

# Answer to MTP\_Intermediate\_Syllabus 2012\_Dec2013\_Set 1

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## Paper 7 - Direct Taxation

Full Marks – 100

Time – 3 Hours

### Section A

(Question No. 1 is COMPULSORY and any FOUR from Question Nos. – 2 to 6)

1.

- (a) Can the Authority giving approval under the Act withdraw even though no such power is specifically vested with him under the Act?

**Answer:**

Section 293C provides that Central Government, Board or Income Tax Authority who is vested with the powers to grant approval shall also have power to withdraw approval at any time after providing an opportunity of being heard to the assessee, even though the Act does not confer on him the specific right to withdraw the approval.

- (b) A Plantation company, holding several acres of land, sold trees of spontaneous growth. The Assessing Officer is of the opinion that there arise capital gains. Discuss.

**Answer:**

Sale proceeds of spontaneous growth will not result in capital gains, as they do not bring in any profit or gain [Suman Tea & Plywood Industries Pvt. Ltd (1997) 226 ITR 34 (SC)]. However, the sale proceeds will be considered under the head "Income from Other Sources".

- (c) What will be the residential status of B Ltd. an Indian company managed from Paris?

**Answer:**

Indian company will always be Resident of India even if it is managed from outside India. Hence, the status of B Ltd. is Resident.

- (d) X Ltd. incurred expenditure for acquiring know-how on 15<sup>th</sup> December, 2012. Is the deduction u/s 35AB available? Justify.

**Answer:**

As the expenditure on know-how is incurred after 31<sup>st</sup> March, 1998, deduction u/s 35AB is not available. However, X Ltd. can claim depreciation u/s 32 against this amount.

- (e) W Ltd., carrying on business of a five star hotel, claims that the building in which the business is carried on has been specifically designed and equipped and therefore must be treated as "Plant" for deduction of depreciation u/s 32. Will the claim be admissible? Justify your answer.

**Answer:**

According to section 43(3), "Plant" specifically excludes Tea Bushes or Livestock or Buildings or Furniture and Fittings. Hence, Hotel Building cannot be treated as "Plant" for the purposes of depreciation.

- (f) Ali owns a plot of land acquired on 1.7.2007 for a consideration of ₹8 lakhs. He enters into an agreement to sell the property on 23.3.2013 for a consideration of ₹18 lakhs. In part performance of the contract, he handed over the possession of land on 26.3.2013 on which date, he received the full consideration. As on 31.3.2013, the sale was pending registration.

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**Discuss liability of capital gains for the assessment year 2013-14 (no computation is required).**

**Answer:**

As per Sec. 2(47), transfer includes part performance of a contract of the nature specified in Sec. 53A of the Transfer of Property Act. In the given case, consideration was received by Ali and the possession was handed over on 26.3.2013. Hence, the part performance condition is satisfied and Ali will be liable for the capital gain for the assessment year 2013-14.

**(g) Mr. Das has incurred long term capital loss of ₹50,000 during the previous year 2012-13. During the same year shares held in trust for minor son of Mr. Das sold earning a long term capital gain of ₹2,50,000 which is not exempt. Can Mr. Das set off the loss incurred by him against the gain on minor's account?**

**Answer:**

Mr. Das will be entitled to set off the loss incurred by him against the gain on minor's account if the income of the minor is subject to clubbing with his income.

**(h) The Income-tax Act, 1961 provides for taxation of a certain income earned by Anil. The Double Taxation Avoidance Agreement, which applies to Anil, excludes the income earned by Anil from the purview of tax. Is Anil liable to pay tax on the income earned by him? Discuss.**

**Answer:**

Where any conflict arises between the provisions of the Double Taxation Avoidance Agreement and the Income-tax Act, 1961, the provisions of the Double Taxation Avoidance Agreement would prevail over those of the Income-tax Act. Anil is, therefore, not liable to pay tax on the income earned by him.

**(i) State whether air conditioner, not used as stock in trade, is a capital asset.**

**Answer:**

Air conditioner, for personal use, is included in the term 'personal effects' and hence, not a capital asset.

**(j) What will be the GAV, if the reasonable lettable value a house property is ₹72,000 but the actual rent of the property is ₹5,000 per month?**

**Answer:**

Annual value in this case is the reasonable lettable value i.e. ₹72,000 being higher than the actual rent of ₹60,000.

**(k) During the previous year 2012-13, Nirmal earned ₹2,01,000 which includes ₹1,000 received by his son (aged 12 years) as an interest on 31.12.2012. Calculate the taxable income of Nirmal.**

**Answer:**

Exemption u/s 10(32) is equal to actual income included in the hands of parent or ₹1,500, whichever is less. Hence, Exemption available to u/s 10 (32) will be ₹1,000 only and Taxable Income of Nirmal is ₹2,00,000.

**(l) R Ltd. incurred ₹5,00,000 for Agricultural Extension Project during the previous year 2012-13. State the allowability of that expenditure.**

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**Answer:**

Allowable Expenditure on Agricultural Extension Project = Amount incurred × 150%  
= ₹5,00,000 × 150% = ₹7,50,000.

- (m) Interest of ₹25,000 on Bank Fixed Deposits, received by minor son of Mrs. Sinha. These Fixed Deposits were made by Mrs. Sinha, out of his son's earnings from stage acting. Discuss the tax treatment in this case.

**Answer:**

If the minor receives any income by exercise of labour, hard work, skill, knowledge or experience then such income shall not be clubbed. In the given case, the income of the minor son of Mrs. Sinha, is from application of special talent, hence, shall not be clubbed in the hands of parents.

[13×1]

2.

- (a) Mrs. Sen is the owner of the business units A and B. A unit has been started with capital contribution from Mr. Sen and B unit has been started out of capital contribution from Mrs. Sen. The particulars of their income for the previous year 2012-13 are as follows:

Particulars	Amount (₹)
(i) Income from A unit	(-) 7,00,000
(ii) Income from B unit	5,00,000
(iii) Income from House Property (The house is owned by Mr. Sen)	2,00,000

How would you assess them for the Assessment Year 2013-14?

**Answer:**

- (i) Mrs. Sen is assessable on the profits from B unit. She cannot set-off the loss from A unit against the profits of B unit. Thus, she would be assessed on ₹5,00,000.
- (ii) The loss from A unit will be included in the total income of Mr. Sen in view of Sec. 64(1)(iv). "Income" includes "loss" also. Mr. Sen is entitled to set-off business loss of A's unit against Income from House Property. Thus, loss of ₹ 5,00,000 would be carried forward but could be set-off only against business profits.

- (b) Ravi avails the benefit of LTC and travelled by air (economy class) on a holiday in India on 25<sup>th</sup> December, 2012 along with his wife and three children consisting of daughter aged 5 years and twin sons of 2 years age. Total cost of tickets reimbursed by his employer was ₹80,000 (₹50,000 for two adults and ₹30,000 for three children). State with reason the amount which can be claimed by Ravi out of reimbursement as not subject to tax? Will your answer be different where among his three children the twins are of 5 years of age and the age of the daughter was of 2 years old?

**Answer:**

The LTC exemption is available only for two children of an individual born after 01.10.1998. In reckoning this limit of two children, children born out of multiple births after the first birth will be treated as one child only.

**First daughter and then twin sons** – The exemption shall apply to all the three children as the twins will be considered as one child. Hence, ₹80,000 can be claimed as exemption.

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**First twin sons and then daughter** – The exemption will apply to the twin sons who are considered as two children and not to the daughter. Hence, only ₹70,000 can be claimed as exemption.

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

Unrealised rent recovered during the P.Y. 2012-2013 relating to P.Y. 2007-2008	(Actual rent receivable – Unrealised rent) of P.Y. 2007-2008	GAV of P.Y. 2007-2008
40,000	1,80,000	1,80,000
30,000	1,50,000	1,60,000
50,000	1,50,000	2,40,000

**Answer:**

Unrealised rent recovered during the P.Y. 2012-2013 relating to P.Y. 2007-2008	(Actual rent receivable – Unrealised rent) of P.Y. 2007-2008	GAV of P.Y. 2007-2008	Taxable Amount
[1]	[2]	[3]	[1 + (2-3)]
40,000	1,80,000	1,80,000	40,000
30,000	1,50,000	1,60,000	20,000
50,000	1,50,000	2,40,000	Nil

- (d) Mr. Shinde, an Indian citizen, is posted in the Indian High Commission at Nairobi during the previous year 2012-13. His emoluments consist of Basic Pay of ₹21,60,000 per month and overseas allowance of ₹8,65,000 per month. Besides, he is entitled to & fro journey to India and also use Government's car at Nairobi. He has no taxable income except salary income stated above.

Compute the total income, if any, taxable in India, if he is a non-resident during the previous year 2012-13

**Answer:**

- As per Section 9(1)(iii), Salary paid by the Government of India to an Indian citizen for services rendered outside India is deemed to accrue or arise in India and is therefore taxable in India.
- As per Section 10(7), allowances or perquisites paid by the Government of India to an Indian citizen or services rendered outside India, is fully exempt from tax. Hence, Total Income of Mr. Shinde for the previous year 2012-13 is ₹2,16,000.

[4+4+3+2]

3.

- (a) AB Ltd., a company providing telecommunication service, obtains a telecom licence on 15<sup>th</sup> April, 2012 for a period of 10 years. Total licence fee is ₹20,00,000. You are required to calculate the amount of deduction u/s 35ABB if –

- The entire amount paid on 10<sup>th</sup> May, 2012
- The entire amount paid on 1<sup>st</sup> May, 2013
- The entire amount is paid in two equal installments on 1<sup>st</sup> May, 2012 and 1<sup>st</sup> May, 2013.

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**Answer:**

- (i) The payment of ₹20,00,000 is deductible in 10 installments over a period of 10 years i.e. ₹2,00,000 per year.
- (ii) The payment is deductible in 9 years starting from the year of payment i.e. the assessment year 2014-15. The amount deductible each year being ₹2,50,000.
- (iii) Deduction u/d 35ABB is available as under -

	1 <sup>st</sup> Installment	2 <sup>nd</sup> Installment	Total
Date of payment	1 <sup>st</sup> May, 2012	1 <sup>st</sup> May, 2013	
Period during which deduction is available	10 years	9 years	
Actual amount paid	10,00,000	10,00,000	
Amount deductible:			
2012-13	1,00,000	—	1,00,000
2013-14 to 2021-22	1,00,000	1,11,111	2,11,111

- (b) Mr. Khan provides the following information regarding his income of previous year 2012-13. Compute income liable to be charged in India in the following cases:

- I. He is an ordinarily resident.
- II. He is a resident but not ordinarily resident.
- III. He is a non-resident.

Particulars	Amount (₹)
Business income earned in India received in Dubai	50,000
Salary received from R Ltd., a foreign company, situated in India	1,08,000
Interest on Pakistan Development Bond (1/3 <sup>rd</sup> received in India)	36,000
Income from agriculture in Nepal received there on 24 <sup>th</sup> November, 2012 but remitted to India on 27 <sup>th</sup> February, 2013	55,000
Income from property in Berlin received outside India	2,50,000
Income earned from business in USA which is controlled from Mumbai (2/5 <sup>th</sup> received in India)	1,75,000
Profit from a business in Chennai which is managed from Sri Lanka	82,000
Profit on a sale of a property in India but received in Pakistan	70,000

**Answer:**

**Computation of Income liable to be charged in India of Mr. Khan for the A. Y. – 2013-14**

Particulars	Case I (₹)	Case II (₹)	Case III (₹)
Business income earned in India received in Dubai	50,000	50,000	50,000
Salary received from R Ltd., a foreign company, situated in India	1,08,000	1,08,000	1,08,000
Interest on Pakistan Development Bond:			
1/3 <sup>rd</sup> received in India	12,000	12,000	12,000
2/3 <sup>rd</sup> received outside India	24,000	—	—
Income from agriculture in Nepal received there on 24 <sup>th</sup> November, 2012 but remitted to India on 27 <sup>th</sup> February, 2013	55,000	—	—
Income from a property in Berlin received there	2,50,000	—	—
Income earned from business in USA which is controlled from Mumbai:			

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2/5 <sup>th</sup> received in India	70,000	70,000	70,000
3/5 <sup>th</sup> received outside India	1,05,000	1,05,000	—
Profit from a business in Chennai which is managed from Sri Lanka	82,000	82,000	82,000
Profit on a sale of a property in India but received in Pakistan	70,000	70,000	70,000
<b>Total</b>	<b>8,26,000</b>	<b>4,97,000</b>	<b>3,92,000</b>

- (c) Discuss whether Mr. Das, an individual, can become a partner in dual capacity, that is, one representing HUF as Karta and the other as representing himself. Is a firm constituted by partners, including a partner in dual capacity, entitled to get the deduction of salary and interest paid to its partner?

**Answer:**

There is nothing in law which prevents an individual to become partner in a firm in dual capacity so long as there is one or more other individuals to join in the partnership. Such partnership is valid and legal and entitled to get the deduction of salary and interest paid to its partners if the requisite conditions are satisfied. [CIT vs. Budhalal Amolakhdas [1981] 5 Taxman 176 (Guj.)]

Hence, Mr. Das can become a partner in dual capacity of a firm and the firm is eligible to get deduction of salary and interest paid to its partners if the requisite conditions are satisfied.

[5+6+2]

4.

- (a) Specify with reason whether following acts can be considered as (I) Tax Management; or (II) Tax Planning; or (III) Tax Evasion; or (IV) Tax Avoidance:

- (i) X deposits ₹70,000 in PPF Account so as to reduce Total Income from ₹3,70,000 to ₹3,00,000.
- (ii) R Ltd. installed an air conditioner costing ₹80,000 at the residence of a director as per terms of his appointment; but treats it as fitted in quality control section in the factory. This is done with the objective to treat it as plant for the purpose of computing depreciation.
- (iii) J Ltd. issues a credit note for ₹50,000 for brokerage payable to H, who is son of J, managing director of the company. The purpose is to increase his income from ₹1,50,000 to ₹2,00,000 and reduce its income correspondingly.
- (iv) G Ltd. maintains register of Tax Deduction at Source affected by it to enable timely compliance.

**Answer:**

Particulars	The Act is considered as	Reason
(i) X deposits ₹70,000 in PPF Account so as to reduce Total Income from ₹3,70,000 to ₹3,00,000.	<b>Tax Planning</b>	Reducing liability by use of beneficial provisions of law
(ii) R Ltd. installed an air conditioner costing ₹80,000 at the residence of a director as per terms of his appointment; but treats it as fitted in quality control section in the factory. This is done with the objective to treat it as	<b>Tax Evasion</b>	Reducing tax liability by dishonest means

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plant for the purpose of computing depreciation.		
(iii) J Ltd. issues a credit note for ₹50,000 for brokerage payable to H, who is son of J, managing director of the company. The purpose is to increase his income from ₹1,50,000 to ₹2,00,000 and reduce its income correspondingly.	<b>Tax Avoidance</b>	Making use of Loopholes in the Provisions of Law
(iv) G Ltd. maintains register of Tax Deduction at Source affected by it to enable timely compliance.	<b>Tax Management</b>	Objective is to ensure compliance with law

(b) The following details have been supplied by the Karta, of an HUF aged 50 years. You are required to compute its total income and tax liability for the Assessment Year 2013-2014.

Particulars	₹
(i) Profits from business (after charging ₹1,00,000 salary to Karta for managing the business)	15,00,000
(ii) Salary received by the member of a family	60,000
(iii) Director's fee received by Karta from B Ltd where HUF holds 20% shares but he became director because of his qualifications,	40,000
(iv) Rental income from house property (after deduction of municipal taxes ₹12,000)	78,000
(v) Dividends (gross) from Indian companies	15,000
(vi) Long-term Capital Gain	80,000
(vii) Short-term Capital Gain	30,000
(viii) Donation to a school, which is an approved institution	1,00,000
(ix) Deposits in Public Provident Fund	20,000
(x) NSC-VIII issues purchased	40,000

Answer:

### Computation of Total Income for the A.Y. 2013-14

Particulars	₹	₹
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(i) Income from House Property: Gross annual value (₹ 78,000 + ₹ 12,000)	90,000	
Less: Municipal Taxes paid	<u>12,000</u>	
Annual value	78,000	
Less: Statutory deduction: 30% × 78,000	<u>23,400</u>	54,600
(ii) Profits and gains from business		15,00,000
(iii) Capital Gains (a) long-term + (b) short-term		1,10,000
(iv) Income from other sources—gross dividends from Indian companies: Exempt [Sec. 10(34)]		<u>Nil</u>
<b>Gross Total Income</b>		<b>16,64,600</b>
Less:		
1. Contribution to approved savings (Sec. 80C)		
(i) Deposits in Public Provident Fund	20,000	
(ii) NSC-VIII Issue	<u>40,000</u>	
	60,000	
2. Donation to recognised school:		
(a) Actual donation: ₹ 1,00,000 or		
(b) 10% of adjusted total income = (Gross Total Income – Long Term Capital Gains – All deductions under Chapter VIA excluding Sec. 80G) of ₹ 15,24,600 (16,64,600 - 80,000 - 60,000)		
whichever is less, is qualifying amount.		
Amount of deduction: : 50% of ₹ 1,00,000	<u>50,000</u>	
		<u>1,10,000</u>
<b>Total Income</b>		<b>15,54,600</b>

### Computation of Tax Liability:

Particulars of total income	Rate of income tax		₹
	₹	₹	
(a) Long-term Capital Gain	80,000	20%	16,000
(b) Balance of total income: ₹ 14,74,600			
(i) First	2,00,000	Nil	—
(ii) Between 2,00,000 – 5,00,000	3,00,000	10%	30,000
(iii) Between 5,00,000 – 10,00,000	5,00,000	20%	1,00,000
(iv) Between 10,00,000 – 14,74,600	4,74,600	30%	1,42,380
<b>Gross Income Tax</b>			<b>2,88,380</b>
Add: Education cess @ 2% on income tax			5,768
SHEC @ 1% on income tax			2,884
<b>Tax Payable</b>			<b>2,97,032</b>
<b>Rounded off u/s 288B</b>			<b>2,97,030</b>

[6+7]

5.

(a) T & Co. Ltd. started two separate industrial undertakings – Unit I and Unit II. Unit I prima facie is eligible for deduction u/s 80IB. For the year ending 31.03.2013, the profit of Unit I was ₹8 Lakhs while Unit II suffered a loss of ₹2 Lakhs.

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The Assessing Officer has allowed the deduction u/s 80IB on the net profit of ₹6 Lakhs. Discuss the validity of the order of the Assessing Officer.

**Answer:**

According to section 80IB deduction is available in respect of the profits or gains derived from the eligible industrial undertaking of the assessee. Section 80IB expressly provides that the deduction under this section shall be calculated on the gains derived from such undertaking.

In view of the above, T & Co. Ltd. is entitled for deduction u/s 80IB at 30% of income derived from Unit I, not on the net income from Unit II.

Hence, the eligible deduction for the assessment year 2013-14 is ₹2,40,000 (i.e. ₹8,00,000 × 30%).

Total Income shall be Net Income from both the undertakings Less Deduction u/s 80IB i.e. ₹6,00,000 Less ₹2,40,000 = ₹3,60,000. Therefore, the action of the Assessing Officer is not valid in law.

- (b) Mr. Singh is engaged in the business of plying goods carriages. On 1<sup>st</sup> April, 2012, he owns 10 trucks (out of which 5 are heavy goods vehicles). On 4<sup>th</sup> May, 2012, he sold one of the heavy goods vehicles and purchased a light goods vehicle on 7<sup>th</sup> May, 2012. This new vehicle could however be put to use only on 15<sup>th</sup> June, 2012.

Compute the total income of Mr. Singh for the assessment year 2013-14, taking note of the following information:

	₹	₹
<b>Freight Charges Received</b>		<b>9,00,000</b>
<b>Less: Operational Expenses</b>	<b>5,60,000</b>	
<b>Depreciation as per Section 32</b>	<b>1,80,000</b>	
<b>Other Office Expenses</b>	<b>60,000</b>	<b>8,00,000</b>
<b>Net Profit</b>		<b>1,00,000</b>
<b>Other business and non-business income</b>		<b>1,20,000</b>

**Answer:**

**Alternative 1.**

### Direct estimation of income u/s 44AE

	₹
5 Light Vehicle [₹4,500 × 5 vehicles × 12 months]	2,70,000
4 Heavy Vehicle [₹5,000 × 4 vehicles × 12 months]	2,40,000
1 Heavy Vehicle [₹5,000 × 1 vehicle × 2 months]	10,000
1 Light Vehicle [₹4,500 × 1 vehicle × 11 months]	49,500
Income from business of plying goods carriage	5,69,500
Add: Other business and non-business income	1,20,000
<b>Total Income</b>	<b>6,89,500</b>

**Note:** Income shall be calculated from the month when assessee acquired the property whether it has been put to use or not. For this purpose, any fraction of the month shall be considered as month.

**Alternative 2.**

### Computation of income as per the provision of Section 28 to 38

	₹	₹
Freight Charges Received		9,00,000
Less: Expenditure related to business		
Operational Expenses	5,60,000	

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Depreciation as per Section 32	1,80,000	
Other Office Expenses	60,000	8,00,000
Income from business of plying goods carriage		1,00,000
Add: Other business and non-business income		1,20,000
<b>Total Income</b>		<b>2,20,000</b>

Since, Mr. Singh has lower taxable income in Alternative 2, his total income is ₹1,20,000. But to claim such lower income than the estimated income computed in Alternative 1 as per provision of section 44AE, he will have to maintain books of accounts as required u/s 44AA and get his accounts audited.

- (c) The Accounts of a Firm are subject to Tax Audit u/s 44AB. Sashi, a working partner of the firm, is entitled to receive a fixed remuneration of ₹15,000 per month. He files his return of income on 28.09.2013 for the assessment year 2013-14. The Assessing Officer charges interest u/s 234A for delay in the filing of return. Discuss the validity of the order of the Assessing Office.**

**Answer:**

According to section 139(1) the due date of filing the return of income in case of a working partner of a Firm, which is subject to tax audit u/s 44AB, is 30<sup>th</sup> September of the relevant assessment year. So, in the given case Sashi has filed his return of income within the due date and he is not liable to pay interest u/s 234A. Therefore, the action of the Assessing Officer is not valid in law.

- (d) Amit borrowed ₹5,00,000 for a post graduate course at USA of his younger son for LIC in 2004, repayable in 10 equal installments of ₹75,000 (₹50,000 as principal and ₹25,000 as interest) starting from previous year 2007-08. Find for what period, assessee can claim deduction u/s 80E if he regularly pays such amount.**

**Answer:**

As per Section 80E, ₹25,000 can be claimed as deduction up to eighth year starting from assessment year 2008-09 i.e. till assessment year 2015-16.

**[3+7+2+1]**

6.

- (a) Discuss the admissibility of the following expenditure with reasons:**

- (i) Provisions made for gratuity as per actuarial valuation ₹1,50,000.**
- (ii) Senior advocate who conducted the Income Tax proceedings before the Income Tax Authorities was paid ₹25,000.**
- (iii) Travelling expenses include ₹45,000 incurred by a Director while travelling abroad to negotiate the purchase of plant and machinery.**
- (iv) A sum of ₹25,000 was provided towards Sales Tax liability in the accounts for the year ended 31.03.2013.**
- (v) A technical consultant was paid consultancy fee of ₹20,000 in cash by the assessee and deduction was claimed towards the expenditure.**
- (vi) 1,000 wrist watches costing ₹1,000 each were presented to customers.**

**Answer:**

- (i) Section 40A(7) provides that any provision for gratuity in the books of accounts shall not be allowed as a deduction unless provision is made for any contribution towards an approved gratuity fund or provision is for gratuity, which has become due and payable during the previous year.

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In the given case, gratuity has been provided in the books as per actuarial valuation but there is no liability due during the year. Hence, the amount of provision for gratuity i.e. ₹1,50,000 shall be disallowed.

- (ii) Section 37 provides that expenditure of revenue nature incurred wholly and exclusively in connection with business or profession, shall be allowed as deduction.  
In the given case, the fees paid to the senior advocate to represent the Company in Income Tax proceeding is incurred wholly and exclusively in connection with business and hence, the same is fully allowed as deduction.
- (iii) Any expense incurred in connection with acquisition or construction of a capital asset should be capitalized.  
In the given case, travelling expenses of ₹45,000 for negotiating purchase of plant and machinery which is a capital asset should be capitalized and not deductible.
- (iv) Section 43B provides that any sum payable by way of tax, duty, cess or fee under any law in force shall be allowed as deduction only if the same is paid on or before the due date of filing return of income u/s 139(1).  
In the given case, a sum of ₹25,000 is provided as Sales Tax Liability in the books for the financial year 2012-13. If the amount so provided is paid before due date of filing the return, the same may be allowed as a deduction in the year of provision i.e. previous year 2012-13 or it may be claimed as a deduction in the year of payment.
- (v) Section 40A(3) provides that where an assessee incurs any expenditure in respect of which payment or aggregate of payments in excess of ₹20,000 is made otherwise than by Account Payee Cheque or Account Payee Demand Draft, whole of such expenditure shall be disallowed.  
In the given case, the assessee has paid the technical consultant ₹20,000 only as consultancy fees and the same shall be allowed as a deduction.
- (vi) Presentation of wrist watches to customers is allowed as expenditure on advertisement under Sec. 37(1). The whole amount of ₹10,00,000 is allowable as deduction as there is no ceiling limit for gift articles.

**(b) B Ltd. owns the following assets:**

	Goodwill	Shares (non- listed)	House Property
Cost of acquisition	Self - generated	₹1,37,000	₹1,00,000
Date of acquisition	—	March 20, 2010	March 20, 2010

Goodwill has been recognised since the commencement of business on October 1, 1981. These capital assets (no depreciation is claimed) are transferred by B Ltd. to its wholly-owned Indian subsidiary company L Ltd. on April 1, 2011. On June 17, 2012, these assets are transferred by L Ltd. for consideration of ₹11,81,000 (i.e., goodwill: ₹7,00,000, shares: ₹2,16,000, house property: ₹2,65,000). Compute the capital gain chargeable to tax in the case of L Ltd. for the assessment year 2013-14.

**Answer:**

	Goodwill ₹	Shares (non- listed) ₹	House Property ₹
Sale consideration	7,00,000	2,16,000	2,65,000
Less: Cost of acquisition to the previous owner	-	-	1,00,000
Less: Indexed cost of acquisition (i.e., ₹1,37,000 x 852 ÷ 632)	Nil	1,84,690	-
Short-term Capital Gain	-	-	1,65,000
Long-term Capital Gain	7,00,000	31,310	-

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- (c) If there were certain disallowances while computing income under normal provisions but the assessment was made on income computed under section 115JB, will the penalty for concealment be leviable?

**Answer:**

Where Assessing Officer made certain disallowance while computing income under normal provisions of the Act and still the tax on income so computed is less than tax payable under section 115JB and the assessment was made on income computed under section 115JB, penalty under section 271(1)(c) cannot be levied as concealment in the form of disallowance of expenditures did not lead to tax evasion.

[6+5+2]

### Section B (Answer ALL Questions)

7.

- (a) Do you consider motor car, used in hiring business, as an asset u/s 2(ea)?

**Answer:**

Motor car, used in hiring business, is not an asset u/s 2(ea) of the Wealth Tax Act, as it is used for commercial purposes.

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

**Answer:**

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

[1+1]

8.

(a)

- (i) From the following information furnished by Mr. Das, determine the value of house property built on leasehold land as at the valuation date 31.3.2013 :

Particulars	₹
Annual Value as per Municipal Valuation	1,75,000
Rent received from tenant (Property vacant for 2 months during the year)	1,50,000
Municipal tax paid by tenant	15,000
Repairs on property borne by tenant	7,000
Refundable deposit collected from tenant as security deposit which does not carry any interest	60,000

The difference between unbuilt area and specified area over aggregate area is 10.5%.

**Answer:**

Assessee: Mr. Das

Valuation Date: 31.3.2013

Assessment Year: 2013-14

Computation of Value of House Property

Step I: Computation of Gross Maintainable Rent (GMR)

Particulars	₹	₹
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## Answer to MTP\_Intermediate\_Syllabus 2012\_Dec2013\_Set 1

Actual Annual Rent [₹1,50,000 x 12/10]		1,80,000
Add: Municipal tax paid by the Tenant	15,000	
Add: 1/9th of Actual Rent Receivable as repair expenses are borne by the tenant [₹1,80,000/9]	20,000	
Add: Interest on Refundable Security Deposit [₹60,000 x 15% x 10/12]	7,500	42,500
<b>GROSS MAINTAINABLE RENT (GMR)</b>		<b>2,22,500</b>

### Step II: Computation of Net Maintainable Rent (NMR)

Particulars	₹	₹
Gross Maintainable Rent (GMR)		2,22,500
Less: Municipal Taxes levied by the local authority	15,000	
Less: 15% of Gross Maintainable Rent [₹2,22,500 x 15%]	33,375	48,375
<b>NET MAINTAINABLE RENT (NMR)</b>		<b>1,74,125</b>

**Step III: Capitalisation of the Net Maintainable Rent (CNMR)** (Assumed that unexpired lease period is more than 50 Years)

NMR × Multiple Factor for an Unexpired Lease Period = ₹1,74,125 × 10 = ₹17,41,250

### Step IV: Addition of Premium to SNMR in case of excess inbuilt area:

Particulars	₹
Capitalisation of the Net Maintainable Asset	17,41,250
Add: Premium for excess of 10.5% unbuilt area over specified area [30% or CNMR]	5,22,375
<b>Value of House Property as per Wealth Tax Act</b>	<b>22,63,625</b>

(ii) Who is liable to file wealth tax returns?

**Answer:**

Every Individual, Hindu Undivided Family and Company whose net wealth exceeds the maximum amount which is not chargeable to wealth tax in any previous year ending of 31st March is liable to file the wealth tax return in Form BA. The maximum limit of net wealth not chargeable to tax under the provisions of the Wealth tax Act, 1957 is ₹30 Lakhs at present.

[6+2]

or

(b)

(i) Satender is aged 35 years. His father settled a property in trust giving whole life interest therein to Satender. The income from the property for the years 2009-10 to 2012-13 was ₹70,000, ₹84,000, ₹90,000, ₹1,08,000, respectively. The expenses incurred each year were ₹2,000, ₹4,000, ₹5,000 and ₹6,000 respectively. Calculate the value of life interest of Satender in the property so settled on the valuation date 31.3.2013, with the help of the factor of 9.267.

**Answer:**

Step	Procedure
1	Average Income for last three years = (₹84,000 + ₹90,000 + ₹1,08,000) / 3 =

## Answer to MTP\_Intermediate\_Syllabus 2012\_Dec2013\_Set 1

	₹94,000.
2	Average Expenses for the last three years = $(₹4,000 + ₹5,000 + ₹6,000) / 3 = ₹5,000$ .
3	Maximum Permissible Expenses = Average Expenses or 5% of Average Income, whichever is less = 5% of ₹94,000 = ₹4,700
4	Average Annual Income = ₹94,000 Less ₹4,700 = ₹89,300.
5	Life Interest = Average Annual Income × Life Interest Factor = ₹89,300 × 9.267 = ₹8,27,543.

- (ii) ABC is a charitable society registered under the Societies Registration Act. On the ground that it was pursuing an objective that involved the carrying of an activity for profit, the Assessing Officer wants to levy wealth tax on it. Is such a society liable to wealth tax?

**Answer:**

According to Section 3 of the Wealth Tax Act, the only taxable entities are individual, HUFs and companies. A society registered under the Societies Registration Act is neither an "Individual" nor a "Hindu Undivided Family" nor a "Company". Moreover it is not an AOP or BOI or Body of Trustees which can be treated as an individual. A society acquires an artificial juridical character which is separate from its members.

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

**Answer:**

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

[5+2+1]

### Section C (Answer ALL Questions)

9.

- (a) A foreign company has established back office in India. Can it be considered as Permanent Establishment?

**Answer:**

Back office is not a Permanent Establishment. Hence, the back office established by the foreign company cannot be considered as Permanent Establishment.

- (b) What is the purpose of Advance Pricing Agreement?

**Answer:**

Advance Pricing Agreement shall include determination of arm's length price or specify the manner in which arm's length price shall be determined, in relation to an international transaction to be entered into, by that person.

- (c) When is Profit Split Method applicable for the purpose of determining the arm's length price of international transactions?

**Answer:**

## Answer to MTP\_Intermediate\_Syllabus 2012\_Dec2013\_Set 1

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Profit Split Method is applicable mainly in international transactions involving transfer of unique intangibles or in multiple international transactions which are so interrelated that they cannot be evaluated separately for the purpose of determining the arm's length price of any one transaction.

**(d) Define Safe Harbour Rules.**

**Answer:**

The rules in which the Income Tax Authorities shall accept the transfer price declared by the assessee is called Safe Harbour Rules.

**(e) "Return on Asset Ratio is one of the profitability ratios" – Explain.**

**Answer:**

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

[5×1]

10.

(a)

**(i) In Resale Price Method, what are the adjustments to be made from the sale price to an unrelated third party by comparing the transaction to other third party transactions?**

**Answer:**

Where it is not possible to compare the transactions even by comparing with the transactions entered by the third party and that the differences have a material effect on price, necessary adjustments shall have to be made to eliminate the effect of such differences. Normally these adjustments are -

- A. **Inventory adjustment:** An adjustment to operating income for ratios other than the ROA is necessary if a comparable company has a different relative level of inventory holding than the tested party. The inventory adjustment thus estimates the implicit capital cost of holding inventory.
- B. **Accounts payable adjustment:** This adjustment eliminates the implicit interest in the price of goods purchased on other than a cash basis from suppliers. The purpose of this adjustment is to identify and eliminate from the profit, the effect of companies' decisions on how to finance purchases.
- C. **Accounts receivable adjustment:** This adjustment eliminates the implicit interest in the price of goods or services sold on other than cash basis to customers. The purpose of this adjustment is to identify and eliminate the profit related to finance decisions of the seller. A company selling on cash basis would receive a lower price than a company selling the goods on terms, because selling on terms subjects the seller to a capital cost that will be reflected in the price.
- D. **Contractual terms:** Where the contractual terms includes the provisions like warranties, terms of credit, facilities for transportation and transshipment of goods, facilities related to quantity of purchase or sale of goods.
- E. **The level of the market:** The adjustments also consider the level of the market, i.e. wholesale, retail, etc.
- F. **Foreign currency adjustments:** In case of an export transaction, the foreign exchange loss because of depreciation of the foreign currency is disadvantageous to the exporter and it results in lower margin. The comparable companies having domestic sale transactions will be having higher margin. If the tested party imports raw material

from foreign company, being an associated enterprise, it will be exposed to foreign exchange risk. The comparable companies using raw material procured from India will not be exposed from this risk. If the comparable companies hedge the FOREX risk using financial instruments adjustment for the same is required for the tested party which does not perform the hedging.

**(ii) How can GAAR be invoked?**

**Answer:**

The procedure for invoking GAAR is as under-

- I. The Assessing Officer shall make a reference to the Commissioner for invoking GAAR and on receipt of reference the Commissioner shall hear the taxpayer and if he is not satisfied by the reply of taxpayer and is of the opinion that GAAR provision are to be invoked, he shall refer the matter to an Approving Panel. In case the assessee does not object or reply, the Commission shall make determination as to whether the arrangements is an impermissible avoidance arrangement or not.
- II. The Approving Panel has to dispose of the reference within a period of 6 months from the end of the month in which the reference was received from the Commissioner.
- III. The Approving Panel shall either declare an arrangement to be impermissible or declare it not to be so, after examining material and getting further inquiry to be made.
- IV. The Assessing Officer will determine consequences of such a positive declaration of arrangement as impermissible avoidance arrangement.
- V. The final order, in case any consequence of GAAR is determined, shall be passed by the Assessing Officer only after approval by the Commissioner and thereafter, first appeal against such order shall lie to the Appellate Tribunal.
- VI. The period taken by the proceedings before the Commissioner and Approving Panel shall be excluded from time limitation for completion of assessment.
- VII. The Board will set-up an Approving Panel consisting of not less than 3 members being — Income-tax Authorities (not below the rank of Commissioner) and an official of the Indian Legal Service (not below the rank of Joint Secretary.)
- VIII. The panel will have a minimum of three members. The procedure and working of Panel shall be administered through subordinate legislation.
- IX. In addition to the above, it is provided that the Board shall prescribe a scheme for regulating the condition and the manner of application of these provisions.

**(iii) What are the steps to be followed for determining Arm's Length Price of an international transaction?**

**Answer:**

The following are the steps to be followed:-

**Step 1:** Selection of comparable companies

**Step 2:** Use of different filters

**Step 3:** Screening of comparables based on FAR Taxation of International Transactions

**Step 4:** Use of Power under Indirect Tax laws [special reference to Sec.133(6) of the Income Tax Act,1961]

**Step 5:** Adjustments

**Step 6:** 5% Safe Harbour

The steps may be enumerated as follows:

**Step 1: Selection of Comparable Companies**

## **Answer to MTP\_Intermediate\_Syllabus 2012\_Dec2013\_Set 1**

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The first step for doing this study is to select comparable companies. This can be selected in the following four ways:-

- a. Industry-wise selection
- b. Product-wise selection
- c. NIC Code-wise selection
- d. Segment-wise selection

The data relating to the financial year in which the international transaction has been entered into must be used in analyzing the comparability of an uncontrolled transaction with an international transaction.

### **Step 2: Use of different filters**

Once there is a selection of comparable companies, the next step is to filter these companies with the use of quantitative and qualitative filters. The following filters are also used sometimes:

- a. Companies whose data is not available for the relevant year
- b. Companies for which sufficient financial data is not available to undertake analysis
- c. Different financial year filter
- d. Turnover filter
- e. Service Income filter
- f. Export filter
- g. Diminishing Loss filter
- h. Related party filter
- i. Companies that had exceptional year/(s) of operation
- j. Employee cost filter
- k. Onsite and offsite filter
- l. Fixed Asset filter
- m. Research & Development Expense filter
- n. Income Tax filter

### **Step 3: Screening of comparables based on FAR**

Comparability of an international transaction with an uncontrolled transaction shall have to be judged with relevance to the following factors:

- a. The specific characteristics of the property transferred or services provided in either transaction;
- b. FAR Analysis- the (F) functions performed, taking into account (A) assets employed or to be employed or the (R) risks assumed by the respective parties to the transactions;
- c. The contractual terms (whether or not such terms are formal or in writing) of the transactions which lay down explicitly or implicitly how the responsibilities, risks and benefits are to be divided between the respective parties to the transactions;
- d. Conditions prevailing in the markets in which the respective parties to the transactions operate, including the geographical location and size of the markets, overall economic development and level of competition and whether the markets are wholesale or retail.

There may arise situation, where it requires further analysis of the following factors:-

- (i) Is there a public issue in the relevant year or previous year?
- (ii) Are the entity's profits exempted from tax?
- (iii) Is there any merger/de-merger, etc., during the relevant time?
- (iv) Is the depreciation policy different?
- (v) Is there a wide difference between various segments' profitability?
- (vi) Is the area of operation, i.e. geography different?
- (vii) Is the volume of operation different?

### **Step 4: Use of power under Indirect Tax Laws**

## Answer to MTP\_Intermediate\_Syllabus 2012\_Dec2013\_Set 1

This power is usually used by the Revenue Department/Authorities, with a special reference to Sec. 133(6) of the Income Tax Act, 1961. The authorities may exercise such powers for getting details which are generally not available in the annual reports of the companies. This power is used more in the earlier years.

### Step 5: Adjustments

Based on specific characteristics of the property transferred or the services rendered in either transaction and the contractual terms (whether or not such terms are formal or in writing) of the transactions which lay down explicitly or implicitly how the responsibilities, risks and benefits are to be divided between the respective parties to the transactions. The following enterprise level and transaction level adjustments are suggested:

- a. Functional differences
- b. Asset differences
- c. Risk differences
- d. Geographical location
- e. Size of the market
- f. Wholesale or retail market
- g. The laws and governmental orders in force
- h. Cost of labour
- i. Cost of capital in the markets
- j. Overall economic development
- k. Level of competition
- l. Accounting practices

However, in practice the following adjustments are provided:

- (i) Working capital adjustment
- (ii) Risk adjustment
- (iii) Volume/geographical/depreciation/idle capacity/first year operation, etc.

### Step 6: 5% Safe Harbour

- a. If the application of the MAM (Most Appropriate Method) leads to determination of more than one price, the arithmetical mean of such prices shall be taken to be the Arm's Length Price (ALP) in relation to the international transaction.
- b. If the ALP so determined is within +/- 5% range of international transaction price, then no adjustments are required
- c. If the ALP is not within +/- 5% range of the international transaction price, then adjustments are required for the whole difference between the ALP and international transactions and benefit of 5% will not be available.

However, the Finance Act, 2012 has fixed the upper limit of safe harbor as 3%

[6+5+9]

or

(b)

- (i) W Ltd. an Indian company sells computer monitor to its 100% subsidiary Q Ltd. in United States @ \$70 per piece. W Ltd. also sells its computer monitor to another Company Z Ltd. in United States @ \$90 per piece. Total income of W Ltd. for the assessment year 2013-14 is ₹15,00,000 which includes sales made for 120 computer monitor @ \$70 to Q Ltd. Compute the arm's length price and taxable income of W Ltd and Q Ltd. The rate of one dollar may be assumed to be equivalent to ₹50 for the sake of simplicity.

**Answer:**

Arm's length price ( $\$90 \times 120 \times ₹50$ ) = ₹5,40,000

**Income of W Ltd.:**

Particulars	₹
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## Answer to MTP\_Intermediate\_Syllabus 2012\_Dec2013\_Set 1

Income as per books of account	15,00,000
Less: Sale consideration 120 monitor sold to Q Ltd.(recorded price)	4,20,000
Add: Sale consideration at arm's length price	5,40,000
Taxable income	16,20,000

### Income of Q Ltd.:

As no income is deemed to accrue or arise in India, nothing is taxable in the hands of Q Ltd.

- (ii) **Khazana Ltd. is an Indian Company engaged in the business of developing and manufacturing industrial components. Its Canadian Subsidiary Techpro Inc. supplies technical information and offers technical support to Khazana Ltd. for manufacturing goods, for a consideration of €1,00,000 per year. Income of Khazana Ltd. is ₹90 Lakhs. Determine the Taxable Income of Khazana Ltd. if Techpro charges €1,30,000 per year to other entities in India. What will be the answer if Techpro charges €60,000 per year to other entities. (Rate per Euro may be taken at ₹50)**

**Answer:**

### Computation of Total Income of Khazana Ltd.

Particulars	₹	₹
When Price Charged for Comparable Uncontrolled Transaction	€1,30,000	€60,000
Price actually paid by Khazana Ltd. [€1,00,000 x 50]	50,00,000	50,00,000
Less: Price charged in Rupees ( under ALP)		
[€1,30,000 x 50]	65,00,000	
[€60,000 x 50]		30,00,000
Incremental Profit on adopting ALP [A]	(15,00,000)	20,00,000
Total Income before adjusting for differences due to Arm's Length Price	90,00,000	90,00,000
Add: Difference on account of adopting Arm's Length Price [ if (A) is positive]	Nil	20,00,000
Total Income of Khazana Ltd	90,00,000	1,10,00,000

**Note:** As per Sec. 92(3), Taxable Income cannot be reduced on applying ALP. Therefore, difference on account of ALP which reduces the Taxable Income is ignored.

- (iii) **When can enterprises be deemed to be “Associated Enterprises”?**

**Answer:**

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

- A. **Shareholding:** One enterprise holds, directly or indirectly, shares carrying not less than 26% of shares/voting power in the other enterprise.
- B. **Shareholding by same person:** Any person or enterprise holds, directly or indirectly, shares carrying not less than 26% of the voting power in each of such enterprises, or
- C. **Loans:** A loan advanced by one enterprise to the other enterprise constitutes not less than 51% of the book value of the total assets of the other enterprise, or
- D. **Guarantee:** One enterprise guarantees not less than 10% of the total borrowings of the other enterprise, or
- E. **Management Control:** More than half of the board of directors or members of the governing board, or one or more executive directors or executive members of the governing board of one enterprise, are appointed by the other enterprise, or

- F. **Control by same person:** More than half of the directors or members of the governing board, or one or more of the executive directors or members of the governing board, of each of the two enterprises are appointed by the same person or persons, or
- G. **Know-how relationship:** The manufacture or processing of goods or articles or business carried out by one enterprise is wholly dependent on the use of know-how, patents, copyrights, trade-marks, licences, franchises or any other business or commercial rights of similar nature, or any data, documentation, drawing or specification relating to any patent, invention, model, design, secret formula or process, of which the other enterprise is the owner or holder of exclusive rights, or
- H. **Purchase relationship:** 90% or more of the raw materials and consumables, required for the manufacture or processing of goods or articles carried out by one enterprise, are supplied by the other enterprise, or by persons specified by the other enterprise and the prices and other conditions relating to the supply are influenced by such other enterprise, or
- I. **Sale relationship:** The goods or articles manufactured or processed by one enterprise, are sold to the other enterprise or to persons specified by the other enterprise and the prices and other conditions relating thereto are influenced by such other enterprise, or
- J. **Control through relatives of individual:** Where one enterprise is controlled by an individual, the other enterprise is also controlled by such individual or his relative or jointly by such individual and relative of such individual, or
- K. **Control through members of HUF:** Where one enterprise is controlled by HUF, the other enterprise is controlled by a member of such HUF, or by a relative of a member of such HUF, or jointly by such member and his relative, or
- L. **Control through Firms etc.:** Where one enterprise is a Firm/AOP/BOI, the other enterprise holds not less than 10% interest in such Firm /AOP/BOI, or
- M. **Other relationships:** There exists between two enterprises, any relationship or mutual interest, as prescribed.

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

**Answer:**

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

- A. The most serious problem is the need to find transactions between independent parties which can be said to be exact compared to the controlled transaction.
- B. It is important to appreciate that in a Multinational Enterprise system, a group first identifies the goal and then goes on to create the associated enterprise and finally, the transactions entered into. This procedure obviously does not apply to independent enterprises. Due to these facts, there may be transactions within a Multinational Enterprise group which may not be between independent enterprises.
- C. Further, the reductionist approach of splitting a Multinational Enterprise group into its component parts before evaluating transfer pricing may mean that the benefits of economies of scale, or integration between the parties, is not appropriately allocated between the Multinational Enterprise group.
- D. The application of the arm's length principle also imposes a burden on business, as it may require the Multinational Enterprise to do things that it would otherwise not do (i.e. searching for comparable transactions, documenting transactions in detail, etc).
- E. Arm's length principle involves a lot of cost to the group.

