

Suggested Answer_Syl12_Dec2015_Paper 7

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 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. (a) In each of the cases given below, one out of four alternatives is correct. Indicate the correct answer (= 1 mark) and give your workings or reasons briefly in support of your answer (= 1 mark) 2×7=14
- (i) A company engaged in manufacturing activity acquires new Plant & Machinery (15% block) costing ` 15 lacs on 30th June, 2014. Depreciation admissible on such new Plant & Machinery in Assessment Year 2015-16 is:
(A) ` 5,25,000
(B) ` 4,50,000
(C) ` 5,00,000
(D) ` 2,25,000
- (ii) Banerjee & Company, Cost Accountants carried out cost audit of a company in financial year 2014-15 for a fee of ` 2,00,000 plus service tax at 12-36%. The amount of tax required to be deducted at source from such fee is
(A) ` 22,472
(B) ` 11,236
(C) ` 20,000
(D) ` 20,600
- (iii) Robin retired from service from MNO Limited after completing 24 years and 3 months. He received gratuity of ` 12,00,000 from the company. He is covered by the Payment of Gratuity Act, 1972. At the time of retirement his salary was ` 60,000 per month. The amount of gratuity taxable in the hands of Robin is
(A) Nil
(B) ` 2,00,000
(C) ` 1,69,230
(D) ` 3,69,231
- (iv) VKS Private Limited issued 15,000 equity shares of ` 10 each at a premium of ` 90 per share on 1st April, 2014 to persons who are resident, when the fair market value was ` 80 per share. Income taxable in the hands of the company is

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- (A) Nil, as it is a capital receipt
- (B) ` 1,50,000
- (C) ` 3,00,000
- (D) ` 13,50,000

(v) A partnership firm has incurred capital expenditure of ` 5 lacs on promotion of family planning among its employees in financial year 2014-15. The amount deductible in computation of its business income for Assessment Year 2015-16 is

- (A) Nil
- (B) ` 1 lac
- (C) ` 5 lacs
- (D) ` 2.50 lacs

(vi) Sridhar has paid premium of ` 30,000 by cheque towards mediclaim insurance of his father who is aged 85 years and not dependent on him in financial year 2014-15. The amount deductible under section 80D from his gross total income is

- (A) Nil
- (B) ` 30,000
- (C) ` 15,000
- (D) ` 20,000

(vii) Madhusudan, whose total income was ` 7 lacs consisting of salary income and income from other sources for Assessment Year 2013-14 filed his return of income on 3rd May, 2015. The return so filed by him is

- (A) a valid return.
- (B) belated return.
- (C) invalid return.
- (D) defective return.

(b) State whether the following statements are true or false (= 1 mark) with brief reason (=1) 2x3=6

- (i) Income from agricultural operation carried out in Bangladesh by a person resident in India is exempted from tax under section 10(1).
- (ii) Provision for doubtful debts is not deductible in computation of "book profit" under section 115 JB for the purpose of computing minimum alternate tax of a company.
- (iii) Royalty received by a foreign company outside India for use of its patents in business operation of an Indian company in India is not liable to tax in India.

Answer:

1. (a)

(i)	A. ` 5,25,000 Normal depreciation: ` 15,00,000 x 15% i.e. ` 2,25,000 + Additional depreciation: ` 15,00,000 x 20% i.e., ` 3,00,000 = ` 5,25,000
(ii)	C. ` 20,000 Tax is required to be deducted at source under section 194J at 10% of the amount of fee without including service tax
(iii)	D. ` 3,69,231 Under section 10(10), least of the following amounts would be exempt out of ` 12,00,000: (i) ` 10,00,000 (ii) ` 12,00,000 (iii) $15/26 \times ` 60,000 \times 24 = ` 8,30,769$ So, the amount taxable = ` 12,00,000 - ` 8,30,769 = ` 3,69,231

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(iv)	C. ` 3,00,000 As VKS Private Ltd is not a company in which public are substantially interested and it issued shares at a premium to persons resident and the aggregate consideration has exceeded the fair market value, such excess is taxable in the hands of the company under section 56(2)(viiib). Therefore, the amount taxable = 15,000 x (`100 - `80) = ` 3,00,000
(v)	A. Nil Deduction under section 36(1)(ix) for expenditure on promotion of family planning among employees is allowed to company only.
(vi)	D. ` 20,000 Medical insurance premium for father who is senior citizen and not dependent on Sridhar is deductible under section 80D for maximum amount of ` 20,000
(vii)	C. Invalid return As per section 139(4) belated return of Income can be filed before expiry of one year from the end of the assessment year or before completion of assessment, whichever is earlier. Time limit for filing belated return for assessment year 2013-14 expired on 31-03-15. Therefore, the return filed on 03-05-2015 is invalid return.

(b)

(i)	False. As per section 10(1), income from agricultural operation is exempted, if such agricultural operation is carried on in India.
(ii)	True. Under section 115JB, amount set aside as provision for doubtful debt is not deductible in computing minimum alternate tax of a company.
(iii)	False. As per section 9(l)(vi), income by way of royalty payable by a person resident in India for use of patent developed by the payee is deemed to accrue or arise in India if the patent is used for the purposes of business or profession in India. In this case the patent has been used for business operation of the Indian company.

2. (a) Mr. Balaji is engaged in the business of production and sale of computer chips since 1st April, 2013. His unit for production is located in Special Economic Zone. He submits the following particulars relating to previous year 2014-15:

Particulars	`
Domestic turnover	25,00,000
Export turnover	75,00,000
Profit of the business as per Profit & Loss Account (after charging depreciation of ` 4,50,000)	15,00,000

Mr. Balaji charges depreciation at 10% on straight line method on plant & machinery acquired in April, 2013. No plant and machinery was acquired in the previous year 2014-15.

Compute total income of Mr. Balaji for the Assessment Year 2015-16. Ignore provision relating to alternate minimum tax. 5

- (b) Mr. Girish is a manager of CNK Limited. The particulars of emoluments and benefits received by him from the employer during the previous year 2014-15 are as follows:

Particulars	`
Basic Salary: up to 30th June, 2014	30,000 p.m.
From 1st July, 2014	35,000 p.m.
Dearness allowance (forming part of salary for retirement benefits)	1,20,000

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Transport allowance	2,000 p.m.
Children education allowance	400 per month for three children
Tiffin allowance (actual expenses incurred ` 4,000 p.m.)	5,000 p.m.
Reimbursement of medical expenses for self and family	25,000
Tax on employment paid by the employer	3,000
Contribution to recognized provident fund	15% of salary

Compute income of Mr. Girish under the head "salary" for Assessment Year 2015-16. 7

- (c) Kandarp, a citizen of India left India on 20-09-2014 for taking up an employment with a company in Japan. He never left India before. What is the residential status of Kandarp for Assessment Year 2015-16? 3

Answer:

2. (a)

Computation of total income of Mr. Balaji for Assessment Year 2015-16

Particulars	`
Profits and gains of business or profession	
Profit as per Profit & Loss Account	15,00,000
Add: Depreciation charged to Profit & Loss Account	4,50,000
	19,50,000
Less: Depreciation as per Income-tax Act (Note 1)	5,73,750
Profit for the year	13,76,250
Less: Deduction under section 10AA in respect of profit from export in SEZ	10,32,188
Total Income	3,44,062

Note: 1

Particulars	`
Cost of plant & machinery : ` 4,50,000 x 100 / 10	45,00,000
Depreciation as per Income-tax Act for previous year 2013-14 at 15%	6,75,000
Written down value as on 1st April, 2014	38,25,000
Depreciation under Income-tax Act for previous year 2014-15 at 15%	5,73,750

Note: 2

Deduction under section 10AA = Profit of business x export turnover of the undertaking / total turnover of the undertaking = ` 13,76,250 x 75,00,000 / 1,00,00,000 = ` 10,32,188

(b)

Computation of income of Mr. Girish under the head "salary" for Assessment Year 2015-16.

Particulars	`	`
Basic salary [(` 30,000 x 3) + (` 35,000 x 9)]		4,05,000
Dearness allowance		1,20,000
Transport allowance (` 2,000 x 12)	24,000	
Less: Exempt under section 10(14) (` 800 x 12)	9,600	14,400
Children education allowance (` 400 x 3 x 12)	14,400	
Less: Exempt under section 10(14) (for maximum 2 children) (` 100x2x12)	2,400	12,000
Tiffin allowance (no exemption is allowed) (` 5,000 x 12)		60,000
Reimbursement of medical expenses for self and family	25,000	

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Less: Exemption	15,000	10,000
Tax on employment paid by the employer		3,000
Contribution to provident fund in excess of 12% of salary [3% of (` 4,05,000 + ` 1,20,000)]		15,750
		6,40,150
Less: Tax on employment deductible under section 16(iii)		3,000
Taxable salary		6,37,150

- (c) As per Explanation to section 6(1) an Indian citizen who leaves India during a previous year for the purpose of taking up employment outside India becomes a resident in India only if he is in India for at least 182 days during that previous year.

In the instant case, Kandarp left India on 20-09-2014 for the purpose of taking up employment in Japan. He never left India before. The period of his stay in India during the previous year 2014-15 is less than 182 days. Hence, Kandarp should be treated as non-resident in India for the Assessment Year 2015-16.

3. (a) Mr. Jeff, an American national is a resident in India for tax purpose during the previous year 2014-15. He owns a house property located in Washington. The property was let out by Mr. Jeff for a monthly rent of US \$ 10,000. He paid municipal tax of US \$ 8,000 in respect of such property to Municipal Corporation of Washington on 1st March, 2015. Interest due for previous year 2014-15 on loan taken from American Express Bank for construction of the property amounted to US \$ 9,000 out of which US \$ 8,000 was actually paid by Mr. Jeff.

Mr. Jeff purchased a plot of land with borrowed fund provided by his brother in previous year 2013-14 at Kanpur for construction of residential building. During the previous year 2014-15 he let out the land to a firm at a monthly rent of ` 6,000 for running a dairy from 1st October, 2014. interest paid on such borrowing during the year amounted to ` 6,000. Mr. Jeff has no other income during the year.

Compute total income of Mr. Jeff for Assessment Year 2015-16 assuming exchange rate as 1 US \$ = ` 60. 7

- (b) PQ & Associates, a partnership firm consisting of two partners P and Q is engaged in the business of manufacturing and sale of soft toys. Its sales during the previous year 2014-15 amounted to ` 75,00,000. As per the partnership deed P and Q are entitled to a remuneration of ` 20,000 each per month. The firm uses machinery for its business purpose and written down value of the machinery under section 43(6) of the Income-tax Act as on 31st March, 2014 is ` 2,50,000. The machinery is eligible for depreciation @ 15%.

Compute the taxable profit from the business assuming that the firm opts for presumptive taxation scheme under section 44AD and also determine the written down value of the machinery as on 31st March, 2015. 5

- (c) What is the tax treatment of family pension received by the legal heir of a deceased employee? 3

Answer:

3. (a)

Computation of Total Income of Mr. Jeff for Assessment Year 2015-16

Particulars	`	`
Income from house property		
House property located in Washington		
Gross Annual Value (US \$ 10000 x 12 x ` 60)	72,00,000	

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Less: Municipal Tax (US \$ 8,000 x 60)	4,80,000	
Net Annual Value		67,20,000
Less: Standard deduction at 30%	20,16,000	
Interest on loan on due basis (US \$ 9,000 x 60)	5,40,000	25,56,000
		41,64,000
Income from other sources		
Rent from land (` 6,000 x 6)	36,000	
Less: Interest on loan under section 57 (` 6,000 x 6/12)	3,000	33,000
Total Income		41,97,000

Notes:

1. Mr. Jeff is resident in India. Therefore, rental income received in Washington for property located there is liable to tax in India by virtue of section 5.
2. Under section 24, interest on loan taken for construction of house property is allowable on due basis. Interest actually paid is not relevant.
3. As the land was let out from 1st October, 2014, interest due for 6 months is allowable as deduction.

(b)

Computation of income of PQ & Associates under the head "profits and gains of business or profession" for Assessment Year 2015-16:

Particulars	`	`
Profit of business at 8% of sales (` 75,00,000 x 8%)		6,00,000
Less: Partners' remuneration as per the limit prescribed in sec. 40(b):		
On first ` 3,00,000 of book profit at 90%	2,70,000	
On balance ` 3,30,000 of book profit at 60%	1,80,000	
	4,50,000	
Actual remuneration (` 20,000 x 2 x 12)	4,80,000	
Lower of the two is deductible		4,50,000
Taxable business income		1,50,000

Where option for presumptive taxation under section 44AD is exercised, the written down value of any asset used for the purpose of the business shall be deemed to have been calculated as the assessee had claimed and had been actually allowed the deduction in respect of depreciation for each of the relevant assessment years.

Therefore, depreciation of ` 37,500 (i.e. 15% of ` 2,50,000) shall be deemed to have been allowed and written down value of the machinery as on 31st March, 2015 = ` 2,50,000 - ` 37,500 = ` 2,12,500.

- (c)** Family pension received by the legal heir of a deceased employee is taxed under the head "income from other sources" under section 56. The legal heir is entitled to claim under section 57 a deduction of a sum equal to 33 1/3% of such income or ` 15,000, whichever is less.

- 4. (a) Mr. Sudhir purchased a plot of land in Kolkata at a cost of ` 10 lacs in financial year 2005-06. He negotiated with Mr. Jain for sale of the land in financial year 2011-12 and obtained earnest money of ` 1 lac from Mr. Jain. Due to failure of Mr. Jain to complete the deal, Mr. Sudhir forfeited the earnest money.**

On 1st May, 2014 Mr. Sudhir obtained earnest money of ` 1.50 lacs from Mr. Mohan who intended to buy the land, but the said negotiation also failed and the earnest money was forfeited by Mr. Sudhir. Finally, Mr. Sudhir sold the land to a company for `

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22 lacs on 1st December, 2014. The value determined by the stamp valuation authority for stamp duty purpose is ` 25 lacs.

Mr. Sudhir bought a residential house for ` 18 lacs in Shimla on 28th February, 2015.

Compute income of Mr. Sudhir under the head "capital gains" for Assessment Year 2015-16.

Cost inflation index-Financial year 2005-06 : 497; Financial year 2014-15 : 1024. 7

(b) Dr. Sagar runs a clinic in Chennai. His Profit & Loss Account for the year ended 31st March, 2015 is given below:

Expenses	`	Income	`
Consumption of medicines	7,75,000	Consultation fees and medical charges	40,45,000
Consumables at clinic	1,55,000	Refund of income tax for earlier years (including interest on refund ` 6,500)	55,500
Salary to staff	20,50,000	Interest on fixed deposit with banks	1,37,500
Contribution to a research institution approved under section 35 (2AA)	50,000	Interest on saving bank account with bank	9,500
Repairs to building	1,20,000		
Depreciation	32,000		
Interest on loan to bank	1,50,000		
Net profit	9,15,500		
	42,47,500		42,47,500

Other information:

- (i) Salary includes ` 4,00,000 paid to a nurse of the clinic without deduction of tax at source.
- (ii) Repairs to building include ` 90,000 being cost of construction of an additional room.
- (iii) Interest on loan includes ` 30,000 being interest for quarter ended 31st March, 2015 which was paid on 5th October, 2015.
- (iv) Depreciation allowable under the Income-tax Act ` 44,000.

Compute total income of Dr. Sagar for Assessment Year 2015-16 indicating reasons in brief for treatment of each item. 8

Answer:

4. (a)

Computation of income of Mr. Sudhir under the head "capital gains" for Assessment Year 2015 - 16:

Particulars	`	`
Full value of consideration:		
Higher of the following:		
Actual consideration	22,00,000	
Stamp duty value	25,00,000	25,00,000
Indexed cost of acquisition (Note 1)		18,54,326
Long-term capital gain		6,45,674
Less: Exemption under section 54F for investment in residential house property ` 6,45,674 x 18,00,000 / 25,00,000		4,64,885
Taxable long-term capital gain		1,80,789

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Note:

1. Computation of indexed cost of acquisition

Cost of acquisition	10,00,000
Less: Earnest money taken in previous year 2011-12 and forfeited	1,00,000
Cost for the purpose of indexation	9,00,000
Indexed cost of acquisition ($\text{₹} 9,00,000 \times 1024 / 497$)	18,54,326

2. Earnest money of ₹ 1,50,000 taken by Mr. Sudhir on 1st May, 2014, which was forfeited due to the transaction not materialising, is taxable under the head "income from other sources" under section 56(2)(ix). Therefore, such amount has not been reduced to compute the indexed cost of acquisition.

(b)

Computation of total income of Dr. Sagar for Assessment Year 2015-16

Particulars		
A. Profits and gains of business or profession		
Net profit as per profit & Loss Account		9,15,500
Add: Disallowance under section 40(a)(ia) out of salary- 30% of salary of ₹ 4 lacs because of non-deduction of tax	1,20,000	
Cost of construction of additional room being capital expenditure not allowable as deduction	90,000	
Interest on loan to bank for last quarter disallowed under section 43B as the same was not paid on or before due date of furnishing return of income i.e. 30-09-2015 (the due date is 30-09-2015, as Dr. Sagar's professional receipts exceed ₹ 25 lakhs and he is liable for tax audit under section 44AB)	30,000	
Depreciation as per books	32,000	2,72,000
		11,87,500
Less: additional deduction in respect of contribution to research institution approved under section 35(2AA) as such contribution qualifies for weighted deduction equal to two times the sum paid	50,000	
Depreciation as per Income-tax Act	44,000	
Refund of income tax not taxable and interest on refund considered separately	55,500	
interest on fixed deposit and interest on savings bank account considered separately ($\text{₹} 1,37,500 + \text{₹} 9,500$)	1,47,000	2,96,500
		8,91,000
B. Income from other sources		
Interest on refund of income tax	6,500	
Interest on fixed deposit	1,37,500	
Interest on savings deposit with bank	9,500	1,53,500
Gross Total Income		10,44,500
Less: Deduction under section 80TTA in respect of interest on savings deposit with bank		9,500
Total income		10,35,000

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OR

Alternate answer is required as per notification no. F.No. 225/207/2015/ITA II order issued under section 119 of the Income Tax Act, 1961 by which date of compulsory filing of return of income has been extended from 30.9.2015 to 31.10.2015.

Alternative Answer:

Computation of total income of Dr. Sagar for Assessment Year 2015-16

Particulars	`	`
A. Profits and gains of business or profession		
Net profit as per profit & Loss Account		9,15,500
Add: Disallowance under section 40(a)(ia) out of salary- 30% of salary of ` 4 lacs because of non-deduction of tax	1,20,000	
Cost of construction of additional room being capital expenditure not allowable as deduction	90,000	
Interest on loan to bank for last quarter is allowed under section 43B as the same was paid on or before due date of furnishing return of income i.e. 31-10-2015 as extended by Notification No. F.No. 225/207/2015/ITA II (the due date is 31-10-2015, as Dr. Sagar's professional receipts exceed ` 25 lakhs and he is liable for tax audit under section 44AB)	Nil	
Depreciation as per books	32,000	2,42,000
		11,57,500
Less: additional deduction in respect of contribution to research institution approved under section 35(2AA) as such contribution qualifies for weighted deduction equal to two times the sum paid	50,000	
Depreciation as per Income-tax Act	44,000	
Refund of income tax not taxable and interest on refund considered separately	55,500	
interest on fixed deposit and interest on savings bank account considered separately (` 1,37,500 + ` 9,500)	1,47,000	2,96,500
		8,61,000
B. Income from other sources		
Interest on refund of income tax	6,500	
Interest on fixed deposit	1,37,500	
Interest on savings deposit with bank	9,500	1,53,500
Gross Total Income		10,14,500
Less: Deduction under section 80TTA in respect of interest on savings deposit with bank		9,500
Total income		10,05,000

5. (a) Mr. Singh had a plot of land in Faridabad, Haryana. The land was acquired by the Government of Haryana in financial year 2011-12. He received ` 6,40,000 towards interest on enhanced compensation from the Government of Haryana in December, 2014. Such interest relates to different financial years as follows:

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2011-12	` 1,50,000
2012-13	` 1,75,000
2013-14	` 2,00,000
2014-15	` 1,15,000

Mr. Singh incurred ` 80,000 as legal expenses in connection with interest on enhanced compensation.

Explain the provisions relating to taxation of interest on enhanced compensation and determine the amount of interest taxable for Assessment Year 2015-16. 6

(b) Scindia Charitable Trust registered under section 12AA of the Income-tax Act has derived the following income during the previous year 2014-15:

Particulars	` in lacs
Income from properties held under trust before charging depreciation	7.50
Depreciation on assets, the cost of which were allowed as application in earlier assessment years	0.50
Voluntary contribution(including corpus donation ` 6 lacs)	15
Amount applied for charitable purpose	10

Compute the tax liability of the trust for Assessment Year 2015-16. 6

(c) Rishi, a minor child is a singer. He earned ` 10 lacs during the previous year 2013-14 for singing in various TV programmes and the same was kept in fixed deposit in banks. Interest on such fixed deposit during the previous year 2014-15 is ` 1.50 lacs. Discuss the tax treatment of interest received by Rishi. 3

Answer:

5. (a)

Provisions relating to taxation of interest on enhanced compensation:

As per section 145A(b), interest received by an assessee on compensation or enhanced compensation shall be deemed to be the income for the year in which it is received, irrespective of the method of accounting followed by the assessee.

As per section 56(2)(viii), income by way of interest received on compensation or enhanced compensation referred to in section 145A(b) shall be assessed as "income from other sources" in the year in which it is received.

As per section 57(iv), a deduction of 50% of such interest shall be allowed. No other deduction would be allowable under any other clause of section 57 in respect of such income.

Therefore, the entire interest of ` 6,40,000 received by Mr. Singh for the different years shall be taxed under the head "income from other sources" in the year of receipt i.e. previous year 2014-15 (Assessment Year 2015-16) after allowing deduction at 50%. Thus, the amount of interest taxable in Assessment Year 2015-16 = ` 6,40,000 - ` 6,40,000 × 50% = ` 3,20,000.

Actual legal expenses of ` 80,000 have no relevance.

(b)

Computation of tax liability of Scindia Charitable Trust for Assessment Year 2015-16

Particulars	`	`
Income from properties held under trust		7,50,000
Voluntary contributions	15,00,000	
Less: Corpus donation not taxable	6,00,000	9,00,000
		16,50,000
Less: 15% of income eligible for accumulation without conditions		2,47,500
Amount available for application for charitable purpose		14,02,500

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Less: Amount applied for charitable purpose		10,00,000
Total Income		4,02,500
Tax payable: ($\text{₹} 4,02,500 - 2,50,000$) x 10%	15,250	
Education cess	458	15,708

Note

With effect from Assessment Year 2015-16, income for the purpose of application shall be determined without allowing deduction for depreciation or otherwise in respect of any asset, the cost of which has been claimed as application of income in the same or any other previous year. Hence depreciation of ₹0.50 lacs has not been considered.

- (c) As per section 64(1A) income of a minor child shall be clubbed in the hands of that parent, whose total income (excluding income of the minor child) is higher.

However, income that accrues or arises to the minor child from any manual work done by him or on account of any activity involving application of his skills, talent or specialized knowledge and experience shall not be clubbed.

In this case, Rishi earned ₹ 10 lacs for singing in various TV programmes. Although such earning was from an activity involving skills, talent, etc., Interest of ₹ 1.50 lacs have arisen from fixed deposit made. Interest income cannot be considered as income arising from activity involving Rishi's skill, talent or specialized knowledge. Therefore, interest on fixed deposit received by Rishi shall be included in the income of that parent, whose total income (excluding such interest income of Rishi) is higher.

6. (a) Specify the persons who are authorised to verify the return of income to be filed under section 139 of the Income-tax Act in the following cases:

- (i) Hindu Undivided Family
- (ii) Domestic Company
- (iii) Political Party

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- (b) Examine whether tax is required to be deducted at source from the following payments made by Prakash Ltd. if so, state the amount of tax to be deducted.

- (i) Commission of ₹ 8,500 paid to Mr. Vaid, an agent;
- (ii) Payment of ₹ 3 lacs to M/S Graphic Printer for purchase of calendars according to specifications of Prakash Ltd. No materials were supplied by Prakash Ltd. to M/S Graphic Printer for this purpose.
- (iii) Royalty of ₹ 32,000 paid to Mr. Rana, a resident of India.

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- (c) State the provisions relating to set-off and carry forward of losses under the head "capital gains".

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Answer:

6. (a) (i) In the case of Hindu Undivided family, the return of income is to be verified by the karta of the family.
If the karta is absent from India or is mentally incapacitated from attending to his affairs, the return of income is to be verified by any other adult member of such family.
- (ii) In case of a domestic company, the return of income is to be verified by the managing director of the company.
If for any unavoidable reason such managing director is not able to verify the return or if there is no managing director, the return is to be verified by any director of the company.

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- (iii) In the case of a political party, the return of income is to be verified by the chief executive officer of such party, whether such executive officer is known as secretary or by any other designation.
- (b) (i) As per section 194 H, any person (not being individual or HUF) responsible for making payment of commission (not being insurance commission) or brokerage is required to deduct tax at source from the commission paid or credited at 10%, if the amount of commission paid or credited during the financial year exceeds `5,000.
As the amount of commission paid exceeds ` 5,000, tax is required to be deducted and the amount of TDS is ` 850 (i.e. 10% of ` 8,500)
- (ii) As per section 194C, "work" includes manufacturing or supplying a product according to the requirements or specification of a customer by using material purchased from such customer.
In the given case, Prakash Ltd did not supply materials to M/S Graphic Printer. Hence, payment of ` 3 lacs does not require deduction of tax at source under section 194C.
- (iii) Under section 194J, royalty paid or payable by any person other than an individual or Hindu Undivided Family to a resident requires deduction of tax at source at 10%, if the amount of royalty exceeds ` 30,000.
Hence, in the given case tax of ` 3,200 is to be deducted at source.
- (c) As per section 71, where the net result of computation under the head "capital gains" is a loss, such capital loss cannot be set-off against income under any other head. Section 74 provides that where for any assessment, the net result under the head "capital gains" is a short-term capital loss or long-term capital loss, the loss shall be carried forward to be set off in the following manner:
- (i) Where the loss so carried forward is a short-term capital loss, it shall be set off against any capital gains, short-term or long-term, arising in that year.
- (ii) Where the loss so carried forward is a long-term capital loss, it shall be set off only against long-term capital gain in that year.
- (iii) Any unabsorbed loss shall be carried forward to the following assessment year up to a maximum 8 assessment years immediately succeeding the assessment year for which the loss was first computed.

Section B

(International Taxation) (Answer any two questions.)

7. (a) XYZ Inc. a company incorporated in USA rendered technical services to ABC Limited, an Indian company for a fee of ` 15 lacs. The entire services were rendered from outside India and the services were utilized by ABC Limited for its business operation in India. Payment was received by XYZ Inc. outside India. XYZ Inc. does not have any place of business or business connection in India.

State, with reasons, whether the aforesaid fees are liable to tax in India.

4

- (b) Jupiter Airlines, a company in Singapore operates its flights to India and vice versa during the previous year 2014-15. It collected charges for carrying passengers as follows:
` 2,00,00,000 received (including ` 50,00,000 in Singapore) for carriage of passengers from Kolkata to Singapore.

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₹ 50,00,000 received in India for carriage of passengers from Singapore to Kolkata. The total expenses on operation of such flights amounted to ₹ 1,00,00,000. Compute the income of Jupiter Airlines chargeable to tax in India for Assessment Year 2015-16. 4

(c) What do you mean by "safe harbor"? 2

Answer:

7. (a) As per section 9(1)(vii), income by way of fees for technical services payable by a person who is resident shall be deemed to accrue or arise in India, if the services are used by such person in a business or profession carried on in India.

Explanation of section 9(2) clarifies that income by way of, inter alia, technical services from services utilized in India would be deemed to accrue or arise in India under section 9(1)(vii) in case of a non-resident and be included in his total income, whether or not such services were rendered in India or the non-resident has a place of business or business connection in India.

In the instant case, the off-shore services were utilized by ABC Limited in its business carried on in India. Therefore, as per Explanation of section 9(2), the fee of ₹ 15 lacs for technical services rendered by XYZ Inc. to ABC Ltd. is deemed to accrue or arise in India and XYZ Inc. is liable to tax in India on such fee.

- (b) As per section 44BBA, in case of non-resident engaged in the business operation of aircraft, the income from business is presumed to be 5% of the following:
- (i) The amount paid or payable (whether in or out of India) to the assessee or to any person on his behalf on account of the carriage of passengers, livestock, mail or goods from any place in India;
 - (ii) The amount received or deemed to be received in India by or on behalf the assessee on account of the carriage of passengers, livestock, mail or goods from any place outside India.

No deduction can be claimed in respect of expenses of ₹ 1,00,00,000.

Hence, the taxable income Jupiter Airlines from business of operating aircraft in India = 5% of ₹ 2,50,00,000 = ₹ 12,50,000.

- (c) "Safe harbor" means circumstances in which the income-tax authorities shall accept the transfer price declared by the assessee.

8. (a) Can Transfer Pricing Office levy penalty on the assessee who has failed to furnish information and documents required by him? What is the quantum of such penalty? 4

- (b) AB Inc., USA holds 60% shares in XY Ltd., an Indian company. XY Ltd. imported 300 fountain pens from AB Inc. at a price of ₹ 2,400 per pen and the same were sold to P Ltd. at a price of ₹ 2,700 per pen. XY Ltd. purchased similar pens from CD Ltd., an Indian company and sold to Q. Ltd., at a gross profit of 10% on sales. XY Ltd., incurred freight and customs duty of ₹ 75 per pen and ₹ 100 per pen respectively in case of imports made from AB Inc. and freight of ₹ 50 per pen in cash of purchases from CD Ltd.

Compute the Arm's length price and the amount of increase in the total income of XY Ltd., if any due to such arm's length price. 6

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Answer:

8. (a) As per section 271 G as amended with effect from 1st October, 2014 by the Finance (No.2) Act, 2014 if any person who has entered into international transaction or specified domestic transaction fails to furnish any information or documents sought for by the TPO, then, such person shall be liable to a penalty which may be levied by the Assessing Officer or the Transfer Pricing Officer or the Commissioner (Appeals). Thus the TPO is a competent authority to levy penalty.

The amount of penalty is 2% of the value of international transaction or specified domestic transaction for such failure.

- (b) As goods imported by XY Ltd. from its associated enterprise, AB Inc. are resold in India, resale price method is applicable for determining arm's length price.

Computation of Arm's Length Price and the amount of increase in total income of XY Ltd.

Particulars	`	`
Resale price of pens purchased from AB Inc., USA		2,700
Less: Normal gross profit at 10% on sales	270	
Difference in expenses in connection with purchases (`175 - ` 50)	125	395
Arm's length price		2,305
Amount paid to AB Inc. (300 x `2,400)	7,20,000	
Arm's length price (300 x `2,305)	6,91,500	
Amount increase in total income of XY Ltd.		28,500

9. (a) Write a note on "other method" of determination of arm's length price. 4

- (b) PSL Limited, an Indian company took a loan of Euro 100 lacs carrying interest at 10-5% p.a. from GK Ltd., a company incorporated in Germany. The said loan was outstanding as on 31st March, 2015. The total book value of assets of PSL Ltd. on the said date was ` 9,500 lacs. GK Ltd. granted a loan of similar amount to PQR Ltd. another Indian company at 9% p.a. Total interest paid during the previous year 2014-15 was Euro 10.50 lacs. Examine whether interest on loan payable by PSL Ltd. to GK Ltd. is subject to transfer pricing provision and if so, what is the adjustment required? Assume one Euro = ` 70. 3

- (c) State the transactions for which profit split method of determination of arm's length price can be applied. 3

Answer:

9. (a) As per section 92C(1)(f) read with Rule 10AB the other method for determination of arm's length price in relation to an international transaction or specified domestic transaction shall be any method which takes into account the price which has been charged or paid or would have been charged or paid, for the same or similar uncontrolled transaction, with or between non-associated enterprises, under similar circumstances, considering all the relevant facts.

The other method allows flexibility to the tax payer to select a method other than five prescribed methods for computing arm's length price of routine transactions such as reimbursements, etc. and non-routine transactions such as transfer of intangibles, etc. This would also enable tax payer to credibly rely on data referred to in commercial negotiations, data points reflecting market conditions and other persuasive

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evidences which would help in establishing arm's length price of the transaction in question.

- (b)** The amount of loan given by GK Ltd to PSL Ltd is ` 7,000 lacs (i.e. Euro 100 lacs x 70). The total book value of assets of PSL Ltd as on 31st March, 2015 is ` 9,500 lacs. The amount financed by GK Ltd. is $\geq 51\%$ of the book value of total assets of PSL Ltd. Hence, GK Ltd. is an associated enterprise and interest paid by PSL Ltd to GK Ltd is subject to transfer pricing provision.

GK Ltd. granted a loan of similar amount to PQR Ltd at 9% p.a. Therefore, such rate of interest is the bench mark rate. The arm's length interest is ` 7,000 lacs x 9% i.e. ` 630 lacs.

Excess interest to be added to income of PSL Ltd = [(Euro 10.50 lacs x 70) - ` 630 lacs]
= ` 105 lacs.

- (c)** Profit split method for determination of arm's length price is mainly applied in case of the following transactions:
- (i) Transactions involving transfer of unique intangibles.
 - (ii) Integrated services provided by more than one enterprise.
 - (iii) Multiple inter-related transactions, which cannot be separately evaluated.