Paper – 7: 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.

1. Answer all questions:

(i) Ascertain the previous year of the income in relation to assessment year 2015–16 in the following cases:

(a) Dr. Raju was appointed as Assistant Professor in Shri Ram College of Commerce for first time on 01.08.2014.

(b) Parash started a cloth business on 27.02.2015.

(c) Vijay Kumar purchased a let out house property of two rooms on 05.07.2014.

(d) Mr. T received a remuneration of ₹50,000 for acting in a T.V. Serial on 10.3.2015 for the first time. [2]

Answer:

(a) 01.08.2014 to 31.03.2015 (b) 27.02.2015 to 31.03.2015

(c) 05.07.2014 to 31.03.2015 (d) 10.03.2015 to 31.03.2015

(ii) Total income of Ritesh, an individual who is less than 60 years of age and resident in India, for the previous year 2014-15 (Assessment year 2015-16) is ₹10,94,000. Compute the tax payable by Ritesh for the assessment year 2015-16. [2]

Answer:

	Tax Liability
First ₹2,50,000	Nil
Next ₹2,50,000 @ 10% i. e. upto ₹5,00,000	25,000
Next ₹5,00,000 @ 20% i. e. exceeding ₹5,00,000 upto ₹10,00,000 @ 20%	1,00,000
Above ₹10,00,000 i.e. on balance ₹94,000 @30%	28,200
	1,53,200
Add: Education Cess & SHEC @ 3%	4,596
	1,57,796
Total –tax (round off)	1,57,800

Note: Tax payable is rounded off to nearest rupees ten. If the last digit of tax payable is ₹5 or more, it is rounded off to higher ten, whereas if the last digit of tax payable is less than ₹5, it is rounded off to lower ten.

(iii) X joined a service on 01.08.2010 in the grade of ₹12,000 - 300 - 13,800 - 400 - 17,800 and his salary was fixed at ₹14,200 from the date of joining. Compute his basic salary for the assessment year 2015-16. [2]

Answer:

		₹
Salary from April, 2014 to July, 2014	₹15,400 × 4	61,600
Salary from August, 2014 to March, 2015	₹15,800 × 8	1,26,400
		1,88,000

Working notes: basic salary drawn

(i)	01.08.2010 to 31.07.2011	₹14,200 p.m
(ii)	01.08.2011 to 31.07.2012	₹14,600 p. m.
(iii)	01.08.2012 to 31.07.2013	₹15,000 p.m.
(iv)	01.08.2013 to 31.07.2014	₹15,400 p.m.
(v)	01.08.2014 TO 31.07.2015	₹15,800 p. m.

(iv) What are the advantages in applying Profit Split Method while determine arm's length price under International Transactions? [2]

Answer:

- Both the Parties to the transaction are evaluated & determination of Transfer Price will be as per the ALP.
- This method can be used when there are no closely comparable transactions between Independent Enterprises.

(v) What are the limitations while determining arm's length price under Resale Price method? [1]

Answer:

It is less reliable in case of any differences between the controlled and uncontrolled transactions and the parties to the transactions which may have a material effect on the resale price margin realized.

It is applicable only when the reseller does not add substantially to the value of the product.

(vi) Define Advance Pricing Agreement? [2]

Answer:

An Advance Pricing Agreement (APA) is an agreement between a Taxpayer and a Taxing Authority on an appropriate Transfer Pricing methodology for set of transactions over a fixed period of time in future. They offer better assurance on transfer Pricing Methods and provide certainty and unanimity of approach.

(vii) Sumit is provided free meals in the office, during office hours, for 300 days during the previous year. The cost of meals to the employer is ₹65 per meal.

(a) Determine the value of perquisite in respect of meals.

(b) What shall be the value if the value per meal is ₹50. [1]

Answer:

(a) If free meal is provided during office hours in the office or business premises, it shall be exempt to the extent of ₹50 per meal and excess if any shall be taxable perquisite.
Hence, value of perquisite in case of free meal shall be 300 × 15 = ₹4,500.

(b) The value of perquisite in this shall be nil.

(viii) Rohit has a house property in Delhi whose Municipal Value is ₹1,00,000 and the Fair Rental Value is ₹1,20,000. It was self occupied by Rohit from 01.04.2014 to 31.07.2014. W.e.f. 01.08.2014 it was let out at ₹9,000 p.m. Compute the annual value of the house property for the assessment year 2015-16 if the municipal taxes paid during the year were ₹20,000. [2]

Answer:

The gross annual value shall be higher of the following two—

		₹
(a)	Expected rent (Municipal value ₹1,00,000 or FRV ₹1,20,000 whichever is higher)	1,20,000
(b)	Actual rent received/receivable for let out period i.e. 9,000 × 8	72,000
	∴ Gross annual value	1,20,000
	Less: Municipal taxes	20,000
	Net annual value	1,00,000

(ix) An electricity company which was charging depreciation on straight line method and whose actual cost of the asset was ₹5,00,000 and written down value ₹4,50,000 sold the said asset during 2014-15 after 2 years. What will be the tax treatment if the asset is sold for:

(a) ₹3,50,000

(b) ₹4,80,000

(c) ₹6,00,000 **[2]**

Answer:

(a) ₹4,50,000 – ₹3,50,000 = ₹1,00,000 will be allowed as terminal depreciation in the previous year 2014-15.

(b) ₹4,80,000–₹4,50,000 = ₹30,000 shall be balancing change and taxable as business income as per section 41(2).

(c) ₹5,00,000-4,50,000 = ₹50,000 shall be balancing charge and hence taxable as business income ₹6,00,000-5,00,000 = ₹1,00,000 shall be short-term capital gain.

(x) X purchased a piece of land on 04.01.1978 for ₹50,000. This land was sold by him on 02.09.2014 for ₹14,00,000. The market value of the land as on 01.04.1981 was ₹1,20,000. Expenses on transfer were 2% of the sale price. Compute the capital gain for the assessment year 2015-16. **[2]**

Answer:

	₹	₹
Sales consideration		14,00,000
Less: Expenses on transfer	28,000	
Indexed cost of acquisition – ₹1,20,000 × $\frac{1024}{100}$	12,28,800	12,56,800
Long-term capital gain		1,43,200

(xi) What are the deductions not allowed where return is not filed within specified time limit? **[2]**

Answer:

Where in computing the total income of an assessee, any deduction is admissible under section 80-IA or section 80-IAB or section 80-IB or section 80-IC or section 80-ID or section 80-IE, no such deduction shall be allowed to him unless he furnishes a return of his income for such assessment year on or before the due date specified under section 139(1).

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

(a) (i) During the financial year 2014-15 Anil Rajak had the following income:

		₹
(A)	**Salary income received in India for services rendered in Hong Kong**	**3,90,000**
(B)	**Income from profession in India, but received in Germany.**	**3,60,000**
(C)	**Property income in Uganda (out of which ₹2,40,000 was remitted to India).**	**5,00,000**
(D)	**Profits earned from business in Bangalore.**	**1,50,000**
(E)	**Agricultural income in Kenya.**	**1,60000**
(F)	**Profits from a business carried on at Nepal but controlled from India.**	**2,20,000**

Compute the income of Anil Rajak for the assessment year 2015-16 if he is (i) resident and ordinarily resident, (ii) Not ordinarily resident, and (iii) Non-resident in India. [4]

Solution:

Computation of Taxable Income of Anil Rajak for the assessment year 2015-16

		R & OR (₹)	NOR (₹)	NR (₹)
(1)	**Income received in India wherever it accrues** Salary received in India for services rendered in Hong Kong.	3,90,000	3,90,000	3,90,000
(2)	**Income accrued in India wherever received**			
	(i) Profit earned from business in Bangalore.	1,50,000	1,50,000	1,50,000
	(ii) Income from profession in India but received in Germany.	3,60,000	3,60,000	3,60,000
(3)	**Income accrued and received outside India**			
	(i) Property income in Uganda.	5,00,000	-	-
	(ii) Agricultural income in Kenya.	160,000	-	-
	(iii) Profits of a business carried on in Nepal but controlled from India.	2,20,000	2,20,000	-
	Total Income	17,80,000	11,20,000	9,00,000

(ii) Tushar is employed with ABC Ltd. on a monthly salary of ₹25,000 per month. The company provides him with the following benefits:

(A) A company owned accommodation is provided to him in Delhi.

(B) The company has given him a housing loan of ₹5,00,000 on 01.04.2014 on which it charges interest @ 6% per annum. The entire loan is still outstanding. (Assume the interest charged by SBI is 10% p.a.)

(C) The company gave him a gift worth ₹15,900 on his 50th birthday on 21.10.2014.

(D) He is allowed to use the video camera belonging to the company. The company had purchased this camera for ₹60,000 on 01.05.2011. This camera was sold to him on 01.08.2014 for ₹30,000

(E) The company had purchased a car on 16.07.2011 for ₹2,50,000. This car is sold to Tushar on 14.07.2014 for ₹80,000. The car was not being used by Tushar.

(F) The company pays the telephone bills of ₹24,000 for the telephone installed at the residence of Tushar.

Compute the Gross income from salary of Tushar for the assessment year 2015-16. [4]

Solution:

	₹	₹
Salary (₹25,000 × 12)		3,00,000
Value of accommodation (15 % of salary)		45,000
Value for housing loan (4% of ₹5,00,000)		20,000
Gift in kind on birthday (₹15,900 - 5,000)		10,900
Value for use of video camera for 4 months (₹60,000 × $\frac{10}{100}\times\frac{4}{12}$)		2,000
Benefit on sale of camera W. D. V. on basis of straight line method (₹60,000 – 18,000 depreciation for 3 completed years) Less: Amount recovered	42,000 30,000	12,000
Benefit on sale of car W. D. V. (see note) Less: Consideration paid	1,60,000 80,000	80,000
Payment of telephone bills		(Exempt)
Gross income from salary		4,69,900

Note. - The car has been used from 16.07.2011 to 14.07.2014 and the completed years in this case are two. Therefore, the WDV shall be determined as under:	
Original cost	2,50,000
Less: Depreciation for first year @ 20%	50,000
W.D.V.	2,00,000
Less: Depreciation for second year	40,000
	1,60,000

(iii) The following incomes are received by Mr. Pawan during financial year 2014 – 15.

	₹
Director's fees	**2,000**
Income from agricultural land in Pakistan	**5,000**
Ground rent for land in Pathankot	**10,000**
Interest on Postal Savings Bank A/c	**100**
Interest on deposits with Industrial Finance Corporation of India	**500**
Dividend from a foreign company	**700**
Rent from sub-letting a house	**26,250**
Rent payable by Mr. Pawan for the sub-let house	**12,000**
Other expenses on sub-let-house	**1,000**
Winnings from horse-race (Gross)	**12,300**
Interest on Securities (gross)	**4,000**

You are required to calculate income from other Sources of Mr. Pawan for the assessment year 2015–16. [4]

Solution:

	₹	₹	₹
Director's fees			2,000
Income from agricultural land in Pakistan			5,000
Ground rent for land in Pathankot			10,000
Interest on Deposits with IFCI			500

Dividend from a foreign company (not to be grossed up)			700
Rent –from sub-letting a house Less: Rent payable for the sub-let house Other expenses	 12,000 1,000	26,250 13,000	 13,250
Winnings from horse – race			12,300
Interest on Securities			4,000
Income from other sources			47,750

(iv) XY & Co. a partnership firm engaged in the manufacturing business has a total turnover of ₹59,00,000 from such business. The partnership deed provides for payment of salary of ₹10,000 p.m. to each of the partners i.e. X and Y. The firm uses machinery for the purpose of its business and the WDV of the machinery as on 01.04.2014 is ₹2,00,000. The machinery is eligible for depreciation @ 15%. Compute the profits from the business, if the firm opts for the scheme under section 44AD.

What will be profit from the business, if each partner is paid ₹20,000 p.m. as salary instead of ₹10,000 p.m. [3]

Solution:
As per section 44AD the profits will be computed as under:
8% of total turnover of ₹59,00,000 = ₹4,72,000 – ₹2,40,000 [as the salary to working partners is within the limits of section 40(b)] = 2,32,000
No deduction will be allowed on account of depreciation.
The WDV of the machinery for next year shall be taken as ₹1,70,000 (2,00,000 - 15% of ₹2,00,000) assuming as if depreciation has been allowed.

Salary as per partnership deed 20,000 × 12 × 2 = 4,80,000
Salary allowed as per section 40(b)

	₹
On first 3,00,000 of profits @ 90% On the balance profit 60% of ₹1,72,000	2,70,000 1,03,200
Total salary allowed as per section 40(b)	3,73,200

∴ Profits from business: ₹4,72,000 – 3,73,200 = ₹98,800

(b) (i) Mr. Shakti has a house property in Delhi whose particulars are as under:

	₹
Municipal value	**3,00,000**
Standard rent	**3,12,000**
Municipal taxes paid	**50,000**
Interest on money borrowed for acquiring the house after 01.04.2012	**1,60,000**
Period of occupation for own residence	**2 months**
Actual rent for 10 months	**35,000 p. m.**
Compute the income from house property for assessment year 2015-16.	

[3]

Solution:

Computation of income from house property

Gross annual value shall be higher of following two

		₹	₹
(a)	Expected rent (Municipal value ₹3,00,000 or FRV ₹4,20,000 whichever is higher i.e. ₹4,20,000 but restricted to standard rent		

	i.e. ₹3,12,000)	3,12,000	
(b)	Actual rent received or receivable (₹35,000 × 10)	3,50,000	3,50,000
Less:	Municipal taxes paid		50,000
	Net annual value		3,00,000
Less:	Deduction u/s 24		
(a)	Statutory deduction @ 30%	90,000	
(b)	Interest on money borrowed for acquisition of house	1,60,000	2,50,000
	Income from house Property		50,000

(ii) A Ltd. has an industrial plot which was purchased on 14.10.1986 for ₹2,00,000. It has since been used for its industrial purposes as an open stockyard. This plot was compulsorily acquired by the Government on 15.11.2010 and a sum of ₹11,90,000 was determined as compensation which was received by the company on 04.04.2013. The company, not being satisfied with the compensation appealed against the above award and the compensation was enhanced by ₹1,00,000 on 30.01.2014 but the enhanced compensation was received on 05.04.2014. Meanwhile, the assessee purchased another industrial plot on 15.09.2013 for ₹1,90,000. On receipt of the enhanced compensation, the company deposited the entire amount under the Capital Gains Accounts Scheme on 30.09.2015. Till the time the amount was deposited, the company used the said amount of ₹1,00,000 for its business purposes. Compute the capital gains for various assessment years arising on this transaction. [5]

Solution:

Assessment year 2011-12: Although there is compulsory acquisition and thus transfer, but capital gain will arise in the previous year, in which full or part of the compensation is received. Assessment year 2014-15

	₹
Full value of consideration	11,90,000
Less: Indexed cost of acquisition – ₹2,00,000 × $\frac{711}{140}$	10,15,714
Long-term capital gain	1,74,286
Less: Exemption u/s 54D	
Cost of land acquired but restricted to capital gain	1,74,286
Taxable capital gains	Nil
Assessment year 2015 - 16	
Enhanced compensation	1,00,000
Less: Cost of acquisition and improvement	Nil
Long-term capital gain	1,00,000
Less: Exemption u/s 54D	1,00,000
Capital gain	Nil

(iii) From the following information submitted to you, compute the total income of A for the assessment year 2015-16 and calculate his tax liability assuming he is not allowed any deduction under sections 80C to 80U.

	₹
Income from salary	**1,80,000**
Income from house property	**40,000**
Business loss	**(-) 1,90,000**
Loss from a specified business referred to in section 35AD	**(-) 60,000**
Short-term capital loss	**(-) 60,000**

Long-term capital gain	**2,40,000**

[4]

Solution:

Computation of total income of A for the assessment year 2015-16

	₹	₹
Income from salary		1,80,000
Income from House property		
Income	40,000	
Less: Business loss adjusted	(-) 10,000	30,000
Business loss	(-) 1,90,000	
Less: Set off against capital gain	1,80,000	
Less: Set off against ho use property income	10,000	Nil
Loss from specified business not allowed to be set off	(-) 60,000	
Income from capital gain		
Long-term capital gain	2,40,000	
Less: short-term capital loss	60,000	
	1,80,000	
Less: Business loss adjusted	1,80,000	Nil
Gross total income		2,10,000
Less: Deductions		Nil
Total income		2,10,000

1. Business loss should first be set off from long-term capital gain as the long-term capital gain is taxable @20% where as the income from house property, in this case, is taxable @ 10%.
2. It may be noted that business loss cannot be set off against income under the head salary.

(iv) X owns the following commercial vehicles:

- **(I) 2 light commercial vehicles — One for 9 months and two days and the other for 12 months.**
- **(II) 2 heavy goods vehicle — one for 6 months and 25 days and the other for 11 months and 12 days**
- **(III) 2 medium goods vehicles — One for 6 months and the other for 8 months and 15 days.**
  - **(a) Compute the income from business if X opts for the scheme u/s 44AE. Also compute his tax liability for the assessment year 2015-16, if he deposits ₹20,000 in PPF Account during the previous year.**
  - **(b) What will be the income if the trucks were not used for business for two months during the year due to strike? [3]**

Solution:

(a) The income u/s 44AE shall be computed as under:

		₹
(i)	10 × 7,500 +12 × 7,500	1,65,000
(ii)	7 × 7,500 + 12 × 7,500	1,42,500
(iii)	6 × 7,500 + 9 × 7,500	1,12,500
	Income from Business	4,20,000

	Less: Deduction u/s 80C	20,000
	Total income	4,00,000
	Tax on ₹4,00,000	15,000
	Less: rebate u/s 87A	2,000
		13,000
	Add: Education cess & SHEC-@ 3%	390
		13,390

(b)Income from vehicles is to be computed for every month or part of the month during which these were owned by the assessee even though these are not actually used for business. Therefore there will be no change in the answer

(c) (i) State with reasons whether the following expenses are admissible as deduction while computing income from business or profession:

(I) An expenditure of ₹20,000 incurred towards cost of neon signs fixed on office premises for advertising the products of the assessee.

(II) Stock-in-trade was lost in fire, amounting to ₹12,000 and was debited to Profit and Loss Account.

(III) Amount spent on a successful suit filed against a person for infringing trade mark of the assessee—₹10,000

(IV) Interest paid to bank ₹15,000 in connection with overdraft obtained for paying dividend.

(V) Entertainment expenses of ₹28,000 incurred during the previous year.

(VI) Capital expenditure of ₹1,00,000 has been incurred towards promotion of family planning amongst employees of ABC Ltd.

(VII) ₹20,000 were spent in the previous year in connection with statutory income tax proceedings.

(VIII) ₹3,000 spent in connection with installation of a new telephone connection.

(IX) Travelling expenses of a Director of ABC Ltd. ₹20,000 incurred on a tour to U.S.A. in connection with the negotiation of purchase of a new machinery.

(X) Compensation paid to the widow and children of deceased employee of the factory on the orders of Labour Court. [5]

Solution:

(I) The Punjab & Haryana High Court in the case of CIT v Liberty Group Marketing Division (2009) 315 ITR 125 (P&H) has held that the expenditure incurred by the assessee on glow sign board did not bring into existence an asset or advantage for the enduring benefit of the business which was attributable to capital. Glow sign board was not an asset of permanent nature. Therefore the expenditure was of revenue nature.

(II) Loss of stock-in-trade by fire is deductible from 'Profit and gains of business or profession'.

(III) Amount spent on a suit filed for infringing the trade mark of ₹10,000 is fully admissible because it is a commercial expediency for security or registration of trade mark.

(IV) Interest of ₹15,000 paid to bank for overdraft for payment of dividend is allowed.

(V) Entertainment expenditure is covered under section 37(1) hence fully allowed.

(VI) Expenditure on promotion of family planning incurred by a company amongst its employees is allowed but if it is of capital nature then 1/5th of the amount spent is allowed in the previous year in which it is incurred and balance in four equal installments in next four previous years. In this case ₹20,000 is allowed in the current previous year and balance in next four previous years (₹20,000 each year).

(VII) Amount spent on income-tax proceedings is allowed as legal charges, hence ₹20,000 is deductible.

(VIII) ₹3,000 is allowed as deduction which are incurred for installation of a new telephone connection.

(IX) Travelling expenses of a Director are fully allowed because the tour was for business purposes. It may also be treated as part of the cost of new machine, if the assessee so desires.

(X) Compensation paid to the widow and children of the deceased employee as per the order of court are fully allowed.

(ii) Ramdhin purchased 5,000 shares of S Ltd. @ ₹200 per share on 05.07.2014. S Ltd. declares a dividend of ₹10 per share. The record date is fixed as 04.09.2014. Ramdhin received the dividend immediately after the record date. The above shares were sold by Ramdhin on 05.11.2014 for:

(a) ₹175 per share
(b) ₹192 per share
(c) ₹205 per share
Compute the income/loss in each case. [4]

Solution:

As the shares have been acquired within 3 months prior to the record date and sold within 3 months after the record date, section 94(7) shall be applicable.

Situation I

Dividend of ₹50,000 shall be exempt in the hands of Ramdhin.

Capital loss on shares

₹8,75,000 - ₹10,00,000 = (-) ₹ 1,25,000

Dividend received = ₹50,000

Loss to the extent of dividend claimed as exempt shall not be allowed to be carried forward.

Therefore, capital loss of ₹75,000 (₹1,25,000 - ₹50,000) shall be allowed to be carried forward.

Situation II

Dividend of ₹50,000 shall be exempt in the hands of Ramdhin.

Capital loss on shares

₹9,60,000 - ₹10,00,000 = (-) ₹40,000

Dividend received = ₹50,000

Therefore, capital loss of ₹40,000 on shares shall not be allowed to be carried forward.

Situation III

Dividend of ₹50,000 shall be exempt in the hands of Ramdhin.

Capital gain on shares

₹10,25,000 - ₹10,00,000 = ₹25,000

As there is capital gain instead of capital loss, section 94(7) is not applicable and such capital gain shall be taxable.

(iii) Mrs. Satya received the following amounts during financial year 2014 –15:

	₹
Gross salary	**5,30,000**
Family Pension ₹10,000 × 12	**1,20,000**
Income of a minor child	**49,000**
Accumulated balance in PF of her husband after his death	**1,00,000**
Gratuity received after the death of husband	**1,00,000**

Calculate taxable income of Mrs. Satya and tax liability for the assessment year 2015-16. **[3]**

Solution:

Computation of taxable income of Mrs. Satya Yadav for the assessment year 2015-16

	₹	₹
Income from salary		
Gross salary	5,30,000	
Less: Deduction	Nil	5,30,000
Income from other sources		
Family pension	1,20,000	
Less: Deduction u/s 56 1/3 or ₹15,000 whichever is less	15,000	1,05,000
Income of a minor child	49,000	
Less: Exemption u/s 10(32)	1,500	47,500
Gross total income		6,82,500
Tax payable		61,500
Add: Education cess & SHEC - @ 3%		1,845
Tax round off		63,350

Note. – Accumulated balance in PF and amount of gratuity received after the death of husband is exempt from tax as it is assumed to be within the limit prescribed by section 10(10).

(iv) An Assessing Officer made an order of Assessment on Ramnath determining the Total Income at ₹ 3,75,000 by an order dated 30.03.2015 in respect of Assessment Year 2012-2013. This was served on the Assessee on 02.04.2015. A tax of ₹1,87,500 was determined subsequently and a Demand Notice served on the Assessee on 20.07.2015. Discuss the validity of the proceedings in the above case. **[3]**

Solution:

U/s 153(1), assessment order u/s 143 or 144 should be passed within 2 Years from the end of the Assessment Year in which the income was first assessable. There is no time limit prescribed as to the service of demand notice, if any raised after passing the above assessment order.

Unless the Total Income is determined and the determination of tax is also done, the assessment cannot be regarded as complete. Order of Assessment implies order of not only determining the Total Income, but also the tax liability due.

In the instant case, the assessment is fully complete only after determination of tax i.e. on 20.07.2015, which is after the prescribed period of 2 years.

In view of the above, the proceeding is time barred and not valid.

(d) (i) Sudhir files a return of income declaring an income of ₹9,15,000 for assessment year 2015-16. A sum of ₹43,000 has already been deducted at source from the income of Sudhir during the financial year 2014-15. Sudhir has paid advance tax as under:

	₹
15-09-2014	**15,000**
14-12-2014	**16,000**
13-03-2015	**22,000**

Compute the interest payable by Sudhir under section 234C. [3]

Solution:

Computation of interest payable by Sudhir under section 234C

	₹
Tax on ₹9,15,000	1,08,000
Add: Education cess + SHEC @ 3%	3,240
	1,11,240
Less: Tax deducted at source	43,000
	68,240

Date upto which advance tax is payable	Advance tax required to be to avoid interest under section 234C	Advance tax paid till date	Interest payable on	Rate of interest	Amount of interest
15-9-2014	30% of ₹68,240 = ₹20,472	15,000	5,472 rounded off to 5,400	3%	162
15-12-2014	60% ₹68,240 = 40,944	31,000	9,944 rounded off to 9,900	3%	297
15-3-2015	100% of ₹68,240	53,000	15,240 rounded off to 15,200	1%	152
					611

(ii) Robin borrows a sum of ₹25,00,000 from the State Bank of India @ 12% p.a. on 01.05.2013 and purchased a house Property for ₹38,00,000 on 04.05.2013. He does not own any residential house property on the date of taking the loan. He has been using the house property for his own residence since its acquisition
Compute the total income of Robin assuming he has salary income of ₹8,40,000 and he deposited ₹1,00,000 in PPF during the previous year 2013-14.
What shall be the answer if the total interest on borrowed money is ₹2,30,000 instead of ₹2,75,000. [3]

Solution:

Computation of total income of Robin for assessment year 2014–2015

	₹	₹
Income from salary		8,40,000
Income from House property		
Annual value	Nil	
Less: Deduction		
Interest limited to	1,50,000	(-) 1,50,000
Gross total income		6,90,000
Less: Deductions u/s 80C	1,00,000	
U/s 80EE	1,00,000	2,00,000
Total income		4,90,000

Working note:

Total interest @ 12% on ₹25,00,000 for 11 months

₹25,00,000 × 11÷12 × 12/100 = 2,75,000

The deduction under section 80EE in this case shall be allowed to the extent of ₹80,000 and the balance ₹20,000 shall allowed in financial year 2014–2015.

(iii) During the previous year 2014-15 a charitable trust earned an income of ₹5,00,000 out of which ₹4,00,000 was received during the previous year 2014-15 and the balance ₹1,00,000 was received during the previous year 2016-17. To claim full exemption of ₹5,00,000 in the previous year 2014-15, state:

(a) What is the maximum amount which can be accumulated to be utilized for charitable or religious purposes at a later date?

(b) How much amount should be actually spent during the previous year 2014-15?

(c) How much amount will be deemed to be utilized during the previous year 2014-15 and within what time should it be actually utilized? [3]

Solution:

	₹
Total income earned	5,00,000
Accumulation allowed @ 15%	75,000
Balance to be utilized during the year	4,25,000
Amount which may be deemed to be utilized because it has not been received during the previous year	1,00,000
Therefore, amount to be actually applied during the previous year	3,25,000

₹1,00,000 received during the previous year 2016-17
should be actually utilized either during the previous year 2016-17 or previous year 2017-18
(a) ₹75,000; (b) ₹3,25,000; (c) ₹1,00,000 to be actual utilised till 31.03.2018

(iv) The gross total income of Upendra for the assessment year 2015-16 is ₹6,20,000 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 Upendra assuming he deposited ₹1,00,000 in PPF and paid premium for health insurance by cheque amounting to ₹15,000. [3]

Solution:

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

	₹	₹
Gross total income		6,20,000
Less: deductions		
U/s 80C	1,00,000	
U/s 80D	15,000	
U/s 80TTA	10,000	1,25,000
Total income		4,95,000
Tax on ₹4,95,000		
Long-term capital gain ₹80,000@20%	16,000	
Short-term capital gain ₹70,000 @ 15%	10,500	
Balance total income ₹3,45,000	9,500	
	36,000	
Less: rebate u/s 87A	2,000	
	34,000	

Add: Education cess & SHEC @ 3%	1,020	
	35,020	

(v) Q filed a Return of Income for the Assessment Year 2014-2015, in due time disclosing a Total Income of ₹4 Lakhs. The taxes due on the income were covered by Taxes Deducted at Source, Advance Tax and Self-Assessment Tax.
The Return was taken for scrutiny by the Assessing Officer, who made large additions to the Income enclosed by Q. On appeal, the High Court set aside the order of assessment and directed for fresh assessment to be made after hearing the parties. The Court Order had become final since neither party had preferred on appeal against it.
The Assessing Officer did not make any fresh assessment with the result that the assessment became barred by time.
Q has filed a petition that since no assessment of his Income had been made by the Assessing Officer the entire taxes paid, including the pre-assessment payments, must be refunded to him.
Is he justified in making this claim? Discuss. [3]

Answer:
U/s 4, tax shall be charged in respect of income of any previous year at the rates specified.
Liability to pay tax u/s 4 does not depend upon the assessment made by the Assessing Officer but depends on the enactment by any Central Act prescribing rates for any assessment year.

When an order of assessment is set aside or annulled and no further assessment can be made the Assessee would be entitled only to the amount of tax paid in excess of the liability incurred by him on the basis of Income disclosed, and not the entire tax paid by him by way of advance tax or self-assessment tax. Amendment of Sec. 240 w.e.f. 1.04.1989 by addition of proviso (b) is declaratory of the law, and therefore retrospective.

Conclusion:

(a) Here, based on the above provisions, Mr. Q is liable to pay tax and hence no refund need be made.

(b) Therefore, the claim of Mr. Q is not tenable.

(e) (i) PQR Ltd is a manufacturer of Steel and allied products. Its Income for Ay 2015–2016 is as follows -

1. Profits and gains from Business computed under the provisions of Income Tax Act	**19,50,000**
2. Book Profit	**1,00,40,000**

Compute the Tax payable by the Company. [5]

Solution:

Assessee: PQR Ltd Previous Year: 2014-15 Assessment Year: 2015 – 16

1. Comparison of Normal Tax and MAT, and Computation of Marginal Relief thereon

Particulars	₹
Tax on total Income = ₹19,50,000 × 30% Add: Surcharge (Since Total Income does not exceed ₹1 Crore)	5,85,000 Nil
Income tax including Surcharge based on Total Income (A)	5,85,000
Tax on Book Profit = ₹1,00,40,000 × 18.5% Add: Surcharge @ 5% (since Book Profits exceed ₹1 Crore)	18,57,400 92,870
Tax on Book Profit including Surcharge = MAT (B)	19,50,270

2. Computation of marginal relief

Particulars		₹
Tax payable [Higher of (1A) or (1B)]		19,50,270
Less: Tax on ₹1 Crore excluding Surcharge (since based on MAT)	₹18,50,000	
Book Profit exceeding ₹1 Crore	₹ 40,000	18,90,000
Marginal relief		60,270

3. Computation of Tax Liability

Particulars	₹
Tax including surcharge [Higher of 1A and 1B] = as per MAT =	19,50,270
Less: Marginal Relief as per 1 (C) above	60,270
Tax payable after Marginal Relief	18,90,000
Add: Education Cess at 2%	37,800
Add: Secondary and Higher Education Cess at 1%	18,900
Total Tax Payable	19,46,700

4. Computation of MAT Credit

Particulars	₹
Tax payable u/s 115JB as per WN 2 above	19,46,700
Less: Tax on Total Income + SC (if applicable) + 2% EC + 1% SHEC = 5,85,000 + Nil + 2% + 1%	6,02,550
MAT Credit available (can be carried forward for 10 successive Asst. Years)	13,44,150

(ii) A, a Resident Indian aged 21 years, earned a sum of ₹10 Lakhs during the Previous Year 2014-2015 from playing Badminton Matches in a Country with which India does not have Double Taxation Avoidance Agreement. Tax of ₹2 Lakhs was levied on such income in the source country. In India, he earned ₹15 Lakhs during the Previous Year 2014-2015 from playing Badminton Matches. He has deposited ₹1 Lakh in Public Provident Fund during the year. Compute his Income Tax Liability for Assessment Year 2015-2016. [4]

Solution:

Assessee: Mr. A Previous Year: 2014-15 Assessment Year: 2015 – 16
Status: Resident Indian Computation of Total Income and Tax payable

Particulars	₹	₹
Profits and Gains from Business or Profession		
(a) Income from playing outside India	10,00,000	
(b) Income from India	15,00,000	
Taxable Profit or Gains from Business or Profession		25,00,000
Gross Total Income		25,00,000
Less: Chapter VIA Deduction		
U/s 80C - Contribution to PPF (allowed upto a maximum of 1,50,000)		(1,00,000)
Total Income		24,00,000
Tax on Total Income (1,25,000 + (24,00,000 - 10,00,000) × 30%)		5,45,000
Add: Education Cess @ 2%		10,900
Add: Secondary and Higher Education Cess @ 1%		5,450

Total Tax Payable Average Rate of Indian Tax (5,61,350 ÷ 24,00,000) Average Rate of Foreign Tax (2,00,000 ÷ 10,00,000) Less: Relief u/s 91 @ 20% of Foreign Income of ₹10,00,000 (Least of the above)	 23.39% 20%	5,61,350 2,00,000
Net Tax Payable (Rounded Off u/s 288 B)		3,61,350

(iii) T has rented out his agricultural land to S who uses the same for agricultural purposes. As per the agreement, 'S' will pay the rent in the shape of agricultural produce from the land to T. T has received during the previous year agricultural produce valued at ₹60,000. He has consumed agricultural produce worth ₹40,000 for his own consumption and the balance has been sold by him for ₹20,000.
Compute the total income for the assessment year 2015-16 assuming he is getting a salary of ₹20,000 p.m. from Y Ltd. He has no other income. Also compute the tax payable by him. [3]

Solution:

Computation of Total income of T for assessment year 2015 – 16

Particulars	₹
Income from salary Salary ₹20,000 × 12 Agriculture income ₹60,000	 2,40,000 Exempt
Gross total Income Less: Deduction	2,40,000 Nil
Total Income	2,40,000

Since Total Income of T is ₹2,40,000 which does not exceed the maximum exempt limit, there will be no integration of Agricultural Income for tax purposes.

(iv) Suvidha Hospitals Pvt. Ltd, the Assessee, has recently been accorded recognition by several Insurance Companies to admit and treat patients on cashless hospitalization basis. Payment to the Assessee Hospital will be made by Third Party Administrators (TPA) who will process the claims of the patients admitted and make the payments to the various hospitals including the Assessee. All TPAs are Corporate Entities. The Assessee wants to know whether the TPAs are bound to deduct tax at source u/s 1943 or u/s 194C. [3]

Answer:

Sec 194J applies even if payment is not made by the person to whom services are rendered. Therefore, TDS u/s 194J has to be deducted by Third Party Administrators (TPA) on payment made to Hospitals on behalf of Insurance Companies for settling medical/ insurance claims with Hospitals.

On failure, TPA shall be liable for Interest u/s 201(1A) and Penalty u/s 271C. No proceeding u/s 201 shall be initiated after the expiry of 6 years from the end of the Financial Year in which such payment has been made without deducting TDS.

If tax has been paid by the Hospitals, and a Certificate from the Auditor of Hospital has been obtained, the TPA shall not be considered-to be in default.

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

(a) (i) REW Ltd., a company incorporated in US, sells laser printer cartridge to its 100 per cent Indian subsidiary AB Ltd. @ $50 per cartridge. REW Ltd. also sells its laser printer cartridge to another company PQR Ltd. in India @ $80 per piece. Total income of AB Ltd. for the assessment year 2014-15 is ₹12,00,000 after making payment for 100 cartridges @ $50 (1$ = ₹ 65). AB Ltd. has deducted tax at source while making payments to REW Ltd. In this case, sale to unrelated party PQR Ltd. is @ $80. Compute the arm's length price and taxable income of REW Ltd. and AB Ltd. The rate of one dollar may be assumed to be equivalent to ₹ 65 in all transactions. [6]

Solution:

Arm's length price of laser printer cartridge, which is sold to AB Ltd. will be $80 per cartridge by comparable uncontrolled price method.

Income of AB Ltd. -

It will be computed as under-

	₹
Income as per books of account	12,00,000
Add: Amount charged by REW Ltd. [$50 x 100 x ₹ 65]	(+) 3,25,000
Less: Arm's length price [$80 x 1 00 X 65]	(-) 5,20,000
Income (after applying arm's length price)	10,05,000

By virtue of section 92(3), one cannot reduce taxable income by applying arm's length price. Therefore, income of AB Ltd. will be ₹ 12,00,000.

Income of REW Ltd. —

If the transactions are actually on a principal-to-principal basis and are at arm's length and the subsidiary company functions and carries on business on its own, instead of functioning as an agent of the parent company, the mere fact that the Indian company is a subsidiary of the non-resident company will not be considered a valid ground for invoking section 9 for assessing the non-resident.

If the aforesaid conditions are satisfied, then REW Ltd. is not chargeable to tax in India.

Conversely, if the aforesaid conditions are not satisfied, REW Ltd. will be chargeable to tax in India in respect of income which arises on sale of goods to AB Ltd. However, the adaptation of arm's length price by the Assessing Officer will not affect the computation of taxable income of REW Ltd. [as per second proviso to section 92C(4) when tax is deducted/deductible, the income of recipient enterprise will not be recomputed if arm's length price is adopted in the case of payer-enterprise].

(ii) What are the practical problems on existing ALP concept? [4]

Answer:

Practical Problems of ALP Concept

1. **True Comparison is difficult**: The commercial and financial conditions governing a transaction between Independent Enterprises are by and large never similar to those existing between Associated Enterprises. Hence, ALP may not be appropriate in such cases.
2. **Availability of Data and Reliability of Available Data**: The comparison of controlled and uncontrolled transactions between Associated and Independent Enterprises usually requires a large quantum of data. There may be difficulty in getting adequate and reliable information and data in order to apply the ALP principle.
3. **Use of Judgments and Subjectiveness**: The tax administration and Taxpayers may have to exercise reason and judgment when applying the ALP.

4. **Absence of Market Price**: There must be a reasonably reliable and Comparable Uncontrolled Market Price. The ALP does not meet this condition because of the nature of the market-place.
5. **Absence of Comparable Market Price for "Intangible" Transactions**: ALP generally fails to achieve a comparable market price for transaction involving intangibles because they are unique. The unique nature of these transactions creates a very wide price range.
6. **Administrative Burden**: In certain cases, the ALP principle may result in an administrative burden for both the Taxpayer and the tax administrations, in evaluating significant numbers and types of cross-border transactions.
7. **Time Lag**: The tax administration may also have to engage in the verification process, sometimes years after the transactions have taken place. This may result in substantial cost being incurred by the Taxpayer and the tax administration.

(b)(i) VK International Ltd, the Assessee, has sold goods on 12.01.2015 to LK Ltd. located in a Notified Jurisdictional Area (NJA), for ₹ 10.50 Crores. The sale price of identical goods sold to an unfamiliar customer in New York during the year was ₹ 11.60 Crores. While the second sale was on CIF basis, the sale to LK Ltd was on F.O.B. basis. Ocean Freight and Insurance amount to ₹ 20 Lakhs.

India has a Double Taxation Avoidance Agreement with the USA. The Assessee has a policy of providing After-Sales Support Services to the tune of ₹ 14 Lakhs to all customers except LK Ltd. The ALP worked out as per Cost Plus Method for identical goods is ₹ 12.10 Crores.

You are required to compute the ALP for the Sales made to LK Ltd, and the amount of consequent increase, if any, in profits of the Assessee-Company. [5]

Solution:

1. Computation of Arm's Length Price of Products sold to LK Ltd. by VK International Ltd.

Particulars	₹ Crores	₹ Crores
Price in a Comparable Uncontrolled Transaction		11.60
Less: Adjustment for Differences -		
(a) Freight and Insurance Charges	(0.20)	
(b) After-Sales Support services	(0.14)	(0.34)
Arm's Length Price Sales to LK Ltd.		11.26

2. Computation of Increase in Total Income of VK International Ltd.

Particulars	₹ Crores
Arm's Length Price as above	11.26
Less: Price at which actually sold to LK Ltd.	10.50
Therefore, increase in Total Income of VK International Ltd.	0.76

Note:

1. ALP given under Cost Plus Model is not considered because ALP determined under Comparable Uncontrolled Transaction Method is considered as Most Appropriate Method in the given case.
2. U/s 92C, when more than one price is determined by the most appropriate method, the Arm's Length Price shall be taken to be the Arithmetical Mean of such prices. Since only one price is available in Most Appropriate Method, the same is considered here.
3. Second Proviso to Sec.92C(2) in relation to permissible variation of 3% is not applicable to transactions with person located in Notified Jurisdictional Area. As the Assessees's customer is in Notified Jurisdictional Area, the principle relating to permissible variation is not applicable.

(ii) Space Motors Ltd, an Indian Company, declared Income of ₹24 Crores computed in accordance with Chapter IV-D but before making any adjustments in respect of the following transactions for the year ended on 31.03.2015:

(A) Royalty of $ 50,00,000 was paid to Fista Ltd for use of technical know—how in the manufacturing of van. However, Fista Ltd had provided the same know-how to another Indian Company for $ 45,00,000. The manufacture of Van by Space Motors Ltd is wholly dependent on the use of technical know-how, in respect of which Fista Ltd has exclusive rights.

(B) Loan of Euro 5 Crores with interest @ 10% p.a. advanced by Hughes Ltd, a French Company, was outstanding on 31.03.2015. The Total Book Value of assets of Space Motors Ltd on the date was ₹ 500 Crores. Hughes Ltd had also advanced similar loan to another Indian Company @ 8% p.a. Total Interest paid for the year was EURO 0.5 Crore.

(C) 7,000 Vans sold to Hitech Ltd which holds 41% Shares in Space Motors Ltd at a price which is less by $ 100 each van than the price charged from Bento Ltd.

Briefly explain the provisions of the Act affecting all these transactions and compute Taxable Income of Space Motors Ltd for A.Y.2015-2016 assuming that the value of 1$ and of 1 EURO was ₹ 60 and ₹ 70, respectively, throughout the year. [5]

Solution:

1. Analysis:

Entity	Existence of Association	Reason	Section
Fista Ltd	Yes	The Assessee is wholly dependent on use of Technical Know-how which is exclusively owned by Fista Ltd.	92A(2)(g)
Hughes Ltd	Yes	Hughes Ltd has financed an amount which is more than 51% of the Book Value of the Total Assets of Space Motors Ltd.	92A(2)(c)
Hitech Ltd	Yes	Hitech Ltd holds Shares carrying more than 26% of the voting power in Space Motors Ltd.	92A(2)(a)

2. Computation of total Income

Assessee: Space Motors Ltd. Previous year: 2014 – 2015 Assessment year: 2015 - 16

Particulars		₹ in Crores	₹ in Crores
Income as computed under Chapter IVD (before adjustments)			24.00
Add: Adjustments for International transactions			
• Excess Payment of Royalty of $ 5,00,000	($ 5,00,000 × ₹ 60)	3.00	
• Excess Interest Paid on Loan of EURO 5 Crores	(€70 × 5 Crores × 2 ÷100)	7.00	
• Difference in Price of Van @ $100 each for 7,000 Vans	($100 × 7,000 × ₹ 60)	4.20	14.20
Taxable Profits and Gains from Business or Profession			38.20

(c) (i) Boulevard Inc. a French Company, holds 40% of Equity in the Indian Company Vasak Technologies Ltd (VTL). VTL is engaged in development of software and maintenance of the same for customers across the globe. Its clientele includes Boulevard Inc.

During the year, VTL had spent 2,000 Man Hours for developing and maintaining software for Boulevard Inc, with each hour being billed at ₹ 1,350. Costs incurred by VTL for executing work for Boulevard Inc. amount to ₹ 18,00,000.

VTL had also undertaken developing software for Bal Industries Ltd for which VTL had billed at ₹ 2,700 per Man Hour. The persons working for Bal Industries Ltd and Boulevard were part of the same team and were of matching credentials and caliber. VTL had made a Gross Profit of 50% on the Bal Industries work.

VTL's transactions with Boulevard Inc. is comparable to transactions with Bal Industries, subject to following differences -

(a) Boulevard gives technical knowhow support to VTL which can be valued at 8% of the Normal Gross Profit. Bal Industries does not provide any such support.
(b) Since the work for Boulevard involved huge number of man hours, a quantity discount of 14% of Normal Gross Profits was given.
(c) VTL had offered 90 Days credit to Boulevard the cost of which is measured at 2% of the Normal Billing Rate. No such discount was offered to Bal Industries Ltd.

Compute ALP and the amount of increase in Total Income of Vasal Technologies Ltd.

[5]

Solution:

1. Computation of Arms Length Gross Profit Mark Up

Particulars	%	%
Normal GP Mark Up		50
Less: Adjustment for Differences		
(a)Technical Support from Boulevard 8% of Normal GP [8% of 50%]	4	
(b)Quantity Discount 14% of Normal GP [14% of 50%]	7	(11)
		39
Add: Cost of Credit to Boulevard 2% of Normal Bill [2% x 50%]	1	1
Arms Length Gross Profit Mark-up		40

2. Computation of Increase in Total Income of VTL

Particulars	₹
Cost of Services Provided to VTL	18,00,000
Arms Length Billed Value $\frac{\text{Cost}}{100 - \text{Arms' Length Mark up}} = \frac{₹18,00,000}{100\% - 40\%}$	30,00,000
Less: Actual Billing to Boulevard [2,000 Hours × ₹ 1,350]	(27,00,000)
Therefore, increase in Total Income of VTL	3,00,000

(ii) Kjo Japan and AB Ltd, an Indian Company are Associated Enterprises. AB Ltd manufactures Cellular Phones and sells them to Kjo Japan and Geel, a Company based at Beijing. During the year AB Ltd supplied 2,50,000 Cellular Phones to Kjo Japan at a price of ₹ 3,000 per unit and 35,000 units to Geel at a price of ₹ 5,000 per unit. The

transactions of AB Ltd with Kjo and Geel are comparable subject to the following considerations -

(a) Sales to Kjo is on FOB basis, sales to Geel are CIF basis. Freight and Insurance paid by Kjo for each unit is ₹ 700.

(b) Sales to Geel are under a free warranty for Two Years whereas sales to Kjo are without any such warranty. The estimated cost of executing such warranty is ₹ 500.

(c) Since Kjo's order was huge in volume, quantity discount of ₹ 200 per unit was offered to it.

Compute Arm's Length Price and amount of increase in Total Income of AB Ltd, if any, due to such Arm's Length Price. [5]

Solution:

1. Computation of Arm's Length Price of Products sold to Kjo Japan by AB Ltd

Particulars	₹	₹
Price per Unit in a Comparable Uncontrolled Transaction		5,000
Less: Adjustment for Differences -		
(c) Freight and Insurance Charges	700	
(d) Estimated Warranty Costs	500	
(e) Discount for Voluminous Purchase	200	(1,400)
Arm's Length Price for Cellular Phone sold to Kjo Japan		3,600

2. Computation of Increase in Total Income of AB Ltd

Particulars	₹
Arm's Length Price per Unit (as computed above)	3,600
Less: Price at which actually sold to Kjo Japan	(3,000)
Increase in Price per Unit	600
No. of Units sold to Kjo Japan	2,50,000
Therefore, increase in Total Income of AB Ltd (2,50,000 × ₹ 600)	₹ 15 Crores