INTERMEDIATE EXAMINATION

GROUP I

(SYLLABUS 2012)

SUGGESTED ANSWERS TO QUESTIONS
DECEMBER 2013

Paper – 7 : DIRECT TAXATION

Time Allowed: 3 Hours **Full Marks: 100**

The figures in the margin on the right side indicate full marks.
Wherever necessary, the candidate may make suitable assumption and state the same clearly in the answer.
All the questions relate to the assessment year 2013 – 2014, unless stated otherwise

Section A
[Question No. 1 is compulsory and answer any four Q. Nos. 2 to 6]

1. **(a) Answer the following sub-divisions briefly in the light of the provisions of the Income-tax Act, 1961: 1 x 8 = 8**
   - **(i) Interest on bank term loan paid during financial year 2012-13 was ₹ 1,21,000. Outstanding as on 31.03.2013 was ₹ 28,000. The assessee paid ₹ 15,000 before the "due date" for filing the return of income under section 139(1). Is the amount paid after the end of the year be eligible for deduction?**
   - **(ii) A Government employee received gratuity of ₹ 16 lakhs upon retirement, in September 2012. How much is taxable?**
   - **(iii) A nationalized bank gave interest reduction of ₹ 1,70,000 in a cash credit account of a trader relating to earlier years. Is the interest reduction chargeable to income-tax? Said interest had not been paid to the bank.**
   - **(iv) Is the right of management in an Indian company a capital asset? On relinquishment directly or indirectly, is it liable to tax?**
   - **(v) A life insurance policy was taken in April, 2012 for a capital sum assured of ₹ 8 lakhs. The annual premium amounts to ₹ 1,10,000 for 10 years. How much is deductible under section 80C?**
   - **(vi) A wind mill was installed in June, 2012 for ₹ 200 lakhs. What is the rate of normal depreciation applicable on such wind mill?**
   - **(vii) Giant Oil Inc. sold crude oil to HPCL, a company in India. The sale was made within India. Is the income arising from such sale liable to tax?**
   - **(viii) A company owned chain of star hotels in India. It has been availing deduction under section 35 AD. In December, 2012, it transferred the operation of hotels (all above two star category) to another group company. Is it eligible to avail the benefit of section 35AD even after the transfer of operating the hotels?**

   (b) Choose the most appropriate alternative: 1 x 5 = 5
   - **(i) Travel expenditure of the patient and the attender for medical treatment abroad is fully exempted, if gross total income before including reimbursement of foreign travel expenditure is**

(A) ₹ 2,00,000 (B) ₹ 2,50,000 (C) ₹ 3,00,000 (D) ₹ 5,00,000

(ii) Audit of accounts u/s 44Ab of the Income-tax Act, 1961 is mandatory for a person carrying on profession where his gross receipts exceed
(A) ₹ 40,00,000 (B) ₹ 60,00,000 (C) ₹ 20,00,000 (D) ₹ 25,00,000

(iii) Long-term capital gain arising from sale of listed shares in a recognized stock exchange (STT paid) is exempt under section _________ of the Income-tax Act, 1961:
(A) 10(35) (B) 10(37) (C) 10(38) (D) 10(36)

(iv) Deduction in respect of interest on deposits in savings account is allowed under section 80 TTA of the Income-tax Act, 1961 for the assessment year 2013-14 to the maximum extent of
(A)₹ 5,000 (B) ₹ 10,000 (C) ₹ 15,000 (D) ₹ 20,000

(v) An assessee who has no income from business or profession will not be required to pay any advance tax if the said assessee is a/an
(A) Firm (B) AOP (C) Senior citizen (D) Indian Company

Answer: 1. (a)

(i) The amount of interest paid before the due date for filing the return is eligible for deduction under section 43B. Thus the amount paid after the end of the account year but before the due date for filing the return of income is deductible.

(ii) As per section 10(10) gratuity of a person being a government employee is exempt without any monetary limit.

(iii) Since the interest payment would not have been allowed earlier in view of section 43B, the waiver is also not chargeable to tax by invoking section 41(1) of the Act.

(iv) Yes, it is a capital asset in view of the Explanation to section 2(14) inserted by the Finance Act, 2012. It is a 'transfer' in view of Explanation 2 to section 2(47). Hence the relinquishment is liable to capital gains tax.

(v) Only 10% of the premium on the capital sum assured is eligible for deduction. The excess is ineligible. The quantum eligible for deduction U/s.80C hence would be ₹ 80,000.

(vi) CBDT has amended the Income Tax Rules to restrict the depreciation allowed on windmills installed on or after 1 April 2012 to 15%. (Notification No. 15/2012).

(vii) As per section 10(48), the income from sale of crude oil by foreign company to any person in India is exempt from tax provided income received in India in Indian currency by a foreign company on account of sale of crude oil to any person in India.

(viii) As per section 35AD(6A) transfer of operation of hotels will not deny the assessee from availing or continuing to avail the benefits of section 35AD.

1.(b)

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

2. (a) What are the circumstances in which previous year and assessment year will be the same? 3

(b) What are the conditions for claiming exception u/s 10(10C) of the Income-tax Act, 1961 relating to Voluntary Retirement Compensation? 3

(c) "Accommodation provided in a hotel will not be a taxable perquisite" in the hands of employee. Is it correct? Briefly explain. 2

(d) Mr. Lai is the owner of a commercial property let out at ₹ 60,000.00 per month. The Corporation tax on the property is ₹ 30,000.00 annually, 60% of which is payable by the tenant: This tax was actually paid on 15.04.2013. He had borrowed a sum of ₹ 40.00 lakhs from his cousin, resident in Singapore (in dollars) for the construction of the property on which interest at 8% is payable. He has also received arrears of rent of ₹ 80,000.00 during the year, which was not charged to tax in the earlier years. What is the property income of Mr. Lal for the assessment year 2013-14? 5

Answer:

2. (a) Previous year and the assessment year will be same in the following cases:

1. Shipping business of non-resident (sec.172)
2. Persons leaving India (sec.174)
3. AOP or BOI or Artificial juridical person formed for a particular event or purpose (sec.l74A)
4. Persons likely to transfer property to avoid tax (sec.175)
5. Discontinued Business (sec.176)

2. (b) Condition for claiming exemption under section 10(10C) are —

(i) Compensation is received at the time of voluntary retirement or termination or voluntary separation;

(ii) Compensation is received in accordance with the scheme of voluntary retirement/ separation which is framed in accordance with prescribed guidelines;

(iii) Maximum amount of exemption is ₹ 5,00,000

(iv) An individual who has retired under the voluntary retirement scheme should not be employed in another Company of the same management;

(v) He should not have received any other voluntary retirement compensation before from any other employer and claimed exemption;

(vi) The person who has avail a relief under section 89 in respect of compensation for voluntary retirement or separation or termination of service, will not be able to claim any exemption under section 10(10C) for the same assessment year or any other assessment year.

2. (c) Accommodation provided in a hotel will not be a taxable perquisite if the following two conditions are fulfilled:

1) The period of such accommodation does not exceed 15 days
2) Such accommodation has been provided on the transfer of the employees from one place to another.

2. (d) Assessee: Mr. LAL: Previous year 2012- 2013 – Assessment year 2013- 2014

Computation of income from house property

Particulars	₹	₹
Let out: So, Annual value u/s (i) (a)/(b) Actual rent ₹60,000.00 x 12		7,20,000.00
Less: Municipal taxes paid during the Financial Year 2012 - 13		NIL
Net Annual value (NAV)		7,20,000.00
Less: Deduction u/s 24 (a) 30% of NAV of ₹ 7,20,000 x 30% (b) Interest on housing loan (Note) ₹ 40,00,000 x 8%	2,16,000.00 3,20,000.00	(-)5,36,000.00
Income from house property before considering arrears of rent		1,84,000.00

Arrears of rent received	80,000.00	
Less: Deduction u/s 25B – 30% of arrears received	24,000.00	56,000.00
Net income from house property		2,40,000.00

Note: It is presumed that the tax has been deducted at source on the amount of interest payable outside India.

3. (a) Chirag, an individual, purchased 5,000 shares of X. Limited at ₹ 50 per share and 4,000 shares of Y. Limited at ₹ 60 per share in the previous year 2009-10 and held them as capital assets.
In the previous year 2011-12, he converted the shares into his stock-in-trade. The fair market value of the shares of both the companies on the date of conversion was ₹ 300 per share.
In the previous year 2012-13, he sold the shares of the two companies at ₹ 380 per share. Shares were sold by way of private sale and hence securities transactions tax was not payable.
Ascertain chargeable capital gain and business income from the above-noted transactions in the hands of Chirag.
Cost Inflation Index:
Financial Year 2009-10 : 632
Financial Year 2011-12 : 785
Financial year 2012-13 : 852 **5**

(b) State, with reasons, the deductibility or taxability of the following items in computation of income under the head "Profits and gains of business or profession":
- **(i) Profit of ₹ 10 lacs on sale of import entitlement.**
- **(ii) A sum of ₹ 15 lacs was spent for acquiring one equipment used for in-house scientific research project which was approved by the prescribed authority.**
- **(iii) Share of profit of ₹ 12 lacs as partner of a partnership firm.**
- **(iv) Expenditure on purchase of raw materials amounting to ₹ 5 lacs from a concern owned by son of the Managing Director of the assessee company.**
- **(v) Interest of ₹ 10 lacs on loan taken from a bank for acquiring a machine in connection with expansion project of the assessee. Loan was taken on 1st April, 2012 and the machine was put to use on 1st July, 2012.** **8**

Answer:

3. (a) Computation of Capital gain for Assessment Year 2013- 2014

Particulars	₹
Fair Market value of Y Ltd. on the date of conversion (deemed consideration) 9,000 x ₹ 300	27,00,000
Less: Indexed cost of Acquisition (₹ 2,50,000 + ₹ 2,40,000) x 785/632	6,08,623
Long term capital gain	20,91,377

Computation of Business Income for Assessment Year 2013- 2014

Particulars	₹
Sale proceeds of Shares (9,000 x ₹ 380)	34,20,000
Less: Fair market Value of Shares on the date of conversion	27,00,000
Business Income	**7,20,000**

Note: As securities transaction tax was not paid, exemption under section 10(38) in respect of long term capital gain is not available.

3.(b) (i) Profit on sale of import entitlement is chargeable to tax under the head "Profits or gains from business or profession" as per charging section 28.

(ii) The assessee is entitled to claim a weighted deduction at 200% of the amount of capital expenditure on in-house scientific research programme approved by the prescribed authority [Section 35(2AB)]. Hence the amount of admissible deduction is ₹ 30 lacs.

(iii) Partner's share in profits of firm is specifically exempted under section 10(2A) in the hands of the partner.

(iv) Such expenditure is allowed unless it is found that the payment is excessive or unreasonable having regard to the fair market value of raw materials received. In such case the excess amount, if any, shall be disallowed under section 40A(2).

(v) Interest on loan for the period from 1st April 2012 to 1st July 2012 i.e. ₹ 2.50 lacs (₹ 10 lacs x 3/12) shall not be allowed under section 36(1)(iii). The balance interest i.e. ₹ 7.50 lacs can be claimed under section 36(1)(iii). Interest to the extent of ₹ 2.50 lacs shall be added to the cost of machine and depreciation can be claimed.

4. (a) Discuss whether the following receipts are chargeable to tax in the hands of the recipients:

(i) Prize money of ₹10,000 awarded to Arjun for participating in a motor car rally.

(ii) Madhu received ₹ 10,000 each from six friends on his 50th birth day.

(iii) Ramesh received a plot of land from his father-in-law as gift on his marriage anniversary. The value assessed by the Stamp Valuation Officer for the purpose of stamp duty was ₹ 5 lacs.

(iv) Pramod purchased shares of Z. Limited at ₹ 1 lac from his friend. The fair market value of the shares on the date of purchase was ₹ 1.70 lacs. 4

(b) Sanjay holds 16% shares in XYZ Private Limited. The company has given him a loan of ₹ 2 lacs on 1st February, 2013. Accumulated profit of the company on that date was ₹ 1.75 lacs. Sanjay repaid the loan on 31st March, 2013. Examine the tax implication, if any, of the above transactions in the hands of Sanjay. 4

(c) Ameet furnishes the following particulars of income/loss pertaining to previous year 2012-13:

	(₹ in lacs)
(i) Profit from trading business	**6**
(ii) Loss from manufacturing business	**1.50**
(iii) Loss from profession	**2.50**
(iv) Profit from speculation in shares	**2.50**
(v) Loss from speculation in commodities	**3**

He has no other income during the year. Determine total income of Ameet for the Assessment Year 2013-14. Also state the loss to be carried forward. The manner of set off must be clearly shown in your answer. 5

Answer:

4. (a) (i) Prize money is an income under section 2(24). It was received by Arjun as a result of application of his skill and experience.

(ii) Any amount received without consideration from any person or persons other than specified relatives, is an income assessable under the head "income from other sources" under section 56(2)(vii), if such amount exceeds ₹ 50,000. As the aggregate amount received as gift from six friends exceeds ₹ 50,000, the amount ₹ 60,000 is taxable under section 56(2)(vii).

(iii) As per section 56(2)(vii) any immovable property received as capital asset is chargeable to tax under the head "income from other sources" if the value assessed by the Stamp Valuation Authority exceeds ₹ 50,000.Hence, the value of land i.e. ₹ 5 lacs is taxable in the hands of Ramesh.

(iv) As per section 56(2)(vii)even if asset is received for inadequate consideration it is taxable in the hands of the recipient, if the difference between fair market value and the amount of consideration exceeds ₹ 50,000. Hence ₹ 70,000 is taxable in the hands of Pramod under the head "income from other sources".

4. (b) As per section 2(22)(e) where a shareholder of a closely held company having 10% or more voting rights in the company, obtains loan or advance from such company, the amount of loan or advance to the extent of accumulated profit of the company shall be deemed to be dividend.

Therefore, the amount of loan to the extent of ₹ 1.75 lacs shall be deemed to be dividend in the hands of Sanjoy.

Sanjoy cannot claim exemption under section 10(34), as the company is not required to pay dividend distribution tax on the amount of deemed dividend.

Further, the company is liable to deduct tax at source under section 194 at 10%.

4. (c) Computation of Total Income of Ameet for Assessment Year 2013 - 2014

Particulars	**₹ in lacs.**
Profit from trading business	6
Less: Set- off of loss from manufacturing business and loss from profession under section 70	4
	2
Profit from speculation in shares	2.5
Less: Set- off of loss from speculation in commodities to the extent possible under section 73	2.5
	NIL
Total Income	2

Unabsorbed loss of ₹ 0.50 lacs from speculation in commodities can be carried forward by Ameet for four assessment years.

5. (a) Raja joined TCI Limited on 1st June, 2012. Emoluments paid and benefits allowed by the company to Raja are as follows:

Particulars	**₹**
Basic Salary	**40,000 p.m.**
Dearness Allowance	**15,000 p.m.**
Incentive	**30,000 p.m.**
A furnished accommodation at Mumbai belonging to the company is provided free. Cost of furniture therein ₹ 3,00,000	
Motor car (with engine cc less than 1.6 litres) owned by the company along with a chauffeur for official and personal purposes	
Salary of sweeper paid by the company	**1,000 p.m.**
Education provided for Raja's son without any fees. Cost of providing education by the school is	**750 p.m.**
Admission fee for corporate membership of a club paid by the company. Bills for club facilities were paid by Raja.	**1,20,000**
House building loan of ₹ 10,00,000 was given by the company to Raja on 1st December, 2012 at interest rate of 5% p.a. No repayment was made during the year.	

Compute the income of Raja Chargeable under the head "Salaries". 7

(b) Manmohan owns a tea estate in Assam. He also owns a nursery wherein he grows plants and sells them. He furnishes the following particulars:

Particulars	₹
(i) Profit from sale of green tea leaves	**1,75,000**
(ii) Profit from manufacturing of tea grown in the garden owned by him	**7,00,000**
(iii) Profit from sale of plants from nursery	**1,00,000**

Compute tax payable by Manmohan for the Assessment Year 2013-14. **6**

Answer:

5. (a) **Assessee: Mr. Raja** **Assessment Year: 2013-14**

Computation of Income from Salary

Particulars	Amount (₹)
Basic Pay (₹ 40,000 x 10 months)	4,00,000
Add: Dearness Allowance (₹ 15,000 x 10 months)	1,50,000
Add: Bonus (₹ 30,000 x 10 months)	3,00,000
Add: Taxable Value of Perquisite related to: -	
furnished accommodation (Note 1)	1,52,500
motor car provided by employer (₹ 1,800 + ₹ 900) x 10 months)	27,000
salary of sweeper - ₹ 1,000 x 10 months	10,000
educational facilities - Note 2	Nil
value of concessional housing loan - Note 3	19,167
corporate Membership Fees – Note 4	Nil
Gross Income from Salary	**8,80,158**

Note 1: Salary for the purpose of computing taxable value of furnished accommodation:

Particulars	Amount (₹)
Basic Salary	4,00,000
Dearness Allowance	1,50,000
Bonus	3,00,000
	8,50,000

Assuming, Mr. Raja stays in a city where population is more than 25,00,000 as per 2001 census, value of unfurnished accommodation = 15% of salary

= 15% of ₹ 8,50,000

= ₹ 1,27,500

Value of furniture provided = 10% p.a. of actual cost

= 10% of ₹ 3,00,000 × 10/12

= ₹ 25,000

(Assuming, value of furniture given in the problem represents actual cost.)

Note 2: Computation of taxable value of perquisite – related to educational facility.

Since tuition fee per month is less than ₹ 1,000.

Amount of perquisite = Nil

Note 3: Computation of taxable value of perquisite – related to interest free housing loan.

Value of Perquisite = Interest @ 10% p.a. less Actual interest charged

= (10.75% - 5%) x ₹ 10,00,000 x 4/12 = ₹ 19,167

Note 4: Corporate membership fees of a club are for the business of the employer of the assessee, will not be treated as perquisite in the hand of employee.

5. (b) In the case of nursery plant, question is silent about whether sapling or seedling process activity has been undertaken or not. So, it is required as per the question that answer should be in both alternatives. Because if sapling or seedling process has been undertaken then it is agricultural Income otherwise not.

Alternative - 1

Computation of Taxable Income for the Assessment Year 2013-14

Nature of Business	Agl Inc.	Non-Agl. Inc.
Profit from sale of green leaves grown in own garden being agricultural Income is exempted under section 10(1)	1,75,000	-
Profit from growing and manufacturing of tea (60% agricultural income and 40% non-agricultural income)	4,20,000	2,80,000
Profit from sale of plants from nursery (agricultural income)	1,00,000	-
Total Income	**6,95,000**	**2,80,000**

Computation of Tax Liability:

	₹
(a) Total Income (Agricultural Income + Non-agricultural Income)	9,75,000
(b) Tax on (a) above	1,25,000
(c) Total of (Agricultural Income + Basic Exemption Limit)	8,95,000
(d) Tax on (c) above	1,09,000
(e) Tax Payable (b) – (d)	16,000
Add: Education Cess @ 2%	320
Add: SHEC @ 1%	160
Total Tax Liability	16,480

Note- It is assumed that sapling & seedling process has been undertaken for nursery plant.

Alternative – 2

Computation of Taxable Income for the Assessment Year 2013-14

Nature of Business	Agl Inc.	Non-Agl. Inc.
Profit from sale of green leaves grown in own garden being agricultural Income is exempted under section 10(1)	1,75,000	-
Profit from growing and manufacturing of tea (60% agricultural income and 40% non-agricultural income)	4,20,000	2,80,000
Profit from sale of plants from nursery (non-agricultural income)	-	1,00,000
Total Income	**5,95,000**	**3,80,000**

Computation of Tax Liability:

	₹
(a) Total Income (Agricultural Income + Non-agricultural Income)	9,75,000
(b) Tax on (a) above	1,25,000
(c) Total of (Agricultural Income + Basic Exemption Limit)	7,95,000
(d) Tax on (c) above	89,000
(e) Tax Payable (b) – (d)	36,000
Add: Education Cess @ 2%	720
Add: SHEC @ 1%	360
Total Tax Liability	37,080

Note - It is assumed that sapling & seedling process has not been undertaken for nursery plant.

6. (a) **State the conditions to be fulfilled for deduction in respect of write off of bad debt.** **3**

(b) **Manoj gifted ₹ 3,00,000 to his wife on 01.07.2012, which she invested in her beauty parlour business. The capital of Mrs. Manoj as on 01.04.2012 was ₹ 6,00,000. The profit for the year ended 31.03.2013 (computed) from business amounts to ₹ 2,40,000.**
The total income of Manoj (before clubbing) who is employed in a company amounts to ₹ 4,50,000 (computed).

Determine the income liable for clubbing in the hands of Mr. Manoj out of the incomes earned by Mrs. Manoj during the financial year 2012-13. **3**

(c) **Compute the quantum of deduction under section 80C for Mr. Niraj for the assessment year 2013-14.** **3**

Particulars	₹
Life Insurance premium	
-Own—Capital sum assured 2,00,000 (being the first premium paid)	25,000
-Brother's life-dependent on Niraj	10,000
-Major son-doing business	5,000
Contribution to recognized provident fund	15,000
Repayment of bank loan for purchase of residential apartment-let out	60,000
Tuition fees for M.Com (part-time) pursued by wife	12,000

(d) **Zoom Ltd. acquired a machinery from Japan on 17.08.2011 for $ 2,50,000.**
The eligible rate of depreciation is 15% and it is used regularly from 10.09.2011. The exchange rate at the time of acquisition was ₹ 50 per dollar and the company paid $ 1,50,000.
The balance payment to the supplier i.e. $ 1,00,000 was paid in September, 2012 when the exchange rate was ₹ 54 per dollar.
Compute depreciation for the assessment year 2013-14. Ignore additional depreciation. **4**

Answer:

6. (a) Section 36(1)(vii) says that any bad debt or part thereof which is written off as irrecoverable it is eligible for deduction if the following conditions are satisfied:

(i) The debt is incidental to the business;
(ii) It should have been taken into account in computing income of the assessee or it should represent money lent in the ordinary course of banking or money lending;
(iii) It should be written off in the books of account;
(iv) The business in respect of which the debt is incurred should be continued during the previous year; and
(v) The successor of a business is also entitled to claim deduction in respect of debt created by the predecessor.

6. (b) The gift was given by Manoj to his wife on 01.07.2012. Reference to Explanation 3 to section 64 must be made. As the opening capital as on 01.04.2012 belongs to Mrs. Manoj, Explanation 3 to section 64 cannot be invoked for the financial year 2012-13.

The opening capital as on 01.04.2012 wholly belonged to Mrs. Manoj and therefore in spite of the gift and its investment in business, no portion of such income would be liable for clubbing.

The total income of Mr. Manoj will not change in any manner by applying the clubbing provisions.

6. (c) **Computation of deduction U/s. 80C**

Particulars	₹
Life insurance premium	
- Own - capital sum assured ₹2,00,000 (being the first premium paid) - limited to 10%	20,000
- Brother's life - dependent on Niraj - not allowed	Nil
- Major son - doing business - allowed	5,000
Contribution to recognized provident fund - allowed	15,000
Repayment of loan for purchase of residential apartment -let out - allowed	60,000
Tuition fees for M.Com (part-time) pursued by wife - not allowed	Nil
Total amount eligible for deduction U/s. 80 C	**1,00,000**

6. (d) **Exchange fluctuation and depreciation**

Particulars	₹
17.08.2011 : Cost of acquisition \$ 2,50,000 X ₹ 50	1,25,00,000
Less: Depreciation for the financial year 2011-12 @ 15%	18,75,000
WDV as on 01- 04 - 2012	1,06,25,000
Add: Exchange fluctuation in September 2012	
\$ 1,00,000 X ₹ 4 each	4,00,000
Block value	1,10,25,000
Depreciation @ 15% for the financial year 2012-13	**16,53,750**

Section B
[Answer all the questions.]

7. State whether the following propositions are correct or not with brief reasons: 1 x 5 = 5

(i) Motor car held by an individual is liable for wealth tax.
(ii) Guest house located in remote area is also liable for wealth tax.
(iii) Urban land held as stock in trade for less than 6 years is exempt from wealth tax.
(iv) Gifted assets held by minor child (not being a child suffering from disability referred to in section 80U) is liable for clubbing with the total wealth of respective donors.
(v) Wealth tax cannot be levied on a co-operative society.

Answer:

7. (i) Yes. Motor car is an asset as per section 2(ea) of the Wealth Tax Act except motor car used by the assessee in the business of running them on hire and held as stock in trade.
(ii) Yes. Guest house is liable for wealth tax regardless of the distance from the local limits of municipality.
(iii) No. Urban land held as stock in trade is exempt from wealth tax for a period of 10 years from the date of its acquisition.
(iv) No. The net wealth of minor is to be clubbed with the net wealth of the parent whoever has more net wealth before such inclusion. It cannot be identified with donors.
(v) Yes. As per section 45 of the Wealth Tax Act no tax shall be levied in respect of the net wealth of any co-operative society.

8. **EITHER**

(a) The return of net wealth of Mr. B was filed in September 2013 for the assessment year 2013-14. A vacant urban land (assessable value ₹ 20 lakhs) was omitted to be disclosed in the return of net wealth. Is it possible to file a revised wealth tax return? If so, what is the time limit? What is the time limit for the Assessing Officer within which

notice is to be issued for assessing the wealth escaping assessment? 3

(b) Is an AOP with members shares being indeterminate be chargeable to wealth tax? 2

OR

(a) The return of net wealth of D (P) Ltd. disclosed net wealth of ₹ 80 lakhs. No advance wealth tax was paid. What is the due date for filing the wealth tax return? Assuming the return for the assessment year 2013-14 was filed in April, 2014. Calculate the interest payable under the Wealth Tax Act for delayed filing of return. 3

(b) Do you agree that the partnership firms are also liable for wealth tax? 2

Answer:

EITHER

8. (a) Yes, it is possible to revise the wealth tax return.

The time limit for revising the wealth tax return is one year from the end of the relevant assessment year or before the completion of assessment, whichever is earlier.

The time limit for assessing the escaped net wealth is 4 years from the end of the relevant assessment year without any approval. Where the assessment has been made the time limit is six years from the end of the relevant assessment year with the approval of Chief Commissioner or Commissioner or Deputy Commissioner.

8. (b) As per section 21AA where the association has chargeable assets and the shares of the members are indeterminate or unknown, the wealth tax shall be levied upon and recovered from such association in the like manner and to the same extent as it would be leviable upon and recoverable from an individual who is a citizen of India and resident in India for the purposes of this Act.

Therefore, the AOP would be liable to wealth tax like any other resident individual.

OR

8. (a) The due date for filing the wealth tax return is similar to the due date for filing the income tax return prescribed in section 139(1) i.e., 30th September 2012.

In the given case the return was filed in April 2014, the assessee D (P) Ltd must pay interest at 1% for every month or part of a month i.e. for 7 months.

Interest = [₹ 80 lakhs minus ₹ 30 lakhs] x 1%] x 1% x 7 = ₹ 3,500

8. (b) No. Partnership firms are not assessable entities under the Wealth Tax Act. However, the net wealth of the firm shall be computed and allocated amongst the partners for taxing the same in their personal assessment. Thus it is indirectly subjected to wealth tax.

Section C

(All questions in this section relate to the transfer pricing provisions under the Income-tax Act, 1961)

9. 1x5 = 5

(i) Who can apply for advance pricing agreement and state the time limit for its withdrawal?

(ii) State any two methods for determining arms length price.

(iii) State any two types of permanent establishments.

(iv) Can the data of earlier year of comparables be used for determination of ALP?

(v) Do you agree that arm's length price determination is applicable when Indian importer imports goods/services from related party at a price more than the price supplied to unrelated parties by a foreign company?

Answer:

(i) Any person who has undertaken an international transaction or who is contemplating to undertake an international transaction is eligible to apply for Advance Pricing Agreement (APA). The applicant may withdraw the application for agreement in Form No. 3CEE at any time before the finalisation of the terms of the agreement. The fee paid shall not be refunded on withdrawal of application by the applicant.

(ii) The methods given in section 92C are: (a) comparable uncontrolled price method (CUP); (b) resale price method; (c) cost plus method; (d) profits split method; (e) transaction net margin method.

(iii) There are three types of permanent establishments.

(a) Basic rule PE - a fixed place of business, office, branch, installation etc.

(b) Service PE - Presence of employees

(c) Agency PE - Presence of dependent agent.

(iv) Yes. The same can be used provided such data reveals facts which could have influence on the determination of the ALP under the transaction which is being compared.

(v) Yes. Arm's length price determination is applicable when Indian importer imports goods/services from related party at a price more than the price supplied to unrelated parties by a foreign company.

10. **EITHER**

(i) State four tests which are to be satisfied before an agreement could be called as "impermissible avoidance arrangement". 4

(ii) What is Berry ratio? Discuss its usefulness in computing ALP. 3

(iii) Narrate the procedures relating to pre-filing consultation of advance pricing agreement. 4

(iv) Can the application for advance pricing agreement be amended? If so, state the conditions. 3

(v) Brain Inc. London has 35% equity in Salem Ltd. The company Salem Ltd. is engaged in development of software and maintenance of customers across the globe, which includes Brain Inc.

During the year 2012-13, Salem Ltd. spent 2000 man hours for developing and maintaining a software for Brain Inc. and billed at ₹ 1000 per hour. The cost incurred for executing maintenance work to Brain Inc. for Salem Ltd. amounts to ₹ 15,00,000. Similar such work was done for unrelated party Try Ltd. in which the profit was at 50%.

Brain Inc. gives technical support to Salem Ltd. which can be valued at 8% of gross profit. There is no such functional relationship with Try Ltd.

Salem Ltd. gives credit period of 90 days the cost of which is 3% of the normal billing rate which is not given to other parties.

Compute ALP under cost plus method in the hands of Salem Ltd. and the impact of the same on the total income. 6

OR

(i) State any six filters which are used in computation of arm's length price. 6

(ii) Explain the term 'tested party'. 3

(iii) State possible cases in which Profit Split Method (PSM) is used for determination of

ALP. 4

(iv) What is cost cover ratio and return on assets ratio? 3

(v) A Co Ltd. of Chennai and Sky Inc. of Singapore are associate enterprises. A Co Ltd. imported 1000 television sets at ₹ 16,000 per set without any warranty period. A Co Ltd. also imports similar TV sets from unrelated party Sign Inc. of Japan. It is imported at ₹ 15,000 per set with warranty time of 2 years. The cost of warranty in respect of goods imported from Sky Inc. for a period of 2 years would cost ₹ 2,000.
Compute arm's length price and the amount of increase in total income of A Co Ltd. as per CUP method. 4

Answer:

Either

10. (i) An arrangement whose main purpose or one of the main purposes is to obtain tax benefit and which also satisfies at least one of the four tests, can be declared as "impermissible avoidance arrangement".

They are (a) arrangement creates rights and obligations which are not normally created between parties dealing at arm's length; (b) it results in misuse or abuse of provisions of tax laws; (c) It lacks commercial substance or is deemed to lack commercial substance; (d) it is carried out in a manner which is normally not employed for bona fide purpose.

(ii) Berry ratio is the ratio of gross profit to operating expenses. It measures the return on operating expenses. As the functions performed by the taxpayers are reflected in the operating expenses, this ratio determines the relationship of the income earned to the functions performed. This ratio helps in overcoming the difficulties in applying the RPM, which does not explain the creation of gross profit. This ratio is used in conducting an arm's length analysis of service oriented industry such as limited risk distributor, advertising, marketing and engineering service. Berry ratio may be used to test whether service providers have earned enough mark up on their operating expenses. In essence, the Berry ratio implicitly assumes that there is the relationship between the level of operating expenses and the level of gross profits earned by routine distributors and service provides.

(iii) Every person proposing to enter into APA must file an application in writing making a request for pre-filing consultation. On the receipt of request in Form No.3CEC, the team shall hold consultation with the person referred to in rule 10G (i.e. a person who has undertaken or contemplating to undertake international transaction).

The competent authority in India or his representative shall be associated in pre-filing consultation involving bilateral or multilateral agreement.

The pre-filing consultation shall include - (a) determining the scope of agreement; (b) identify transfer pricing issues; (c) determine the suitability of international transaction for the agreement; and (d) discuss the broad terms of the agreement.

The pre-consultation agreement will not bind the Board or the person to enter into an agreement or initiate the agreement process. It shall not be deemed to mean that the person has applied for entering into an agreement.

(iv) Yes. The applicant may request in writing for an amendment to the application at any stage before the finalization of the terms of the agreement.

The DGIT for unilateral agreement or the competent authority in India for bilateral or multilateral agreement may allow the amendment if it does not have the effect of altering the nature of application originally filed.

An amendment is possible only if it is accompanied by the additional fee, if any, necessitated by such amendment in accordance with rule 10 - I.

(v) **Salem Ltd**

Computation of ALP under Cost plus method

Particulars	₹
Normal gross profit mark up	50.00
Less: Adjustment for differences	
Technical support from Brain Inc.	8.00
	42.00
Add: Cost of credit to Brain Inc. 3% of normal bill (3% of 50)	1.50
Arm's length gross profit mark up	43.50
Cost of services provided to Brain Inc.	15,00,000
Arm's length billed value	
Cost / [(100 - arm's length markup)]	
= 15,00,000/ (100% -43.5)	26,54,867
Less: Billed amount	20,00,000
Increase in total income of Salem Ltd	6,54,867

OR

10. **(i)** (a) Turnover filter, (b) export filter, (c) related party filter, (d) employee cost filter, (e) fixed asset filter, (f) R&D expense filter; (g) Income-tax filter; (h) diminishing loss filter; (i) Different financial year filter; and (j) On site and off site filter.

(ii) As per OCED guidelines, a tested party is an enterprise that offers a high degree of comparability or would require lesser adjustment with uncontrolled companies. Consequently, the enterprise that requires the least amount of adjustments as compared to potentially comparable companies should be the tested party. Hence in most cases, the tested party will be the least complex of the controlled taxpayers and will not own valuable intangible property or unique assets that distinguish it from potential uncontrolled comparables.

(iii) In the following cases Profit Split Method (PSM) could be applied —

(a) Transactions involving transfer of unique intangibles.

(b) Multiple inter-related international transactions which cannot be evaluated separately for determining the ALP of any one transaction.

As per OCED guidelines, a transactional profit method that identifies the combined profit to be split between the associated enterprises from a controlled transaction is known as profits split method. The profits are split between the associated enterprises based upon an economically valid basis that approximates the division of profit that would have been anticipated and reflected in an agreement made at arm's length.

(iv) The cost cover ratio measures the ability of a company to cover its operating expenses through operating revenue. Given the limitation of financial information publicly available, the operating expenses of a selected comparable company are the sum of its operating revenue less EBIT.

Return on assets ratio measures, the amount of EBIT per rupee of asset invested. This is a profitability ratio for measuring each company's operational efficiency, i.e. how efficiently the assets have been deployed by the company.

(v) Determination of the ALP under CUP method

A Co. Ltd.

	Amount (₹)
Purchase price of television set per unit, from Sign Inc (unrelated party) including warranty cost for 2 years	15,000
Less: Adjustment for warranty cost to arrive at price without warranty cost	2,000
ALP	13,000
Purchase price of television set per unit, from Sky Inc., without warranty	16,000
Excess differential price per unit, liable for ALP adjustment	3,000
No. of television sets involved	1,000
Reduction in purchase price, having an impact of increasing the total income (₹ 3,000 x 1,000)	30,00,000