

Paper-7 Direct Taxation

PTP_Intermediate_Syllabus 2012_Jun2015_Set 3

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 | List | Make a list of |
| | What you are expected to know | State | Express, fully or clearly, the details/facts |
| | | Define | Give the exact meaning of |
| | | COMPREHENSION | Describe |
| | What you are expected to understand | 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 | Apply |
| | How you are expected to apply your knowledge | 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 | Analyse | Examine in detail the structure of |
| | How you are expected to analyse the detail of what you have learned | 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, whether an assessee can claim depreciation under section 32, on capital expenditure incurred on construction of any structure in a building, which is taken on lease, for the purposes of business or profession.
 - (ii)** State, whether an assessee can claim deduction of expenditure incurred on scientific research, carried on by him.
 - (iii)** State the circumstance, when interest is levied under Section 234A of the Income Tax Act, 1961. Also, state the rate at which interest is payable.
 - (iv)** The W.D.V of a block (plant and machinery, rate of depreciation 15%) as on 01.04.2014 is ₹6,40,000. A machinery costing ₹1,00,000 was acquired on 10.08.2014, but put to use on 10.11.2014. During February 2015, part of this block was sold for ₹4,00,000. Calculate the amount of depreciation.
 - (v)** Mr. Saketh, an Indian resident, is provided with furnished accommodation from February, 2015, by his employer. The value of furniture amounts to ₹95,000. The actual hire charges paid by his employer, for the furniture is ₹6,000 p.a. What would be the value of furniture to be included along with value of unfurnished house for A.Y 2015-16?
 - (vi)** Ace Enterprises Ltd. has unabsorbed specified business loss of ₹4,50,000 for the Previous Year 2014-15. How many years this can be carried forward?
 - (vii)** Anita, an Indian resident, received ₹ 80,000 in December 2014 towards recovery of unrealized rent, which was deducted from actual rent during previous year 2013-14. What would be the amount taxable under Section 25AA of the Income Tax Act, 1961?
 - (viii)** Mr. Prakash (aged 66 years), an Indian resident, paid medical insurance premium of ₹ 19,000 by cheque and ₹1,000 by cash during June 2014 under a Medical Insurance Scheme of the General Insurance Corporation. The above sum was paid for insurance of his own health. Calculate the amount of deduction available under Section 80D.
 - (ix)** Mr. K. Raghu, a resident individual, pays a rent of ₹6,000 per month. His adjusted total income is ₹3,00,000 (i.e Gross Total Income as reduced by deductions under Chapter VI-A of the Income Tax Act, 1961, except under Section 80GG). The assessee is not in receipt of House Rent Allowance. Compute the amount of deduction available under Section 80GG of the Income tax Act, 1961.
 - (x)** What is the period under which an assessee can file revised return?
 - (xi)** Where a member of a HUF has converted or transferred his self-acquired property for inadequate consideration into joint family property, and such converted property is subsequently partitioned among the members of the family. Whether the income derived from such converted property as is received by the spouse of the transferor will be taxable?

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- (xii) What is the percentage of income derived from property held under trust (wholly for charitable or religious purpose) , should be applied for the approved purposes, for claiming exemption under section 11 of the Income Tax Act, 1961.
- (xiii) What is the amount of deduction available u/s 16(ii) of the Income Tax Act, 1961 in respect of entertainment allowance received by a Government employee?
- (xiv) Whether a commercial house given on rent for 320 days during the Previous Year is cover under the definition of assets u/s 2(ea)(i) of Wealth Tax Act?
- (xv) Whether a residential flat allotted to its employee (having substantial interest) by a company where the salary of the employee is ₹ 9,99,000 p.a. is taxable assets under wealth tax act?
- (xvi) Explain the purpose of Advance Pricing Agreement.
- (xvii) Explain the validity of an agreement of advance pricing if the person obtain APA by means of fraud.
- (xviii) Who is the authorized person to furnish the report under section 92E of the Transfer Pricing Regulation Act in India?
- (xix) Whether advance pricing Agreement can be entered into for Specified Domestic Transactions?
- (xx) What are the methods of computing arm's length price?

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

(a)(i) From the following particulars compute the 'Income from House Property' of Mr. Dutta for the Assessment Year 2015 - 2016 :

Mr. Dutta inherited a property on 1.4.2011 from which gross rental income is ₹ 30,000 per year. Municipal Tax of the property is ₹ 1,000 per quarter of which 50% is borne by the tenant. Mr. Dutta took loan of ₹ 80,000 from a bank for heavy repairing of the property out of which he spent ₹ 40,000 for his sister's marriage and the balance spent for repairing of the property. He paid during the year 2014-2015 ₹ 6,000 as interest on bank loan and spent ₹100 per month for collection of rent. **[6]**

(a)(ii) From the following information of Mr. K. Das, compute the income from salary for the Assessment Year 2015-16.

(1) Net salary ₹ 1,20,000. (2) Amount deducted from salary at source ₹ 10,000 for employee's contribution to R.P.F. and for rent ₹ 500 p.m. (3) Bonus ₹ 10,000 (4) Dearness allowance ₹ 12,000. (5) Conveyance allowance ₹ 5,000. (6) Medical allowance ₹ 4,000. (7) Employer's contribution to R.P.F. @ 13% on basic plus D.A. (8) Interest on R.P.F. @ 14% is ₹ 5,600.

He has been provided a rent-free accommodation at Kolkata including furniture costing ₹50,000. **[7]**

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(b)(i) Miss Tashlima started a business of manufacturing cosmetic goods. She incurred the following expenses before the commencement of her business:

| S.N. | | ₹ |
|------|--------------------------------------------------------------------------------|--------|
| (a) | Expenses for market survey | 25,000 |
| (b) | Legal charges for drafting an agreement with other for setting up her business | 20,000 |
| (c) | Expenses for preparation of feasibility report | 15,000 |
| (d) | Expenditure for raising loan for the business | 4,000 |

Her business was started on 1.7.09:

Book value of assets on 31.3.15 were:

| S.N. | | ₹ |
|------|-----------|-----------|
| (a) | Building | 10,00,000 |
| (b) | Machinery | 10,00,000 |
| (c) | Furniture | 4,00,000 |
| (d) | Stock | 4,00,000 |
| (e) | Patent | 1,00,000 |

Calculate the allowable preliminary expenditure for the Assessment Year 2015-16. [7]

(ii) Discuss the provisions of the Income Tax Act relating to Capital Expenditure incurred by an Assessee, for the purpose of scientific research. Sri S. K. Bakshi a spare parts dealer, furnishes the following particulars of his income for the Previous Year ended 31.03.15.

Profit and Loss A/c
for the year ended 31.03.15

| Dr. | | Cr. | |
|--------------------------|----------|---------------------|----------|
| Particulars | ₹ | Particulars | ₹ |
| To Salaries | 50,000 | By Gross Profit b/d | 2,50,000 |
| „ Rent, Rates & Taxes | 12,000 | „ Dividend | 5,000 |
| „ Legal charges | 4,000 | „ Bank Interest | 1,000 |
| „ Interest on Capital | 3,000 | | |
| „ Office Expenses | 14,000 | | |
| „ Provision for Bad Debt | 2,600 | | |
| „ Income Tax | 22,000 | | |
| „ Depreciation | 13,000 | | |
| „ Insurance Premium | 6,000 | | |
| „ Net Profit | 1,29,400 | | |
| | 2,56,000 | | 2,56,000 |

Other Information

- i. One-third of the premises is used by him for his own residence.
- ii. Legal charges include ₹ 1,000 in connection with Income Tax proceedings.
- iii. Office expenses include ₹ 1,000 as daily Puja Expenses in the shop.
- iv. Depreciation as per Income Tax Rules ₹ 15,000. Compute Shri Bakshi's Income from Business for the Assessment Year 2015-16. [6]

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(c) (i) Mr. Robin sells a residential house property at a long-term capital gain of ₹ 75,000. He invests ₹ 80,000 within 3 years in construction of the first floor and barsati (to be used for residence) to another house owned by him since 1949. Is ₹ 75,000 exempt from tax under section 54? (Specify in details) **[3]**

(c)(ii) Vinay purchases the following movable and immovable properties from persons who are not his relatives. State the tax liability in the hands of Vinay.

| Date of purchase | Property | Purchase price ₹ | Stamp duty value ₹ | Fair market value ₹ |
|------------------|--------------|---------------------|-----------------------|------------------------|
| April 22, 2014 | House I | 21 lakh | 21.5 lakh | ---- |
| June 27, 2014 | Plot of land | 30 lakh | 30.5 lakh | ---- |
| August 22, 2014 | Gold ring | 5 lakh | ---- | 5.5 lakh |
| October 23, 2014 | Shares | 8 lakh | ---- | 8.5 lakh |

[7]

(c)(iii) State whether assets having personal effects are also capital assets or not [as per section 2(14)(ii) of Income-tax Act]? **[3]**

(d) (i) State the taxability of the following five incomes —

- A. Dividend
- B. Bonus
- C. Winning from lotteries etc.
- D. Fees and commission
- E. Gift

[10]

(d) (ii) Write to whom Alternate Minimum Tax shall not be applicable as per Section 115JEE (2).

[3]

(e) (i) Ms. Anna, an individual resident Indian, aged 62 years, frequently visits a foreign university to deliver lectures and receives honorarium of ₹ 3,35,000 for the same. Tax of ₹ 33,500 was deducted in the foreign country. India did not have any double taxation avoidance agreement with that foreign country. The particulars of income earned in India are stated as follows:

- (i) In India, her total income amounted to ₹10,20,000.
- (ii) Contribution to the Public Provident fund - ₹ 1,40,000.
- (iii) Contribution to the approved Pension Fund of LIC - ₹ 64,000.
- (iv) Contribution to Central Government Health Scheme during the previous year - ₹36,000.
- (v) Payment of medical Insurance premium, for mother (who is not dependent on her) - ₹21,000.

Compute the tax liability of Ms. Anna for the Assessment Year 2015-16.

[7]

(e)(ii) Mr. Sakti submits the following details of his income for the assessment year 2015-16:

| Particulars | ₹ |
|----------------------------|----------|
| Income from salary | 6,00,000 |
| Loss from house property | (80,000) |
| Income from sugar business | 1,00,000 |

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| | |
|-------------------------------------------------------------|------------|
| Loss from iron ore business (b/f) (discontinued in 2008-09) | (2,40,000) |
| Short term capital loss | (1,20,000) |
| Long term capital gain | 80,000 |
| Dividend | 10,000 |
| Lottery Winnings | 1,00,000 |
| Winnings from card games | 12,000 |
| Agricultural Income | 40,000 |
| Long term capital Gain on sale of shares | 20,000 |
| Short term Capital Loss under Section 111A | 20,000 |
| Bank Interest | 10,000 |

Calculate gross total income and losses to be carried forward for the A.Y 2015-16.

[6]

Section B

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

(a) (i) Discuss in respect of the following items, the manner of treatment for Mrs. Sita's wealth-tax assessment for the assessment year 2015-16.

1. Mrs. Sita has two cars for her personal use each being of value of ₹ 95,000.
2. She has another house property at Nainital given to her as a gift by her father on January 1, 1971 on the occasion of her birthday. This house is also used by her as her own residence where she lives during summer vacations only. The value of the house on March 31, 2015 was ₹ 25,00,000.
3. Jewellery received from her father at the time of her marriage in 1956 was of the value of ₹ 1,20,000 on March 31, 2015.

[3]

(a)(ii) Compute the taxable net wealth and wealth tax payable by ABC Ltd. from the following particulars:

- Land in urban area (Construction is not permitted as per Municipal Laws in force) ₹50,00,000.
- Cash Balance (as per books) ₹ 2,75,000.
- Guest House (situated in a place which is 30 kms away from the local limits of the municipality) ₹ 35,00,000.

[5]

(b) Mr. Rajat Jain, an individual, furnishes the following information, relating to the assets and liabilities as on 31.03.2015:

| Sl. No | Particulars | Amount (₹) |
|--------|---------------------------------------------------------------------------------------------------------------------------------------------------------------|------------|
| (i) | Plot of land at Mumbai, comprising an area of 1200 square meters, (on which building has been constructed without the approval of the appropriate authority). | 50,00,000 |
| (ii) | Building constructed on land at Mumbai, without the approval of the | 20,00,000 |

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| | | |
|-------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------|
| | appropriate authority, and used for his business purposes. | |
| (iii) | Two residential house properties, (one of the house properties is used for the purpose of business, by Mr. Rajat Jain) | 10,00,000 (each) |
| (iv) | Urban Land was purchased in August 2012 located in Pune, in the name of his son who is suffering from a disability specified under Section 80U of the Income Tax Act, 1961. The age of his son on 31.03.2015 was 17 years. | 5,00,000 |
| (v) | House located in Ahmedabad, shown in his wealth-tax return for the A.Y 2014-15 at ₹50 Lakh was sold on 20.03.2015 for ₹60 Lakh, but the sale deed thereof was executed on 03.04.2015. | 55,00,000 |
| (vi) | Motor cars held as stock-in-trade. | 75,00,000 |
| (vii) | Gold jewellery brought into India from Singapore, where he was residing, on his return to India on 01.11.2010, for permanently residing in India. | 12,00,000 |
| (viii) | Jewellery made of platinum. | 18,00,000 |
| (ix) | Jewellery gifted to wife from time to time, were available with her on the valuation date. The jewellery was acquired for ₹10 Lakhs. | 35,00,000 (Fair Market Value) |
| (x) | Interest in the coparcenary property of the Hindu Undivided Family, of which he is a member. | 25,00,000 |
| (xi) | Cash in hand, recorded in the books of account. | 10,00,000 |
| (xii) | Fixed Deposits in a co-operative bank. | 20,00,000 |
| Liabilities | | |
| (xiii) | Loan borrowed for marriage of daughter | 12,00,000 |
| (xiv) | Loan borrowed for construction of building at Mumbai | 10,00,000 |

The minor married daughter of Mr. Rajat Jain holds a plot of land at Bhopal, valued at ₹40 Lakhs. The amounts stated against the assets, except cash in hand, are the values determined as per Section 7 of the Wealth Tax Act, 1957 read with Schedule III thereto. Compute the net wealth of Mr. Rajat Jain, as on the valuation date 31.03.2015.

State the reasons for inclusion, or exclusion of the various items.

[8]

Section C

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

- (a) (i) Stray Machine Works Ltd., an Indian company declared an income of ₹ 450 crores. However, this income was declared before taking into account the following adjustments:
- 25,000 machines were sold to Gold Industries Ltd at a price, which is lower than the normal transaction price by \$250 per car. Gold Industries Ltd. holds 35% shares in Stray Machine Works Ltd.
 - Wellwisher Ltd. was paid a royalty of \$ 2,40,00,000, for use of its technical know-how. However, another Indian company had paid \$ 2,00,00,000 as royalty to Wellwisher Ltd.

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for a similar transaction. Stray Machine Works Ltd. was completely dependent on the technical knowhow supplied by Wellwisher Ltd., for the manufacture of the machineries.

- Hiland Finance Ltd. extended a loan of Euro 850 crores to Stray Machine Works Ltd., carrying an interest @10% p.a, which was outstanding in the books of Stray Machine Works Ltd. as on 31.03.2015. Hiland Finance Ltd. had extended a loan of similar amount to another Indian company @ 9% p.a. Total interest paid for the year was Euro 85 crores. The total assets of Stray Machine Works Ltd., as on 31.03.2015 was ₹ 100,000 crores. The value of 1\$ and 1 Euro may be taken to be ₹62 and ₹82 respectively.

With reference to the provisions of the Act, analyse the nature of transactions, and determine the income of the company chargeable to tax for the A.Y 2015-16. **[6]**

(ii) Explain the meaning of "specified domestic transactions" which are subject to transfer pricing provisions? **[4]**

(b) (i) Quality Ltd., an Indian company, is engaged in manufacturing electronic components. 74% of the shares of the company are held by Quality Inc., incorporated in USA. Quality Ltd. has borrowed funds from Quality Inc. at LIBOR plus 150 points. The LIBOR prevalent at the time of borrowing is 4% for US\$. The borrowings allowed under External Commercial Borrowings Guidelines issued under the Foreign Exchange Management Act are LIBOR plus 200 basis points. Discuss whether the borrowing made by Quality Ltd. is at arm's length ('LIBOR' means London Inter Bank Offer Rate). **[6]**

(b) (ii) What are the objectives of Profit Split Method (PSM)? **[4]**

(c) (i) MN Inc. of France and R Ltd. of India are associated enterprises. R Ltd. imports 2,000 compressors for Air Conditioners from MN Inc. at ₹ 7,500 per unit and these are sold to Happy Cooling Ltd at a price of ₹11,000 per unit. R Ltd. had also imported similar products from Winter Inc. Poland and sold outside at a Gross Profit of 20% on Sales.

MN Inc. offered a quantity discount of ₹1,500 per unit. Winter Inc. could offer only ₹500 per unit as Quantity Discount. The freight and customs duty paid for imports from Winter Inc. Poland had cost R Ltd. ₹ 1,200 per piece. In respect of purchase from Winter Inc., R Ltd. had to pay ₹200 only as freight charges.

Determine the Arm's Length Price and the amount of increase in Total Income of R Ltd. **[7]**

(c)(ii) What is the object of introducing Transfer Pricing? **[3]**