block Destroyed (₹)
1.4.14	W.D.V. of the Block Add : Cost of New Asset purchased relating to the Block	10,00,00,000 5,00,00,000	10,00,00,000 5,00,00,000
		15,00,00,000	15,00,00,000

	Less : Compensation received	18,00,00,000	18,00,00,000
	Short Term Capital Gains	3,00,00,000	3,00,00,000
		u/s 50(2)	u/s 50(1)

If Compensation Received ₹ 8,00,00,000
Block of Assets u/s 2(11)

	Particulars	All assets destroyed	Part of Block destroyed	
1.4.14	W.D.V. of the Block (opening) Add : Cost of New Asset purchased relating to the Block	10,00,00,000 5,00,00,000	10,00,00,000 5,00,00,000	
		15,00,00,000	15,00,00,000	
	Less : Compensation received	8,00,00,000	8,00,00,000	
	Short Term Capital Loss	7,00,00,000	-	
	W.D.V. of the Block before Depreciation		7,00,00,000	= WDV (Depreciation to be charged on WDV)
	Less: Depreciation @15%	u/s 50(2)	1,05,00,000	
	W.D.V. of the Block (closing)		5,95,00,000	

(ii) Ravi owns a residential house which was purchased by him in 1975 for ₹ 1,80,000. The FMV as on 1.4.81 was ₹ 6,00,000. This house is sold by him on 16.7.2014 for a consideration of ₹ 75,00,000. The brokerage and expenses on transfer was ₹75,000. Compute Capital Gains for the Assessment Year 2015-16.
If he invests ₹ 15,00,000 for purchase of a new house on 15.3.2015.
If the HP so purchased in 15.3.2015 is again sold in 21.10.15 for ₹ 20 lacs, what will be the tax liability? [6]

Solution :
Computation of Capital Gains for the A.Y. 2015-16

	₹
Consideration for transfer Less : Expenses on transfer	75,00,000 (75,000)
Net Consideration	**74,25,000**
Less : Indexed Cost of Acquisition $\left[6,00,000 \times \frac{1024}{100}\right]$	(61,44,000)
Long Term Capital Gain Less : **Exemption u/s 54** Cost of New HP Purchased ₹ 15,00,000 (exemption restricted upto the balance of LTCG)	**12,81,000** (12,81,000)
Taxable Long Term Capital Gain	**NIL**

If the HP purchased in 15.3.2015 is again sold on 21.10.15 for ₹20 lacs, there arise Short Term Capital Gain. The cost of acquisition shall be adjusted to the extent of Long Term Capital Gain exemption already availed.

Computation of Capital Gains for the A.Y. 2016-17

	₹	₹
Consideration for transfer		20,00,000
Less : **Cost of Acquisition**		
Cost of purchase	15,00,000	
Less : Exemption u/s 54 availed during A.Y. 2015-16 now withdrawn	NIL	15,00,000
Short Term Capital Gains		**5,00,000**

(iii) Sandip borrowed a sum of ₹24,00,000 on 1.4.2012 @12% p.a. to construct the building for the purpose of his business. The construction of house property was completed on 30.6.2014 and put to use immediately. The loan is still outstanding. Cost of construction of building is ₹55 lakh. Calculate the actual cost of building which shall be eligible for depreciation. [2]

Solution:

Computation of Actual cost of Building

Cost of construction	₹55,00,000
Add: Interest from 1.4.2012 to 30.6.2014 (₹24,00,000 × 12/100 × 27/12)	6,48,000
Total actual cost eligible for depreciation	48,52,000

Note:

Interest payable after 30.6.2014 shall be allowed as revenue expenditure.

(d) (i) During the Previous Year 2014-15, Mrs. Rachita (aged 46 years) pays the following installments of advance tax :

	₹
On September 15, 2014	**12,000**
On December 15, 2014	**28,000**
On March 15, 2015	**32,000**
On March 16, 2015	**16,000**

Mrs. X files return of ₹ 14,02,000. Assessment is also completed on the basis of income returned by Mrs. X after making addition of ₹ 50,000 (date of assessment order : January 20, 2016). Mrs. X is entitled to tax credit of ₹ 60,600 on account of tax deducted at source. Compute interest under sections 234B and 234C. [6]

Solution :

Interest liability under section 234B

	₹
Income (14,02,000+50,000)	14,52,000
Tax on ₹7,26,000	2,60,600
Less: Tax deducted at source	60,600
Assessed tax	2,00,000
90% of assessed tax	1,80,000
Advance tax paid during 2014-15 (i.e., ₹12,000 + ₹28,000 + ₹32,000 + ₹16,000)	88,000

Since advance tax during the Previous Year 2014-15 is less than 90% of assessed tax, Mrs. Rachita is liable to pay interest under section 234B, i.e., on the shortfall of ₹1,12,000 (being ₹ 2,00,000 – ₹88,000) for 10 months (₹ 1,12,000 × 1/100 × 10) which comes to ₹ 11,200.

Interest liability under section 234C :
Tax on ₹ 14,02,000 = ₹2,45,600 + 3% on Education and Higher Education Cess = ₹2,52,968

Due date	Advance Tax Payment ₹	Advance Tax paid ₹	Cumulative Advance Tax paid before due date ₹	Shortfall in Payment ₹	Surplus ₹	Months	Interest @ 1% p.m. ₹
15.09.2014	30% of ₹2,52,968 = 75,890	12,000	12,000	63,890	-	3	1,917
15.12.2014	60% of ₹2,52,968 = 1,51,781	28,000	40,000	1,11,781	-	3	3,353
15.03.2015	100% of ₹2,52,968 = ₹2,52,968	48,000	88,000	1,64,968	-	1	1,650
							6,920

(ii) Mr. Abdul, a resident assessee, runs a manufacturing business in Delhi. For the Previous Year 2014-2015, he disclosed his Taxable Income as below:

	₹
Business Profits	**3,70,000**
Long-term Capital Gains	**30,000**
Short-term Capital Gain	**40,000**

He has hired furnished accommodation for his own use and pays ₹ 10,000 p.m. He has paid donation amounting to ₹ 10,000 to National Defence Fund. He has deposited ₹ 70,000 under a scheme framed by the Life Insurance Corporation for maintenance of his dependant brother with a severe disability. The disability is certified by the medical authority. Compute his Total Income for the Assessment Year 2015-2016. [7]

Solution :
Computation of Total Income of Mr Abdul — Assessment Year 2015-2016

Particulars	₹	₹
Income from Business (computed)		3,70,000
Long-term Capital Gain (computed)		30,000
Short-term Capital Gain (computed)		40,000
Gross Total Income		4,40,000
Deductions from Gross Total Income:		
(i) Deposit for maintenance of a dependent with disability [Sec. 80DD]	70,000	
(ii) Charitable donations to National Defence Fund [Sec. 80G]: Amount of Deduction @ 100% of ₹ 10,000	10,000	
	80,000	
(iii) Expenditure incurred on rent [Sec. 80GG] [W.N.1]	24,000	84,000
Total Income		3,56,000

Workings Note 1:

Particulars	₹	₹
Expenditure incurred on rent [Sec. 80GG]: • [Rent paid -10% of AGTI], i.e. 1,20,000 – 33,000 = 87,000, or • 25% of AGTI, i.e. 25% of 3,30,000 = ₹ 57,500, or • ₹ 2,000 p.m. = ₹ 24,000 whichever is lower, is to be deducted, i.e. ₹ 24,000		
Adjusted Gross Total Income for Sec. 80GG:		
Gross Total Income		4,40,000
Less: Aggregate of		
2. All permissible deduction from GTI except for deduction for u/s 80GG	80,000	
(ii) Any Long-term Capital Gain	30,000	1,10,000
Adjusted Gross Total Income [AGTI] for Sec. 80GG		**3,30,000**

(iii) Compute the taxable income in the following situations

	Situation I	**Situation II**
	₹	**₹**
Income/loss from manufacturing business	**2,10,000**	**(-) 5,60,000**
Income/loss from speculation business	**(-) 1,80,000**	**5,50,000**
Profit/Loss from a specified business referred to in section 35AD	**(-)1, 40,000**	**1,80,000**
Short-term capital gains/loss	**(-) 1,70,000**	**(-) 1,70,000**
Agricultural income/loss	**(-) 40,000**	**60,000**

[2]

Solution:

	Situation I	Situation II
	₹	₹
Income/loss from manufacturing business	2,10,000	(-) 5,60,000
Income/loss from speculation business	No set off	5,50,000
Profit/Loss from a specified business referred to in section 35AD	No set off	1,80,000
Total Income	2,10,000	1,70,000

(e)(i) Shri Rampur Charitable Trust (Regd.) submits the particulars of its income / outgoing for the Previous Year 2014-2015 as below :

		₹
(i)	**Income from property held under trust for charitable purposes:** **(₹ 3,20,000 out of ₹ 20,00,000 is received in PY 2015-2016)**	**20,00,000**
(ii)	**Voluntary contributions (out of which ₹ 1,50,000 will form part of the corpus)**	**4,00,000**

The trust spends ₹ 4,12,500 during the Previous Year 2014-2015 for charitable purposes. In respect

of ₹ 3,20,000, it has exercised its option to spend it within the permissible time-limit in the year of receipt or in the year, immediately following the year of receipt.
The trust spends ₹ 5,00,000 during the Previous Year 2013-2014 and ₹ 2,00,000 during the Previous Year 2015-2016. Compute and discuss the chargeabiliry of the income of the trust. [5]

Solution :

(A) Computation of taxable income and tax liability of the charitable trust for the PY 2014-2015 / AY 2015-2016

Particulars			₹
(i) Income from property held under trust for charitable purposes			20,00,000
(ii) Voluntary contributions (₹ 4,00,000 - ₹ 1,50,000)			2,50,000
			22,50,000
Less: 15% set apart for future application			3,37,500
Balance			19,12,500
Less: Amount spent during the Previous Year for charitable purposes			4,12,500
Balance			15,00,000
Less: Income not received during the Previous Year 2014-2015			3,20,000
Taxable Income			11,80,000
	Tax payable	Rate of tax	
	2,50,000	Nil	-
	2,50,000	10%	25,000
	5,00,000	20%	1,00,000
	1,80,000	30%	54,000
			1,79,000
Add: Education Cess @ 2%			3,580
Add: SHEC @ 1%			1,790
Tax Payable			**1,84,370**

(B) Previous Year 2015-2016 /AY 2016-2017

	₹
Income received during the Previous Year 2015-2016	3,20,000
Amount spent for charitable purposes during 2014-2015	2,00,000
Taxable Income	**1,20,000**

(ii) Ms. R who draws a salary of ₹ 20,000 p.m. received the following gifts during the previous year 2014-15:
- **(a) Gift of ₹ 5,00,000 on 16.4.2014 from a friend.**
- **(b) Gift of jewellery fair market value of which is ₹ 3,00,000 on 17.5.2014 from her fiancee.**
- **(c) Gifts of ₹ 51,000 each received from her 4 friends on the occasion of her marriage on 21.10.2014.**
- **(d) Gift of ₹ 1,00,000 on 22.11.2014 from her mother's sister.**
- **(e) Gift of ₹ 60,000 on 25.11.2014 from her father's brother.**
- **(f) Gift of ₹ 50,000 from her husband's friend on 1.12.2014.**
- **(g) Gift of ₹ 21,000 on 15.12.2014 from her mother's friend.**
- **(h) Gift of ₹ 26,000 on 25.12.2014 from her brother's father in law.**
- **(i) Gift of ₹ 1,21,000 from her husband's brother.**
- **(j) Gift of ₹ 26,000 from her employer.**

(k) Scholarship of ₹ 1,20,000 from a charitable institution registered under section 12AA.

(l) He has purchased a immovable property from B who is not his relative from a sum of ₹24,50,000. The stamp duty value of the property is ₹ 26,00,000.

(m) She purchased bullion for ₹ 4,40,000 whose fair market value is ₹ 4,85,000.

(n) Gift of immovable property from her friend whose stamp duty value is ₹ 5,00,000.

Compute her total income for the assessment year 2015-16. [8]

Solution:

	₹	₹
Income under the head salary		
Salary 20,000 x 12	2,40,000	
Add: Cash gift from employer	26,000	
	2,66,000	
Less: Deduction	Nil	2,66,000
Income from other sources		
(1) Gift of money		
(i) Gift from a friend is includable	5,00,000	
(ii) Gifts received from her 4 friends are exempt as they have been received on the occasion of her marriage	---	
(iii) Gift from her mother's sister is exempt as the donor is covered in the definition of relative	---	
(iv) Gift from her father's brother is exempt as the donor is covered in the definition of relative	---	
(v) Gift of ₹ 50,000 from her husband's friend on 1.12.2014 is taxable as aggregate sum of money received during the year exceeds ₹ 50,000	50,000	
(vi) Gift of ₹ 21,000 from her mother's friend is includable as aggregate sum of money received during the year exceeds ₹ 50,000	21,000	
(vii) Gift from her brother's father in law is taxable as the donor is not covered in the definition of relative	26,000	
(viii) Gift from her husband's brother is exempt as the donor is covered in the definition of relative	---	
(ix) Gift from her employer is taxable as income from salary	---	
(x) Gift in the form of scholarship from charitable institution registered u/s 12AA	Exempt	
(2) Gift of moveable property		
Gift of jewellery is taxable	3,00,000	
(3) Moveable property acquired for inadequate consideration		
Difference between fair market value of movable property and purchase price does not exceed ₹ 50,000	Not taxable	
(4) Gift of immovable property		
Gift of immovable property received from her friend	5,00,000	

(5) Immovable property acquired for inadequate consideration		
Difference between stamp duty value and purchase price	1,50,000	15,47,000
Total income		18,13,000

(iii) Gross Total Income of Abhishek for previous year 2014-15 is ₹7,20,000. He had taken a loan of ₹10,00,000 in 2013-14 from a Bank for pursuing the MBA course by his son from IIM Bangalore. During the previous year 2014-15, he repaid the 1st installment of loan of ₹75,000 and interest of ₹90,000. Compute his Total Income for assessment year 2015-16. [2]

Solution:

Computation of Total Income of Abhishek

	₹
Gross Total Income	7,20,000
Less: Deduction u/s 80E on account of interest payment	90,000
Total Income	6,30,000

Question No 3. Answer any two questions [2 × 10 = 20]

(a) (i) XYZ Ltd., a company incorporated in US, sells laser printer cartridge to its 100 per cent Indian subsidiary AB Ltd. @ $50 per cartridge. XYZ Ltd. also sells its laser printer cartridge to another company PQR Ltd. in India @ $80 per piece. Total income of AB Ltd. for the assessment year 2014-15 is ₹12,00,000 after making payment for 100 cartridges @ $50 (1$ = ₹ 49). AB Ltd. has deducted tax at source while making payments to XYZ Ltd. In this case, sale to unrelated party PQR Ltd. is @ $80. Compute the arm's length price and taxable income of XYZ Ltd. and AB Ltd. The rate of one dollar may be assumed to be equivalent to ₹ 49 in all transactions. [6]

Solution:

Arm's length price of laser printer cartridge, which is sold to AB Ltd. will be $80 per cartridge by comparable uncontrolled price method.

Income of AB Ltd. -

It will be computed as under-

	₹
Income as per books of account	12,00,000
Add: Amount charged by XYZ Ltd. [$50 x 100 x ₹ 49]	(+) 2,45,000
Less: Arm's length price [$80 x 1 00 X 49]	(-) 3,92,000
Income (after applying arm's length price)	10,53,000

By virtue of section 92(3), one cannot reduce taxable income by applying arm's length price. Therefore, income of AB Ltd. will be ₹ 12,00,000.

Income of XYZ Ltd. —

If the transactions are actually on a principal-to-principal basis and are at arm's length and the subsidiary company functions and carries on business on its own, instead of functioning as an agent of the parent company, the mere fact that the Indian company is a subsidiary of the non-resident company will not be considered a valid ground for invoking section 9 for assessing the non-resident.

If the aforesaid conditions are satisfied, then XYZ Ltd. is not chargeable to tax in India.

Conversely, if the aforesaid conditions are not satisfied, XYZ Ltd. will be chargeable to tax in India in respect of income which arises on sale of goods to AB Ltd. However, the adaptation of arm's length price by the Assessing Officer will not affect the computation of taxable income of XYZ Ltd. [as per second proviso to section 92C(4) when tax is deducted/deductible, the income of recipient enterprise will not be recomputed if arm's length price is adopted in the case of payer-enterprise].

(ii) X Ltd, operating in India, is the dealer for the goods manufactured by ZOR Ltd of Japan. ZOR Ltd owns 55% of Shares of X Ltd, and out of 7 Directors of the Company, 4 were appointed by them. The Assessing Officer after verification of transactions of ₹ 350 Lakhs of X Ltd for the relevant year and by noticing that the Company had failed to maintain the requisite records and had also not obtained the Accountants' Report, adjusted its Income by making an addition of ₹ 35,00,000 to the declared income and also issued a Show Case Notice to levy various penalties. X Ltd seek your expert opinion. [4]

Answer:

1. Principle:
   (a) Associated Enterprises: Two Enterprises shall be deemed to be Associated Enterprises, if -
   - One Enterprise holds, directly or indirectly, shares carrying not less than 26% of shares/voting power in the other Enterprise (or)
   - More than half of Board of directors or members of Governing Board, or one or more Executive Directors or Executive Members of the Governing Board of one Enterprise, are appointed by the other Enterprise.

   (b) Assessing Officer's Powers u/s 92C(3):
   Where during the course of any proceeding for the assessment of income, the Assessing Officer is, on the basis of material or information or document in his possession, of the opinion that—
   (a) the price charged or paid in an international transaction or specified domestic transaction has not been determined in accordance with sub-sections (1) and (2); or
   (b) any information and document relating to an international transaction or specified domestic transaction have not been kept and maintained by the assessee in accordance with the provisions contained in sub-section (1) of section 92D and the rules made in this behalf; or
   (c) the information or data used in computation of the arm's length price is not reliable or correct; or
   (d) the assessee has failed to furnish, within the specified time, any information or document which he was required to furnish by a notice issued under sub-section (3) of section 92D,

   the Assessing Officer may proceed to determine the arm's length price in relation to the said international transaction or specified domestic transaction in accordance with sub-sections (1) and (2), on the basis of such material or information or document available with him:

Provided that an opportunity shall be given by the Assessing Officer by serving a notice calling upon the assessee to show cause, on a date and time to be specified in the notice, why the arm's length price should not be so determined on the basis of material or information or document in the possession of the Assessing Officer.

(c) Penalty Provisions relating to non-compliance are also applicable.

2. Analysis and Conclusion:
   (a) In the given question, since ZOR Ltd holds 55% of the Shares of X Ltd, both are Associated Enterprises.
   (b) As the value of aggregate transactions of X Ltd with ZOR Ltd exceeds ₹ 1 Crore, X Ltd should maintain the prescribed documents and records. Since X Ltd has not maintained the required documents, A.O. is empowered to determine the ALP based on the materials available to him and levy penalty, after giving opportunity of being heard to X Ltd.
   (Note: Assumed that ₹ 350 Lakhs of transactions of X Ltd are carried out with ZOR Ltd)
   (c) If the Accountants' Report is not obtained, then the A.O. can levy penalty of ₹ 1 Lakh u/s 271BA.

(b) (i) HUM Medical Equipments Inc. (HUM) of Canada has received an order from a leading UK based Hospital for development of a hi-tech medical equipment which will integrate the best of software and latest medical examination tool to meet varied requirements. The order was for 2,50,000 Euros.

To execute the order, HUM joined hands with its subsidiary CARE Components Inc. (CCI) of USA and Bioinformatics India Ltd (BIL), an Indian Company. CCI holds 40% of BIL.

HUM paid to CCI and BIL Euro 70,000 and Euro 80,000 respectively and kept the balance for itself.

In the entire transaction, a profit of Euro 80,000 is earned. Bioinformatics India Ltd incurred a Total Cost of Euro 75,000 in execution of its work in the above contract.

The Relative Contribution of HUM, CCI and BIL may be taken at 35%, 25% and 40% respectively.

Compute the Arm's Length Price and the incremental Total Income of Bioinformatics India Ltd, if any due to adopting Arm's Length Price determined in this case. [6]

Solution:

	Particulars	**Euros**
(A)	Share of each of the Associates in the Combined Net Profit of 50,000 Euros	
	Share of BIL [Contribution of 40% x € 80,000]	32,000
	Share of CCI [Contribution of 25% x € 80,000]	20,000
	Share of HUM [Contribution of 35% x € 80,000]	28,000
(B)	Computation of Incremental Total Income of BIL	
	Total Cost to Bioinformatics India Ltd	75,000
	Add: Share in the Profit to BIL (from above)	32,000
	Revenue of BIL on the basis of Arm's Length Price	1,07,000
	Less: Revenue Actually received by BIL	(80,000)
	Increase in Total Income of BIL	27,000

Note: Combined Net Profit has been apportioned in Relative Contribution Ratio as specified above.

(ii) What are the practical problems on existing ALP concept? [4]

Answer:

Practical Problems of ALP Concept

1. **True Comparison is difficult**: The commercial and financial conditions governing a transaction between Independent Enterprises are by and large never similar to those existing between Associated Enterprises. Hence, ALP may not be appropriate in such cases.
2. **Availability of Data and Reliability of Available Data**: The comparison of controlled and uncontrolled transactions between Associated and Independent Enterprises usually requires a large quantum of data. There may be difficulty in getting adequate and reliable information and data in order to apply the ALP principle.
3. **Use of Judgments and Subjectiveness**: The tax administration and Taxpayers may have to exercise reason and judgment when applying the ALP.
4. **Absence of Market Price**: There must be a reasonably reliable and Comparable Uncontrolled Market Price. The ALP does not meet this condition because of the nature of the market-place.
5. **Absence of Comparable Market Price for "Intangible" Transactions**: ALP generally fails to achieve a comparable market price for transaction involving intangibles because they are unique. The unique nature of these transactions creates a very wide price range.
6. **Administrative Burden**: In certain cases, the ALP principle may result in an administrative burden for both the Taxpayer and the tax administrations, in evaluating significant numbers and types of cross-border transactions.
7. **Time Lag**: The tax administration may also have to engage in the verification process, sometimes years after the transactions have taken place. This may result in substantial cost being incurred by the Taxpayer and the tax administration.

(c) RV Ltd, an Indian Company, exports grapes to SUV Inc for an amount of ₹ 30 Lakhs. SUV Inc is located in a Notified Jurisdictional Area (NJA).
RV Ltd charges ₹ 38 Lakhs and ₹ 40 Lakhs for sale of similar goods to DP Inc and RC Inc respectively which are not located in NJA and both of them are not Associated Enterprises of RV Ltd.
Assuming that permissible variation notified by Central Government for such class of International Transactions is 6% of the Transaction Price, state the tax implications u/s 94A in respect of the above transaction by RV Ltd to SUV Inc. [10]

Answer:

1. Principle & Analysis:
   (a) Since SUV Inc is located in a NJA, the transaction of Export of Grapes by the Indian Company would be deemed to be an International Transaction.
   (b) SUV Inc and RV Ltd would be deemed to be Associated Enterprises.
   (c) The Prices of ₹ 38 Lakhs and ₹ 40 Lakhs for sale of similar goods to DP Inc and RC Inc respectively being independent entities located in a Non-NJA, can be taken into consideration for determining the Arm's Length Price (ALP) under Comparable Uncontrolled Price Method.
2. Conclusion:
   (a) Where more than one price is determined by the most appropriate method, ALP in relation to an International Transaction or Specified Domestic Transaction undertaken on or after 01.04.2014, shall be computed in prescribed manner. [Arithmetic Mean &

Deemed ALP provisos do not apply.]

(b) Since more than one price is determined by the Method, the ALP would be the Arithmetical Mean of such prices.

(c) So, the ALP = $\frac{₹38,00,000 + ₹40,00,000}{2}$ = ₹ 39,00,000, whereas Transfer Price = ₹ 30,00,000.

(d) Since the ALP is more than the Transfer Price, the ALP of ₹ 39,00,000 would be considered as the Income arising from the International Transaction between RV Ltd and SUV Inc.

Note: The benefit of permissible variation between the ALP and the Transfer Price at the rate notified by the Central Government (In this case 6%) for a particular class of International Transaction would not be available where Transfer Pricing Provisions are attracted u/s 94A. Therefore, it is not necessary to determine the impact of such permissible variation. However, no such methods are prescribed so far. Hence, it is assumed that the above transaction is entered into prior to 01.04.2014 and solved using older provisions.