

Paper-7 – Applied Direct Taxation

MTP_Intermediate_Syllabus 2012_Dec2015_Set 1

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

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

Paper-7 – Applied Direct Taxation

Time Allowed: 3 hours

Full Marks: 100

All the questions relate to the assessment year 2015-16, unless stated otherwise.

Working notes should form part of the answers.

Answer all questions.

Question No 1.

(i) An amount of ₹ 5 Lakhs was paid on 17.03.2015 to the parents of Rakesh by the Government of Maharashtra as a compensation to the grieved family whose only son Rakesh lost his life in Mumbai local train serial bomb blasts. Is the amount of compensation received chargeable to tax? **[2]**

(ii) A Special Purpose Distinct Entity (regulated by SEBI), set up in the form of a trust to undertake securitization activities, receives ₹ 20 Lakhs from the activities of securitization, and distributes ₹ 5 Lakhs to its Investors. What would be the tax implications in the hands of:

- (a) The Special Purpose Distinct Entity, in respect of its Income from the activity of Securitization, and
- (b) Investors, in respect of Income distributed by the Special Purpose Distinct Entity. **[2]**

(iii) PQR Limited has written off certain debts as Bad Debts in the books of account and claimed deduction u/s 36(1)(vii) in the Return of Income filed for Assessment Year 2015-2016. The Assessing Officer (A.O.) made disallowance for deduction of Bad Debts on the ground that the Debts have not been established to have become irrecoverable and bad in the previous year 2014-2015. Examine the correctness of the action of A.O. **[2]**

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

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

(vi) What are the advantages while computing arm's length price Transactional Net Margin Method? **[2]**

(vii) X & Co. Diagnostic Centre P Ltd. has claimed Referral Fee paid to doctors as Revenue Expenditure for the Assessment Year 2015-16. However, TDS has been deducted u/s 194H of the Income Tax Act, 1961 for the said payments. The Assessing Officer proposes to disallow such expenditure. Examine the correctness of the action of the Assessing Officer. **[2]**

(viii) XYZ Ltd incurred expenditure amounting to ₹ 3,00,000 in connection with the issue of Rights Shares and ₹ 2,00,000 in connection with the issues of Bonus Shares during the year ending 31.03.2015. The Company seeks your opinion in the matter of eligibility for deduction of the expenditure incurred from its business profits for the Assessment Year 2015-2016. **[2]**

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(ix) B Ltd is a Company engaged in the business of Financing and Investment in Shares. It suffered loss of ₹ 3,00,000 on account of Futures and Options, a transaction in the form of Derivatives in which the underlying asset was Shares. Explain the allowability, under the provisions of Income Tax Act 1961. **[1]**

(x) A Farmer, being Resident of Jaipur, sold his Rural Agricultural Land situated in Nepal and received Indian Rupees 2 Lakhs over the cost of acquisition of this land. Explain the taxability of the sale. **[2]**

(xi) Mr. Pal received a painting by M.F. Hussain worth ₹ 2 Lakhs from his nephew on his 10th wedding anniversary. Discuss the tax implications. **[2]**

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

(a)(i) The W.D.V. of the block of assets as on 1.4.2014 was ₹ 20 lacs. Rate of Depreciation @ 15%. An asset of the same block was acquired on 11.5.14 for ₹ 12 lacs. There was a fire on 18.9.2014 and the assets were destroyed by fire and the assessee received a sum of ₹ 36 lacs from the insurance company. Compute the Capital Gain assuming:

- (a) All the assets were destroyed by fire
- (b) Part of the block was destroyed by fire

Would your answer differ if the assessee received ₹21,00,000 from insurance company assuming:

- (a) All the assets were destroyed by fire
- (b) Part of the block was destroyed by fire

[5]

(ii) Mrs. K holds 7% equity shares in T Ltd., where her married sister, Mrs. L also holds 14% equity shares. Mr. K is employed with T Ltd., without holding technical professional qualification. The particulars of their income for the Previous Year 2014-2015 are given as follows:

	Income of Mr. K	Income of Mrs. K	
(a) Gross Salary from T Ltd.	3,04,000	—	
(b) Dividend from T Ltd.	—	12,000	
(c) Income from House Property	1,80,000	—	[3]

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(iii) Mr. Q gets the following gifts during the Previous Year 2014-2015.

	Date of Gift	Name of the Donor	Amount of Gift (₹)
1.	01.07.2014	Gift from R, a friend, by cheque	60,000
2.	01.09.2014	Cash gift from N, nephew	1,20,000
3.	01.12.2014	Gift of diamond ring on his birthday, by a friend, C	75,000
4.	15.12.2014	Cash gifts of ₹ 31,000 each made by four friends on the occasion of his marriage	1,24,000
5.	21.12.2014	Cash gift made by wife's sister on house opening ceremony	51,000
6.	15.01.2015	Cash gift from a close friend of father-in-law.	1,51,000
7.	31.01.2015	Cash gift made by great-grandfather	1,51,000
8.	01.02.2015	Cash gift received under the Will of a friend, who is seriously ill.	1,65,000
9.	15.02.2015	Cash gift made by a business friend on his birthday	51,000
10.	31.03.2015	Cash gifts made by three friends of ₹ 25,000 each	75,000

Besides this, JK is engaged in the business of sale and purchase of retail goods. He maintains no account books. Gross turnover from retail trading is ₹ 50,00,000. Compute his total income for the Assessment Year 2015-2016.

[4]

(iv) What do you mean by annexure less return? What is the manner of filling the return of income?

[3]

(b) (i) Mr. Manash Cooperative Society Ltd. furnishes the following particulars of its income for the Previous Year ended on 31st March 2015:

(i)	Interest on Government securities	1,60,000
(ii)	Profits from banking business	4,50,000
(iii)	Income from purchase and sale of agricultural implement and seeds to its members	2,50,000
(iv)	Income from marketing of agricultural produce of its members	4,00,000
(v)	Profits and gains of business	2,20,000
(vi)	Income from cottage industry	3,50,000
(vii)	Interest and dividends (gross) from other cooperative societies	30,000

Compute Total Income of the society and calculate the Tax Payable by it for the Assessment Year 2015-2016.

[8]

(ii) Ms. Radhika, a resident Indian, furnishes the details for the Assessment Year 2015-2016 :

Particulars	Amount (₹)
(1) Income from profession	2,94,000
(2) Share of income from a partnership in country X (tax paid in Country X for this income in equivalent Indian Rupees 10,000)	50,000
(3) Commission income from a concern in country Y (tax paid in country Y @ 20%, converted in equivalent Indian Rupees)	40,000
(4) Interest on scheduled banks [other than savings account]	20,000

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Ms. Radhika wishes to know whether she is eligible to any double taxation relief, if so, its quantum. India does not have any Double Taxation Avoidance Agreement with countries X and Y. [5]

(iii) Compute the amount of TDS on the following payments made by M/s P Ltd during the Previous Year 2014- 2015 as per the provisions of the Income Tax Act, 1961 –

(a)	01.10.2014	Payment of ₹3,00,000 to Mr. "R" a transporter who is having PAN.
(b)	01.11.2014	Payment of Fee for Technical Services of ₹25,000 and Royalty of ₹ 28,000 to Mr. Shyam who is having PAN.

[2]

(c)(i) 'B', an Indian citizen left India for the first time on 20.9.2013 for employment in Denmark. During the Previous Year 2014-15 he comes to India on 5.5.2014 for 150 days. Determine the residential status of 'B' for the Assessment Years 2014-15 and 2015-16. [4]

(ii) Mr. Dipak, after serving Z Ltd. for 23 years 7 months, opted the Voluntary Retirement Scheme. Total tenure of service: 30 years. Compensation received ₹ 15,00,000. Last drawn Salary (i.e. Basic Pay + D.A, forming part of retirement benefits) ₹ 20,000. Compute exemption & taxable value of VRS compensation. [4]

(iii) Mr. Kanoria has estates in Rubber, Tea and Coffee. He derives income from them. He has also a nursery wherein he grows plants and sells. For the previous year ending 31.3.2015, he furnishes the following particulars of his sources of income from estates and sale of Plants. You are requested to compute the taxable income for the Assessment year 2015-2016.

- (a) Manufacture of Rubber ₹ 12,00,000
- (b) Manufacture of Coffee grown and cured ₹ 8,00,000
- (c) Manufacture of Tea ₹ 14,00,000
- (d) Sale of Plants from Nursery ₹ 3,00,000.

[4]

(iv) State the consequences if Firm fails to fulfill condition under section 184 of the Income Tax Act, 1961. [3]

(d) (i) Find out the amount of advance tax payable by Mr. X on specified dates under the Income Tax Act, 1961 for the Previous Year 2014-15:

	₹
Business income	11,00,000
Long Term Capital Gain on 31-5-2014	6,40,000
Winning from lotteries on 12-6-2014	2,00,000
Bank interest	20,000
Other income	20,000
Investment in PPF	1,50,000
Tax deducted at source : Case I	3,12,000
Case II	1,00,000

[6]

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(ii) The gross total income of Mr. Raju for the assessment year 2015-16 is ₹6,10,000 which includes long-term capital gain ₹80,000, short-term capital gain referred to in section 115A ₹70,000 and interest on saving bank deposit ₹12,000. Compute the tax payable by Mr. Raju assuming he deposited ₹1,00,000 in PPF and paid premium for health insurance by cheque amounting to ₹15,000. **[5]**

(iii) XY & Co., a partnership concern had established an undertaking for manufacturing computer software in Special Economic Zone. It furnishes the following particulars of its second year operations, ended on 31-03-2015:

Particulars	₹ (in lakh)
Total Sales of business	250.00
Export Sales	200.00
Profit of the business	20.00

Out of the total export sales, realisation of sale of ₹ 12.5 lakh is difficult because of the deficiency of the buyer. Realisation of rest of the sales is received in time.

The plant and machinery used in the business had been depreciated @ 15% on SLM basis of depreciation and depreciation of ₹ 6 lakh was charged to the Profit and Loss Account.

Compute the taxable income of XY & Co for the Assessment Year 2015-2016. **[4]**

(e)(i) Mr. Sandip owns two houses, which are occupied by him for his own residence. The detailed particulars of houses and his other incomes for the Previous Year 2014-15 are given below:

Particulars	House A	House B
Fair Rent	5,00,000	5,00,000
Municipal Value	4,80,000	4,50,000
Standard Rent	4,50,000	5,20,000
Municipal taxes paid	50,000	60,000
Interest on loan for the FY 2014-15	1,60,000	2,20,000
Date of loan	1.12.2003	1.04.2004
Date of completion	31.03.2005	31.03.2007
Certificate of interest attached with return of income	No	Yes

Mr. Sandip earns income from other sources amounting to ₹ 3,00,000

Compute his Total Income and advise him which house should be opted for self-occupation. **[5]**

(ii) ABC & Co. is a partnership firm, consisting 3 partners A, B and C. The firm is dissolved on 31.12.14. The assets of the firm were distributed to the partners as under :

Particulars	Block of Machinery (given to A)	Stock (given to B)	Land (given to C)
Year of acquisition	1990-91	2002-03	1978-79
Cost of acquisition (₹)	27,20,000	4,00,000	10,000
Market value as on 31.12.14	17,00,000	6,00,000	27,00,000
WDV as on 31.12.14	11,40,000	—	—

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Value at which given to partners as per agreement	12,00,000	4,50,000	18,00,000
Market value as on 1.4.81	—	—	2,70,000

Compute the income taxable in the hands of the firm for the Assessment Year 2015-16. What shall be the cost of acquisition of such assets to the partners of the firm? **[5]**

(iii) For the previous year 2014–15, the business income of Sohan Ltd. before allowing expenditure on family planning is ₹2,20,000. The company had incurred the following expenditure on family planning amongst its employees during the previous year 2014-15:

- (1) Revenue expenses on family planning ₹1,10,000.
- (2) Capital expenditure on family planning ₹6,00,000.

Compute the deduction available for expenditure on family planning to the company assuming the company has income from other sources amounting to ₹20,000.

What will be your answer if the revenue expenditure on family planning is ₹2,15,000 instead of ₹1,10,000. **[5]**

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

(a)(i) FLT LLP of France and Squar Ltd of India are associated enterprises. Squar Ltd. imports 5,000 compressors for Air Conditioners from FLT at ₹ 7,800 per unit and these are sold to Bihar Cooling Solutions Ltd at a price of ₹ 11,000 per unit. Squar Ltd. had also imported similar products from Cold Ltd and sold outside at a Gross Profit of 20% on Sales.

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

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

(ii) Himalaya Ltd is an Indian Company engaged in the business of developing and manufacturing Industrial components. Its Canadian Subsidiary Su-power Inc. supplies technical information and offers technical support to Himalaya for manufacturing goods, for a consideration of Euro 2,00,000 per year.

Income of Himalaya Ltd is ₹ 180 Lakhs. Determine the Taxable Income of Himalaya Ltd if Su-power charges Euro 2,60,000 per year to other entities in India. What will be the answer if Su-power charges Euro 1,20,000 per year to other entitles. (Rate per Euro may be taken at ₹ 60) **[5]**

(b)(i) Mobeaux LLP of Poland and Vishnu Ltd of India are Associated Enterprises. Vishnu imports 2000 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 Vishnu had also imported similar products from De-Heat Ltd and sold outside at a Gross Profit of 20% on Sales.

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 to

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Vishnu ₹ 1,200 a piece. In respect of purchase from De-Heat, Vishnu had to pay ₹ 200 only as Freight Charges.

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

(ii) EML Limited, an Indian Company, is engaged in manufacturing electronic components. 74% of the Shares of the Company are held by EML Inc. incorporated in USA. EML Limited has borrowed funds from EML Inc. at LIBOR plus 150 points. The LIBOR prevalent at the time of borrowing is 4% for US \$. The Borrowings allowed under the External Commercial Borrowings Guidelines issued under FEMA are LIBOR plus 200 basis points. Discuss whether the Borrowing made by EML Ltd is at Arm's Length. **[5]**

(c) What are the consequences of Non-Compliance with Regulations under International Transaction? **[10]**