

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 a Company.
- (ii) State the taxability or otherwise, of interest received from the Central/State Government, in the hands of a non-resident.
- (iii) State the provisions relating to exemption of income of mutual funds, as contained in Section 10(23D) of the Income tax Act, 1961.
- (iv) State the taxability or otherwise, of salary, perquisite, allowance, received as gift by an employee from the employer.
- (v) State the taxability or otherwise of income from house property, which is used by the assessee for the purposes of his own business.
- (vi) State, whether an assessee can claim depreciation under section 32, on capital expenditure incurred on construction of any structure in a building, which is taken on lease, for the purposes of business or profession.
- (vii) State, whether an assessee can claim deduction of expenditure incurred on scientific research, carried on by him.
- (viii) State the circumstance, when interest is levied under Section 234A of the Income Tax Act, 1961. Also, state the rate at which interest is payable.

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

- (i) Remuneration received in respect of services rendered on a foreign ship is exempt in the case of:
 - (a) A resident;
 - (b) A non-resident, who is not a citizen of India;
 - (c) Resident, but not ordinarily resident;
 - (d) A citizen of India.

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- (ii) Rent or revenue derived from land, is treated as an agricultural income, if:
- (a) It is derived from land;
 - (b) It is derived from land situated in India;
 - (c) It is derived from land situated in India, used for agricultural purposes;
 - (d) It is derived from land situated in India, used for agricultural and business purposes.
- (iii) Deduction under section 80C of the Income Tax Act, 1961 can be claimed for fixed deposit made in any scheduled bank, if the minimum period of deposit is:
- (a) 5 years;
 - (b) 8 years;
 - (c) 10 years;
 - (d) 12 years.
- (iv) The maximum exemption in respect of transport allowance granted to an employee to meet his expenditure for the purpose of commuting between the place of his residence and the place of his duty shall be:
- (a) ₹600 per month;
 - (b) ₹700 per month;
 - (c) ₹800 per month;
 - (d) ₹900 per month.
- (v) The gross annual value of a house property, whose Municipal Value is ₹30,000, Actual Rent is ₹32,000, Fair Rent is ₹36,000 and Standard Rent is ₹40,000, shall be:
- (a) ₹36,000;
 - (b) ₹35,000;
 - (c) ₹30,000;
 - (d) ₹40,000.

Solution to Question 1 (a)

- (i) Section 6(3) of the Income Tax Act, 1961 provides that, an Indian company is always resident in India. A foreign company is resident in India only if, during the previous year, control and management of its affairs is situated wholly in India.
- (ii) Section 9(1)(v) of the Income Tax Act, 1961 provides that, interest received from the Central Government, or any State Government is deemed to accrue/ arise in India in the hands of the recipient. Hence, interest received from the Central/State Government, is taxable in the hands of a non-resident.
- (iii) Section 10(23D) of the Income Tax Act, 1961 provides that any income of the following mutual funds (subject to the provisions of Section 115R to 115T) is not chargeable to tax-

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- a. A mutual fund registered under the SEBI Act or regulations made thereunder;
- b. A notified Mutual Fund set up by a public sector bank, or a public financial institution or authorized by RBI.

(iv) Salary, perquisite or allowance may come as a gift to an employee and yet it would be taxable. The Income Tax Act, 1961 does not make any distinction between gratuitous payment and contractual payment.

However, if payment made to an employee is in the nature of personal gifts/testimonial, it is not taxable as salary. However, such payment exceeding ₹50,000, may be taxable under section 56(2)(vi), under the head "Income from other Sources".

(v) Where an assessee uses his property for carrying on any business or profession, no income is chargeable to tax under the head "Income from House Property". The assessee, in such a case, is not entitled to claim any deduction on account of rent in respect of such house property, in computing the taxable profits of the business or profession. In case of such house property, depreciation is allowable under Section 32 of the Income Tax Act, 1961.

(vi) Explanation 1 to section 32(1) of the Income Tax Act, 1961 provides that, if an assessee carries on business or profession in a building not owned by the assessee, but which has been taken on lease by him, he can claim depreciation under section 32, on capital expenditure incurred on construction of any structure in such building, by way of improvement, renovation or extension.

(vii) Section 35(1) of the Income Tax Act, 1961 provides that, where the assessee himself carries on scientific research and incurs revenue expenditure during the previous year, deduction is allowed for such expenditure, only if such research relates to his business.

(viii) If a return of income is furnished after the due date, or is not furnished, the assessee is liable to pay interest under Section 234A of the Income Tax Act, 1961 at the rate of one percent per month or part of a month, for the period commencing from the date immediately following the due date of filing return of income and ending on the date of furnishing return of income, or the date of completion of assessment under Section 144 of the Income Tax Act, 1961.

Solution to Question 1 (b)

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- (i) (b) A non-resident, who is not a citizen of India.
- (ii) (c) It is derived from land situated in India, used for agricultural purposes.
- (iii) (a) 5 years.
- (iv) (c) ₹800 per month.
- (v) (a) ₹36,000.

Question 2

(a) Compute the total income of Mr. Mukul for the A.Y. 2014-15 from the following information, relating to his income for the previous year 2013-14:

- (i) He received salary of ₹ 30,000 per month including conveyance allowance @ ₹ 3,000 per month for official purposes.
- (ii) He deposited ₹ 3,000 per month in his account under a pension scheme notified by the Central Government.
- (iii) He paid a sum of ₹ 72,000 during the year as interest on loan taken in June, 2009 from bank for higher studies of his son.
- (iv) He paid health insurance premium for himself and for his family members ₹ 10,200 in cash and ₹ 10,800 by credit card.
- (v) He invested ₹ 48,000 in notified bonds issued by NABARD in January 2014.
- (vi) Equity shares having fair market price of ₹ 1,20,000 (on the date of exercise of option) were allotted to him by the company at a concessional price of ₹ 24,000 on 04.06.2013, which were sold by him for ₹ 2,16,000 on 02.03.2014.

(b) Mr. Umesh did not file his return of income for the Assessment Year 2013-14 and a notice under section 142(1) of the Income Tax Act, 1961 was issued by the assessing Officer in November, 2013. The return of income was filed in December, 2013. He wants to file a revised return in January, 2014. Explain, whether it is possible to file a revised return?

(c) Explain whether it is mandatory for an assessee to claim depreciation under Section 32 of the Income Tax Act, 1961?

[8+3+2]

Solution to Question 2(a)

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Computation of total income of Mr. Mukul for the Assessment Year 2014-15

Particulars	Amount (₹)	Amount (₹)
Salaries		
Gross Salary Received	3,60,000	
Add: Shares allotted at concessional price – fair market value less the amount recovered from the employee [Section 17(2)(vi)] [NOTE 5]	96,000	
	4,56,000	
Less: Conveyance allowance exempt under Section 10(14) [NOTE 1]	36,000	4,20,000
Capital Gains		
Short term Capital Gain: [NOTE 5]		
Sale consideration of equity shares sold on 02.03.2014	2,16,000	
Less: Fair Market value of shares on the date of exercise of option (i.e. 04.06.2013).	1,20,000	96,000
GROSS TOTAL INCOME		5,16,000
Less: Deductions under Chapter VI-A		
Under Section 80C		
Investment in notified bonds issued by NABARD.	48,000	
Under Section 80CCD		
For deposit in pension scheme notified by the Central Government [NOTE 2]	32,400	
Under Section 80D		
For payment of health insurance premium by credit card. [NOTE 4]	10,800	
Under Section 80E		
For payment of interest on loan taken from bank for higher studies of son. [NOTE 3]	72,000	1,63,200
TOTAL INCOME		3,52,800

NOTE:

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1. Conveyance allowance received for official duties is fully exempt under Section 10(14) of the Income Tax Act, 1961.
2. Section 80CCD of the Income Tax Act, 1961 allows deduction of employee's and employer's contribution to pension scheme notified by the Central Government, subject to a maximum of 10% of salary, in the case of individuals employed by employer on or after 01.01.2004. Salary, for this purpose shall include dearness allowance and shall exclude all other allowances and perquisites.

Thus, deduction allowable to Mr. Mukul, under Section 80CCD of the Income Tax Act, 1961, shall be lower of the two following amounts:

- (i) 10% of (3,60,000 – 36,000) = 32,400.
- (ii) 36,000.

3. The deduction under section 80E of the Income Tax Act, 1961 available to an individual, in respect of interest on loan taken for his higher education has been extended to include interest on such loan taken for higher education of his relative i.e. his spouse or, his or her children. Hence, Mr. Mukul is eligible to claim deduction under Section 80E of the Income Tax Act, 1961.
4. For claiming deduction under Section 80D, the payment of medical insurance premium has to be made by any mode other than cash. Hence, payment of 10,200 made in cash will not qualify for deduction under Section 80E of the Income Tax Act, 1961.
5. The value of any specified security or sweat equity shares allotted or transferred by the employer, free of cost or at concessional rate to the employee would be treated as a perquisite in the hands of the employee. The value would be the fair market value of the specified security or sweat equity shares on the date on which the option is exercised by the employee as reduced by the amount actually paid by, or recovered from the employee in respect of such securities or shares.

Consequently, Section 49(2AA) provides that for the purpose of computing capital gains in the hands of the employee at the time of sale of such securities/ shares by the employee, the cost of acquisition shall be the fair market value, which has been taken into account for the purposes of computing the perquisite value in the hands of the employee.

Solution to Question 2(b)

Section 139(5) of the Income Tax Act, 1961 stipulates that when a return is furnished under Section 139(1), or in response to a notice issued under section 142(1) of the Income tax Act, 1961, and later on, the assessee discovers any omission or wrong statement therein, he may

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furnish a revised return at any time before the expiry of one year from the end of the relevant assessment year or before the completion of assessment whichever is earlier.

Though the return is a belated return, filed in December 2013, since the return was filed in response to a notice issued under section 142(1) of the Income tax act, 1961, the assessee can file a revised return before the expiry of one year from the end of the relevant assessment year i.e. by 31.03.2015.

Solution to Question 2(c)

According to the Explanation 5 to Section 32(1) of the Income Tax Act, 1961, allowance of depreciation is mandatory. Therefore, depreciation has to be provided mandatorily while calculating income from business/ profession, whether or not, the assessee has claimed the same while computing the total income.

Question 3

(a) State with reasons, based on the provisions of the Act, as to chargeability of the following receipts to tax in the Assessment Year 2014-15:

- 1. Rent of ₹ 1 Lakh charged from the tenants occupying houses (constructed on the land situated in India and used for agricultural purposes). The houses were used for residential purposes.**
- 2. In addition to salary, Minister of Minority Welfare received an amount of ₹ 2,000 per month as an entertainment allowance.**
- 3. Rent of ₹ 55,000, due for the period 01.04.2010 to 31.08.2010, was received on 23.12.2013, because of a court order. The property was sold out by the owner on 08.04.2013.**
- 4. Growth Ltd. follows mercantile system of accounting. During the previous year 2013-14, it has negotiated with its bankers and converted an interest amount of ₹ 5 Lakhs into term loan which includes ₹ 2 Lakhs pertaining to the previous year 2013-14. Can the interest of ₹ 2 Lakhs pertaining to the Assessment Year 2013-14, be allowed as business expenditure?**

(b) Mr. Vighnesh received the following gifts during the P.Y. 2013-14, from his friend Mr. Mukesh:

- (i) Cash gift of ₹60,000 on his birthday, 31st August, 2013.**

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(ii) 50 shares of Theta Ltd., the fair market value of which was ₹1,20,000 on the date of transfer i.e. 01.11.2013. The gift was received on the occasion of Diwali. Mr. Mukesh had originally purchased the shares on 13.06.2013, at a cost of ₹70,000.

Further on 05.01.2013, Mr. Vighnesh purchased land from his brother's relative for ₹10,00,000. On 7th March, 2014, the assessee sold 50 shares of Theta Ltd. for ₹1.5 Lakhs.

Compute the Gross Total Income of Mr. Vighnesh, comprising of incomes chargeable under the heads "Income from Other source" and "Capital Gains" for A.Y. 2014-15.

[8+5]

Solution to Question 3(a)

1. As per Section 10(1) of the Income Tax Act, 1961, agricultural income is exempt from tax. The meaning and scope of agricultural income is defined in Section 2(1A) of the Income Tax Act, 1961. According to Explanation to Section 2(1A) of the Income Tax Act, 1961, any income derived from the use of building, constructed on agricultural land, for any purpose (including letting for residential purposes or for the purpose of any business or profession) other than agriculture shall not be agricultural income. In this case, the house was occupied for residential purposes. Therefore the rent of ₹ 60,000 from letting out of houses constructed on agricultural land shall not be treated as agricultural income, by virtue of Explanation 2 to Section 2(1A) of the Income Tax Act, 1961. Hence, such income would be chargeable to tax.
2. The entertainment allowance received by the Minister of Surface Transport is taxable under the head "Salaries". However deduction under Section 16(ii) is allowable to the extent of the least of the following:
 - (i) 1/5th of the salary
 - (ii) ₹ 5,000.
 - (iii) Actual entertainment allowance received i.e. ₹ 24,000 in this case.
3. As per section 25AA of the Income tax act, 1961, unrealized rent would be deemed to be the income chargeable under the head "Income from House Property". Accordingly, it would be chargeable to income-tax, as income of that previous year in which such rent is realized, whether or not the assessee is the owner of that property in that previous year. Therefore, in this case, unrealized rent of 55,000 would be charged to tax in the P.Y. 2013-14, under the head "Income from House Property", even though he is no longer the owner of the house property.
4. Under Section 43B of the Income Tax Act, 1961, interest on term loans and advances to scheduled banks shall be allowed only in the year of payment of such interest

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irrespective of the method of accounting followed by the assessee. Explanation 3D to Section 43B of the Income tax Act, 1961 provides that if any interest payable by the assessee is converted into term loan, the interest so converted and not actually paid shall not be deemed as actual payment, and hence would not be allowed as deduction. Therefore, the interest of ₹ 2 Lakhs converted into loan cannot be claimed as a deduction.

Solution to Question 3(b)

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

Particulars	Amount (₹)	Amount (₹)
<u>Capital Gains</u>		
<u>Short term Capital Gain</u>		
Sale Consideration of shares of Theta Ltd.	1,50,000	
Less: Cost of Acquisition (deemed to be the fair market value charged to tax under Section 56(2)(vii) of the Income tax Act, 1961	1,20,000	30,000
<u>Income from other sources</u>		
(i) Cash gift received on 31.08.2013, is taxable under Section 56(2)(vii) of the Income Tax Act, 1961.	60,000	
(ii) Fair Market Value of shares of Theta Ltd. is taxable.	1,20,000	
(iii) Purchase of land for inadequate consideration on 05.30.2014, would not attract the provisions of Section 56(2)(vii), since there is a consideration and only where the consideration is fully absent, it is chargeable to tax.	NIL	1,80,000
GROSS TOTAL INCOME		2,10,000

Question 4

**(a) Sterling LLP reports the following details for the previous year 2013-14:
Net Profit as per Profit and Loss account ₹54,00,000.**

The following items are reflected in the Profit and Loss Account:

Credits	₹ in lakhs
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Dividend from Indian companies	1
Net profit from an undertaking eligible for 100% deduction under section 80-IA	20
Profit on sale of vacant site	7
"Debits:	
Working partner's salary	12
Interest on capital to partners @ 12%	15
Provision for income tax	14
Commission (tax was deducted in previous year 2012-13 and remitted before the 'due date' for filing the return of income)	5.20
Depreciation	12

Other information –

- (i) Depreciation allowable under section 32 of the Income-tax Act, 1961 is ₹ 8 lacs.
- (ii) Long-term capital gain on sale of vacant site (computed) ₹ 5 lacs.
- (iii) Working partner's salary and interest on capital to partners are authorized payment but subject to limits of section 40(b).

Calculate:

- (i) Total income and regular income tax payable (as per normal provisions) for the Assessment Year 2014-15.
 - (ii) Adjusted total income and alternate minimum tax payable for the Assessment Year 2014-15.
- (b) Distinguish between the nature of penalty leviable under Section 271AA and Section 271B of the Income Tax Act, 1961.

[10+3]

Solution to Question 4(a)

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Computation of total income and tax liability of Sterling LLP as per the normal provisions for Assessment Year 2014-15

Particulars	₹	
Net profit as per Profit and Loss A/c		54,00,000
Less: Income exempt or taxable under different heads		
Dividend (Exempt under section 10(34))	1,00,000	
Profit on sale of vacant site (taxable under Capital Gains)	7,00,000	8,00,000
		46,00,000
Add: Working partner's salary (considered separately)	12,00,000	
Provision for income-tax (not a deductible expenditure)	14,00,000	
Depreciation	12,00,000	38,00,000
		84,00,000
Less: Depreciation allowable under section 32		8,00,000
Book profit		76,00,000
Less: Working partners' salary (Refer Working Note below)		12,00,000
Income under the head "Profits and Gains of business or profession"		64,00,000
Long term capital gain (computed)		5,00,000
Gross total income		69,00,000
Less: Deduction under section 80-1A		20,00,000
Total Income		49,00,000
Tax thereon : On ₹ 44 lacs @ 30%		13,20,000
On ₹ 5 lacs @ 20% (LTCG)		1,00,000
		14,20,000
Add: Education cess & secondary and higher education cess @ 3%		42,600
Total tax liability		14,62,600

Computation of Alternate Minimum Tax under Section 115JC

Particulars	₹
Total Income	49,00,000

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Add: Income from undertaking eligible for section 80 – IA deduction	20,00,000
Adjusted Total Income	69,00,000
Tax thereon @ 18.5%	12,76,500
Add: Education cess & secondary and higher education cess @ 3%	38,295
Total tax liability	13,14,795
Round off	13,14,800

As the tax liability under section 115JC is less than regular income tax payable, Sterling LLP has to pay tax as per the regular provisions i.e. ₹ 14,62,600.

Working Note:

Working partners' salary of ₹12 lakhs is to be restricted to the limits under section 40(b)(v) i.e.

First ₹ 3,00,000 of Book Profit	90% or ₹1,50,000 whichever is more	₹ 2,70,000
Remaining ₹ 73,00,000 of Book Profit	60%	₹43,80,000
		<u>₹ 46,50,000</u>

Since the actual salary of ₹12 lakhs is less than ₹ 46,50,000, actual salary is allowable as deduction.

Solution to Question 4(b)

Differences between the penalties leviable under Section 271AA and Section 271B of the Income Tax Act, 1961

Basis of Difference	Section 271AA	Section 271B
Types of Default	Section 271AA of the Income Tax Act, 1961 provides for penalty for failure to keep and maintain information and documents, in respect of international transactions, or failure to report international transaction or furnishing of incorrect information.	Section 271B of the Income Tax Act, 1961 provides for penalty for failure to get accounts audited as required under Section 44AB of the Income Tax Act, 1961

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Minimum Penalty	A sum equal to 2% of the value of each international transaction.	One-half per cent of total sales, turnover of gross receipts or ₹1.50 Lakhs, whichever is less.
Maximum Penalty	There is no maximum penalty.	₹1.5 Lakh.
Authority levying the Penalty	Assessing Officer or Commissioner (Appeals)	Assessing Officer

Question 5

(a) Discuss the liability for tax deduction at source in the following cases for the A.Y. 2014-15:

- (i) An Indian company pays gross salary including allowances and monetary perquisites amounting to ₹5,60,000 to its Finance Manager. Besides, the company provides non-monetary perquisites to him in the same period whose value is estimated at ₹2,40,000.
- (ii) Indira, an individual whose total sales in business during the year ended 31.03.2014 was ₹ 120 Lakhs, paid ₹ 6.5 Lakhs by cheque on 12.02.2014 to a contractor (an individual), for construction of his business premises, in full and final settlement. No amount was credited earlier to the account of the contractor in the books of Indira.
- (iii) A television company pays ₹ 1,50,000 to a cameraman for shooting of a documentary film.
- (iv) M/s. Joy Ltd. paid to Mr. Juneja ₹ 1,80,000 for compulsory acquisition of his house as per law of the State Government.

(b) Neeta Jain, engaged in various types of activities, gives the following types of particulars for her income for the previous year 2013-14:

- (i) Profit of business of consumer and house hold products: ₹ 1,00,000.
- (ii) Loss of business of readymade garments: ₹ 20,000.
- (iii) Brought forward loss of catering business which was closed in A.Y. 2013-14: ₹ 30,000.
- (iv) Short-term loss on sale of securities and shares: ₹ 30,000.
- (v) Profit of speculative transactions entered into during the year: ₹ 25,000.
- (vi) Loss of speculative transactions of A.Y. 2009-10, not set off till A.Y. 2013-14: ₹ 30,000.

Compute the total income of Ms. Neeta Jain for the A.Y. 2014-15.

Solution to Question 5(a)

(i)

Particulars	Amount (₹)
Gross Salary, allowances and monetary perquisites	5,60,000
Non monetary perquisites	2,40,000
(A) Total Salary	8,00,000
(B) Tax Liability	92,700
(C) Average rate of tax [(A)/(B)]	11.5875%

The company can deduct ₹92,700 at source from the salary of Finance Manager. Alternatively, the company can pay tax on non-monetary perquisites as under:

Tax on non-monetary perquisites = 11.5875% of ₹2,40,000 = ₹27,810.
Balance to be deducted from salary = ₹64,890.

If the company pays tax of ₹27,810 on non-monetary perquisites, the same is not a deductible expenditure as per Section 40(a) of the Income Tax Act, 1961. It is not chargeable to tax in the hands of the employee under Section 10(10CC) of the Income tax Act, 1961.

(ii) An individual who is liable for tax audit under Section 44AB in the immediately preceding previous year is liable to deduct tax at source under Section 194C of the Income Tax Act, 1961 for the previous year 2013-14, in respect of the payment made to the contractor exceeding ₹ 30,000 in a single payment and ₹ 75,000 in aggregate during the previous year. Turnover of the assessee - Ms. Indira, exceeded ₹ 1 crores in the previous year 2013-14. Therefore, Indira is liable to get her accounts audited for the previous year 2013-14, under Section 44AB of the Income Tax Act, 1961. As the payment during the previous year 2013-14 to the contractor had exceeded the limits prescribed in Section 194C of the Income Tax Act, 1961, tax has to be deducted at source.

Tax to be deducted at source in the given case: ₹ 6,50,000 × 1% = ₹ 6,500.

(iii) If the camera-man is an employee of the T.V. Company, the provisions of Section 192 of the Income tax Act, 1961 will apply and tax has to be deducted at the time of payment. However, if he is a professional, the provisions under Section 194J of the Income Tax Act, 1961 will apply and hence tax @ 10% will have to be deducted at the time of credit of ₹1,50,000 or on its payment, whichever is earlier.

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(iv) As per Section 194LA of the Income Tax Act, 1961, any person responsible for payment to a resident, any sum in the nature of compensation or consideration, on account of compulsory acquisition under any law, of any immovable property, is responsible for deduction of tax at source, if such payment or the aggregate of such payments to the resident during the previous year exceeds ₹2,00,000. In the given case, liability to deduct tax does not arise as the payment does not exceed ₹2,00,000.

Solution to Question 5(b)

Computation of total income of Ms. Neeta Jain, for the A.Y. 2014-15

Particulars	Amount (₹)	Amount (₹)
Profit of business of consumer and house hold products	1,00,000	
Less: Loss of business of readymade garments	20,000	
	80,000	
Less: Brought forward loss of catering business which was closed in A.Y. 2013-14	30,000	50,000
Profit of speculative transaction		25,000
TOTAL INCOME		75,000

Note:

1. Loss of speculative transaction of A.Y. 2009-10 is not allowed to be set off against the profit of speculative transaction of the A.Y. 2014-15, since, as per the provisions of Section 73(4) of the Income Tax Act, 1961, such loss can be carried forward for set-off for a maximum period of 4 years only i.e. up to A.Y. 2013-14.
2. Short term capital loss of ₹30,000 on sale of securities and shares to be carried forward as per Section 74 of the Income Tax Act, 1961, since there is no income under the head Capital Gains for the A.Y. 2014-15. The loss is to be carried forward for set-off in future years against income chargeable under the head "Capital Gains". Such loss can be carried forward for a maximum period of 8 assessment years.

Question 6

(a) State whether the following assesseees have to file return of income and if so, the due date of filing return for the Assessment Year 2014-15:

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- (i) A registered trade union having income from let out property of ₹1,90,000.
- (ii) A public trust hospital having an aggregate annual receipt of ₹110 Lakhs and availing exemption under Section 10(23C)(via) with total income of ₹1,65,000, before giving effect to such exemption.
- (iii) A charitable trust registered under Section 12AA of the Income tax Act, 1961, having total income of ₹2,10,000.

- (b) Flora Ltd. provides you with the following extracts from its Balance Sheet for the previous year ending on 31.03.2014:

Particulars	Amount (₹)	
	Unit X	Unit Y
Fixed Assets	75,00,000	1,70,00,000
Debtors	75,00,000	56,00,000
Liabilities	21,00,000	38,00,000
Stock-in-trade	37,50,000	19,00,000
Reserves		1,11,00,000
Share Premium		12,50,000

The paid up capital of Flora Ltd. amounted to ₹250 Lakhs.

The company acquired Unit Y on 01.04.2011. They made certain capital additions in the form of fixed assets for ₹19 Lakhs, during the year 2011-12. The members of the company have authorized the Board in their meeting held on 25.02.2013 to dispose off the Unit 'Y'. The company decides to sell the unit 'Y', by way of slump sale for ₹170 Lakhs as consideration.

The buyer agreed with the vendor-company to give time for putting through the sale, but not later than 31.07.2014, subject to a discount of 2% on agreed sale consideration. However, this discount is not applicable, if the sale is completed after 31.03.2014. The written down value of the fixed assets of Unit Y under section 43(6) is ₹112 Lakhs.

Discuss the impact of the date of sale on the taxation of capital gains in the hands of Flora Ltd.

[6+7]

Solution to Question 6(a)

- (i) A registered trade union is having income from house property, which is exempt under Section 10(24) of the Income Tax Act, 1961.

Answer to MTP_Intermediate_Syllabus 2012_Jun2014_Set 2

Section 139(4C) of the Income tax act, 1961 mandates filing of return only when the total income exceeds the maximum amount which is not chargeable to tax without giving effect to the provisions of Section 10 of the Income Tax Act, 1961. Even without giving effect to Section 10(24), the total income is less than the basic exemption limit of ₹2,00,000, the trust is not mandatorily requires to file return of income.

- (ii) Section 139(4C) of the Income tax Act, 1961 mandates filing of return only when the total income exceeds the maximum amount which is not chargeable to tax without giving effect to the provisions of Section 10 of the Income Tax Act, 1961.

Since the total income of the public trust hospital, without giving effect to the exemption under Section 10(23C)(via), is less than the basic exemption limit of ₹2,00,000, the trust need not file its return of income.

- (iii) As per Section 139(4A) of the Income Tax Act, 1961, a charitable trust registered under Section 12AA must file its return of income, if its total income computed as per the provisions of the Income Tax Act, 1961, without giving effect to the provisions of Section 11 and 12 of the Income Tax Act, 1961, exceeds the maximum amount which is not chargeable to income-tax. Since, the total income of the charitable trust exceeds ₹2,00,000, it has to file return of income for the A.Y. 2014-15.

Since, the charitable trust has to get its accounts audited, the due date of filing return of income by a charitable trust is 30th September of the Assessment Year.

Solution to Question 6(b)

Determination of net worth of Unit Y of Flora Ltd.

Particulars	Amount (₹in Lakhs)	
Written Down value of the depreciable assets under Section 43(6) of the Income Tax Act, 1961	112	
Book Value of the non-depreciable assets:		
Debtors	56	
Stock in Trade	19	187
Less: Liabilities		38
Net Worth		149

Statement showing comparative computation of taxable capital gains in the hands of

Answer to MTP_Intermediate_Syllabus 2012_Jun2014_Set 2

Flora Ltd.

Particulars	Sale before 31.03.2014	Sale after 31.03.2014
Sale Consideration	170,00,000	170,00,000
Less: Discount	3,40,000	NIL
Net Sale Consideration	1,66,60,000	170,00,000
Less: Net Worth	1,49,00,000	1,49,00,000
Short Term Capital Gain	17,60,000	----
Long Term Capital Gain		21,00,000
Tax Rate	30.90%	20.60%
Tax payable thereon	5,43,840	4,32,600

Since, the tax leviable on capital gains, arising out of the transfer of undertaking 'Y' is lower, if the undertaking is transferred after 31.03.2014, it would be beneficial to Flora Ltd. (from the perspective of taxation of capital gains) to transfer the undertaking after 31.03.2014.

Section B

Question 7

- (a) State the provisions of the Wealth Tax Act, 1957 relating to the assets transferred under revocable transfers. Also, explain the term 'revocable transfers'.
- (b) State the provisions of the Wealth Tax Act, 1957 relating to conversion by an individual of his self-acquired property into joint family property.

[3+2]

Solution to Question 7(a)

Assets transferred under revocable transfers – Under the provisions of Section 4(1)(a)(iv) of the Wealth Tax Act, 1957, when an asset is transferred by an individual to a person or an association of person after March 31, 1956, under a revocable transfer, and the asset may be held by the transferee on the relevant valuation date in the same form in which it was transferred or otherwise, the transferred asset is considered a 'deemed asset' of transferor.

Answer to MTP_Intermediate_Syllabus 2012_Jun2014_Set 2

Revocable transfer – The following transactions are treated as revocable transfers [clause (b) of Explanation to Section 4 of the Wealth Tax Act]:

- a. if the transfer is revocable within a period of 6 years or if it is revocable during the lifetime of the beneficiary; or
- b. if the transferor derives any benefits, directly or indirectly, from the assets transferred; or
- c. if the transferor has a right to re-transfer, directly or indirectly, in respect of the whole or any part of the assets or income from the assets so transferred; or
- d. if the transferor has the right to re-assume power, directly or indirectly, over the whole or any part of the assets or the income from the assets so transferred.

Solution to Question 7(b)

Section 4(1A) of the Wealth Tax Act, 1957 provides that, if an individual is a member of a Hindu undivided family and he converts his separate property into property belonging to his Hindu undivided family, or if he transfers his separate property to his Hindu undivided family after December 31, 1969, directly or indirectly, without adequate consideration, the converted or transferred property shall be deemed to be the property of the individual and the value of such property is includible in his net wealth.

If the converted or transferred property becomes the subject-matter of a total or a partial partition among the members of the family, the converted or transferred property or any part thereof, which is received by the spouse of the transferor, is deemed to be the asset of the transferor and is includible in his net wealth.

Question 8 [OPTION- I]

Vineet is an individual, who is resident and ordinarily resident in India. The values of his assets and liabilities as per Schedule III of the Wealth Tax Act, 1957, as on 31.03.2014, are as follows:

Particulars	Amount (₹)
Guest House in Hong Kong	10,00,000
Jewellery gifted to his wife	15,00,000
Value of interest in the assets of a firm as a partner	8,00,000
Cash in hand	3,00,000
He took a loan for building the residential house in Mumbai	75,000

Answer to MTP_Intermediate_Syllabus 2012_Jun2014_Set 2

Commercial complex at Delhi having 20 offices which were let out for the whole of the previous year.	30,00,000
Residential house in Mumbai, which is let-out for 320 days in that previous year	10,00,000

Compute the net wealth and the wealth tax liability of Mr. Vineet for the A.Y. 2014-15. (5)

OR

Question 8 [OPTION- II]

- (a) State the provisions relating to valuation of jewellery under the Wealth Tax Act, 1957.
- (b) Mr. Maheshwar is aged 35 years. His father has settled a property in trust giving whole life interest therein to Maheshwar. The income from the property for the years 2010-11 to 2013-14 was ₹35,000, ₹40,500, ₹41,000 and ₹43,000 respectively. The expenses incurred each year were ₹1,500, ₹8,500, ₹250 and ₹9,000 respectively.

Calculate the value of life interest of Mr. Maheshwar in the property so settled on the valuation date March 31, 2014 on the assumption that the value of house as per Schedule III is ₹20 lakh. [Multiplier at the age of 35 is 10.804].

[2+3]

Solution to Question 8 [OPTION- I]

Computation of net wealth and wealth tax liability of Mr. Vineet for the A.Y. 2014-15

Particulars	Amount (₹)
Guest House in Hong Kong	10,00,000
Jewellery gifted to his wife	15,00,000
Value of interest in the assets of a firm as a partner	8,00,000
Cash in hand (NOTE 1)	2,50,000
Commercial complex at Delhi having 20 offices which were let out for the whole previous year. (NOTE 2)	NIL
Residential house in Mumbai, which is let-out for 320 days in that previous year. (NOTE 2)	NIL
NET WEALTH	35,50,000
WEALTH TAX LIABILITY @ 1%	35,500

Working Notes:

Answer to MTP_Intermediate_Syllabus 2012_Jun2014_Set 2

1. In case of an individual, cash in hand in excess of ₹50,000 is an 'asset', under the provisions of Section 2(ea) of the Wealth Tax Act, 1957.
2. Commercial complexes and Residential property let out for at least 300 days during the previous year, do not fall within the purview of 'Assets' under Section 2(ea) of the Wealth Tax Act, 1957.
3. Loan taken for building residential house in Mumbai, which has been let-out for more than 320 days, shall not be allowed as a deduction in the computation of the net wealth, as the said residential house is not subject to the levy of the wealth tax.

Solution to Question 8 [OPTION- II]

(a) The value of jewellery shall be estimated to be the price which it would fetch if sold in the open market on the valuation date (i.e., fair market value). Where the value of jewellery does not exceed ₹ 5,00,000, a statement in Form No. O-8A is to be submitted. Where the value of the jewellery exceeds ₹ 5,00,000, a report of a registered valuer in Form No. O-8 should be submitted. The report is not binding on Assessing Officer (Valuation Officer) and he can determine fair market value of jewellery.

The value of jewellery determined by the Valuation Officer for any assessment year shall be taken to be the value of such jewellery for the subsequent four assessment years subject to the prescribed adjustments.

(b) Mr. Maheshwar has a life interest in the property whose value has to be determined under Rule 17 of Schedule III to Wealth-Tax Act.

Particulars	2011-12	2012-13	2013-14	Total	Average
(i) Income	40,500	41,000	43,000	1,24,500	41,500
(ii) Expenses	8,500	250	9,000	17,750	5917
(iii) Deductible Expenses = ₹5,917 or 5% of ₹41,500 whichever is less)					2075
(iv) Average Annual Income [(i)-(iii)]					39,425
(v) Value of Life Interest shall be lower of the following:					4,25,947.70

Answer to MTP_Intermediate_Syllabus 2012_Jun2014_Set 2

a. [(iv) × 10.804]					
b. ₹20 Lakh.					

Section C

Question 9

(a) Discuss the concept of “Permanent Establishment”, in the context of Double Taxation Avoidance Agreements.

(b) State the factors to be considered in determining whether a country is a tax haven or not.

(2+3)

Solution to Question 9 (a)

The concept of “Permanent Establishment” gained significance in the context of Double Taxation Avoidance Agreements. However, the concept of “Permanent Establishment” has not been defined in the Income Tax Act, 1961.

As per the Double Taxation Avoidance Agreements, “Permanent Establishment” means a fixed place of business through which the business of an enterprise is wholly or partly carried on. “Permanent Establishment” includes, a wide variety of arrangements, i.e. a place of management, a branch, an office, a factory, a workshop or a warehouse, a mine, a quarry, an oilfield etc. Imposition of tax on a foreign enterprise is done only if it has a Permanent Establishment in the contracting state.

Isolated or occasional transaction through some persons or agencies, do not create liability for tax on the basis of Permanent Establishment. There has to be continuity of activities contributing to the earning of income.

Tax is to be computed by treating the Permanent Establishment as a distinct and independent enterprise. Normally, all the tax treaties contain a definition of “Permanent Establishment”. “Permanent Establishment” means a fixed place of business. It includes a construction site and installation project provided such activities last more than the specified time.

Solution to Question 9 (b)

Answer to MTP_Intermediate_Syllabus 2012_Jun2014_Set 2

A tax haven is a place where tax is not levied on income or it is taxed at a lower rate. The factors to be considered in determining whether a particular country is a tax haven or not, has been stated as under:

1. Either tax is not levied on income of a person or, tax is levied at a nominal rate.
2. Such a country does not possess any system of exchange of information, with respect to its tax regime.
3. The tax regime of such country lacks transparency.
4. In such a country, there is limited regulatory supervision or lack of financial disclosure to the Government.
5. The Government of the country facilitates the establishment of the foreign owned enterprises without the need for strict compliance of local laws.
6. Such countries normally introduce legislative provisions, which tend to attract foreign investment in their country.

Question 10 (OPTION-I)

- (a) International Ltd. - a US Company has a subsidiary Native Ltd. in India. International Ltd. sells mobile phones to Native Ltd. for resale in India. International Ltd. also sells mobile phones to Country Ltd. - another mobile phone reseller in India. The sales quantity and price fixed by International Ltd. are as follows:

Buyer	Sale Price (₹/ unit)	Sale Quantity (mobile phones)
Native Ltd.	12,000	48,000
Country Ltd.	11,000	

The warranty in case of sale of mobile phones by Native Ltd. is handled by itself, whereas for sale of mobile phones by Country Ltd., International Ltd. is responsible for warranty for 6 months. Both International Ltd. and Native Ltd. extended warranty at a standard rate of ₹500 per annum.

In respect of the given transactions:

- (i) Compute the Arm's Length Price for Native Ltd. for the given transactions.
 - (ii) Compute the additions required to be made in the total income of Native Ltd.
 - (iii) Also state whether the provisions of Section 10AA and Chapter- VIA, are applicable on the recomputed total income of Native Ltd.
- (b) Techno King India Ltd., is a financial BPO arm of Techno King Inc., Germany. It bills Techno King Inc., at \$ 20,00,000 per month for its services. Techno King India Ltd., also provides the same services to SG Ltd., South Africa and bills it at \$ 18,00,000 per month. The man-hours

Answer to MTP_Intermediate_Syllabus 2012_Jun2014_Set 2

spent on each work form the basis of billing. The direct cost of services per hour for Techno King India Ltd., works out to \$500 and the indirect cost of services per hour for Techno King India Ltd., works out to \$2000 per hour. In a month of 30 days Techno King India Ltd. works at 2 shifts per day, consisting of 7 hours work for Techno King Inc., Germany and 6 hours work for SG Ltd. respectively. Determine, whether the transactions are done at Arm's Length.

- (c) Clear View Glasses Ltd., India exports semi finished glasses to its parent company Clear View Glasses Inc., USA. The exports are made at \$ 200 per glass to the US Company (Freight and Insurance costs \$75 is incurred separately). The cost per glass works out to \$125 on import. Clear View Glasses Inc., USA polishes the glasses and markets the same @ \$ 500 per glass. The polishing and marketing process cost @ \$100 per glass. Compute the Arm's Length Price (ALP), for the said transaction.
- (d) Luxury Life, India exports bath furniture only to its holding company, Luxury Life, Canada. The sale price per furniture is CAD 2,500. The direct and indirect costs amount to CAD 1,750. The furniture industry in India, of the comparable companies, has earned total export revenue of CAD 3,750 million. The industry average of total expenses of comparable companies works out to 85%. Compute the arm's length price of Luxury Life India.
- (e) Discuss whether adjustment is required in the context of transfer pricing provisions, where the transfer price adopted for an international transaction for sale of goods by an Indian company during the previous year 2012-13 is ₹100 Lakhs, whilst the Arm's Length Price determined using the most appropriate method are ₹96 Lakhs and ₹ 112 Lakhs. Assume that the rate of permissible variation prescribed by the Central Government is 2% of the transfer price for this class of the international transaction.

(4+4+4+4+4)

OR

Question 10 (OPTION-II)

- (a) The Income Tax Act, 1961 provides for taxation of a certain income earned by Nilesh. The Double Taxation Avoidance Agreement, which applies to Nilesh, excludes the income earned by Nilesh from the purview of tax. Is Nilesh liable to pay tax on the income earned by him? Discuss.
- (b) Ms. Lakshmi, a resident Indian, furnishes the details for the Assessment Year 2014-15 :

Particulars	Amount (₹)
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Answer to MTP_Intermediate_Syllabus 2012_Jun2014_Set 2

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

(c) A foreign company WorldBiz Inc. carries on business in India through a branch office located in India. It submits the following information for the year ended 31.03.2014.

	Particulars	₹ Lakhs
(a)	Royalties received in pursuance of an agreement entered into on 30-06-2003 with an Indian concern	200
	Expenditure to earn the above income	
	(i) Depreciation as per Income Tax Act on assets in branch in India	10
	(ii) Depreciation as per Income Tax Act on assets located in head office in U.S.A. which assets are partially used for Indian operations	9
	(iii) Salaries & other expenses of staff in India	120
	(iv) Payment to Singapore office for use of their data in India	6
	(v) Reimbursement of actual expenses incurred by Head office for the Indian Branch	12
	(vi) Paid to Head Office for apportionment of Certain head office expenditure	15
(b)	Interest received from Indian concerns for moneys lent in foreign currency	50
	Collection charges for the interest	5
(c)	Commission income received in India	90
	Expenses to earn the commission income	11

Answer to MTP_Intermediate_Syllabus 2012_Jun2014_Set 2

Compute the total income and tax liability for the Assessment Year 2014-15.

(d) Define "Specified Domestic Transaction", in the context of provisions relating to transfer pricing.

(4+4+7+5)

Solution to Question 10 (OPTION-I)

Solution to Question 10(a)

Since, Native Ltd. is a subsidiary company of International Ltd., Native Ltd. and International Ltd. are associated enterprises. Hence in respect of the transactions of sale of mobile phones by International Ltd. to Native Ltd., Arm's Length Price (ALP) has to be computed, using the Comparable Uncontrolled Price Method, as under:

Computation of the Arm's Length Price

Particulars	Amount (₹)
Sale price charged by International Ltd. to Country Ltd.	11,000
Less: Cost of Warranty for 6 months included in the price charged to Country Ltd. (₹ 500 × 6/12)	250
Arm's Length Price (ALP)	10,750
Actual Sale price charged by International Ltd. to Native Ltd.	12,000
Difference per unit, for price charged	1,250
Additions required to be made in the computation of the total income of Native Ltd. (₹1,250 × 48,000 units)	600,00,000

Exemption under section 10AA of the Income Tax Act, 1961 and the provisions of Chapter VI-A shall not be applicable for computation of total income of Native Ltd.

Solution to Question 10(b)

Techno King Ltd. provides services for different consumers consuming different man-hours each. From the given information, the Gross Margins realized can be identified. It is suitable to apply Cost plus Method as the Gross Margins can be identified only in proportion to the man-hours spent. Therefore, the Gross Margins realized from each customer shall be computed taking man-hours as the basis.

Computation of Gross Margins

Answer to MTP_Intermediate_Syllabus 2012_Jun2014_Set 2

Particulars	Techno King Ltd.	SG Ltd.
	Amount (₹)	
Billing Price	20,00,000	18,00,000
Less: Direct Cost of Service		
\$500 × 7 hours × 30 days	1,05,000	
\$500 × 6 hours × 30 days		90,000
	18,95,000	17,10,000
Less: Indirect Cost of Service		
\$200 × 7 hours × 30 days	4,20,000	
\$200 × 6 hours × 30 days		3,60,000
Gross Margin	14,75,000	13,50,000
Total man hours	210 hrs	180 hrs
Gross Margin per hour	7,024	7,500

The margin realized from the transactions with Associated Enterprises is less than the unrelated transaction. Techno King Ltd., India has to offer the same margin for the international transactions with the Associated Enterprise also. Therefore, the Arm's Length Price shall be fixed at \$7,500 per hour.

Solution to Question 10(c)

In the given case, a single product is captively consumed and ultimately sold by the associated enterprises. The profit realized by the product is one and same. Therefore, the suitable method to determine the Arm's Length Price will be the Profit Split Method.

Particulars	Amount (in \$)	Amount (in \$)
Sale Price		500
Less: Costs incurred		
Manufacturing Costs of Clear View Glasses Ltd.	125	
Polishing and Marketing Costs of Clear View Glasses Ltd.	100	225
		275
Less: Freight Insurance Costs		75
Net Profit		200
Apportionment of profit on the basis of Direct Costs incurred		
Clear View Glasses Ltd. India [200 × 125/225]		111
Clear View Glasses Inc. USA [200 × 100/225]		89
Total Profit		200

Answer to MTP_Intermediate_Syllabus 2012_Jun2014_Set 2

Therefore, a profit of \$111 per glass shall be treated as arm's length price for the transactions, entered into between the associated enterprises.

Solution to Question 10(d)

Luxury Life, India exports bath furniture only to its parent company. There are no other comparable uncontrolled transactions available within the company. As the assessee company functions in the furniture industry, the industry averages shall be taken as the comparable transaction. The Margins realized by the assessee and the Industry shall be compared for arriving at the Arm's Length price. The only method which recognizes the Net Margins comparison is Transaction Net Margin Method.

Computation of Net Margins

Particulars	Amount (in CAD)
(A) Net Margin made by Luxury Life, India	
Sales made by Luxury Life, India	2,500
Less: Direct and Indirect Costs	1,750
Net Margin	750
Net Margin to Sales	30%
(B) Net Margin of the Industry	
Industry Turnover	3,750
Less: Total Expenses @ 85%	3,188
Net Margin	562
Net Margin to Sales	15%

As the Net Margin realized by Luxury Life, India is more than the net margin realized by the industry, International transactions between the associated enterprises shall be regarded as adhering with the arm's length pricing principles.

Solution to Question 10(e)

Answer to MTP_Intermediate_Syllabus 2012_Jun2014_Set 2

The proviso to Section 92C(2) of the Income Tax Act, 1961 provides that, where more than one price is determined by the most appropriate method, the arm's length price shall be taken to be the arithmetical mean of such prices.

However, if the arithmetical mean, so determined, is within such percentage of the transfer price, as notified by the Central Government, then the transfer price shall be deemed to be the arm's length price and no adjustment is required to be made.

The arithmetical mean of the prices = ₹ [(96+112)/2] lakhs = ₹104 Lakhs

The rate of permissible variation prescribed by the Central Government is 2%, i.e. 2% of ₹100 Lakhs = ₹2 Lakhs.

Since, the variation between the arm's length price of ₹104 Lakhs and the transfer price of ₹100 Lakhs is not within the limit of 2% of Transfer Price, the arm's length price shall be ₹104 Lakhs.

The Assessing Officer may compute the total income of the Indian Company having regard to the arm's length price of ₹104 Lakhs so determined. No deduction shall be allowed under Chapter-VI A or Section 10AA, in respect of ₹4 Lakhs, being the amount of income by which the total income of the Indian company is enhanced after application of the arm's length price of ₹104 Lakhs.

Solution to Question 10 (OPTION-II)

Solution to Question 10(a)

Section 90(2) of the Income Tax Act, 1961 makes it clear that where the Central Government has entered into a Double Taxation Avoidance Agreement with a country outside India, then in respect of an assessee to whom such agreement applies, the provisions of the Act shall apply to the extent, they are more beneficial to the assessee. This means that where tax liability is imposed by the Act, the Double taxation Avoidance Agreement may be resorted to for reducing or avoiding the tax liability.

However, as per Section 90(4) of the Income Tax Act, 1961 inserted by the Finance Act, 2012, the assessee, in order to claim relief under the agreement, has to obtain a certificate [Tax Residence Certificate (TRC)] from the Government of that country containing such particulars as may be prescribed, declaring the residence of the country outside India. The submission of Tax Residence Certificate containing the prescribed particulars shall be necessary, but not a sufficient condition for availing benefits of the agreement. In effect, further conditions can be stipulated for claiming treaty benefits in addition to the requirement of submission of Tax Residence Certificate.

Answer to MTP_Intermediate_Syllabus 2012_Jun2014_Set 2

In the case of any conflict between the provisions of Double Taxation Avoidance Agreement and the provisions of Income Tax Act, 1961, the provisions of the Double Taxation Avoidance Agreement would prevail over those of the Income Tax Act, 1961. Nilesh is, therefore, not liable to pay tax on the income earned by him provided he submits the Tax Residence Certificate obtained from the Government of the other country and fulfills such other conditions as may be prescribed for claiming the treaty benefits.

Solution to Question 10(b)

Computation of total income of Ms. Lakshmi for the A.Y. 2014-15

Particulars	Amount (₹)	Amount (₹)
(a) Profits and gains of Business or Profession		
(i) Income from profession	1,94,000	
(ii) Share of income in partnership firm in Country X	40,000	2,34,000
(b) Income from other sources:		
(i) Interest from scheduled bank	20,000	
(ii) Commission earned in Country Y	30,000	50,000
TOTAL INCOME		2,84,000

Computation of Tax Liability on Total Income for the Assessment Year 2014-15

Particulars	Amount (₹)	Amount (₹)
Tax on Total Income of ₹2,84,000		8,400
Add: Surcharge on Income Tax	Nil	
Add: Education Cess @ 2%	168	
Add: Secondary and Higher Education Cess @ 1%	84	252
		8,652
Less: Double Taxation relief (Note 1)		2,135
Tax payable		6,517
Tax payable (rounded off)		6,520

NOTE:

1. Average rate of tax in the foreign country = $(₹8,000 + 20\% \text{ of } ₹30,000) / ₹70,000 \times 100 = 20\%$.

Average rate of tax in India = $₹ 8,652 / ₹ 2,84,000 \times 100 = 3.05\%$

Double Taxation Relief = $3.05\% \text{ of } ₹70,000 = ₹2,135$.

Answer to MTP_Intermediate_Syllabus 2012_Jun2014_Set 2

Solution to Question 10(c)

Since the foreign company has a permanent establishment in India and the agreement for royalty is entered into after 31.03.2003, Section 44DA is applicable. It is assumed that the contract for royalty is effectively connected with such branch in India.

	Particulars	₹ (in Lakhs)	₹ (in Lakhs)
(1)	Income under the head profits and Gain of Business profession		200
	Royalties received		
Less:	(i) Depreciation as per Income Tax Act on assets in branch in India	10	
	(ii) Depreciation on assets located in head office not allowed since assets are not wholly and exclusively used for the Indian branch and also it does not amount to reimbursement of expenses	Nil	
	(iii) Salaries & Other expenses of staff in India	120	
	(iv) Payment to Singapore office not allowed as it does no amount to reimbursement of expenses	Nil	
	(v) Reimbursement of actual expenses incurred by Head Office	12	
	(vi) Paid to Head Office for apportionment of Head Office expenses not allowed as it is not reimbursement of actual expenses	Nil	142
	Income from Royalty		58
(2)	Income from Interest	50	
Less:	Expenses not allowed as per section 115A	Nil	50
(3)	Commission Income	90	
Less:	Expenses	11	79
	Total Income		187

Particulars	₹
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Answer to MTP_Intermediate_Syllabus 2012_Jun2014_Set 2

Tax on 58 Lakhs @ 40%	23.20 Lakhs
Tax on 50 Lakhs @ 20% u/s 115A	10.00 Lakhs
Tax on 79 Lakhs @ 40%	31.60 Lakhs
	64.80 Lakhs
Add: Surcharge @2%	1.296 Lakhs
Total tax and surcharge	66.096 Lakhs
Add: 3% Education cess	1,98,288
Total Tax Liability	68,07,888
Rounded off	68,07,890

Solution to Question 10(d)

For the purposes of Section 92BA and Sections 92, 92C, 92D and 92E, "specified domestic transaction" in case of an assessee means any of the following transactions, not being an international transaction, namely:

- (i) any expenditure in respect of which payment has been made or is to be made to a person referred to in clause (b) of sub-section (2) of section 40A;
- (ii) any transaction referred to in section 80A;
- (iii) any transfer of goods or services referred to in sub-section (8) of section 80-IA;
- (iv) any business transacted between the assessee and other person as referred to in sub-section (10) of section 80-IA;
- (v) any transaction, referred to in any other section under Chapter VI-A or section 10AA, to which provisions of sub-section (8) or sub-section (10) of section 80-IA are applicable; or
- (vi) any other transaction as may be prescribed,

and where the aggregate of such transactions entered into by the assessee in the previous year exceeds a sum of five crore rupees.]