

Answer to PTP_Intermediate_Syllabus 2012_Dec2013_Set 1

Paper 7 - Direct Taxation

Section A

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

1.

(a) Answer each of the following questions:

- (i) T Ltd. purchased a plant costing ₹10 lakhs. Before commencement of commercial production the company incurred ₹30,000 on trial run. The products generated by trial run were sold at ₹20,000. Compute the Actual Cost of the plant for the purpose of Section 43(1).

Answer:

Computation of Actual Cost

	₹	₹
Cost of the plant		10,00,000
Add:		
Expenses on trial run	30,000	
Amount realised on sale of the products generated on trial run	20,000	10,000
Actual Cost for the purpose of Section 43(1)		10,10,000

- (ii) During the previous year 2012-13, Mr. Sinha paid ₹1,70,000 for interest on loan taken on 20.12.2009 for the construction of a house property. The construction was completed on 12.05.2012. Mr. Sinha uses this house property for his residential purpose. He has no other house property. What is the amount of interest deductible u/s 24(b)?

Answer:

As the loan taken for the construction of the residential house after 1st April, 1999 and the construction is completed within 3 years from the end of the financial year in which the loan was taken, Mr. Sinha is eligible for deduction u/s 24(b) ₹1,50,000 or the amount of interest paid during the year (₹1,70,000), whichever is lower i.e. ₹1,70,000.

- (iii) Calculate the amount of tax payable by Mr. Ram, a resident individual, who has taxable Long Term Capital Gains of ₹55,000 and income from other sources ₹1,20,000 during the previous year 2012-13.

Answer:

As the amount of total income i.e. ₹1,75,000 (55,000+1,20,000) does not exceed the exemption limit of ₹2,00,000, no tax is payable by Mr. Ram for the previous year 2012-13.

- (iv) Mr. Dutta received gold bars worth ₹75,000 from his father and a motor bike worth ₹85,000 from his friends as gift on the occasion of his birthday on 28.02.2013. Is it to be treated as income from other sources of Mr. Dutta?

Answer:

In the given case, Mr. Dutta received gold bars worth ₹75,000 from his father who is a relative and hence, not taxable.

He also received a motor bike worth ₹85,000 from his friends. Motor bike is not a property and hence, not taxable.

- (v) Rishi owns a Tea estate. During the previous year, he has earned ₹5,25,000 from the sale of tea grown and manufactured in his estate. Compute his business income?

Answer to PTP_Intermediate_Syllabus 2012_Dec2013_Set 1

Answer:

In the given case, it is given that Rishi has earned ₹5,25,000 from the sale of tea grown and manufactured in his estate. Assuming the amount given is his income computed as per the Act, 40% of ₹5,25,000 i.e. ₹2,10,000 is his business income as per Rule 8.

- (vi) Hari is an owner of a farm house. He earned ₹85,000 as rent from the film producer for shooting of a movie in the farm house. Is this an agricultural income?

Answer:

An amount of ₹85,000 is earned as rent from the film producer for shooting of a movie in the farm house. It is not an agricultural income.

- (vii) Rabi has paid ₹55,000 for the previous year 2012-13 on 01.03.2013 towards interest on loan taken for his higher education. How much will he be allowed as deduction u/s 80E?

Answer:

100% of the interest paid i.e. ₹55,000 will be allowed to Rabi as deduction u/s 80E.

- (viii) Rahul, resident individual having business income, is required to audit his books of accounts under the Income Tax Act. What is the due date by which Rahul is required to file his return?

Answer:

The due date of filing 30th September of the Assessment Year for Rahul, as his books of accounts is required to be audited under the Income Tax Act.

[8×1]

(b) Choose the correct answer

- (i) The profit arising on sale of a painting held for two generations is
(A) Not Liable to tax as paintings being personal effect is not a capital asset
(B) Liable to tax as long term capital gain
(C) Liable to tax as short term capital gains
(D) Not liable to tax as it is held for five years before being sold

Answer: (B) Liable to tax as long term capital gain

- (ii) The following is not a venture capital undertaking for the purposes of Section 10(23F), if engaged in business of :
(A) Generation of power
(B) Telecommunications
(C) Providing infrastructure facility
(D) Dairy farming whose shares are not listed in a recognized stock exchange

Answer: (D) Dairy farming whose shares are not listed in a recognized stock exchange

- (iii) Validity period of stay of recovery granted by ITAT is
(A) One year
(B) Three years
(C) 180 days
(D) Till final order is passed by Tribunal

Answer: (C) 180 days

Answer to PTP_Intermediate_Syllabus 2012_Dec2013_Set 1

(iv) The provisions of AMT shall apply to a non-corporate assessee who has claimed any deduction:

- (A) 80G
- (B) 80E
- (C) 80IA
- (D) 80C

Answer: (C) 80IA

(v) The following is exempt income:

- (A) Travel concession to employee
- (B) Remuneration received for valuation of answer scripts
- (C) Perquisites in India
- (D) Encashment of leave salary whilst in service

Answer: (A) Travel concession to employee

[5×1]

2.

(a) The Head Office of Achariya, a Hindu Undivided Family, is situated in Kenya. The family is managed by Avik Achariya, since 1980, who is resident in India in only 4 out of 10 years preceding the previous year 2012-13 and he is present in India for more than 729 days during the last 7 years. Determine the residential status of the family for the assessment year 2013-14 if the affairs of the family's business are (i) wholly controlled from Kenya or (ii) partly controlled from India.

Answer:

(i) If affairs of a Hindu Undivided Family are controlled from a place outside India, the family will be non-resident. Accordingly, Achariya HUF is non-resident for the assessment year 2013-14.

(ii) Affairs of the family's business are partly controlled from India during the previous year 2012-13. Hence, the family is resident in India. However, it would be ordinarily resident in India if karta satisfies the following two conditions laid down by section 6(6)(b):

- (A) He has been resident in India in at least 2 out of 10 years preceding the previous year.
- (B) He has been present in India for at least 730 days during 7 years preceding the previous year.

As Avik Achariya, the karta of the family, is present in India 4 out of 10 years preceding the previous year 2012-13 and also is present in India for more than 729 days during the last 7 years, the family would be resident and ordinarily resident in India for the assessment year 2013-14.

(b) Abir functioned as the managing director of MSN Ltd. under an agreement, which was to be operative from February 1, 2008 for a term of five years. The agreement, inter alia, provided for payment of gratuity to the managing directors, as per the terms of the agreement, at the time of termination of appointment. During the accounting year 2012-13 after the expiry of the said agreement on February 1, 2013, Abir received ₹1,05,000 gratuity in accordance with the terms of the agreement. Thereafter, Abir is appointed as managing director under a fresh agreement which also contains a clause as to payment

Answer to PTP_Intermediate_Syllabus 2012_Dec2013_Set 1

of gratuity. Abir claims that u/s 10(10) a part of the gratuity received is exempt from tax. The Assessing Officer is of the opinion that the assessee's services have not been terminated, with the result that no gratuity falls due and consequently, Section 10(10) is not applicable. Discuss whether Abir is entitled for exemption.

Answer:

When an employee retires and earns gratuity and the same employer offers such employee a job under a fresh agreement and the new agreement provides for the payment of gratuity, that would no way, militate against the concept of gratuity if such gratuity is paid on the fresh retirement.

Retirement, in the case of a managing director, will be a matter of contract and the agreement may provide for payment of gratuity on the expiration of the term of appointment. Therefore, whatever happens to the managing director thereafter, whether the managing director is appointed for a fresh term under a fresh agreement or not, the earlier agreement works itself out and consequently, when the managing director retires, he or she would be entitled to whatever gratuity is contemplated as payable under the agreement. The fact that such a person is employed again under a fresh contract without any break would make no difference, for it will not alter the character of the earlier payment made pursuant to the agreement. Therefore, in the instant case, Section 10(10) is attracted and Abir is entitled to the admissible deduction.

(c) Ratul once again wants to revise his return of income which is already revised. Can he do so? If so, under what circumstances.

Answer:

If the assessee discovers any omission or any wrong statement in a return, it is possible to revise such return subject to time limit prescribed in section 139(5) if the assessee has filed the original return before due date. The time limit being one year from the end of the relevant assessment year or before the completion of the assessment, whichever is earlier.

The Income Tax Act does not have any limit in respect of number of times for which the return of income may be revised by the assessee. Hence, a revised return could be revised any number of times, provided the revision is made within the prescribed time limit.

In the given case, Ratul wants to revise his return of income which is already revised. He can do so if it done within the time as prescribed i.e. one year from the end of the relevant assessment year or before the completion of the assessment, whichever is earlier.

[5+5+3]

3.

(a) The question whether a particular income is income from salary or is income from business depends upon whether the contract is a contract of service or is a contract for service. Illustrate.

Answer:

Particulars	Contract of Service	Contract for Service
(i) Meaning	Employer-Employee relationship is vital. The Employee does the work for his master.	In this contract, a person offers his services to any person who is willing to pay the charges therefore.
(ii) Control	Control and supervision vests in	The day-to-day control is

Answer to PTP_Intermediate_Syllabus 2012_Dec2013_Set 1

	the Master (employer). The servant (employee) is bound to follow the master's directions.	normally absent in the case of contract for service.
(iii) Execution of work	Employee works under the close supervision of his Employer who determines the manner of execution of work. (Control over What should be done and How)	The person executing the job is answerable only for the work to be carried out in accordance with the terms of contract. He has discretion to do the work in his own way. (Control over what should be done and not how to do it)
(iv) Remuneration	An employee works for remuneration, which may be paid monthly or on any suitable basis as per agreement.	The person rendering the service is entitled to the fruits of his labour, and also liable for the losses.
(v) Example	Aman Khan, an actor, is an employee of Filmy (P) Ltd. He gets a remuneration of ₹30 Lakhs p.m. He acts in several films but producers pay the fees for those services directly to Filmy (P) Ltd. Here, employer-employee relationship exists between him and Filmy (P) Ltd. Hence, his remuneration will be assessed as Salary.	Anil is an actor. He acts in several films at a time with remuneration ranging from ₹1 Crore to ₹3 Crores. The producers of films pay him directly for his services. There is no employer-employee relationship between the producers and him. The receipts will be assessed as business income.

From the above discussion it is clear that the question whether a particular income is income from salary or is income from business depends upon whether the contract is a contract of service or is a contract for service.

(b) One of the exceptions to the rule that the income of the previous year shall be assessed in the subsequent assessment year is the shipping business of non-resident. List the other exceptions to the rule.

Answer:

Apart from the shipping business of non-resident, following are the exception to the rule that the income of the previous year shall be assessed in the subsequent assessment year:

- (i) **Persons leaving India [Section 174]:** If it appears to the Assessing Officer that an individual may leave India shortly and has no intention of returning to India.
- (ii) **AOP or BOI or Artificial Juridical Person formed for a particular event or purpose [Sec. 174A]:** If it appears that an association or a body etc. is likely to be dissolved in the same year or immediately after such year in which it was formed.
- (iii) **Persons likely to transfer property to avoid tax [Section 175]:** If it appears that a person is likely to charge, sell, transfer, dispose of (or otherwise part with) any of his movable or immovable asset during the previous year with a view to avoid tax.
- (iv) **Discontinued business [Section 176]:** If a business or profession is discontinued during the previous year. The income of the business or profession is taxable at the discretion of the Assessing Officer in the year in which it is discontinued or it may be taxed in the normal assessment year.

Answer to PTP_Intermediate_Syllabus 2012_Dec2013_Set 1

- (c) From the details given below find out the taxable amount of recovery of unrealized as per the provision of Sec. 25AA.

Unrealised rent recovered during the P.Y. 2012-2013 relating to P.Y. 2006-2007	(Actual rent receivable – Unrealised rent) of P.Y. 2006-2007	GAV of P.Y. 2006-2007
30,000	1,80,000	1,80,000
20,000	1,50,000	1,60,000
50,000	1,20,000	1,40,000

Answer:

Unrealised rent recovered during the P.Y. 2012-2013 relating to P.Y. 2006-2007	(Actual rent receivable – Unrealised rent) of P.Y. 2006-2007	GAV of P.Y. 2006-2007	Taxable Amount
[1]	[2]	[3]	[1 + (2-3)]
30,000	1,80,000	1,80,000	30,000
20,000	1,50,000	1,60,000	10,000
50,000	1,20,000	1,40,000	30,000

- (d) Som, 14 years old, has been admitted as partner to the benefit of a firm, SKK Co. on 01.04.2012. The firm paid ₹20,000 as interest on his capital @ 10% p.a. simple interest during the previous year 2012-13. State the tax implications.

Answer:

In the given case, interest of ₹20,000 [subject to exemption of ₹1,500 u/s 10(32)] will be included in the income of Som's father or mother whose total income (excluding such interest) is greater. If, however, the marriage of the parent does not subsist, such income will be includible in the income of the parent who maintains Som in the relevant previous year.

[5+3+3+2]

4.

- (a) During the previous year 2012-13, Avik, a resident individual, has made contribution of ₹7,000 to an approved research association for carrying out research in natural science and ₹8,000 to National Fund for Rural Development. Determine his taxable income if he is (i) a salaried employee, drawing ₹2,00,000 as taxable salary or (ii) a businessman whose income from business (without deducting the above mentioned contribution) is ₹2,00,000.

Answer:

Computation of taxable income for the assessment year 2013-14

Particulars	Salaried Employee (₹)	Businessman (₹)
Salary	2,00,000	—
Income from business	—	2,00,000
Deduction u/s 35 [₹7,000 × 1.75]	—	12,250
Deduction u/s 35CCA	—	8,000
Gross Total Income	2,00,000	1,79,750
Less: Deduction u/s 80GGA [₹7,000 + ₹8,000]	15,000	—
Net Income	1,85,000	1,79,750

Answer to PTP_Intermediate_Syllabus 2012_Dec2013_Set 1

Note: Deduction u/s 80GGA is not available in the case of an assessee where income includes income chargeable under the head "Profits and Gains of Business or Profession".

- (b) The Assessing Officer issued a notice on 27th November, 2013 calling upon Mr. Sen to file the return for the assessment year 2012-13. Mr. Sen, in response to the notice, furnished a return of loss claiming the carry forward of business loss and depreciation. State whether he would be entitled to the benefit of carry forward as claimed in the return.**

Answer:

Mr. Sen has been issued a notice and he has furnished the return in response to the said notice. It is, therefore, clear that he has not filed the return of loss voluntarily within the time allowed u/s 139(1) read with section 139(3). Section 80 provides that no loss will be allowed to be carried forward and set off u/s 72(1), unless such loss is determined in pursuance of a return filed accordance with the provision of section 139(3). Therefore, Mr. Sen will not be in a position to carry forward the business loss by virtue of the specific provisions of section 80. However, he will be in a position to carry forward the unabsorbed depreciation. The benefit of carry forward of depreciation is governed by section 32(2). Unlike section 80, section 32(2) does not stipulate that the return should be filed within a particular time limit in order that he may get the benefit of carry forward.

- (c) Subodh gifted ₹40,00,000 to his fiancée, Rina on 15.09.2012 and she booked fixed deposit with that amount on the same date. They got married on 25th December, 2012. On 15.03.2013, she received ₹2,00,000 as interest on that amount. The Assessing Officer wants to club this income in the hand of Subodh – Justify.**

Answer:

Section 64(1)(iv) provides that where an asset (other than house property) is transferred by an individual to his or her spouse directly or indirectly otherwise than for adequate consideration or in connection with an agreement to live apart any income from such asset will be deemed to be the income of transferor. However, the provision of this section is not applicable if assets are transferred before marriage.

In the given case, Subodh gifted ₹40,00,000 to Rina before their marriage, hence, the interest of ₹2,00,000 earned by Rina during the previous year 2012-13 on the gifted amount cannot be clubbed in the hands of Subodh. Therefore, the contention of the Assessing Officer is not correct.

- (d) Sampat received ₹18,00,000 being maturity proceeds of LIC policy that he had taken out in the name of his wife. Assessing Officer contends that the amount, received by him alive, is taxable as income from other sources in the year of receipt – Justify**

Answer:

Since, Sampat had been paying the premium amount, the taxability of the maturity proceeds will have to be considered in his hands by virtue of the clubbing provisions.

However, any amount received on maturity proceeds of LIC policy is totally exempt from tax u/s 10(10D) of the Income Tax Act, 1961. Hence, the sum of ₹18,00,000 received will be totally exempted.

[5+3+3+2]

Answer to PTP_Intermediate_Syllabus 2012_Dec2013_Set 1

5.

- (a) Ranbir purchased a house property on 2nd January, 1977 for ₹1,00,000. On 21st March, 1988, he enters into an agreement to sell the property to Samir for ₹4,00,000 after taking an advance of ₹50,000. On Samir's failure to pay the balance amount within the stipulated time, Ranbir forfeited the advance amount. Ranbir sold the house property on 1st May, 2012 for a consideration of ₹25,00,000. Fair market value of the house property as on the 1st April, 1981 is ₹90,000.

Calculate the taxable amount of Capital Gains.

What will be the taxable amount of Capital Gains, if the fair market value of the house property as on the 1st April, 1981 is ₹5,00,000.

Answer:

Statement showing calculation of taxable amount of Capital Gains

Particulars	Fair market value as on 01.04.1981	
	₹90,000	₹5,00,000
	₹	₹
Sale Consideration	25,00,000	25,00,000
Indexed cost of acquisition:		
[(₹1,00,000 - ₹50,000) × 852 ÷ 100]	4,26,000	—
[(₹5,00,000 - ₹50,000) × 852 ÷ 100]	—	38,34,000
Long Term Capital Gains/(Long Term Capital Loss)	20,74,000	(13,34,000)

Note:

- I. The Amount so forfeited to be deducted from the cost of acquisition.
- II. If an asset purchased before 01.04.1981, the cost of acquisition will be fair market value on 01.04.1981 or the actual cost of acquisition whichever is higher.

- (b) Dev, aged 48 years, resident in India, furnishes the following information for the previous year ended 31-3-2013 :

	₹
House property income (Net)	19,500
Business income	85,000
Capital gains (short-term)	25,000
Capital gains (long-term)	3,500
Income from horse race	16,000
Income from card games	17,000
Additional information are as follows :	
Brought forward business loss for AY 2005-06	12,000
Unabsorbed depreciation for AY 2010-11	6,000
Long-term capital loss for AY 2009-10	12,000
Loss from horse race suffered in AY 2009-10	8,000
Speculative loss for AY 2008-09	10,000

Dev has taken a life insurance policy for his son (aged 25) working in a software company for a salary of ₹5,00,000 per annum. He has paid premium of ₹20,000 in cash for a capital sum assured of ₹2,00,000/-.

He has paid PPF of ₹81,000 by raising a loan from his friend.

Calculate total income. State the items to be carried forward.

Answer to PTP_Intermediate_Syllabus 2012_Dec2013_Set 1

Answer:

Computation of taxable income for the assessment year 2013-14

	₹	₹
Income from House property		19,500
Profits and Gains of Business or Profession :		
Business income	85,000	
Less : Brought forward business loss	12,000	
Less : Unabsorbed depreciation allowance	6,000	
Chargeable business income		67,000
Capital Gains :		
Long-term Capital Gains	3,500	
Less : Brought forward long term loss	12,000	
Net LTCG		Nil
Short term Capital Gains		25,000
Income from Other Sources :		
Income from horse race	16,000	
Less : Brought forward Loss from horse race	8,000	
	8,000	
Card games income	17,000	
Income chargeable under this head		25,000
Gross Total Income		1,36,500
Less : Deduction under Chapter VIA		
Under section 80C		
LIP Not to exceed 10% of sum assured	20,000	
Public Provident Fund	81,000	
Maximum permissible amount 1,00,000		1,00,000
Total income		36,500
Tax on above		Nil

Note: Since, the amount of Total Income is lower than ₹2,00,000 i.e. the exemption limit, no tax is payable.

- Speculative loss for AY 2008-09 cannot be set off as it can be set off only against income from speculative income within 4 assessment years immediately succeeding assessment year in which it was occurred.
- Long-term capital loss ₹8,500 pertaining to the AY 2009-10 can be carried forward.

(c) "Depreciation is allowed only when it is claimed" – state the correctness of the statement.

Answer:

The statement is false as according to Explanation 5 to Sec. 32, depreciation is allowed even if not claimed by the assessee.

[5+7+1]

6.

(a) SD Ltd., an Indian company, submits the following information for the previous year 2012-13:

	₹
Business income	2,15,000
Long Term Capital Gains on sale of Gold bars on 30th September, 2012	1,25,000

Answer to PTP_Intermediate_Syllabus 2012_Dec2013_Set 1

Winning from lottery on 28 th December, 2012 (after deducting tax at source of ₹18,000)	42,000
--	--------

Calculate the minimum amount of advance tax payable by way of different installments to ensure that interest liability u/s 234C is not attracted.

Answer:

Computation of Total Income of SD Ltd. for the previous year 2012-13

Particulars	Amount ₹
Profits and Gains of Business or Profession	2,15,000
Capital gains: Long Term Capital Gains	1,25,000
Income from other sources: Winning from lotteries (42,000+18,000)	60,000
Total Income	4,00,000

Computation of tax liability of ABC Ltd. for the previous year 2012-13

Particulars	Long Term Capital Gain	Lottery income	Business income
	₹	₹	₹
Income	1,25,000	60,000	2,15,000
Tax rate	20%	30%	30%
Tax on above	25,000	18,000	64,500
Add : Education cess & SHEC	750	540	1,935
Tax and cess payable	25,750	18,540	66,435
Less : TDS	—	18,000	—
Advance tax payable	25,750	540	66,435

Advance tax to be paid on specified dates

Date	Advance tax on LTCG		Advance tax on Lottery income		Advance tax on Business income		Total (a+b+c) ₹
	Workings	Amount (a) ₹	Workings	Amount (b) ₹	Workings	Amount (c) ₹	
15.06.2012	As LTCG occurred on	Nil	As lottery income occurred on	Nil	15% of ₹66,435	9,965	9,965
15.09.2012	30.09.2012	Nil	28.12.201	Nil	30% of ₹66,435	19,931	19,931
15.12.2012	75% of ₹25,750	19,313	2	Nil	30% of ₹66,435	19,930	39,243
15.03.2013	25% of ₹25,750	6,437	100% of ₹540	540	25% of ₹66,435	16,609	23,586
Total		25,750		540		66,435	92,725

(b) M/s. AB an enterprise sold one of its undertaking consisting of Machinery A (Rate of depreciation 30%), Machinery B (Rate of depreciation 15%), Building X (Rate of depreciation 10%), for ₹1,50,00,000 on 9.9.2012

Machinery A originally acquired for ₹5,00,000 on 1.9.2009

Machinery B originally acquired for ₹10,00,000, on 30.10.2010

Building X acquired on 18.4.2012 for ₹4,00,000

Answer to PTP_Intermediate_Syllabus 2012_Dec2013_Set 1

During the year a new Machinery C (15%) purchased for ₹5,00,000 on 6.6.2012

Compute depreciation

Machinery (Rate of depreciation 30%) block (WDV as on 1.4.2012 is ₹9,00,000)

Machinery (Rate of depreciation 15%) block (WDV as on 1.4.2012 is ₹8,00,000)

Building (Rate of depreciation 10%) block (WDV as on 1.4.2012 is ₹5,00,000)

Answer:

Computation of depreciation for respective blocks

	Machinery 30% block	Machinery 15% block	Building 10% block
W.D.V. as on 1.4.2009	9,00,000	8,00,000	5,00,000
Add: Purchase under the block during the year	Nil	5,00,000	4,00,000
Sale under slump sale	2,45,000	9,25,000	4,00,000
	6,55,000	3,75,000	5,00,000
Depreciation	1,96,500	56,250	50,000

Working:

WDV of the assets sold under slump sale

	Machinery A	Machinery B	Building X
Original cost of assets sold	5,00,000	10,00,000	4,00,000
Less: Depreciation -			
Financial Year 2009-10	1,50,000	—	—
Financial Year 2010-11	1,05,000	75,000	—
WDV of the assets sold under slump sale	2,45,000	9,25,000	4,00,000

(c) Is the income of a dealer in shares by way of dividend taxable under the head "Profits and Gains of Business or Profession"?

Answer:

For charging the income under the head "Profits and Gains of Business or Profession" the following conditions should be satisfied:

- There should be a business or profession.
- The business or profession should be carried on by the assessee.
- The business or profession should have been carried on by the assessee at any time during the previous year.

In case of a dealer deals with shares, profit on sale of share is business income. However, dividend on such shares is a return on investment hence, taxable under the head Income from Other Sources. Again, section 10(34) provides that any income by way of dividend is exempt from tax. Hence, the dividend so received by the dealer is exempt from tax.

[6+5+2]

Section B (Answer all the questions)

(7)

(i) Can an individual authorize another person to sign the return of wealth on his or her behalf?

Answer:

Answer to PTP_Intermediate_Syllabus 2012_Dec2013_Set 1

Section 15A of the Wealth Tax Act, 1957 provides that in certain situations like where the individual is absent from India or where for any reason, he is not in a position to sign in the return, can authorise another person to give signature on his/her behalf.

- (ii) In case of valuation for wealth tax purposes of immovable property in Nagpur, What do you mean by Specified Area?**

Answer:

In case of valuation for wealth tax purposes of immovable property in Nagpur, specified area means 65% of the aggregate area.

[1+1]

(8)

(A)

- (a) Is it correct to state that every member of AOP is an “assessee” for the purpose of Wealth Tax?**

Answer:

Section 2(c) read with section 21AA of the Wealth Tax Act clearly indicate that the term “assessee” includes every member of AOP. Section 21AA also provides that, where shares of member of AOP is determinate or known, interest of members in the assets of the AOP shall be valued as per Rule 16 and 17 of Schedule III and when shares of member is indeterminate or unknown, wealth tax is levied on the AOP.

- (b) Avik Rao is a coparcener of a Hindu Undivided Family. There was a partition in the family in June, 2012 and under terms of the partition deed certain assets of the family were allotted to Avik’s wife. The Assessing Officer included these assets in Avik’s individual assessment under the provisions of sub-clauses (i) and (ii) of section 4(1)(a) of the Wealth Tax Act. Is the Assessing Officer justified in his action?**

Answer:

Section 4(1)(a) of the Wealth Tax Act is applicable only if assets are transferred by an individual. Since, in the given case, assets are transferred by the HUF, the action of the Assessing Officer is not tenable in law. However, clubbing u/s 4(1)(a)(ii) cannot be avoided. However, in the given case Avik’s wife is not a minor (assumed), hence clubbing is not tenable in law.

- (c) Discuss whether the following are “assets” u/s 2(ea)”**

- (i) A commercial multi-storied building given on rent.**
- (ii) A commercial house property used by a Hindu Undivided Family for the purpose of carrying on own business.**
- (iii) Mr. Kotoky owns a house property which is occupied by a firm in which he is a partner for its business purposes.**
- (iv) Rabi owns a residential house property. However, till 31st March, 2013, it is under construction (original cost of plot of land was ₹85,00,000, construction expenditure incurred up to 31st March, 2013 is ₹50,00,000).**

Answer:

- (i) A commercial multi-storied building given on rent is not an “asset”.
- (ii) A commercial house property used by a Hindu Undivided Family for carrying on a business or profession is not an “asset”.
- (iii) A building occupied by a person for the purpose of any business or profession carried on by him is not an “asset”. This condition is satisfied when a person who being the

Answer to PTP_Intermediate_Syllabus 2012_Dec2013_Set 1

owner of certain premises, makes the same available to the firm, in which he is a partner, for carrying on business.

- (iv) A property under construction (including investment on construction) is not liable to wealth tax.

[2+2+(1×4)]

or

(B)

- (a) Jay owns a building at Delhi. He used the building for his business purposes up to 21.09.2012. Since then it is let out to a tenant who uses the building for residential purpose. Is it an asset u/s 2(ea) of the Wealth Tax Act for the assessment year 2013-14?

Answer:

Jay owns a building. It is used for business purposes up to 21st September, 2012. On 31st March, 2013, it is not used for own business purposes. Therefore, Exception 3 given by 2(ea)(i)(3) is not applicable.

Moreover, Exception 4 given by Section 2(ea)(i)(4) is not applicable as it was not let out for residential purpose for a minimum period of 300 days during the previous year ending on 31st March, 2013.

Hence, it is an asset u/s 2(ea) for the assessment year 2013-14.

- (b) Calculate the net wealth in each of the following cases:

- (i) Mr. Z owns utensils of gold, the value of which as on 31.03.2013 is ₹25 lakhs. He takes a loan of ₹10 lakhs by pledging these utensils.
- (ii) On 30.12.2012, by taking a bank overdraft of ₹30 lakhs, Mr. W purchased gold bullions. Fair value of the gold bullions as on 31.03.2013 is ₹33 lakhs.

Answer:

- (i) In this case, Mr. Z takes loan by pledging the utensils but not for the purpose of purchase the utensils. Hence, this loan cannot be deducted from the value of the wealth. Therefore, Net Wealth = ₹25 lakhs.

- (ii) In this case, the loan is taken for the purpose of purchasing the gold bullions and hence, is a "debt owed". Therefore, Net Wealth = ₹33 lakhs - ₹30 lakhs = ₹3 lakhs.

- (c) Jubin owns a plot of land in Mumbai whose total area is 900 sq. mts. He constructs a building on 1/3rd of the plot. Find the amount of premium to be added to the capitalized value.

Answer:

Aggregate Area = 900 sq. mts.

Built Area = 900 sq. mts. ÷ 3 = 300 sq. mts.

Unbuilt Area = Aggregate Area – Built Area = 900 sq. mts. – 300 sq. mts. = 600 sq. mts.

Specified Area = 900 sq. mts. × 60% (since, the property is in Mumbai) = 540 sq. mts.

Excess of Unbuilt Area over Specifies Area = 600 sq. mts. – 540 sq. mts. = 60 sq. mts.

60 sq. mts. as percentage of aggregate area = $\frac{60 \text{ sq. mts.}}{900 \text{ sq. mts.}} \times 100 = 6.67\%$

As the excess of unbuilt area over specified area is more than 5% but not more than 10% of the aggregate area, premium to be added is 20% of the capitalized value.

[3+(1+1)+3]

Answer to PTP_Intermediate_Syllabus 2012_Dec2013_Set 1

Section C (Answer all the questions)

(9)

(i) **What do you mean by uncontrolled transaction under Transaction Net Margin Method?**

Answer:

Uncontrolled transaction means a transaction between unrelated enterprises, whether resident or non-resident.

(ii) **Can the transfer price ignore dumping, R&D expenses and start-up cost in judging the arm's length price?**

Answer:

Such matters like dumping, R&D expenses and start-up cost are commercial realities, which cannot be ignored.

(iii) **What do you mean by Unrelated Enterprise in the context of International Transaction?**

Answer:

Enterprises are said to be unrelated, if they are not associated or deemed to be associated u/s 92A.

(iv) **Are related parties u/s 40A(2) same as for associated enterprises for application of Transfer Pricing Rules?**

Answer:

Related parties are those referred in pre-existing 40(A)(2)(b) with addition of a subsidiary company where holding company is covered by the provisions has substantial interest. Hence, related parties u/s 40A(2) are same as for associated enterprises for application of Transfer Pricing Rules.

(v) **Under Transfer Pricing Study, in the Annexure to which form is the statement of particulars to be furnished?**

Answer:

Under Transfer Pricing Study, the statement of particulars is to be furnished in the Annexure to Form No. 3CEB for the Income Tax Act, 1961.

[1×5]

(10)

(A)

(a) **Briefly describe your understanding on Cross-border Transactions.**

Answer:

Cross border transaction means a transaction in an international or foreign security, or a transaction in a domestic security in which at least one of the counterparties is located outside the home country of the domestic security. Cross Border Transaction services means services related to transaction which involve two or more countries. In India there are two Acts which primarily seems to show concern when a person (Indian Resident or Foreign Resident) undertakes cross border transactions viz.

(i) Foreign Exchange Management Act, 1999

(ii) Income Tax Act, 1961

Answer to PTP_Intermediate_Syllabus 2012_Dec2013_Set 1

Therefore, it is imperative that a person needs to deal with both the above mentioned Acts to enter into a cross-border transaction.

(b) What is the binding nature of the arm's length price determined by the Transfer Pricing Officer upon a reference made to him by the Assessing Officer?

Answer:

The Assessing Officer with the prior approval of the Commissioner may refer the computation of Arm's Length Price to the Transfer Pricing Officer. The Transfer Pricing Officer shall determine the Arm's Length Price following the prescribed process and send a written copy of the Assessing Officer and the tax payer. The Arm's Length Price determined by the Transfer Pricing Officer shall be binding upon the Assessing Officer and the Assessing Officer cannot complete the assessment of an income from international transaction in disregard of the order passed by the Transfer Pricing Officer.

(c) Will transfer pricing rules be applicable, where income is computed on the basis of books profits?

Answer:

It has been held by the Authority for Advance Ruling that book profits tax (i.e. MAT) is mandatory for all companies including foreign companies. Since it is treated as overriding the normal provisions for computation of income, a non-resident will be liable on book profits irrespective of any relief that may be otherwise available in respect of statutory liability under Double Taxation Avoidance Agreements. Controversial as the view is, it still means that if it is the law, transfer pricing will have no relevance, when non-resident is liable on book profits tax, an inference which is highly controversial.

(d) Will the transfer pricing rules apply for purposes of capital gains as in the case of transfer of shares of unlisted companies incorporated in India?

Answer:

If the transaction is one, where an associated enterprise is involved, there is no reason at all, why transfer pricing rules should have no application. Hence, the rules will apply for purposes of capital gains as in the case of transfer of shares of unlisted companies incorporated in India.

(e) What are the factors which have to be considered after arriving at the profit margin on the basis of comparables for arriving at arm's length price in a particular case?

Answer:

Profit margin is one, which is reckoned from comparable cases but adjustment would be required to arrive at the applicable Arm's Length Price in any particular case. Where adjustments without excluding the following items were not considered justified as not having any influence over the profit margin for arriving at arm's length price are:

- Personal expenses
- Expenses on risk management
- Interest income
- Unrelated purchase expenses
- Subsequent losses
- Non-operative expenditure
- Compensation for closure of branches
- Research expenses

Answer to PTP_Intermediate_Syllabus 2012_Dec2013_Set 1

- (f) MS Ltd., an Indian company, is a subsidiary of RV Inc., a company registered in US. It purchased raw materials from RV Inc. Purchase prices of raw material determined by the most appropriate method are ₹9,950, ₹10,000 and ₹10,050 per unit. However, MS Ltd. pays to RV Inc. ₹10,500 per unit. Determine the Arm's Length Price. Assume that the tolerance range notified by the Government is 5 percent.

Determine the arm's length price if MS Ltd. pays ₹9,600 to RV Inc.

Answer:

Computation of Arm's Length Price

	MS Ltd. pays to RV Inc. ₹10,500 per unit	MS Ltd. pays to RV Inc. ₹9,600 per unit
Arithmetic mean of a price determined under the most appropriate methods $[(₹9,950 + ₹10,000 + ₹10,050)/3]$ (₹)	10,000	10,000
Price at which raw material is purchased from associate enterprise under international transaction (₹)	10,500	9,600
Difference between arithmetic mean and transaction price (₹)	500	400
5% of transaction price (₹)	525	480
Whether exceeds 5% of transaction price	Yes	Yes
Arm's Length Price (₹)	10,000	10,000

- (g) MND Inc., a company incorporated in US, sells printer to its 100% Indian subsidiary SW Ltd. @ \$100 per printer. MND Inc. also sells its printer to another company RD Ltd. in India @ \$120 per printer. Total income of SW Ltd. for the assessment year 2013-14 is ₹14,00,000 after making payment for 50 printers @ \$100(1\$=₹50). SW Ltd. has deducted tax at source while making payment to MND Inc. Compute the arm's length price and taxable income of MND Inc. and SW Ltd. Assume the rate of one Dollar to be equivalent to ₹50 in all transaction.

What will be yours answer, if MND Inc. sells its printer to RD Ltd. @ \$90 per printer.

Answer:

MND Inc. sells its printer to RD Ltd. @ \$120 per printer

Arm's Length Price of printer which is sold to SW Ltd. will be \$120 per printer.

Income of SW Ltd.:

Particulars	Amount (₹)
Income as per books of accounts	14,00,000
Add: amount charged by MND Ltd. [$\$100 \times 50 \times ₹50$]	2,50,000
Less: Arm's Length Price [$\$120 \times 50 \times ₹50$]	3,00,000
Income after applying Arm's Length Price	13,50,000

By virtue of section 92(3), one cannot reduce taxable income by applying Arm's Length Price, Therefore, income of SW Ltd. will be ₹14,00,000.

MND Inc. sells its printer to RD Ltd. @ \$90 per printer

Arm's Length Price will be \$90 per printer.

Income of SW Ltd. after applying Arm's Length Price = ₹14,00,000 + ₹2,50,000 - ₹2.25.000
[i.e. $\$90 \times 50 \times ₹50$] = ₹14,25,000.

Income of MND Ltd.:

Answer to PTP_Intermediate_Syllabus 2012_Dec2013_Set 1

If we assume that the transaction are actually on a principal to principal basis and are at Arm's Length and SW Ltd. functions and carries on business on its own, instead of functioning as an agent of the present company, then MND Ltd. is not chargeable to tax in India.

Otherwise, MND Ltd. will be chargeable to tax in India in respect of income which arises on sale of goods to SW Ltd. However, the adoption of Arm's Length Price by the Assessing Officer will not affect the computation of taxable of MND Ltd.

[2+2+2+1+3+5+5]

or

(B)

(a) When will you deem two enterprises to be associated enterprises?

Answer:

Two enterprises shall be deemed to be associated enterprises, if, at any time during the previous year, any of the following conditions are attracted -

- (i) **Shareholding:** One enterprise holds, directly or indirectly, shares carrying not less than 26% of shares/voting power in the other enterprise.
- (ii) **Shareholding by same person:** Any person or enterprise holds, directly or indirectly, shares carrying not less than 26% of the voting power in each of such enterprises, or
- (iii) **Loans:** A loan advanced by one enterprise to the other enterprise constitutes not less than 51% of the book value of the total assets of the other enterprise, or
- (iv) **Guarantee:** One enterprise guarantees not less than 10% of the total borrowings of the other enterprise, or
- (v) **Management Control:** More than half of the board of directors or members of the governing board, or one or more executive directors or executive members of the governing board of one enterprise, are appointed by the other enterprise, or of each of the two enterprises are appointed by the same person or persons, or
- (vi) **Know-how relationship:** The manufacture or processing of goods or articles or business carried out by one enterprise is wholly dependent on the use of know-how, patents etc. of which the other enterprise is the owner or holder of exclusive rights, or
- (vii) **Purchase or sale relationship:** 90% or more of the raw materials and consumables, required for the manufacture or processing of goods or articles carried out by one enterprise, are supplied by the other enterprise, or by persons specified by the other enterprise or the goods or articles manufactured or processed by one enterprise, are sold to the other enterprise or to persons specified by the other enterprise and the prices and other conditions relating to such purchase or sale are influenced by such other enterprise, or
- (viii) **Control through relatives of individual or members of HUF:** Where one enterprise is controlled by an individual or a Hindu Undivided Family, the other enterprise is also controlled by such individual or a member of such HUF or relative such individual or a member of such HUF or jointly by such individual and relative of such individual, or
- (ix) **Control through Firms etc.:** Where one enterprise is a Firm/AOP/BOI, the other enterprise holds not less than 10% interest in such Firm /AOP/BOI, or
- (x) **Other relationships:** There exists between two enterprises, any relationship or mutual interest, as prescribed.

(b) Briefly explain the role of market forces in determining the Arm's Length Price?

Answer:

In case of transactions between Independent enterprises, the conditions of their commercial and financial relations are, ordinarily, determined by the market force.

Whereas, in case of transactions between Multinational Enterprises, their commercial and financial relations may not be affected by the external forces in the same way, although associated enterprises often seek to replicate the dynamics of the market forces in their dealings with each other.

(c) Briefly explain Profit Split Method in determining Arm's Length Price.

Answer:

Profit Split Method is mainly applicable in international transactions involving transfer of unique intangibles or in multiple international transactions which are so inter-related that they cannot be evaluated separately for the purpose of determining the Arm's Length Price of any one transaction.

Step I: Determine the combined net profit of the associated enterprises arising from the international transaction in which they are engaged.

Step II: Determine the relative contribution made by each of the associated enterprises to the earning of such combined net profit. This is determined on the basis of the functions performed, assets employed and risks assumed by each enterprise and on the basis of reliable external market data which indicates how such contribution would be determined by unrelated enterprises performing comparable functions in similar circumstances.

Step III: Split the combined net profit amongst the enterprises on the basis of reasonable returns and in proportion to their relative contributions, as determined in Step II. (Note below)

Step IV: Arm's Length Price = Profit apportioned to the assessee under Step III + Cost incurred during the transaction.

Note: Combined Net Profit shall be split as under:

III.A. First Split = Reasonable Return: Allocate an amount to each enterprise so as to provide it with a basic return appropriate for the type of international transaction with reference to market returns achieved in similar types of transactions by independent enterprises.

III.B. Second Split = Contribution Ratio: Allocate the residual net profit amongst the enterprises in proportion to their relative contribution.

III.C. Total Profit: Share of profit of each enterprise = Step III.A + III.B

(d) "The Arm's Length Principle, although survives upon the international consensus, does not necessarily mean that it is perfect" – Discuss.

Answer:

The Arm's Length Principle, although survives upon the international consensus, does not necessarily mean that it is perfect. There are difficulties in applying this principle in a number of situations.

- (i) The most serious problem is the need to find transactions between independent parties which can be said to be exact compared to the controlled transaction.
- (ii) It is important to appreciate that in a Multinational Enterprise system, a group first identifies the goal and then goes on to create the associated enterprise and finally,

Answer to PTP_Intermediate_Syllabus 2012_Dec2013_Set 1

- the transactions entered into. This procedure obviously does not apply to independent enterprises. Due to these facts, there may be transactions within a Multinational Enterprise group which may not be between independent enterprises.
- (iii) Further, the reductionist approach of splitting a Multinational Enterprise group into its component parts before evaluating transfer pricing may mean that the benefits of economies of scale, or integration between the parties, is not appropriately allocated between the Multinational Enterprise group.
 - (iv) The application of the arm's length principle also imposes a burden on business, as it may require the Multinational Enterprise to do things that it would otherwise not do (i.e. searching for comparable transactions, documenting transactions in detail, etc).
 - (v) Arm's length principle involves a lot of cost to the group.

(e) Can the Transfer Pricing Officer accept use of multiyear data for determining of Arm's Length Price in an International Transaction?

Answer:

The Transfer Pricing Officer can accept the use of multiple year data for determining the Arm's Length Price in an international transaction if the effect of the transaction in more than one year.

Where the international transactions have effect more than one previous year, fresh documentation need not be maintained separately in respect of each previous year, unless there is any significant change in the nature or terms of the international transaction, in the assumptions made or in any other factor which could influence the transfer price. In case of such significant change, fresh documentation under Rule 10D(1)/(2) shall be maintained bringing out the impact of the change on the pricing of the international transaction.

(f) Shortly explain the procedure for computation of Arm's Length Price under various methods.

Answer:

Rule 10B explain the computation of the Arm's Length Price for an international transaction in the following methods–

- (i) Comparable uncontrolled Price Method
- (ii) Resale Price Method
- (iii) Cost Plus Method
- (iv) Profit Split Method
- (v) Transaction Net Margin Method

[5+2+5+4+2+2]