Paper-7 Direct Taxation

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

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

Working notes should form part of the answers.

Section A

[Answer all the Questions]

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

(i) Mr. X, a person of Indian origin came to India on a visit in the previous year 2013-14. He stayed in India for 130 days. From financial years 2009-2010 to 2012-13 his total stay in India was for 400 days. Determine the residential status of Mr. X for the assessment year 2014-15.

[2]

Answer: Mr. X would be treated as a non-resident since a minimum stay of 182 days in India is necessary in the previous year, so as to be treated as a resident. (Explanation (ii) to section 6(1)].

(ii) A is a owner of land in Noida. Such land was being used for agricultural purpose from last 3 years. On 2.4.2003 his land was acquired by Central Government. The assessee had received compensation of ₹5 crore in respect of land on 1.7.2004. Whether A would be liable to pay tax or not on compensation or capital gain received by him? [2]

Answer: Capital gains received due to compulsory acquisition of agricultural land if fully exempt from tax u/s 10(37) of the Income tax Act from assessment year 2005-06. The assessee fulfilled all conditions which are required under this section. Hence, the Capital gain of ₹5 crore is exempt from tax under the head "Capital Gains".

(iii) X, resident, pays ₹60,000 on medical treatment of his mother who is 67 years old. He received ₹20,000 from insurance company, ₹10,000 from employer. Determined the amount of deduction available u/s 80DDB. [2]

Answer:

Amount of deduction available under section 80DDB –

= ₹30,000 (60,000 – 20,000 - 10,000).

Deduction to be reduced by insurance claim received and reimbursed from employer.

(iv) Where a trust incurs a debt for the purposes of the trust, whether the repayment of the debt would amount to an application of the income for the purposes of the trust? [2]

Answer: The loan was taken by the trust to fulfill the objects of the trust. Therefore, the repayment of the loan will amount to an application of the income for charitable and religious purposes.

(v) Compute the tax liability of an Individual for the assessment year 2014-15 from the following data:

	(₹)	
Net agricultural income	**1,20,000**	
Total non-agricultural income	**1,60,000**	**[2]**

Answer:

No income-tax is payable in this case since the total non-agricultural income does not exceed the exemption limit i.e. ₹2,00,000.

(vi) X & Co. is paying income-tax on an income of ₹2 crores. The company has declared a dividend @10% amounting to ₹50 lacs. The company also receives a dividend from a subsidiary company of ₹4 lacs. Calculate the additional income-tax. [2]

Answer:

Additional income-tax was payable on declared dividend of ₹50 lakhs. Dividend received from subsidiary Co. amounting to ₹4 lakh. The additional income tax is payable on ₹50 lacs minus ₹4 lakhs equal to ₹46 lacs. Additional Income-tax @15%, amount ₹ 15% of 46 lacs i.e. ₹6,90,000.

(vii) How many years can a company carry forward unabsorbed depreciation loss? [1]

Answer: Unabsorbed depreciation can be carried forward indefinitely and the business need not be continued in order to get the benefit of carry forward of unabsorbed depreciation.

(viii) A house is let out for 7 month @₹1,500 P.M. and for 3 months @₹2,000 P.M. It remains vacant for the balance 2 months. Calculate the annual rent under wealth tax Act, 1957.

[2]

Answer:

$$= \frac{7 \times 1,500 + 3 \times 2,000}{10} \times 12$$

= 19,800

(ix) Whether the provision of arm's length price is applicable in case if these result into reduction of income or increase of loss? [2]

Answer: The provision of section 92 relating to determination of arm's length price shall not apply where the computation of income under section 92(2A) or determination of allowance for any expense or interest under sub-section (2A) or the determination of cost or expense allocated or apportioned as the case may, contributed under sub-section (2A) has the effect of reducing the income chargeable to tax or increasing the loss computed on the basis of entries made in the books of account in respect of the previous year in which the specified domestic transaction was entered into.

(x) Tarun Ltd. has two units. One of these units is situated in Uttrakhand for which Tarun Ltd. is claiming 100% deduction of profits under section 80-IC. Tarun Ltd. filed the return of income as under:

Business Income	**(₹)**
Profit from non-eligible business	**54,00,000**
Profit from business eligible for deduction u/s 80-IC	**32,00,000**
Gross total income	**86,00,000**
Less: Deduction u/s 80-IC	**32,00,000**
	54,00,000

Eligible unit has purchased goods worth ₹6 crores from non-eligible unit whose fair market value as determined by A.O. is ₹6.30 Crores.

Compute the total income of Tarun Ltd. [2]

Answer:

Gross total income as computed above	86,00,000
Less: Deduction u/s 80-IC (32,00,000 – 30,00,000)	
(Lower value of purchase price due to which excess profit has been computed)	2,00,000
Total Income	84,00,000

(xi) When reference is made to Transfer Pricing Officer under section 92CA(1) of Income Tax Act, 1961. [1]

Answer: Where any person, being the assessee, has entered into an specified domestic transaction in any previous year, and the Assessing Officer considered it necessary or expedient so to do, he may, with the previous approval of the Commissioner, refer the computation of the arm's length price in relation to the said specified domestic transaction under section 92C to the Transfer Pricing Officer. [Section 92CA(1)]

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

(a) (i) Calculation of Income Tax in the case of an employee below the age of sixty years having a handicapped dependent (With valid PAN furnished to employer). For A.Y. 2014-2015

S. No.	Particulars	₹
1	Gross Salary	3,20,000
2	Amount spent on treatment of a dependant, being person with disability (but not severe disability)	7000
3	Amount paid to LIC with regard to annuity for the maintenance of a dependant, being person with disability(but not severe disability)	50,000
4	GPF Contribution	25,000
5	LIP Paid	10,000

[5]

Solution:

Computation of Tax

S.No.	Particulars	₹
1	Gross Salary Less: Deduction U/s 80DD (Restricted to ₹50,000/- only)	3,20,000 50,000
2	Taxable income Less: Deduction U/s 80C (i) GPF ₹25,000/- (ii) LIP ₹ 10,000/- = ₹35,000/-	2,70,000 35,000
3	Total Income	2,35,000
4	Income Tax thereon/payable Add: (i) Education Cess @2% (ii) Secondary and Higher Education Cess @1%	3,500 70 35
5	Total Income Tax payable	3,605
6	Rounded off to	3,610

(ii) Mr. Y submits the following particulars of his income for the assessment year 2014-2015

	(₹)
Income (other than income from business & profession)	**4,00,000**
Dividend from Indian Company	**1,000**
Interest on Bank Deposit	**2,000**
Life Insurance Premium paid	**6,000**
Donation to Jawahar Lal Nehru Memorial Fund	**15,000**
Donation to Prime Minister's National Relief Fund	**16,000**
Donation to a Public Charitable Institution	**24,000**
Donation to a University for statistical research approved U/s 35(1)(iii)	**5,000**

Determine the net income and tax liability for the assessment year 2014-2015. [8]

Solution:

Computation of Taxable Income:-

	₹
Income	4,00,000
Dividend from Indian Co.	1,000 (exempt)
Interest on Bank Deposit	2,000
Gross total Income	**4,02,000**
Less: Deductions under Chapter VI-A	
U/s 80C for Life Insurance Premium	6,000
U/s 80G (see Note 1)	35,500
U/s 80GGA for Donation to University (see note 3)	5,000
Net Income	**3,55,500**
Tax on ₹ 3,55,500 [(3,55,500 – 2,00,000)x 10%]	15,550
Add : Surcharge @ 10%	NIL
Add : Education Cess @ 2%	311
Add : Additional SHE Cess @ 1%	156
Net Tax payable	16,017

Note 1: Computation of deduction u/s 80G in respect of donations-

	₹
Qualifying amount:-	
Donation to Jawahar Lal Nehru Memorial Fund	15,000
Donation to Prime Minister's National Relief Fund	16,000
Donation to Public Charitable Institution	24,000
Gross qualifying amount	**55,000**
(i) Donation to Jawahar Lal Nehru Memorial Fund (without any maximum limit)	15,000
(ii) Donation to Prime Minister's National Relief Fund (without any maximum limit)	16,000
(iii) Donation to Public Charitable Institution [least of (a) ₹ 24,000 & (b) ₹ 39,100 being 10% of adjusted gross total income calculated in Note 2]	24,000
Net qualifying amount	**55,000**
Amount deductible:	
50% of Net Qualifying Amount of Item (i) & (iii) [i.e., 50% of (15,000 + 24,000)]	19,500
100% of Net Qualifying Amount of item(ii)	16,000
	35,500

Note 2: Adjusted gross total income –

		₹
Gross total income		4,02,000
Less: Amount of deduction under Chapter VI-A (except 80G)		
U/s 80 C	6,000	
U/s 80 GGA	5,000	11,000
Adjusted gross total income		3,91,000

Note-3 : Deduction u/s 80 GGA is allowed in the Case where gross total income does not include income from business profession.

(b)(i) Tax liability of M/s. XYZ Ltd. for A.Y. 2014-2015 is estimated at ₹ 80,000. Determine the amount of instalment of advance-tax payable and date of payment. [4]

Solution:

Installment of Advance-tax and their due date is as under:-

	₹
1st installment of advance-tax payable on or before 15th day of June 2013 @15% of advance-tax liability.	12,000
2nd installment of advance-tax payable on or before 15th day of Sept. 2013 @ 30% [i.e. 45%-15%] of advance-tax liability.	24,000
3rd installment of advance-tax payable on or before 15th day of Dec. 2013 @ 30% [i.e. 75%-45%] of advance-tax liability.	24,000
4th installment of advance-tax payable on or before 15th day of March 2014 @ 25% [i.e. 100%-75%] of the advance-tax liability.	20,000

(ii) Assessment year 2014-15

	(₹)
- **Salary per month (exclusive of benefits & perquisites)**	**30,000**
- **Dearness allowance (2/5 forming part of retirement benefits)**	**3,000**
- **Actual House rent allowance received from employer per month**	**3,000**
- **Actual rent paid by the employee per month in respect of residential Accommodation at Delhi**	**5,000**
- **Commission @1% of annual turnover of ₹40,00,000**	**40,000**

Calculate the permissible House Rent allowance. [4]

Solution:

		₹
House Rent Allowance-		
(a) Amount received on account of H.R.A. from employer		3,000
(b) Actual rent paid	5,000	
Less : 1/10th of salary (30,000 +1,200 + 3,333) = 34,533	3,453	1,547
(c) 1/2 of the salary as residential accommodation is situated at Delhi.		17,267

The least of the above is ₹ 1,547 which is the amount exempt from house rent allowance. So relief of ₹ 1,547 per month is permissible in respect of house rent allowance received from the employer.

Note 1:- In case the house is situated at any place other than Delhi, Bombay, Calcutta & Madras then deduction would have been least of (a) amount received on a/c of HRA i.e. 3,000 (b) Actual rent paid less 1/10 of salary i.e. (5000-3453) 1547 (c) of 2/5 salary i.e. 13,813. Hence amount exempt is 1,547 being the least of the three.

Note 2:- Employees who are not in receipt of house rent allowance from their employers but who pay rent for their residential accommodation in excess of 10% of their salary are entitled to claim deduction u/s 80GG of the Income-tax Act. It may be noted that for the purpose of deduction of tax at source from salary of employees, the employers are entitled to allow deduction u/s 80GG in respect of rent paid by the employees subject to the condition that the employee should satisfy all the conditions provided in section 80GG.

(iii) Mr. Y requires to compute total taxable income in the Assessment Year 2014-15. He had received various incomes which come under the head "Income from other sources". Calculate taxable income of Mr. Y:-

(i) Interest on NSC VII ₹2,000

(ii) Family Pension ₹65,000 p.a.

(iii) Rent received from machinery on hire ₹4,000 p.m., he spent ₹5,000 p.a for repairs and ₹2,000 p.a for insurance against risk of damage.

(iv) Dividend received by Indian Company ₹3,000

(v) Interest on Kisan Vikas Patra ₹1,500

(vi) Winning from Lotteries ₹1,20,000. [5]

Solution:

Computation of taxable income for the A.Y.2014-15 of Mr. Y

		₹
Income from other sources		
(i) Interest on NSC VII		2,000
(ii) Family Pension	65,000	
Less: Exempt (See Note - ii)	15,000	50,000
(iii) Rent received	48,000	
Less: Repairs	5,000	
Insurance	2,000	41,000
(iv) Dividend received from Indian Company		Exempt
(v) Interest on Kisan Vikas Patra		1,500
Total Income		94,500
Less: Interest on NSC (See Note i)		2,000
Taxable Income		**92,500**

Notes:- (i) Interest on National Saving Scheme allowed for deduction u/s 80CCA.

(ii) U/s. 57, Family pension allowed for deduction—

(a) 33.33% of Actual amount – 3 3.33% x 65000 = 21664

(b) ₹ 15,000

whichever is less, so in this case ₹15,000 will be exempt.

(iii) On lottery TDS compulsory is deductible @ 30% and income will not added to other income.

(c)(i) Mr. X, an employee retired from service on 30.9.2013 after completing 42 years of service. He received ₹3,10,000 as gratuity. His average monthly salary in the last 10 months was ₹13,000. He is not covered by the Payment of Gratuity Act, 1972. His present salary being ₹15,000 per month. Dearness allowance received is ₹3,000 per month. Calculate total Income of assessee for A.Y. 2014-2015. [4]

Solution:

		₹
Basic Salary		90,000
Dearness allowance		18,000
Gratuity received	3,10,000	
Less: exempt U/s 10(10) (see note 1)	2,73,000	37,000
Taxable Income		1,45,000

Note 1:

Average monthly salary	13,000
The amount of gratuity received exempt from tax is the least of the following:	
(i) Actual amount received	3,10,000
(ii) One-half month's salary for each year of completed service 1/2 x 42 x 13,000	2,73,000
(iii) Ceiling amount	10,00,000

(ii) Mr. Y. retires from ABC Ltd. on 30th June, 2013. He gets pension of ₹ 800 per month upto 31st January, 2014. With effect from 1st February, 2014 he gets 80% of the pension commuted for ₹80,000. Calculate the taxable pension of Mr. Y. if-

(a) he does not receive gratuity

(b) he receives ₹3,000 as gratuity at the time of retirement. [5]

Solution:

In case of a non-government employee commuted pension is partly exempt from tax, however uncommuted pension is fully taxable. Amount of taxable pension would be calculated as under:

Uncommuted pension [Chargeable to tax in both the cases (a) and (b)]	₹
Uncommuted pension upto 31st January, 2014 [800x7]	5,600
Uncommuted pension from 1st Feb. to 31st March, 2014 [(20/100) x 800 x 2]	320
Total uncommuted pension taxable as salary	5,920
Commuted pension:	
Commuted value of 80% [i.e. 80% of full pension]	80,000
Commuted value of full pension [i.e. (100/80) x 80,000]	1,00,000
(a) If Mr. Y does not receive gratuity :	
Commuted pension received	80,000
Less : Amount exempt u/s 10 (10A) (ii) [i.e. one-half of the commuted value of full pension i.e. 1/2x1,00,000]	50,000
Commuted pension taxable	30,000
(b) If Mr. Y receives gratuity :-	
Commuted pension received	80,000
Amount exempt u/s 10 (10A) (ii) [one-third of the commuted value of full pension i.e. 1/3x1,00,000]	33,333
Commuted pension taxable	46,667

(iii) A partnership firm, having four partners has a business income of ₹5,00,000 before paying salary @ ₹6,000 p.m. to each of its partners. Calculate tax on firm for A.Y. 2014-2015. [4]

Solution:

		₹
Business income		5,00,000
Less —		
Salary ₹2,88,000 i.e. [₹6,000x12x4] subject to limit prescribed by section 40(b)-		
First ₹ 3,00,000 @ 90% or ₹ 1,50,000 (whichever's higher)	2,70,000	
Next on the balance ₹ 2,00,000 @ 60%	1,20,000	
(whichever is less) [3,90,000 or 2,88.000]	3,90,000 or 2,88,000	2,88,000
Taxable income		2,12,000
Tax liability for A.Y. 2014-2015 @ 30%		63,600

Add: Surcharge @10% Add : Education cess @ 2% Add: SHE Cess @1%	NIL 1,272 636
Total tax payable	**65,508**

Notes:

1. Taxable salary in the hands of individual partners will be adjusted to give effect the amount disallowed u/s 40(b) and such adjusted salary will be taxed in their individual hands as business income.
2. The new limits of payment of remuneration to any partner applicable from A.Y. 2010-2011.
3. For F.Y. 2013-2014 (A.Y. 2014-2015) 10% Surcharge levied, if total income exceed 1 crore.

(d)(i) A Ltd., a domestic company and engaged in the business of trading in shares and has manufacturing plant of rubber in Gujarat. The assessee have following income for the assessment year 2014-2015.

a) Trading Business of shares ₹3,70,000

b) Manufacturing Business ₹8,50,000

c) Book profit after deducting securities transaction tax ₹1,00,20,000

(Revised) **[7]**

Solution:

Particulars	**A.Y. 2014-2015**
Income from trading in shares	3,70,000
Income from manufacturing shares	8,50,000
Total Income Income tax @30% Add: Surcharge @10%	12,20,000 3,66,000 NIL
 Add: Education Cess @2% SHE Cess @1%	3,66,000 7,320 3,660
Total Income-tax (1)	3,76,980
Minimum alternate tax (under normal provision) [See Note 3] Tax on book profit of ₹ 1,00,20,000 @18.5% Surcharge @5%	 18,53,700 92,685
Total on book profit & Surcharge (2)	19,46,385
Minimum Alternate tax (under marginal relief) Tax on book profit of ₹ 1,00,00,000 Add: 100% of book profit in excess of ₹ 1,00,00,000	18,00,000 20,000
Total Tax (3) Minimum Alternate tax (including Surcharge) after marginal relief [(2) or (3) whichever is lower] (4)]	18,20,000 18,20,000
Normal tax or minimum alternate tax whichever is higher [(1) or (4)] Add: Education Cess @2% Add: Secondary and higher education Cess @1%	18,20,000 36,400 18,200
Tax liability (5) Less: Tax liability if minimum alternate tax is ignored (1)	18,74,600 3,76,980
Tax credit available u/s 115JAA(2A)	14,97,620

(ii) Rajesh owns a residential house, who takes loan of ₹6,00,000 @ 12% p.a. for construction of his house on 1st Oct., 2006. Construction of the house was completed on 22nd Feb., 2013. If date of repayment of loan is (i) 26th May, 2010 and (ii) 3rd April, 2012.

(a) Actual rent received by the owner is ₹4,50,000;

(b) Municipal value ₹3,20,000;

(c) Fair rental value ₹4,00,000;

(d) Standard rent ₹3,80,000.

The owner paid municipal taxes of ₹40,000 for the previous year. Find out the Income from house property for the assessment year 2014-2015. [6]

Solution:

Computation of Gross Annual Value

	Case (i)	**Case (ii)**
Grass annual value	4,50,000	4,50,000
Less: Municipal taxes	40,000	40,000
Net annual value	4,10,000	4,10,000
Less: Deduction u/s 24-		
(a)Statutory deduction (30% of NAV)	1,23,000	1,23,000
(b)Interest on borrowing current year	NIL	72,000
(c)Interest on pre-constrution period	52,460	79,200
Income from house property-	2,34,540	1,37,000

Note- Maximum interest allowable on loan is ₹ 1,50,000.

(i) If date of repayment is 26th May, 2009 and date of completion of construction is 22nd Feb., 2012 -1st Oct, 2005-31st March, 2009 = 3 years 7 months, 26 days
Interest on pre-construction = 6,00,000 x 12/100x3yrs. 7months. 26 days
= 2,63,200x1/5
= ₹ 52,640

(ii) If date of repayment of is 3rd April, 2011
The date of loan taken and till the end of 31st March proceeding the date of completion of construction date of repayment of loan, whichever is earlier.
1st Oct, 2005- 31st March, 2011 = 5 years 6 months
Interest on pre- construction = 6,00,000 x 12/100 x 5.5
= 3,96,000/5
= 79,200

Computation of Gross annual value-

Step 1- Higher of (b)or(c), subject to maximum (d)	3,80,000
Step 2- higher of (a) or step 1	4,50,000
Gross Annual Value	**4,50,000**

(e)(i) Mr. X has sold his building for ₹32,00,000 on 15th Jan'2014. He had purchased the plot in 1980 at a total consideration of ₹2,00,000 and constructed the building in F.Y.1985-86, 1986-87 and 1992-93 and invested ₹ 2,00,000, ₹2,50,000 and ₹2,00,000 during the respective financial years. Fair market value of the plot as on 1-4-81 was ₹2,50,000. The brokerage @ 2% was paid by Mr. X for effecting the sale of building. Compute capital gain. [5]

Solution:

			A.Y. 2014-2015 ₹
	Sale consideration		32,00,000
	Less : Brokerage 2% of the sale of building		64,000
	Net sale consideration	**(a)**	**31,36,000**
	Less :		
I.	Indexed Cost of plot [i.e. 2,50,000 x 939 ÷ 100)		23,47,500
II.	Indexed cost of construction		
	(1) For construction during 1985-86 [i.e. 2,00,000 x 939 ÷ 133]		14,12,030
	(2) For construction during 1986-87 [i.e. 2,50,000 x 939 ÷ 140]		16,76,786
	(3) For construction during 1992-93 (i.e. 2,00,000 x 939 ÷ 223]		10,52,691
	Total indexed cost of acquisition and improvement	**(b)**	**64,89,007**
	Capital Loss (a-b) :		**(33,53,007)**

(ii) Calculate the Gross Taxable income of Mr. Pranav Gupta for the A.Y. 2014-2015 after adjusting following Profits Losses given under different heads of Income are as follows:-

		(₹)
(a)	**Income from Salary**	**4,20,000**
(b)	**Income from house property-**	
	House I	**48,000**
	House II	**(-)22,000**
	House III (Self occupied)	**(-)50,000**
(c)	**Profit and gains of from business & Profession-**	
	Manufacturing business	**72,000**
	Trading Business	**(-) 32,000**
	Business X (speculative)	**95,000**
	Business Y (speculative)	**(-)1,40,000**
(d)	**Long-term Capital Gains from the transfer of house**	**1,20,000**
	Short term Capital Loss from the transfer of shares	**(-) 65000**
(e)	**Income from other Sources-**	
	Winning from lotteries	**37,500**
	Loss from Card Games	**(-)30,000**
	Interest received	**28,000**

[8]

Solution:

Calculation of Gross Taxable Income of Mr. Pranav Gupta for A.Y. 2014-2015.

	₹	₹
(a) Income from Salary		4,20,000
(b) Income from house property-		
House I	48,000	
House II	(-)22,000	
House III (Self occupied)	(-)50,000	(-)24,000
(c) Profit and gains of from Business & Profession (Non-speculative)		
Manufacturing business	72,000	
Trading Business	(-)32,000	40,000
Profit and gains of from business & Profession (Speculative)		
Business X	95,000	
Business Y	(-)1,40,000	NIL
(d) Long-term Capital Gains -		
Long-term Capital Gain	1,20,000	
Short term Capital Loss	(-)65,000	55,000
(e) Income from other Sources-		
Winning from lotteries	37,500	
Interest received	28,000	65,500
Gross Taxable Income		**5,56,500**

Notes:

(a) Loss from Speculative business of ₹45,000 will be carried forward to the A.Y. 2015-2016 under the same Income of Speculation business.

(b) Loss from Card games of ₹ 30,000 will be carried forward to the A.Y. 2015-2016 under the same income not even allowed under the same head "Income from other sources".

(c) From A.Y.2013-2014, exemption limit for individual increased from ₹1,80,000 to ₹2,00,000.

Section B

3. Answer any one Question [1 × 8 = 8]

(a) Mr. A. completed construction of house property at Delhi in 1982, the aggregate area of the plot is 600 sq. mtrs., while the built-up area of the house is 200 sq. mtrs. The total cost of the house (including cost of land) is ₹11,00,000. The fair rental value of the house is ₹7,500 per month, but the house is let out at a rent of ₹ 8,000 per month and he has accepted security deposit of ₹1,00,000. Mr. A pays municipal taxes ₹10,000, ground rent ₹1,000, insurance premia for coverage of risk of damage to house ₹2,000 and collection charges ₹500 during the previous year ended on 31.3.2014. Expenses on repairs are borne by tenant. Compute the value of the house property as on 31.3.2014 being the valuation date of Mr. A for A.Y. 2014-2015 assuming the house is built on (a) freehold land, or (b) leasehold land (unexpired period of lease of the land being 55 years) or (c) lease hold land (unexpired period of lease of the land being 30 years). [8]

Solution:

(a) Calculation of net maintainable rent

	₹
Fair rental value or actual rent received, whichever is higher (8,000 x 12) Add: (i) 15% of deposit held 15/100x1,00,000 (ii)1/9 x 96,000 (as expenditure on repairs is borne by tenant)	96,000 15,000 10,667
Gross maintainable rent Less: (i) Municipal taxes ₹ 10,000 (ii) 15% of gross maintainable rent (15/100x1,21,667) ₹ 18,250	1,21,667 28,250
Net maintainable rent	**93,417**

(b) Capitalisation of net maintainable rent

	Freehold land	Leasehold land (unexpired period of lease 55 years)	Leasehold land (unexpired period of lease 30 years)
Net maintainable	x 12.5	x 10	x 8
Rent (₹ 93,417)	₹ 11,67,713	₹ 9,34,170	₹ 7,47,336

(c) Capitalisation of unbuilt area

The unbuilt area of the plot i.e. 400 sq. mtrs. (aggregate area 600 sq. mtrs, built-up area 200 sq. mtrs.) is in excess of the specified area i.e.360 sq. mtrs. (60% of the aggregate area 600 sq. mtrs.) by 40 sq. mtrs. i.e. 6.67% of aggregate area, hence, a premium @20% will be added to the capitalised value calculated above:

	Freehold land	Leasehold land (unexpired period of lease 55 years)	Leasehold land (unexpired period of lease 30 years)
Capitalised value as calculated above	₹ 11,67,713	₹ 9,34,170	₹ 7,47,336
Add: 20%	₹ 2,33,543	₹ 1,86,834	₹ 1,49,467
Total	**₹ 14,01,256**	**₹ 11,21,004**	**₹ 8,96,803**

(d) Value of house under rule 3-

	Freehold land	Leasehold land (unexpired period of lease 55 years)	Leasehold land (unexpired period of lease 30 years)
(a) Value as determined above	₹ 14,01,256	₹ 11,21,004	₹ 8,96,803
(b) Actual cost of construction	₹ 11,00,000	₹ 11,00,000	₹ 11,00,000
Value of house for wealth tax purposes (A or B whichever is higher)	₹ 14,01,256	₹ 11,21,004	₹ 11,00,000

Notes:-

1. Ground rent, insurance premia and collection charges are not deductible.
2. It is assumed that Mr. A holds an another house which is claimed as exempt u/s 5(vi).

(b) Mrs. Sudha, an individual, submits the following particulars of her assets and liabilities on 31st March, 2014.

	(₹)
Self occupied residential house	**7,80,000**
Motor car for personal use	**3,10,000**
Urban land (situated in area within the jurisdiction of municipality)	**8,00,000**

Equity shares in an Indian Joint stock company	**2,50,000**
Units in Unit Trust of India	**1,50,000**
Jewellery	**1,30,000**
Deposits under National Deposit Scheme	**60,000**
Cash in hand	**70,000**
Deposits made in a finance company	**2,00,000**
Borrowing for the purchase of residential house	**5,00,000**
Loan taken to purchase equity shares	**1,00,000**

Note: One more house is transfer by Mrs. Sudha to her spouse without any adequate consideration.

Determine her wealth tax liability for A.Y. 2014-15. (Revised) [8]

Solution:

Computation of Net Wealth for A.Y. 2014-2015

	₹
(1) Self occupied residential house	---
(2) Value of asset transferred by her	7,80,000
(3) Motor Car	3,10,000
(4) Urban Land	8,00,000
(5) Jewellery	1,30,000
(6) Cash in hand (in excess of ₹ 50,000)	20,000
	32,10,000
Less: Debt owed for purchase of residential house	---
Net Wealth	32,10,000
Less : Basic exemption (See Note-vii)	30,00,000
Taxable wealth	**2,10,000**
Wealth-tax payable @1%	**₹ 2,100**

Notes:

(i) Loan taken to purchase equity shares is not deductible from net wealth.
(ii) Debt owed for purchase of residential house is not deductible from net wealth as it relates to an exempt asset.
(iii) Equity shares are not an asset for the purpose of wealth tax.
(iv) Units in Unit Trust of India are also not an asset.
(v) Deposits under National deposit Scheme is also not an asset.
(vi) Deposit made in a finance company is also not an asset for the purpose of wealth tax.

Section C

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

(a)(*i*) A Ltd. is an Indian company. It has a manufacturing unit in Andhra Pradesh. It is a subsidiary company of X Ltd., a US company. X Ltd. gets royalty from A Ltd. on supply of technical information which is used by A Ltd. for manufacturing goods in its unit in Andhra Pradesh. For similar transfer of technical information to any unrelated entity X Ltd. charges $8,000 per year. However, from A Ltd. it charges (a) $11,000 or $6,000 per year which is subject to tax

deduction by A Ltd. Exchange rate is ₹59 per US dollar. Income of A Ltd. for the assessment year 2014-15 before deducting payment for technical information to A Ltd. is ₹76,00,000. Find out the income of X Ltd. and A Ltd. [5]

Solution:

	Situation (a) ₹	Situation (b) ₹
Arm's length price ($ 8000 X 59) (a)	4,72,000	4,72,000
Income of A Ltd. Income Less: Payment to X Ltd. at recorded price [$11,000×59, $6,000×59]	 76,00,000 6,49,000	 76,00,000 3,54,000
Income as per books of account (c) Add: Recorded price Less: Arm's length price [i.e., (a)]	69,51,000 (+)6,49,000 (-)4,72,000	72,46,000 (+)3,54,000 (-)4,72,000
Total (d) Taxable income [(d), but it cannot be lower than (c), as per section 92(3)] Income of X Lid.	71,28,000 71,28,000	71,28,000 72,46,000
Actual payment [i.e., (b)] as tax has been deducted by the payer [see Note]	6,49,000	3,54,000

As per second proviso to section 92C(4), where income of payer has been recomputed by applying the arm's length price, then the income of payee associate enterprise shall not be recomputed if tax has been deducted or is deductible on such payment. Therefore, income of X Ltd. shall not be reduced in situation (1).

(ii) A Inc. is an American company situated in New Jersey. It has three subsidiary companies-X Ltd. (an Indian company), Y Ltd. (a South African company) and Z Ltd. (a Nigerian company). X Ltd. has a manufacturing plant in Andhra Pradesh. Raw material is imported from Y Ltd. and Z Ltd. Approximately 90 per cent of the manufactured goods are exported to A Inc. Remaining goods are sold in domestic market. The profit and loss account of X Ltd. for the year ending March 31, 2014 is given below—

(Rupees in crore)

Import of raw material from Y Ltd.	**1 00**	**Export to A Inc.-**	**280**
Import of raw material from Z Ltd.	**80**	**Domestic sale**	**60**
Other expenses	**90**		
Net profit	**70**		
	340		**340**

Net profit is ₹70 crore over total cost of ₹340 crore (which comes to 20.59 per cent margin over cost). Since the assessment year 2012-13, the assessment of X Ltd. is completed by adopting the Transaction Net Margin Method (TNMM). Discuss the applicability of arm's length range (3 per cent variation) in this case. [5]

Solution:

Calculation of profit margin after applying 3% variation (Rupees in crore)

	Amount before 3% variation	3% variation	Amount after 3% variation		Amount before 3% variation	3% variation	Amount after 3% variation
Import from Y Ltd. Import from Z Ltd. Other expenses Net profit	100 80 90 70	3 2.4 -- --	97 77.6 90 83.8	Export to A Inc. Domestic sale	280 60	8.4 --	288.4 60
	340		348.4		340		348.4

Net profit after 3% adjustment will be ₹ 83.3 crore over total cost of ₹ 348.4 crore (which comes to 24.05% margin over cost). If profit margin according to TNMM method is equal to or less than 24.05%, the aforesaid transaction would be considered to be at arm's length and no adjustment would be required. Conversely, however, if profit margin according to TNMM is more than 24.05%, the aforesaid transaction will not be considered to be at arm's length and necessary adjustment would be required.

(b) X Ltd., an Indian company, is a subsidiary company of Y Inc., a company registered in the Netherlands. It purchased raw materials from Y Inc. Purchase prices of raw material determined by the most appropriate method are ₹9,950 and ₹10,000 per unit. X Ltd., however, paid to Y Inc. ₹10,400 (Situation I), ₹10,500 (Situation 2), ₹10,600 (Situation 3), ₹9,400 (Situation 4), ₹9,500 (Situation 5) and ₹9,600 (Situation 6). Determine the arm's length price in the six situations for the assessment year 2014-15. Tolerance range notified by the Government is 3 per cent. [10]

Solution:

Computation of arm's length price

	Situation 1 ₹	Situation 2 ₹	Situation 3 ₹	Situation 4 ₹	Situation 5 ₹	Situation 6 ₹
Arithmetic mean of price determined under the most appropriate methods [(₹ 10,000 + ₹ 9,950) - 2] (a)	9,975	9,975	9,975	9,975	9,975	9,975
Price at which raw material is purchased from associate enterprise under international transaction (b)	10,400	10,500	10,600	9,400	9,500	9,600
Difference between arithmetic mean and transaction price[(a)-(b)or(b)-(a)](c)	425	525	625	575	475	375
3% of transaction price [i.e., 3% of (b)] (d) Whether difference exceeds 3% of transaction	312	315	318	282	285	288
price [or (c) is more than (d)] (e)	Yes	Yes	Yes	Yes	Yes	Yes
Arm's length price [if difference is more than 3% of transaction price, then arithmetic mean is taken as arm's length price; otherwise no adjustment would be required]	9,975	9,975	9,975	9,975	9,975	9,975
Under section 92(3), by adopting arm's length price taxable income cannot be reduced (whether adopting arm's length price will reduce taxable income)	No	No	No	Yes	Yes	Yes
Purchase price of raw material to be taken into consideration for calculating taxable income of X Ltd. after applying provisions of section 92	9,975	9,975	9,975	9,400	9,500	9,600

(c)(i) A Ltd., an Indian company, sells computer monitor to its 100 per cent subsidiary X Ltd. in United States @ $ 50 per piece. A Ltd. also sells its computer monitor to another company Y Ltd. in United States @ $80 per piece. Total income of A Ltd. for the assessment year 2014-15 is ₹12,00,000 which includes sales made for 100 computer monitor @ $50 to X Ltd. Compute the arm's length price and taxable income of A Ltd. The rate of one dollar may be assumed to be equivalent to ₹59 for the sake of simplicity. [5]

Solution:

	₹
Arm's length price ($ 80 x 100 x ₹ 59)	4,72,000
Income of A Ltd. Income as per books of account Less : Sale consideration 100 monitor sold to X Ltd. (recorded price) Add : Sale consideration at arm's length price	 12,00,000 (-) 2,95,000 (+)4,72,000
Taxable income	13,77,000

Income of X Ltd.

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

(ii) What are the difficulties arises in applying the arm's length principle? [5]

Answer:

The arm's length principle, although survives upon the international consensus, does not necessarily mean that it is perfect. There are difficulties in applying this principle in a number of situations.

(a) The most serious problem is the need to find transactions between independent parties which can be said to be exact compared to the controlled transaction.

(b) It is important to appreciate that in an MNE system, a group first identifies the goal and then goes on to create the associated enterprise and finally, the transactions entered into. This procedure obviously does not apply to independent enterprises. Due to these facts, there may be transactions within an MNE group which may not be between independent enterprises.

(c) Further, the reductionist approach of splitting an MNE group into its component parts before evaluating transfer pricing may mean that the benefits of economies of scale, or integration between the parties, is not appropriately allocated between the MNE group.

(d) The application of the arm's length principle also imposes a burden on business, as it may require the MNE to do things that it would otherwise not do (i.e. searching for comparable transactions, documenting transactions in detail, etc).

(e) Arm's length principle involves a lot of cost to the group.