Paper 7- Direct Taxation

Paper 7- Direct Taxation

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

Section A (80 Marks)

Income Tax

I. Answer question No. 1 which is compulsory and any FOUR from Question No. 2 to 7

1. a) Fill up the blanks: **5 × 1=5**

i) Interest on capital borrowed for repairs of self-occupied property is deductible upto a maximum of ` _______.

ii) Shares given to the employee free of cost under ESOP is taxable if he is ______ (specified/non-specified/either specified or non-specified).

iii) Cost of improvement of self-generated capital asset, being tenancy right shall be ________.

iv) Loss from owning and maintaining the race camels can be carry forward for a maximum of _____ assessment years.

v) The due date of filing the return of income of a charitable trust which is claiming exemption u/s. 12AA is __________.

Answer:

i) 30,000
ii) either specified or non-specified
iii) actual price
iv) 8
v) 30th September or 30th November of Ray as the case may be.

b) Choose the most appropriate alternative: **5 × 1 = 5**

i) Deduction under Section 32AD is allowed to:
   a) Corporate assessee in notified area.
   b) Non-corporate assessee in notified area.
   c) Corporate and non-corporate assessee in notified area.
   d) None of the above.

ii) For the purpose of computation of capital gain, securities transaction tax is :
   a) Allowed as deduction
   b) Form part of cost
   c) Neither allowed as deduction nor form part of cost
   d) None of the above

iii) Loss from trading in derivates through a recognised stock exchange can be carried forward for:
   a) 8 years
   b) 4 years
   c) Unlimited years.
   d) None of the above

iv) Deduction u/s. 80E in respect of interest on education loan is allowed for:
   a) 10 years or till the interest is paid whichever is earlier.
   b) 8 years or till the interest is paid whichever is earlier.
   c) 10 years
   d) 8 years

v) Dividend received by a shareholder of an Indian Company engaged in growing and manufacturing of tea shall be treated as:
   a) Agricultural income upto 60%
   b) Agricultural income upto 100%

c) Non-agricultural income upto 60%
d) Non-agricultural income upto 100%

Answer:

i) c
ii) c
iii) a
iv) b
v) d

c) State true or false with reasons: **5 × 2=10**

i) There is no capital gain on the transfer of self generated asset being goodwill of a profession.
ii) Loss cannot be set off against clubbed income.
iii) Expenditure relating to corporate social responsibility shall be allowed as deduction u/s. 37(1).
iv) "Project Allowance" is taxable as "Profits in lieu of Salary".
v) Gross Annual Value of a Property can be negative.

Answer:

i) True. Capital gain does not arise on the transfer of self-generated capital asset being goodwill of profession.
ii) False. When income is taxable, loss can be set off against such income.
iii) False. As per explanation for section 37(1), expenditure relating to CSR is not exempted is not deductible.
iv) True. Any amount which is not exempted is also termed as "Profits – in- lieu – of salary".
v) False. GAV of house property can be "Zero but not negative.

2. **a)** Mr. Rohit is employed with R Ltd on a basic salary of ` 15,000 p.m. He is also entitled to DA of 25% of basic salary but only 75% of DA is included in salary for all service benefits. The company gives HRA of ` 5,000 p.m. His basic salary has been increased to ` 18,000 p.m with effect from 1-12-2015. He is staying with his parents till 31-10-2015. From 1-11-2015 he has taken an accommodation on rent and pays ` 4,000 p.m. During the year he received arrears of salary relating to earlier years amounting ` 12,000. Compute his gross salary for the AY 2016-17. **8**

b) A, B and C are the three equal co-owners of the property in Mumbai, which has 6 identical units. B and C have occupied one unit each for their residence and the remaining units are let out to a tenant for ` 20,000 p.m. The municipal value of property is ` 4,20,000. The other particulars of the property are:

(i) Municipal tax paid ` 24,000.
(ii) Collection charges of let-out units ` 6,000.
(iii) Repairs of self occupied units ` 2,000.
(iv) Interest on loan for construction of the property which has completed in 1994 ` 1,92,000.

Compute income of each co-owner for AY 2016-17. **7**

Answer:

a) Computation of Salary for A. Y. 2016 – 2017

	`
Basic pay [15,000 × 9 + 18,000 × 3]	1,89,000
D. A. [25% of basic pay]	47,250
H .R. A [w. N)	49,975
Arrears of salary	12,000
Gross Salary	2,98,225

Calculation of taxable H. R. A
Up to 31-10-2015, entire HRA is taxable as he is staying with his parents.
Taxable HRA = 5,000 × 7 = `35,000

From 01.11.2015, exemption u/s 10(13A) is available as he took accommodation on rent
Taxable HRA = HRA – AOE u/s 10(13A)
= 5,000 × 2 – 4,437 = `5,563
Amount of exemption u/s 10(13A):
(i) HRA = `10,000
(ii) Rent paid – 10% of salary= 4,000 × 2 – 10% of 35,625 = `4,437
(iii) 40% of salary
40% of 35,625 = `14,250

Salary = B. Pay + D.A forming part of salary + commission on turnover.
= [15,000 × 2] + [30,000 × 25% × 75%] + Nil
= `35,625
Form 01.01.2015, exemption u/s 10(13A) is available.
However, there is increase in salary.
Taxable HRA = HRA – AOE u/s 10(13A)
= 5,000 × 3 – 5,588 = ` 9,412

AOE u/s 10(13A):
(i) HRA = `15,000
(ii) Rent – 10% of Salary =4,000 × 3 – 10% of 64,125 =` 5,588
(iii) 40% of salary =40% of 64,125 = `25,650
Salary = [18,000 × 3] + (54,000 × 25% × 75%) =` 64,125
Total taxable HRA = 35,000 + 5,563 + 9,412 =` 49,975

(b) Computation of IHP of Co- owners
Income from let-out property

Reasonable Expected Rent:

MV or FR Whichever is lower = 4,20,000 × 4/6 = `2,80,000

Amount rent:

20,000 × 12 =` 2,40,000

Gross Annual Value =` 2,80,000

(-) M. Taxes 16,000
(24,000 × 4/6)
Net Annual Value (NAV) 2,64,000

(-) Standard deduction @ 30%	79,200
Interest on Loan	
1,92,000 × 4/6	1,28,000
Share at 2 : 1 : 1	56,800

Income from Self – occupied property

Particulars	B	C
NAV	Nil	Nil
(-) Interest on loan 1,92,000 × 2/6 × ½ or `30,000 Whichever is lower	30,000	30,000
	(30,000)	(30,000)

Income of each Co-owner

Particulars	A	B	C
Let-out property 56,800 (2 : 1 : 1)	28,400	14,200	14,200
Self – occupied property	-	(30,000)	(30,000)
	28,400	(15,800)	(15,800)

3. **a)** Mr. Sinha, a practicing CMA submits the following receipts and payments:

(A) Receipts:

i) Consultation fees ` 80,000
ii) Audit fees ` 30,000
iii) Miscellaneous receipts ` 10,000
iv) Gifts from clients ` 20,000
v) Rent from property ` 60,000
vi) Interest on Govt. Securities ` 4,000

(B) Payments:

(i) Salary to staff and other establishment expenses ` 25,000.
(ii) Travelling expenses ` 20,000.
(iii) Subscription to CMA institute ` 2,000.
(iv) Purchase of books (annual publications) for professional use ` 8,000.
(v) Interest on bank loan ` 6,000.
(vi) Donations to National Flood Relief Fund ` 4,000.

(C) Other information:

(i) 25% of the books were purchased on 1-1-2016.
(ii) Bank loan was taken for construction of second house which is not yet completed.
(iii) 1/4th of travelling does not relate to profession.

Compute total income of Mr. Sinha for AY 2016-17. **8**

b) Mrs. Diana purchased 1200 listed shares on 1-4-1995 for ` 60,000. Company has declared a right issue in the ratio of 2 : 1 at a price of `30 per share on 1-4-2015. She sold half of the right at ` 20 per share and subscribes the remaining. She sold all the shares at ` 90 per share on 31-3-2016 and paid brokerage @ 2%. She also paid STT at the applicable rate. Compute capital gain for AY 2016-17. CII 1995-96 is 281 and 2015-16 is 1081. **7**

Answer:

(a) Total income of Mr. Sinha

	`	`
Professional receipts:		
Consultation fees	80,000	
Audit fees	30,000	
Miscellaneous receipts	10,000	
Gifts from clients	20,000	1,40,000
Professional payments:		
Staff salary	25,000	
Travelling (20,000 × ¾)	15,000	
Subscription	2,000	
Depreciation books 8,000 × 25% × 100% × ½ 8,000 × 75% × 100%	7,000	49,000

Professional Income = `1,40,000 – 49,000= `91,000

Income from House Property

Particulars	`
GAV	60,000
(-) M. Taxes	Nil
NAV	60,000
(-) S. D @ 30%	18,000
	42,000

Total Income

	`
IHP	42,000
PGBP	91,000
IOS	4,000
GTI	1,37,000
(-) Deduction u/s 80G Donation	4,000
Total income	1,33,000

Note: (1) Interest on loan is related to property under construction.
(2) Books used for less than 180 days are eligible for half depreciation.

(b) Computation of Capital Gain

Particulars	Original Shares	Right Shares	Rights
Full Sale Consideration 1,200 × 90 300 × 90	1,08,000	27,000	6,000

300 × 20			
(-) ICOA 1,200 × 50 × 1,081/281	2,30,818	-	-
(-) COA 300 × 30	-	9,000	Nil
(-) Transfer expenses STT Brokerage @ 2%	- 2,160	- 540	- Nil
LTCL STCG	1,12,978 -	- 17,460	- 6,000

Note:

(1) LTCL is not considered as it is exempted u/s 10 (38).

(2) STCG of `17,460 is chargeable to tax @ 15% u/s 111A.

(3) STCG of `6,000 is chargeable to tax under normal rate.

4. **a)** Mr. Vivek received the following incomes:

i) 9% Tax-free UP Govt. Loan (net) ` 10,000.

ii) 12% Debentures of X Ltd (net) ` 16,200.

iii) 8% National Plan Certificates ` 4,000.

iv) 7% Debentures of local authority ` 4,500.

v) Rent from sub-letting of property ` 15,000.

vi) Dividend from a Co-operative Society ` 3,000.

He incurred the following expenditure:

(i) Bank commission @ 2% for collection of income in respect of interest.

(ii) Rent of sub-let property ` 8,000.

(iii) Lottery ticket purchased for ` 3,000.

Compute income from other sources. **8**

b) An individual grows sugarcane to manufacture sugar. He gives the following information:

i) Cost of cultivation of sugar cane ` 4,00,000

ii) Market value of sugarcane ` 6,00,000

iii) Other manufacturing cost ` 3,00,000

iv) Salary of Manager `1,00,000

v) Sales of Sugar ` 20,00,000

Calculate tax liability for the AY 2016-17. **7**

Answer:

(a)

Computation of IOS

Particulars	`
Interest on UP Govt. Loan	10,000
Interest on debentures of X Ltd. 16,200 × 100/90	18,000
Interest on National plan certificates	Exempt

Interest on debentures	4,500
Rent from sub-letting	15,000
Dividend from Co-operative society	3,000
Income u/s 56	50,500
(-) Deduction u/s 57 Bank commission [10,000 + 16,200 + 90% of 4,500] × 2%	605
Rent of Sub- let property	8,000
Income from Other Sources	41,895

Note: (1) No grossing is required in case of interest on UP Govt. Loan
(2) Interest on NPC is exempt u/s 10(15).
(3) Lottery ticket expenses is not deductible.

(b) Calculation of tax liability

	`
Business Income:	
Sale of sugar	20,00,000
(-) market value of cane	6,00,000
Salary of manager	1,00,000
Other expenses	3,00,000
	10,00,000
Agricultural Income:	
Market value of case	6,00,000
(-) Cost of Cultivation	4,00,000
	2,00,000

Tax Liability:

Step I Tax on aggregate of agricultural and non-agricultural income
tax on `12,00,000 = `1,85,000
[2,50,000 × 0% + 2,50,000 × 10% + 5,00,000 × 0% + 2,00,000 × 30%]

Step II Tax on agricultural income and exemption limit. Tax on `4,50,000 =` 20,000
[2,50,000 × 0% + 2,00,000 × 10%]

Step III Step I – Step II =` 1,65,000

Step IV No rebate

Step V Add: Cess @ 3% 4,950
Net tax payable 1,69,950

5. **a)** Mr. Arjun submits the following;

i) Income from house property ` 1,20,000

ii) Business income ` 1,80,000

iii) Short term capital gain ` 60,000

iv) Long term capital gain on sale of equity shares through recognised stock exchange ` 40,000.

v) Interest from saving bank deposit ` 18,000.

vi) Winnings from horse races (net) ` 28,000.

vii) He pays ` 3,000 p.m. as rent for his residential house. Neither he, nor his family owns any residential house.

viii) Premium on Mediclaim policy ` 30,000.

Compute his total income for AY 2016-17. **7**

b) R, S and G are equal partners of a firm. The firm has got loss of ` 80,000 for the year ended on 31-3-2015. S retired from the firm on 31-3-2015 and P joined on 1-4-2015 as an equal partner. The firm made a profit of ` 1,00,000 for the year ending 31-3-2016 but it wants to set-off brought forward loss of ` 80,000 of the previous year against this profit. Examine the possibility of the firms claim. Calculate income of the firm and allocate the shares of R, S and G for the AY 2016-17. **8**

Answer:

(a) Computation of total income of Mr. Arjun

Particulars	`
Income under head House Property	1,20,000
Income under head profit and gains from Business or Profession	1,80000
Short Term Capital Gain	60,000
Long Term Capital Gain	Exemption u/s 10(38)
Income from other sources- Interest of Saving Bank Account	18,000
Winnings from horse races (2,80,000 × 100/70)	40,000
GTI	4,18,000
(-) Deduction under Chapter VIA 80D Medical claim (max)	25,000
Deduction u/s 80TTA Interest on SB Account (MAX)	10,000
Deduction u/s 80GG (Working Note)	NIL
Total Income	3,83,000

Calculation of Deduction u/s 80GG:

AGTI = GTI – LTCG u/s 112 – STCG u/s 111A – All deduction u/s 80c to 80U except 80GG

= 4,18,000 – 25,000 – 10,000

= ` 3,83,000

(i) Max `2,000 p. m. =24,000

(ii) Rent paid – 10% of AGTI
3,000 × 12 – 10% of 3,83,00 Nil

(iii) 25% of AGTI = 95,750

whichever is lower

(b) Computation of total income of the firm

Particulars	`
Profit for the year 2015 – 2016	1,00,000
(-) Brought forward loss (80,000 × 2/3)	53,333
Total income	46,667

Allocation of share among the partners

R	= 1,00,000 × 1/3 – 80,000 × 1/3	= `6,667
S	=	= Nil
G	= 1,00,000 × 1/3 – 80,000 × 1/3	= `6,667
P	= 1,00,000 × 1/3	= `33,33
		46,667

6. a) A charitable trust gets the following income:

i) Voluntary contribution (without any specific direction) ` 24,00,000.

ii) Voluntary contribution (with specific direction that they form part of corpus) ` 14,00,000.

iii) Income from property held under the trust ` 8,00,000.

During the previous year 2015-16, the trust spends `12,00,000 for charitable purpose in India and gives donation of `2,00,000 to another Charitable Trust. It sets apart ` 10,00,000 for the purpose of completing construction of a charitable educational institution.

During the previous year 2010-11, the trust sets apart ` 8,00,000 for the purpose of completing construction of a charitable hospital but a deduction of ` 7,50,000 is allowed during 2010-11. The trust utilizes ` 5,00,000 upto 31-3-2016 for the construction of hospital and gives donation of ` 1,00,000 to another charitable trust out of the accumulated amount. Determine taxable income of the trust for AY 2016-17. **10**

(b) Mr. Don, a foreign national (not being a person of Indian origin), came to India for the first time on 1-5-2011. During the financial years 2011-12, 2012-13, 2013-14, 2014-15 and 2015-16, he was in India for 132 days, 81 days, 12 days, 209 days and 84 days respectively. He left India permanently on 23-6-2015. Determine the residential status of Mr. Don for the AY 2016-17. What would be his status if he is an Indian Citizen?

Answer:

(a) Computation of taxable income of Trust

Particulars	`
Income from property	8,00,000
Voluntary contribution (general)	24,00,000
Voluntary contribution (specific)	-
Total income (-) General exemption @ 15%	32,00,000 4,80,000
	27,20,000
(-) Exemption based on application:	
Amount spent for charity	12,00,000
Donation to another trust	2,00,000
Amount set apart for construction of Educational Institution for Charitable purpose	10,00,000
	3,20,000

Amount of deduction allowed out of amount set apart for charitable purpose during 2010 – 11 = 7,50,000

(-) Amount utilized for charitable purpose = 5,00,000

Taxable income	2,50,000

Total taxable Income =` 5,70,000

Note: (1) Donation to another charitable trust out of the amount set a part for charitable purpose is not considered as application for charitable purpose.

(2) Taxable income is charged at maximum marginal rate.

(b) Determination of residential status of Mr. Don.

Mr. Don is in India for 84 days during the previous year 2015 – 2016 and 434 days during 4th years immediately preceding the previous year (i. e. 2011 – 12 to 2014 – 2015/ 132 + 81 + 12 + 209 days).

Thus he satisfies the second basic condition and become resident in India for the year 2015 – 2016. However, he does not satisfy additional conditions levied u/s 6(6) (i. e. stay in India for 730 days out of 7 preceding years and resident in India for 2 years out of 10 preceding years) . Therefore, he is resident but not ordinary resident in India for the assessment year 2016 – 2017.

Residential status if Mr. Don is an Indian Citizen:

In case, he is an Indian citizen, he become resident in India if his stay is at least 182 days during the previous year 2015 – 2016 in which he is leaving. As he does not satisfy the basic condition, be become non- resident for the assessment year 2016 – 17.

7. **(a)** A, B and C are partners in a firm sharing profits and losses equally. The following particulars are available for the year:

(i) Loss as per P & L A/c (after debiting partner's remuneration and interest on capital) ` 5,00,000.

(ii) Remuneration to partners:

A (working Partner) ` 2,10,000

B (non-working partner) ` 1,40,000

C (working partner) ` 70,000

(iii) Interest on capital

A's capital ` 1,00,000 and interest ` 12,000.

B's capital ` 1,25,000 and interest ` 17,500.

C's capital ` 1,50,000 and interest ` 24,000.

You are required to compute total income of firm and its partners for the AY 2016-17. **8**

(b) Given below is the P & L A/c of ABC Ltd:

Particulars	`	Particulars	`
Purchases	3,00,000	Sales	5,50,000
Depreciation	40,000	Revaluation Reserve	15,000
Establishment	90,000	Long term capital gain	90,000
Income tax	10,000	Agricultural income	35,000
General Reserve	20,000		
Provision for sales tax	30,000		

Dividend proposed Cultivation expenses Net Profit	15,000 5,000 1,80,000		
	6,90,000		**6,90,000**

The company has brought forward business loss and unabsorbed depreciation ` 20,000 and ` 30,000 respectively.

Calculate tax payable (consider MAT provisions). **7**

Answer:

(a) Computation of total income of firm

Particulars	`
Net loss	(5,00,000)
(+) Remuneration of partners (2,10,000 + 1,40,000 + 70,000)	4,20,000
(+) Interest in excess of 12% A [12,000 – 12% of 1,00,000] B [17,500 – 12% of 1,25,000] C [24,000 – 12% of 1,50,000]	 Nil 2,500 6,000
Book profits	(71,500)
(-) Deduction u/s 40 (b) Remuneration of partners (W. N)	1,50,000
Business Loss	(2,21,500)

Calculation of remuneration to working partners

Particulars	`
Salary as per P & L A/c [2,10,000 + Nil + 70,000]	2,80,000
Permissible limit in case of loss	1,50,000
Whichever is lower	1,50,000

Allocation amongst partners

	A	B	C
Share from Firm [exempt u/s 10(2A)]	Nil	Nil	Nil
Remuneration (3 : 0: 1)	1,12,500	Nil	37,500
Interest @ 12%	12,000	15,000	18,000
Deemed business Income	1,24,500	15,000	55,500

(b) Calculation of tax liability of ABC. Ltd.

Particulars	Total Income	Book Profits
Net profit	1,80,000	1,80,000
(+) Depreciation	-	40,000
Income tax	10,000	10,000
General reserve	20,000	20,000
Provision for sales tax u/s 43B	30,000	-
Dividend	15,000	15,000
Cultivation u/s 10(1)	5,000	-
(-) Revaluation reserve	15,000	-

LTCG	90,000	-
Agricultural income u/s 10(1)	35,000	35,000
Depreciation	-	40,000
BF loss or Depreciation (WEL)	-	20,000
	1,20,000	1,75,000
Business Income /Book Profits (-) BF business loss (-) Unabsorbed Depreciation	 20,000 30,000	
PGBP	70,000	

Regular Tax

Tax on LTCG @ 20.60% = 90,000 × 20.60% = `18,540

Tax on Business Income @ 30.90% = 70,000 × 30.90% = `21,630

Total tax = `40,170

MAT u/s 115 JB

MAT on book profits @ 19.055% = `1,75,000 × 19.055% =`33,350 (Rounded off)

Net tax = Regular tax or MAT (whichever is higher)

= `40,170

SECTION-B (20 Marks)

INTERNATIONAL TAXATION AND TRANSFER PRICING

Answer question No. 8 which is compulsory and any one from Question No. 9 and 10

8. A) Fill in the blanks: 4 × 1=4

a) Relief on foreign income if there is no Avoidance of Double Tax Agreement is called _____ relief.

b) Relief in case of specified associations in India which enters into an agreement with any specified associations in a specified territory outside India is given under section ______________.

c) Income _______ (can/cannot) be decreased on applying the methods of Arm's Length Price.

d) If one enterprise holds at least 26% of the voting rights of another enterprise, they are said to be __________ enterprises.

B) Select the suitable answer: 4 × 1=4

(a) Unilateral relief on foreign income is allowed at:
- i) Average tax rate on foreign income.
- ii) Average tax rate on total income.
- iii) Average tax rate on foreign income or total income whichever is lower.
- iv) None of the above

(b) Foreign income is taxable in India on the basis of
- i) Source of income
- ii) Residential status of person
- iii) Citizenship of person
- iv) None of the above

(c) Advance pricing agreement shall not binding if

i) Voluntarily agreed
ii) There is change in law
iii) Both
iv) None of the above

(d) Transaction entered with a person located in Notified Jurisdictional Area shall be deemed to be
i) Domestic Transaction
ii) International Transaction
iii) Invalid Transaction
iv) None of the above

Answer: (A)

a. Unilateral
b. 90A
c. Cannot
d. Deemed associate.

(B)
a. (iii)
b. (ii)
c. (ii)
d. (ii)

9. a) Mr. Y, a resident and not ordinarily resident in India submits the following:

i) Income from property in India ` 3,00,000.

ii) Income from business outside India but its control is from India ` 2,00,000.

iii) Dividend from a domestic company is ` 50,000.

iv) Interest on deposits outside India ` 80,000.

He deposited ` 20,000 in NSC IX Issue ` 20,000 out of Indian Income. There is no ADT agreement. You are required to calculate amount of relief on foreign income and calculate net payable by Mr. Y. Assume rate of tax outside India @ 6%. **6**

(b) (i) What are the circumstances under which two enterprises are said to be associated for Transfer Pricing Study?
(ii) What are the transactions covered under Transfer Pricing Study?
(iii) When a transaction is said to be deemed international transaction?
(iv) What is Notified Jurisdictional Area? **6**

Answer:

(a) Calculation of net tax of Mr. Y (NOR)

Particulars	`
IHP in India	3,00,000
PGBP outside India (Controlled from India)	2,00,000
Dividend [Exempt u/s 10(34)	-
Interest outside India	Not taxable
GTI	5,00,000
(-) Deduction u/s 80C (NSC IX)	20,000
Total income	4,80,000

Step I Double taxed income `2,00,000

Step II ATR on Total income $= \frac{\text{Tax on T. I}}{\text{T. I}} \times 100$

Tax on TI = `2,50,000 × 0% + `2,30,000 × 10% = `23,000

(-)Rebate u/s 87A `2,000

21,000

(+) Cess @ 3% 630

21,630

ATR $= \frac{21,630}{4,80,000} \times 100$ = 4.50%

Step III ATR on Foreign Income $= \frac{\text{Tax on FI}}{\text{F I}} \times 100$ = 6% (given)

Step IV Relief = FI × lower ATR

= 2,00,000 × 4.50% =` 9,000

Step V Net tax = Tax on TI – relief u/s 91

= `21,630 – 9,000 = `12,630

(b) (i) Two enterprise are said to be associated u/s 92A (i), if one enterprise participate in the management or control or capital of the other enterprise or one enterprise participate in the management or control or capital of two or more enterprises.

(ii) Transactions covered under Transfer Pricing are (sec 92 F (ii));

- (a) any activity relating to the production storage, supply, purchase, lease of goods or dealing in intellectual property rights,
- (b) Provisions of services,
- (c) Transaction in money,
- (d) Construction contracts,
- (e) Investment activity,
- (f) Dealing with shares and securities of anybody corporate,
- (g) Any other transaction having a bearing on the profits, losses or assets.

(iii) A transaction with other person in pursuance of pre-existing agreement between such other person and the associated or deemed associated enterprise is said to be deemed international transaction u/s 92 B(1).

(iv) Any country or territory specified by the central government having regard to the lack of effecting exchange of information with such country or territory in relations to nay international transaction entered by a tax payer is called Notified Jurisdictional Area u/s 94A.

10. (a) X Ltd is engaged in providing outsourcing services to two foreign companies i.e. Y Ltd, which is an associated enterprise in Australia and Z Ltd, which is not an associated enterprise in Germany. During the month of December X Ltd has provided services to both the companies and following information is available:

	Y Ltd	**Z Ltd**
No. Of hours of service	6 per day	7 per day
Direct cost of service	`1200 per hour	` 1000 per hour
Indirect cost of service	` 3400 per hour	` 3600 per hour
Total consideration	` 12 lakhs	` 15 lakhs

Calculate equitable profits of X Ltd. **6**

(b) **(i)** "No income should be taxed twice". Given exceptions to the above concept. What is the relief allowed in case of double taxation? **3**

(ii) Discuss the objectives of Advance Pricing Agreement in the case of study of transfer pricing. **3**

Answer:

(a) Calculation of equitable profit of X Ltd.

	Y Ltd. (AE)	Z Ltd. (UAE)
Direct cost	1,200	1,000
Indirect cost	3,400	3,600
Total cost per hour	4,600	4,600
Total cost per day	4,600 × 6 = 27,600	4,600 × 7 = 32,200
Total cost in December	27,600 × 31 = 8,55,600	32,200 × 31 = 9,98,200
Profit earned	12,00,000	15,00,000
(Total consideration – total cost)	(-) 8,55,600	(-) 9,98,200
	3,44,400	5,01,800
Profit margin per hour	$\frac{3,44,400}{31\times 6}$ = 1851.61	$\frac{5,01,800}{31\times 7}$ = 2312.41
Equitable profit	31 × 6 × 23	31 × 7 × 2312.44 = 5,01,800

(b) (i) "No income should be taxed twice".

Exception: If income is earned in one country, such income is taxed on the basis of source and if the person who earns such income is resident in another country, same income is taxed on the basis of residential status. In such case, relief is allowed either u/s 90 (bilateral relief) or u/s 91 (unilateral relief) based on "Avoidance of double taxation Agreements".

(ii) Objective of advance pricing agreement:

(1) Application of appropriate methods of transfer pricing for the transactions over a fixed period of time in future.
(2) Binding the tax payer and CIT including the authorities subordinate to CIT in respect of transactions covered under APA.
(3) Completion of assessment/re-assessment proceedings taking modified return filed by the assessee into consideration.
(4) It provides the manner in which ALP shall be determined in relation to international transactions.