

Paper-7 Direct Taxation

Answer to PTP_Intermediate_Syllabus 2012_Jun2015_Set 2

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
		Identify	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 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) State the manner of determination of residential status of Hindu Undivided Family.**
 - (ii) Explain the taxation of the Limited Liability Partnerships.**
 - (iii) State the conditions to be fulfilled for availing exemption from tax, in respect of remuneration received by foreign individual.**
 - (iv) State the provisions relating to the taxability of the leave salary at the time of retirement of the Central/State Government employees.**
 - (v) State the head(s) of income, under which the income from sub-letting house property is charged to income tax, under the provisions of the Income Tax Act, 1961.**
 - (vi) State the conditions to be fulfilled by the assessee for claiming depreciation on assets, while determining business income.**
 - (vii) State the quantum of deduction available to an Indian company, in respect of expenditure incurred on amalgamation.**
 - (viii) State the circumstances, in which an assessee is not required to pay advance tax.**
 - (ix) State the manner of determination of residential status of a Company.**
 - (x) State the taxability or otherwise, of interest received from the Central/State Government, in the hands of a non-resident.**
 - (xi) State the provisions relating to exemption of income of mutual funds, as contained in Section 10(23D) of the Income tax Act, 1961.**
 - (xii) State the taxability or otherwise, of salary, perquisite, allowance, received as gift by an employee from the employer.**
 - (xiii) State the taxability or otherwise of income from house property, which is used by the assessee for the purposes of his own business.**
 - (xiv) Whether a residential house given on rent for 300 days during the Previous Year is cover under the definition of assets u/s 2(ea)(i) of Wealth tax act?**
 - (xv) Whether a land situated within the jurisdiction of a municipality or a cantonment board, which has a population of 9,900 as per the last census less than 10,000, is amount to assets u/s 2(ea)(v) of Wealth tax act.**
 - (xvi) How long records are required to be maintained by assessee who has entered into international transactions?**
 - (xvii) In which forms a report from an accountant is required to be furnished under section 92E by every person who has entered into an international transaction?**

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- (xviii) What are the basic two conditions for applicability of arm's length price in the international transaction?
- (xix) When do the transfer pricing rules affect to a business?
- (xx) What is the standard search criteria for the uncontrolled comparables in the Public data bases ?

Answer:

(i) Residential status of HUF

The residential status of HUF depends upon the control and management of the affairs of the HUF.

A HUF is said to be resident in India within the meaning of Section 6(2) of the Income Tax Act, 1961 in any previous year, if during that year the control and management of its affairs is situated wholly or partly in India. If the control and management of its affairs is situated wholly outside India during the relevant previous year, it is considered non-resident.

A resident HUF is ordinarily resident in India, if the Karta or manager of the family (including successive Karta is resident and ordinarily resident in India.

(ii) Taxation of Limited Liability Partnership (LLP)

As per Income Tax Act 1961, LLPs are treated like partnership firms for the purpose of computation of Income Tax. All the rules which are applicable to the partnership firm are also applicable to LLPs. The provisions relating to Alternate Minimum Tax are also applicable to the Limited Liability Partnerships.

The rates of taxation applicable to LLPs are stated as follows:

LLP is taxable @ 30%

Surcharge 10% (If total income exceeding ₹ 1 crore)

Education cess @ 2% .

Secondary & Higher education cess (SHEC) @ 1%.

- (iii) The remuneration received by a foreign individual in his capacity as an employee of a foreign enterprise for the services rendered by him during his stay in India would be exempt if the following conditions are fulfilled:
- (a) The foreign enterprise is not engaged in any trade or business in India.
 - (b) The total period of stay of the individual in India during the previous year does not exceed 90 days.
 - (c) Such remuneration is not liable to be deducted from the income of the employer chargeable to tax in India under the Income-tax Act.
- (iv) Under Section 10(10AA)(i) of the Income tax act, 1961, in the case of Central/ State Government employees, any amount received as cash equivalent of leave salary in respect of the period of earned leave at his credit at the time of retirement/ superannuation, is exempt from tax.
- (v) Income is taxable under the head "Income from House Property", only if the assessee is the owner of a house property. Income from sub-letting house property, is to be charged to tax, either under the head "Profits and Gains of Business or Profession" (under Section 28)

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or, under the head "Income from other sources" (Section 56), depending upon the facts of each case.

- (vi)** In order to avail depreciation under the provisions of the Income Tax Act, 1961, the following conditions must be fulfilled:
1. Asset must be owned by the assessee.
 2. It must be used for the purpose of the business or profession.
 3. It should be used during the relevant previous year.
 4. Depreciation is available on the tangible as well as the intangible assets.
- (vii)** Under Section 35DD of the Income Tax Act, 1961, if an Indian company incurs any expenditure for the purpose of amalgamation, it is allowed as deduction in five successive years in five equal annual instalments. The first instalment is deductible in the previous year in which the amalgamation or demerger takes place.
- (viii)** The liability to pay advance tax, does not arise in the following circumstances:
1. The assessee has opted for the scheme of computing business income under section 44AD on presumptive basis.
 2. A resident individual, who is at least 60 years of age at any time during the financial year, not having income from business/ profession, is not required to pay advance tax.
- (ix)** Section 6(3) of the Income Tax Act, 1961 provides that, an Indian company is always resident in India. A foreign company is resident in India only if, during the previous year, control and management of its affairs is situated wholly in India.
- (x)** Section 9(1)(v) of the Income Tax Act, 1961 provides that, interest received from the Central Government, or any State Government is deemed to accrue/ arise in India in the hands of the recipient. Hence, interest received from the Central/State Government, is taxable in the hands of a non-resident.
- (xi)** Section 10(23D) of the Income Tax Act, 1961 provides that any income of the following mutual funds (subject to the provisions of Section 115R to 115T) is not chargeable to tax-
- a. A mutual fund registered under the SEBI Act or regulations made thereunder;
 - b. A notified Mutual Fund set up by a public sector bank, or a public financial institution or authorized by RBI.
- (xii)** Salary, perquisite or allowance may come as a gift to an employee and yet it would be taxable. The Income Tax Act, 1961 does not make any distinction between gratuitous payment and contractual payment.
However, if payment made to an employee is in the nature of personal gifts/testimonial, it is not taxable as salary. However, such payment exceeding ₹50,000, may be taxable under section 56(2)(vi), under the head "Income from other Sources".
- (xiii)** Where an assessee uses his property for carrying on any business or profession, no income is chargeable to tax under the head "Income from House Property". The assessee, in such a case, is not entitled to claim any deduction on account of rent in respect of such house property, in computing the taxable profits of the business or profession. In case of such house property, depreciation is allowable under Section 32 of the Income Tax Act, 1961.

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- (xiv) Residential house rented for more than 300 days are excluded from the definition of assets.
- (xv) Population is less than 10,000, hence the property is not considered as assets.
- (xvi) The information and documents specified in section 92D shall be kept and maintained for a period of 8 years from the end of the relevant assessment year.
- (xvii) The report from an accountant which is required to be furnished under section 92E by every person who has entered into an international transaction during the previous year shall be in Form No. 3CEB.
- (xviii) The basic two conditions for applicability of arm's length price in the international transaction are:
(i) There should be transaction between two associated enterprises; and
(ii) Enterprises should be regarded as Associate Enterprises.
- (xix) When two or more associated enterprises companies enter into a joint contract during an global transaction in order to allocate a particular cost incurred in relation with a profit, service or facility presented by any one or all of the companies, such a cost shall be calculated taking into account the arm's length price of the particular assistance, service, or facility, as applicable.
- (xx) There is no standard search criteria for the uncontrolled comparables in any of the public data bases and the same is not prescribed in the Income-tax Act or in the Income-tax Rules.

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

(a) (i) Is e-filing of return mandatory? State the assessee's for whom e-filing of returns is mandatory? [6]

Answer:

CBDT has vide notification No. 34/2013 dated 01.05.2013 has made it mandatory for the following category of the Assesses to file their Income Tax Return Online from A.Y. 2013-14 :-

- (i) It is mandatory for every person (not being a co. or a person filing return in ITR 7) to e-file the return of income if its total income exceeds ₹5,00,000
- (ii) an individual or a Hindu Undivided Family, being a resident, having assets (including financial interest in any entity) located outside India or signing authority in any account located outside India and required to furnish the return in Form ITR-2 or ITR-3 or ITR-4, as the case may be.
- (iii) Every person claiming tax relief under Section 90, 90A or 91 of the Income-tax Act shall file return in electronic mode.
- (iv) Those who are required to get their Account audited under Section 44AB, 92E, 115JB of the Income-tax Act.

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(b)(i) T Ltd. is engaged in the business of manufacture of computer hardware since 2007. During the previous year 2014-15, the following assets acquired put to use:

(₹ 000)

Particulars	Block 1 ₹	Block 2 ₹	Block 3 ₹
Rate of Depreciation	15%	30%	60%
No. of assets in the block	10	10	15
Depreciated value of the block on 1.4.14	2,800	3,500	1,500
Addition of plant (during P.Y. 2014-15)			
Plant P	5,700	—	—
Plant Q	—	400	—
Plant R	—	—	1,700
Sale of old plants	500	2,870	5,200

Plants P, Q and R are acquired during May 2014 and put to use during September 2014. However, plant Q is put to use in the last week of March 2015.

Find out the amount of depreciation, additional depreciation and capital Gain.

[8]

Solution:

Calculation of Depreciation and Additional Depreciation for year A.Y. 2015-16

Particulars	Block 1 15%	Block 2 30%	Block 3 60%
	₹	₹	₹
Opening W.D.V.	28,00,000	35,00,000	15,00,000
Add : Purchase	57,00,000	4,00,000	17,00,000
	85,00,000	39,00,000	32,00,000
Less : Sales value of old plant	5,00,000	28,70,000	52,00,000
	80,00,000	10,30,000	20,00,000

Calculation of Depreciation

	Block 1	Block 2	Block 3	Total
Depreciation for 6 months	Nil	1,54,500	—	1,54,500
Depreciation for full year (80,00,000 x 15%)	12,00,000	—	—	12,00,000
				13,54,500
Additional Depreciation				
Value of assets	57,00,000	4,00,000	17,00,000	
Use for	180 days or more	Less than 180 days	180 days or more	
Rate of depreciation	20%	10%	20%	
Amount of Depreciation	11,40,000	40,000	3,40,000	15,20,000

Total amount of Depreciation (additional + normal) = 15,20,000 + 13,54,500 = 28,74,500

Note : For Block 3 no depreciation is to be charged as closing W. D. V. is negative(—). ₹ 20,00,000 and is to be treated as short term capital gain.

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(b) (ii) Mr. Amit, an employee of a mercantile firm, retired on 1st July 2014 at a monthly salary of ₹14,000 after completing 28 years 9 months of service and received ₹1,06,000 as leave encashment. Leave availed by him during his service period was 14 months. His monthly average salary was ₹ 13,500.

Calculate the taxable amount of leave encashment of Mr. Amit if he is a

(a) a Government employee; (b) Non-Government employee.

[5]

Solution:

(a) Computation of taxable income of Mr. Amit for the Assessment year 2015-16—being a Government employee

Particulars	₹	₹
Encashment of leave salary	1,06,000	
Less: Exemption u/s 10(10AA)	1,06,000	Nil
Taxable Amount		Nil

(b) Being a Non-Government employee

Particulars	₹	₹
Encashment of leave salary		1,06,000
Less: Exemption u/s 10(10AA)		
Least of the following 4 alternatives :		
1. Actual amount received	1,06,000	
2. Maximum	3,00,000	
3. 30 days' average salary x (No. of completed service period - leave utilized) [13,500 x (28 - 14)]	1,89,000	
4. 10 months' average salary (13,500 x 10)	1,35,000	1,06,000
Taxable Amount		Nil

(c)(i) Mr. Ankit is the owner of a building at Kolkata. The building was let out up to 1st Nov. 2014, then it was occupied by him for his own residence. A loan of ₹ 5,00,000 was taken for the construction of house. Interest on loan is 10%. The loan is still unpaid.

From the following further information calculate Income from House Property :

(i) Municipal Tax @ 10% ₹ 9,000

(ii) Standard rent ₹ 90,000

(iii) Rent per month ₹ 8,000

(iv) Repairing charges ₹ 6,000

(v) Unrealized rent [2012-2013] ₹ 16,000.

(vi) Municipal Tax paid for [2012-2013] ₹ 4,000.

(vii) Cost of special amenities ₹ 4,000 provided to tenant upto 1st Nov 2014.

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Solution:

Computation of Income from House Property of Mr. Ankit, a resident individual, for the Assessment Year 2015-2016 relating to previous year 2014-2015

Particulars	Amount (₹)	Amount (₹)
Gross Annual value	90,000	
Less: Municipal Tax (9,000 + 4,000)	13,000	
Net Annual Value		77,000
Less: Deduction u/s 24		
(i) u/s 24(a): Standard deduction @ 30% of N.A.V.	23,100	
(ii) u/s 24(b): Interest on loan (5,00,000 x 10%)	50,000	
		73,100
Income from House Property		3,900

Working notes:

$$\text{Municipal Value} = 9,000 \times \frac{100}{10} \times \frac{10}{9} = 1,00,000$$

$$\text{Rent received/receivable} = 8,000 \times 7 = 56,000$$

$$\text{Less : Cost of special amenities} \quad \underline{4,000}$$

$$\quad \quad \quad \underline{52,000}$$

(c)(ii) Discuss the admissibility or otherwise of the following items of computation of income under the head 'Profits and Gains from Business or Profession' for the Assessment Year 2015-16:

- (a) ₹ 400 paid to an Income Tax Advisor for conducting an appeal before the Income Tax Appellate Tribunal.**
- (b) ₹ 600 paid for raising loan of ₹ 20,000. The loan is repayable after five years.**
- (c) ₹ 2,000 for shifting the factory from one place to another for easier supply of raw materials.**
- (d) ₹ 3,000 paid to a trade association representing assessee's business for propoganda against the move for nationalisation of his trade.**
- (e) Legal expenses amounting to ₹ 1,000 paid for defending assessee's title on an asset.**
- (f) Paid ₹10,000 being cost of machine purchased for scientific research relating to the business.**
- (g) ₹ 600 paid for legal charges for drafting partnership deed.**
- (h) ₹700 considered as bad debt. The debtors were declared insolvent having no asset. The amount was, however, not yet written off as irrecoverable in the accounts of the assessee.**

[8]

Solution

- (a) Amount paid for income tax proceeding to the income tax advisor is allowable as business expenses u/s 37(1).
- (b) It is assumed that the loan was taken for the interest of the business and expenses relating to raising such loan is also allowable as expenses u/s 37(1).
- (c) ₹ 2,000 paid for shifting of office from one place to another place will not be allowed as expenses for computing income from business as this is not revenue expenditure [Sitaypur Sugar Work Ltd. vs CIT (1963)].
- (d) ₹ 3,000 paid to a trade association for propoganda in favour of assessee's business against the move for nationalisation office trade is allowable as business expenses for computation of profit and gain of business [Ambala Bus Syndicate (P) Ltd. vs CIT (1974)].
- (e) Legal Expenses amounting ₹1,000 paid for depending assessee's title on an asset is allowable as business expenses u/s 37(1) [Transport Co. (P) Ltd. vs CIT].
- (f) ₹10,000 paid for purchase of machine which has been used for scientific research relating to the business of the assessee is totally allowable as deduction u/s. 35(1) for computation of

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profits and gains of business.

- (g) ₹600 paid to lawyer for drafting partnership deed should be treated as allowable expenses, if it has been paid during the constitution of business, whereas if such amount is incurred before the commencement of business, such expenses will be treated as preliminary expenses and allowable as deduction u/s 35D as per provision of such section.
- (h) The amount receivable from debtors is really bad and allowable but under Section 36 (1) (viii) the amount of bad debt should be written off in the books of accounts. In our problem, the bad debt has not yet been written off in the books of account— hence it is not allowable as deduction.

(d) (i) The Net Profit of ZX Ltd. for the year ended March 31, 2015 amounted to ₹ 7,50,000 after debiting/crediting the following items:

Particulars	₹
Provision for bonus (paid on November 15,2015)	30,000
Provision for commission to employees (paid on December 1,2014)	76,000
Payment of annual installment under an approved agreement to a foreign collaborator for technical knowhow	1,00,000
Legal expenses incurred for issue of capital	30,000
Interest paid on unpaid purchase price of business assets	15,000
Cost of goods purchased from Y Co. Ltd. which was paid by bearer cheque	50,000
Sales include sale of gold not being stock in trade (indexed cost of acquisition ₹ 1,70,000)	2,00,000
Rent received from Staff for the quarters allotted	75,000
Rent received for commercial property rented to a foreign bank	1,50,000
Expenditure on scientific research include cost of land ₹ 30,000 and ₹ 20,000 paid to approved national laboratory. Land revenue in connection with worker's quarters and let-out commercial property (paid on June 15,2014)	12,000

Calculate Taxable Income of the company for the Assessment Year 2015-16. The answer should clearly indicate the basis for treatment of each item. [8]

Solution:

Computation of Taxable Income of the company for the Assessment Year 2015-16, relating to the Previous Year 2014-15

	Particulars	₹	₹
	Net Profit as per Profit and Loss Account		7,50,000
Add:	Disallowed Expenses		
	Provision for bonus	30,000	
	Provision for commission	76,000	
	Legal expenses incurred for issue of capital [being capital expenditure]	30,000	

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	Expenditure on scientific research	50,000	
	Land revenue for commercial property	8,000	
	Goods purchase by bearer cheque u/s 40A(3)	50,000	2,44,000
			9,94,000
Less:	Disallowed Income		
	Rent received from commercial property	1,50,000	
	Sale of gold (not being stock in trade)	2,00,000	3,50,000
			6,44,000
Less:	Allowable Expenses		
	Expenses on scientific research u/s 35 (1) (20,000 x 125%)		25,000
	Income from Business		6,19,000
	Income from House Property		
	Gross annual value	1,50,000	
Less:	Municipal Tax	Nil	
Less:	Standard deduction u/s 24(a) (30% of 1,50,000)	45,000	1,05,000
	Income from long-term capital gain		
	Sales value of gold	2,00,000	
Less:	Indexed cost of acquisition	1,70,000	30,000
	Gross Total Income		7,54,000

Note:

- (1) Provision for Bonus and Provision for commission is allowable as deduction under cash basis u/s 43B.
- (2) Interest paid on Unpaid purchase price of Business assets is allowable u/s 36(1) (iii).
- (3) Scientific research expenditure through an approved national laboratory is allowable as deduction @ 125% on such payment whereas deduction u/s 35(1) is not allowable on the purchase of land.
- (4) Rent received from staff-quarter is business income.
- (5) Land revenue will be allowed as deduction for staff-quarter only, i.e.

$$\text{₹} \left(12,000 \times \frac{1,50,000}{2,25,000} \right) = \text{₹} 8,000.$$

(d)(ii) Shri Chand retired on 1st September 2014 after completing 32 years and 9 months of service. At the time of retirement he was drawing a basic salary of ₹ 7,500 p.m. (Annual increment of ₹ 150 falls due on 1st January every year) and dearness allowance ₹ 1,500 p.m. He received ₹ 1,50,000 as gratuity on retirement.

Compute the taxable gratuity of Shri Chand for the assessment year 2015-16.

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Solution:

Computation of taxable gratuity of Shri Chand, a resident individual, for the assessment year 2015-16 relating to the previous year 2014-15.

Particulars	₹	₹	₹
Gratuity received		1,50,000	
Less: Exemption u/s 10(10)(iii) (not covered by Gratuity Act) Least of the following three alternatives			
(i) Actual gratuity received	1,50,000		
(ii) Maximum limit	10,00,000		
(iii) Half month's average salary x no. of completed service years ($\frac{1}{2} \times 8,970 \times 32$)	1,43,520	1,43,520	6,480
Taxable Gratuity			6,480

Workings note:

Last 10 months' salary

$$(7,500 \times 8) + \{(7,500 - 150) \times 2\} = 74,700$$

$$\text{D.A.} = 1,500 \times 10 = 15,000$$

$$\underline{89,700}$$

$$\text{Average salary} = 89,700 \times \frac{1}{10} = ₹8,970$$

(e) (i) Dr. Mahesh, a resident individual, (aged 55 years) is a medical practitioner. The details relating to the previous year 2014-15, as contained in the Receipts and Payments Account, has been furnished as follows:

Receipts and Payments Account

Dr.			Cr.
Receipts	Amount (₹)	Payments	Amount (₹)
To balance b/f	1,00,000	By commercial vehicle A/c [Commercial Vehicle purchased before 01-10- 2014]	6,00,000
To sale of medicines A/c	5,00,000	By Drawings A/c	3,00,000
To Consultation Fees A/c	1,00,000	By Surgical equipments A/c [Surgical equipments purchased before 01-10- 2014]	1,00,000
To Fees received on visit A/c	4,00,000	By Loan A/c [Installment paid including interest of ₹44,666]	2,42,000

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To Honorarium A/c	50,000	By Medical Insurance Premium A/c	32,000
To Family Pension A/c	2,80,000	By Housing loan A/c [Installment paid including principal component of ₹96,000]	2,16,000
To Interest received on Savings Bank Account A/c	10,000	By Advance Tax A/c	40,000
To Lottery Winnings A/c (net after deduction of TDS @ 30%)	50,000	By purchase of medicines A/c	55,000
To Agricultural Income A/c	1,00,000	By payment for medical journal A/c	15,000
To Share of income from HUF A/c	1,50,000	By Vehicle expenses A/c	45,000
To Loan from bank A/c	3,00,000	By Bank Deposit A/c [Bank deposit done in bank for 5 years]	2,00,000
		By Balance c/f	1,95,000
	20,40,000		20,40,000

Other relevant information is as under:

- The self-occupied property of Mr. Mahesh was constructed in 1998, with a loan from LIC Housing of ₹10,00,000 out of which ₹6,00,000 was still due. The assessee made an arrangement of refinancing from SBI on 01-04-2014 at the rate of 10%. One-fourth of the portion of the house is used for purposes of running clinical establishment.
- He invested in term deposit of ₹2,00,000 in Bank of Baroda on 01-07-2014 for a period of 5 years in the name of his minor daughter at 10% per annum.
- The commercial vehicle was purchased on 01-07-2014 for ₹6,00,000, It was partly financed by a loan of ₹3,00,000. One-fourth use of the vehicle is estimated to be for personal purposes.
- Medical Insurance Premium of ₹16,000 was paid by the assessee for himself and ₹16,000 was paid for the dependent mother, aged 74 years (who is an Indian resident).
- The share from HUF's income amounted to ₹50,000.

Compute the total income of Mr. Mahesh, ignoring depreciation on building, for the A.Y 2015-16.

[8]

Solution:

Computation of total income Assessee: Mr. Mahesh

Assessment Year: 2015-16	₹	₹	Previous Year: 2014-15	
	₹	₹	₹	₹
Income from house property:				
Annual value of self-occupied house		Nil		
Less: Interest on loan [₹45,000, being 3/4 th of ₹60,000] (Restricted to ₹30,000)		(30,000)	(30,000)	

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Income from profession:				
Sale of medicine	5,00,000			
Consultation fees	1,00,000			
Visiting fee	4,00,000			
Total income		10,00,000		
Less: Expenses				
Medicine purchased	55,000			
Medical journal	15,000			
Vehicle expenses (3/4 th)	33,750			
Interest on Loan (3/4 th)	33,500			
Interest on housing loan (1/4 th)	15,000			
Depreciation				
Surgical instrument (15% of ₹1,00,000)	15,000			
Vehicle (3/4 th of 15% of ₹6,00,000)	67,500			
Total expenses		2,34,750		
			7,65,250	
Income from other sources				
Family Pension	2,80,000			
Less: Deduction under section 57(iia)				
$33\frac{1}{3}\%$ or ₹15,000, which is lower	15,000	2,65,000		
Honorarium		50,000		
Saving bank interest		10,000		
Interest on bank FD in the name of minor daughter [₹2,00,000 x 10% x 9/12]	15,000			
Less: Exempt under section 10(32)	1,500	13,500		
Winning from lottery		50,000		
			3,88,500	
Gross total Income				11,23,750
Less: Deductions under Chapter VI – A				
Under section 80C				
Repayment of housing loan (96,000 x $\frac{3}{4}$)			72,000	
Under section 80D				
Medical Insurance Premium Own (allowed to the extent of ₹ 15,000)		15,000		
Mother (Senior Citizen, hence fully allowed since Premium is less than ₹20,000)		16,000		
		31,000	31,000	
Under section 80TTA				
Interest on deposit in a saving account of bank			10,000	
Total deduction				113,000
Total income				10,10,750

Notes:

1. Since the residential house was constructed before 01.04.1999, the deduction for interest is restricted to ₹30,000.

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2. Since $\frac{1}{4}$ th portion of house is used for business purposes, therefore, $\frac{1}{4}$ th share of interest paid is deductible while computing business income.
3. Agricultural income is exempt under section 10(1) and share of income from HUF is exempt under section 10(2).
4. Term deposit of ₹2,00,000 in the name of minor daughter does not qualify for deduction under section 80C. However, principal repayment of housing loan ($\frac{3}{4}$ th) would qualify for deduction under section 80C. Therefore the deduction under section 80C would be ₹72,000 (i.e. $\frac{3}{4}$ th of ₹96,000).
5. Depreciation @ 15% has been provided on surgical instruments. It is also possible to assume that the surgical instruments mentioned in the question are life- saving medical equipment (for example, surgical laser) and therefore, eligible for depreciation @ 40%.

(e)(ii) The book profits of Sky Heights Ltd., for the previous year 2014-15 computed in accordance with Section 115JB is ₹ 37.50 Lakhs. If the total income computed for the same period as per the provisions of the Income Tax Act, 1961 is ₹ 7.50 Lakhs, compute the tax payable by the company in the Assessment Year 2015-16. Is Sky Heights Ltd. eligible for any tax credit? If so, for how many years, shall Sky Heights Ltd. avail such tax credit? [5]

Solution:

Computation of tax payable in the Assessment Year 2015-16 by Sky Heights Ltd.

Particulars	Amount (₹)
(A) Tax on total income computed in accordance with the provisions of the Income tax act, 1961 = ₹7.50 Lakhs × 30%	2,25,000
(B) Income tax @ 18.5% of the book profits = ₹37.50 Lakhs × 18.5%	6,93,750
Since, the tax payable on book profits exceed the tax payable on total income computed in accordance with the provisions of the Income Tax Act, 1961, therefore Sky Heights Ltd. is liable to pay Minimum Alternate Tax.	
Tax payable on book profit	6,93,750
Add: Surcharge	Nil
Add: Education Cess @ 2%	13,875
Add: Senior and higher Education Cess @ 1%	6,938
(C) TAX PAYABLE IN THE ASSESSMENT YEAR 2015-16	7,14,563
(D) TAX CREDIT AVAILABLE TO THE COMPANY [(A)- (B)] Tax credit shall be available to Sky Heights Ltd. for ten succeeding assessment years for set-off against the tax payable on total income during such period. If the credit is not so set off, it shall lapse.	4,68,750

Section B

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

(a) (i) State whether wealth tax is chargeable in respect of net wealth of the following persons under the Wealth Tax Act, 1957:

- A. Holder of an impartible estate**
- B. Association of Persons**
- C. Partnership firms.**

[5]

Answer:

- A. Holder of an impartible estate:** Holder of an impartible estate is chargeable to wealth tax. Section 4(6) of the Wealth Tax Act, 1957 provides that, the holder of an impartible estate is deemed to be the individual owner of all properties, comprised in the estate.
- B. Association of Persons:** Association of Persons is not chargeable to wealth tax. When the shares of the members are determinate or known, then members of an AOP are liable to wealth tax in respect of their share in the property of the AOP.
- C. Partnership firms:** Partnership firms are not chargeable to wealth tax. Wealth Tax is payable by individuals, HUF and companies only. All other persons are not chargeable to wealth tax.

(a)(ii) An Association of Persons (AOP), comprising of two members Anil and Dilip, owns an urban land valued at ₹60 Lakhs, on the valuation date 31.03.2015. State the tax implications under the Wealth Tax Act, 1957.

[3]

Solution:

The tax implications of an asset owned by an Association of Persons (AOP), under the Wealth Tax Act, 1957, are as follows:

- As per Section 3 of the Wealth Tax Act, 1957, only individuals, Hindu undivided Families (HUF) and Companies are liable to wealth tax. Therefore, an Association of Persons (AOP) is not chargeable to wealth tax.
- However, as per Section 4(1)(b) of the Wealth Tax Act, 1957, the value of interest of a member of an AOP in the assets of the AOP is to be included in his net wealth. Schedule III lays down the manner of determination of the value of such interest.
- Section 21AA deals with a situation where the shares of the members of an AOP are indeterminate or unknown. Where assets chargeable to wealth tax are held by an AOP and the individual shares of the members are indeterminate or unknown on the date of formation or at any time thereafter, wealth tax is to be levied in the like manner and to the same extent as applicable to an individual.

(b) (i) State the circumstances in which Rule 3 of Schedule III shall not apply for valuation of immovable property, under the provisions of the Wealth Tax Act, 1957.

[2]

Answer:

As per Rule 8 of Schedule III, the provision contained in Rule 8 of Schedule III shall not apply in the following circumstances:

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1. Where the Assessing Officer is of opinion, having regard to the facts and circumstances of the case, that it is not practicable to apply the provisions of Rule 3 to such a case.
2. Where the difference between the unbuilt area and the specified area exceeds 20% of the aggregate area.
3. Where the property is constructed on a leasehold land and the lease expires within a period not exceeding 15 years from the relevant valuation date and the deed on lease does not give an option to the lessee for the renewal of the lease.

In all the above circumstances, the value of the property shall be determined in the manner laid down in Rule 20.

(b)(ii) Mayur House Constructions Ltd. furnishes the following particulars of its wealth for the valuation date as on 31.03.2015:

	Particulars	₹ in lacs
(i)	Land in urban area (held as stock in trade since 1999)	70
(ii)	Motor cars (including one imported car worth ₹35 lacs used for hiring)	45
(iii)	125 acres of land acquired at Ghaziabad township on 15.5.2013 for construction of commercial complex	150
(iv)	Two Residential flats of 950 sq feet each provided to 2 employees (salary of one employee exceeds ₹10 lacs per annum)	30
(v)	Farm house of 8 acres at a remote village	7
(vi)	Cash in hand as per cash book	5
Liabilities:		
(i)	Loan for purchase of land at urban area	50
(ii)	Loan for purchase of land at Ghaziabad	100
(iii)	Wealth-tax liability for A.Y. 2015-16	10
(iv)	Loan for construction of residential flats	10

Compute the net wealth of the company for the A. Y. 2015 – 2016.

[6]

Solution:

Computation of Net Wealth of Mayur House Constructions Ltd.

Sl. No.	Particulars	₹ in lacs
Assets [as per the definition of assets under Section 2(ea) of the Wealth Tax Act, 1957]		
(i)	Land in urban area (held as stock in trade since 1999) - [NOTE 1]	70
(ii)	Motor cars (excluding imported car not being an asset since it is used for hiring) [45 lac - 35 lac]	10

Answer to PTP_Intermediate_Syllabus 2012_Jun2015_Set 2

(iii)	Land at Ghaziabad township - [NOTE 2]	Nil
(iv)	(a) Residential flat provided to an employee drawing salary less than ₹10 lacs per annum - not an asset	Nil
	(b) Residential flat provided to an employee drawing salary exceeding ₹10 lacs per annum is an asset [30 x 1/2]	15
(v)	Farm house at a remote village - [NOTE 3]	Nil
(vi)	Cash in hand as per cash book - [NOTE 4]	Nil
		95
Less: Liabilities		
(i)	Loan for purchase of land in urban area - [NOTE 1]	50
(ii)	Loan for purchase of land at Ghaziabad - not deductible since the land, being stock-in-trade, is not an asset under section 2(ea). [NOTE 2]	Nil
(iii)	Wealth-tax liability for A.Y.2015-16 - wealth tax liability is not deductible	Nil
(iv)	Loan for construction of residential flats - the portion relating to taxable asset (1/2) is deductible i.e. ½ x10 lacs	5
Total Liabilities		55
Net Wealth		40

NOTE:

1. Land in urban area is a taxable asset, under the provisions of Wealth Tax Act, 1957 since it is held as stock-in-trade for more than 10 years. Hence, loan for purchase of land in urban area is deductible.
2. Since the assessee is engaged in construction business, land and building would form part of his stock-in-trade. Hence, land at Ghaziabad township is not taxable. Loan for purchase of land at Ghaziabad is not deductible since the land, being stock-in-trade, is not an asset under Section 2(ea) of the Wealth Tax Act, 1957.
3. Farm house at a remote village is not an asset as it is not situated within 25 km of a municipality.
4. Cash in hand as per cash book is not an asset since it represents cash recorded in the books

Section C

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

(a)(i) The transfer price adopted for an international transaction of sale of goods by an Indian Company during the financial year 2014-15 is ₹ 35 lakhs, whilst the Arm's Length Price determined using the most appropriate method are ₹ 32 Lakhs and ₹ 42 lakhs. With reference to transfer pricing provisions, discuss whether any adjustment is required. The rate of permissible variation prescribed by the Central Government may be assumed to be, 2% of the transfer price for this class of international transaction. [5]

Answer to PTP_Intermediate_Syllabus 2012_Jun2015_Set 2

Solution:

The proviso to Section 92C(2) provides that Arm's Length Price shall be taken to be the arithmetical mean of prices, where more than one price is determined by the most appropriate method.

However, if the arithmetical mean, so determined, is within such percentage of transfer price, as prescribed by the Central Government, then, the transfer price shall be deemed to be the arm's length price and no adjustment is required to be made.

In the given case, the arithmetical mean of prices is = ₹(32 Lakhs + 42 Lakhs)/2 = ₹37 Lakhs.

Variation permitted as percentage of transfer price = ₹35 Lakhs x 2% = ₹70,000

The Arithmetic Mean is ₹ 37 Lakhs and the permissible variation is ₹70,000 (2% of the transfer price). Thus, the Arithmetic Mean is not within the prescribed limit of the transfer price.

Hence, the Arm's Length Price shall be ₹ 37 Lakhs.

(a) (ii) Discuss whether transfer pricing provisions under the Income Tax Act, 1961 are attracted in respect of the following transactions –

- (a) Provision of marketing management services by PQR Inc. to its Indian subsidiary PQR Ltd.**
- (b) Lease of transportation vehicle by ABC Ltd. from X Inc. X Inc. guarantees 15% of the borrowings of ABC Ltd.**
- (c) Sale of industrial design by A Ltd. to LMN Inc., a Dutch company, which holds 29% of the shares of A Ltd.**
- (d) Mr. Yadav, a resident Indian, holds 25% equity share capital in Alka Ltd, a domestic company. Alka Ltd. hires trucks owned by Mr. Yadav 's son and pays rent of ₹ 2 lakh.**
- (e) ABC Ltd., a domestic company, has two units A & B. Unit A, which commenced business two years back, is engaged in the business of developing a toll road. Unit B is carrying on the business of trading in cement. Unit B transfers cement to the value of ₹ 5 lakh to Unit A for ₹3 lakh.**

[5]

Solution :

- (a) The scope of the term "international transaction" has been amplified by the Finance Act, 2012 by insertion of Explanation to section 92B. According to the said Explanation, international transaction includes, inter alia, provision of marketing management services. PQR Inc and PQR Ltd. are associated enterprises, since PQR Inc., being the holding company, satisfies the condition of holding shares carrying not less than 26% of the voting power in PQR Ltd. Since the provision of marketing management services by PQR Inc. to PQR Ltd. is an "international transaction" between associated enterprises, transfer pricing provisions are attracted in this case.
- (b) Lease of tangible property falls within the scope of "international transaction". Tangible property includes "transportation vehicle". X Inc. and ABC Ltd. are associated enterprises, since X Inc. guarantees more than 10% of the total borrowings of ABC Ltd. Therefore, lease of a transportation vehicle by ABC Ltd. from X Inc. is an international transaction with an associated enterprise, and consequently, the provisions of transfer pricing are attracted in this case.
- (c) The scope of the term "intangible property" has been amplified to include, inter alia, industrial design, which is an engineering intangible. Sale of intangible property falls within

Answer to PTP_Intermediate_Syllabus 2012_Jun2015_Set 2

the scope of the term "international transaction". Since LMN Inc. holds shares of A Ltd. carrying not less than 26% of the voting power, LMN Inc. and A Ltd. are associated enterprises. Therefore, since sale of industrial design by A Ltd. to LMN Inc. is an international transaction between associated enterprises, the provisions of transfer pricing are attracted in this case.

- (d) This transaction falls within the meaning of 'specified domestic transaction' under new section 92BA, since the rental payment has been made to a related person referred to in section 40A(2)(b) i.e. relative (i.e. son) of Mr. Yadav, who has substantial interest in the business of Alka Ltd., since he is the beneficial owner of shares carrying not less than 20% voting power. However, such a transaction would be treated as a "specified domestic transaction" to attract transfer pricing provisions only if the aggregate of such transactions during the year as specified in section 92BA exceeds a sum of ₹ 5 crore.
- (e) Unit A is eligible for deduction@100% of the profits derived from its eligible business (i.e., the business of developing a toll road) under section 80-IA. However, Unit B is not engaged in any "eligible business". Since Unit B has transferred cement to Unit A at a price lower than the fair market value, it is an inter-Unit transfer of goods between eligible business and other business, where the consideration for transfer does not correspond with the market value of goods. Therefore, this transaction would fall within the meaning of "specified domestic transaction" to attract transfer pricing provisions, if the aggregate value of transactions during the year specified in section 92BA exceeds ₹5 crore.

(b)(i) A resident of India has paid tax in a foreign country in respect of his income which accrued in that country. India has no double taxation avoidance agreement with that country. Such income is also taxable in India. Explain whether any relief is available to him in respect of the tax paid by him. [3]

Answer:

The assessee can claim unilateral relief provided under Section 91 of the Income Tax Act, 1961.

If any person who is resident in India in any previous year proves that, in respect of his income which accrued or arose during that previous year outside India (and which is not deemed to accrue or arise in India), he has paid in any country with which there is no agreement under section 90 of the Income Tax Act, 1961 for the relief or avoidance of double taxation, income-tax, by deduction or otherwise, under the law in force in that country, he shall be entitled to the deduction from the Indian income-tax payable by him of a sum calculated on such doubly taxed income at the Indian rate of tax or the rate of tax of the said country, whichever is lower, or at the Indian rate of tax if both the rates are equal.

Hence, he will be entitled to a deduction from the Indian income tax payable by him of a sum calculated on such doubly taxed income so included in his total income, at the Indian rate of tax or the rate of tax of the said country, whichever is lower or at the Indian rate of tax, if both rates are equal.

(b)(ii) List out at least seven documents, which ought to be maintained by an associated enterprise which is subject to transfer pricing provisions. [7]

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Answer:

The various types of information and documents to be maintained in respect of an international transaction by the associated enterprise and the transfer pricing method used are prescribed in Rule 10D of the Income Tax Rules, as under:

- (a) A description of the ownership structure of the enterprise and details of shares or other ownership interest held therein by other enterprises;
- (b) A profile of the multinational group of which the assessee enterprises i.e. taxpayer is a part and the name, address, legal status and country of tax residence of each of the enterprises comprised in the group with whom international transactions have been made by the taxpayer and the ownership linkages among them;
- (c) A broad description of the business of the taxpayer and the industry in which it operates and the business of the associated enterprises;
- (d) The nature, terms and prices of international transaction entered into with each associated enterprise, details of property transferred or services provided and the quantum and the value of each such transaction or class of such transaction;
- (e) A description of the functions performed, risks assumed and assets employed or to be employed by the taxpayer and by the associated enterprise involved in the international transaction;
- (f) A record of the economic and market analysis, forecasts, budgets or any other financial estimates prepared by the taxpayer for its business as a whole or separately for each division or product which may have a bearing on the international transaction entered into by the taxpayer;
- (g) A record of uncontrolled transactions taken into account for analysing their comparability with the international transaction entered into, including a record of the nature, terms and conditions relating to any uncontrolled transaction with third parties which may be relevant to the pricing of the international transactions;
- (h) A record of the analysis performed to evaluate comparability of uncontrolled transactions with the relevant international transaction;
- (i) A description of the methods considered for determining the arm's length price in relation to each international transaction or class of transaction, the method selected as the most appropriate method along with explanations as to why such method was so selected, and how such method was applied in each case;
- (j) A record of the actual working carried out for determining the arm's length price, including details of the comparable data and financial information used in applying the most appropriate method and adjustments, if any, which were made to account for differences between the international transaction and the comparable uncontrolled transactions or between the enterprises entering into such transaction;
- (k) The assumptions, policies and price negotiations if any which have critically affected the determination of the arm's length price;
- (l) Details of the adjustments, if any made to the transfer price to align it with arm's length price determined under these rules and consequent adjustment made to the total income for tax purposes;
- (m) Any other information, data or document, including information or data relating to the associated enterprise, which may be relevant for determination of the arm's length price.

Rule 10D also prescribes that the above information is to be supported by authentic documents which may include the following:

- (a) Official publications, reports, studies and data bases of the government of the country of residence of the associated enterprise or of any other country;

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- (b) Reports of market research studies carried out and technical publications of institutions of national or international repute;
- (c) Publications relating to prices including stock exchange and commodity market quotations;
- (d) Published accounts and financial statements relating to the business of the associated enterprises;
- (e) Agreements and contracts entered into with associated enterprises or with unrelated enterprises in respect of transaction similar to the international transactions;
- (f) Letters and other correspondence documenting terms negotiated between the taxpayer and associated enterprise;
- (g) Documents normally issued in connection with various transaction under the accounting practices followed.

(c)(i) “Under the special provisions of the Income Tax Act, 1961, any income arising from an international transaction shall be computed having regard to the arm’s length price.”

In this context, explain the circumstances in which the provisions of arm’s length price shall be applicable. Discuss the scope of such provisions governing the determination of the arm’s length price. Also, state the circumstances in which such provisions shall not apply. [4]

Answer:

Under the provisions of Section 92(1) of the Income Tax Act, 1961 any income arising from an International transaction shall be computed having regard to the ‘arm’s length price’. When the international transaction comprises of only an outgoing, the allowance for any expense or interest arising from the international transaction shall also be determined having regard to the arm’s length price.

Thus, the provisions of arm’s length price shall apply to both income-generating transactions (e.g. sale of goods, royalty, fees for technical services, know-how etc. for providing services) as well as transactions resulting into expenditure (e.g. purchases, interest on loan etc.).

The provisions shall not apply if their application results in decrease in the overall incidence of tax in India in respect of the parties involved in the international transactions. Where the computation of the income or determination of the allowance for any expenses or interest or any cost or expense allocated or apportioned, as the case may be, computed under Section 92(2) of the Income Tax Act, 1961 has the effect of reducing the income chargeable to tax or increasing the loss computed on the basis of entries made in the books of account in respect of the previous year in which the international transaction was entered into, the provisions shall not apply. [Section 92(3) of the Income tax Act, 1961]

‘Arm’s Length Price’ means a price which is applied or proposed to be applied in a transaction between the persons other than associated enterprises, in controlled conditions. It is the price that would have existed between the enterprises not associated or related with each other [Section 92F(ii)].

(c)(ii) Compute the ‘Arm’s Length Price’ (ALP) in the following cases:

- (a) Kanchi Healthcare Ltd. is a 100% Indian subsidiary of a US Company. The parent company sells one of its products to the Indian subsidiary at a price of US\$ 100 per unit. The same product is sold to unrelated buyers in India at a price of US\$ 125 per unit.**

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- (b) The US parent company sells the same product to an unrelated company in India @ US\$ 80 per unit.
- (c) A sold a machine to B (Associated enterprise) and in turn B sold the same machinery to C (an independent party) at sale margin of 30% for ₹2,10,000, but without making any additional expenses and charge. [6]

Solution:

Computation of Arm's Length Price

Sl. No.	Particulars	Amount (₹)
(i)	(A) Price charged by US parent company for supply to its 100% Indian subsidiary.	100 US\$
	(B) Sale price to an unrelated buyer in India per unit Since there is no loss of revenue to the Government, due to the international transaction, there is no need to compute Arm's Length Price.	125US\$
(ii)	(A) Price charged by US parent company for supply to an unrelated Indian buyer per unit.	80US\$
	(B) Price charged by US parent company for supply to its 100% Indian subsidiary.	100 US\$
	Applying Comparable Uncontrolled Price Method (Arm's Length Price per unit)	80US\$
(iii)	(A) Sales price to B	2, 10,000
	(B) Gross Margin = ₹2,10,000 × 30%	63,000
	(C) Arm's Length Price = [(A)- (B)]	1, 47,000