

**Paper-7 – Direct Taxation**

## PTP\_Intermediate\_Syllabus 2012\_June2016\_Set 1

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

	<b>Learning objectives</b>	<b>Verbs used</b>	<b>Definition</b>
<b>LEVEL B</b>	<b>KNOWLEDGE</b>  What you are expected to know	List	Make a list of
		State	Express, fully or clearly, the details/facts
		Define	Give the exact meaning of
	<b>COMPREHENSION</b>  What you are expected to understand	Describe	Communicate the key features of
		Distinguish	Highlight the differences between
		Explain	Make clear or intelligible/ state the meaning or purpose of
		Identity	Recognize, establish or select after consideration
		Illustrate	Use an example to describe or explain something
	<b>APPLICATION</b>  How you are expected to apply your knowledge	Apply	Put to practical use
		Calculate	Ascertain or reckon mathematically
		Demonstrate	Prove with certainty or exhibit by practical means
		Prepare	Make or get ready for use
		Reconcile	Make or prove consistent/ compatible
		Solve	Find an answer to
		Tabulate	Arrange in a table
	<b>ANALYSIS</b>  How you are expected to analyses the detail of what you have learned	Analyse	Examine in detail the structure of
		Categories	Place into a defined class or division
		Compare and contrast	Show the similarities and/or differences between
		Construct	Build up or compile
Priorities		Place in order of priority or sequence for action	
Produce		Create or bring into existence	

**PAPER- 7: Direct Taxation**

**Time Allowed: 3 hours**

**Full Marks: 100**

**All the questions relate to the assessment year 2016-17, unless stated otherwise.**

**Working notes should form part of the answers.**

**Answer all questions.**

**1. Answer all the questions**

- (a) State the taxability of recovery of bad debt allowed u/s 36(1)(vii). **[2]**
- (b) What are the circumstances under which an assessee is said to be "assessee in default"? **[2]**
- (c) What are the criteria for claiming exemptions from salary income by crew member of foreign ship? **[2]**
- (d) Anirudh is a regional sales manager of A Ltd. He is paid salary plus commission based on volume of sales effected by him. Anirudh claimed that the expenses incurred by him for earning the commission should be allowed ad deduction. Discuss the validity of his claim. **[2]**
- (e) State the taxability of sum received under Keyman Insurance Policy. **[2]**
- (f) Whether lease rent on temporary suspension of business is taxable under "business income" or under "income from other source"? **[2]**
- (g) A Charitable Institution registered u/s 12A of the Income Tax Act, 1961 filed in Form No. 10 for seeking permission to accumulate unapplied Income u/s 11(2) of the Act for the objects of the Institution and submitted it to the Assessing Officer along with the resolution for accumulation. The A.O found that the objects for which accumulation was sought were not particularized in as much as they covered the entire range of objects of the Institution. Can the Assessing Officer deny the benefit of accumulation in such case? **[2]**
- (h) Mahesh, a Resident and Ordinarily resident in India and having a House Property and a Bank Account outside India is not required to file Return of Income for AY 2016-17, if his Total Income is below the maximum amount not liable to tax. Is this statement correct? **[2]**
- (i) Smarajit, whose Income consists of Salary Income only, files his return of income for assessment year 2013-14 on 02.04.2015. Is the return a valid return? **[2]**
- (j) What are the basis of selection of Most Appropriate Method? **[2]**

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### 2. Answer any four questions [4 x 15 = 60]

**(a)(i)** Compute the tax Liability and the Marginal relief in the following situations, for resident assessee with taxable Income as under for Previous year 2015 – 2016:

Name of Individual	A	B	C
Age of Assessee	45 years	65 years	84 years
Total Income	₹ 1.04 Crores	₹ 1.04 Crores	₹ 1.04 Crores

[7]

**(a)(ii)** Ms. Vivitha paid a sum of \$ 5,000 to Mr. Kulasekhara, a Management Consultant practicing in Colombo, specializing in Project Financing. The payment was made in Colombo. Mr. Kulasekhara is Non-Resident. The Consultancy related to a project in India with possible Ceylonese collaboration. Is this payment chargeable to tax in India in the hands of Mr. Kulasekhara, since the services were used in India? [5]

**(a)(iii)** Mr. Ravi, an IAS Officer, was posted to USA by the Government of India on 11.07.2015 for a period of 3 years, He was paid salary of ₹ 3 Lakhs for the period 01.04.2015 to 01.07.2015 and of ₹ 12 Lakhs for period upto 31.03.2016. He left India for USA in the night of 10.07.2015 and did not come even for a day until 31.03.2016. Examine the taxability of the above Income. [3]

**(b)(i)** MNO Ltd has one undertaking at Special Economic Zone (SEZ) and another at Domestic Tariff Area (DTA).

Following are the details given to you for the Previous year 2015 – 2016:

Particulars	Unit in SEZ	Unit in DTA
Total Sales	200	100
Export Sales	150	80
Net Profit	40	10

Compute the quantum of eligible deduction u/s 10AA for the AY. 2016-2017 in the following situations -

- Both the units were set up and began manufacturing from 25.07.2010.
- Both the units were set up and began manufacturing from 10.04.2012.

[7]

**(b)(ii)** Mr. Gobind received Retrenchment Compensation of ₹10,00,000 after 30 years and 4 months of service. At the time of retrenchment, he was receiving Basic Salary of ₹20,000 p.m. and Dearness Allowance of ₹5,000 p.m. Compute his taxable Retrenchment Compensation. [4]

**(b)(iii)** Mr. Divyam avails the benefit of LTC and went by air (economy class) on a holiday in India on 25.01.2016 along with his wife and three children consisting of son aged 4 years and twin daughters of 1 year age. Total Cost of Tickets reimbursed by his Employer was ₹90,000 (₹60,000 for 2 adults and 30,000 for the three children). State with reason the amount which can be claimed by Mr. Divyam out of the reimbursement as not subject to tax? Will your answer be different where among his three children the twins were of 4 years of age and the age of the son was of 1 year? [4]

**(c)(i)** Mr. Kadam is entitled to a salary of ₹25,000 per month. He is given an option by his Employer either to take House Rent Allowance or a Rent Free Accommodation which is owned by the Company. The HRA amount payable was ₹ 5,000 per month. The rent for the Hired Accommodation was ₹6,000 per month at New Delhi, Advise Mr. Kadam whether it would be

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beneficial for him to avail HRA or Rent Free Accommodation. Give your advice on the basis Net Take Home Cash Benefits. **[8]**

**(c)(ii)** Singhania & Co. own six machines, put into use for business in March, 2015. The depreciation on these machines is charged at 15%. The Written Down Value of these machines at the end of the previous year relevant to Assessment Year 2015-2016 was ₹ 8,50,000. A new Plant was bought for ₹8,50,000 on 30<sup>th</sup> November, 2015. Three of the old machines were sold on 10<sup>th</sup> June 2015 for ₹11,00,000.

(a) Determine the claim of Depreciation for Assessment Year 2016-2017.

(b) Compute the Capital Gains liable to Tax for Assessment Year 2016-2017.

(c) If Singhania & Co. had sold the three machines in June, 2015 for ₹21,00,000, will there be any difference in your above workings? Explain. **[7]**

**(d)(i)** The Assessment was made u/s 143(1) for AY 2011-2012. The Assessee has received a notice u/s 148 on 06.04.2014 for re-opening of assessment. Can the Assessee challenge the legality of notice on the ground of change of opinion? **[4]**

**(d)(ii)** Tani purchased a Land at a Cost of ₹10 Lakhs in the Financial Year 1983-1984 and held the same as her Capital Asset till 31.03.2012. Tani started her Real Estate Business on 01.04.2012 and converted the said Land into Stock-in-Trade of her business on the said date, when the Fair Market Value of the Land was ₹ 150 Lakhs.

She Constructed 20 flats of equal size, quality and dimension. Cost of construction of each flat is ₹8 Lakhs. Construction was completed in December, 2015. She sold 15 flats at ₹20 Lakhs per flat between January 2016 and March 2016. Remaining 5 flats were held in stock as on 31.03.2016. She invested ₹50 Lakhs in Bonds issued by RECL on 31.03.2016.

Compute the amount of chargeable Capital Gain and Business Income in the hands of Tani arising from above transactions for Assessment Year 2016-2017 indicating clearly the reasons for treatment for each item. CII: FY 1983-1984 - 116, FY 2012-2013 - 852, FY 2015-2016 - 1081. **[7]**

**(d)(iii)** Sea Port Shipping Line, a Non-Resident Foreign Company operating its ships on the Indian Ports during the Previous Year ended on 31.03.2016 had collected freight of ₹100 Lakhs, Demurrages of ₹20 Lakhs and Handling Charges of ₹10 Lakhs inclusive of an amount of ₹ 40 Lakhs collected in US Dollars for the cargo booked for JNPT (Mumbai) from Antwerp. The expenses of operating its fleet during the year for the Indian Ports were ₹110 Lakhs. The Company denies its liability to tax in India. Examine. **[4]**

**(e)(i)** X Ltd transferred its fertilizers business to a new Company Y Ltd by way of demerger, w.e.f appointed date as 01.04.2015 after satisfying the conditions of Demerger. Further information given -

(a) WDV of entire block of Plant & Machinery held by "X" Ltd as on 01.04.2015 is ₹ 100 Crores.

(b) Out of the above, WDV of Block of Plant and Machinery of Fertilizer Division is ₹70 Crores.

(c) X Ltd has Unabsorbed Depreciation of ₹50 Lakhs as at 31.03.2015.

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On the above facts, you are required to explain the provisions of the Income Tax Act as to –

- (i) Allowability of Depreciation, post-merger for X Ltd and Y Ltd as at 31.03.2016 duly calculating the depreciation.
- (ii) State how the Unabsorbed Depreciation has to be dealt with for the Assessment Year 2016-2017. **[7]**

**(e)(ii)** M, an individual, is 70 years of age. He is a sitting member of the State Assembly of Karnataka and for the PY 2015-2016 received the following amounts from the Assembly Secretariat –

- |                            |                                       |
|----------------------------|---------------------------------------|
| (a) Basic pay              | ₹ 9,000 p.m.                          |
| (b) Constituency Allowance | ₹24,000 p.m.                          |
| (c) Telephone Allowance    | ₹12,000 p.m.                          |
| (d) Electricity Allowance  | ₹ 9,000 p.m. (from June 2014 onwards) |

He owns a house in Delhi which has been let out at ₹60,000 p.m. He received rent for 10 months only, the house having remained vacant for two months. Municipal Taxes of ₹3,600 were paid by the tenant. Interest of ₹42,000 was paid by M on amount borrowed by him to buy the house. M has an agricultural income of ₹1,65,000. Compute his Tax Liability. **[8]**

### 3. Answer any two questions [2 x 10 = 20]

**(a) (i)** Speedy Motors Ltd, an Indian Company, declared Income of ₹20 Crores computed in accordance with Chapter IV-D but before making any adjustments in respect of the following transactions for the year ended on 31.03.2016:

- A. Royalty of \$50,00,000 was paid to Fista Ltd. for use of technical know-how in the manufacturing of van. However, Fista Ltd had provided the same know-how to another Indian Company for \$ 45,00,000. The manufacture of Van by Speedy Motors Ltd is wholly dependent on the use of technical know-how, in respect of which Fista Ltd has exclusive rights.
- B. Loan of Euro 5 Crores with interest @ 10% p.a. advanced by Hughes Ltd, a French Company, was outstanding on 31.03.2016. The Total Book Value of assets of Speedy Motors Ltd on the date was ₹500 Crores. Hughes Ltd had also advanced similar loan to another Indian Company @ 8% p.a. Total Interest paid for the year was EURO 0.5 Crore.
- C. 7,000 Vans sold to Hitech Ltd which holds 41% Shares in Speedy Motors Ltd at a price which is less by \$ 100 each van than the price charged from Bento Ltd.

Briefly explain the provisions of the Act affecting all these transactions and compute Taxable Income of Speedy Motors Ltd for A.Y.2016-2017 assuming that the value of 1\$ and of 1 EURO was ₹65 and ₹ 75, respectively, throughout the year. **[5]**

**(a)(ii)** X Ltd, operating in India, is the dealer for the goods manufactured by Yen Ltd of Japan. Yen Ltd owns 55% of Shares of X Ltd, and out of 7 Directors of the Company, 4 were appointed by them. The Assessing Officer after verification of transactions of ₹300 Lakhs of X Ltd for the relevant year and by noticing that the Company had failed to maintain the requisite records and had also not obtained the Accountants' Report, adjusted its Income by making an addition of ₹30,00,000 to the declared income and also issued a Show Case Notice to levy various penalties. X Ltd seek your expert opinion. **[5]**

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**(b)(i)** "Mingle Engineering Ltd", a Korean Non Resident Company, had entered into an agreement for designing, fabricating, hook-up and commissioning of a platform in Bombay High with "Crude Oil India Ltd" an Indian Company. The agreement entered into was in two parts, one for the value to be charged for fabrication of structure in Korea for ₹ 20 Crores (having element of Profit in it of ₹2 Crores) and other for the Installation and Commissioning of the structure in Bombay High for ₹15 Crores (having element of Profit in it of ₹1.5 Crores). The Korean Company will also be setting up an Office in India for the activity of installation and commissioning of the platform which is likely to be completed in 9 months.

On these facts, you are required to answer -

- (a) Whether the office of Mingle Engineering Ltd. to be opened in India be considered as its "Permanent Establishment"/ "Business Connection"?
- (b) The amount of profits, if any, of the Non-Resident Company subject to tax in India.
- (c) The Income subject to Tax in India, when the ALP of the fabrications of structure is determined at ₹ 19 Crores. **[5]**

**(b)(ii)** Mobeaux LLP of Poland and Vamsi Ltd of India are Associated Enterprises. Vamsi imports 1000 compressors for Air Conditioners from Mobeaux at ₹7,500 per unit and these are sold to Winland Cooling Solutions Ltd at ₹11,000 per unit. Vamsi had also imported similar products from De-Heat Ltd and sold outside at a Gross profit of 20% on Sales.

Mobeaux offered a Quantity Discount of ₹1,500 per unit. De-Heat could offer only ₹500 per unit as Quantity Discount, The Freight and Customs Duty paid for imports from Poland had cost Vamsi ₹1,200 a piece. In respect of purchase from De-Heat, Vamsi had to pay ₹ 200 only as Freight Charges.

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

**(c)(i)** VKS International Ltd, the Assessee, has sold goods on 12.01.2016 to L Ltd. located in a Notified Jurisdictional Area (NJA), for ₹10.5 Crores. The sale price of identical goods sold to an unfamiliar customer in New York during the year was ₹11.5 Crores. While the second sale was on CIF basis, the sale to L Ltd was on F.O.B. basis. Ocean Freight and Insurance amount to ₹20 Lakhs.

India has a Double Taxation Avoidance Agreement with the USA. The Assessee has a policy of providing After-Sales Support Services to the tune of ₹14 Lakhs to all customers except L Ltd. The ALP worked out as per Cost Plus Method for identical goods is ₹ 12.10 Crores.

You are required to compute the ALP for the Sales made to L Ltd, and the amount of consequent increase, if any, in profits of the Assessee—Company. **[5]**

**(c)(ii)** Kio Japan and AB Ltd, an Indian Company are Associated Enterprises. AB Ltd manufactures Cellular Phones and sells them to Kio Japan and Geel, a Company based at Beijing. During the year AB Ltd supplied 2,50,000 Cellular Phones to Kio Japan at a price of ₹3,000 per unit and 35,000 units to Geel at a price of ₹4,800 per unit. The transactions of AB Ltd with Kio and Geel are comparable subject to the following considerations -

- (a) Sales to Kio is on FOB basis, sales to Geel are CIF basis. Freight and Insurance paid by Kio for each unit is ₹700.
- (b) Sales to Geel are under a free warranty for Two Years whereas sales to Kio are without any such warranty. The estimated cost of executing such warranty is ₹500.
- (c) Since Kio's order was huge in volume, quantity discount of ₹200 per unit was offered to it.

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Compute Arm's Length Price and amount of increase in Total Income of AB Ltd, if any, due to such Arm's Length Price. **[5]**