

## INTERMEDIATE EXAMINATION GROUP I (SYLLABUS 2012)

### SUGGESTED ANSWERS TO QUESTIONS DECEMBER 2015

#### Paper-7: DIRECT TAXATION

Time Allowed : 3 Hours

Full Marks : 100

*The figures in the margin on the right side indicate full marks.  
Wherever required, the candidate may make suitable assumption(s) and  
State the same clearly in the answer.*

*Working notes should form part of the relevant answer.  
All the questions relate to the Assessment Year 2015-16, unless stated otherwise.*

#### Section A

[Answer Question No. 1, which is compulsory and any four from Question Nos. 2 to 6]

1. Answer the following questions with brief reasons/workings: 2×10=20
- (a) Mr. Vishnu received ₹2,00,000 on 10th April, 2014 as advance from Mr. Ram in pursuance of an agreement to transfer a vacant land held as capital asset. The agreement was cancelled later. Mr. Vishnu retained 50% of the advance and refunded the balance to Mr. Ram. What is the tax implication in the hands of Mr. Vishnu?
- (b) Are profits on transfer of shares and securities held by a Foreign Institutional Investor chargeable to tax under the head "profits and gains of business or profession" or "capital gains"?
- (c) Mr. David, a citizen of Spain came to India for the first time in previous year 2010-11 and stayed for 100 days in that year. During the previous years 2011-12, 2012-13, 2013-14 and 2014-15 he stayed in India for 120 days, 110 days, 80 days and 90 days respectively. What is the residential status of Mr. David for the assessment year 2015-16?
- (d) Mr. G gifted a house property to his son, Mr. H (age 20 years) on 5th June, 2014. The property was acquired by Mr. G on 10th October, 2011. Mr. H held the property as capital asset and transferred the property on 20th October, 2014 for ₹ 20 lakhs. Is the capital gain short-term or long-term?

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- (e) A foreign company cannot approach Dispute Resolution Panel in respect of its assessment. Is this statement correct?
- (f) X. Limited is an Indian company. However, it carries on business in USA. All the shareholders are residents of USA. The Board meetings and Annual General Meetings are held outside India. What is the residential status of X. Limited?
- (g) The Statement of Profit and Loss of KCL Limited is debited by an amount of ₹ 1,20,000 in respect of an advertisement of company's product in a newspaper owned by a political party. Is such expense allowable in computation of income from business?
- (h) Interest of ₹ 15,000 on bank fixed deposits is received by the minor son of Ms. Santi. These fixed deposits were made by Ms. Santi out of her son's earnings from stage acting. What is the tax treatment of interest?
- (i) The Statement of Profit and Loss of a company includes interest of ₹ 5,00,000 on a loan taken for financing its expansion scheme. The machineries purchased with the borrowed amount were in transit at the end of the year. Is such interest allowable as deduction in computation of the company's business income?
- (j) Is a company liable to pay advance tax when it is required to pay tax on "book profit" under section 115JB?

**Answer:**

1. (a) As per section 56(2)(ix) read with section 2(24)(xvii) (both introduced by the Finance (No.2) Act, 2014), any sum received as advance or otherwise in the course of negotiations for transfer of a capital asset is chargeable to tax under the head "income from other sources", if the advance sum is forfeited and the negotiation does not result in transfer of such capital asset.

Thus, the amount retained by Vishnu is chargeable to tax under the head "income from other sources"

- (b) As per section 2(14) as amended by the Finance (No.2) Act, 2014 "capital asset" shall also mean any securities held by a Foreign Institutional Investor (FI) which has invested in such securities in accordance with regulations made under the Securities and Exchange Board of India Act.

Securities held by FIIs must be in accordance with regulations of SEBI. Even though they are held as stock in trade, they will be treated as capital asset and the gain or loss arising therefrom will be taxed as income under the head "capital gains".

- (c) During the previous year 2014-15 Mr. David stayed in India for less than 182 days and his aggregate stay in 4 preceding previous years were 410 days (100 + 120 + 110 + 80). As he has satisfied one of the basic conditions, he is a resident in India.

Further, he was non-resident in 9 out of 10 previous years preceding the previous year 2014-15 or stayed in India for less than **730** days in 7 previous years preceding the previous year 2014-15. Hence, his status is resident but not ordinary resident.

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## Alternate Answer

OR,

During the previous year 2014-15 Mr. David stayed in India for less than 182 days and his aggregate stay in 4 preceding previous years were 410 days (100+120+110+80). As he has satisfied one of the basic conditions, he is a resident in India.

But he has not satisfied any of the following additional conditions:

- (i) Resident in India for at least 2 years out of the preceding 10 Previous Years.
- (ii) Physically present in India for at least 730 days during the 7 preceding Previous Years.

Hence, his status is resident but not ordinary resident.

- (d) As per clause (b) of Explanation 1 to section 2(42A) where the capital asset becomes the property of the assessee in the circumstances mentioned in section 49(1), the period for which the asset was held by the previous owner shall be included in counting the period of holding. Section 49(1)(ii) covers cases where the capital asset became the property of the assessee under a gift or will.

As the property was originally acquired by Mr. G on 10.10.2011 and the transfer was made by his son on 20.10.2014, the resultant capital gain is a long-term capital gain in the hands of Mr. H.

- (e) Eligible assessee under section 144C(15) includes 'any foreign company'. Therefore, a foreign company, whether it has international transaction liable for transfer pricing adjustment or not, can approach the Dispute Resolution Panel under section 144C.
- (f) As per section 6(3), a company is said to be resident in India in any previous year if (i) it is an Indian Company, or (ii) In case of other company whose control and management of the affairs of the company is wholly in India.  
X Limited is an Indian Company. Therefore, X Limited is a resident in India even if the business is carried on outside India and the meeting of the board and shareholders are held outside India.
- (g) As per section 37(2B), no deduction is allowed in respect of expenditure incurred by an assessee on advertisement in any souvenir, brochure, tract, pamphlet or the like published by a political party. News paper published by a political party is not in the nature of any souvenir or brochure or tract or pamphlet or similar thing published by a political party. Therefore, expenses on advertisement in news paper of the political party are allowable as deduction.
- (h) As per section 64(1A), if income arises or accrues to a minor child on account of any manual work done by him or activity involving application of his skill, talent, or specialized knowledge and experience, such income is outside the scope of clubbing.

In this case, the earning of minor son from stage acting is not to be clubbed with the income of the parent. But interest on fixed deposit made out of such earning is not attributable to the stage acting of the minor. Hence, such interest is to be included in the total income of minor son's father or mother, whose total income before such inclusion is higher.

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- (i) Interest paid in respect of capital borrowed for the purpose of business or profession is admissible under section 36(1)(iii). However, as per the proviso to section 36(1)(iii) interest paid in respect of capital borrowed for acquiring an asset for extension of existing business or profession (whether capitalised in the books of account or not) for any period beginning from the date on which the capital was borrowed for acquisition of the asset till the date on which such asset was put to use shall not be allowed as deduction.

In the instant case, the machineries were not received till the end of the year and were in transit and accordingly, not put to use till the end of the year. Therefore, interest of ₹ 5,00,000 will not be allowed as deduction.

However, the cost of the asset shall be increased by the amount of interest of ₹5,00,000 and depreciation shall be admissible on the enhanced cost, once the asset is put to use.

- (j) According to section 207, tax is payable in advance during any financial year in respect of the total income of the assessee which would be chargeable to tax for the assessment year following that financial year.

Under section 115JB(1), where the tax payable on total income is less than 18.5% of "book profit" of a company, the "book profit" would be deemed to be the total income and tax would be payable at 18.5%.

Since in such cases, the book profit is deemed to be total income, tax shall be payable in advance as per the provisions of section 207 in respect of book profit also.

**It is also possible to give answer in the following manner.**

There is specific provision in section 115JB(5) providing that all other provisions of the Income-tax Act shall apply to every assessee, being a company mentioned in that section.

Section 115JB is a self-contained code pertaining to MAT and by virtue of sub-section (5) thereof, the liability for payment of advance tax would be attracted.

- 2. (a) MNO Ltd. commenced commercial production of its unit located in Special Economic Zone (SEZ) from 01.04.2006. It furnishes the following information for the year ended 31.03.2015:**

Particulars	₹ in lakhs
Total sales	100
Export sales	50
Profit earned	30

**Compute the deduction under section 10AA and income chargeable to tax for the assessment year 2015-16. Your computation must be supported by reasons. 4**

- (b) Mr. Sridhar an employee of XY Ltd. received ₹ 8 lakhs as leave salary on his retirement on 28.02.2015. Average salary drawn during last 10 months ₹ 35,000. Last drawn salary is ₹ 40,000. He rendered service of 24 years and 7 months. Leave taken while in**

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service 9 months. Leave entitlement as per employer's rules is 1½ months for each completed year of service. Calculate the taxable leave salary for the assessment year 2015-16. 4

- (c) ABC Private Limited allotted 10,000 shares of ₹ 10 each to Mr. A at ₹ 20 per share. The fair market value of the shares on the date of allotment was determined at ₹ 15 per share. Will such allotment have any tax implication in the hands of ABC (P) Ltd? What would be your answer in case the company is a listed company in Bombay Stock Exchange? If Mr. A is a non-resident, state the implication. 4
- (d) Explain the tax incidence in the case of a transfer of a let out property, which is not revocable during the life time of the transferee. 3

**Answer:**

2. (a) **Computation of income chargeable to tax in the case of MNO Ltd for the Assessment Year 2015-16**

Particulars	₹ in lakhs
Net Profit	30.00
Deduction under section 10AA: [ Export turnover X profit earned / total turnover ] X 50%	
[ 50 lakhs X 30 lakhs / 100 lakhs ] X 50% =	7.50
Income chargeable to tax	22.50

**Note:** Where the unit located in SEZ commences production or manufacturing articles or things or provides any service on or after 01.04.2005, it is eligible for deduction under section 10AA.

The quantum of deduction is 100% of the profits for the first 5 years and 50% of the profits for the next five years.

The unit of MNO Ltd was commenced from 01.04.2006 and the first five years have already expired. Hence it is eligible for 50% deduction for the next 5 consecutive assessment years. The assessment year 2015-16 falls within 10 years and hence the assessee is eligible for 50% of net profit by way of deduction under section 10AA.

2. (b) Taxable leave salary of Mr. Sridhar - Assessment Year 2015-16

Total leave eligible on the basis of one month for each year of completed service	24 months
Leave taken	9 months
Leave to his credit	15 months
Average of last 10 months salary	₹ 35,000

**Note:** The statutory limit is only one month salary for each completed year of service. Hence, 1.5 months entitlement will not have any implication.

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	₹	₹
Actual leave salary		8,00,000
Less: Exempt U/s. 10(10AA) to the least of the following		
(i) Cash equivalent of leave to the credit of the employee (₹ 35,000×15)	5,25,000	
(ii) 10 months salary (₹ 35,000 × 10)	3,50,000	
(iii) Monetary limit notified	3,00,000	
(iv) Actual leave salary	8,00,000	3,00,000
Taxable leave		5,00,000

2. (c) Where a company, not being a company in which the public are substantially interested, receives, in any previous year, from any person being a resident, any consideration for issue of shares that exceeds the face value of such shares, the aggregate consideration received for such shares as exceeds the fair market value of the shares chargeable to tax as income of the company under the head "Other Sources".

ABC (P) Ltd has received ₹ 5 per share more than the fair market value of the shares. The fair market value of the shares has been determined at ₹15 per share. The amount chargeable to tax in the hands of the company would be ₹ 5 X 10,000 shares = ₹ 50,000.

In case the company is one in which public are substantially interested, section 56(2)(viib) will not apply. The receipt of amount on allotment of shares exceeding the face value and fair market value will not have any tax implication in the hands of company.

In case Mr. A is a non-resident, the provisions of section 56(2)(viib) will not apply and the excess amount received by ABC (P) Ltd will not be chargeable to tax.

2. (d) As per section 61, any income arising by virtue of a revocable transfer shall be included in the total income of the transferor.

However, section 62 says that section 61 will not apply in respect of any income arising by virtue of a transfer which is not revocable during the life time of the transferee. Thus when the income arises to the transferee by virtue of a transfer which is not revocable during his life time, section 61 will not apply.

Thus the property income is chargeable to tax in the hands of transferee and. not in the hands of the transferor.

- 3. (a) Mr. Shiva (age 62) having 4 heavy goods vehicles and 3 non-heavy goods vehicles wants to show the income chargeable to tax on presumptive basis. During the year 2014-15, he received interest on enhanced compensation of ₹ 5 lakhs relating to compulsory acquisition of land (made in the year 1991). He borrowed ₹ 3 lakhs for renovation of a let out property from which he earned rental income of ₹ 10,000 per**

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month. Interest on borrowal for house renovation for the year is ₹ 42,000. Compute his total income and income tax liability for the assessment year 2015-16. 5

(b) Mr. Harbhajan employed in Gama Ltd. furnishes you the following information for the year ended 31.03,2015:

(i) Basic salary upto 31.12.2014 ₹ 60,000 per month.

(ii) Basic salary from 01.01.2015 ₹ 70,000 per month.

Note: Salary is due and paid on the last day of every month.

(iii) Dearness Allowance @ 40% of basic salary.

(iv) Bonus equal to one month salary paid in February 2015 on basic salary and DA applicable for that month.

(v) Employer's contribution to Provident Fund account of the employee at 15% of basic salary.

(vi) Profession tax paid ₹ 5,000 of which ₹ 2,000 was paid by employer.

(vii) Facility of laptop and computer was provided to Harbhajan both for official and personal use. Cost of laptop ₹ 35,000 and computer ₹ 25,000 acquired by the company on 01.01.2015.

(viii) A motor car owned by the employer is provided to the employee meant for both official and personal use from 01.12.2014. Running expenses fully met by the employer which amounts to ₹ 35,000. The motor car (cubic capacity of engine exceeds 1.6 litres) was self driven by Mr. Harbhajan.

Compute the salary income chargeable to tax in the hands of Mr. Harbhajan for the assessment year 2015-16. 7

(c) State the scope of and time limit for rectification of order passed by the Assessing Officer under the Income-tax Act. 3

**Answer:**

3. (a) **Computation of total income of Mr. Shiva for the Assessment Year 2015-16**

Particulars		₹	₹
Income from house property:			
Rental income		1,20,000	
Less: Deduction U/s 24 @ 30%	36,000		
Interest on monies borrowed for renovation	30,000		
		66,000	
Income from house property			54,000
Income from business			
Presumptive income u/s 44AE @ ₹ 7500 × 7 × 12			6,30,000
Other Sources:			
Interest on enhanced compensation		5,00,000	
Less: Deduction U/s 57(iv) @ 50%		2,50,000	

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			2,50,000
Total Income			9,34,000
Income tax on ₹ 9,34,000			1,06,800
Add: Cess @ 3%			3,204
Total tax liability			1,10,004

3. (b) Computation of income from salaries of Mr. Harbhajan for Assessment year 2015 – 2016

Particulars	₹	₹
Basic salary (60,000 × 9) + (70,000 × 3)		7,50,000
Dearness allowance 40% of ₹7,50,000		3,00,000
Bonus (₹70,000 + 40% thereon)		98,000
Employers contribution to PF @ 15%	1,12,500	
Less: Exempt @ 12% of ₹7,50,000	90,000	
		22,500
Profession tax paid by employer		2,000
Laptop and computer provided by the employer – exempt		Nil
Motor car (cubic capacity of engine more than 1.6 litres) ₹2,400 for 4 months		9,600
Gross salary		11,82,100
Less: Profession tax paid U/s.16(2)		5,000
<b>Taxable Salary</b>		<b>11,77,100</b>

3. (c) An income tax authority with a view to rectifying any mistake apparent from the record may pass an order of rectification. The order of rectification shall be to -
- amend any order passed by it under the provisions of this Act ;
  - amend any intimation or deemed intimation under sub-section (1) of section 143;
  - amend any intimation under sub-section (1) of section 200A.

The time limit for passing an order of rectification under section 154 shall be made within four years from the end of the financial year in which the order sought to be amended was passed.

4. (a) State the circumstances under which the Assessing Officer may refer the valuation of capital asset to the Valuation Officer. 4

(b) The Statement of Profit and Loss of XYZ Limited for the previous year 2014-15 shows a net profit of ₹ 8,50,390 after debiting/crediting the following items:

- Purchase of goods for ₹ 42,000 (market value ₹ 35,000) from one of the directors of the company.
- Interest of ₹ 1,00,000 paid on loan taken from Mr. Ron of USA without deducting tax at source.

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- (iii) Advance of ₹ 90,000 paid in earlier year for purchase of machinery written off.
- (iv) Income tax on perquisites of employees paid by the company ₹ 20,000.
- (v) Recovery of bad debt of ₹ 30,000 which was disallowed in previous assessment of the company.

Compute income of XYZ Limited under the head “profits and gains of business or profession” for Assessment Year 2015-16 indicating reasons for treatment of each item.

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- (c) Mr. Suresh Raina sold a residential building for ₹ 75,00,000 on 1st July, 2014. It was acquired for ₹ 22,04,000 on 1st June, 2007. The stamp duty valuation of the property at the time of acquisition was ₹ 25,00,000 and at the time of transfer was ₹ 85,00,000. He paid brokerage at 1% at the time of transfer. He deposited ₹ 40,00,000 in bonds of Rural Electrification Corporation Ltd. in March, 2015 and deployed the balance in a business commenced by him. He has business loss of ₹ 5,00,000 for the year ended 31st March, 2015. Compute total income of Mr. Suresh Raina and advise by what date he must file his return of income.

Cost inflation index- F.Y. 2007-08; F. Y. 2014-15: 1024

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**Answer:**

4. (a) Under section 55A, with a view to ascertaining the fair market value of a capital asset for the purposes of computation of capital gain, the Assessing Officer may refer the valuation of capital asset to a Valuation Officer in the following circumstances—
- (a) Where the value of the asset as claimed by the assessee is in accordance with the estimate made by a registered valuer, if the Assessing Officer is of opinion that the value so claimed is at variance with its fair market value;
  - (b) in any other case, if the Assessing Officer is of opinion that—
    - (i) the fair market value of the asset exceeds the value of the asset as claimed by the assessee by more than 15 per cent **and** ₹ 25,000; or
    - (ii) having regard to the nature of the asset and other relevant circumstances, it is necessary so to do.
4. (b)

### Computation of income of XYZ Limited under the head “profits and gains of business or profession” for Assessment Year 2015-16

Particulars	₹	₹
Net profit as per Statement of Profit and Loss		8,50,000
Add: Disallowance of excess amount paid to director for purchase of goods (note 1)	7,000	
Disallowance of interest on loan paid to non-resident without deduction of tax at source (note 2)	1,00,000	
Disallowance of advance for purchase of machinery written off (note 3)	90,000	
Disallowance of income tax on non-monetary		

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perquisites of employees (note 4)	20,000	2,17,000
Less: recovery of bad debts disallowed in earlier assessment year (note 5)		10,67,390 30,000
Profits and gains of business or profession		10,37,390

**Notes:**

1. Purchase of goods for which payment has been made to director, an interested person referred to in section 40A(2) is disallowed to the extent such payment exceeds the fair market value of goods. Therefore, amount of ₹ 7,000 is disallowed under section 40A(2).
  2. Interest paid to non-resident without deduction of tax at source is fully disallowed under section 40(a)(i).
  3. Loss due to non-recovery of advance paid for purchase of machinery (i.e. capital advance) is loss of capital nature and hence, write off of such advance is disallowed.
  4. Income tax paid on non-monetary perquisites of employees is disallowed under section 40(a)(v)
  5. Since the amount of bad debt was disallowed in earlier assessment year, recovery of such debt in previous year 2014-15 shall not be deemed as income under section 41(4). As the amount has been credited to the Statement of Profit & loss, the same is reduced in computation of business income.
4. (c)

Computation of total income of Mr. Suresh Raina for the assessment year 2015-16

Particulars	₹	₹
Income from business		(5,00,000)
Capital gains		
Sale consideration	85,00,000	
Less: Brokerage @1% on ₹ 75 lakhs	75,000	
	84,25,000	
Less: Indexed cost of acquisition 22,04,000 × 1024/551*	40,96,000	
Long term capital gain	43,29,000	
Less: Deduction U/s. 54EC	40,00,000	
		3,29,000
Total Income		(1,71,000)

**Note:** In order to carry forward the business loss, Mr. Suresh Raina must file the return of income before the due date specified in section 139(1) of the Act.

\*This steps involves single calculation. Hence, if any candidate uses any other cost inflation factor, full credit should be given for the step, even though the consequential figures are different.

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5. (a) Raja is the owner of a residential house property having two independent floors of equal size in Chennai. The ground floor of the property has been let out to a tenant at rent of ₹ 15,000 per month from 1<sup>st</sup> June, 2014. The first floor of the property is occupied by Raja for his residential purpose.

Other particulars relating to the property are as follows:

Particulars	₹
Standard Rent	3,20,000 p.a.
Municipal valuation	3,80,000 p.a.
Fair rent	3,70,000 p.a.
Annual municipal tax (50% paid)	57,000
Interest on loan taken for construction of property for the year 2014-15	30,000
Annual insurance premium	5,000

Compute income from house property of Raja for the Assessment Year 2015-16. 7

- (b) Mumbai People Co-operative Society has derived the following income during the previous year 2014-15:

	₹
Income from processing, with the aid of power, of agricultural produce of its members	40,000
Income from collective disposal of labour of its members	65,000
Interest from another co-operative society	30,000
Income from House Property	80,000
Income from other business	61,000

Determine the total income of Mumbai People Co-operative Society for Assessment Year 2015-16. 6

- (c) Ms. Priya has kept a fixed deposit of ₹ 10 lakhs with State Bank of India on which she received interest of ₹ 80,000. Subsequently she borrowed ₹ 5 lakhs from the same bank on the security of the fixed deposit. Interest paid on such loan is ₹ 50,000. She offered interest income of ₹ 30,000 (after adjustment of interest paid ₹ 50,000). Is she correct? 2

Answer:

5. (a)

**Computation of income from house property of Raja for Assessment Year 2015-16**

Particulars	₹	₹
First floor (rented) (50% of total area)		
Municipal value (₹ 3,80,000 x 50%)	1,90,000	
Fair rent (₹ 3,70,000 x 50%)	1,85,000	
Standard rent (₹ 3,20,000 x 50%)	1,60,000	
Expected rent is the higher of municipal value and fair rent, but restricted to standard rent	1,60,000	
Rent receivable for the whole year (₹ 15,000 × 12)	1,80,000	
Actual rent received due to vacancy (₹ 1,80,000 - ₹ 30,000)	1,50,000	

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Owing to vacancy the actual rent received is less than expected rent. Therefore, the actual rent received is the Gross Annual Value		
Gross Annual Value		1,50,000
Less: Municipal tax – actually paid (₹ 57,000 x 50% x 50%)		14,250
Net Annual value		1,35,750
Less: deductions under section 24		
30% of net annual value	40,725	
Interest on loan (₹ 30,000 x 50%)	15,000	
		55,725
Taxable income from 1 <sup>st</sup> floor		80,025
Ground floor (self-occupied) (50% of total area) Annual Value	Nil	
Less: Deduction under section 24 in respect of interest on loan (₹30,000 x 50%)	15,000	(15,000)
Income from house property		65,025

**Note:** No deduction is admissible in respect of insurance premium

5. (b)

### Computation of total income of Mumbai People Co-operative Society for Assessment Year 2015-16

Particulars	₹	₹
Income from house property		80,000
<b>Business Income</b>		
Income from processing of agricultural produce with the aid of power	40,000	
Income from collective disposal of labour	65,000	
Income from other business	61,000	
		1,66,000
<b>Income from other sources</b>		
Interest from other co-operative society		30,000
Gross Total Income		2,76,000
Less: <u>Deduction under section 80P in respect of</u>		
Interest from other co-operative society-sec. 80P(2)(d)	30,000	
Collective disposal of labour-sec. 80P(2)(a)(vi)	65,000	
Other business income-sec 80P(2)(c)	50,000	1,45,000
Total Income		1,31,000

5. (c) As per section 57, any expenditure (not being capital expenditure) incurred to earn income chargeable under the head "income from other sources" shall be allowed as deduction against such income.

Interest on fixed deposit with SBI is the income in the hands of Ms. Priya. Interest on loan taken from bank on security of such fixed deposit is not an expenditure incurred to earn interest on fixed deposit. Therefore, in the given case, interest of ₹ 50,000 paid by her is not allowable as deduction and the entire interest income of ₹ 80,000 is taxable in her hands.

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6. (a) Raj Industries Ltd. furnishes you the following information for the year ended 31.03.2015:

- (i) Net Profit as per Statement of Profit and Loss ₹ 16,00,000.
- (ii) Provision for warranties to customers Statement of Profit and Loss ₹ 2,00,000.
- (iii) Wealth tax paid debited to Statement of Profit and Loss ₹ 30,000.
- (iv) Agricultural income credited to Statement of Profit and Loss ₹ 1,00,000.
- (v) Deferred tax credited to Statement of Profit and Loss account ₹ 4,00,000.
- (vi) The company has as per books: Brought forward depreciation of ₹ 2,50,000 and Business loss of ₹ 3,00,000.

Compute "book profit" under section 115JB for the assessment year 2014-15. 6

(b) Mr. Vignesh and his wife Smt. Buddhi furnish the following information for the year ended 31.03.2015:

Particulars	₹
(i) Salary income (computed) of Smt. Buddhi	5,50,000
(ii) Income of minor son Brijesh who suffers from disability specified in section 80U	1,50,000
(iii) Income of minor daughter Chitra from singing	85,000
(iv) Income from business (computed) of Mr. Vignesh	4,00,000
(v) Rental income from property earned by Smt. Buddhi during the year ₹ 4,80,000. The property was gifted by Vignesh 3 years ago out of love and affection.	
(vi) Income of minor daughter Chitra from company deposit	20,000

Compute the total income of Mr. Vignesh and Smt. Buddhi for the Assessment Year 2015-16. 5

(c) Mrs. Zeenat is running a proprietary business whose accounts are audited under section 44AB since her turnover always exceeded ₹ 100 lakhs. She pays a monthly rent of ₹ 13,000 for the office premises to Mr. Jack, the owner of the building, an individual. She also pays ₹ 10,000 per month to Mr. Jack for the use of furniture, fixtures and vacant land appurtenant to the building. Is she liable to deduct tax at source on these payments? If no tax is deducted at source, what would be the consequence? 4

**Answer:**

6. (a) A

### Computation of "Book Profit" of Raj Industries Ltd for Assessment Year 2015-16

Particulars	₹	₹
Net profit as per Statement of Profit and Loss		16,00,000
Add: provision for warranties to customers is an ascertained liability. Hence, no addition is required		Nil
Wealth tax is not to be added back. Only income tax paid/payable/provided is added back		Nil

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Less: Agricultural income being exempt is to be excluded	1,00,000	16,00,000
Deferred tax credit to be excluded	4,00,000	
Lower of brought forward loss or unabsorbed depreciation as per books is deductible	2,50,000	7,50,000
Book profit under section 115JB		8,50,000

6. (b)

### Computation of Total Income

		Mr. Vignesh	Smt. Buddhi
Salary income			5,50,000
Business income	—	4,00,000	—
Clubbing of Income: Rental income	4,80,000		
Less: Deduction U/s. 24	1,44,000		
		3,36,000	
Total income before clubbing		7,36,000	5,50,000
<b>Clubbing of minors income:</b>			
Minor son Brijesh, income not liable for clubbing as he suffers from the disability specified in section 80U			
Minor daughter Chitra from the activity of singing not liable for clubbing. Income from company deposit for minor daughter Chitra liable for clubbing. Since the total income before clubbing is more in the hands of Mr. Vignesh it is to be clubbed in his hands after allowing deduction of ₹1500 U/s. 10(32)		18,500	
Total Income		7,54,500	5,50,000

6. (c) Since Mrs. Zeenat an individual whose accounts are required to be audited under section 44AB for the immediately preceding financial year she has to deduct tax at source on the payments covered by Chapter XVII-B.

Section 194-I deals with tax deduction at source out of payment of rent towards the use of land or building together with furniture, fittings etc. Since the aggregate rental payment towards building and use of furniture etc being ₹ 2,76,000 exceeds the limit of ₹1,80,000, tax is deductible at source at 10% from the payments made to Mr. Jack.

Non-deduction of tax at source would attract disallowance under section 40(a)(ia) at 30% of the expenditure. The amount liable for disallowance would be 30% of ₹ 2,76,000 being ₹ 82,800. Further the penal consequences for non-deduction of tax at source would also be attracted.

If the payee has admitted the income and filed the return and gives the prescribed declaration to the payer i.e. Mrs. Zeenat, then the disallowance under section 40(a)(ia) will not apply.

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## Section B

### (International Taxation and Transfer Pricing)

Answer any two questions out of three questions.

7. (a) Explain 'associated enterprise' in the context of taxation of income. 3
- (b) State whether the following transactions are international transactions between associated enterprises: 3
- (i) A Co. Ltd. of Delhi has guaranteed a bank term loan of ₹ 25 crores (converted in Indian rupee) availed by Mckinsey Inc. of Hong Kong. The loan guaranteed is 11% of the total borrowings of Mckinsey Inc.
- (ii) Four partners of FA LLP of Mumbai are directors in Beta Co. Ltd. of UK. There are 9 directors in the governing board of Beta Co. Ltd. During the year FA LLP exported goods to Beta Co. Ltd. for ₹ 20 crores, which is 80% of its total turnover.
- (iii) Ramesh & Co. a partnership firm located in Bangalore is 100% dependent on raw materials supplied by Abdul LLP of Singapore. There is no other investment or financial interest between these two entities.
- (c) Richard Shipping Co. of Australia is engaged in shipping business. It received ₹ 600 lakhs towards carriage of goods from the port of Kolkata to Sydney during the year 2014-15. The net tonnage of the ship exceeded 25,000 and the total quantum of goods carried was 60,000 tonnes. The assessee wants to offer income on presumptive basis. Compute the income and state the procedure for tax compliance. 4
- Note:** Presumptive income for a qualifying ship exceeding 25,000 net tonnage is ₹ 11,770 plus ₹ 29 for each 100 tonnes exceeding 25 tonnes.

### Answer:

7. (a) An enterprise in relation to another enterprise shall be an associated enterprise -
- (i) which participates, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise; or
- (ii) in respect of which one or more persons who participate, directly or indirectly, or through one or more intermediaries, in its management or control or capital, or the same persons who participate, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise.
7. (b) (i) When one enterprise guarantees not less than 10% of the total borrowings of the other enterprise, they are deemed to be associated enterprises. Therefore the transaction is that of an international transaction between associated enterprises.
- (ii) When more than half of the directors of the governing board are common, they are said to be associated enterprises. In this case, 4 directors out of 9 directors of Beta Co Ltd are from FA LLP of Mumbai. Therefore, they are not associated enterprises in spite of huge export turnover effected by FA LLP of Mumbai.
- (iii) When one enterprise is dependent for 90% or more on another enterprise for raw materials and consumables, they are said to be associated enterprises regardless of the financial interest inter se between them.

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7. (c) Since the assessee is a non-resident, the provisions of Chapter XII-G relating to income of shipping companies based on tonnage capacity of ships cannot be applied. It is not a qualifying company as specified in section 115VC.

The assessee has to offer income under section 44B.

In the case of non-resident engaged in the business of operation of ships a sum equal to 7.5% of the amount received towards carriage of passengers, livestock, mail or goods shipped at any port in India is chargeable to tax.

In view of the above, the amount liable to tax under section 44B would be 7.5% of Rs.600 lakhs being ₹ 45 lakhs.

Before the departure of the ship from any port in India, the master of the ship must prepare and furnish to the Assessing Officer a return of the full amount paid or payable to the owner or charterer or any person on his behalf on account of the carriage of all passengers, livestock, mail or goods shipped at that port since the last arrival of the ship thereat.

8. (a) **LV Ltd., an Indian company supplied textile articles to its holding company BB Ltd., Spain during the year 2014-15. LV Ltd. also supplied the same product to another Spain based company VX Ltd., an unrelated party. During the year, it supplied 10,000 units to BB Ltd. at Euro 100 per unit. It supplied 4000 units to VX Ltd. at Euro 110 per unit. It gave 3 months credit time to BB Ltd. and whereas to VX Ltd. it supplied against payment i.e. no credit time was given. The cost of capital may be taken as 12% per annum. Compute the arm's length price for the transaction with BB Ltd. 1 Euro = ₹ 80. 4**
- (b) **What are the specified domestic transactions which are liable for transfer price adjustments? 4**
- (c) **A branch office of a foreign company in India has loss of ₹ 20 lakhs after charging head office expenses of ₹ 50 lakhs. Explain with reasons the amount of income chargeable to tax in the hands of the branch for the assessment year 2015-16. 2**

**Answer:**

8. (a) LV Ltd supplied goods to its foreign holding company BB Ltd at Euro 100 per unit with a credit time of 3 months. To the unrelated party VX Ltd it supplied at Euro 110 per unit with no credit time.

The cost of capital is given as 12% per annum which means 1% per month. The supply to unrelated party with no credit time and to the related party with 3 months credit period show that the cost of capital at 3% for the extended credit time of 3 months.

	In Euro
Price per unit supplied to related party	100
Add: Cost of capital for 3 months	3
Adjusted price per unit to the related party	103
Price charged to unrelated party	110
Under priced for related party	7
No. of units supplied 10,000 × 7 =	70000

Arms length price to related party to be adjusted 70000 × 80 = ₹ 56 lakhs

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8. (b) Section 92BA specifies the meaning of specified domestic transaction. The following transactions are specified domestic transactions covered for adjustments/consequences of sections 92, 92C, 92D and 92E, namely:—
- (i) any expenditure in respect of which payment has been made or is to be made to a person referred to in clause (b) of sub-section (2) of section 40A;
  - (ii) any transaction referred to in section 80A;
  - (iii) any transfer of goods or services referred to in sub-section (8) of section 80-IA;
  - (iv) any business transacted between the assessee and other person as referred to in sub-section (10) of section 80-IA;
  - (v) any transaction, referred to in any other section under Chapter VI-A or section 10AA, to which provisions of sub-section (8) or sub-section (10) of section 80-IA are applicable; or
  - (vi) any other transaction as may be prescribed,
- and where the aggregate of such transactions entered into by the assessee in the previous year exceeds a sum of five crore rupees.

8. (c) Section 44C restricts the quantum of expenditure relating to head office to the extent of the actual expenditure or 5% of the adjusted total income whichever is less.

The adjusted total income means the total income before deducting head office expenditure. The adjusted total income in this case is ₹ 30 lakhs ((₹ 20 lakhs) + ₹ 50 lakhs). The amount eligible for deduction under section 44C is 5% of ₹ 30 lakhs being ₹ 1.50 lakhs. Hence the total income liable to tax is ₹ 28.50 lakhs (₹ 30 lakhs less 5%).

9. (a) **When an advance pricing agreement may be declared void *ab initio*? What are the consequences in such situation?** **3**
- (b) **Write short note on Tax Residency Certificate (TRC).** **3**
- (c) **What are the objectives of a double taxation avoidance agreement?** **4**

## Answer:

9. (a) As per section 92CC(7), the CBDT may, with the approval of the Central Government, by an order declare an advance pricing agreement void *ab initio*, if it finds that the agreement has been obtained by the person by fraud or misrepresentation of facts. As per section 92CC(8) upon declaring the agreement void *ab initio*-
- (a) All the provisions of the Act shall apply to the person as if such agreement had never been entered into; and
  - (b) Notwithstanding anything contained in the Act, for the purpose of computing any period of limitation under the Act, the period beginning with the date of such agreement and ending on the date of order under section 92CC(7) shall be excluded.
9. (b) As per section 90 and section 90A, a non-resident assessee to whom double taxation avoidance agreement applies, shall be entitled to claim relief under such agreement, if he obtains a certificate of his being a resident (tax residency certificate) in any country outside India or specified territory outside India, as the case

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may be, from the Government of that country or specified territory. Thus, for availing benefit of DTAA tax residency certificate is required.

Tax residency certificate contains the following information:

- (i) Status of the assessee (individual, firm, company, etc.)
- (ii) Nationality (in case of individual), country or specified territory of incorporation or registration.
- (iii) Tax identification number in the country or specified territory of residence. If there is no such number, then a unique number on the basis of which the assessee claims to be a resident and the period for which residential status is applicable.
- (iv) Address of the assessee in the country or specified territory outside India.

9. (c) **Objectives of Double Taxation Avoidance Agreement:**

The Central Government may enter into an agreement with the Government of any country outside India or specified territory outside India,

- (a) for the granting of relief in respect of
  - (i) income on which have been paid both income-tax under this Act and income-tax in that country or specified territory, as the case may be, or
  - (ii) income-tax chargeable under this Act and under the corresponding law in force in that country or specified territory, as the case may be, to promote mutual economic relations, trade and investment, or
- (b) for the avoidance of double taxation of income under this Act and under the corresponding law in force in that country or specified territory, as the case may be, or
- (c) for exchange of information for the prevention of evasion or avoidance of income-tax chargeable under this Act or under the corresponding law in force in that country or specified territory, as the case may be, or investigation of cases of such evasion or avoidance, or
- (d) for recovery of income-tax under this Act and under the corresponding law in force in that country or specified territory, as the case may be, and may, by notification in the Official Gazette, make such provisions as may be necessary for implementing the agreement.