

Paper 7 - Direct Taxation

Section A

(Question No. 1 is compulsory and any four from Question No. 2 to 6)

Question 1

(a) Answer the following sub-divisions briefly in the light of the provisions of the Income-tax Act, 1961: (1×8)

- (i) State the manner of determination of residential status of Hindu Undivided Family.
- (ii) Explain the taxation of the Limited Liability Partnerships.
- (iii) State the conditions to be fulfilled for availing exemption from tax, in respect of remuneration received by foreign individual.
- (iv) State the provisions relating to the taxability of the leave salary at the time of retirement of the Central/State Government employees.
- (v) State the head(s) of income, under which the income from sub-letting house property is charged to income tax, under the provisions of the Income Tax Act, 1961.
- (vi) State the conditions to be fulfilled by the assessee for claiming depreciation on assets, while determining business income.
- (vii) State the quantum of deduction available to an Indian company, in respect of expenditure incurred on amalgamation.
- (viii) State the circumstances, in which an assessee is not required to pay advance tax.

(b) Choose the correct alternative: (1×5)

- (i) Under Section 10(10) of the Income tax Act, 1961, the maximum amount of gratuity received which is not chargeable to tax shall be;
 - (a) ₹ 3,50,000
 - (b) ₹ 3,00,000
 - (c) ₹ 2,50,000
 - (d) ₹ 10,00,000.
- (ii) Loss from business can be set-off against other income in subsequent assessment year except:
 - (a) Income from speculation business
 - (b) Income under the head house property
 - (c) Income under the head other sources
 - (d) Income under the head Salaries.

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(iii) In respect of every domestic company having total income exceeding ₹1 crore, but less than ₹10 crore, the rate at which surcharge is charged on the income tax payable is:

- (a) 5%
- (b) 10%
- (c) 7.5%
- (d) 2%

(iv) Credit of Minimum Alternate Tax (MAT) in respect of excess amount of tax paid under Section 115JB of the Income tax Act, 1961 could be carried forward for-

- (a) 8 Assessment Year
- (b) 5 Assessment Year
- (c) 7 Assessment Year
- (d) 10 Assessment Year.

(v) A company is said to be a resident in India in previous year, if:

- (a) It is an Indian company.
- (b) The control and management is wholly situated in India
- (c) Either it is an Indian company or the control and management is wholly situated in India
- (d) It is both an Indian Company and the control and management is wholly situated in India.

Solution to Question 1(a)

(i) Residential status of HUF

The residential status of HUF depends upon the control and management of the affairs of the HUF.

A HUF is said to be resident in India within the meaning of Section 6(2) of the Income Tax Act, 1961 in any previous year, if during that year the control and management of its affairs is situated wholly or partly in India. If the control and management of its affairs is situated wholly outside India during the relevant previous year, it is considered non-resident.

A resident HUF is ordinarily resident in India, if the Karta or manager of the family (including successive Karta) is resident and ordinarily resident in India.

(ii) Taxation of Limited Liability Partnership (LLP)

As per Income Tax Act 1961, LLPs are treated like partnership firms for the purpose of computation of Income Tax. All the rules which are applicable to the partnership firm are also applicable to LLPs. The provisions relating to Alternate Minimum Tax are also applicable to the Limited Liability Partnerships.

The rates of taxation applicable to LLPs are stated as follows:

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LLP is taxable @ 30%
Surcharge- Nil
Education cess @ 2% .
Secondary & Higher education cess (SHEC) @ 1%.

- (iii) The remuneration received by a foreign individual in his capacity as an employee of a foreign enterprise for the services rendered by him during his stay in India would be exempt if the following conditions are fulfilled:
- (a) The foreign enterprise is not engaged in any trade or business in India.
 - (b) The total period of stay of the individual in India during the previous year does not exceed 90 days.
 - (c) Such remuneration is not liable to be deducted from the income of the employer chargeable to tax in India under the Income-tax Act.
- (iv) Under Section 10(10AA)(i) of the Income tax act, 1961, in the case of Central/ State Government employees, any amount received as cash equivalent of leave salary in respect of the period of earned leave at his credit at the time of retirement/ superannuation, is exempt from tax.
- (v) Income is taxable under the head "Income from House Property", only if the assessee is the owner of a house property. Income from subletting house property, is to be charged to tax, either under the head "Profits and Gains of Business or Profession" (under Section 28) or, under the head "Income from other sources" (Section 56), depending upon the facts of each case.
- (vi) In order to avail depreciation under the provisions of the Income Tax Act, 1961, the following conditions must be fulfilled:
1. Asset must be owned by the assessee.
 2. It must be used for the purpose of the business or profession.
 3. It should be used during the relevant previous year.
 4. Depreciation is available on the tangible as well as the intangible assets.
- (vii) Under Section 35DD of the Income Tax Act, 1961, if an Indian company incurs any expenditure for the purpose of amalgamation, it is allowed as deduction in five successive years in five equal annual instalments. The first instalment is deductible in the previous year in which the amalgamation or demerger takes place.
- (viii) The liability to pay advance tax, does not arise in the following circumstances:
1. The assessee has opted for the scheme of computing business income under section 44AD on presumptive basis.
 2. A resident individual, who is at least 60 years of age at any time during the financial year, not having income from business/ profession, is not required to pay advance tax.

Solution to Question 1(b)

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- (i) ₹10,00,000.
- (ii) Income under the head Salaries.
- (iii) 5%.
- (iv) 10 Assessment Year.
- (v) Either it is an Indian company or the control and management is wholly situated in India.

Question 2

- (a) Mr. Kumar (an Indian citizen), a Government employee serving in the Ministry of External Affairs, left India for the first time on 31.03.2013, due to his transfer to High Commission of New Zealand. He did not visit India any time during the previous year 2013-14. He has received the following income for the financial year 2013-14:

SL. No	Particulars	Amount (₹)
(i)	Salary	6,00,000
(ii)	Foreign Allowance	5,00,000
(iii)	Interest on fixed deposit from a bank in India	2,00,000
(iv)	Income from agriculture in Bangladesh	4,00,000
(v)	Income from house property in Bangladesh	3,50,000

Calculate his gross total income for Assessment Year 2014-15.

- (b) Mr. Verma, a non-resident, residing in United States since 1960, came back to India on 01.04.2012 for permanent settlement. What will be his residential status for Assessment Years 2013-14 and 2014-15?
- (c) Mr. Arun Kumar is a resident Indian. During the F.Y 2013-14, interest of ₹1,92,000 was credited to his Non-Resident (External) Account with the SBI. ₹20,000 being interest on fixed deposit with SBI was credited to his savings bank account during this period. He also earned ₹4,000 as interest on this savings account. Is Mr. Arun Kumar required to file return of income? Would the answer remain the same, if he owns one shop in Mumbai of area 130 sq. ft?
- (d) State the provisions of Section 10(10D), as regards exemption of any sum received under a Life Insurance Policy.

[4+3+3+3]

Solution to Question 2(a)

As per Section 6(1), Mr. Kumar is a non-resident for the A.Y. 2014-15, since he was not present in India at any time during the previous year 2013-14.

As per section 5(2) of the Income Tax Act, 1961, a non-resident is chargeable to tax in India only in respect of the following incomes:

- (i) Income received or deemed to be received in India; and
- (ii) Income accruing or arising or deemed to accrue or arise in India.

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In view of the above provisions, income from agriculture in Bangladesh and income from house property in Bangladesh would not be chargeable to tax in the hands of Mr. Kumar, assuming that the same were received in Bangladesh.

Income from 'Salaries' payable by the Government to a citizen of India, for services rendered outside India is deemed to accrue or arise in India as per section 9(1)(iii) of the Income Tax act, 1961. Hence, such income is taxable in the hands of Mr. Kumar, even though he is a non-resident.

However, allowances or perquisites paid or allowed as such outside India by the Government to a citizen of India for rendering service outside India is exempt under Section 10(7) of the Income Tax Act, 1961. Hence, foreign allowance of ₹4,00,000 is exempt under Section 10(7) of the Income Tax Act, 1961.

Computation of Gross Total Income of Mr. Kumar for the A.Y. 2014-15

Particulars	Amount (₹)
Salaries	6,00,000
Income from other sources: Interest on fixed deposit from a bank in India	2,00,000
Gross Total Income	8,00,000

Solution to Question 2(b)

Mr. Verma is a resident in India in A.Y. 2013-14 and A.Y. 2014-15, since he has stayed in India for a period of 365 days (more than 182 days) during the P.Y 2012-13 and P.Y. 2013-14, respectively.

As per Section 6(6) of the Income Tax Act, 1961, a person will be "Resident but not ordinarily resident" in India in any previous year, if such person:

- (i) Has been a non-resident in 9 out of 10 previous years preceding the relevant previous year; or
- (ii) Has during the 7 previous years immediately preceding the relevant previous year been in India for 729 days or less.

If he does not satisfy either of these conditions, he would be a resident and ordinarily resident.

In the instant case, applying the above, the status of Mr. Kumar for the Previous Year 2012-13, will be "Resident but not ordinarily resident".

For the Previous Year 2013-14 (A.Y. 2014-15), his status would continue to be resident, but not ordinarily resident, since he was a non-resident in 9 out of 10 previous years immediately preceding the previous year and also had stayed for less than 729 days in 7 previous years immediately preceding the relevant previous year.

Therefore, his status for:

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- (i) A.Y 2013-14 – “Resident, but not ordinarily resident”.
- (ii) A.Y 2014-15 – “Resident, but not ordinarily resident”.

Solution to Question 2(c)

Computation of total income of Mr. Arun Kumar for A.Y. 2014-15

Particulars	Amount (₹)	Amount (₹)
Income from other sources:		
	NIL	
(i) Interest earned from Non- Resident (External) Account [NOTE-1]	20,000	
(ii) Interest on bank fixed deposit	4,000	
(iii) Interest on savings bank account		24,000
GROSS TOTAL INCOME		24,000
Less: Deduction under Section 80TTA- Interest on saving bank account		4,000
Total Income		20,000

An individual is required to furnish a return of income under Section 139(1) of the Income Tax act, 1961, if his total income exceeds the maximum amount not chargeable to tax i.e. ₹2,00,000 for the A.Y. 2014-15. Hence, Mr. Arun Kumar is not required to file a return of income as his total income is below ₹2,00,000.

The aspect of Mr. Arun Kumar occupying/ owning a shop area of 130 sq. ft. in Mumbai, would not make any difference.

NOTE:

1. Interest earned from Non- Resident (External) Account is exempt under Section 10(14)(ii) of the Income Tax Act, 1961, assuming that Mr. Arun Kumar has been permitted by RBI to maintain the aforesaid account.

Solution to Question 2(d)

Exemption of any amount received from Life Insurance Policies [Section 10(10D)]

Any sum received under a life insurance policy, including the sum allocated by way of bonus on such policy, other than—

- (a) any sum received under sub-section (3) of section 80DD or sub-section (3) of section 80DDA ; or
- (b) any sum received under a Keyman insurance policy; or
- (c) any sum received under an insurance policy issued on or after the 1st day of April, 2003 but before 1st day of April, 2012, in respect of which the premium payable for any of the years during the term of the policy exceeds twenty per cent or ten per cent, if the policy is issued on or after 1st day of April, 2012 of the actual capital sum assured.

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(d) any sum including the sum allocated by way of bonus received under an insurance policy issued on or after 01.04.2013 for the insurance on the life of any person who is —

- (i) a person with disability or a person with severe disability as referred to in section 80U; or
- (ii) suffering from disease or ailment as specified in the rules made u/s 80DDB.

shall be exempt u/s 10(10D) if the premium payable for any of the years during the term of the policy does not exceed 15% of the actual capital assured instead of 10%.

Provided that the provisions of this sub-clause shall not apply to any sum received on the death of a person.

Question 3

(a) Mr. Malhotra has four minor children consisting of three daughters and one son. The annual incomes of 3 daughters are ₹18,000, ₹9,000 and ₹12,400. The annual income of the son is ₹8,600.

The son of Mr. Malhotra earned this income, as prize money for winning different singing competitions. The daughter, who earns an annual income of ₹9,000, suffers from disability under Section 80U of the Income Tax Act, 1961.

Calculate the amount of income earned by minor children to be clubbed in the hands of Mr. Malhotra.

(b) Mr. Singhal having Gross Total Income of ₹7,00,000 for the financial year 2013-14, furnishes you the following information:

- (i) Deposited ₹50,000 in tax saver deposit in the name of the major son in a nationalized bank.
- (ii) Paid ₹25,000 towards premium on life insurance policy of his married daughter (Sum Assured ₹2,50,000).
- (iii) Contributed ₹10,000 to Prime Minister's National Relief fund.
- (iv) Donated ₹20,000 to a Government recognized institution for scientific research by a cheque.
- (v) Mr. Singhal's Gross Total Income consisted only of income under the heads "Salaries" and "Income from House Property".

Calculate the total income of Mr. Singhal for the A.Y 2014-15.

(c) Mr. Vignesh is a co-owner of a house property along with his brother holding equal share in the property.

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Particulars	₹
Municipal value of the property	1,60,000
Fair rent	1,50,000
Standard rent under the rent control Act	1,70,000
Rent received	15,000 p.m.

The loan for the construction of this property is jointly taken and the interest charged by the bank is ₹ 25,000, out of which ₹ 21,000 has been paid. Interest on the unpaid interest is ₹ 450. To repay this loan, Raman and his brother have taken a fresh loan and interest charged on this loan is ₹ 5,000. The municipal taxes of ₹5,100 have been paid by the tenant.

Compute the income from this property chargeable in the hands of Mr. Vighnesh for the A. Y. 2014-15.

[4+4+5]

Solution to Question 3(a)

As per Section 64(1A) of the Income Tax Act, 1961, in computing the total income of an individual, all such income accruing or arising to a minor child shall be included. However, the following incomes of minor children shall not be clubbed with the income of the parent.

- (i) Income of a minor child suffering from disability under Section 80U should not be clubbed with the income of Mr. Malhotra.
- (ii) The income accruing or arising to a minor child on account of any manual work done by them or activity involving application of their skill, talent or specialized knowledge and experience, shall not be clubbed with the total income of the parent. Hence, the income of the son shall also not be clubbed in the hands of Mr. Malhotra, since the same has been won by the minor son, as prize money for winning different singing competitions.

Under Section 10(32) of the Income Tax Act, 1961, income of each minor child includible in the hands of the parent under Section 64(1A) would be exempt to the extent of the actual income or ₹1,500, whichever is lower. The remaining income would be included in the hands of the parent.

Computation of income earned by minor children to be clubbed in the hands of Mr. Malhotra

SL. No	Particulars	Amount (₹)	Amount (₹)
(i)	Income of two daughters (₹18,000 + ₹12,400) Less: Income exempt under Section 10(32) (₹1,500+ ₹1,500)	30,400 3,000	27,400
(ii)	Income of son	NIL	NIL
Total income to be clubbed in the hands of Mr. Malhotra, as per section 64(1A)			27,400

NOTE- In the absence of any information to the contrary, it has been assumed that:

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- (i) The total income of Mr. Malhotra exceeds the total income of Mrs. Malhotra, hence the income of the minor children are clubbed in the hands of Mr. Malhotra.
- (ii) This is the first year in which such income is being clubbed.

Solution to Question 3(b)

Computation of total income of Mr. Singhal for the A.Y. 2014-15

Particulars	Amount (₹)	Amount (₹)
Gross Total Income		7,00,000
Less: Deductions under Chapter VI-A		
UNDER SECTION 80C		
(i) Deposit in tax saver deposit in the name of the major son in a nationalized bank. [NOTE 1]	NIL	
(ii) Premium on life insurance policy of his married daughter.[NOTE 2]	25,000	
UNDER SECTION 80G		
(iii) Contribution to Prime Minister's National Relief fund – [NOTE 3]	10,000	
UNDER SECTION 80GGA		
(iv) Donation to a Government recognized institution for scientific research [NOTE 4]	20,000	55,000
TOTAL INCOME		6,45,000

NOTE:

1. Fixed Deposit in the name of son does not qualify for deduction under Section 80C of the Income Tax Act, 1961.
2. Premium on Life Insurance Policy of the married daughter of Mr. Singhal is eligible for deduction under Section 80C of the Income Tax Act, 1961.
3. Contribution to PM's National Relief Fund is eligible for deduction under Section 80G of the Income Tax Act, 1961.
4. Donation to a Government recognized institution for scientific research is eligible for deduction under Section 80GGA, since the payment has been made by way of cheque.

Solution to Question 3(c)

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Computation of income from house property of Mr. Vighnesh for A.Y. 2014-15

Particulars	Amount (₹)	Amount(₹)
Gross Annual Value (Note 1)		3,60,000
Less: Municipal taxes - paid by the tenant, hence not deductible		Nil
Net Annual Value (NAV)		3,60,000
Less: Deductions under section 24		
(i) 30% of NAV	1,08,000	
(ii) Interest on housing loan (Note 2)		
- Interest on loan taken from bank	50,000	
- Interest on fresh loan to repay old loan for this property	10,000	1,68,000
Income from house property		1,92,000
50% share taxable in the hands of Mr. Vighnesh (See Note 3 below)		96,000

NOTE:

1. Computation of Gross Annual Value (GAV)

GAV is the higher of Annual Letting Value (ALV) and actual rent received. ALV is the higher of municipal value and fair rent, but restricted to standard rent.

Particulars	₹	₹
(i) Municipal value of property	3,20,000	
(ii) Fair rent	3,00,000	
(iii) Higher of (a) and (b)		3,20,000
(iv) Standard rent	3,40,000	
(v) Annual Letting Value [lower of (c) and (d)]		3,20,000
(vi) Actual rent [30,000 x 12]		3,60,000
(vii) Gross Annual Value [higher of (e) and (f)]		3,60,000

2. Interest on housing loan is allowable as a deduction under section 24 on accrual basis. Further, interest on fresh loan taken to repay old loan is also allowable as deduction. However, interest on unpaid interest is not allowable as deduction under section 24.
3. Section 26 provides that where a house property is owned by two or more persons whose shares are definite and ascertainable, the share of each such person in the income of house property, as computed in accordance with Sections 22 to 25, shall be included in his respective total income. Therefore, 50% of the total income from the house property is taxable in the hands of Mr. Vighnesh since he is an equal owner of the property.

Question 4

- (a) On 21-03-2013, Mr. Haridas gifted to his wife Mrs. Priya 300 listed shares, which had been bought by him on 19-04-2012 at ₹ 3,000 per share. On 01-06-2013, bonus shares were allotted in the ratio of 1:1. All these shares were sold by Mrs. Priyaas under:

Date of sale	Manner of sale	No. of shares	Net sales value
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			(₹)
21.05.2013	Sold in recognized stock exchange, STT paid	150	3,20,000
21.07.2013	Private sale to an outsider	All bonus shares	2,00,000
28.02.2014	Private sale to her friend Mrs. Sunita (Market value on this date was ₹2,10,000)	150	1,80,000

State the income-tax consequences in respect of the sale of the shares by Mrs. Priya, showing clearly the person in whose hands the same is chargeable, the quantum and the head of income in respect of the above transactions. Detailed computation of total income is NOT required.

Net sales value represents the amount credited after all taxes, levies, brokerage, etc., and the same may be adopted for computing the capital gains.

Cost inflation index for the FY 2013-14 is 939 and for the FY 2012-13 is 852.

(b) Mr. Naresh, aged 54 years, is the Production Manager of Great Works Ltd. From the following details, compute the taxable income for the assessment year 2014-15.

Basic salary	₹ 50,000 per month
Dearness allowance	40% of basic salary
Transport allowance (for commuting between place of residence and office)	₹3,000 per month
Motor car running and maintenance charges fully paid by employer (The motor car is owned by the company and driven by the employee. The engine cubic capacity is above 1.60 litres. The motor car is used for both official and personal purpose by the employee.)	₹60,000
Expenditure on accommodation in hotels while touring on official duties met by the employer	₹80,000
Loan from recognized provident fund (maintained by the employer)	₹60,000
Lunch provided by the employer during of office hours.	₹24,000
Cost to the employer Computer (cost ₹ 35,000) kept by the employer in the residence of Mr. Naresh from 01.06.2013	
Mr. Naresh made the following payments: Medical insurance premium: Paid in Cash Paid by account payee crossed cheque	₹4,800 ₹ 15,200

[6+7]

Solution to Question 4(a)

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Where an asset has been transferred by an individual to his spouse otherwise than for adequate consideration, the income arising from the sale of the said asset by the spouse will be clubbed in the hands of the individual.

Where there is any accretion to the asset transferred, income arising to the transferee from such accretion will not be clubbed. Hence, the profit from sale of bonus shares allotted to Mrs. Priya will be chargeable to tax in the hands of Mrs. Priya.

Therefore, the capital gains arising from the sale of the original shares has to be included in the hands of Mr. Haridas, and the capital gains arising from the sale of bonus shares would be taxable in the hands of Mrs. Priya.

Where an asset received by way of gift has been sold, the period of holding of the previous owner should be considered for determining whether the capital gain is long term or short term. The cost to the previous owner has to be taken as the cost of acquisition.

Income taxable in the hands of Mrs. Priya Short-term capital gains (on sale of 100 bonus shares)

Particulars	Amount(₹)
Sale consideration	2,00,000
Less: Cost of acquisition of bonus shares	Nil
Short – term capital gains	2,00,000

Income/loss to be clubbed in the hands of Mr. Haridas Long-term capital gains/loss

	Particulars	Amount(₹)
(i)	150 shares sold on 21.05.2013 in a recognized stock exchange, STT paid. Long-term capital gains on sale of such shares is exempt under section 10(38)	Nil
(ii)	Shares sold to a friend on 28.02.2014	
	Sale consideration	1,80,000.00
	Less: Indexed cost of acquisition of 100 shares (₹3,000 x 150 x 939/852)	4,95,950.70
	Long term capital loss to be included in the hands of Mr. Haridas	3,15,950.70

Taxability in the hands of Mrs. Sunita under the head "Income from other sources":

Mrs. Sunita has received shares from her friend, Mrs. Priya, for inadequate consideration. Even though shares fall within the definition of "property" under section 56(2)(vii), the provisions of section 56(2)(vii) would not be attracted in the hands of Mrs. Sunita, since the difference between the fair market value of shares and actual sale consideration does not exceed ₹50,000.

Solution to Question 4(b)

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Computation of taxable income of Mr. Naresh for the A.Y.2014-15

Particulars	₹	₹
Basic salary (₹ 50,000 x 12)		6,00,000
Dearness allowance @ 40% of basic salary		2,40,000
Transport allowance (₹ 3,000 x 12)	36,000	
Less: Exemption under section 10(14) (₹ 800 x 12)	9,600	26,400
Motor car running & maintenance charges paid by employer (Note-1)		28,800
Expenditure on accommodation in hotels while touring on official duty is not a perquisite in the hands of employee and hence not chargeable to tax		Nil
"Loan from recognized provident fund - not chargeable to tax		Nil
Value of lunch provided during office hours	24,000	
Less: Exempt under Rule 3(7) (iii) (Note-2)	15,000	9,000
Computer provided in the residence of employee by the employer -not chargeable to tax [Rule 3(7) (vii)]		Nil
Gross Salary		9,04,200
Less: Deduction under Chapter VI-A		
Deduction under section 80D in respect of medical insurance premium paid by cheque amounting to ₹ 15,200 but restricted to ₹15,000 (Note-3)		15,000
Taxable income		8,89,200

Notes:

1. As per Rule 3(2), if the motor car (whose engine cubic capacity is above 1.60 litres) is owned by the employer and is used for both official and personal purpose by the employee, then, the value of perquisite for use of motor car would be ₹ 2,400 per month. Therefore value of perquisite for use of motor car would be ₹ 2,400 x 12 = ₹ 28,800
2. As per Rule 3(7) (iii), lunch provided by the employer during office hours is not considered as perquisite upto ₹ 50 per meal. Since, the number of working days is not given in the question, it is assumed to be 300 days during the F.Y. 2013-14. Therefore, ₹ 15,000 (i.e. 300 x ₹ 50) would be exempt and the balance ₹ 9,000 (i.e. ₹24,000 - ₹ 15,000) would be taxable.
3. Medical insurance premium paid in cash of ₹4,800 is not allowable as deduction under Section 80D. Further, deduction for medical insurance premium paid through cheque is restricted to ₹ 15,000, which is the maximum deduction allowable.

Question 5

- (a) Jayesh Ltd. has a block of assets carrying 15% rate of depreciation. The written down value of such block, on 01.04.2013 was ₹60 Lakhs. It purchased another asset (second-hand plant and machinery) of the same block on 01.11.2013 for ₹16 Lakhs, and put to use on the same day. Jayesh Ltd. was amalgamated with Ganapati Ltd. with effect from 01.01.2014.

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You are required to compute the depreciation allowable to Jayesh Ltd. and Ganapati Ltd. for the previous year ended on 31.03.2014, assuming that the assets were transferred to Ganapati Ltd at ₹80 Lakhs.

(b) Maxwell Industries Ltd. furnishes you the following information:

BLOCK OF ASSETS	RATE OF DEPRECIATION	WRITTEN DOWN VALUE AMOUNT (₹)
Block I: Plant and Machinery (10 Looms)	15%	5,00,000
Block II: Buildings (3 buildings)	10%	12,50,000

BLOCK OF ASSETS	DATE OF ACQUISITION/ SALE	WRITTEN DOWN VALUE AMOUNT (₹)
Block I: Plant and Machinery		
Acquired 5 Looms	05.07.2013	4,00,000
Sold 15 Looms	07.12.2013	10,00,000
Acquired 2 Looms	10.01.2014	3,00,000

Compute depreciation claim for the A.Y. 2014-15.

(c) Excel Networks Ltd. which follows mercantile system of accounting, obtained licence on 01.06.2012 from the Department of telecommunication for a period of 10 years. The total licence fee payable is ₹20,00,000. The relevant details are:

Year ended 31 st March	License fee payable for the year (₹)	Payments Made	
		Date	Amount (₹)
2013	12,00,000	30.03.2013	4,00,000
		15.05.2013	8,00,000
2014	8,00,000	28.02.2014	5,50,000

Balance of ₹ 2,50,000 is pending as on 31.03.2014.

Calculate the amount of deduction available to the assessee under Section 35ABB of the Income tax act, 1961 for the assessment years 2013-14 and 2014-15. Can any deduction be claimed under Section 32 also?

(d) Explain the provisions relating to deductibility of interest paid on capital borrowed for the purpose of business or profession.

[4+4+3+2]

Solution to Question 5(a)

Computation of depreciation allowable to Jayesh Ltd. and Ganapati Ltd.
for the A.Y. 2014-15

Particulars	Amount (₹)	Amount (₹)
Written Down Value (WDV) as on 01.04.2013		60,00,000
Add: Addition during the year (used for less than 180 days)		16,00,000
Total		76,00,000

Answer to MTP_Intermediate_Syllabus 2012_Jun2014_Set 1

Depreciation:		
(i) On ₹60,00,000 @ 15%	9,00,000	
(ii) On ₹15,00,000 @ 7.5%	1,12,500	10,12,500
Apportionment between two companies:		
(a) Amalgamating Company Jayesh Ltd.		
₹9,00,000 × 275/365	6,78,082	
₹1,12,500 × 61/151	45,447	7,23,529
(b) Amalgamated Company Ganapati Ltd.		
₹9,00,000 × 90/365	2,21,918	
₹1,12,500 × 90/151	67,053	2,88,971
TOTAL DEPRECIATION		10,12,500

NOTE:

- The aggregate deduction, in respect of depreciation allowable to amalgamating company and amalgamated company, in the case of amalgamation shall not exceed in any case, the deduction calculated at prescribed rates, as if the amalgamation had not taken place. Such deduction shall be apportioned between the amalgamating company and amalgamated company in the ratio of the number of days for which the assets were used by them.
- The price at which the assets were transferred, i.e., ₹80 Lakhs, has no implication in computing eligible depreciation.

Solution to Question 5(b)

Computation of depreciation for Maxwell Industries Ltd.

Particulars	Amount (₹)	Amount (₹)
Block I: Plant and Machinery (Rate of Depreciation – 15%)		
Opening WDV	5,00,000	
Add: Additions during the year:		
(i) 5 Looms acquired on 5 th July	4,00,000	
(ii) 2 Looms acquired on 10 th January	3,00,000	12,00,000
Less: Assets sold during the year (15 Looms sold on 7 th December)		10,00,000
W.D.V as on 31st March 2014 (2 Looms)		2,00,000
(A) Depreciation on ₹ 2,00,000 @ 15% (limited to 50%) [NOTE 1]		15,000
Block II: Buildings (Rate of Depreciation – 10%)		
Opening WDV (3 Buildings)	12,50,000	
(B) Depreciation on ₹12,50,000 @ 10%		1,25,000
(C) Total depreciation [(A) + (B)]		1,40,000

NOTE:

- Closing balance of block of plant and machinery represents the looms acquired on 10th January. These looms have been put to use for less than 180 days during the previous year, and therefore, only 50% of normal depreciation is permissible.

Answer to MTP_Intermediate_Syllabus 2012_Jun2014_Set 1

2. No additional depreciation @ 20% of the cost of new plant and machinery is provided for assuming that all conditions contained in the Section 32(1)(ia) have not been fulfilled.

Solution to Question 5(c)

As per section 35ABB of the Income Tax Act, 1961, any amount actually paid for obtaining licence to operate telecommunication services, shall be allowed as deduction in equal installments during the number of years for which the licence is in force. Therefore, the year of actual payment is relevant and not the previous year in which the liability for the expenditure was incurred according to the method of computing regularly followed by the assessee.

Computation of deduction admissible under Section 35ABB of the Income Tax Act, 1961

Particulars	Unexpired period of licence	Amount of deduction allowable under Section 35ABB	Year from which such deduction is admissible
₹4,00,000 paid on 30.03.2013 [P.Y. 2012-13]	10 years	₹4,00,000/10 = ₹40,000	A.Y. 2013-14
₹13,50,000 paid during the year ended 31.03.2014 [P.Y. 2013-14]	9 years	₹13,50,000/9 = ₹1,50,000	A.Y. 2014-15

Deduction admissible under Section 35ABB for the A.Y. 2013-14 and A.Y. 2014-15

Assessment Year	Amount of deduction allowable under Section 35ABB
A.Y. 2013-14	₹40,000
A.Y. 2014-15	₹40,000 + ₹1,50,000 = ₹1,90,000

Where a deduction under Section 35ABB is claimed and allowed, deduction under Section 32(1) of the Income tax Act, 1961 cannot be allowed for the same previous year or any subsequent previous year.

Solution to Question 5(d)

Under Section 36(1)(iii) of the Income Tax ACT, 1961, deduction is allowed in respect of capital borrowed for the purposes of business or profession, while computing income under the head "Profits and Gains of business or Profession".

Further Explanation 8 to Section 43(1) clarifies that interest relatable to a period after the asset is first put to use, cannot be capitalized. Interest in respect of capital borrowed for any period from the date of borrowing to the date on which the asset was first put to use should, however, be capitalized in the case of extension of existing business or profession.

Answer to MTP_Intermediate_Syllabus 2012_Jun2014_Set 1

The proviso to Section 36(1)(iii) provides that no deduction shall be allowed in respect of any amount of interest paid, in respect of capital borrowed for acquisition of a new asset or for extension of existing business or profession (whether capitalized in the books of account or not) for any period beginning from the date (on which the capital was borrowed for acquisition of the asset, till the date on which such asset was first put to use.

Question 6

- (a) Mr. Mahesh, acquired a residential house in January 2000 for ₹10,00,000 and made some improvements by way of additional construction to the house, incurring expenditure of ₹2,00,000 in October 2004. He sold the house property in October 2013 for ₹75,00,000. The value of property was adopted as ₹80,00,000 by the State Stamp valuation authority for registration purposes. He acquired a residential house in January, 2013 for ₹25,00,000. He deposited ₹20,00,000 in capital gains bond issued by the National Highways Authority of India (NHAI) in June 2014.

Calculate the capital gain chargeable to tax for the A.Y. 2014-15.

What would be the tax consequence and in which assessment year it would be taxable, if the house property acquired in January, 2013 is sold for ₹40,00,000 in March 2015 ?

Cost Inflation Index:

F.Y. 1999-2000 = 389

F.Y 2004-2005 = 480

F.Y. 2013-14 = 939

- (b) On 10.10.2013, Mr. Madhav (a bank employee) received ₹5,00,000 towards interest on enhanced compensation from State Government in respect of compulsory acquisition of his land effected during the financial year 2008-09.

Out of this interest, ₹1,50,000 relates to the financial year 2010-11; ₹1,65,000 to the financial year 2011-12; and ₹1,85,000 to the financial year 2012-13. He incurred ₹50,000 by way of legal expenses to receive interest on such enhanced compensation.

How much of interest on enhanced compensation would be chargeable to tax for the A.Y. 2014-15?

- (c) When would the dividend income be taxed in the hands of a shareholder?
- (d) State the applicability of TDS provisions and amount of tax to be deducted at source in the following cases:
- (i) Rent paid for hire of machinery by Mac. Works Ltd. to Mr. Bhuvan ₹2,10,000.
- (ii) Fee paid to Dr. Kapoor by Shyam (HUF) ₹35,000 for surgery performed to a member of the family.

[6+3+2+2]

Answer to MTP_Intermediate_Syllabus 2012_Jun2014_Set 1

Solution to Question 6(a)

(a) Computation of Capital Gains chargeable to tax for A.Y. 2014-15

Particulars	Amount (₹)	Amount (₹)
Sale Consideration (i.e. Stamp Duty Value) (Note 1)		80,00,000
Less: Indexed Cost of Acquisition ₹10,00,000 × 939/389	24,13,881.75	
Less: Indexed Cost of Improvement ₹2,00,000 × 939/480	3,91,250	28,05,131.75
		51,94,868.25
Less: Exemption under Section 54 of the Income Tax Act, 1961 (Note 2)		25,00,000.00
TAXABLE CAPITAL GAINS		26,94,868.25

Notes:

1. As per the provisions of Section 50C, in case the stamp duty value adopted by the stamp valuation authority is higher than the actual sale consideration, the stamp duty value shall be deemed as the full value consideration.
2. Exemption under Section 54 of the Income tax act, 1961 is available, if a new residential house is purchased within one year before or two years after the date of transfer. Since, the cost of new residential house is less than the capital gain, capital gain to the extent of cost of new asset is exempt under Section 54.
3. Exemption under Section 54EC is available in respect of investment in bonds of national Highways Authority of India, only if the investment is made within a period of six months after the date of such transfer. In this case, since the investment is made after six months, exemption under section 54EC would not be available.

- (b)** If the new asset purchased by the assessee on the basis of which exemption under section 54 is claimed, is transferred within 3 years from the date of its acquisition, then for computing the taxable short-term capital gain on such transfer, the capital gain exempted earlier shall be reduced from the cost of acquisition of such asset.

Computation of capital gain on transfer of house purchased in January 2013

Particulars	Amount (₹)	Amount (₹)
Sale Consideration		40,00,000
Less: Cost of Acquisition	25,00,000	
Less: Capital Gains exempted earlier	(25,00,000)	NIL
Short term Capital gains		40,00,000

Answer to MTP_Intermediate_Syllabus 2012_Jun2014_Set 1

Solution to Question 6(b)

Section 145A provides that interest received by the assessee on enhanced compensation shall be deemed to be the income of the assessee of the year in which it was received, irrespective of the method of accounting followed by the assessee and irrespective of the financial year, to which it relates.

Section 56(2)(viii) of the Income Tax Act, 1961 states that such income shall be taxable as "Income from other Sources."

50% of such income shall be allowed as deduction by virtue of Section 57(iv) and no other deduction shall be permissible from such income.

Computation of interest on enhanced compensation taxable as "Income from Other sources" for the A.Y. 2014-15

Particulars	Amount (₹)
Interest on enhanced compensation taxable	5,00,000
Less: Deduction under Section 57(iv) @ 50%	2,50,000
Taxable interest on enhanced compensation	2,50,000

Solution to Question 6(c)

The provisions relating to the year of taxability of dividend are contained in Section 8 of the Income-tax Act, 1961:

- (i) Any dividend declared by a company or distributed or paid by it within the meaning of section 2(22) shall be deemed to be the income of the previous year in which it is so declared, distributed or paid, as the case may be.
- (ii) Any interim dividend shall be deemed to be the income of the previous year in which the amount of such dividend is unconditionally made available by the company to the member who is entitled to it.

Any dividend which is liable for dividend distribution tax covered by section 115-0 (being a dividend declared by a domestic company) is exempt under section 10(34) and hence would not be chargeable to tax. However, dividend referred to in Section 2(22)(e) is not subject to dividend distribution tax in the hands of the domestic company under section 115-0, but would be chargeable to tax in the hands of the shareholder.

Solution to Question 6(d)

- (i) Since the rent paid for hire of machinery by Mac. Works Ltd. to Mr. Bhuvan exceeds ₹1,80,000, the provisions of section 194-1 for deduction of tax at source are attracted.

The rate applicable for deduction of tax at source under section 194-1 on rent paid for hire of plant and machinery is 2% assuming that Mr. Bhuvan had furnished his permanent account number to Mac Works Ltd.

Therefore, the amount of tax to be deducted at source:
= ₹ 2,10,000 x 2% = ₹ 4200.

- (ii) As per the provisions of section 194J, a Hindu Undivided Family is required to deduct tax at source on fees paid for professional services only if it is subject to tax audit under section 44AB in the financial year preceding the current financial year.

However, if such payment made for professional services is exclusively for the personal purpose of any member of Hindu Undivided Family, then, the liability to deduct tax is not attracted.

Therefore, in the given case, even if Mr. Shyam(HUF) is liable to tax audit in the immediately preceding financial year, the liability to deduct tax at source is not attracted in this case since, the fees for professional service to Dr. Kapooris paid for a personal purpose i.e. the surgery of a member of the family.

Section-B

Question 7

- (a) An Association of Persons (AOP), comprising of two members Saroj and Pankaj, owns an urban land valued at ₹60 Lakhs, on the valuation date 31.03.2010. State the tax implications under the Wealth Tax Act, 1957.
- (b) State the circumstances in which Rule 3 of Schedule III shall not apply for valuation of immovable property, under the provisions of the Wealth Tax Act, 1957.

[3+2]

Solution to Question 7(a)

The tax implications of an asset owned by an Association of Persons (AOP), under the Wealth Tax Act, 1957, are as follows:

- (i) As per Section 3 of the Wealth Tax Act, 1957, only individuals, Hindu undivided Families (HUF) and Companies are liable to wealth tax. Therefore, an Association of Persons (AOP) is not chargeable to wealth tax.
- (ii) However, as per Section 4(1)(b) of the Wealth Tax Act, 1957, the value of interest of a member of an AOP in the assets of the AOP is to be included in his net wealth. Schedule III lays down the manner of determination of the value of such interest.
- (iii) Section 21AA deals with a situation where the shares of the members of an AOP are indeterminate or unknown. Where assets chargeable to wealth tax are held by an AOP and the individual shares of the members are indeterminate or unknown on the date of formation or at any time thereafter, wealth tax is to be levied in the like manner and to the same extent as applicable to an individual.

Answer to MTP_Intermediate_Syllabus 2012_Jun2014_Set 1

Solution to Question 7(b)

As per Rule 8 of Schedule III, the provision contained in Rule 8 of Schedule III shall not apply in the following circumstances:

1. Where the Assessing Officer is of opinion, having regard to the facts and circumstances of the case, that it is not practicable to apply the provisions of Rule 3 to such a case.
2. Where the difference between the unbuilt area and the specified area exceeds 20% of the aggregate area.
3. Where the property is constructed on a leasehold land and the lease expires within a period not exceeding 15 years from the relevant valuation date and the deed on lease does not give an option to the lessee for the renewal of the lease.

In all the above circumstances, the value of the property shall be determined in the manner laid down in Rule 20.

Question 8

Dream House Constructions Ltd. furnishes the following particulars of its wealth for the valuation date as on 31.03.2014:

	Particulars	₹ in lacs
(i)	Land in urban area (held as stock in trade since 1998)	70
(ii)	Motor cars (including one imported car worth ₹35lacs used for hiring)	45
(iii)	125 acres of land acquired at Ghaziabad township on 15.5.2012 for construction of commercial complex	150
(iv)	Two Residential flats of 950 sq feet each provided to 2 employees (salary of one employee exceeds ₹5 lacs per annum)	30
(v)	Farm house of 8 acres at a remote village	7
(vi)	Cash in hand as per cash book	5
Liabilities:		
(i)	Loan for purchase of land at urban area	50
(ii)	Loan for purchase of land at Ghaziabad	100
(iii)	Wealth-tax liability for A.Y. 2014-15	10
(iv)	Loan for construction of residential flats	10

Compute the net wealth of the company for the A. Y. 2014 – 2015. (5)

OR

Ms. Sumitra has a house property at New Delhi, which she has rented out to Ms. Vineeta. The cost of acquisition of the property (acquired in 2003) is ₹40 Lakh. Determine the value of her property as on the valuation date 31.03.2014, from the following particulars:

- (i) The annual value of the property as per municipal records is ₹6 Lakhs.
- (ii) The monthly rent for the property is ₹45,000.

Answer to MTP_Intermediate_Syllabus 2012_Jun2014_Set 1

- (iii) Municipal taxes @10% of the municipal value of the property are paid partly by the tenant (40%) and partly by Mrs. Sumitra (60%).
- (iv) The cost of the repairs of the house property is entirely borne by the tenant.
- (v) The tenant has given an interest-free deposit of ₹2 Lakh to Ms. Sumitra.
- (vi) The unexpired period of lease on the valuation date is 20 years.

(5)

Solution to Question 8 (OPTION-I)

Computation of Net Wealth of Dream House Constructions Ltd.

Sl. No	Particulars	₹ in lacs
Assets [as per the definition of assets under Section 2(ea) of the Wealth Tax Act, 1957]		
(i)	Land in urban area (held as stock in trade since 1998) - [NOTE 1]	70
(ii)	Motor cars (excluding imported car not being an asset since it is used for hiring) [45 lac - 35 lac]	10
(iii)	Land at Ghaziabad township - [NOTE 2]	Nil
(iv)	(a) Residential flat provided to an employee drawing salary less than ₹5 lacs per annum - not an asset (b) Residential flat provided to an employee drawing salary exceeding ₹5 lacs per annum is an asset [30 x 1/2]	15
(v)	Farm house at a remote village - [NOTE 3]	Nil
(vi)	Cash in hand as per cash book - [NOTE 4]	Nil
		95
Less: Liabilities		
(i)	Loan for purchase of land in urban area - [NOTE 1]	50
(ii)	Loan for purchase of land at Ghaziabad - not deductible since the land, being stock-in-trade, is not an asset under section 2(ea). [NOTE 2]	Nil
(iii)	Wealth-tax liability for A.Y.2014-15 - wealth tax liability is not deductible	Nil
(iv)	Loan for construction of residential flats - the portion relating to taxable asset (1/2) is deductible i.e. 1/2 x 10lacs	5
	Total Liabilities	55
	Net Wealth	40

NOTE:

- Land in urban area is a taxable asset, under the provisions of Wealth Tax Act, 1957 since it is held as stock-in-trade for more than 10 years. Hence, loan for purchase of land in urban area is deductible.
- Since the assessee is engaged in construction business, land and building would form part of his stock-in-trade. Hence, land at Ghaziabad township is not taxable. Loan for purchase of land at Ghaziabad is not deductible since the land, being stock-in-trade, is not an asset under Section 2(ea) of the Wealth Tax Act, 1957.

Answer to MTP_Intermediate_Syllabus 2012_Jun2014_Set 1

3. Farm house at a remote village is not an asset as it is not situated within 25 km of a municipality.
4. Cash in hand as per cash book is not an asset since it represents cash recorded in the books

OR

Solution to Question 8 (OPTION-II)

Valuation of House Property at New Delhi of Ms. Sumitra, as on the valuation date 31.03.2014

Particulars	Amount(₹)	Amount(₹)
Actual Rent (₹45,000 × 12)		5,40,000
Add:		
(i) Municipal taxes borne by the tenant =(₹6 Lakhs×10%×40%)	24,000	
(ii) Repairs borne by the tenant (one-ninth of actual rent received).	60,000	
(iii) 15% of amount of deposit of ₹2 Lakh.	30,000	1,14,000
(A) ANNUAL RENT		6,54,000
(B) MUNICIPAL VALUE		6,00,000
GROSS MAINTAINABLE RENT [Higher of (A) and (B)]		6,54,000
Less: Corporation Tax (₹6 Lakh × 10%)	60,000	
Less: 15% of Gross Maintainable Rent	98,100	1,58,100
(C) NET MAINTAINABLE RENT		4,95,900
(D) CAPITALISED VALUE OF NMR (Higher of the following two)		
Capitalised Value[(C)×8]	39,67,200	
Cost of Acquisition	40,00,000	40,00,000

The value of the House Property of Ms. Sumitra as on the valuation date 31.03.2014 is ₹40 Lakh.

Section C

Question 9

Discuss whether transfer pricing provisions under the Income Tax Act, 1961 are attracted in respect of the following transactions –

- (i) Provision of marketing management services by PQR Inc. to its Indian subsidiary PQR Ltd.
- (ii) Lease of transportation vehicle by ABC Ltd. from X Inc. X Inc. guarantees 15% of the borrowings of ABC Ltd.
- (iii) Sale of industrial design by A Ltd. to LMN Inc., a Dutch company, which holds 29% of the shares of A Ltd.

Answer to MTP_Intermediate_Syllabus 2012_Jun2014_Set 1

- (iv) Mr. Ganesh, a resident Indian, holds 25% equity share capital in Alpha Ltd, a domestic company. Alpha Ltd. hires trucks owned by Mr. Ganesh's son and pays rent of ₹ 2 lakh.
- (v) Beta Ltd., a domestic company, has two units A & B. Unit A, which commenced business two years back, is engaged in the business of developing a toll road. Unit B is carrying on the business of trading in cement. Unit B transfers cement to the value of ₹ 5 lakh to Unit A for ₹3 lakh.

(5)

Solution to Question 9

- (i) The scope of the term "international transaction" has been amplified by the Finance Act, 2012 by insertion of Explanation to section 92B. According to the said Explanation, international transaction includes, inter alia, provision of marketing management services. PQR Inc and PQR Ltd. are associated enterprises, since PQR Inc., being the holding company, satisfies the condition of holding shares carrying not less than 26% of the voting power in PQR Ltd. Since the provision of marketing management services by PQR Inc. to PQR Ltd. is an "international transaction" between associated enterprises, transfer pricing provisions are attracted in this case.
- (ii) Lease of tangible property falls within the scope of "international transaction". Tangible property includes "transportation vehicle". X Inc. and ABC Ltd. are associated enterprises, since X Inc. guarantees more than 10% of the total borrowings of ABC Ltd. Therefore, lease of a transportation vehicle by ABC Ltd. from X Inc. is an international transaction with an associated enterprise, and consequently, the provisions of transfer pricing are attracted in this case.
- (iii) The scope of the term "intangible property" has been amplified to include, inter alia, industrial design, which is an engineering intangible. Sale of intangible property falls within the scope of the term "international transaction". Since LMN Inc. holds shares of A Ltd. carrying not less than 26% of the voting power, LMN Inc. and A Ltd. are associated enterprises. Therefore, since sale of industrial design by A Ltd. to LMN Inc. is an international transaction between associated enterprises, the provisions of transfer pricing are attracted in this case.
- (iv) This transaction falls within the meaning of 'specified domestic transaction' under new section 92BA, since the rental payment has been made to a related person referred to in section 40A(2)(b) i.e. relative (i.e. son) of Mr. Ganesh, who has substantial interest in the business of Alpha Ltd., since he is the beneficial owner of shares carrying not less than 20% voting power. However, such a transaction would be treated as a "specified domestic transaction" to attract transfer pricing provisions only if the aggregate of such transactions during the year as specified in section 92BA exceeds a sum of ₹ 5 crore.
- (v) Unit A is eligible for deduction@100% of the profits derived from its eligible business (i.e., the business of developing a toll road) under section 80-IA. However, Unit B is not engaged in any "eligible business". Since Unit B has transferred cement to Unit A at a price lower than the fair market value, it is an inter-Unit transfer of goods between eligible business and other

Answer to MTP_Intermediate_Syllabus 2012_Jun2014_Set 1

business, where the consideration for transfer does not correspond with the market value of goods. Therefore, this transaction would fall within the meaning of "specified domestic transaction" to attract transfer pricing provisions, if the aggregate value of transactions during the year specified in section 92BA exceeds ₹5 crore.

Question 10

(a) A resident of India has paid tax in a foreign country in respect of his income which accrued in that country. India has no double taxation avoidance agreement with that country. Such income is also taxable in India. Explain whether any relief is available to him in respect of the tax paid by him.

(b) "Under the special provisions of the Income Tax Act, 1961, any income arising from an international transaction shall be computed having regard to the arm's length price." In this context, explain the circumstances in which the provisions of arm's length price shall be applicable. Discuss the scope of such provisions governing the determination of the arm's length price. Also, state the circumstances in which such provisions shall not apply.

(c) Compute the 'Arm's Length Price' (ALP) in the following cases:

(i) Medicare Angel Ltd. is a 100% Indian subsidiary of a US Company. The parent company sells one of its products to the Indian subsidiary at a price of US\$ 100 per unit. The same product is sold to unrelated buyers in India at a price of US\$ 125 per unit.

(ii) The US parent company sells the same product to an unrelated company in India @ US\$ 80 per unit.

(iii) A sold a machine to B (Associated enterprise) and in turn B sold the same machinery to C (an independent party) at sale margin of 30% for ₹2,10,000, but without making any additional expenses and charge. Here Arm's length price would be calculated as

Sales price to B = ₹2, 10,000
Gross Margin = ₹ 2,10,000 × 30% = ₹63,000
Transfer price = ₹1, 47,000

(d) List out at least seven documents, which ought to be maintained by an associated enterprise which is subject to transfer pricing provisions.

[3+4+6+7]

OR

Question 10

(a) What are the "Tax exemption" available with respect to foreign income under Income-Tax Act, 1961.

(b) Discuss the scope of the provisions the Central Government may make under Section 90A(1) of the Income Tax Act, 1961 in respect of an agreement between specified associations.

Answer to MTP_Intermediate_Syllabus 2012_Jun2014_Set 1

- (c) A Foreign Company has entered into an agreement with an Indian Company on 1.6.2003 under which industrial equipment belonging to the firm has been leased to the latter on an annual lump sum payment. How will the lease rent be taxed in the hands of the foreign company in the Assessment Year 2014-15?
- (d) Magneta Ltd., a foreign company, enters into an agreement with Joy Ltd., an Indian company. The agreement related to a matter included in the Industrial Policy of the current year and is in accordance with the policy. During the year 2012-13, a royalty of ₹60,00,000 is paid by Joy Ltd. to Magneta Ltd., Magneta Ltd., has spend ₹15,00,000 on expenses covered under Section 28 to 44.

Compute the tax payable by Magneta Ltd. under the following situations:

- (i) Joy Ltd. pays the Income-tax payable by Magneta Ltd., as per the terms of agreement entered into before 1.6.2002.
- (ii) The agreement does not provides that Joy Ltd., will bear the tax but it is mutually agreed by the parties that royalty of ₹60,00,000 will be paid net of taxes.

[5+5+4+6]

Solution to Question 10 [OPTION-I]

Solution to Question 10 (a)

The assessee can claim unilateral relief provided under Section 91 of the Income Tax Act, 1961.

If any person who is resident in India in any previous year proves that, in respect of his income which accrued or arose during that previous year outside India (and which is not deemed to accrue or arise in India), he has paid in any country with which there is no agreement under section 90 of the Income Tax Act, 1961 for the relief or avoidance of double taxation, income-tax, by deduction or otherwise, under the law in force in that country, he shall be entitled to the deduction from the Indian income-tax payable by him of a sum calculated on such doubly taxed income at the Indian rate of tax or the rate of tax of the said country, whichever is lower, or at the Indian rate of tax if both the rates are equal.

Hence, he will be entitled to a deduction from the Indian income tax payable by him of a sum calculated on such doubly taxed income so included in his total income, at the Indian rate of tax or the rate of tax of the said country, whichever is lower or at the Indian rate of tax, if both rates are equal.

Solution to Question 10 (b)

Under the provisions of Section 92(1) of the Income Tax Act, 1961 any income arising from an International transaction shall be computed having regard to the 'arm's length price'. When the international transaction comprises of only an outgoing, the allowance for any eXpense or interest arising from the international transaction shall also be determined having regard to the arm's length price.

Answer to MTP_Intermediate_Syllabus 2012_Jun2014_Set 1

Thus, the provisions of arm's length price shall apply to both income-generating transactions (e.g. sale of goods, royalty, fees for technical services, know-how etc. for providing services) as well as transactions resulting into expenditure (e.g. purchases, interest on loan etc.).

The provisions shall not apply if their application results in decrease in the overall incidence of tax in India in respect of the parties involved in the international transactions. Where the computation of the income or determination of the allowance for any expenses or interest or any cost or expense allocated or apportioned, as the case may be, computed under Section 92(2) of the Income Tax Act, 1961 has the effect of reducing the income chargeable to tax or increasing the loss computed on the basis of entries made in the books of account in respect of the previous year in which the international transaction was entered into, the provisions shall not apply. [Section 92(3) of the Income tax Act, 1961]

'Arm's Length Price' means a price which is applied or proposed to be applied in a transaction between the persons other than associated enterprises, in controlled conditions. It is the price that would have existed between the enterprises not associated or related with each other [Section 92F(ii)].

Solution to Question 10 (c)

Computation of Arm's Length Price

Sl. No.	Particulars	Amount (₹)
(i)	(A) Price charged by US parent company for supply to its 100% Indian subsidiary.	100 US\$
	(B) Sale price to an unrelated buyer in India per unit	125US\$
	Since there is no loss of revenue to the Government, due to the international transaction, there is no need to compute Arm's Length Price.	
(ii)	(A) Price charged by US parent company for supply to an unrelated Indian buyer per unit.	80US\$
	(B) Price charged by US parent company for supply to its 100% Indian subsidiary.	100 US\$
	Applying Comparable Uncontrolled Price Method (Arm's Length Price per unit)	80US\$
(iii)	(A) Sales price to B	2, 10,000 63,000
	(B) Gross Margin = ₹2,10,000 × 30%	1, 47,000
	(C) Arm's Length Price = [(A)- (B)]	

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Solution to Question 10 (d)

The various types of information and documents to be maintained in respect of an international transaction by the associated enterprise and the transfer pricing method used are prescribed in Rule 10D of the Income Tax Rules, as under:

- (i)** A description of the ownership structure of the enterprise and details of shares or other ownership interest held therein by other enterprises;
- (ii)** A profile of the multinational group of which the assessee enterprises i.e. taxpayer is a part and 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 made by the taxpayer and the ownership linkages among them;
- (iii)** A broad description of the business of the taxpayer and the industry in which it operates and the business of the associated enterprises;
- (iv)** The nature, terms and prices of international transaction entered into with each associated enterprise, details of property transferred or services provided and the quantum and the value of each such transaction or class of such transaction;
- (v)** A description of the functions performed, risks assumed and assets employed or to be employed by the taxpayer and by the associated enterprise involved in the international transaction;
- (vi)** A record of the economic and market analysis, forecasts, budgets or any other financial estimates prepared by the taxpayer for its business as a whole or separately for each division or product which may have a bearing on the international transaction entered into by the taxpayer;
- (vii)** A record of uncontrolled transactions taken into account for analysing their comparability with the international transaction entered into, including a record of the nature, terms and conditions relating to any uncontrolled transaction with third parties which may be relevant to the pricing of the international transactions;
- (viii)** A record of the analysis performed to evaluate comparability of uncontrolled transactions with the relevant international transaction;
- (ix)** A 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;
- (x)** A 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 transaction;
- (xi)** The assumptions, policies and price negotiations if any which have critically affected the determination of the arm's length price;

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- (xii) Details of the adjustments, if any made to the transfer price to align it with arm's length price determined under these rules and consequent adjustment made to the total income for tax purposes;
- (xiii) 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.

Rule 10D also prescribes that the above information is to be supported by authentic documents which may include the following:

- (i) Official publications, reports, studies and data bases of the government of the country of residence of the associated enterprise or of any other country;
- (ii) Reports of market research studies carried out and technical publications of institutions of national or international repute;
- (iii) Publications relating to prices including stock exchange and commodity market quotations;
- (iv) Published accounts and financial statements relating to the business of the associated enterprises;
- (v) Agreements and contracts entered into with associated enterprises or with unrelated enterprises in respect of transaction similar to the international transactions;
- (vi) Letters and other correspondence documenting terms negotiated between the taxpayer and associated enterprise;
- (vii) Documents normally issued in connection with various transaction under the accounting practices followed.

Solution to Question 10 [OPTION-II]

Solution to Question No. 10(a)

Special tax incentives provided to FII's in respect of income from securities and capital gains:

1. Income other than income by way of dividends referred to in section 115-O received in respect of securities (other than units referred to in section 115AB): Such income would be taxable @ 20 percent;

The following points should be noted:

- (i) The amount of income-tax calculated on the income by way of interest referred to in Section 194LD shall be at the rate of 5 per cent.
- (ii) Deduction under sections 28 to 44C or clause (i) or clause (iii) of section 57 or under Chapter VI-A shall not be allowed in respect of income referred above.

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2. Income by way of short-term or long-term capital gains arising from the transfer of such securities would be taxable @ thirty percent and ten percent respectively.

However, such short term capital gains referred to in Section 111A (i.e. on which securities transaction tax has been paid) shall be taxable @ fifteen percent.

First and second provisos to section 48 shall not apply for the computation of capital gains arising out of the transfer of securities referred above.

Other exemptions include:

- (a) Exemptions for new industrial undertakings in FTZ's;
- (b) Deductions in case of royalties and fees for technical services earned by foreign nationals in India.

Special tax concessions are made available EEC investors under section 10(23BBB) of the Income Tax Act 1961.

There are other incentives for tax holidays specially relating to investments made in new industrial undertakings in under-developed areas. Moreover tax holiday facilities available for power generating sector and investment in building infrastructures

There is also provision for deduction for capital expenditure for scientific research under section 35 of the Act.

To encourage venture capital financing, section 10(23FB) of the act provides an income tax exemption for all dividends and long term capital gains of a venture capital fund or a venture capital company from investments made by way of equity shares in venture capital undertakings. To obtain this exemption, venture capital fund or company must obtain approval from the prescribed authority and satisfy the prescribed conditions.

Solution to Question No. 10(b)

The Central Government is empowered by section 90A to enter into an agreement with any specified association in the specified territory outside India and the Central Government has been authorized to make such provisions as may be necessary for adopting and implementing such agreement. The provisions may be made:

(a) For granting relief in respect of:

- (i) income on which tax have been paid both under Income Tax Act,1961 and Income Tax Act prevailed in that specified territory; or
- (ii) Income tax chargeable under Income Tax Act, 1961 and under the corresponding law in force in that specified territory to promote mutual economic relations, trade and investment.

(b) For the avoidance of double taxation of income under Income Tax Act, 1961 and under the corresponding law in force in that specified territory.

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- (c) For exchange of information for the prevention of evasion or avoidance of income tax chargeable under Income Tax Act, 1961 or under the corresponding law in force in that specified territory, or investigation of cases of such evasion or avoidance.
- (d) For recovery of income-tax under Income Tax Act, 1961 and under the corresponding law in force in that specified territory.

Where the Central Government has entered into an agreement with the specified association of any specified territory outside India for granting relief of tax, avoidance of double taxation, then, the provisions of Income Tax Act, 1961 shall apply to the assessee to whom such agreement applies, to the extent they are more beneficial to him.

Solution to Question No. 10(c)

Under section 9(1)(vi) of the Income Tax Act, 1961, the expression "royalty" would include any lump sum consideration for the use of or the right to use any industrial, commercial or scientific equipment but not including the amount referred to in Section 44BB of the Income Tax Act, 1961.

Under Section 115A, any income by way of royalty or fees for technical services (FTS) other than income referred to in section 44DA, received from Government or an Indian concern in pursuance of an agreement made by the foreign company with Government or the Indian concern (the agreement is approved by the Central Government or where it relates to the matter included in the industrial policy, for the time being in force, of the Government of India, the agreement is in accordance with that policy) will be taxable @ 25%.

This will be subject to the provisions of the Double Taxation Avoidance Agreement between India and the country in which the foreign company is assessed.

Solution to Question No. 10(d)

- (i) As per Section 10(6A) of the Income Tax Act, 1961, if as per the terms of the agreement, which is entered into before 1.6.2002 tax on royalty is payable by the Government or Indian concern, the tax so paid will not be included in the total income of the foreign company as such, it will be an exempt income in the hands of the foreign company. Therefore, in the instant case, the total royalty income will not be grossed up and income from royalty will be ₹60,00,000. No deduction is allowed in respect of any expenditure under Section 28 and 44C of the Income Tax Act, 1961.

Particulars	Amount(₹)
The total income of Sigma Ltd.	60,00,000
Tax payable @ 25.75 % (including education cess + SHEC)	15,45,000
Less: Tax paid by Joy Ltd.	15,45,000
Net tax payable	Nil

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- (ii) Since Section 10(6A) is not applicable as the terms of agreement do not provide for payment of tax by Joy Ltd., the total income will be computed as under:

Particulars	Amount(₹)
Net income	60,00,000
Gross Income = Net income x 100/100-TDS = ₹60,00,000 x 100/74.25	80,80,808
Tax payable by Sigma Ltd. @ 25.75% on ₹80,80,808	20,80,808
Less: Tax to be borne by Joy Ltd.	20,80,808
Balance Tax Payable	Nil