

# Answer to MTP\_Intermediate\_Syllabus 2012\_Dec2013\_Set 2

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## Paper 7 - Direct Taxation

Full Marks – 100

Time – 3 Hours

### Section A

(Question No. 1 is COMPULSORY and any FOUR from Question Nos. – 2 to 6)

1.

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

**Answer:**

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

- (b) Calculate the amount of tax payable by Mr. Ram, a resident individual, who has taxable Long Term Capital Gains of ₹55,000 and income from other sources ₹1,20,000 during the previous year 2012-13.

**Answer:**

As the amount of total income i.e. ₹1,75,000 (55,000+1,20,000) does not exceed the exemption limit of ₹2,00,000, no tax is payable by Mr. Ram for the previous year 2012-13.

- (c) X Ltd. paid Excise Duty for the previous year 2012-13 on 07.10.2013. In which assessment year, will it be allowed?

**Answer:**

X Ltd. paid tax after the due date for filling return of income, deduction will be allowed only in the year of actual payment i.e. previous year 2013-14 relevant to assessment year 2014-15.

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

**Answer:**

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

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

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

**Answer:**

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

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

**Answer:**

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

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

**Answer:**

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

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

**Answer:**

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

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

**Answer:**

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

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

**Answer:**

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

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

**Answer:**

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

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

**Answer:**

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

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

**Answer:**

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

**[13×1]**

**2.**

**(a) Do you think notice issued u/s 142(1) and notice u/s 143(2) mean same? Justify your answer.**

**Answer:**

Notice issued u/s 142(1) is different from that of notice issued u/s 143(2) in the following ways:

<b>Notice u/s 142(1)</b>	<b>Notice u/s 143(2)</b>
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It is a notice to file return of income or produce accounts or documents or furnish information as the Assessing Office may require	It is a notice for making assessment u/s 143(3)
No assessment is possible by issue of this notice	Assessment can be made only if the notice u/s 143(2) is served on the assessee.
No time limit is prescribed for service of this notice	Time limit of 6 months from the end of relevant assessment year prescribed for service of notice
Approval of Joint Commissioner is necessary if statement of all assets and liabilities not included in accounts is required	No approval required
Books of accounts can be called for, for a maximum period of 3 years prior to the previous year	No such restriction is there in this case
Notice can be served even if no return of income is furnished	Notice can be served only if the return of income has been furnished

- (b) Z Ltd. (a foreign company), A (a resident individual) and B (a resident individual) are three members of an AOP sharing profit in the ratio of 5:2:3. Personal incomes of A and B are ₹20,000 and ₹10,000 respectively. However, Z Ltd. has no other personal income. Taxable income of the AOP for the assessment year 2013-14 is ₹2,00,000 which includes Long Term Capital Gains of ₹50,000. Calculate amount of tax payable by the AOP, if it applies maximum marginal rate.**

**Answer:**

Particulars	Amount of Income ₹	Shares of Partners		
		Z Ltd. ₹	A ₹	B ₹
Long Term Capital Gains	50,000	25,000	10,000	15,000
Other Income	1,50,000	75,000	30,000	45,000

In this case, ₹75,000 (being shares in other income pertaining to Z Ltd.) is chargeable to tax at a rate higher than 30.90%. Consequently tax liability of the AOP will be determined as under:

Particulars	₹
Tax on ₹75,000 (41.2% of ₹75,000)	30,900
Tax on Long Term Capital Gains (20.60% of ₹50,000)	10,300
Tax on balance income [30.90% of ₹(2,00,000 – 75,000 – 50,000)]	23,175
<b>Total Tax Payable</b>	<b>64,375</b>

- (c) What are the conditions for deduction of unrealised rent?**

**Answer:**

Rule 4 of the Income-tax Rules as substituted by the Income-tax (Eighth Amendment) Rules, 2001 prescribes the conditions as under:

Unrealised rent – For the purposes of the Explanation below sub-section (1) of section 23, the amount of rent which the owner cannot realise shall be equal to the amount of rent payable but not paid by a tenant of the assessee and so proved to be lost and irrecoverable where,—

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- I. the tenancy is bona fide;
- II. the defaulting tenant has vacated, or steps have been taken to compel him to vacate the property;
- III. the defaulting tenant is not in occupation of any other property of the assessee;
- IV. the assessee has taken all reasonable steps to institute legal proceedings for the recovery of the unpaid rent or satisfies the Assessing Officer that legal proceedings would be useless.

[5+5+3]

3.

(a) Ms. Sania, a resident Indian, furnishes the details for the assessment year 2013-14 :

	Amount (₹)
<b>Income from profession</b>	<b>1,94,000</b>
<b>Share of income from a partnership in country X ( tax paid in Country X for this income in equivalent Indian Rupees 8,000)</b>	<b>40,000</b>
<b>Commission income from a concern in country Y ( tax paid in country Y @ 20%)</b>	<b>30,000</b>
<b>Interest on scheduled banks [other than savings account]</b>	<b>20,000</b>

Ms. Sania wishes to know whether she is eligible to any double taxation relief or not, and if she is eligible, its quantum. India does not have any Double Taxation Avoidance Agreement with countries X and Y.

**Answer:**

### Computation of Total Income for the Assessment Year 2013-14

Particulars	Amount (₹)	Amount (₹)
(a) Income from Business or Profession:		
Income from Profession	1,94,000	
Share of income in partnership firm in Country X	<u>40,000</u>	2,34,000
(b) Income from other sources:		
Interest from scheduled bank	20,000	
Commission earned in Country Y, assumed from other sources	<u>30,000</u>	<u>50,000</u>
<b>Total Income</b>		<b><u>2,84,000</u></b>

### Computation of Tax Liability on Total Income for the Assessment Year 2013-14

Particulars	Amount (₹)
Tax on Total Income of ₹ 2,84,000	8,400
Add: Surcharge on Income Tax	Nil
Add: Education Cess @ 2%	168
Add: Secondary and Higher Education Cess @ 1%	<u>84</u>
	8,652
Less: Double taxation relief [70,000 x 3.05%]	<u>2,135</u>
Tax Payable	<u>6,517</u>
<b>Rounded off u/s 288B</b>	<b>6,520</b>

**Note:**

- I. Ms. Sania is entitled to deduction from the Indian Income Tax payable by her of a sum calculated on such doubly taxed income at:

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- a. Average rate of tax in the foreign country = 20% i.e.  $[(\text{₹ } 8,000 + 20\% \text{ of ₹ } 30,000)/(40,000+30,000)] \times 1000$
- b. Average rate of tax in India =  $(8,652/2,84,000) \times 100 = 3.05\%$   
Whichever is lower.
- II. As interest received from scheduled bank other than savings account, deduction u/s 80TTA is not available.
- (b) Ravi, a member in two AOPs namely RLT & Co. and Ravi & Rina, provides the following details of his income for the year ended on 31.03.2013 -**
- (i) RLT & Co. assessed at normal rates of tax had credited in his account amount of ₹1,60,000 as interest on capital, ₹2,10,000 as salary and ₹50,000 as share of profit.
- (ii) A house property located at Chennai was purchased on 01.07.2008 with the borrowed capital in Ravi & Rina jointly shared equally and occupied by both of them for self residential purposes. Total interest paid for the year 2012-13 on the borrowed capital was ₹5,00,000.
- Compute the Total Income of Ravi and the Tax Liability thereon for the A.Y. 2013-14 and support your answer with brief reasons.**

**Answer:**

**Assessee: Ravi**

**Previous Year: 2012-13**

**Assessment Year: 2013-14**

### Computation of Total Income and Tax Liability

Particulars	₹	₹
<b>Income under the head House property</b>		
Net Annual Value (Self Occupied Property)	Nil	
<b>Less:</b> Deduction u/s 24		
Interest [5,00,000 x 50%] – Restricted to ₹1,50,000	<u>(1,50,000)</u>	(1,50,000)
<b>Profits and Gains from Business or Profession</b>		
Interest on capital	1,60,000	
Salary	2,10,000	
Share income from RLT & Co.	50,000	4,20,000
<b>Gross Total Income</b>		<b>2,70,000</b>
<b>Less:</b> Deduction under Chapter VI-A		Nil
<b>Total Income</b>		<b>2,70,000</b>
Tax on Total Income		7,000
<b>Add:</b> Education Cess at 2%		140
<b>Add:</b> Secondary and Higher Education Cess at 1%		70
<b>Tax Payable</b>		<b>7,210</b>
Average Rate of Tax (Total Tax Payable / Total Income)		2.67%
<b>Less:</b> Rebate u/s 110 [AOP Income x Average rate of tax] [₹4,20,000 x 2.67% = ₹11,214. Rebate restricted to tax payable]		<b>(7,210)</b>
<b>Net Tax Payable</b>		<b>NIL</b>

**Working Note:**

- I. As per section 26, where the house property is owned by two or more persons whose share is definite and ascertainable, the income from such property shall be taxed in the individual assessment of the members.
- II. If the property is self-occupied, then the part of self occupancy is applicable to each co-owner individually and they are entitled for deduction u/s 24 independently.
- III. If AOP is chargeable to tax at normal rate applicable for individuals, then the member is eligible for rebate u/s 110.

4.

(a) What are the powers that are enjoyed by Joint Commissioner of Income Tax?

**Answer:**

Joint Commissioners of Income Tax are appointed by the Central Government. They enjoy the following powers:

- (i) Power regarding discovery, production of evidence, etc. [Sec. 131]
- (ii) Power of search and seizure, if authorised. [Sec. 132]
- (iii) Power to call for information. [Sec. 133]
- (iv) Power to survey [Sec. 133A]
- (v) Power to make an enquiry [Sec. 135]
- (vi) Power to collect certain information [Sec. 133B]
- (vii) Power to inspect register of companies. [Sec. 134]
- (viii) Power to sanction reopening of assessment after the expiry of 4 years, if the assessment is made under any section other than sections 143(3) and 147.

(b) State whether the following transactions can be considered as transfer:

- (i) A house transferred by way of will to stepson
- (ii) Bonus shares given by a company to its shareholders
- (iii) Giving the right to use the asset
- (iv) A piece of land transferred by a holding company to its subsidiary company in which the holding company holds 90% of the total shares of the subsidiary company
- (v) Giving away jewellery for a piece of land
- (vi) Getting money in lieu of shop in a shopping complex
- (vii) A building is transferred under a scheme of amalgamation

**Answer:**

- (i) Any transfer by will is not transfer. Hence, the transfer of the house property by way of will to stepson will not be considered as transfer as per section 47(iii).
- (ii) Issue of Bonus share is not transfer. Hence, Bonus shares given by a company to its shareholders will not be considered as transfer.
- (iii) Giving the right to use the asset is not a transfer of asset since, it is only hired.
- (iv) In the given case, the land has been transferred by a holding company to its subsidiary company in which the holding company holds 90% of the total shares of the subsidiary company. Since, the subsidiary company is not a 100% subsidiary, it does not satisfy the conditions of section 47(iv) and hence, it is a transfer.
- (v) Exchange of jewellery with land is transfer of both.
- (vi) In the given case, money being consideration of shop, hence it is considered as a transfer.
- (vii) A building is transferred under a scheme of amalgamation will not be considered as a transfer as per section 47(vi).

(c) A Ltd. is engaged in the business of growing and manufacturing tea in India. During the previous year 2011-12, it deposited ₹100 lakh (40% of the business profit) in the "special account" and claims the same as deduction u/s 33AB. During 2012-13, the company withdraws ₹45 lakh from the "special account" which utilized as follows:

- (i) ₹35 lakh for the purpose of the scheme framed by the Tea Board on 31<sup>st</sup> December, 2012;
- (ii) ₹4 lakh for other purpose on 17<sup>th</sup> January, 2013.

₹6 lakh is not utilized up to 31<sup>st</sup> March, 2013.

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Find out the amount chargeable to tax for the assessment year 2013-14.

**Answer:**

For the assessment year 2013-14, ₹10,00,000 is treated as business income (i.e. ₹4,00,000, being the amount of misutilised by the company plus ₹6,00,000, being the amount which is not utilized by the company during 2012-13). Out of ₹10,00,000, 40% i.e. ₹4,00,000 is taken as non-agricultural income and 60% i.e. ₹6,00,000 is deemed as agricultural income.

[4+7+2]

5.

- (a) Dey & Co. (a firm of Arup Dey and Binay Roy with unlimited liability) is engaged in the business of wholesale trading (turnover of 2012-13 being ₹87,00,000) It wants to claim the following deductions –

Particulars	Amount (₹)
Salary to partners [as permitted by section 40(b)]	50,000
Salary to employees	4,30,000
Depreciation	2,10,000
Purchases	74,55,000
Other expenses	2,95,000
<b>Total</b>	<b>84,40,000</b>

Determine the net income of Dey & Co. for the assessment year 2013-14 assuming that long term capital gain is ₹50,000 and the firm is eligible for deduction of ₹8,000 u/s 80G. The firm has a brought forward loss of ₹1,50,000 (previous year 2009-10) of a trading which has been discontinued. The books of account of the firm have not been audited.

**Answer:**

Statement showing calculation of Net Income of Dey & Co. for the assessment year 2013-14

Particulars	Amount (₹)
Income from business (8% of ₹87,00,000)	6,96,000
Less: Expenses –	
Salary to partners as permitted by section 40(b)	50,000
Income from business	6,46,000
Less: Brought forward loss	1,50,000
Profits and gains from business or profession	4,96,000
Capital Gains	50,000
Gross Total Income	5,46,000
Less: Deduction under sections 80C to 80U	8,000
<b>Net Income</b>	<b>5,38,000</b>

- (b) Goutam, on retirement from two firms on 1<sup>st</sup> July, 2012 of which he was a partner, received a sum of ₹47,000 in excess of the amount due to him towards his capital and profits. The Assessing Officer wants to treat the sum of ₹47,000 as capital gains in the hands of Goutam. Is the Assessing Officer legally correct?

**Answer:**

It is settled that there is no distinction between a case of a retirement of the partner from and dissolution of the partnership firm. When, therefore, a partner retires from a partnership firm and the amount of his shares in the net partnership assets after deduction of liabilities

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and prior charges is determined on taking accounts on the footing of notional sale of the partnership and given to him, what he receives is his share in the partnership and not any consideration for transfer of his interest in the partnership to the continuing partners. There is, thus, in the given case, no element of transfer of interest in the partnership assets by the retiring partner to the continuing partners. The Assessing Officer is, therefore, not legally correct to treat ₹47,000 as capital gains in the hands of Goutam. [CIT vs. R. Lingmallu Raghukumar (2002) 124 Taxman 127(SC)].

(c) The shareholding of Mr. K and Mrs. K in S Ltd., is given as follows:

Shareholding of K	7%
Shareholding of Mrs. K	9%
Shareholding of M, brother of K	8%
Shareholding of F, father of Mrs. K	5%

Mr. K and Mrs. K are employed with S Ltd. None of them hold technical qualification. Mr. K gets salary @ ₹10,000 p.m. and Mrs. K gets @ ₹12,000 p.m.

Income from Other Sources:	₹
Mr. K	80,000
Mrs. K	1,00,000

Compute total income for the assessment year 2013-14

Answer:

### Computation of Total Income for the AY 2013-14

Particulars	Mr. K ₹	Mrs. K ₹
1. Gross Salary	<u>1,20,000</u>	1,44,000
Salary income of Mr. K to be included in the total income of Mrs. K as her Income from Other Sources is greater and both of them have substantial interest along with their relative in S Ltd.		1,20,000
2. Income from Other Sources	<u>80,000</u>	<u>1,00,000</u>
<b>Total Income</b>	<u>80,000</u>	<u>3,64,000</u>

(d) During his 197 days' stay in India in the previous year 2012-13, David, a citizen of U.K. is all the time moving from one place to another. He claims that he is non-resident in India for the assessment year 2013-14 on the following grounds:

(i) He had never visited India before 1<sup>st</sup> April, 2012.

(ii) During 2012-13, though he is in India for 197 days, he could not spend two consecutive nights at any one place.

(iii) For the assessment year 2013-14, he is resident in U.K. according to English Income Tax Act. He insists that he cannot be resident of two countries for the same assessment year.

Do you agree with him?

Answer:

The claim of David is not tenable, as he is in India for 197 days during the previous year 2012-13. He satisfies one of the two basic conditions (namely, presence of 182 days or more during the previous 2012-13) and none of the additional conditions. He is, therefore, resident but not ordinarily resident in India for the assessment year 2013-14. The fact that he could not spend two consecutive nights at any one place is immaterial. Moreover, a person who is resident in



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India may become resident of any other country according to the tax laws of that country for the same or a different assessment year.

[4+3+4+2]

6.

- (a) Abhay is a resident individual. He suffers from a severe disability as certified by medical authority. He is mainly dependent upon his brother Abir (a resident individual) for support and maintenance. Abir annually incurs a sum of ₹15,000 on medical treatment of Abhay. Income of Abhay and Abir is ₹20,000 and ₹6,50,000 respectively. Find out the net income of Abhay and Abir for the assessment year 2013-14.

Answer:

### Statement showing calculation of Total Income

Particulars	Abhay (₹)	Abir (₹)
Gross Total Income	20,000	6,50,000
Less: Deduction under section 80C to 80U		
u/s 80DD	–	1,00,000
u/s 80U	–	–
Net Income	20,000	5,50,000

**Note:** If deduction is claimed by Abhay u/s 80U then no deduction will be available to Abir u/s 80DD. Income of Abhay is not chargeable to tax. Abhay should not claim any deduction u/s 80U.

- (b) Who is liable for prosecution for the offences made by HUF under Income Tax Act?

Answer:

As per section 278C(1), where an offence under the Income Tax Act has been committed by a Hindu Undivided Family, the karta thereof shall be deemed to be guilty of the offence and shall be liable to be proceeded against and punished accordingly.

The karta shall not be liable to any punishment if he proves that the offence was committed without his knowledge or that he had exercised all due diligence to prevent the commission of such offence.

As per section 278C(2), where an offence under this Act has been committed by a Hindu Undivided Family and it is proved that the offence has been committed with the consent or connivance of, or is attributable to any neglect on the part of, any member of the Hindu Undivided Family, such member shall also be deemed to be guilty of that offence and shall be liable to be proceeded against and punished accordingly.

- (c) During the Previous Year 2012-13, Mrs. X (aged 46 years) pays the following installments of advance tax :

	₹
On September 15, 2012	6,000
On December 15, 2012	14,000
On March 15, 2013	16,000
On March 16, 2013	18,000

Mrs. X files return of ₹7,01,000. Assessment is also completed on the basis of income returned by Mrs. X after making addition of ₹25,000 (date of assessment order: January 20, 2014). Mrs. X is entitled to tax credit of ₹12,510 on account of tax deducted at source. Compute interest under sections 234B and 234C.

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**Answer:**

Interest liability under section 234B

	₹
Income (7,01,000+25,000)	7,26,000
Tax on ₹7,26,000	77,456
Less: Tax Deducted at Source	12,510
Assessed Tax	64,946
90% of Assessed Tax	58,451

Advance tax paid during 2012-13 (i.e., ₹6,000 + ₹14,000 + ₹16,000 + ₹18,000) = ₹54,000.

Since advance tax during the Previous Year 2012-13 is less than 90% of assessed tax, Mrs. X is liable to pay interest under section 234B, i.e., on the shortfall of ₹10,946 (being ₹64,946 – 54,000) for 10 months ( $₹10,946 \times 1/100 \times 10$ ) which comes to ₹1,095..

**Interest liability under section 234C:**

**Tax on ₹7,01,000 = ₹70,200 + 3% on Education and Higher Education Cess = ₹72,306**

Due date	Advance Tax Payment ₹	Advance Tax paid ₹	Cumulative Advance Tax paid before due date ₹	Shortfall in Payment ₹	Surplus ₹	Months	Interest @ 1% p.m. ₹
15.09.2012	30% of ₹ 72,306 = 21,692	6,000	6,000	15,692	—	3	471
15.12.2012	60% of ₹ 72,306 = 43,384	14,000	20,000	23,384	—	3	702
15.03.2013	100% of ₹ 72,306 = 72,306	34,000	54,000	18,306	—	1	183
							<b>1,356</b>

[3+3+7]

**Section B  
(Answer ALL the Questions)**

7.

- (a) Mr. More gifted a piece of land to his daughter in law after obtaining approval of the authorities constructed 5 shops as at and let out the same. The value of shops on valuation date 31.03.2013 is ₹50,00,000. In whose hand it is taxable?

**Answer:**

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

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

**Answer:**

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

[1+1]

8.

(a)

- (i) Rishi has the following assets on 31<sup>st</sup> March, 2013:

Asset	Market Value (₹)	Loan Outstanding (₹)
Gold	87,00,000	10,00,000
Residential House at Pune	45,00,000	2,00,000
Residential House at Andheri	90,00,000	27,00,000
Residential House at Mahape (Let out though out the year)	65,00,000	11,00,000
Commercial House at Thane used for his own business	1,15,00,000	50,00,000
Shares	25,00,000	5,00,000
Boat	1,50,000	2,50,000
Motor Car	9,00,000	3,00,000
Bank deposit	58,00,000	Nil
Commercial complex at Andheri having 25 offices	2,50,00,000	1,55,00,000

Besides above mentioned loans, Rishi took a loan of ₹1,00,000 from his bank for his brother's marriage. Moreover, out of loan of ₹2,50,000 taken for boat, he utilized ₹50,000 for financing expenses on his foreign visit.

Determine his net wealth.

**Answer:**

Net wealth of Rishi shall be determined as under:

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

Net Wealth = Market value of assets – Loan outstanding

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$$= ₹(1,42,50,000 - 17,00,000) = ₹1,25,50,000$$

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

- (ii) Binay, Karta of HUF, out of HUF funds gifted to his nephew an amount of ₹3,00,000 on 01.01.2013. The coparceners of the HUF challenged the gifts and as a consequence gifts were held to be void. Discuss whether the amount of ₹3,00,000 is taxable as wealth of Binay HUF for the valuation dated 31.03.2013.

**Answer:**

As the amount actually gifted by the HUF, the provisions of Sec. 4(5A) are not attracted. As on the valuation date 31.03.2013, the said amount of ₹3,00,000 does not belong to the HUF. Therefore, the same cannot be charged to Wealth Tax in the hands of Binay HUF. Hence, in the case, challenging by the coparceners is of no consequence.

[6+2]

or

(b)

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

**Answer:**

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

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

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

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

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

- (ii) Wasim owns three cars and silver furniture (value of cars being ₹25,00,000 and of silver furniture being ₹35,00,000 of 31.03.2013). He take loan of ₹4,70,000 by pledging there to invest in shares. You are requested by Wasim to calculate amount of wealth tax payable by him for the assessment year 2013-14.

**Answer:**

**Assessee:** Wasim

**Valuation Date:** 31.03.2013

**Assessment Year:** 2013-14

**Calculation of Net Wealth**

Particulars	Amount (₹)
Car	25,00,000
Silver Furniture	35,00,000
Shares (not an asset)	Nil
Gross Wealth	60,00,000

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Less: Debt (loan of ₹4,70,000 is not deductible as it is taken to purchase shares which are not assets)	Nil
<b>Net Wealth</b>	<b>60,00,000</b>
Less: Basic Exemption	30,00,000
<b>Net Taxable Wealth</b>	<b>30,00,000</b>
<b>Tax @ 1%</b>	<b>30,000</b>

- (iii) Mrs. Rishika Yadav received jewellery from her father at the time of her marriage in 1956 was of the value of ₹25,50,000 on 31<sup>st</sup> March, 2013. Is this included in the net wealth of Mrs. Rishika Yadav?

**Answer:**

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

[3+4+1]

### Section C (Answer ALL the Questions)

9.

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

**Answer:**

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

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

**Answer:**

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

- (c) What do you mean by Residual Profit Split?

**Answer:**

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

- (d) Can the Board enter in Advance Pricing Agreement?

**Answer:**

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

- (e) Who can enter into an APA?

**Answer:**

Any person, who –

(i) has undertaken an international transaction; or

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(ii) is contemplating to undertake an international transaction, shall be eligible to enter into an APA.

[5×1]

10.

(a)

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

**Answer:**

The four tests are —

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

- (ii) **When can Profit Split Method (PSM) be used for determination of Arm's Length Price in an international transaction?**

**Answer:**

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

- (1) Transactions involving transfer of unique intangibles;
- (2) Multiple inter-related international transactions which cannot be evaluated separately for determining the ALP of any one transaction.
  - I. The extent of economies of backward and forward integration, the existence of intangibles on both sides of the transaction, and complex functional and transactional structures may limit the use of standard approaches to economic analysis for transfer pricing purposes (i.e. performing comparable company searches to apply the TNMM). In those circumstances, the arm's length nature of transactions may be better evaluated by considering the transaction from an end-to-end perspective, and thus PSM can be applied.
  - II. This method can be used in situations where economies of integration differentiate the tested party from the comparables, provided these are taken into account in the principle for allocating profits. The method enables accounting for valuable intangibles being developed on both sides of the transaction.
  - III. The allocation of profit can be calculated based on principles that take into account the contribution of intangibles in the industry's or the group's value creation process.
  - IV. This method is also well suited to complex transactions where several entities are involved in the same functions and it is not possible to define precisely the scope of functions and responsibilities. While this method has not been widely used, it has been somewhat popular in the financial services industry.

- (iii) **Swinhoe LLP of France and Rani Ltd. of India are associated enterprises. Rani Ltd. imports 3,000 compressors for Air Conditioners from Swinhoe at ₹7,500 per unit and these are sold to Paharpur Cooling Solutions Ltd. at a price of ₹11,000 per unit. Rani Ltd. had also imported similar products from Cold Ltd and sold outside at a Gross Profit of 20% on Sales. Swinhoe offered a quantity discount of ₹1,500 per unit. Cold could offer only ₹500 per unit as Quantity Discount. The freight and customs duty paid for imports from France had cost Rani**

## Answer to MTP\_Intermediate\_Syllabus 2012\_Dec2013\_Set 2

Ltd. ₹1,200 per piece. In respect of purchase from Cold Ltd, Rani Ltd. had to pay ₹200 only as freight charges.

Determine the Arm's Length Price and the amount of increase in Total Income of Rani Ltd.

**Answer:**

**Computation of Arm's Length Price of Products bought from Swinhoe, France by Rani Ltd.**

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

**Computation of Increase in Total Income of Rani Ltd.**

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

**(iv) Describe in short the procedure to deal with requests for bilateral or multilateral advance pricing agreements.**

**Answer:**

- (I) Where a person has made request for a bilateral or multilateral advance pricing agreement in an application filed in Form No. 3 CED in accordance with rule 10-I, the request shall be dealt with subject to provisions of this rule.
- (II) The process for bilateral or multilateral advance pricing agreement shall not be initiated unless the associated enterprise situated outside India has initiated process of advance pricing agreement with the competent authority in the other country.
- (III) The competent authority in India shall, on intimation of request of the applicant for a bilateral or multilateral agreement, consult and ascertain willingness of the competent authority in other country or countries, as the case may be, for initiation of negotiation for this purpose.
- (IV) In case of willingness of the competent authority in other country or countries, as the case may be, the competent authority in India shall enter into negotiation in this behalf and endeavour to reach a set of terms which are acceptable to the competent authority in India and the competent authority in the other country or countries, as the case may be.
- (V) In case of an agreement after consultation, the competent authority in India shall formalise a mutual agreement procedure arrangement with the competent authority in other country or countries, as the case may be, and intimate the same to the applicant.
- (VI) In case of failure to reach agreement on such terms as are mutually acceptable to parties mentioned in sub-rule 4, the applicant shall be informed of the failure to reach an agreement with the competent authority in other country or countries.
- (VII) The applicant shall not be entitled to be part of discussion between competent authority in India and the competent authority in the other country or countries, as the case may be; however the applicant can communicate or meet the competent authority in India for the purpose of entering into an advance pricing agreement.

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- (VIII) The applicant shall convey acceptance or otherwise of the agreement within thirty days of it being communicated.
- (IX) The applicant, in case the agreement is not acceptable, may at its option continue with process of entering into an advance pricing agreement without benefit of mutual agreement process or withdraw application in accordance with rule 10J.

**(v) How can you classify the methods for determining arm's length price in international transactions?**

**Answer:**

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

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

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

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

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

[2+4+6+5+3]

OR

**(b)**

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

**Answer:**

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

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

**Analysis and Conclusion:**

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



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

(ii) **Briefly explain Profit Split Method in determining Arm's Length Price.**

**Answer:**

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

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

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

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

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

**Note:** Combined Net Profit shall be split as under:

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

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

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

(iii) **"Every person who has entered into an international transaction shall keep and maintain certain information and documents" — what are these information and documents?**

**Answer:**

**(A) DOCUMENTS: Under Rule 10D,** every person who has entered into an international transaction shall keep and maintain the following information and documents:

1. **Ownership details:** Description of the ownership structure of the assessee enterprise with details of shares or other ownership interest held therein by other enterprises.
2. **Group details:** Profile of the multinational group of which the assessee enterprise is a part along with 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 entered into by the assessee and ownership linkages among them.
3. **Business details:** Broad description of the business of the assessee and the industry in which the assessee operates and of the business of the associated enterprises with whom the assessee has transacted.
4. **International Transaction details:** Nature and terms (including prices) of international transactions entered into with each associated enterprises, details of property transferred or services provided and the quantum and the value of each

- such transaction or class of such transaction.
5. **Functional details:** Description of the functions performed, risks assumed and assets employed or to be employed by the assessee and by the associated enterprises involved in the international transaction.
  6. **Details of factors influencing international transactions:** Record of the economic and market analyses, forecasts, budgets or any other financial estimates prepared by the assessee for the business as a whole and for each division of product separately, which may have a bearing on the international transactions entered into by the assessee.
  7. **Uncontrolled transactions details:** Record of uncontrolled transactions taken into account for analysing their comparability with the international transactions entered into, including a record of the nature, terms and conditions relating to any uncontrolled transaction with third parties which may be of relevance to the pricing of the international transactions.
  8. **Comparability details:** Record of the analysis performed to evaluate comparability of uncontrolled transactions with the relevant international transaction.
  9. **Details of method selected for Arm's Length Price:** 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.
  10. **Details of computation of Arm's Length Price:** 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 transactions.
  11. **Assumptions:** Assumptions, policies and price negotiations, if any, which have critically affected the determination of the Arm's Length Price.
  12. **Adjustments:** Details of the adjustments, if any, made to transfer price to align them with arm's length prices determined under these rules and consequent adjustment made to the total income for tax purposes.
  13. **Other relevant details:** 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.

### (B) FRESH DOCUMENTS:

1. **No Significant Change:** Where an international transaction continues to have effect for more than one previous year, fresh documentation need not be maintained separately unless there is a significant change in -
  - (a) Nature or terms of the international transaction,
  - (b) Assumptions made,
  - (c) Any other factor which could influence the transfer price.
2. **Significant Change:** In case of any significant change, fresh documents required to bring out the impact of the change on the international transaction should also be maintained.

### (C) SUPPORTING DOCUMENTS: The information specified above should be supported by authentic documents, which may include the following -

1. Official publications, reports, studies and data base from the Government of the country of residence of the associated enterprise, or of any other country,
2. Reports of market research studies carried out and technical publications brought

## **Answer to MTP\_Intermediate\_Syllabus 2012\_Dec2013\_Set 2**

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- out by institutions of national or international repute,
3. Price publications including stock exchange and commodity market quotations,
  4. Published accounts and financial statements relating to the business affairs of the associated enterprises,
  5. Agreements and contracts entered into with associated enterprises or with unrelated enterprises in respect of transactions similar to the international transactions,
  6. Letters / other correspondence documenting any terms negotiated between the assessee and the associated enterprise,
  7. Documents normally issued in connection with various transactions under accounting practices followed.

**(iv) Briefly discuss the various factors that are to be considered while selecting Most Appropriate Method.**

**Answer:**

In selecting the Most Appropriate Method, following factors shall be considered -

- (I) The nature and class of the international transaction,
- (II) The class or classes of associated enterprises entering into the transaction and the functions performed by them taking into account assets employed or to be employed and risks assumed by such enterprises,
- (III) The availability, coverage and reliability of data necessary for application of the method,
- (IV) The degree of comparability existing between the international transaction and the uncontrolled transaction and between the enterprises entering into such transactions,
- (V) The extent to which reliable and accurate adjustments can be made to account for differences, if any, between the international transaction and the comparable uncontrolled transaction or between the enterprises entering into such transactions,
- (VI) The nature, extent and reliability of assumptions required to be made in application of a method.

**[4+5+8+3]**