

**Paper-7 – Direct Taxation**

## Answer to PTP\_Intermediate\_Syllabus 2012\_June2016\_Set 1

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

	<b>Learning objectives</b>	<b>Verbs used</b>	<b>Definition</b>
<b>LEVEL B</b>	<b>KNOWLEDGE</b>  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
	<b>COMPREHENSION</b>  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
	<b>APPLICATION</b>  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
	<b>ANALYSIS</b>  How you are expected to analyses the detail of what you have learned	Analyse	Examine in detail the structure of
		Categories	Place into a defined class or division
		Compare and contrast	Show the similarities and/or differences between
Construct		Build up or compile	
Priorities		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 2016-17, unless stated otherwise.

Working notes should form part of the answers.

Answer all questions.

### 1. Answer all the questions

**(a) State the taxability of recovery of bad debt allowed u/s 36(1)(vii). [2]**

**Answer:**

Recovery of bad debts allowed u/s 36(1)(vii) is taxable u/s 41(4) of the Income Tax Act, 1961 in the following conditions :

- (i) If recovered amount is greater than the unallowed amount, then such excess is treated as Income u/s 41(4).
- (ii) If the recovery amount is less than the unallowed amount, then such deficiency is allowed as deduction u/s 36(2)(ii).

Recovery by successor of business is not Taxable.

**(b) What are the circumstances under which an assessee is said to be "assessee in default"? [2]**

**Answer:**

Assessee in Default includes person who –

1. fail to deduct and remit TDS (Sec. 191).
2. Fail to pay tax and any other sum demanded (Sec. 220).

**(c) What are the criteria for claiming exemptions from salary income by crew member of foreign ship? [2]**

**Answer:**

Criteria for claiming exemptions from salary income by crew member of foreign ship:

- (i) Individual must be Non-Resident.
- (ii) His total stay in India should not exceed 90 days in the previous year.

**(d) Anirudh is a regional sales manager of A Ltd. He is paid salary plus commission based on volume of sales effected by him. Anirudh claimed that the expenses incurred by him for earning the commission should be allowed ad deduction. Discuss the validity of his claim. [2]**

**Answer:**

Commission paid to the assessee was with reference to the volume of sales to encourage the employee to effect a higher volume of sales. Such commission is in addition to salary, and would

## **Answer to PTP\_Intermediate\_Syllabus 2012\_June2016\_Set 1**

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also form part of salary and hence no deduction was allowable in respect of any expenditure incurred to earn the commission.

**(e) State the taxability of sum received under Keyman Insurance Policy. [2]**

**Answer:**

The sums received under a Keyman Insurance Policy, including the sum allotted by way of bonus on such policy, is considered as Income u/s 2(24)(xi).

**(f) Whether lease rent on temporary suspension of business is taxable under “business income” or under “income from other source”? [2]**

**Answer:**

Rental income of leasing out machinery used in business, because of temporary suspension of business to tide over the crisis condition, is “Business Income”. [Shri Lakshmi Mills Ltd, 20 ITR 451, Vikram Cottan Mills Ltd, 169 ITR 597 (SC)]

**(g) A Charitable Institution registered u/s 12A of the Income Tax Act, 1961 filed in Form No. 10 for seeking permission to accumulate unapplied Income u/s 11(2) of the Act for the objects of the Institution and submitted it to the Assessing Officer along with the resolution for accumulation. The A.O found that the objects for which accumulation was sought were not particularized in as much as they covered the entire range of objects of the Institution. Can the Assessing Officer deny the benefit of accumulation in such case? [2]**

**Answer:**

The claim for accumulation of unapplied income cannot be denied, even if the objects for which accumulation is sought are not particularized in as much as they cover entire range of objects of true. [Bharat Krishak Samaj v. DIT (2008) 166 Taxman 147 (Del.)]  
Therefore, the Assessing Officer cannot deny the benefit of accumulation.

**(h) Mahesh, a Resident and Ordinarily resident in India and having a House Property and a Bank Account outside India is not required to file Return of Income for AY 2016-17, if his Total Income is below the maximum amount not liable to tax. Is this statement correct? [2]**

**Answer:**

A Person (Ordinarily resident) who is not required to furnish a return and who during the previous year has any asset (including any Financial Interest in any entity) located outside India or signing authority in any account located outside India has to furnish a Voluntary Return u/s 139(1).

**(i) Smarajit, whose Income consists of Salary Income only, files his return of income for assessment year 2013-14 on 02.04.2015. Is the return a valid return? [2]**

**Answer:**

U/s 139(4), where an assessee who fails to file the return of Income within the due date u/s 139(1), may file a belated return either before the completion of assessment or within one year from the end of the relevant assessment year.

## Answer to PTP\_Intermediate\_Syllabus 2012\_June2016\_Set 1

In the given case, Mr. Smarajit, filed the return of income for the assessment year 2013-14 on 02.04.2015, i.e. after the time limit mentioned u/s 139(4). So, it shall be treated as an Invalid Return.

**(j) What are the basis of selection of Most Appropriate Method?**

**[2]**

**Answer:**

The Most Appropriate Method shall be adopted having regard to the nature of transaction or class or associated persons or functions performed by such persons, as CBDT may prescribed.

**2. Answer any four questions [4 x 15 = 60]**

**(a)(i) Compute the tax Liability and the Marginal relief in the following situations, for resident assesseees with taxable Income as under for Previous year 2015 – 2016:**

Name of Individual	A	B	C
Age of Assessee	45 years	65 years	84 years
Total Income	₹ 1.04 Crores	₹ 1.04 Crores	₹ 1.04 Crores

**[7]**

**Solution:**

Particulars	A	B	C
1. (a) Tax on Total Income	$1,25,000 + (1,04,00,000 - 10,00,000) \times 30\% = 29,45,000$	$1,20,000 + (1,04,00,000 - 10,00,000) \times 30\% = 29,40,000$	$1,00,000 + (1,04,00,000 - 10,00,000) \times 30\% = 29,20,000$
(b) Surcharge at 12%	3,53,400	3,52,800	3,50,400
Total of above	32,98,400	32,92,800	32,70,400
2. (a) Tax if Income = ₹1 Crore	$1,25,000 + (1,00,00,000 - 10,00,000) \times 30\% = 28,25,000$	$1,20,000 + (1,00,00,000 - 10,00,000) \times 30\% = 28,20,000$	$1,00,000 + (1,00,00,000 - 10,00,000) \times 30\% = 28,00,000$
(b) Amount of Income exceeding ₹1 Crore	4,00,000	4,00,000	4,00,000
Total of above	32,25,000	32,20,000	32,00,000
3. Marginal relief (1-2)	73,400	72,800	70,400
4. Tax Payable (1-3)	32,25,000	32,20,000	32,00,000
5. Edu cess at 2% on (4)	64,500	64,400	64,000
6. SHEC at 1% on (4)	32,250	32,200	32,000
7. Tax Payable	33,21,750	33,16,600	32,96,000

**Note:** The above Assesseees Mr. A, Mr. B and Mr. C fall in the three categories of Individuals based on age, and different Basic Exemption Limits are applicable for them. The maximum Income for which Marginal Relief is applicable for the three categories are as under –

Category	I	II	III
Description	Individuals other than (II) and (III)	Resident Senior Citizens of the age 60 - 80 Years	Resident Very Senior Citizens of the age 80 Years or more

## Answer to PTP\_Intermediate\_Syllabus 2012\_June2016\_Set 1

Income upto which Marginal Relief is applicable	₹ 1,05,10,542	₹ 1,05,09,638	₹ 1,05,06,024
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Beyond these levels of income, Marginal Relief would be Nil for the above categories of Assesses.

**(a)(ii) Ms. Vivitha paid a sum of \$ 5,000 to Mr. Kulasekhara, a Management Consultant practicing in Colombo, specializing in Project Financing. The payment was made in Colombo. Mr. Kulasekara is Non-Resident. The Consultancy related to a project in India with possible Ceylonese collaboration. Is this payment chargeable to tax in India in the hands of Mr. Kulasekhara, since the services were used in India? [5]**

**Answer:**

Fees for Technical Services paid by Resident or Non-Resident, for the purpose of carrying on Business or Profession in India or to earn any Income from any Source in India is deemed to accrue or arise in India. Hence, it is taxable for all Assesseees, irrespective of their Residential Status.

The above payment of \$ 5,000 made by Ms. Vivitha to Mr. Kulasekhara, a Non-Resident, related to a project in India, is taxable in the hands of Mr. Kulasekhara, in India.

**(a)(iii) Mr. Ravi, an IAS Officer, was posted to USA by the Government of India on 11.07.2015 for a period of 3 years, He was paid salary of ₹ 3 Lakhs for the period 01.04.2015 to 01.07.2015 and of ₹ 12 Lakhs for period upto 31.03.2016. He left India for USA in the night of 10.07.2015 and did not come even for a day until 31.03.2016. Examine the taxability of the above Income. [3]**

**Answer:**

**Principle:**

**U/s 9(1)(iii)**, Salaries paid by Government of India to an Indian Citizen for services rendered outside India shall be deemed to accrue or arise in India, and is hence taxable in India, irrespective of whether he is a Resident or Non-Resident in India during the Relevant Previous Year.

**U/s 10(7)**, Allowances or Perquisites provided by the Government of India to an Indian Citizen for services rendered outside India, is fully exempt from Tax.

**Conclusion:** In the above case, the entire Salary of ₹15 Lakhs of Mr. Ravi who is appointed by the Government of India is **taxable** in India as Salaries u/s 9(1)(iii).

**(b)(i) MNO Ltd has one undertaking at Special Economic Zone (SEZ) and another at Domestic Tariff Area (DTA).**

**Following are the details given to you for the Previous year 2015 – 2016:**

Particulars	Unit in SEZ	Unit in DTA
<b>Total Sales</b>	<b>200</b>	<b>100</b>
<b>Export Sales</b>	<b>150</b>	<b>80</b>
<b>Net Profit</b>	<b>40</b>	<b>10</b>

**Compute the quantum of eligible deduction u/s 10AA for the AY. 2016-2017 in the following situations -**

- 1. Both the units were set up and began manufacturing from 25.07.2010.**
- 2. Both the units were set up and began manufacturing from 10.04.2012. [7]**

## Answer to PTP\_Intermediate\_Syllabus 2012\_June2016\_Set 1

**Solution:**

**Assessee: MNO Ltd**

**Previous year: 2015 – 2016**

**Assessment year: 2016 - 2017**

**Computation of Business Income**

**(₹ In Lakhs)**

1. Commencement in Previous Year	2010-2011	2012-2013
Profits derived from Unit in SEZ <b>Exemption u/s 10AA</b>	40	40
Profit of Business $\times \frac{\text{Export Turnover}}{\text{Total Turnover}} = 40 \times \frac{150}{200}$	30	30
<b>2. Exemption u/s 10AA</b>		
100% for first 5 Years 50% for next 5 Years	PY 2010-2011 to 2014-15 PY 2015-2016 to 2020-21	PY 2012- 2013 to 2016 -17 PY 2017- 2018 to 2022 -23
<b>3. Exemption for PY 2015-2016</b>	50% of Pfts = 50% of 30 = <b>15</b>	100% of Pfts = 100% of 30 = <b>30</b>

**Note:**

- No deduction is available for Unit in Domestic Tariff Area (DTA) as it is not covered u/s 10AA.
- For the First 5 consecutive A.Ys commencing from relevant P.Y in which unit has begun to manufacture or produce articles or things, quantum of deduction shall be 100% of profits from export. For the next 5 A.Ys the deduction shall be 50%.

**(b)(ii) Mr. Gobind received Retrenchment Compensation of ₹10,00,000 after 30 years and 4 months of service. At the time of retrenchment, he was receiving Basic Salary of ₹20,000 p.m. and Dearness Allowance of ₹5,000 p.m. Compute his taxable Retrenchment Compensation. [4]**

**Solution:**

**Assessee: Mr. Gobind**

**Previous Year: 2015-2016**

**Assessment Year: 2016-2017**

Particulars	₹	₹
Amount of Retrenchment Compensation Received		10,00,000
<b>Less: Exemption u/s 10(10B) = Least of the following -</b>		
(a) Actual amount of Compensation received	10,00,000	
(b) ₹ 5,00,000	5,00,000	
(c) Amount under Industrial Disputes Act, 1947 = $\frac{15}{30} \times ₹25,000 \times 30$ years	3,75,000	(3,75,000)
<b>Taxable Amount of Retrenchment Compensation</b>		<b>6,25,000</b>

**Note:** Assumed that the given pay is the Average pay of past 3 months.

**(b)(iii) Mr. Divyam avails the benefit of LTC and went by air (economy class) on a holiday in India on 25.01.2016 along with his wife and three children consisting of son aged 4 years and twin daughters of 1 year age. Total Cost of Tickets reimbursed by his Employer was ₹90,000 (₹60,000 for 2 adults and 30,000 for the three children). State with reason the amount which can be claimed by Mr. Divyam out of the reimbursement as not subject to tax? Will your answer be different where among his three children the twins were of 4 years of age and the age of the son was of 1 year? [4]**

## Answer to PTP\_Intermediate\_Syllabus 2012\_June2016\_Set 1

### Solution:

LTC exemption is available only for 2 children of an individual born after 01.10.1998. In reckoning this limit of two children, children born out of multiple births after the first birth will be treated as one child only.

**Case 1:** First Son and then Twin Daughters: The exemption shall apply to all the three children as the twins will be considered as one child. Therefore, the entire ₹90,000 can be claimed as exemption.

**Case 2:** First Twin Daughters and then Son: The exemption will apply only to the Twin Daughters (considered as two children) and not the son. Here only ₹80,000 [60,000 + (30,000 × 2/3<sup>rd</sup>)] can be claimed as exemption.

**(c)(i) Mr. Kadam is entitled to a salary of ₹25,000 per month. He is given an option by his Employer either to take House Rent Allowance or a Rent Free Accommodation which is owned by the Company. The HRA amount payable was ₹ 5,000 per month. The rent for the Hired Accommodation was ₹6,000 per month at New Delhi, Advise Mr. Kadam whether it would be beneficial for him to avail HRA or Rent Free Accommodation. Give your advice on the basis Net Take Home Cash Benefits. [8]**

### Solution:

**Assessee: Mr. Kadam Previous Year: 2015-2016 Assessment Year: 2016-2017 Status: Resident**

Particulars	Option 1 -HRA	Option 2 - RFA
Basic Salary (₹25,000 × 12)	3,00,000	3,00,000
Perquisite value of Rent Free Accommodation (15 % of ₹3,00,000)(Note1)	N.A	45,000
House Rent Allowance (5000 × 12) <span style="float: right;">60,000</span>		
<b>Less:</b> Exempt u/s 10(13A) - Least of the following		
- 50% of Salary (50% of ₹ 3,00,000) <span style="float: right;">1,50,000 (Note 2)</span>		
- Actual HRA received (₹5,000 × 12) <span style="float: right;">60,000</span>		
- Rent (₹ 6,000 × 12) <b>Less</b> 10% of Salary <span style="float: right;">42,000 (42,000)</span>	18,000	N.A
<b>Gross Salary</b>	3,18,000	3,45,000
<b>Less:</b> Deduction u/s 16	Nil	Nil
<b>Income under the head "Salaries"</b>	<b>3,18,000</b>	<b>3,45,000</b>
Gross Total Income	<b>3,18,000</b>	<b>3,45,000</b>
Less: Deduction under Chapter VI-A	Nil	Nil
<b>Total Income</b>	<b>3,18,000</b>	<b>3,45,000</b>

Particulars	Option 1 -HRA	Option 2 - RFA
Tax on Total Income [(3,18,000 – 2,50,000) × 10% & (3,45,000 – 2,50,000) × 10%]	6,800	9,500
<b>Less:</b> Rebate u/s 87A – 100% of the tax payable or ₹2,000 whichever is less.	(2,000)	(2,000)
<b>Tax payable</b>	4,800	7,500
<b>Add:</b> Education Cess @ 2%	96	150
<b>Add:</b> Secondary and Higher Education Cess @ 1%	48	75
<b>Total tax payable (Round off)</b>	<b>4,940</b>	<b>7,730</b>

### Notes:

- Assumed that new Delhi has population > 25 lakhs as per latest census. Salary for the purpose of RFA is ₹3,00,000.



## Answer to PTP\_Intermediate\_Syllabus 2012\_June2016\_Set 1

2. **Salary:** Basic + D. A. (Considered for retirement benefits) + Commission (based on fixed turnover by employee) = ₹3,00,000

### Cash Flow Statement

Particulars	Option 1-HRA	Option 2-RFA
Inflow: Salary (Basic + HRA)	3,60,000	3,00,000
Less: Outflow: Rent paid (₹6000 × 12 months)	(72,000)	Nil
Tax on Total Income	(4,950)	(7,730)
<b>Net Cash Inflow</b>	<b>2,83,060</b>	<b>2,92,270</b>

**Decision:** Since Net Cash Flow is higher under Option 2, it is beneficial if Mr. Kadam opts for Rent Free Accommodation even though Tax Liability is higher under that option.

(c)(ii) Singhania & Co. own six machines, put into use for business in March, 2015. The depreciation on these machines is charged at 15%. The Written Down Value of these machines at the end of the previous year relevant to Assessment Year 2015-2016 was ₹ 8,50,000. A new Plant was bought for ₹8,50,000 on 30<sup>th</sup> November, 2015. Three of the old machines were sold on 10<sup>th</sup> June 2015 for ₹11,00,000.

(a) Determine the claim of Depreciation for Assessment Year 2016-2017.

(b) Compute the Capital Gains liable to Tax for Assessment Year 2016-2017.

(c) If Singhania & Co. had sold the three machines in June, 2015 for ₹21,00,000, will there be any difference in your above workings? Explain. [7]

**Solution:**

**Assessee:** Singhania & Co.

**Previous Year:** 2015 – 16

**Assessment year:** 2016 – 17

### 1. Computation of Depreciation for the AY 2016 – 17, when Sale Consideration is ₹11,00,000

Particulars	₹
Opening WDV as on 01.04.2015	8,50,000
<b>Add:</b> Additions on 30.11.2015	8,50,000
<b>Gross Block Value</b>	17,00,000
<b>Less:</b> Sale Value of 3 machines (10.06.2015)	(11,00,000)
Net Block Value	6,00,000
<b>Less:</b> Depreciation at 15% × 50% (See Note)	(45,000)
Additional Depreciation at 20% × 50% (See Note)	(60,000)
<b>Closing WDV AD ON 31.03.2016</b>	<b>4,95,000</b>

**Note:**

- It Since the value of Depreciable Block is fully constituted by the newly acquired Machinery, which are held for less than 180 days, Depreciation and Additional Depreciation is claimed at 50% of the normal rates only. 12, Balance 50% of Additional Depreciation shall be allowed in AY 2017-2018. However, this Benefit is not applicable for Normal Depreciation.
- Computation of Short term capital gain for AY 2016–2017, when Sale consideration is ₹21,00,000

Particulars	₹
Opening WDV as on 01.04.2015	8,50,000
Add: Additions on 30.11.2015	8,50,000
Gross Block Value	17,00,000
Less: Sale Value of 3 machines	(21,00,000)
Short Term capital gain u/s 50	4,00,000

## **Answer to PTP\_Intermediate\_Syllabus 2012\_June2016\_Set 1**

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<b>WDV of Block as at 31.03.2016</b>	<b>Nil</b>
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**(d)(i) The Assessment was made u/s 143(1) for AY 2011-2012. The Assessee has received a notice u/s 148 on 06.04.2014 for re-opening of assessment. Can the Assessee challenge the legality of notice on the ground of change of opinion? [4]**

**Answer:**

Intimation u/s 143(1) cannot be considered as completion of assessment in respect of any previous year.

Further, Section 147 provides for income escaping assessment, even when the original assessment under other sections has been carried out, provided notice is served on the Assessee within the due date specified u/s 149, i.e, 4 years from the end of the relevant assessment year.

Hence, the Assessee cannot contest the validity of notice based on the change of opinion since the assessment u/s 143(1) cannot be considered as the conclusion of matters in respect of relevant Assessment Year.

**(d)(ii) Tani purchased a Land at a Cost of ₹10 Lakhs in the Financial Year 1983-1984 and held the same as her Capital Asset till 31.03.2012. Tani started her Real Estate Business on 01.04.2012 and converted the said Land into Stock-in-Trade of her business on the said date, when the Fair Market Value of the Land was ₹ 150 Lakhs.**

**She Constructed 20 flats of equal size, quality and dimension. Cost of construction of each flat is ₹8 Lakhs. Construction was completed in December, 2015. She sold 15 flats at ₹20 Lakhs per flat between January 2016 and March 2016. Remaining 5 flats were held in stock as on 31.03.2016. She invested ₹50 Lakhs in Bonds issued by RECL on 31.03.2016.**

**Compute the amount of chargeable Capital Gain and Business Income in the hands of Tani arising from above transactions for Assessment Year 2016-2017 indicating clearly the reasons for treatment for each item. CII: FY 1983-1984 - 116, FY 2012-2013 - 852, FY 2015-2016 - 1081. [7]**

**Solution:**

**Assessee: Tani                      Previous Year: 2015 – 2016                      Assessment Year: 2016 – 2017**

1. **Transfer:** Conversion of capital asset into stock - in trade is a transfer u/s 2(47).
2. **Year of Chargeability:** The Capital Gain is taxable in the Previous Year in which such converted stock is sold otherwise transferred.
3. **Year of Indexation:** Indexation shall apply only on the basis of Year of Conversion.
4. **Computation:** In the year of sale or transfer of stock, the Income shall be computed as under -
  - (a) Capital Gain = Fair Market Value of Stock on date of Conversion Less Indexed Cost of Acquisition.
  - (b) Business Income = Consideration received on Sale Less FMV of Capital Asset on date of conversion.

## Answer to PTP\_Intermediate\_Syllabus 2012\_June2016\_Set 1

5. Since, only 15 out of 20 Flats have been sold in the Previous Year, only proportionate amount based on Number of Flats to be taken for Profits and Gains of Business or Profession and Capital Gains.
6. **Benefit u/s 54EC:** Capital Gains arising from conversion of Capital Asset into Stock-in-Trade shall be invested in specified assets u/s 54EC within 6 months from the **date such Stock-in-Trade is sold or otherwise transferred in terms of Sec.45(2).**

Computation of Business Income and Capital Gains		(In Lakhs)	
Particulars	₹	₹	₹
<b>Profits and Gains of Business or Profession:</b>			
Sale of Asset (15 Flats × 20 Lakh each)	300.00		
<b>Less:</b> FMV on the date of transfer ( $150 \times \frac{15}{20}$ )	(112.50)		
<b>Less:</b> Cost of Construction (15 Flats × 8 Lakhs each)	(120.00)		
<b>Profits and gains of Business or Profession</b>			<b>67.50</b>
<b>Capital Gains:</b>			
Consideration for transfer = Fair market value on date of conversion	112.50		
<b>Less:</b> Expenses for transfer	Nil		
Net Consideration	112.50		
<b>Less:</b> Indexed Cost of Acquisition – $\frac{\text{Cost of Acquisition} \times \text{CIT of Year of Conversion}}{\text{CIT of Year of Acquisition}} = \left(10 \times \frac{852}{116} \times \frac{15}{20}\right)$	(50.09)		
Long Term Capital Gains (Before Exemption)	57.41		
<b>Less:</b> Exemption u/s 54EC	(50.00)		
Long Term Capital Gains (After Exemption)			<b>7.41</b>
<b>Gross Total Income</b>			<b>74.91</b>

(d)(iii) Sea Port Shipping Line, a Non-Resident Foreign Company operating its ships on the Indian Ports during the Previous Year ended on 31.03.2016 had collected freight of ₹100 Lakhs, Demurrages of ₹20 Lakhs and Handling Charges of ₹10 Lakhs inclusive of an amount of ₹ 40 Lakhs collected in US Dollars for the cargo booked for JNPT (Mumbai) from Antwerp. The expenses of operating its fleet during the year for the Indian Ports were ₹110 Lakhs. The Company denies its liability to tax in India. Examine. [4]

**Solution:**

**U/s 172 read with Sec.44B**, in case of a Non-Resident who carries on the business of carriage of goods, passengers, mails or livestock shipped at any port in India, 7.5% of the amount paid / payable (including Demurrage and Handling Charges) to the Non-Resident in respect of that carriage shall be deemed to be income accruing in India, irrespective of whether the income is paid or payable in or outside India.

The tax on the above amount shall be paid before the departure of the ship or arrangements must be made by the master of the ship for its payment within 30 days of the departure of the ship.

The Non-Resident is entitled to opt for regular assessment under the other provisions of the Act. Such claim shall be made before the end of the Assessment Year.

## Answer to PTP\_Intermediate\_Syllabus 2012\_June2016\_Set 1

Sea Port Shipping Line, being a Non-Resident Shipping Company, should pay tax on the deemed Business Income of ₹9.75 Lakhs [(₹100 Lakhs + ₹20 Lakhs + ₹10 Lakhs) × 7.5%] amounting to ₹4,02,000 [₹9.75 Lakhs × 40% (i.e. ₹3,90,000) + EC at 2% on ₹ 3,90,000 + SHEC at 1% on ₹3,90,000]. But, the Company can opt for regular assessment under the regular provisions of the Act, before the end of AY 2016-2017.

**(e)(i) X Ltd transferred its fertilizers business to a new Company Y Ltd by way of demerger, w.e.f appointed date as 01.04.2015 after satisfying the conditions of Demerger. Further information given -**

- (a) WDV of entire block of Plant & Machinery held by "X" Ltd as on 01.04.2015 is ₹ 100 Crores.
- (b) Out of the above, WDV of Block of Plant and Machinery of Fertilizer Division is ₹70 Crores.
- (c) X Ltd has Unabsorbed Depreciation of ₹50 Lakhs as at 31.03.2015.

On the above facts, you are required to explain the provisions of the Income Tax Act as to –

- (i) Allowability of Depreciation, post-merger for X Ltd and Y Ltd as at 31.03.2016 duly calculating the depreciation.
- (ii) State how the Unabsorbed Depreciation has to be dealt with for the Assessment Year 2016-2017. [7]

**Solution:**

Under Explanation 2A & 2B of Sec.43(6), where in any Previous Year, any asset forming part of Block of Assets is transferred by a Demerged Company to the Resulting Company -

**WDV of Assets after Demerger in the hands of the Demerged Company:**

= WDV of Assets before Demerger Less WDV of Assets transferred to Resulting Company  
= ₹ 100 Crores – ₹ 70 Crores = ₹30 Crores.

**WDV of Assets in the hands of the Resulting Company:**

= WDV of Transferred Assets of Demerged Company immediately before Demerger  
= ₹70 Crores.

**Computation of Depreciation**

Particulars	X Ltd	Y Ltd
WDV of Assets	30	70
Less: Depreciation @ 15%	(4.5)	(10.5)
<b>WDV of Assets as on 31.03.2016</b>	<b>25.5</b>	<b>59.5</b>

**Treatment of Unabsorbed Depreciation:**

- (a) If Unabsorbed Depreciation is directly relatable to Resulting Company: It is set off in the hands of Resulting Company.
- (b) If Unabsorbed Depreciation is not directly relatable to the undertaking transferred to the Resulting Company: Apportioned between Demerged Company and Resulting Company in the ratio –

$$\frac{\text{Loss of Demerged Company prior to Demerger} \times \text{Assets transferred to Resulting Company}}{\text{Total Assets of Demerged Company prior to Demerger}}$$

- (c) Since the Unabsorbed Depreciation is not directly related to the Undertaking transferred to the Resulting Company, it shall be set off as follows: (₹ In Lakhs)

## Answer to PTP\_Intermediate\_Syllabus 2012\_June2016\_Set 1

Particulars	X Ltd.	Y Ltd.
Unabsorbed Depreciation to be carried forward for the purposes of set off	15 (50 × 30/100)	35 (50×70/100)

**Note:** It is assumed that Total Assets of the Demerger Company prior to Demerger, Consists only of Plant and machinery.

(e)(ii) M, an individual, is 70 years of age. He is a sitting member of the State Assembly of Karnataka and for the PY 2015-2016 received the following amounts from the Assembly Secretariat –

- |                            |                                       |
|----------------------------|---------------------------------------|
| (a) Basic pay              | ₹ 9,000 p.m.                          |
| (b) Constituency Allowance | ₹24,000 p.m.                          |
| (c) Telephone Allowance    | ₹12,000 p.m.                          |
| (d) Electricity Allowance  | ₹ 9,000 p.m. (from June 2014 onwards) |

He owns a house in Delhi which has been let out at ₹60,000 p.m. He received rent for 10 months only, the house having remained vacant for two months. Municipal Taxes of ₹3,600 were paid by the tenant. Interest of ₹42,000 was paid by M on amount borrowed by him to buy the house. M has an agricultural income of ₹1,65,000. Compute his Tax Liability. [8]

**Solution:**

**Assessee: Mr. M (MLA)                      Previous year: 2015 – 16                      Assessment Year: 2016- 17**

### 1. Computation of Total Income and Tax Liability

Particulars	₹	₹
<b>Income from House Property:</b>		
Annual Value u/s 23 (₹60,000 × 12). But owing to vacancy reduced to ₹60,000 × 10	6,00,000	
<b>Less:</b> Municipal Tax (Paid by the Tenant - Not deductible)	NIL	
<b>Net Annual Value</b>	6,00,000	
<b>Less:</b> Deduction u/s 24 -		
(a) 30% of Net Annual Value	(1,80,000)	
(b) Interest on Housing Loan	(42,000)	3,78,000
<b>Income from Other Sources:</b>		
Basic Pay (₹9,000 × 12)	1,08,000	
Constituency Allowance (₹24,000 × 12)	2,88,000	
Telephone Allowance (₹12,000 × 12)	1,44,000	
Electricity Allowance (₹ 9,000 × 10)	90,000	
<b>Total before Exemption u/s 10(17)</b>	<b>6,30,000</b>	
Exempt u/s 10(17) Constituency Allowance (Fully Exempt)	(2,88,000)	3,42,000
<b>Total Income (Rounded off)</b>		<b>7,20,000</b>

### 2. Computation of Tax payable

Particulars	₹
1. Total income + Agricultural Income [₹7,20,000 + ₹1,65,000]	8,85,000
2. Tax on above [₹ 20,000 + (₹ 8,85,000 – ₹5,00,000) × 20%]	97,000
3. Basic Exemption + Agricultural Income [₹ 3,00,000 + ₹1,65,000]	4,15,000
4. Tax on above = Rebate for Agricultural Income [₹4,15,000 – ₹2,50,000] × 10%	11,500
5. Tax Payable = Step 2 - Step 4 [₹ 97,000 - ₹ 11,500]	85,000

## Answer to PTP\_Intermediate\_Syllabus 2012\_June2016\_Set 1

6. Education Cess at 2%	1,710
7. Secondary and Higher Education Cess at 1%	855
8. <b>Total Tax Payable (Rounded off)</b>	<b>88,070</b>

### 3. Answer any two questions [2 x 10 = 20]

(a) (i) Speedy Motors Ltd, an Indian Company, declared Income of ₹20 Crores computed in accordance with Chapter IV-D but before making any adjustments in respect of the following transactions for the year ended on 31.03.2016:

- A. Royalty of \$50,00,000 was paid to Fista Ltd. for use of technical know-how in the manufacturing of van. However, Fista Ltd had provided the same know-how to another Indian Company for \$ 45,00,000. The manufacture of Van by Speedy Motors Ltd is wholly dependent on the use of technical know-how, in respect of which Fista Ltd has exclusive rights.
- B. Loan of Euro 5 Crores with interest @ 10% p.a. advanced by Hughes Ltd, a French Company, was outstanding on 31.03.2016. The Total Book Value of assets of Speedy Motors Ltd on the date was ₹500 Crores. Hughes Ltd had also advanced similar loan to another Indian Company @ 8% p.a. Total Interest paid for the year was EURO 0.5 Crore.
- C. 7,000 Vans sold to Hitech Ltd which holds 41% Shares in Speedy Motors Ltd at a price which is less by \$ 100 each van than the price charged from Bento Ltd.

Briefly explain the provisions of the Act affecting all these transactions and compute Taxable Income of Speedy Motors Ltd for A.Y.2016-2017 assuming that the value of 1\$ and of 1 EURO was ₹65 and ₹ 75, respectively, throughout the year. [5]

**Solution:**

#### 1. Analysis:

Entity	Existence of Association	Reason	Section
Fista Ltd.	Yes	The Assessee is wholly dependent on use of Technical Know-how which is exclusively owned by Fista Ltd.	92A(2)(g)
Hughes Ltd.	Yes	Hughes Ltd has financed an amount which is more than 51% of the Book Value of the Total Assets of Speedy Motors Ltd.	92A(2)(c)
Hitech Ltd.	Yes	Hitech Ltd holds Shares carrying more than 26% of the voting power in Speedy Motors Ltd.	92A(2)(a)

#### 2. Computation of Total Income

Assessee: Speedy Motors Ltd.      Previous Year: 2015 – 2016		Assessment year: 2016 – 17	
Particulars	₹ in Crores	₹ in Crores	
Income as computed under Chapter IVD (before adjustments)			20.00
<b>Less:</b> Adjustments for International transactions			
• Excess Payment of Royalty of \$ 5,00,000 (\$ 5,00,000 × ₹ 65)	3.25		
• Excess Interest Paid on Loan of EURO 5 Crores (€ 75 × 5 Crores × 2 ÷ 100)	7.50		
• Difference in Price of Van @ \$100 each for 7,000 Vans (\$100 × 7,000)			

## Answer to PTP\_Intermediate\_Syllabus 2012\_June2016\_Set 1

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× ₹65)	4.55	15.30
<b>Taxable Profits and Gains from Business or Profession</b>		<b>4.70</b>

(a) (ii) X Ltd, operating in India, is the dealer for the goods manufactured by Yen Ltd of Japan. Yen 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 ₹300 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 ₹30,00,000 to the declared income and also issued a Show Case Notice to levy various penalties. X Ltd seek your expert opinion. [5]

**Answer:**

**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.

**Assessing Officer's Powers u/s 92C(3):** During the course of any proceeding for the assessment of income, the Assessing Officer may determine the ALP on the basis of the available material / information / document, on the basis of such material / information / document in his possession, if he is of the opinion that -

- (a) the price charged or paid in an International Transaction / Specified Domestic Transaction has not been determined as per the prescribed manner,
- (b) any information and document relating to an International Transaction / Specified Domestic Transaction have not been kept and maintained by the Assessee in the prescribed manner as per Sec.92D(1),
- (c) the information or data used in computation of the ALP is not reliable or correct,
- (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 u/s 92D(3).

**Penalty Provisions** relating to non-compliance are also applicable.

**Analysis and Conclusion:**

- (a) In the given question, since Yen Ltd holds 55% of the Shares of X Ltd, both are Associated Enterprises.
- (b) As the value of aggregate transactions of X Ltd with Yen 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.



## **Answer to PTP\_Intermediate\_Syllabus 2012\_June2016\_Set 1**

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(Note: Assumed that ₹300 Lakhs of transactions of X Ltd are carried out with Yen Ltd)

- (c) If the Accountants' Report is not obtained, then the A.O. can levy penalty of ₹1 Lakh u/s 271BA.

**(b)(i) "Mingle Engineering Ltd", a Korean Non Resident Company, had entered into an agreement for designing, fabricating, hook-up and commissioning of a platform in Bombay High with "Crude Oil India Ltd" an Indian Company. The agreement entered into was in two parts, one for the value to be charged for fabrication of structure in Korea for ₹ 20 Crores (having element of Profit in it of ₹2 Crores) and other for the Installation and Commissioning of the structure in Bombay High for ₹15 Crores (having element of Profit in it of ₹1.5 Crores). The Korean Company will also be setting up an Office in India for the activity of installation and commissioning of the platform which is likely to be completed in 9 months.**

On these facts, you are required to answer -

**(a) Whether the office of Mingle Engineering Ltd. to be opened in India be considered as its "Permanent Establishment"/ "Business Connection"?**

**(b) The amount of profits, if any, of the Non-Resident Company subject to tax in India.**

**(c) The Income subject to Tax in India, when the ALP of the fabrications of structure is determined at ₹ 19 Crores. [5]**

**Solution:**

The Korean Company for the purpose of commissioning of the platform in Bombay High Seas shall be having an office in India for a period of around 9 months. Maintaining of an Office by the Non-Resident in India for the conduct of its business shall be treated as a 'Permanent Establishment.

In a contract for fabrication, designing, hook-up and commissioning of platform in Bombay High, fabrication work was completed in Korea. PE was established in India after fabrication but before installation. Hence, profits relating to fabrication in Korea are not taxable in India, but income relating to installation is taxable. [CIT vs Hyundai Heavy Industries Co. Ltd. 291ITR (SC) 482]

**Conclusion:**

(a) 
$$\text{Variation} = \frac{\text{Computed ALP} - \text{Actual Price}}{\text{Actual Price}} = \frac{19 - 20}{20} = 5\% \text{ (absolute \% is taken, being Cost \%)}$$

(b) Since, the above variation exceeds the permissible 3% limit, the difference of ₹1 Crore being excessive payment / cost is disallowed.

(c) So, Profits attributable to the PE are only ₹1.5 Crores relating to activity of commissioning, hook up and installation of the platform in Bombay High, which is being conducted / supervised from the Office in India.

(d) The profits of ₹2 Crores relating to the fabrication work of the platform is not taxable in India, because the completed structure is to be supplied from Korea. Such profits are not attributed to the PE, because the work of fabrication was completed in Korea prior to coming into existence of the PE connection in India. However, Income there from is subject to ALP.

**(b)(ii) Mobeaux LLP of Poland and Vamsi Ltd of India are Associated Enterprises. Vamsi imports 1000 compressors for Air Conditioners from Mobeaux at ₹7,500 per unit and these are sold to Winland Cooling Solutions Ltd at ₹11,000 per unit. Vamsi had also imported similar products from De-Heat Ltd and sold outside at a Gross profit of 20% on Sales.**



## Answer to PTP\_Intermediate\_Syllabus 2012\_June2016\_Set 1

Mobeaux offered a Quantity Discount of ₹1,500 per unit. De-Heat could offer only ₹500 per unit as Quantity Discount, The Freight and Customs Duty paid for imports from Poland had cost Vamsi ₹1,200 a piece. In respect of purchase from De-Heat, Vamsi had to pay ₹ 200 only as Freight Charges.

Determine the Arm's Length Price and the amount of increase in Total Income of Vamsi Ltd. [5]

**Solution:**

### Computation of Arm's Length Price of Products bought from Mobeaux, Poland by Vamsi Ltd.

Particulars	₹	₹
Resale Price of Goods Purchase from Mobeaux		11,000
<b>Less:</b> Adjustment for Differences –		
(a) Normal gross Profit Margin at 20% of Sale price [20% × ₹11,000]	2,200	
(b) Incremental Quantity discount by Mobeaux [₹1,500 – ₹500]	1,000	
(c) Difference in Purchase related Expenses [₹1,200 – ₹200]	1,000	(4,200)
<b>Arms Length price</b>		<b>6,800</b>

### Computation of Increase in Total Income of Vamsi Ltd.

Particulars	₹
Price at which actually bought from Mobeaux LLP of Poland	7,500
<b>Less:</b> Arms Length Price per unit under Resale Price Method	(6,800)
<b>Decrease in Purchase Price per Unit</b>	700
No. of Units purchased from Mobeaux	1,000
<b>Therefore, increase in Total Income of Vamsi (1,000 Units × ₹700)</b>	<b>₹7,00,000</b>

(c)(i) VKS International Ltd, the Assessee, has sold goods on 12.01.2016 to L Ltd. located in a Notified Jurisdictional Area (NJA), for ₹10.5 Crores. The sale price of identical goods sold to an unfamiliar customer in New York during the year was ₹11.5 Crores. While the second sale was on CIF basis, the sale to L Ltd was on F.O.B. basis. Ocean Freight and Insurance amount to ₹20 Lakhs.

India has a Double Taxation Avoidance Agreement with the USA. The Assessee has a policy of providing After-Sales Support Services to the tune of ₹14 Lakhs to all customers except L Ltd. The ALP worked out as per Cost Plus Method for identical goods is ₹ 12.10 Crores.

You are required to compute the ALP for the Sales made to L Ltd, and the amount of consequent increase, if any, in profits of the Assessee—Company. [5]

**Solution:**

### Computation of Arm's Length Price of Products sold to L Ltd by VKS International Ltd.

Particulars	₹ Crores	₹ Crores
Price in a Comparable Uncontrolled Transaction		11.5
<b>Less:</b> Adjustment for Differences -		
(a) Freight and Insurance Charges	(0.20)	
(b) After-Sales Support services	(0.14)	(0.34)
<b>Arm's Length Price Sales to L Ltd</b>		<b>11.16</b>

### Computation of Increase in Total Income of VKS International Ltd.

Particulars	₹ Crores
Arm's Length Price as above	11.16

## Answer to PTP\_Intermediate\_Syllabus 2012\_June2016\_Set 1

Less: Price at which actually sold to L Ltd.	10.50
Therefore, <b>increase in Total Income of VKS International Ltd.</b>	<b>₹0.66</b>

**Note:**

1. ALP given under Cost Plus Model is not considered because ALP determined under Comparable Uncontrolled Transaction Method is considered as Most Appropriate Method in the given case.
2. U/s 92C, when more than one price is determined by the most appropriate method, the Arm's Length Price shall be taken to be based on the prescribed method. Since only one price is available in Most Appropriate Method, the same is considered here.
3. Second Proviso to Sec.92C(2) in relation to permissible variation of 3% is not applicable to transactions with person located in Notified Jurisdictional Area. As the Assessee's customer is in Notified Jurisdictional Area, the principle relating to permissible variation is not applicable.

**(c)(ii) Kio Japan and AB Ltd, an Indian Company are Associated Enterprises. AB Ltd manufactures Cellular Phones and sells them to Kio Japan and Geel, a Company based at Beijing. During the year AB Ltd supplied 2,50,000 Cellular Phones to Kio Japan at a price of ₹3,000 per unit and 35,000 units to Geel at a price of ₹4,800 per unit. The transactions of AB Ltd with Kio and Geel are comparable subject to the following considerations -**

**(a) Sales to Kio is on FOB basis, sales to Geel are CIF basis. Freight and Insurance paid by Kio for each unit is ₹700.**

**(b) Sales to Geel are under a free warranty for Two Years whereas sales to Kio are without any such warranty. The estimated cost of executing such warranty is ₹500.**

**(c) Since Kio's order was huge in volume, quantity discount of ₹200 per unit was offered to it.**

**Compute Arm's Length Price and amount of increase in Total Income of AB Ltd, if any, due to such Arm's Length Price.** **[5]**

**Solution:**

**Computation of Arm's Length Price of Products sold to Kio Japan by AB Ltd.**

Particulars	₹	₹
Price per Unit in a Comparable Uncontrolled Transaction		4,800
<b>Less:</b> Adjustment for Differences -		
(a) Freight and Insurance Charges	700	
(b) Estimated Warranty Costs	500	
(c) Discount for Voluminous Purchase	200	(1,400)
<b>Arm's Length Price for Cellular Phone sold to Kio Japan</b>		<b>3,400</b>

**Computation of increase in Total Income of AB Ltd.**

Particulars	₹
Arm's Length Price per Unit	3,400
<b>Less:</b> Price at which actually sold to Kio Japan	(3,000)
Increase in Price per Unit	400
No. of Units sold to Kio Japan	2,50,000
Therefore, increase in Total Income of AB Ltd (2,50,000 × ₹ 400)	₹ 10 Crores