Paper-7 – Applied Direct Taxation

The following table lists the learning objectives and the verbs that appear in the syllabus learning aims and examination questions:

	Learning objectives	Verbs used	Definition
LEVEL B	KNOWLEDGE What you are expected to know	List	Make a list of
		State	Express, fully or clearly, the details/facts
		Define	Give the exact meaning of
	COMPREHENSION What you are expected to understand	Describe	Communicate the key features of
		Distinguish	Highlight the differences between
		Explain	Make clear or intelligible/ state the meaning or purpose of
		Identity	Recognize, establish or select after consideration
		Illustrate	Use an example to describe or explain something
	APPLICATION How you are expected to apply your knowledge	Apply	Put to practical use
		Calculate	Ascertain or reckon mathematically
		Demonstrate	Prove with certainty or exhibit by practical means
		Prepare	Make or get ready for use
		Reconcile	Make or prove consistent/ compatible
		Solve	Find an answer to
		Tabulate	Arrange in a table
	ANALYSIS How you are expected to analyse the detail of what you have learned	Analyse	Examine in detail the structure of
		Categorise	Place into a defined class or division
		Compare and contrast	Show the similarities and/or differences between
		Construct	Build up or compile
		Prioritise	Place in order of priority or sequence for action
		Produce	Create or bring into existence

Paper-7 – Applied Direct Taxation

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

All the questions relate to the assessment year 2015-16, unless stated otherwise.
Working notes should form part of the answers.
Answer all questions.

Question No 1.

(i) An amount of ₹ 5 Lakhs was paid on 17.03.2015 to the parents of Rakesh by the Government of Maharashtra as a compensation to the grieved family whose only son Rakesh lost his life in Mumbai local train serial bomb blasts. Is the amount of compensation received chargeable to tax? [2]

Answer:

Any compensation received on account of disaster by an Individual or his Legal Heir from the Central or State Governmerts or Local Authority is exempt.

Disaster means a catastrophe, mishap, calamity or grave occurrence in any area, arising from natural or man-made causes, or by accident or negligence.

Hence, the above compensation received by Rakesh's parents from the Government of Maharashtra is exempt.

(ii) A Special Purpose Distinct Entity (regulated by SEBI), set up in the form of a trust to undertake securitization activities, receives ₹ 20 Lakhs from the activities of securitization, and distributes ₹ 5 Lakhs to its Investors. What would be the tax implications in the hands of:

(a) The Special Purpose Distinct Entity, in respect of its Income from the activity of Securitization, and

(b) Investors, in respect of Income distributed by the Special Purpose Distinct Entity. [2]

Answer:

(a) In case of Special Purpose Distinct Entities set up as a Trust, and whose activities are regulated by SEBI, the income from the activity of securitization is exempt. Hence, the Income of ₹ 20 Lakhs from the activity of securitization, is exempt u/s 10(23DA).

(b) Income Distributed by a Securitization Trust is exempt from tax in the hands of Recipient Investors [Sec. 10(35A]. Additional Income Tax u/s 115TA is levied on such Distributed Income in the hands of Securitization Trust.

(iii) PQR Limited has written off certain debts as Bad Debts in the books of account and claimed deduction u/s 36(1)(vii) in the Return of Income filed for Assessment Year 2015-2016. The Assessing Officer (A.O.) made disallowance for deduction of Bad Debts on the ground that the Debts have not been established to have become irrecoverable and bad in the previous year 2014-2015. Examine the correctness of the action of A.O. [2]

Answer:
Assessee should only establish that the Debt was written off to claim u/s 36(1)(vii). It is not necessary to establish that the debt in fact has become irrecoverable.
The Assessee has established that the Debt was written off in the books of accounts and it is assumed that the condition u/s 36(1)(vii) has been fully satisfied. Therefore, the action taken by the Assessing Officer is not correct.

(iv) State the circumstances under which Profit Split Method is applicable for determination of arm's length price under International Transactions. [2]

Answer:
This method is used mainly in International Transactions/Specified Domestic Transactions involving transfer of unique intangibles, or in multiple International Transactions/Specified Domestic Transaction which are so inter-related that they cannot be evaluated separately for the purpose of determining the Arm's Length Price of any one transaction.

(v) What are the limitations in implementation of Transactional Net Margin method while computing the arm's length price of an International Transactions? [1]

Answer:

Limitations in implementation of Transactional Net Margin method
Tax Payers may not have access to enough specific information on the profit attributable to uncontrolled transactions to make a valid application of the method.

(vi) What are the advantages while computing arm's length price Transactional Net Margin Method? [2]

Answer:
- It is based on Net Margins are less affected by Transactional differences.
- The Net Margins are also more tolerant to Functional Differences between Controlled and Uncontrolled transactions than Gross Profit Margins
- It is not necessary to determine the Functions performed and responsibilities assumed by more than one of the associated enterprises.
- It is favorable where one of the parties to the transaction is Complex and has many Inter-related activities or when it is difficult to obtain reliable information about one of the parties.

(vii) X & Co. Diagnostic Centre P Ltd. has claimed Referral Fee paid to doctors as Revenue Expenditure for the Assessment Year 2015-16. However, TDS has been deducted u/s 194H of the Income Tax Act, 1961 for the said payments. The Assessing Officer proposes to disallow such expenditure. Examine the correctness of the action of the Assessing Officer. [2]

Answer:
Commission paid to Doctors by a Diagnostic Center for referring patients for Diagnosis cannot be allowed as Business Expenditure. Since such activity is contrary to the provisions of Indian

Medical Council Regulations, the action of the Assessing Officer in disallowing the Referral Fee paid to Doctors is valid. Whether TDS is deducted or not, is not relevant in this regard.

(viii) XYZ Ltd incurred expenditure amounting to ₹ 3,00,000 in connection with the issue of Rights Shares and ₹ 2,00,000 in connection with the issues of Bonus Shares during the year ending 31.03.2015. The Company seeks your opinion in the matter of eligibility for deduction of the expenditure incurred from its business profits for the Assessment Year 2015-2016. [2]

Answer:

Rights Issue Expenses ₹ 3,00,000: Expenditure incurred by the Assessee on the issue of Right Shares is an inadmissible expenditure u/s 37.

Bonus Issue Expenses ₹ 2,00,000: Expenditure in connection with the issue of Bonus Shares constitutes revenue expenditure and deductible u/s 37.

(ix) B Ltd is a Company engaged in the business of Financing and Investment in Shares. It suffered loss of ₹ 3,00,000 on account of Futures and Options, a transaction in the form of Derivatives in which the underlying asset was Shares. Explain the allowability, under the provisions of Income Tax Act 1961. [1]

Answer:

Eligible Transaction in respect of trading in Derivatives carried out in RSE is not a speculative transaction. If the Company satisfies the "Eligible Transaction" condition, then the loss shall not be treated as Speculative Loss, and shall be treated as normal Business Loss.

(x) A Farmer, being Resident of Jaipur, sold his Rural Agricultural Land situated in Nepal and received Indian Rupees 2 Lakhs over the cost of acquisition of this land. Explain the taxability of the sale. [2]

Answer:

U/s 2(14), only Rural Agricultural Lands in India are not a Capital Asset.

In the given case, the farmer has sold Rural Agricultural Lands in Nepal. Therefore, the transaction attracts Capital Gains as the sale falls under the definition of Capital Gains.

(xi) Mr. Pal received a painting by M.F. Hussain worth ₹ 2 Lakhs from his nephew on his 10th wedding anniversary. Discuss the tax implications. [2]

Answer:

Paintings are included in the definition of "Property". So, when paintings received without consideration, are taxable u/s 56(2)(vii), as the Aggregate Fair Market Value of paintings exceed ₹ 50,000.

Gift received from a Relative is exempt from tax. However, Relative does not include nephew, hence entire value is taxable in this case.

Question 2. Answer any four questions [4 × 15 = 60]

(a)(i) The W.D.V. of the block of assets as on 1.4.2014 was ₹ 20 lacs. Rate of Depreciation @ 15%. An asset of the same block was acquired on 11.5.14 for ₹ 12 lacs. There was a fire on 18.9.2014 and the assets were destroyed by fire and the assessee received a sum of ₹ 36 lacs from the insurance company. Compute the Capital Gain assuming:

(a) All the assets were destroyed by fire

(b) Part of the block was destroyed by fire

Would your answer differ if the assessee received ₹21,00,000 from insurance company assuming:

(a) All the assets were destroyed by fire

(b) Part of the block was destroyed by fire [5]

Solution :

If Compensation received ₹ 30,00,000

Block of Assets u/s 2(11)

	Particulars	All assets destroyed	Part of Block destroyed
1.4.14	W.D.V. of the Block	20,00,000	20,00,000
	Add : Cost of New Asset purchased relating to the Block	12,00,000	12,00,000
		32,00,000	32,00,000
	Less : Compensation received	36,00,000	36,00,000
	Short Term Capital Gains	4,00,000	4,00,000
		u/s 50(2)	u/s 50(1)

If Compensation Received ₹ 21,00,000

Block of Assets u/s 2(11)

	Particulars	All assets destroyed	Part of Block destroyed	
1.4.14	W.D.V. of the Block	20,00,000	20,00,000	
	Add : Cost of New Asset purchased relating to the Block	12,00,000	12,00,000	
		32,00,000	32,00,000	
	Less : Compensation received	21,00,000	21,00,000	
	Short Term Capital Loss	11,00,000	11,00,000	= WDV
	Less : Depreciation @ 15%	u/s 50(2)	1,65,000	(Depreciation to be charged on WDV)
			9,35,000	

(ii) Mrs. K holds 7% equity shares in T Ltd., where her married sister, Mrs. L also holds 14% equity shares. Mr. K is employed with T Ltd., without holding technical professional qualification. The particulars of their income for the Previous Year 2014-2015 are given as follows:

	Income of Mr. K	Income of Mrs. K	
(a) Gross Salary from T Ltd.	**3,04,000**	**—**	
(b) Dividend from T Ltd.	**—**	**12,000**	
(c) Income from House Property	**1,80,000**	**—**	**[3]**

Solution :

Computation of Total Income of Mr. K & Mrs. K for the A.Y. 2015-2016

Particulars	**Mr. K** (₹)	**Mrs. K** (₹)
Gross Salary	3,04,000	
Taxable Salary to be included in the total income of Mrs. K [Sec. 64(1)(ii)]	—	3,04,000
Add: Income from House Property	1,80,000	
Add: Income from Other Sources :	—	—
Dividends to Mrs. K, but under Sec. 10(34)exempt	—	Nil
Total Income	1,80,000	3,04,000

Note:

1. In the instant case, Mrs. K along with his sister holds substantial interest in T Ltd. and Mr. K does not hold professional qualification. Accordingly, remuneration of Mr. K has been included in the total income of Mrs. K.
2. If the requisite conditions of clubbing are satisfied, clubbing provision will apply even if their application results into lower incidence of tax.

(iii) Mr. Q gets the following gifts during the Previous Year 2014-2015.

	Date of Gift	**Name of the Donor**	**Amount of Gift (₹)**
1.	**01.07.2014**	**Gift from R, a friend, by cheque**	**60,000**
2.	**01.09.2014**	**Cash gift from N, nephew**	**1,20,000**
3.	**01.12.2014**	**Gift of diamond ring on his birthday, by a friend, C**	**75,000**
4.	**15.12.2014**	**Cash gifts of ₹ 31,000 each made by four friends on the occasion of his marriage**	**1,24,000**
5.	**21.12.2014**	**Cash gift made by wife's sister on house opening ceremony**	**51,000**
6.	**15.01.2015**	**Cash gift from a close friend of father-in-law.**	**1,51,000**
7.	**31.01.2015**	**Cash gift made by great-grandfather**	**1,51,000**
8.	**01.02.2015**	**Cash gift received under the Will of a friend, who is seriously ill.**	**1,65,000**
9.	**15.02.2015**	**Cash gift made by a business friend on his birthday**	**51,000**
10.	**31.03.2015**	**Cash gifts made by three friends of ₹ 25,000 each**	**75,000**

Besides this, JK is engaged in the business of sale and purchase of retail goods.
He maintains no account books. Gross turnover from retail trading is ₹ 50,00,000.
Compute his total income for the Assessment Year 2015-2016. **[4]**

Solution :

Computation of Taxable Income for the AY 2015-2016

Particulars	**Amount (₹)**
1. Income from retail trading business [Sec. 44 AD] (8% ₹ 50,00,000)	4,00,000
2. Income from Other Sources (money gifts):	
(i) Cash gift from a friend, by cheque	60,000
(ii) Cash gift from nephew, not covered by the definition of relative	1,20,000
(iii) Gift of diamond ring — Jewellery gift taxable	75,000
(iv) Cash gifts on the occasion of marriage are not chargeable even if such gifts are made by unrelated persons	—
(v) Cash gift made by wife's sister, a relative, not taxable	—
(vi) Cash gift by a friend of father-in-law, unrelated person	1,51,000
(vii) Cash gift made by great-grand father, a relative	—
(viii) Cash gift received under Will in contemplation of death of a friend	—
(ix) Cash gift made by a business friend on his birthday	51,000
(x) Cash gifts, made by three friends, of ₹ 25,000 each	75,000
Total Income	9,32,000

(iv) What do you mean by annexure less return? What is the manner of filling the return of income? **[3]**

Answer :

The return of income required to be furnished in Form No.ITR-1,ITR-2,ITR-3,ITR-4, ITR-5, ITR-6 or ITR-7 shall not be accompanied by a statement showing the computation of the tax payable on the basis of the return, or proof of the tax, if any, claimed to have been deducted or collected at source or the advance tax or tax on self-assessment, if any, claimed to have been paid or any document or copy of any account or Form or report of audit required to be attached with the return of income under any of the provisions of the Act.

Manner of filling the return: The return of income referred to in sub-rule (1) may be furnished in any of the following manners, namely:-

(i) Furnishing the return in a paper form;
(ii) Furnishing the return electronically under digital signature;
(iii) Transmitting the data in the return electronically and thereafter submitting the verification of the return in Form ITR-V;
(iv) Furnishing a bar-coded return in paper form.

(b) (i) Mr. Manash Cooperative Society Ltd. furnishes the following particulars of its income for the Previous Year ended on 31st March 2015:

(i)	**Interest on Government securities**	**1,60,000**
(ii)	**Profits from banking business**	**4,50,000**
(iii)	**Income from purchase and sale of agricultural implement and seeds to its members**	**2,50,000**
(iv)	**Income from marketing of agricultural produce of its members**	**4,00,000**
(v)	**Profits and gains of business**	**2,20,000**

(vi)	**Income from cottage industry**	**3,50,000**
(vii)	**Interest and dividends (gross) from other cooperative societies**	**30,000**

Compute Total Income of the society and calculate the Tax Payable by it for the Assessment Year 2015-2016. [8]

Solution :

Dinesh Pally Co-operative Society Ltd.

Computation of income of the for the Previous Year 2014-2015 relating to the Assessment Year 2015-2016 :

Particulars	**₹**	**₹**
1. Profits and Gains of Business or Profession:		
a) Banking business	4,50,000	
b) Income from purchase and sale of agricultural implements and seeds to its members	2,50,000	
c) Income from marketing of agricultural produce of its members	4,00,000	
d) Profits and gains of business	2,20,000	
e) Income from cottage industry	3,50,000	16,70,000
2. Income from Other Sources:		
a) Interest on Government securities	1,60,000	
b) Interest and dividends from other cooperatives	30,000	1,90,000
Gross Total Income		18,60,000
Less: Deduction allowable from gross total income under Sec. 80P		
1. Banking business [Assumed it is a Rural Development Bank]	4,50,000	
2. Income from purchase and sale of agricultural implement and seeds to its members	2,50,000	
3. Income from marketing of agricultural produce of its members	4,00,000	
4. Income from cottage industry	3,50,000	
5. Interest on Government securities(not eligible for deduction)	Nil	
6. Interest and dividends from other cooperative societies	30,000	14,80,000
Total Income		3,80,000

Computation of Tax Liability :

Particulars	**Rate**	₹
On first ₹ 10,000	10%	1,000
On next ₹ 10,000	20%	2,000
On balance ₹ 3,60,000	30%	1,08,000
Income Tax Payable Add: Education cess @ 2% Add: SHEC @ 1%		1,11,000 2,220 1,110
Tax Payable		**1,14,330**

Note: It is assumed that the provisions of Alternate Minimum Tax are not applicable.

(ii) Ms. Radhika, a resident Indian, furnishes the details for the Assessement Year 2015-2016 :

Particulars	Amount (₹)
(1) Income from profession	**2,94,000**
(2) Share of income from a partnership in country X (tax paid in Country X for this income in equivalent Indian Rupees 10,000)	**50,000**
(3) Commission income from a concern in country Y (tax paid in country Y @ 20%, converted in equivalent Indian Rupees)	**40,000**
(4) Interest on scheduled banks [other than savings account]	**20,000**

Ms. Radhika wishes to know whether she is eligible to any double taxation relief, if so, its quantum. India does not have any Double Taxation Avoidance Agreement with countries X and Y. [5]

Solution :

(1) Computation of Total Income for the Assessment Year 2015-16

Particulars	Amount (₹)	Amount (₹)
(a) Income from Business or Profession:		
(i) Income from Profession	2,94,000	
(ii) Share of income in partnership firm in country X	50,000	3,44,000
(b) Income from other sources:		
(i) Interest from scheduled bank	20,000	
(ii) Commission earned in Country Y, assumed from other sources	40,000	60,000
Total Income		**4,04,000**

(2) Computation of Tax Liability on Total Income for the Assessment Year 2015-16

Particulars	Amount (₹)
Tax on Total Income of ₹ 4,04,000	15,400
Add: Surcharge on Income Tax	Nil
Add: Education Cess @ 2%	308
Add: Secondary and Higher Education Cess @ 1%	154
	15,862
Less: Double taxation relief : 90,000 x 3.93%	(3,537)
Tax Payable	12,325
Rounded off u/s 288B	12,330

Notes :

(i) Average rate of tax in the foreign country = 20% i.e. [(₹ 10,000 + 20% of ₹ 40,000)/ (50,000+40,000)] ×100 = 20%

(ii) Average rate of tax in India = (15,862/4,04,000) × 100 = 3.93%

(iii) Compute the amount of TDS on the following payments made by M/s P Ltd during the Previous Year 2014- 2015 as per the provisions of the Income Tax Act, 1961 –

(a)	**01.10.2014**	**Payment of ₹3,00,000 to Mr. "R" a transporter who is having PAN.**
(b)	**01.11.2014**	**Payment of Fee for Technical Services of ₹25,000 and Royalty of ₹ 28,000**

		to Mr. Shyam who is having PAN.

[2]

Solution:

Assessee: M/s. P Ltd. **Previous year: 2014 – 2015** **Assessment year: 2015 – 2016**

Computation of amount of Tax to be Deducted at Source

Date	Particulars	TDS (₹)	Reason
01.10.2014	Payment of ₹3,00,000 to Mr. R, a transporter, having PAN	Nil	TDS need not be deducted u/s 194C irrespective of the type/ size of transporter, if he submits PAN.
01.11.2014	Payment of Fee for Technical Services ₹25,000 and Royalty ₹28,000 to Mr. Shyam who is having PAN	Nil	TDS need not be deducted u/s 194J since Payments does not exceed ₹30,000 on Fees for Technical Services and Royalty considered separately.
	Total	**Nil**	

(c)(i) 'B', an Indian citizen left India for the first time on 20.9.2013 for employment in Denmark. During the Previous Year 2014-15 he comes to India on 5.5.2014 for 150 days. Determine the residential status of 'B' for the Assessment Years 2014-15 and 2015-16. **[4]**

Solution :

During the Previous Year 2013-14 (A.Y. 2014-15) 'B' was in India for 175 days (30+31+30+31+31+21) and therefore, does not satisfy the first condition. As regards the second condition, although he was here in the four preceding Previous Years for more than 365 days as he was permanently in India but for the relevant Previous Year 2013-14 he should have been here for 182 days instead of 60 days as he is a citizen of India and leaves India in 2013-14 for employment abroad.

He neither satisfies the first, nor the second condition and is therefore, Non-Resident in India. Similarly, during the previous year 2014-15 (A.Y. 2015-16) he visits India for 150 days. In this case also, the period of 60 days will be substituted by 182 days as he is a citizen of India. Therefore, he will be a Non-Resident in India even for the Previous Year 2014-15 (A.Y. 2015-16).

(ii) Mr. Dipak, after serving Z Ltd. for 23 years 7 months, opted the Voluntary Retirement Scheme. Total tenure of service: 30 years. Compensation received ₹ 15,00,000. Last drawn Salary (i.e. Basic Pay + D.A, forming part of retirement benefits) ₹ 20,000. Compute exemption & taxable value of VRS compensation. **[4]**

Solution :

Total tenure of service = 30 × 12 = 360 months

Actual length of service = 23 years 7 months = 283 months

No. of months of service left= (360 - 283) months = 77 months

Computation of Taxable VRS compensation

Particulars	Amount (₹)	Amount (₹)
Amount received as VRS Compensation Less: Exemption u/s 10(10C): Least of the followings: (i) Actual amount received (ii) Maximum Limit (iii) The highest of the following: Last drawn salary x 3 x No. of fully completed years of service =20,000 x 3 x 23= 13,80,000 Last drawn salary x Balance of no. of months of service left. = 20,000 x 77 months = 15,40,000	 15,00,000 5,00,000 15,40,000	15,00,000 5,00,000
Taxable VRS Compensation		10,00,000

(iii) Mr. Kanoria has estates in Rubber, Tea and Coffee. He derives income from them. He has also a nursery wherein he grows plants and sells. For the previous year ending 31.3.2015, he furnishes the following particulars of his sources of income from estates and sale of Plants. You are requested to compute the taxable income for the Assessment year 2015-2016.

(a) Manufacture of Rubber ₹ 12,00,000

(b) Manufacture of Coffee grown and cured ₹ 8,00,000

(c) Manufacture of Tea ₹ 14,00,000

(d) Sale of Plants from Nursery ₹ 3,00,000. [4]

Solution:

Assessee: Mr. Tony Previous Year: 2014-15 Assessment Year: 2015-2016

From the words 'Mr. Tony has estates', it is presumed that he had grown Tea, Coffee and Rubber, and also Plants in his Estates, and the amount given is the Profits of the Business.

Computation of Taxable Income is as under —

Particulars	Agricultural Income	Non-Agricultural Income
Growing and Manufacture of Rubber [Rule 7A]	12,00,000 × 65% = ₹ 7,80,000	12,00,000 × 35% = ₹ 4,20,000
Grown and Cured Coffee [Rule 7B]	8,00,000×75% = ₹ 6,00,000	8,00,000 × 25% = ₹ 2,00,000
Growing and Manufactured of Tea [Rule 8]	14,00,000 × 60% = ₹ 8,40,000	14,00,000 × 40% = ₹ 5,60,000
Growing & Sale of Plant by Nursery [See Note]	₹3,00,000	—
Total	₹25,20,000	₹ 11,80,000
Taxable Income	Exempt u/s 10(1)	₹ 11,80,000

(iv) State the consequences if Firm fails to fulfill condition under section 184 of the Income Tax Act, 1961. [3]

Answer:

The following are the consequences when the Firm is – (a) assessed u/s 144, (Best Judgment) or (b) fails to fulfill the conditions u/s 184 –

(a) In the hands of Firm: No deduction shall be allowed in respect of any payment of Interest, Salary, Bonus, Commission or Remuneration made by such Firm to any of its Partners u/s 40(b).

(b) In the hands of Partners: Interest, Salary, Bonus, Commission or Remuneration disallowed as above, shall not be treated as Income u/s 28(v).

Note: When a Firm fails to fulfill the conditions u/s 184, it shall not be assessed as an AOP. It shall only be assessed as a Firm subject to above provisions.

(d) (i) Find out the amount of advance tax payable by Mr. X on specified dates under the Income Tax Act, 1961 for the Previous Year 2014-15:

	₹
Business income	**11,00,000**
Long Term Capital Gain on 31-5-2014	**6,40,000**
Winning from lotteries on 12-6-2014	**2,00,000**
Bank interest	**20,000**
Other income	**20,000**
Investment in PPF	**1,50,000**
Tax deducted at source : Case I	**3,12,000**
Case II	**1,00,000**

[6]

Solution:

Computation of Total Income of Mr. X for the Previous Year 2014-15:

Particulars	**Details**	**Amount (₹)**
Profits and Gains of Business or Profession		11,00,000
Capital gains : Long Term Capital Gains		6,40,000
Income from Other Sources		
Winning from lotteries	2,00,000	
Bank interest	20,000	
Other income	20,000	2,50,000
Gross Total Income		19,80,000
Less : Deduction u/s 80C — Deposits	1,50,000	
in PPF Deduction u/s 80TTA	10,000	1,60,000
Total Income		18,20,000

Computation of Tax liability of Mr. X for the Previous Year 2014-15:

Income	**Case 1 (₹)**	**Case 2 (₹)**
Long Term Capital Gain (₹ 6,40,000 @ 20%)	1,28,000	1,28,000
Winning from lotteries (₹ 2,00,000 @ 30%)	60,000	60,000
Balance Income (₹ 18,20,000-6,40,000-2,00,000 = 9,80,000)		
Tax on first ₹ 2,50,000	Nil	Nil
Next ₹ 2,50,000 @10%	25,000	25,000
On balance ₹ 4,80,000 @20%	96,000	96,000
Tax	3,09,000	3,09,000
Add : Education cess & SHEC	9,270	9,270

	3,18,270	3,18,270
Less : Tax Deducted at Source	3,12,000	1,00,000
Total Tax Payable	6,270	2,18,270

Advance tax to be paid on specified dates

Case I: Since amount of tax payable is less than ₹10000, assessee is not liable to pay advance tax.
Case II : Advance Tax Payable

Due Date	Tax Liability (₹)	Amount of Instalment (₹)
15.09.2014	30% of 2,18,270 = 65,481	65,481
15.12.2014	60% of 2,18,270= 1,30,962	1,30,962– 65,481= 65,481
15.03.2015	100% of 2,18,270= 2,18,270	2,18,270 -65,481-65,481= 87,308

(ii) The gross total income of Mr. Raju for the assessment year 2015-16 is ₹6,10,000 which includes long-term capital gain ₹80,000, short-term capital gain referred to in section 115A ₹70,000 and interest on saving bank deposit ₹12,000. Compute the tax payable by Mr. Raju assuming he deposited ₹1,00,000 in PPF and paid premium for health insurance by cheque amounting to ₹15,000. [5]

Solution:

Computation of tax payable by Raju for the assessment year 2015-16

	₹	₹
Gross total income		6,10,000
Less: Deductions		
U/s 80C	1,00,000	
U/s 80D	15,000	
U/s 80TTA	10,000	1,25,000
Total Income		4,85,000
Tax on ₹4,85,000		
Long-term capital gain ₹80,000 @ 20%	16,000	
Short-term capital gain ₹70,000 @ 15%	10,500	
Balance total income ₹3,35,000	8,500	
	35,000	
Less: rebate u/s 87A	2,000	
	33,000	
Add: Education cess & SHEC @ 3%	990	
	33,990	

(iii) XY & Co., a partnership concern had established an undertaking for manufacturing computer software in Special Economic Zone. It furnishes the following particulars of its second year operations, ended on 31-03-2015:

Particulars	₹ (in lakh)
Total Sales of business	250.00
Export Sales	200.00
Profit of the business	20.00

Out of the total export sales, realisation of sale of ₹ 12.5 lakh is difficult because of the deficiency of the buyer. Realisation of rest of the sales is received in time.

The plant and machinery used in the business had been depreciated @ 15% on SLM basis of depreciation and depreciation of ₹ 6 lakh was charged to the Profit and Loss Account.

Compute the taxable income of XY & Co for the Assessment Year 2015-2016. [4]

Solution:

Computation of Taxable Income for the A.Y. 2015-16

Particulars	₹ (in lakh)
Profit of business	20,00,000
Add : Depreciation charged on SLM basis	6,00,000
	26,00,000
Less: Depreciation on WDV basis @ 15% of 34,00,000 –[See Note below]	5,00,000
	20,90,000
Less: Deduction under Sec. 10AA : 20,90,000 × 75 ÷100	15,67,500
Taxable Income	5,22,500

Note :

1. Computation of Depreciation:

	₹
Total purchase price of machine : [6,00,000 ÷15] × 100	40,00,000
Less: Depreciation in the first year @ 15%	6,00,000
WDV at the end of first year	34,00,000
Less: Depreciation for second year @ 15%	5,10,000
WDV at the end of second year	28,90,000

2. Export Turnover:

Export Sales	2,00,00,000
Less: Remittance not received due to insolvency of buyer	12,50,000
	1,87,50,000

(e)(i) Mr. Sandip owns two houses, which are occupied by him for his own residence. The detailed particulars of houses and his other incomes for the Previous Year 2014-15 are given below:

Particulars	House A	House B
Fair Rent	**5,00,000**	**5,00,000**
Municipal Value	**4,80,000**	**4,50,000**
Standard Rent	**4,50,000**	**5,20,000**
Municipal taxes paid	**50,000**	**60,000**

Interest on loan for the FY 2014-15	**1,60,000**	**2,20,000**
Date of loan	**1.12.2003**	**1.04.2004**
Date of completion	**31.03.2005**	**31.03.2007**
Certificate of interest attached with return of income	**No**	**Yes**

Mr. Sandip earns income from other sources amounting to ₹ 3,00,000

Compute his Total Income and advise him which house should be opted for self-occupation. [5]

Solution :

Computation of Income from House Property under different options

Particulars	House A ₹	House B ₹
(a) Assuming both properties are self-occupied (SO)		
Annual Value	Nil	Nil
Less : Interest on loan	(-) 30,000	(-) 1,50,000
Loss from House Property	(-) 30,000	(-) 1,50,000
(b) Assuming both properties as deemed let out (DLO)		
Gross Annual Value	4,50,000	5,00,000
Less : Municipal taxes paid	(-) 50,000	(-) 60,000
Net Annual Value	4,00,000	4,40,000
Less : Permissible deduction :		
(i) Statutory deduction : 30% of Net Annual Value	(-) 1,20,000	(-) 1,32,000
(ii) Interest on loan	(-)1,60,000	(-) 2,20,000
Income from House Property	1,20,000	88,000
(c) Criteria for selection of house for self-occupied : Lowest taxable income	Option I	Option II
Income from house A	(-)30,000 (SO)	1,20,000 (DLO)
Income from house B	88,000 (DLO)	(-)1,50,000 (SO)
Income from Other Sources	3,00,000	3,00,000
Total Income	3,58,000	2,70,000

Conclusion : House B should be treated as self-occupied.

Gross Annual Value = Higher of Municipal value or fair rent but restricted to standard rent.

(ii) ABC & Co. is a partnership firm, consisting 3 partners A, B and C. The firm is dissolved on 31.12.14. The assets of the firm were distributed to the partners as under :

Particulars	Block of Machinery (given to A)	Stock (given to B)	Land (given to C)
Year of acquisition	**1990-91**	**2002-03**	**1978-79**
Cost of acquisition (₹)	**27,20,000**	**4,00,000**	**10,000**
Market value as on 31.12.14	**17,00,000**	**6,00,000**	**27,00,000**
WDV as on 31.12.14	**11,40,000**	**—**	**—**

Value at which given to partners as per agreement	**12,00,000**	**4,50,000**	**18,00,000**
Market value as on 1.4.81	**—**	**–**	**2,70,000**

Compute the income taxable in the hands of the firm for the Assessment Year 2015-16. What shall be the cost of acquisition of such assets to the partners of the firm? [5]

Solution :

Computation of Short Term Capital Gains on Block of Machinery

	₹
Sale consideration (i.e. the market value)	17,00,000
Less : Cost of Acquisition (WDV of the block)	11,40,000
Short Term Capital Gains	5,60,000

Income from Business (on transfer of stock)

	₹
Market value of stock	6,00,000
Less : Cost of Acquisition	4,00,000
Business Income	2,00,000

Computation of Capital Gains on transfer of land

	₹
Consideration for transfer	27,00,000
Less : Indexed cost of Acquisition : $2,70,000 \times \frac{1024}{100}$	27,64,800
Long Term Capital Gains	(64,800)

Cost of acquisition of assets to the partners

	₹
Partner "A"	12,00,000
Partner "B"	4,50,000
Partner "C"	18,00,000

(iii)For the previous year 2014–15, the business income of Sohan Ltd. before allowing expenditure on family planning is ₹2,20,000. The company had incurred the following expenditure on family planning amongst its employees during the previous year 2014-15:

(1) Revenue expenses on family planning ₹1,10,000.

(2) Capital expenditure on family planning ₹6,00,000.

Compute the deduction available for expenditure on family planning to the company assuming the company has income from other sources amounting to ₹20,000.

What will be your answer if the revenue expenditure on family planning is ₹2,15,000 instead of ₹1,10,000. [5]

Solution:

	₹	₹
Profits before deduction of expenditure on family planning		2,20,000
Less: revenue expenses	1,10,000	
Capital expenditure (1/5th of ₹6,00,000, ₹1,20,000 but allowed to the extent of business income)	1,10,000	2,20,000
Business income		Nil
Income from other sources	20,000	
Less: unabsorbed capital expenditure of family planning	20,000	
Gross Total Income		Nil

The balance unabsorbed capital expenditure on Family Planning of ₹10,000 will be carried forward like unabsorbed depreciation.

	₹	₹	₹
Profit before deduction of expenditure on family planning		2,20,000	
Less: revenue expenses	2,15,000		
1/5th capital expenditure	1,20,000		
	3,35,000		
Deduction limited to business income		2,20,000	Nil
Balance family planning expenditure	1,15,000		
Set off against income from other sources	20,000		
Unabsorbed family planning expenditure carried forward	95,000		
Income from other sources		20,000	
Less: Set off family planning expenditure		20,000	Nil
Gross total income			Nil

Question No 3. Answer any two questions [2 × 10 = 20]

(a)(i) FLT LLP of France and Squar Ltd of India are associated enterprises. Squar Ltd. imports 5,000 compressors for Air Conditioners from FLT at ₹ 7,800 per unit and these are sold to Bihar Cooling Solutions Ltd at a price of ₹ 11,000 per unit. Squar Ltd. had also imported similar products from Cold Ltd and sold outside at a Gross Profit of 20% on Sales.

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

Determine the Arm's Length Price and the amount of increase in Total Income of Squar Ltd. [5]

Solution:

A. Computation of Arm's Length Price of Products bought from FLT, France by Squar Ltd.

Particulars	₹	₹
Resale Price of Goods Purchased from FLT		11,000

Less: Adjustment for differences		
(a) Normal gross Profit margin @ 20% of sale price [20% × ₹ 11,000]		2,200
(b) Incremental Quantity Discount by FLT [₹ 1,500 – ₹ 500]		1,000
(c) Difference in Purchase related Expenses [₹ 1,200 – ₹ 200]		1,000
Arms Length Price		**6,800**

B. Computation of Increase in Total Income of Squar Ltd

Particulars	₹	₹
Price at which actually bought from FLT LLP of France		7,800
Less : Arms Length Price per unit under Resale Price Method		(6,800)
Decrease in Purchase Price per Unit		1,000
No. of Units purchased from FLT		1,000
Increase in Total Income of Squar Ltd [5,000 Units × ₹ 1,000]		₹ 50,00,000

(ii) Himalaya Ltd is an Indian Company engaged in the business of developing and manufacturing Industrial components. Its Canadian Subsidiary Su-power Inc. supplies technical information and offers technical support to Himalaya for manufacturing goods, for a consideration of Euro 2,00,000 per year.

Income of Himalaya Ltd is ₹ 180 Lakhs. Determine the Taxable Income of Himalaya Ltd if Su-power charges Euro 2,60,000 per year to other entities in India. What will be the answer if Su-power charges Euro 1,20,000 per year to other entitles. (Rate per Euro may be taken at ₹ 60) [5]

Solution:

Computation of Total Income of Himalaya Ltd.

Particulars		
When Price Charged for Comparable Uncontrolled Transaction	2,00,000	1,20,000
Price actually paid by Himalaya Ltd [€ 2,00,000 x 60]	1,20,00,000	1,20,00,000
Less: Price charged in Rupees (under ALP) [€ 2,60,000 x 60] [€ 1,20,000 x 60]	1,56,00,000	72,00,000
Incremental Profit on adopting ALP [A]	(36,00,000)	48,00,000
Total Income before adjusting for differences due to Arm's Length Price	1,80,00,000	1,80,00,000
Add: Difference on account of adopting Arm's Length Price [if (A) is positive]	Nil	48,00,000
Total Income of Himalaya Ltd	1,80,00,000	2,28,00,000

Note : U/s 92(3), Taxable Income cannot be reduced on applying ALP. Therefore, difference on account of ALP which reduces the Taxable Income is ignored.

(b)(i) Mobeaux LLP of Poland and Vishnu Ltd of India are Associated Enterprises. Vishnu imports 2000 compressors for Air Conditioners from Mobeaux at ₹ 7,500 per unit and these are sold to Winland Cooling Solutions Ltd at ₹11,000 per unit Vishnu had also imported similar products from De-Heat Ltd and sold outside at a Gross Profit of 20% on Sales.

Mobeaux offered a Quantity Discount of ₹ 1,500 per unit. De-Heat could offer only ₹ 500 per unit as Quantity Discount. The Freight and Customs Duty paid for imports from Poland had cost to Vishnu ₹ 1,200 a piece. In respect of purchase from De-Heat, Vishnu had to pay ₹ 200 only as Freight Charges.
Determine the Arm's Length Price and the amount of increase in Total Income of Vishnu Ltd. [5]

Solution:

1. Computation of Arm's Length Price of Products bought from Mobeaux, Poland by Vishnu Ltd.

Particulars	₹	₹
Resale Price of Goods Purchased from Mobeaux		11,000
Less: Adjustment for Differences -		
(a) Normal Gross Profit Margin at 20% of Sale Price [20% × ₹11,000]	2,200	
(b) Incremental Quantity Discount by Mobeaux [₹ 1,500 - ₹ 500]	1,000	
(c) Difference in Purchase related Expenses [₹ 1,200 - ₹200]	1,000	(4,200)
Arms Length Price		6,800

2. Computation of Increase in Total Income of Vishnu Ltd.

Particulars	₹
Price at which actually bought from Mobeaux LLP of Poland	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 Mobeaux	2,000
Therefore, increase in Total Income of Vishnu (2,000 Units × ₹ 700)	**₹ 14,00,000**

(ii) EML Limited, an Indian Company, is engaged in manufacturing electronic components. 74% of the Shares of the Company are held by EML Inc. incorporated in USA. EML Limited has borrowed funds from EML Inc. at LIBOR plus 150 points. The LIBOR prevalent at the time of borrowing is 4% for US $. The Borrowings allowed under the External Commercial Borrowings Guidelines issued under FEMA are LIBOR plus 200 basis points. Discuss whether the Borrowing made by EML Ltd is at Arm's Length. [5]

Solution:

1. Associated Enterprises: Two Enterprises shall be deemed to be associated enterprises, if, at any time during the Previous Year, one Enterprise holds, directly or indirectly, shares carrying not less than 26% of shares/voting power in other enterprise. Hence, EML Ltd. and EML Inc. are Associated Enterprises.
2. Transaction Value:
   (a) The Transaction Value shall be determined on the basis of Arm's Length Price (ALP) under Uncontrolled Transaction in case of transactions between Associated Enterprises.
   (b) However, ALP is not applicable if the computation of Income / Expense / Interest u/s 92(1) or determination of Cost or Expense allocated or apportioned or contributed u/s 92(2), has the effect of - (i) reducing the Income chargeable to tax, or (ii) increasing

the Loss, computed on the basis of entries made in the Books of Account.

3. Determination of ALP:

Particulars	Computation		Rate of Interest
Comparable Uncontrolled Rate	LIBOR + 2%	= 4% + 2%	6%
Actual Transaction Rate	LIBOR + 1.50%	= 4% + 1.5%	5.50%

4. Conclusion:

(a) The transaction has occurred at a rate lower than comparable uncontrolled rate, and hence is not an Arm's Length Transaction.

(b) When ALP is adopted, Interest Expenses will increase, thereby reducing the taxable Income. Hence, ALP is not applicable u/s 92(2) in this case.

(c) What are the consequences of Non-Compliance with Regulations under International Transaction? [10]

Answer:

Consequences of Non-Compliance with Regulations

Section	Act / Omission	Consequence	Authority
92C(3)	Use of Price other than ALP Non-Maintenance of information / documents Unreliable/Incorrect information Failure to furnish documents required u/s 92D	Determination of ALP by Assessing Officer after giving Show Cause Notice to Assessee.	AO / C1T(A)
271(1)(c)	Addition to Income / Disallowance consequent to determination of ALP by Assessing Officer	Concealment Penalty: Minimum=100% Maximum=300% of tax evaded	AO / CIT(A)/err
271AA	Failure to maintain documents u/s 92D(1) or 92D(2), Failure to report such transactions, or maintain or furnishing any Incorrect information or document.	Penalty at 2% on the value of each International Transaction / Specified Domestic Transaction	AO / CTT(A) TPO
271G	Failure to furnish documents /information required by AO/ CTT (A) u/s 92D(3)		
271BA	Failure to file report in Form No.3CEB before due date.	Penalty of ₹ 1 Lakh.	AO
272A(2)(a)	Failure to comply with a notice issued u/s 94(6) regarding furnishing of information relating to securities.	₹ 100/day of default.	JOT/JDIT/ Higher Authority

Note: The penalty u/s 271AA shall be in addition and not in substitution of penalty u/s 271BA & u/s 271.

Exception from penalties:

1. If the Assessee proves that the price charged/paid in International Transaction/Specified Domestic Transaction is determined in good faith and with due diligence, Concealment Penalty u/s 271(1)(c) shall not be imposed.
2. If the Assessee proves that failure u/s 271AA, 271G and 271BA is due to a reasonable cause, penalty shall not be imposed.