

Paper 7- Direct Taxation

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Full Marks: 100

Time Allowed: 3 hours

Section A (80 Marks)

Income Tax

I. Answer question No. 1 which is compulsory and any FOUR from Question No. 2 to 7

1. a) Fill up the blanks:

5 × 1=5

- i) Periodical pension received by a Government employee is _____.
- ii) Cost of acquisition of self generated capital asset, being route permit shall be _____.
- iii) Loss from house property cannot be adjusted from _____.
- iv) Belated return of income _____ (can/cannot) be revised.
- v) Interest on capital borrowed for repairs of let-out property is deductible on _____ (accrual/payment) basis.

Answer:

- i) taxable
- ii) nil
- iii) winnings from lotteries etc.
- iv) cannot
- v) accrual

b) Choose the most appropriate alternative:

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- i) AOP should consist of:
 - a) Individuals only
 - b) Persons other than individuals only
 - c) Individuals and HUF only
 - d) None of the above
- ii) An Indian Company, where place of effective management is outside India, shall be:
 - a) Resident in India
 - b) Non-resident in India
 - c) Not ordinarily resident in India
 - d) None of the above
- iii) Casual income received by the assessee
 - a) Exempt upto ` 50,000
 - b) Fully exempt
 - c) Fully taxable
 - d) None of the above
- iv) Free meal worth ` 120 per meal for 200 days provided by the employer during working hours in a remote area is:
 - a) Exempt upto ` 50 per meal
 - b) Taxable upto ` 50 per meal
 - c) Fully exempt

- d) Fully taxable

- v) Unrealised rent of a property shall be excluded from:
 - a) Gross Annual Value
 - b) Net Annual Value
 - c) Income from property
 - d) All the three

Answer:

- i) d
- ii) a
- iii) c
- iv) c
- v) a

c) State true or false with reasons:

5 × 2 =10

- i) Salary received by the partner from the firm in which he is a partner is taxable under the head salary.
- ii) Gross Annual Value of a property cannot exceed rent as per the Rent Control Act.
- iii) Depreciation is allowed as deduction u/s. 32 in case of registered owner only.
- iv) Loss can be set off only by the assessee who has incurred the loss.
- v) Benefit of indexation is not available in case of Capital Indexed Bonds for computation of long term capital gain.

Answer:

- i) False. Salary of a partner is chargeable to tax u/s 28 (v) as deemed business income.
- ii) False. Reasonable expected rent or annual rent whichever is higher is taken as GAV.
- iii) False. Depreciation is allowed as deduction to the user of asset, whether registered or not.
- iv) True. However, there are certain exceptions like amalgamation, demerges and succession.
- v) False. Capital Indexed Bonds are one of the exception under which benefit of Indexation is available.

2. a) Miss Jaya, a resident individual owns a property in Chennai, 50% of the area is letout at a monthly rent of ` 15,000 and the remaining is used for her residence. Standard rent and fair rent of the portion of property letout is ` 18,000 p.m and ` 20,000 p.m respectively. Municipal taxes of the property is ` 10,000. The property is constructed by taking a loan from a nationalised bank. She repaid the loan of ` 60,000 including interest of ` 20,000. She also owns a property in UK and receives rent @ £ 1000 p.m. She paid municipal taxes of £ 1000. The value of one pound is to be taken as ` 90. Compute total income for the AY 2016-17. **8**

- b) Mr. Rao was employed in a public limited company. His salary was fixed at 15,000 p.m. in the grade of ` 14,500 – ` 500 – ` 21,500 with effect from 1-8-2012. Dearness Allowance is paid at 15% of salary. He retired from service on 1-1-2016 after 20 years of service and receives the following payments:
- (i) Recognised Provident Fund (yearly contribution is 10% of salary) ` 3,00,000.
 - (ii) Periodical Pension ` 6,000 p.m.
 - (iii) Gratuity ` 4,50,000.

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Compute total income for the AY 2016-17.

7

Answer:

a) Computation of total income.

Letout property [50%]

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Municipal value or fair rent (Whichever is higher)	$20,000 \times 12 = 2,40,000$
Or Standard rent (Whichever is Lower)	$18,000 \times 12 = 2,16,000$
RER or AR (Whichever is higher)	2,16,000 or 1,80,000
Gross Annual Value (GAV)	2,16,000
(-) Municipal taxes ($10,000 \times 50\%$)	5,000
Net Amount Value (NAV)	2,11,000
(-) Standard deduction (S. D) @ 30%	63,300
Interest on loan ($20,000 \times 50\%$)	10,000
	1,37,700

Self – Occupied Property [50%]

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Net Annual Value (NAV)	Nil
(-) Interest on Loan ($20,000 \times 50\%$)	10,000
	(-) 10,000

Property in UK

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GAV ($1,000 \times 12 \times 90$)	10,80,000
(-) Municipal taxes ($1,000 \times 90$)	90,000
NAV	9,90,000
(-) Standard Deduction @ 30%	2,97,000
	6,93,000

	\
Income under head House property ($1,37,700 - 10,000 + 6,93,000$)	8,20,700
IHP	8,20,700
Other income	Nil
Gross Total Income (GTI)	8,20,700
(-) Deduction u/s 80C Repayment of loan ($60,000 - 20,000$)	40,000
Total Income	7,80,700

b) Computation of Total income

	\
Basic pay [$16,000 \times 5 + 16,500 \times 5$]	1,62,500
Dearness allowance @ 15%	24,375
RPF [up to 12% is exempted]	Nil (employer contribution)
Periodical pension ($6,000 \times 2$)	12,000
Gratuity [Working note]	2,63,700

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Salary income	4,62,575
Other income	Nil
GTI	4,62,575
(-) Deduction u/s 80c RPF by employer 10% of salary	18,630
Total income	4,43,945
Round off	4,43,950

Note:

(i)	Salary on	01-08-2012	= 15,000 p. m.
	Salary on	01-08-2013	= 15,500 p. m.
	Salary on	01-08-2014	= 16,000 p. m.
	Salary on	01-08-2015	= 16,500 p. m.

Salary from 01.04.2015 to 01.08.2015	= 16,000 p. m.
and from 01.09.2015 to 01.01.2016	= 16,500 p. m.

(ii) Payment from RPF is exempt u/s 10(12)

Working Note:

$$\begin{aligned} \text{Salary} &= \text{Basic pay} + \text{D. A forming part of salary} \\ &= [16,500 \times 4 + 16,000 \times 6] + 15\% \text{ of } `1,62,000 \\ &= `1,86,300 \end{aligned}$$

$$\begin{aligned} \text{Taxable gratuity} &= \text{Amount of gratuity} - \text{Amount of exemption u/s 10 (10)} \\ &= `4,50,000 - 1,86,300 \\ &= `2,63,700 \end{aligned}$$

Amount of exemption u/s 10(10) = Actual gratuity or $\frac{1}{2} \times \text{Average Salary} \times \text{LDS}$
Or
`10 lakhs whichever is lower.

$$\begin{aligned} \text{Average salary} &= 10 \text{ months average salary} \\ &= \frac{1,86,300}{10} = 18,630 \end{aligned}$$

$$\frac{1}{2} \times \text{AS} \times \text{LDS} = \frac{1}{2} \times 18,630 \times 20 = `1,86,300$$

3. a) Mr. Roy was the owner of following assets.

	Year of Acquisition	Cost	FMV as on 1-4-1981
House Property	1974-75	20,000	40,000
Listed debentures	1992-93	80,000	--
Listed Equity Shares	1998-99	40,000	--

Mr. Roy died on 10-10-2001 and as per his will assets transferred to his son Mr. Sai. These assets are sold on 10-10-2015 for a total consideration of `40,00,000 (house property `25,00,000; listed debentures `14,00,000 and listed shares `1,00,000). Compute the amount of capital gain chargeable to tax for the AY 2016-17 assuming that shares were sold through a recognised stock exchange and securities transaction tax was paid on such sale. CII for the financial years 1981-82, 1992-93, 1998-99, 2001-02 and 2015-16 is 100, 223, 351, 426 and 1081 respectively. **8**

b) Mr. Modi is the owner of a small manufacturing unit and submits the following particulars:-

(A) Net Profit, before charging the following items `1,40,000.

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- i) Provision for doubtful debts `10,000.
- ii) Donation to PM National Relief Fund `5,000.
- iii) Contribution to National Laboratory for research not related to business ` 4,000.
- iv) Stationery bill paid in cash `25,000.
- v) Advertisement bill paid by way of account payee cheques `30,000.
- vi) Expenses on income-tax assessment `2,000.
- vii) Purchase of patents on 1-11-2015 for ` 40,000.
- viii) Life Insurance Premium ` 3,000.

(B) Incomes not taken into accounts:

- (i) Bank interest ` 5,000.
- (ii) Interest on units of UTI ` 4,000.
- (iii) Export incentives ` 3,000.

(C) Opening Stock value was ` 27,500 which is valued at cost plus 10% basis, whereas value of closing stock was ` 27,000 which is valued at cost minus 10% basis.

Compute total income for the AY 2016-17.

7

Answer:

a) Computation of capital gain

	House	Debenture	Equity Share
Full sale Consideration	25,00,000	14,00,000	1,00,000
(-) Index Cost of Acquisition $40,000 \times \frac{1,081}{426}$	1,01,502	-	1,01,502
(-) Cost of Acquisitions	-	80,000	-
	23,98,498	13,20,000	Nil

Note:

- (1) CIT of the year in which asset is first held is considered in case of inherited property.
- (2) COA or FMV as on 01-04-1981 whichever is considered.
- (3) LTCG or LTCL on sale of equity shares on which Security Transaction Tax is paid is exempted u/s 10(38)

b) Computation of total income.

Particulars	`
Net profit as per P & L A/c	1,40,000
(-) Contribution to National lab $4,000 \times 200\%$	8,000
Advertisement Bill	30,000
Tax assessment Depreciation on Patents $40,000 \times 25\% \times \frac{1}{2}$	5,000
	95,000
(+) Export incentives	3,000
Over valuation in opening stock	

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$27,500 \times \frac{10}{110}$	2,500
Under valuation in closing stock	
$27,000 \times \frac{10}{90}$	3,000
Profit & gain from Business or Profession	1,03,500
Income from Other Source (IOS)	
Bank Interest	5,000
Interest from UTI	Nil
Gross Total Income	1,08,500
(-) Deduction under chapter VI A	
Sec 80G	
100% of PM NRF	5,000
Total Income	1,03,500

Notes:

- (1) Patents are used for less than 180 days.
- (2) Weighted deduction @ 200% is allowed irrespective of contribution to National lab.
- (3) Interest from units of UTI is exemption u/s 10(35)

4. a) Mr. Rahul submits the following information:-

- (i) Gross salary per annum ` 2,50,000
- (ii) Rent of property ` 5,000 p.m.
- (iii) Agricultural income ` 80,000
- (iv) Receipt from sale of spontaneously grown trees ` 40,000.
- (v) NSC IX purchased on 31-1-2016 ` 20,000.

Compute total income and calculate tax liability for the AY 2016-17.

8

b) From the following particulars submitted by Mr. Patel compute his income from other sources for the AY 2016-17:

- (i) Director's meeting fees ` 6,000.
- (ii) Agricultural income from Pakistan ` 4,000.
- (iii) Interest on bank deposits (net) ` 10,800.
- (iv) Interest on post office savings bank account ` 5,000.
- (v) Interest on NSC IX ` 1,000.
- (vi) Dividend from X Ltd ` 3,000.
- (vii) Lottery Prize received after TDS ` 35,000.
- (viii) Expenses on purchase of lottery ticket ` 2,000.

8

Answer:

a) Tax liability of Mr. Rahul for A. Y. 2016 – 2017

Particulars	`
Salary Income	2,50,000
Income from House Property (Working Note)	42,000

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Gross Total Income	2,92,000
(-) Deduction u/s 80C NSC IX	20,000
Total Income	2,72,000

W. N: Income from house property

Particulars	`
Gross Annual Value (5,000 × 12)	60,000
(-) Municipal taxes	Nil
Net Annual Value	60,000
(-) Standard Deduction @ 30%	8,000
	42,000

Tax Liability -

Step I Tax on aggregate of Agricultural Income and Total Income
 = Tax on 80,000 + 2,72,000
 = 2,50,000 × 0% + 1,02,000 × 10%
 = `10,200

Set II Tax on aggregate of Agricultural Income and Basic Exemption Limit
 = Tax on 80,000 + 2,50,000
 = 2,50,000 × 0% + 80,000 × 10%
 = `8,000

Set III Tax under Step I – Tax under Step II
 = `2,200

Set IV Deduct rebate u/s 87A `2,000
 = `200

Step V Add cess @ 3%
 = 6

Tax liability = `206

Rounded off u/s 288B = `210

Note:

- (1) Sale of spontaneously grown trees is a capital receipt and not taxable.
- (2) Agricultural income is exempted u/s 10(1). However, included for tax rate purpose.

b) Computation of income from other source for A. Y. 2016 – 2017

Particulars	`
Director's fee	6,000
Agricultural Income	4,000
Interest on bank Deposit $(10,800 \times \frac{100}{90})$	12,000
Interest on POSBA (5,000 – 3,500)	1,500
Interest on NSC IX	1,000
Dividend [exempt u/s 10(34)]	Nil

MTP_ Intermediate _Syllabus 2012_Dec2016_Set 1

Lottery Prize ($35,000 \times \frac{100}{70}$)	50,000
Income u/s 56	74,500
(-) Deduction u/s 57	Nil
Income from Other Sources	74,500

Note:

- (1) Net income is grossed in case of bank deposits and lottery prize.
- (2) Interest on POSBA is eligible for exemption u/s 10(15) up to `3,500
- (3) Interest on POSBA is eligible for deduction u/s 80TTA up to `10,000.
- (4) Expenses on purchase of lottery ticket are not deductible.

5. a) From the following particulars, compute total income of Mr. Varma for the AY 2016-17:

- (i) Loss from self-occupied property ` 50,000.
- (ii) Business Income ` 2,50,000.
- (iii) Speculation loss `20,000.
- (iv) Long term capital gain ` 1,20,000.
- (v) Short term capital loss ` 10,000.
- (vi) Loss under the head "income from other sources" ` 30,000.
- (vii) Contribution to Public Provident Fund ` 30,000.

7

b) Mr. Kapil, who is a lawyer in Mumbai, furnishes the following particulars:

- (i) Income from Profession ` 2,10,000.
- (ii) STCG on sale of equity shares through recognised stock exchange ` 30,000.
- (iii) LTCG on sale of land ` 50,000.
- (iv) Interest on Government Securities ` 40,000.
- (v) Payment of interest on loan taken from a bank for higher studies ` 20,000.
- (vi) Payment for mediclaim policy on his own health and health of spouse ` 10,000.
- (vii) Donation to National Children's Fund ` 30,000.

Determine his total income and tax payable for the AY 2016-17.

8

Answer:

a) Computation of Total income

Particulars	`	`
Business Income		2,50,000
Long term capital gain	1,20,000	
(-) STCL	10,000	
(-) Loss from Property	50,000	
(-) Loss from other source	30,000	30,000
(Gross Total Income)		2,80,000
(-) Deduction u/s 80C		

MTP_ Intermediate _Syllabus 2012_Dec2016_Set 1

Contribution to Public Provident Fund		30,000
Total Income		2,50,000

Note:

- (1) Speculation loss is carry forward for 4th years.
- (2) All losses are adjusted from LTCG as it is chargeable @ 20%.
- (3) Deduction u/s 80c is allowed from business income of `2,50,000. Hence net business income is `2,20,000.
- (4) Relief `30,000 (i. e. BEL – PGBP) is allowed from LTCG. Hence, tax on LTCG is “Nil”.

b) Total Income of Kapil

Particulars	
PGBP	2,10,000
STCG u/s 111A	30,000
LTCG u/s 112	50,000
Interest	40,000
GTI	3,30,000
(-) Deduction u/s 80E Interest on education loan	20,000
Deduction u/s 80D Medical Claim	10,000
Deduction u/s 80G Donation to NCF	30,000
Total income	2,70,000

Tax liabilities

Total income taxable under Slab rate = `2,70,000 – 30,000 – 50,000 = `1,90,000

Relief = basic exemption limit – Total Income

= `2,50,000 – 1,90,000

= `60,000

Relief is adjusted from LTCG u/s 112 and STCG u/s 111A

Tax on (TCG = [50,000 – 50,000] × 20% = Nil

Tax on STCG u/s 111A = [30,000 – 10,000] × 15% = `3,000

Less @ 3% = 90

Total tax = 3,090

6. a) Mr. Bhim, a not-ordinarily resident in India submits you the following:

- (i) Royalty from Government of India ` 10,000.
- (ii) Business income earned outside India ` 30,000.
- (iii) Interest received from a non-resident against a loan provided to him to purchase a property in India ` 20,000.
- (iv) Fees for technical services provided to a non-resident to run a business in India ` 40,000.
- (v) Income from business in India but controlled from outside India ` 50,000.
- (vi) Dividend from an Indian Company ` 5,000.

Determine his total income for the AY 2016-17.

8

MTP_ Intermediate _Syllabus 2012_Dec2016_Set 1

- b) Compute taxable income and calculate tax liability of a co-operative society, not being a consumer co-operative society for the AY 2016-17;
- (i) Income from cottage industry `25,000.
 - (ii) Marketing of agricultural produce grown by members `35,000.
 - (iii) Income from purchase and sale of agricultural implements to members `5,000.
 - (iv) Profits and gains of business `90,000.
 - (v) Interest from other co-operative society `10,000.
 - (vi) Interest on units of notified Mutual Fund `20,000.
 - (vii) Donation to National Defence Fund `10,000.

7

Answer:

- a) Total Income of Mr. Bhim (Not – ordinary resident)
- | | |
|-----------------|-----------------------------|
| Royalty | 10,000 |
| Business income | Nil (Outside india) |
| Interest | Nil (Accrued outside india) |
| Fees | 40,000 |
| Business income | 50,000 |
| Dividend | <u>Exempt u/s 10(34)</u> |
| Total Income | <u>1,00,000</u> |

- b) Taxable income of co-operative society

Particulars	`
Cottage industry	25,000
Marketing	35,000
Sale of agricultural implements	5,000
PGBP	90,000
Interest from Co- operative society	10,000
Interest from NMF	Exempt u/s 10 (35)
Gross Total Income	1,65,000

(-) Deduction u/s 80p		
Cottage industry	25,000	
Marketing	35,000	
Sale of implements	5,000	
PGBP (up to `50,000)	50,000	
Interest	10,000	1,25,000
(-) Deduction u/s 80G		
National Defence Fund (NDF)		10,000
Total Income		30,000

Tax Liability:

$$\begin{aligned}
 &10,000 \times 10\% + 10,000 \times 20\% + 10,000 \times 30\% \\
 &\qquad\qquad\qquad = 6,000 \\
 &EC + SHEC @ 3\% \qquad = \underline{180}
 \end{aligned}$$

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Tax Payable (₹) = 6,180

- 7 (a) X Ltd has suffered a net loss of ₹10,00,000. The accounts revealed the following items debited to profit and loss account and certain additional information is gathered:
- i) X Ltd has collected charity of ₹40,000 @ 0.5% of its turnover and spent ₹25,000. Both the items are taken into the accounts.
 - ii) Interest on OD from a bank for payment of income tax ₹ 10,000.
 - iii) Penalty ₹5,000 on account of non-fulfillment of an export order with a foreign customer.
 - iv) The company has paid ₹1,00,000 towards acquisition of patent rights and a sum of ₹ 10,000 has been debited to Profit & Loss Account treating it as deferred revenue expenditure.
 - v) A term loan has been waived by the Government ₹ 30,000 which has been credited to P & L A/c.
 - vi) Payment of interest on loan from the bank for payment of dividends ₹ 8,000.
 - vii) Salary and wages include outstanding bonus ₹ 2,000 which is payable as per Labour Tribunal Order.
- Compute business income of X Ltd for AY 2016-17. **10**
- (b) The total income of AOP is ₹ 3,00,000. It has three members i.e. X Ltd, a foreign company and two individuals P & Q. They share at 2 : 1 : 1, Calculate tax payable by AOP. Also calculate its tax liability if share is not known. **5**

Answer:

- (a) Computation of business income of X Ltd.

Particulars	₹
Net loss	(10,00,000)
(-) Non-trading receipt (Charity)	40,000
(-) Non- trading expenses	25,000
(+) interest on OD for payment of income tax	10,000
(+) Payment for patent rights	10,000
(-) Waiver of term loan	30,000
(+) outstanding bonus u/s 43B	2,000
Business Loss	(10,23,000)

Note:

- (1) Business loss is carry forward for 8 AY's.
- (2) Penalty for breach of contract is deductible.
- (3) Acquisition of patent right is eligible for depreciation u/s 32 @ 25% and unabsorbed depreciation of ₹25,000 is carry forward for unlimited number of years.
- (4) Interest on loan for payment of dividend is deductible.

- b) Calculation of tax liability of AOP
Total income = ₹3,00,000

- (i) When share is known
 $3,00,000 \times 2/4 \times 41.20\% = 61,800$
 $3,00,000 \times 2/4 \times 30.90\% = \underline{46,350}$
1,08,150
- (ii) When share is not known
 $3,00,000 \times 41.20\% = \text{`1,23,600}$

SECTION-B (20 Marks)

INTERNATIONAL TAXATION AND TRANSFER PRICING

II. Answer question No. 8 which is compulsory and any one from Question No. 9 and 10

8. A) Fill in the blanks: 4 × 1=4

- a) Relief on foreign income if there is Avoidance of Double Tax Agreement is called bilateral relief under section _____.
- b) Unilateral relief u/s. 91 on foreign income is allowed to _____ (resident/non-resident) in India.
- c) Determination of reasonable profit in case of combined profit of the associated/deemed associated enterprise is on the basis of _____ method.
- d) Unexplained payment to the person situated in Notified Jurisdictional Area is considered as _____.

Answer:

- (a) 90
(b) resident
(c) profit Split
(d) taxable Income

B) Select the suitable answer: 4 × 1 =4

- a) Exempted foreign income is taken into consideration for:
i) Tax purpose
ii) Tax rate purpose
iii) Relief purpose
iv) None of the above
- b) Unilateral relief at the rate of least of average tax rate on foreign income or average tax rate on total income is given on:
i) Foreign income
ii) Total income
iii) Indian Income
iv) None of the above
- c) Advance pricing agreement will become void ab initio if
(i) There is change in law
(ii) Agreement obtained by fraud
(iii) Voluntarily agreed
(iv) None of the above
- d) Due date of filing of return of income in case of a person who is required to furnish report u/s. 92E is:
i) 31st July of RAY

MTP_ Intermediate _Syllabus 2012_Dec2016_Set 1

- ii) 30th September of RAY
- iii) 30th November of RAY
- iv) None of the above

Answer:

- (a) (ii)
- (b) (i)
- (c) (ii)
- (d) (iii)

9. a) Mr. X, resident in India, earns the following income. You are required to calculate the amount of relief available to him and net tax payable.

- (i) Salary from employment in India ` 4,00,000.
- (ii) Rent from property outside India ` 2,00,000.
- (iii) Short term capital gain on sale of capital asset in India ` 3,00,000.
- (iv) Interest from securities outside India ` 1,00,000.

He deposited ` 50,000 in his PPF out of foreign income. There is ADT agreement, according to which foreign income is exempted in India but it should be taken into consideration for tax rate purpose. Tax on foreign income outside India is @ 18%. **6**

- b) (i) What is safe harbour in computation of arm's length price under Transfer Pricing Study?
- (ii) What are the methods of computation of arm's length price?
- (iii) What do you mean by Cross Border Transactions?
- (iv) What are the transactions covered under Specified Domestic Transactions? **6**

Answer:

(a) Calculation of Net tax

Particulars	`
Salary	4,00,000
STCG	3,00,000
GTI	7,00,000
(-) Deduction u/s 80c (PPF)	50,000
Total Income	6,50,000
Foreign Income	
Rent from property (2,00,000 – 30% of 2,00,000)	1,40,000
Interest on Securities	1,00,000
	8,90,000

$$\begin{aligned} \text{Tax on `89,00,000} &= 2,50,000 \times 0\% + 2,50,000 \times 10\% + 3,90,000 \times 20\% &= 1,03,000 \\ (+) \text{ Cess @ 3\%} & &= \underline{\underline{3,090}} \\ & &= \text{`1,06,090} \end{aligned}$$

$$\text{Tax rate} = \frac{1,06,090}{8,90,000} \times 100 = 11.92\%$$

$$\text{Tax on total income @ 11.92\%} = 6,50,000 \times 11.92\% = \text{`77,480}$$

$$\text{Amount of relief u/s 90} = \text{`1,06,090} - 77,480 = \text{`28,610}$$

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- (b) (i) Safe harbor is the variation which is accepted in case of computation of reasonable profits. Variation within (\pm) 3% does not require any adjustment. Where only one comparable is selected for the purpose of determining (ALP), benefit of safe harbour is not available.
- (ii) Methods of computation of ALP are:
1. Comparable uncontrolled price.
 2. Re-sale price
 3. Cost plus
 4. Profit split
 5. Transaction Net Margin.
- (iii) Cross border transaction means any transaction which involves two or more countries. When there is cross border transaction, the persons involved should follow the provision of FEMA, 1999 and Income – tax Act, 1961. All income in course of cross Border Transaction to tax in India.
- (iv) Specified Domestic Transactions, to which the income is to be computed u/s 92, having regard to ALP, if the aggregate amount of transactions in a previous in a previous year exceeds, `20 crores. The following transactions are covered under this.
1. Any payment referred u/s 40A (2)
 2. Any transaction referred to in Sec 80IA.
 3. Any transactions referred under chapter VIA or sec.10AA, to which provisions of sec. 80IA are applicable.
 4. Any transaction as may be prescribed.

10. (a) X Ltd, an Indian company, engaged in supply of heavy range machines. It entered into a contract with Y Ltd, a foreign company, in which X Ltd has 50% share in equity and Z Ltd, another foreign company in which X Ltd has 25% share in equity for supply of machines. The following information is available:

Particulars	Y Ltd (in USA)	Z Ltd (in UK)
No. Of machines supplied	10,000	9,800
CIF value	` 7,000 per machine	--
FOB value	--	` 7,500 per machine
Discount	` 250 per machine	Nil
Insurance	` 30 lakhs	Not available
Freight	` 25 lakhs	Not available

Calculate reasonable profits of X Ltd if profit as shown by X Ltd is ` 90 lakhs. **6**

- (b) (i) Discuss the steps involved in the process of computing arm's length price under the study of Transfer Pricing. **3**
- (ii) Discuss the steps involved in granting of unilateral relief on foreign income which suffered double tax when there is no double tax avoidance agreement. **3**

Answer:

- (a) Calculation of reasonable profit of X Ltd.

Particulars	Y Ltd (in DAE)	Z Ltd (in UAE)
CIF	7,000	-

MTP_ Intermediate _Syllabus 2012_Dec2016_Set 1

FOB	-	7,500
(+) Discount	250	
(-) Insurance $\left(\frac{30,00,000}{10,000}\right)$	300	
(-) Freight $\left(\frac{25,00,000}{10,000}\right)$	250	
FOB Value	6,700	7,500

ALP = 6,700 or 7,500 (WEH)

Difference per machine = 7,500 – 6,700 = `800

Increase in profit = 10,000 × 800 = `80,00,000

Profit of X Ltd. = 90,00,000 + 80,00,000 = 1,70,00,000

(b) (i) Steps in the process of computing ALP

1. Selection of comparable companies
2. Use of different filters
3. Screening of comparability
4. Use of powers under the Act
5. Adjustments
6. Safe harbor.

(ii) Steps in granting unilateral relief u/s 91;

1. Ascertain doubly taxed income.
2. Ascertain average tax rate on total Income.
3. Ascertain average tax rate on foreign income.
4. Find lower average tax rate.
5. Relief is calculated on doubly taxed income at the rate determined under Step (4).