Paper-7 Direct Taxation

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

All the questions relate to the assessment year 2014-15, unless stated otherwise.

Working notes should form part of the answers.

Section A

[Answer all the Questions]

(1) Answer the following sub-divisions briefly in the light of the provisions of the Income-tax Act, 1961: (1×20)

(i) State, whether an assessee can claim depreciation under section 32, on capital expenditure incurred on construction of any structure in a building, which is taken on lease, for the purposes of business or profession.

(ii) State, whether an assessee can claim deduction of expenditure incurred on scientific research, carried on by him.

(iii) State the circumstance, when interest is levied under Section 234A of the Income Tax Act, 1961. Also, state the rate at which interest is payable.

(iv) The W.D.V of a block (plant and machinery, rate of depreciation 15%) as on 01.04.2013 is ₹6,40,000. A machinery costing ₹1,00,000 was acquired on 10.08.2013, but put to use on 10.11.2013. During February 2014, part of this block was sold for ₹4,00,000. Calculate the amount of depreciation.

(v) Vinod Mehta, an Indian resident, is provided with furnished accommodation from February, 2014, by his employer. The value of furniture amounts to ₹95,000. The actual hire charges paid by his employer, for the furniture is ₹6,000 p.a. What would be the value of furniture to be included along with value of unfurnished house for A.Y 2014-15?

(vi) Ace Enterprises Ltd. has unabsorbed depreciation of ₹4,50,000 for the Previous Year 2013-14. How many years this can be carried forward?

(vii) Somlata, an Indian resident, received ₹1,00,000 in December 2013 towards recovery of unrealized rent, which was deducted from actual rent during previous year 2012-13. What would be the amount taxable under Section 25AA of the Income Tax Act, 1961?

(viii) Mr. Deepak Sharma (aged 66 years), an Indian resident, paid medical insurance premium of ₹ 19,000 by cheque and ₹1,000 by cash during June 2013 under a Medical Insurance Scheme of the General Insurance Corporation. The above sum was paid for insurance of his own health. Calculate the amount of deduction available under Section 80D.

(ix) Mr. Mukul Sharma, a resident individual, pays a rent of ₹6,000 per month. His adjusted total income is ₹3,00,000 (i.e Gross Total Income as reduced by deductions under Chapter VI-A of the Income Tax Act, 1961, except under Section 80GG). The assessee is not in receipt of House Rent Allowance. Compute the amount of deduction available under Section 80GG of the Income tax Act, 1961.

(x) What is the period under which an assessee can file revised return?

(xi) Where a member of a HUF has converted or transferred his self-acquired property for inadequate consideration into joint family property, and such converted property is subsequently partitioned among the members of the family. Whether the income derived from such converted property as is received by the spouse of the transferor will be taxable?

(xii) What is the percentage of income derived from property held under trust (wholly for charitable or religious purpose) , should be applied for the approved purposes, for claiming exemption under section 11 of the Income Tax Act, 1961.

(xiii) What is the amount of deduction available u/s 16(ii) of the Income Tax Act, 1961 in respect of entertainment allowance received by a Government employee?

(xiv) Weather a commercial house given on rent for 320 days during the Previous Year is cover under the definition of assets u/s 2(ea)(i) of Wealth Tax Act?

(xv) Whether a residential flat allotted to its employee (having substantial interest) by a company where the salary of the employee is ₹ 9,99,000 p.a. is taxable assets under wealth tax act?

(xvi) Explain the purpose of Advance Pricing Agreement.

(xvii) Explain the validity of an agreement of advance pricing if the person obtain APA by means of fraud.

(xviii) Who is the authorized person to furnish the report under section 92E of the Transfer Pricing Regulation Act in India?

(xix) Whether advance pricing Agreement can be entered into for Specified Domestic Transactions?

(xx) How many years a person should kept and maintained of information and documents under section 92D?

Answer:

(i) Explanation 1 to section 32(1) of the Income Tax Act, 1961 provides that, if an assessee carries on business or profession in a building not owned by the assessee, but which has been taken on lease by him, he can claim depreciation under section 32, on capital expenditure incurred on construction of any structure in such building, by way of improvement, renovation or extension.

(ii) Section 35(1) of the Income Tax Act, 1961 provides that, where the assessee himself carries on scientific research and incurs revenue expenditure during the previous year, deduction is allowed for such expenditure, only if such research relates to his business.

(iii) If a return of income is furnished after the due date, or is not furnished, the assessee is liable to pay interest under Section 234A of the Income Tax Act, 1961 at the rate of one percent per month or part of a month, for the period commencing from the date immediately following the due date of filing return of income and ending on the date of furnishing return of income, or the date of completion of assessment under Section 144 of the Income Tax Act, 1961.

(iv) Computation of depreciation to be charged for the A.Y 2014-15

Particulars	**Amount (₹)**
W.D.V of a block (plant and machinery), as on 01.04.2013	6,40,000
Less: Sale of part of block	4,00,000
	2,40,000
New machine acquired on 10.08.2013	1,00,000
Depreciation on block of assets: (i) On ₹ 2,40,000 @ 15% = ₹ 36,000 (ii) On ₹ 1,00,000 @ 15% × ½= ₹ 7,500	43,500

(v) While computing the value of perquisite of rent-free furnished accommodation, provided by the employer, the value of furniture shall be the actual hire charges payable (whether paid or payable), if furniture is hired by the employer.

Value of furniture, to be included in the value of rent-free furnished accommodation

= ₹6,000 × 2/12 = ₹1,000

(vi) Section 32(2) of the Income Tax Act, 1961 provides that unabsorbed depreciation can be carried forward by the assessee himself, for consecutive assessment years, for an indefinite period, and can be set off against any income, whether chargeable under the head "Profits and gains of business or profession" or under any other head (except income under the head "Salaries").

(vii) Section 25AA of the Income Tax Act, 1961 provides that, the receipt of unrealized rent of an earlier year, in the current year, shall be deemed to be income chargeable under the head "Income from House property", in the year of its receipt. So the entire amount of ₹1,00,000 is taxable.

(viii) Mr. Deepak Sharma, being a senior citizen, is eligible for claiming deduction under Section 80D of the Income tax Act, 1961, of an amount up to ₹ 20,000. However, the assessee has paid part of the medical insurance premium in cash (₹1,000). To the extent, such premium has been paid in cash, the expenditure shall stand disallowed. Mr. Deepak Sharma shall be entitled to claim a deduction under Section 80D of a sum of ₹ 19,000.

(ix) The amount deductible under Section 80GG of the Income Tax Act, 1961 is the least of the following:

(i) ₹2,000 per month.
(ii) 25 per cent of adjusted total income.
(iii) The excess of actual rent paid over 10 per cent of adjusted total income.

So the amount of deduction u/s 80GG is ₹24,000.

(x) An assessee can file a revised return of income at any time before the completion of assessment or before expiry of one year from the end of the relevant assessment year, whichever is earlier.

(xi) Section 64(2) of the Income Tax Act, 1961 provides that, if the property converted or transferred by an individual, to the HUF, as the joint family property, is subsequently distributed amongst the members of the family, upon partition of the HUF, the income derived from such converted property, as is received by the spouse of the transferor will be included in the income of the transferor.

(xii) For claiming exemption from tax under Section 11 of the Income Tax Act, 1961, a charitable trust or institution should apply at least 85% of the income from property held under such trust for charitable or religious purposes in India.

(xiii) Section 16(ii) of the Income Tax Act, 1961 provides for deduction in respect of entertainment allowance received by a Government employee, to the least of the actual entertainment allowance received, or, 20% of salary, or, ₹ 5,000.

(xiv) Commercial house falling under the category of commercial establishments. Hence, this is taxable assets u/s 2(ea)(i).

(xv) A residential house which is allotted by a company to an employee who is in whole-time employment, having a gross annual salary of less than ₹10,00,000 is not an asset.

(xvi) APA shall include determination of the 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 the person.

(xvii) The Board is empowered to declare, with the approval of Central Government, any such agreement to be void ab initio, if it finds that the agreement has been obtained by the person by fraud or misrepresentation of facts. Once an agreement is declared void ab initio, all the provisions of the Act shall apply to the person as of such APA had never been entered into.

(xviii) Any person who has involved in an international transaction in the previous year shall submit the report in Form 3CEB through a Chartered Accountant, duly verified and certified by him, on or before the date (i.e. 30th September of every year) prescribed by the authority, furnishing all the required details .

(xix) Advance pricing agreement cannot be entered for Specified Domestic Transactions.

(xx) The Board, vide rule 10D(5) has prescribed that the information and documents shall be kept and maintained for a period of 8 years from the end of the relevant assessment year.

2. Answer any four Questions [4 × 13 = 52]

(a)(i) From the following particulars compute the 'Income from House Property' of Mr. Mitra for the Assessment Year 2014 - 2015 :

Mr. Mitra inherited a property on 1.4.2010 from which gross rental income is ₹ 30,000 per year. Municipal Tax of the property is ₹ 1,000 per quarter of which 50% is borne by the tenant Mr. Mitra took loan of ₹ 80,000 from a bank for heavy repairing of the property out of which he spent ₹ 40,000 for his sister's marriage and the balance spent for repairing of the property. He paid during the year 2013-2014 ₹ 6,000 as interest on bank loan and spent ₹100 per month for collection of rent. [6]

Solution

Computation of Income from House Property of Mr. Mitra for the A.Y. 2014-2015 relating to the previous year 2013-14

Particulars	₹	₹	₹
Income from House Property			
House (fully let-out)			
Gross Annual Value	30,000		
Less : Municipal Tax (1,000 x 4) x 50%	2,000		
Less: Deduction u/s 24(a)		28,000	
30% of Net Annual Value on Standard Deduction			
Deduction u/s 24(b)	8,400		
Interest on Loan $(6{,}000 \times \frac{40{,}000}{80{,}000})$	3,000		
		11,400	
Total Income from House Property			16,600

Notes : 1. Municipal tax paid by tenant is not allowable deduction.

2. Interest on loan will be allowed in proportion to the loan used for the Building.

(ii) From the following information of Mr. A. S. Ghosh, compute the income from salary for the Assessment Year 2014-15.

(1) Net salary ₹ 1,20,000. (2) Amount deducted from salary at source ₹ 10,000 for employee's contribution to R.P.F. and for rent ₹ 500 p.m. (3) Bonus ₹ 10,000 (4) Dearness allowance ₹ 12,000. (5) Conveyance allowance ₹ 5,000. (6) Medical allowance ₹ 4,000. (7) Employer's contribution to R.P.F. @ 13% on basic plus D.A. (8) Interest on R.P.F. @ 14% is ₹ 5,600.

He has been provided a rent-free accommodation at Kolkata including furniture costing ₹50,000. [7]

Solution:

Computation of Income from salary of Mr. A. S. Ghosh, a resident individual, for the Assessment Year 2014-15 relating to previous year 2013-14.

Particulars	₹	₹	₹
Net Salary	1,20,000		
Add: Amount deducted from salary -			
Employee's contribution to R.P.F.	10,000		
Rent	6,000		
Basic Salary		1,36,000	
Add: Dearness allowance		12,000	1,48,000
Add: Bonus			10,000
Add: Medical allowance			4,000
Add: Conveyance allowance		5,000	
Less: Exemption u/s 10(14)		5,000	Nil
Add: Employer's contribution to R.P.F. (1,48,000 x 13%)		19,240	
Less: 12% of salary (1,48,000 X 12%)		17,760	1,480
Add: Interest on R.P.F (excess of 9.5%)			1,800
Add: Rent-free furnished accommodation		24,300	
[u/s. 17(2)(ii)] (1,62,000 X 15%)			
Add: 10% of cost of furniture (50,000 X 10%)		5,000	
		29,300	
Less: Rent deducted		6,000	23,300
Income from Salary			1,88,580

(b)(i) Miss Titir started a business of manufacturing cosmetic goods. She incurred the following expenses before the commencement of her business:

S.N.		**₹**
(a)	**Expenses for market survey**	**25,000**
(b)	**Legal charges for drafting an agreement with other for setting up her business**	**20,000**
(c)	**Expenses for preparation of feasibility report**	**15,000**
(d)	**Expenditure for raising loan for the business**	**4,000**

Her business was started on 1.7.08:

Book value of assets on 31.3.09 were:

S.N.		**₹**
(a)	**Building**	**10,00,000**
(b)	**Machinery**	**10,00,000**
(c)	**Furniture**	**4,00,000**
(d)	**Stock**	**4,00,000**
(e)	**Patent**	**1,00,000**

Calculate the allowable preliminary expenditure for the Assessment Year 2014-15. [7]

Solution:

Calculation of the cost the project:

	₹
Building	10,00,000
Machinery	10,00,000
Furniture	4,00,000
	24,00,000

Eligible Amount of preliminary expenses:

	₹
Expenses For Market Survey	25,000
Legal charges for drafting agreement	20,000
Expenses for Preparation of feasibility report	15,000
	60,000

Qualifying amount for deduction u/s 35D lower of the following two:

	₹
(a) 5% of the cost of the project i.e. ₹ 24,00,000 x 5%	1,20,000
(b) Actual amount of preliminary expenses	60,000
Deduction for A. Y. 2014-15 u/s 35D is $\frac{1}{5}$th of ₹ 60,000	12,000

(ii) Discuss me provisions of the Income Tax Act relating to Capital Expenditure incurred by an Assessee, for the purpose of scientific research. Sri P. K. Nag a spare parts dealer, furnishes the following particulars of his income for the Previous Year ended 31.03.13.

Profit and Loss A/c
for the year ended 31.03.14

Dr. **Cr.**

Particulars	₹	Particulars	₹
To Salaries	50,000	By Gross Profit b/d	2,50,000
„ Rent, Rates & Taxes	12,000	„ Dividend	5,000
„ Legal charges	4,000	„ Bank Interest	1,000
„ Interest on Capital	3,000		
„ Office Expenses	14,000		
„ Provision for Bad Debt	2,600		
„ Income Tax	22,000		
„ Depreciation	13,000		
„ Insurance Premium	6,000		
„ Net Profit	1,29,400		
	2,56,000		2,56,000

Other Information

i. **One-third of the premises is used by him for his own residence.**
ii. **Legal charges include ₹ 1,000 in connection with Income Tax proceedings.**
iii. **Office expenses include ₹ 1,000 as daily Puja Expenses in the shop.**
iv. **Depreciation as per Income Tax Rules ₹ 15,000. Compute Shri Nag's Income from Business for the Assessment Year 2014-15.** **[6]**

Solution:

Computation of Income from Business of P. K. Nag, resident individual, for the Assessment Year 2014-15, relating to the Previous Year 2013-14

Particulars	₹	₹
Net Profit as per Profit and Loss Account		1,29,400
Add: Disallowed Expenses		
Interest on Capital	3,000	
Provision for Bad Debt	2,600	
Income Tax 22,000	22,000	
Depreciation (T.S.)	13,000	
Rent, Rates and Taxes (12,000 x $^1/_3$)	4,000	44,600
Less: Disallowed Income		
Dividend	5,000	
Bank Interest	1,000	6,000
		1,68,000
Less: Allowable Expenses		
Depreciation (allowed by I.T.O.)		15,000
Income from Business		1,53,000

Notes: Office expenses include daily puja expenses as allowable expenses.

(c) (i) Mr. Dey sells a residential house property at a long-term capital gain of ₹ 75,000. He invests ₹ 80,000 within 3 years in construction of the first floor and barsati (to be used for residence) to another house owned by him since 1949. Is ₹ 75,000 exempt from tax under section 54? (Specify in details) **[3]**

Answer:

The words "house property" in section 54 does not mean an independent and completed house. They have the same meaning as the concept of house property in sections 22 to 27 and it includes an independent unit such as the first floor of house. In fact, there can be no doubt that the section takes into account all independent residential units, particularly in the days when multi-storied flats are becoming the order of the day. The amount of capital gain is invested by Mr. Dey in the construction of a house property within the meaning of section 54, which is completed within a period of 3 years after the date of the sale. Further, the house property so constructed is admittedly used for the purpose of residence. Hence, Mr. Dey is entitled to the exemption under section 54.

(ii) Ravi purchases the following movable and immovable properties from persons who are not his relatives. State the tax liability in the hands of Ravi.

Date of purchase	Property	Purchase price ₹	Stamp duty value ₹	Fair market value ₹
April 22, 2013	**House I**	**21 lakh**	**21.5 lakh**	**----**
June 27, 2013	**Plot of land**	**30 lakh**	**30.5 lakh**	**----**
August 22, 2013	**Gold ring**	**5 lakh**	**----**	**5.5 lakh**
October 23, 2013	**Shares**	**8 lakh**	**----**	**8.5 lakh**

[7]

Solution:

Section 56(2)(vii)(b) of Income-tax Act has been amended with effect from assessment year 2014-15 to cover the case of receipt of receipt of immovable property with inadequate consideration. The amended provision is applicable only when an individual or HUF has received an immovable property for a consideration which less than the stamp duty value of the property by an amount exceeding ₹ 50,000.

House I - House I is purchased for less than stamp duty value. The difference is ₹ 50,000. The amended provision is applicable only if stamp duty value is more than purchase price and the difference is more than ₹ 50,000. Consequently, nothing is taxable in the hands of Ravi on purchase of House I. However, in the hands of the transferor, stamp duty value of ₹ 21.5 lakh will be taken as sale consideration under section 50C or 43CA.

Plot of land - Plot of land is purchased for ₹ 30 lakh. Stamp duty value is ₹ 30.5 lakh. The inadequacy of consideration is ₹ 50,000. Since it is not more than ₹ 50,000, the amended provision is not applicable. Consequently, nothing is taxable in the hands of Ravi under section 56. It may be noted that inadequacy of consideration of ₹ 50,000 of House I and inadequacy of consideration of plot of land of ₹ 50,000 cannot be clubbed (such clubbing is required in the case of recipient of movable properties). In the hands of the transferor, ₹ 30.5 lakh is taken as full value of consideration by virtue of section 50C or 43CA.

Gold ring and shares - Gold ring is purchased for less than fair market value. Likewise, shares are purchased for less than fair market value. The two assets come within the definition of "movable property" under section 56. The aggregate inadequacy of consideration is more than ₹ 50,000 (i.e., ₹ 5.5 lakh - ₹ 5 lakh + ₹ 8.5 lakh - ₹ 8 lakh = ₹ 1 lakh). Consequently, ₹ 1 lakh is taxable under section 56(2). In the hands of the transferors of gold ring and shares, ₹ 5 lakh and ₹ 8 lakh, respectively, will be taken as sale consideration. Section 50C or section 43CA is not applicable on transfer of movable properties.

(iii) State whether assets having personal effects are also capital assets or not [as per section 2(14)(ii) of Income-tax Act]? [3]

Answer:

Assets having personal effects are not capital assets under section 2(14)(ii) of Income-tax Act, if the following conditions are satisfied:

1. It should be movable property (including wearing apparel and furniture).
2. It should be held for personal use by the assessee or any member of his family dependent on him.
3. It should not be jewellery, archaeological collections, drawings, paintings, sculptures, or any work of art.

(d) (i) State the taxability of the following five incomes —

- **A. Dividend**
- **B. Bonus**
- **C. Winning from lotteries etc.**
- **D. Fees and commission**
- **E. Gift [10]**

Answer:

A. Dividend is defined by section 2(22) *of Income-tax Act*. Dividend from an Indian company is not taxable in the hands of shareholders. However, deemed dividend under section 2(22)(e) from an Indian company or any dividend from a foreign company is taxable in the hands of shareholders under the head "Income from other sources".

B. It is taxable in the year of receipt if it has not been taxed earlier on due basis. While contractual bonus is regarded as salary, gratuitous bonus is taxable as perquisite. If bonus is received in arrears, the assessee can claim relief in terms of section 89.

C. It includes any winnings from lotteries, crossword puzzles, races including horse races, card games and other games of any sort or from gambling or betting of any form or nature whatsoever. These receipts are chargeable to tax under the head "Income from other sources".

D. Fees and commission are taxable as salary irrespective of the fact that they are paid in addition to or in lieu of salary. However, if fees and commission is paid to a person (other than an employee), it is not taxable as salary income. For instance, commission paid to a director (not being an employee) for his giving guarantee for repayment of loan, etc. is taxable under the head "Income from other sources".

E. If any sum of money or property is received during a previous year without consideration by an individual or a Hindu undivided family from any person or persons exceeds ₹ 50,000, the whole of such amount is taxable in the hands of the recipient as income from other sources.

(ii) Write to whom Alternate Minimum Tax shall not be applicable as per Section 115JEE (2). [3]

Answer:

The provisions of Alternate Minimum Tax under Chapter XII-BA shall not apply to-

(i) an Individual; or

(ii) a Hindu Undivided Family; or

(iii) an Association of Persons or a Body of Individuals (whether incorporated or not) or

(iv) an Artificial Juridical Person referred to in section 2(31) (vii),

if the Adjusted Total Income of such person does not exceed ₹ 20,00,000.

(e) (i) Ms. Jennifer D' Souza, an individual resident Indian, aged 62 years, frequently visits a foreign university to deliver lectures and receives honorarium of ₹ 3,35,000 for the same. Tax of ₹ 33,500 was deducted in the foreign country. India did not have any double taxation avoidance agreement with that foreign country. The particulars of income earned in India are stated as follows:

(i) In India, her total income amounted to ₹10,20,000.

(ii) Contribution to the Public Provident fund - ₹ 1,40,000.

(iii) Contribution to the approved Pension Fund of LIC- ₹ 64,000.

(iv) Contribution to Central Government Health Scheme during the previous year- ₹36000.

(v) Payment of medical Insurance premium, for mother (who is not dependent on her) - ₹21,000.

Compute the tax liability of Ms. Jennifer D' Souza for the Assessment Year 2014-15. [7]

Solution:

Computation of tax liability of Ms. Jennifer D' Souza for the Assessment Year 2014-15

Assessee: Ms. Jennifer D' Souza

Assessment Year: 2014-15 **Previous Year: 2013-14**

Particulars	**₹**	
Indian Income Foreign Income		10,20,000 3,35,000
Gross Total Income		**13,55,000**
Less: Deductions Deposit in PPF **[Section 80C]** Contribution to approved Pension Fund of LIC **[Section 80CCC]**	1,40,000 64,000	
	2,04,000	
The aggregate deduction under Sections 80C, 80CCC and 80CCD(1) has to be restricted to ₹1,00,000 **[Section 80CCE]**	1,00,000	1,00,000
Contribution to Central Government Health Scheme.**[Section 80D]** (Under Section 80D, the maximum deduction allowed to a senior citizen is ₹20,000)	20,000	20,000
Medical insurance premium paid for mother **[Section 80D]**	20,000	20,000
GROSS DEDUCTIONS		**1,40,000**
TOTAL INCOME		**12,15,000**

TAX ON TOTAL INCOME Income Tax payable Education Cess @ 2% Secondary and Higher Education Cess@ 1%	 1,89,500 3,790 1,895	 1,95,185
Average rate of tax in India [₹1,95,185/12,15,000 x 100] **Average rate of tax in foreign country** [₹33,500/3,35,000 x 100] Rebate under Section 91 shall be limited to the lower of average Indian tax rate or average foreign tax rate **Hence, rebate under Section 91 shall be = (₹335000 x 10%)**		16.06% 10% 33,500
Tax payable in India (₹ 1,95,185 - ₹ 33500)		1,61,685

(ii) Mr. Satish submits the following details of his income for the assessment year 2014-15:

Particulars	**₹**
Income from salary	**6,00,000**
Loss from house property	**(80,000)**
Income from sugar business	**1,00,000**
Loss from iron ore business (b/f)(discontinued in 2007-08)	**(2,40,000)**
Short term capital loss	**(1,20,000)**
Long term capital gain	**80,000**
Dividend	**10,000**
Lottery Winnings	**1,00,000**
Winnings from card games	**12,000**
Agricultural Income	**40,000**
Long term capital Gain on sale of shares	**20,000**
Short term Capital Loss under Section 111A	**20,000**
Bank Interest	**10,000**

Calculate gross total income and losses to be carried forward for the A.Y 2014-15. [6]

Solution:

Computation of Gross Total Income of Mr. Satish for the A.Y 2014-15

Particulars	**₹**	**₹**
Salaries: Income from salary	 6,00,000	
Income from house property Loss from house property	 (80,000)	5,20,000
Profits and Gains of Business of profession: Income from sugar business Less: Brought forward loss from iron ore business **Balance business loss of ₹1,40,000 carried forward to A.Y 2015-16**	 1,00,000 (2,40,000)	 ---
Capital Gains Long term capital gain Less: Short term capital loss **Capital Losses to be carried forward:** i. Short Term Capital Loss of ₹40,000 to be carried forward	 80,000 (1,20,000)	 ---

ii. Short term Capital Loss under Section 111A, of ₹20,000 to be carried forward		
Income from other sources:		
Lottery Winnings	1,00,000	
Winnings from card games	12,000	
Bank Interest	10,000	1,22,000
GROSS TOTAL INCOME		**6,42,000**
Losses to be carried forward to A.Y 2015-16 **i. Loss of ₹1,40,000 from iron-ore business** **ii.Short term Capital Loss of ₹40,000** **iii.Short term Capital Loss under Section 111A, of ₹20,000 to be carried forward**		

NOTES:

1. Dividend Income is exempt under Section 10(34), assuming that dividend is received from a domestic company.
2. Agricultural Income is exempt under Section 10(1).
3. Long term Capital gain, on which STT is paid is exempt under Section 10(38).
4. It is presumed that, loss from iron-ore business relates to the previous year 2007-08, the year in which the business is discontinued.

Section B

3. Answer any two Questions [1 × 8 = 8]

(a) (i) Discuss in respect of the following items, the manner of treatment for Mrs. P's wealth-tax assessment for the assessment year 2014-15.

1. **Mrs. P has two cars for her personal use each being of value of ₹ 95,000.**
2. **She has another house property at Nainital given to her as a gift by her father on January 1, 1971 on the occasion of her birthday. This house is also used by her as her own residence where she lives during summer vacations only. The value of the house on March 31, 2014 was ₹ 25,00,000.**
3. **Jewellery received from her father at the time of her marriage in 1956 was of the value of ₹ 1,20,000 on March 31, 2014. [3]**

Answer:

1. ₹1,90,000 (₹ 95,000 × 2) is chargeable to wealth-tax.
2. Value of the house is to be included in the net wealth of Mrs. P. She can, however, claim exemption under section 5(vi).
3. Jewellery received in 1956 is outside the purview of section 4. Therefore, it will be included in the net wealth of Mrs. P.

(ii) Compute the taxable net wealth and wealth tax payable by X Ltd. from the following particulars:

- **Land in urban area (Construction is not permitted as per Municipal Laws in force) ₹50,00,000.**

- **Cash Balance (as per books) ₹ 2,75,000.**
- **Guest House (situated in a place which is 30 kms away from the local limits of the municipality) ₹ 35,00,000. [5]**

Solution:

Assessee: X Ltd. Valuation Date: 31.3.2014 Assessment Year: 2014-15

Computation of Taxable Net Wealth and Wealth Tax Payable

Nature of Assets	₹	Reasons
Land in Urban Area	Nil	Land in which construction is not permitted as per municipal law is not an asset u/s 2(ea) of Wealth-tax Act
Cash Balance	Nil	Cash as per books - Not an asset u/s 2(ea) of Wealth-tax Act
Guest House	35,00,000	Asset u/s 2(ea) of Wealth-tax Act
Net Wealth	35,00,000	
Less: Basic Exemption	30,00,000	
Taxable Net Wealth	5,00,000	
Tax Payable @1%	**5,000**	

(b) Mr. Rajendra Sinha, an individual, furnishes the following information, relating to the assets and liabilities as on 31.03.2014:

Sl. No	Particulars	Amount (₹)
(i)	**Plot of land at Mumbai, comprising an area of 1200 square meters, (on which building has been constructed without the approval of the appropriate authority).**	**50,00,000**
(ii)	**Building constructed on land at Mumbai, without the approval of the appropriate authority, and used for his business purposes.**	**20,00,000**
(iii)	**Two residential house properties, (one of the house properties is used for the purpose of business, by Mr. RajendraSinha)**	**10,00,000 (each)**
(iv)	**Urban Land was purchased in August 2011 located in Pune, in the name of his son who is suffering from a disability specified under Section 80U of the Income Tax Act, 1961. The age of his son on 31.03.2014 was 17 years.**	**5,00,000**
(v)	**House located in Ahmedabad, shown in his wealth-tax return for the A.Y 2013-14 at ₹50 Lakh was sold on 20.03.2014 for ₹60 Lakh, but the sale deed thereof was executed on 03.04.2014.**	**55,00,000**
(vi)	**Motor cars held as stock-in-trade.**	**75,00,000**
(vii)	**Gold jewellery brought into India from Singapore, where he was residing, on his return to India on 01.11.2009, for permanently residing in India.**	**12,00,000**
(viii)	**Jewellery made of platinum.**	**18,00,000**
(ix)	**Jewellery gifted to wife from time to time, were available with her on**	**35,00,000**

	the valuation date. The jewellery was acquired for ₹10 Lakhs.	**(Fair Market Value)**
(x)	**Interest in the coparcenary property of the Hindu Undivided Family, of which he is a member.**	**25,00,000**
(xi)	**Cash in hand, recorded in the books of account.**	**10,00,000**
(xii)	**Fixed Deposits in a co-operative bank.**	**20,00,000**
Liabilities		
(xiii)	**Loan borrowed for marriage of daughter**	**12,00,000**
(xiv)	**Loan borrowed for construction of building at Mumbai**	**10,00,000**

The minor married daughter of Mr. RajendraSinha holds a plot of land at Bhopal, valued at ₹40 Lakhs. The amounts stated against the assets, except cash in hand, are the values determined as per Section 7 of the Wealth Tax Act, 1957 read with Schedule III thereto.
Compute the net wealth of Mr. RajendraSinha, as on the valuation date 31.03.2014.
State the reasons for inclusion, or exclusion of the various items. [8]

Solution:

Assessee: Mr. RajendraSinha Valuation Date: 31.03.2014 Assessment Year: 2014-15

Computation of net wealth

Sl. No.	Particulars	Note	Amount (₹)	Amount (₹)
ASSETS (as per the definition of "Assets", under Section 2(ea) of the Wealth Tax Act, 1957)				
(i)	Plot of land in Mumbai.	**1**		50,00,000
(ii)	Building constructed on land at Mumbai, without the approval of the appropriate authority.	**2**		NIL
(iii)	Residential house properties.	**3**		NIL
(iv)	Urban Land was purchased in Pune, in the name of his son who is suffering from a disability specified under Section 80U of the Income Tax Act, 1961.	**4**		NIL
(v)	House located in Ahmedabad, which has already been sold.	**5**		NIL
(vi)	Motor cars held as stock-in-trade.	**6**		NIL
(vii)	Gold jewellery brought into India from Singapore	**7**		NIL
(viii)	Jewellery made of platinum.	**8**		18,00,000
(ix)	Jewellery gifted to wife	**9**		35,00,000
(x)	Interest in the coparcenary property of the Hindu Undivided Family	**10**		NIL
(xi)	Cash in hand, in excess of ₹50,000	**11**		9,50,000
(xii)	Fixed Deposits in a co-operative bank	**12**		NIL
(A) TOTAL ASSETS				**1,12,50,000**

LESS:	**Liabilities**			
(xiii)	Loan borrowed for marriage of daughter	**13**		NIL
(xiv)	Loan borrowed for construction of building at Mumbai	**14**		NIL
(B) TOTAL LIABILITIES				**NIL**
(C) NET WEALTH [(A)- (B)]				**1,12,50,000**

NOTE:

1. Plot of land at Mumbai, comprising an area of 1200 square meters, (on which building has been constructed without the approval of the appropriate authority), is an asset under Section 2(ea) of the Wealth Tax Act, 1957, and is therefore, included in the computation of the net wealth of the assessee. Since, the plot of land comprises an area of more than 500 square meters, it is not eligible for exemption under Section 5(vi) of the Wealth Tax Act, 1957.
2. Building constructed on land at Mumbai, without the approval of the appropriate authority, is not an asset under Section 2(ea) of the Wealth Tax Act, 1957, since the building is being used for the purposes of business.
3. The assessee owns two residential house properties. One of the house property shall be exempt from the levy of wealth tax. This is so because, a house used exclusively for residential purpose is treated as an 'Asset' under Section 2(ea) of the Wealth Tax Act, 1957, but is exempt under Section 5(vi) of the Wealth Tax Act, 1957.
   The other house property shall also be exempt from the levy of wealth tax, because, the residential property is used for the purposes of business.
4. Urban Land is an asset, by virtue of Section 2(ea)(v) of the Wealth Tax Act, 1957. However, since, the same is in the name of his minor son, who suffers from a disability specified under Section 80U of the Income Tax Act, 1961, the clubbing provisions are not applicable as per Section 4(1)(a)(ii) of the Wealth tax Act, 1957.
5. The house property, located in Ahmedabad, was sold during the year and is, therefore, not an asset of the assessee, but is an asset of the beneficial owner, since ownership of the property passes on sale of property and execution of sale deed only confirms the act of the parties.
6. Motor cars held as stock-in-trade do not fall within the Meenakshiew of the definition of an 'Asset', under Section 2(ea) of the Wealth Tax Act, 1957, and hence, is not chargeable to wealth tax.
7. Gold jewellery brought into India on 01.11.2009, from Singapore is exempt under Section 5(v) of the Wealth Tax Act, 1957, for seven successive assessment years, beginning with the Assessment Year 2010-11.
8. Jewellery made of platinum, is an asset under Section 2(ea) of the Wealth Tax Act, 1957, and is, therefore, included in the net wealth.
9. The fair market value of the Jewellery gifted to wife, will be included in the computation of the net wealth of Mr. RajendraSinha, as per the provisions of Section 4(1)(a)(i), read with Rule 18 of Schedule III of the Wealth Tax act, 1957.
10. Interest in the coparcenary property of the Hindu Undivided Family, of which Mr. Rajendra Sinha is a member, is exempt under Section 5(ii) of the Wealth Tax Act, 1957.

11. Cash in hand, in excess of ₹50,000, is includible in the net wealth of an individual, whether such cash is recorded in the books of account, or not.
12. Fixed Deposits in a co-operative bank do not constitute 'assets' within the meaning of Section 2(ea) of the Wealth Tax Act, 1957, and is hence, not included in the computation of the net wealth of the assessee.
13. Loan borrowed for marriage of daughter, is not deductible, since, only loans in relation to assets (under Section 2(ea) of the Wealth Tax Act, 1957) are deductible.
14. Since, building constructed in Mumbai, is used for business purposes, it is excluded from the computation of the net wealth of the assessee. Hence, the loan taken for construction of such property shall also not be admissible as a deduction.
15. Assets held by a minor married daughter are not includible in the computation of the net wealth of the any parent under Section 4(1)(a)(ii) of the Wealth Tax Act, 1957. Hence, the value of plot of land at Bhopal, held by the minor married daughter, does not form part of the net wealth of Mr. Rajendra Sinha.

Section C

4. Answer any two Questions [2 × 10 = 20]

(a) (i) Sterling Machine Works Ltd., an Indian company declared an income of ₹ 450 crores. However, this income was declared before taking into account the following adjustments:

- **25,000 machines were sold to Diamond Industries Ltd at a price, which is lower than the normal transaction price by $250 per car. Diamond Industries Ltd. holds 35% shares in Sterling Machine Works Ltd.**
- **Wellington Ltd. was paid a royalty of $ 2,40,00,000, for use of its technical know-how. However, another Indian company had paid $ 2,00,00,000 as royalty to Wellington Ltd. for a similar transaction. Sterling Machine Works Ltd. was completely dependent on the technical knowhow supplied by Wellington Ltd., for the manufacture of the machineries.**
- **Beijing Finance Ltd. extended a loan of Euro 850 crores to Sterling Machine Works Ltd., carrying an interest @10% p.a, which was outstanding in the books of Sterling Machine Works Ltd. as on 31.03.2014. Beijing Finance Ltd. had extended a loan of similar amount to another Indian company @ 9% p.a. Total interest paid for the year was Euro 85 crores. The total assets of Sterling Machine Works Ltd., as on 31.03.2014 was ₹ 100,000 crores.**

The value of 1$ and 1 Euro may be taken to be ₹62 and ₹82 respectively.

With reference to the provisions of the Act, analyse the nature of transactions, and determine the income of the company chargeable to tax for the A.Y 2014-15. [6]

Solution:

The provisions of Chapter X of the Act relate to the determination of the Arm's Length Price , in case of any income arising from an international transaction involving two or more associated enterprises. The term 'Associated Enterprise' has been defined in Section 92A.

With reference to the provisions of Section 92A of the Income Tax Act 1961, the transactions of Sterling Ltd. has been analysed as follows:

Transaction of Sterling Ltd. with	**Whether transacting party an associated enterprise or not?**	**Supporting statutory provision**
Diamond Industries Ltd.	Associated Enterprise	As per Section 92A(2)(a), a company holding shares carrying more than 26% of the voting power of another company, shall be deemed to be "Associated Enterprises".
Wellington Ltd.	Associated Enterprise	Wellington Ltd. and Sterling Industries Ltd. have been considered as "Associated Enterprises", by virtue of Section 92A(2)(g).
Beijing Finance Ltd.	Associated Enterprise	Beijing Finance Ltd. and Sterling Industries Ltd. have been considered as "Associated Enterprises", by virtue of Section 92A(2)(c), since this company has financed an amount which is more than 51% of the book value of the total assets of Sterling Ltd.

Determination of the total income of Sterling Machine Works Ltd. after necessary adjustments

Particulars	**Amount (₹ in crores)**
Income of Sterling Machine Works Ltd. prior to adjustments	450
Add: Difference arising out of adjustments in the value of international transactions	
(i) Difference in price of machinery supplied to Diamond Industries Ltd. (25,000 cars x ₹62 x $ 250)	38.75
(ii) Difference in excess payment of royalty to Wellington Ltd. ($ 40,00,000 x ₹62)	24.80
(iii) Difference in excess interest paid on loan from Beijing Finance Ltd. (Euro 850 crores x 1/100 x ₹82)	697
TOTAL INCOME	1210.55

(ii) Explain the meaning of "specified domestic transactions" which are subject to transfer pricing provisions? [4]

Answer:

The "specified domestic transactions", which are subject to transfer pricing provisions, means any of the following transactions, not being an international transactions, namely-

1. Any expenditure in respect of which payment has been made or is to be made to a related person referred to in Section 40A(2)(b) of the Income Tax act, 1961;
2. Any transaction referred to in Section 80A of the Income Tax Act, 1961, i.e., inter-unit transfer of goods and services by an undertaking or unit or enterprise or eligible business to other

business carried on by the assessee or vice versa, for consideration not corresponding to the market value on the date of transfer;

3. Any transfer of goods or services referred to in Section 80-IA(8) of the Income Tax Act, 1961, i.e., inter-unit transfer of goods or services between eligible business and other business, where the consideration for transfer does not correspond with the market value of goods and services;
4. Any business transacted between the assessee carrying on eligible business and other person as referred to in Section 80-IA(10) of the Income Tax Act, 1961;
5. Any transaction, referred to in any other Section under Chapter VI-A or Section 10AA, to which provisions of Section 80-IA(8) , or Section 80-IA(10) of the Income Tax Act, 1961are applicable; or
6. Any other transaction as may be prescribed.

However, the above mentioned transactions shall not be treated as specified domestic transaction in case the aggregate of such transactions entered into by the assessee in the previous year does not exceed a sum of ₹5 crore.

(b) (i) Secure Ltd., an Indian company, is engaged in manufacturing electronic components. 74% of the shares of the company are held by Secure Inc., incorporated in USA. Secure Ltd. has borrowed funds from Secure Inc. at LIBOR plus 150 points. The LIBOR prevalent at the time of borrowing is 4% for US$. The borrowings allowed under External Commercial Borrowings Guidelines issued under the Foreign Exchange Management Act are LIBOR plus 200 basis points. Discuss whether the borrowing made by Secure Ltd. is at arm's length ('LIBOR' means London Inter Bank Offer Rate). [6]

Solution:

One of the methods for determination of arm's length price in an international transaction is Comparable Uncontrolled Price (CUP) Method. Under the CUP Method, the price charged or paid for property transacted or services rendered in comparable uncontrolled transaction, or a number of such transactions, is identified. Such price is adjusted to account for differences, if any, between the international transaction and the comparable uncontrolled transaction or between the enterprises entering into such transactions, which could materially affect the price in the open market. The adjusted price so arrived at is taken to be an arm's length price in respect of the property transferred or services provided in the international transaction.

Secure Inc., USA and Secure Ltd., the Indian Company shall be deemed to be associated enterprises, since the former holds more than 26% voting power in the latter.

The arm's length rate of interest can be determined by using the CUP Method having regard to the rate of interest on External Commercial Borrowing permissible as per Guidelines issued under the Foreign Exchange management Act, 1999.

The interest rate permissible is LIBOR plus 200 basis points i.e., 4% + 2% = 6%, which can be taken as the arm's length rate. The interest rate applicable on the borrowing by Secure Ltd., India from Secure Inc. USA, is LIBOR plus 150 basis points i.e., 4% + 1.5% = 5.5%. Since the rate of interest, (5.5%) is less than the arm's length rate of 6%, the borrowing made by Secure Ltd. is not at arm's length. However, in this case the taxable income of Secure Ltd., India would be lower if the arm's length rate is applied. Hence, no adjustment is required since the law of transfer pricing will not apply if there is a negative impact on the existing profits.

(ii) What are the objectives of Profit Split Method (PSM)? [4]

Answer:

The objectives of Profit Split Method (PSM) —

1) To determine the relative value of each controlled taxpayer's contribution;
2) To assess the impact of the controlled taxpayer's contribution on the success of the relevant business activity;
3) To identify and evaluate the impact of the controlled taxpayer's contribution that reflects the functions performed, risks assumed, and resources employed.
4) To eliminate the effect on profits of special conditions made or imposed in a controlled transaction (or in controlled transactions that are appropriate to aggregate) by determining the division of profits that independent enterprises would have expected to realize from engaging in the transaction or transactions.
5) To identify the profit to be split for the associated enterprises from the controlled transactions in which the associated enterprises are engaged.

(c) (i) Mcnil Inc. of France and Robot Ltd. of India are associated enterprises. Robot Ltd. imports 2,000 compressors for Air Conditioners from Mcnil Inc. at ₹ 7,500 per unit and these are sold to Happy Cooling Solutions Ltd at a price of ₹11,000 per unit. Robot Ltd. had also imported similar products from Thunder Inc. Poland and sold outside at a Gross Profit of 20% on Sales.

Mcnil Inc. offered a quantity discount of ₹1,500 per unit. Thunder Inc. could offer only ₹500 per unit as Quantity Discount. The freight and customs duty paid for imports from Thunder Inc. Poland had cost Robot Ltd. ₹ 1,200 per piece. In respect of purchase from Thunder Inc., Robot Ltd. had to pay ₹200 only as freight charges.

Determine the Arm's Length Price and the amount of increase in Total Income of Robot Ltd. [7]

Solution:

Computation of Arm's Length Price of Products bought from Mcnil Inc., France by Robot Ltd, India

Particulars	**Amount (₹)**
Resale Price of Goods Purchased from Mcnil Inc.	11,000
Less: Adjustment for Differences –	
a) Normal Gross Profit Margin at 20% of Sale Price [20% x ₹ 11,000]	2,200
b) Incremental Quantity Discount by Megabyte Inc.[₹ 1,500 - ₹ 500]	1,000
c) Difference in Purchase related Expenses[₹ 1,200 - ₹ 200]	1,000
Arms Length Price	**6,800**

Computation of Increase in Total Income of Robot Ltd

Particulars	**Amount (₹)**
Price at which actually bought from Mcnil Inc. of France	7,500

Less: Arms Length Price per unit under Resale Price Method	(6,800)
Decrease in Purchase Price per unit	700
No. of units purchased from Mcnil Inc.	3,000 units
Increase in Total Income (2,000 units x ₹ 700)	₹ 14,00,000

(ii) What is the object of introducing Transfer Pricing? [3]

Solution:

The existence of different tax rates in different countries offers multinational enterprises to fix up their prices for goods and services and allocate profits among the enterprises within the group in such a way that there may be either no profit or negligible profit in the jurisdiction which taxes such profits and substantial profit in the jurisdiction which is tax haven or where the tax liability is minimum. This may adversely affect a country's share of due revenue and which may lead to erosion of tax revenue. Therefore, transfer pricing provisions have been brought with a view to provide a statutory framework which can lead to computation of reasonable, fair and equitable profits and tax in India, in the case of such multinational enterprises.