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 [20 Marks]

(i) 'G' was born in England in 1966. His father was born in America in 1936. 'G's' grandfather was born in Labore in 1916. Will 'G' be a Resident in India if he visits India for 180 days during the previous year 2014-15. [2]

Answer:
An Individual is said to be resident in India if he satisfies any one of the following two condition:
(a) He is in India for a period or periods amounting in all to 182 days or more in the relevant previous year; or
(b) He is in India for 60 days or more during the relevant previous year and has been in India for 365 days or more during 4 previous years immediately preceding the relevant previous year.

Conclusion:
G is a person of Indian origin as his grandfather was born in Lahore in 1916 i.e., in undivided India and therefore, the second condition is not applicable in his case and the first condition is not satisfied as he visits India for less than 182 days. Hence, Mr. G is not the resident of India.

(ii) Mr. Pawan is an employee of ABC Ltd. getting a salary of ₹40,000 per month which is due on the 1st of next month and is paid on the 7th of the next month. Salary for which months will be taxable for assessment year 2015-16? [2]

Answer:
Income from salary is taxable on receipt or accrual basis, whichever is earlier. Any salary due from an employer to an assessee in the previous year, whether paid in that previous year or not, shall be chargeable to income tax under the head of salaries. If the salary is payable on monthly basis, it normally becomes due at the end of the month although it is paid in the next month. In this case, it will be taxable on 'due' basis because 'due' is earlier than 'receipt'. Therefore, salary is normally taxable from April to March as the salary of March becomes due at the end of the month.
However, in some cases the salary becomes due on the 1st day of the next month. In that case we shall tax the salary from March to February because salary of month of march of current year will be due only in the next financial year and the salary of month of March of last previous year became due only on 1st April of the current year.

The salary for the months of March, 2014 to February, 2015 will be taxable for assessment year 2015-16 because salary for March, 2014 was due on 01.04.2014 and salary of March, 2015 will become due on 01.04.2015 i.e., the next financial year.

(iii) Mr. A is to receive Interest from a Notified Infrastructure Debt Fund eligible for exemption u/s 10(47) of ₹6,00,000. Mr. A is a Resident of Notified Jurisdictional Area u/s 94A. Explain the tax treatment in the hands of Mr. A. [2]

Solution:

Computation of Tax Payable on the Interest

Particulars	₹
Interest Income received from a Notified Infrastructure Debt Fund	6,00,000
Tax @ 5% u/s 115A since the Fund is eligible for exemption u/s 10(47)	30,000
Add: Education Cess @ 2%	600
Add: Secondary and Higher Education Cess @ 1%	300
Total Tax Payable on the Interest Income	30,900

Note: TDS shall be deducted at the rate of 30% u/s 94A, since the Income is received by a Resident in Notified Jurisdictional Area. Since the provisions of Sec. 94A contain a non-obstante clause, the rate of 30% u/s 94A shall be applied as against the rate of 5% as specified u/s 194LB. However, Mr. A is eligible for refund of excess tax deducted by way of TDS.

(iv) What are the factors need to be considered for selection of Most Appropriate Method while calculating Arm's Length price under International Transaction? [2]

Answer:

Factors to be considered in selecting the most appropriate method are –

(a) Nature and Class of the International Transaction / Specified Domestic Transaction,

(b) Class or classes of Associated Enterprises entering into the transaction and the functions performed by them, taking into account assets employed or to be employed and risks assumed by such enterprises,

(c) Availability, coverage and reliability of data necessary for application of the method,

(d) Degree of comparability existing between the International Transaction / Specified Domestic Transaction and the Uncontrolled transaction, and between the Enterprises entering into such transactions,

(e) Extent to which reliable and accurate adjustments can be made to account for differences, if any, between the International Transaction / Specified Domestic Transaction and the comparable Uncontrolled Transaction or between the Enterprises entering into such transactions,

(f) Nature, extent and reliability of assumptions required to be made in application of a method.

(v) What do you mean by Wholesale Trading under International Transaction? [1]

Answer:

Wholesale trading means – an International Transaction or Specified Domestic Transaction of trading in goods, which fulfils the following conditions, namely:

(a) Purchase cost of finished goods is 80% or more of the total cost pertaining to such trading activities, and

(b) Average monthly closing inventory of such goods is 10% or less of sales pertaining to such trading activities.

(vi) State the consequences if Firm fails to fulfill condition under section 184 of the Income Tax Act, 1961. [2]

Answer:

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

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

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

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

(vii) Ellumurate the steps in computation of total income of a Partnership Firm. [2]

Answer:

Step 1: Determine the Residential Status of the Firm u/s 6(2).
Step 2: Determine the Income chargeable to tax u/s 5.
Step 3: Compute the Total Income of the Firm.
Step 4: Compute Tax Liability at 30% Plus Education Cess @ 2% Plus SHEC @ 1%.
Step 5: Consider the application of AMT, and the final amount of Tax Payable.

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

Answer:

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

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

(ix) Gurudev Engineers Pvt. Ltd. is running an Industrial Undertaking whose profits are eligible for deduction u/s 80-IA of the Income Tax Act, 1961. During the year ended 31.03.2015, the Undertaking was engaged in Eligible Business referred to in Section 80-IA(4), which however, consisted solely of executing Works Contract awarded by the State Government. Is the Assessee eligible to claim deduction u/s 80-IA(4) in respect of Profits derived from this undertaking? [2]

Answer:

Principle: Sec. 80-IA will not apply to a business which is in the nature of Works Contract awarded by any person (including Central or State Government) and executed by the undertaking or enterprise.

Analysis and Conclusion: Hence, in the given case, deduction u/s 80-IA(4) shall not be given in respect of the profits derived from the undertaking, which arise as a result of Works Contract.

(x) What are the incomes exempted under the hand of Political Parties? [1]

Answer:

The following Incomes are exempt from tax:

(a) Income from House Property;
(b) Income from Other Sources;
(c) Voluntary Contributions received;
(d) Capital Gains.

(xi) State with reasons the tax implications of the following – Rent of ₹60,000 charged from Tenants occupying houses constructed on the land situated in India and used for agricultural purposes. [2]

Answer:

As per the explanation of section 2(1A), income derived from any building or land, arising from use of such building or land for any purpose including letting out for residential purposes or for the purposes of business or profession, is not Agricultural Income.

Only Agricultural Income is exempt u/s 10(1). So, the rent of ₹60,000 charged from tenants occupying the house constructed on the land used for agricultural purposes is liable to tax under the head Income from House Property.

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

(a) (i) X came to India from America for the first time on 10.10.2014. He returns to his home country after staying in India upto 05.07.2015. Will he be a resident in India for the assessment year 2015-16? [3]

Solution:

An Individual is said to be resident in India if he satisfies any one of the following two condition:

I. He is in India for a period or periods amounting in all to 182 days or more in the relevant previous year; or

II. He is in India for 60 days or more during the relevant previous year and has been in India for 365 days or more during 4 previous years immediately preceding the relevant previous year.

In this case although X has been in India for a continuous period of 270 days but it falls in two previous years i.e., previous year 2014-15 and previous year 2015-16. During the previous year 2014-15, his stay in India was only 173 days (22 + 30 + 31 + 31 + 28 + 31) (i.e., 10.10.2014 to 31.03.2015). Therefore, he will be a non-resident in India in previous year 2014-15 as he does not satisfy the first condition of 182 days stay in India during the previous year. Further, the second condition is also not satisfied as, although, he was in India for more than 60 days in the relevant previous year, he was not here for 365 days or more in 4 preceding previous years as he came to India for the first time on 10.10.2014. He would also be non-resident in previous year 2015-16, for the same reasons, if he does not come to India thereafter, as the period of stay in India will be 96 days only (i.e., 01.04.2015 to 5.7.2015). The second condition is also not satisfied as in the preceding 4 years he was here only for 173 days.

(ii) Mr. A is employed with ABC Ltd. on a basic salary of ₹ 30,000 per month. He is also entitled to a dearness allowance of 20% of basic salary. 70% of the dearness allowance is included in salary for retirement benefits. The company gives him HRA of ₹ 15,000 per month.

With effect from 01.01.2015 he receives an increment of ₹ 5,000 in his basic salary.

During the previous year 2014-15 he has received arrears of salary pertaining to earlier years amounting to ₹ 40,000.

'A' was staying with his parents till 31.10.2014. From 01.11.2014 he takes an accommodation on rent in Delhi and pays ₹ 12,500 per month as rent for the accommodation.

Compute his gross salary for the assessment year 2015-16. [5]

Solution:

	₹	₹
Basic Salary:		
- 30,000 × 9	2,70,000	
- 35,000 × 3	1,05,000	3,75,000
Dearness allowance: 20% of basic salary		75,000
Arrears of salary		40,000
Actual amount of house rent allowance received	1,80,000	
Less: Exemption under section 10(13A)	43,690	1,36,310
Gross Salary		6,26,310

Working Notes:

In the above question, there are two factors which are changed but calculation of HRA will be done in 3 parts i.e., (i) 01.04.2014 to 31.10.2014 when he did not pay any rent (ii) 1.11.2014 – when he has paid rent but there is no change in other factors (iii) 01.01.2015 to 31.03.2015 – when the salary has incurred.

I. Since no rent has been paid from 01.04.2014 to 31.10.2014, no exemption shall be available for that period.

II. For the period November and December 2014 exemption will be as under:

	Particulars	₹
(a)	Actual HRA received (15,000 × 2)	30,000
(b)	Rent paid – 10% of salary [25,000 – 10% of (60,000+8,400)] i.e. [25,000 – 6,840]	18,160
(c)	50% of salary of ₹ 68,400 (₹ 18,160 will be exempt.	34,200

III. For the period 01.01.2015 to 31.03.2015, exemption will be minimum of the following 3 amounts:

	Particulars	₹
(a)	Actual HRA received (15,000 × 3)	45,000
(b)	Rent paid – 10% of salary [37,500 –10% of (1,05,000+14,700)] i.e. [37,500 –11,970]	25,530
(c)	50% of salary of ₹ 1,19,700	59,850

Therefore, ₹ 25,530 will be exempt.

The total exemption shall be Nil + ₹ 18,160 + 25,530 = 43,690.

(iii) Business income of Q Ltd. before allowing expenditure on scientific research for the previous year 2014-15 is ₹2,50,000. The company has incurred the following expenditure on scientific research during the previous year 2014-15.

	₹
Revenue expenditure on Scientific Research	**2,60,000**
Capital Expenditure on Scientific Research	**5,00,000**

Compute the deduction available on account of Scientific Research assuming the company does not have any other income. **[3]**

Solution:

Business income before claiming expenditure on Scientific Research	2,50,000
Less: (i) Revenue expenditure on Scientific Research	2,60,000
(ii) Capital expenditure on Scientific Research ₹5,00,000	
(Not allowed in this year as there are no profits)	Nil
Business Loss	10,000

(iv) WR Ltd. constructed a building and started operating a hotel of 3 star category w.e.f. 1.4.2014. The company incurred the following expenditure in this connection.

1. Capital expenditure (including cost of land ₹50 lakhs) incurred during December, 2013 to March 2014 which were capitalized in the books of accounts 31.3.2014.	**₹1,10,00,000**
2. Capital expenditure incurred during previous year 2014-15 (it includes ₹20 lakhs paid for Goodwill)	**₹1,40,00,000**

(I) Compute the deduction available under section 35AD in the assessment year 2015-16.

(II) What will be your answer if such building was constructed for operating a hospital of 100 beds for patients. **[4]**

Solution:

(I) ₹

Capital expenditure incurred before commencement but capitalized in books of account	₹1,10,00,000
Less: Cost of land not eligible for deduction under section 35AD	₹50,00,000
	₹60,00,000
Capital expenditure incurred during previous year 2014-15 exclusive of value of goodwill	₹1,20,00,000
Deduction allowable under section 35AD	₹1,80,00,000

(II) Since the hospital has started operations after 1.4.2012, the deduction allowed shall be 150% of ₹1,80,00,000 i.e. ₹2,70,00,000.

(b) (i) R has 9 house properties situated at Delhi.

Property A is let out for business

Property B is let out for residential purposes

Property C has four identical units:

Unit P – Let out for residential purposes throughout the previous year

Unit Q – Used for own business

Unit R – Used for own residence

Unit S – Let out for residential purposes; but w.e.f. 01.01.2015 was also used for own residence.

The particulars of property A and B are as under:

	Property A (₹)	Property B (₹)
Municipal Value	50,000	60,000
Actual rent	5,000 P.M.	6,000 P.M.
Fair Rent	70,000	
Standard Rent	54,000	
Date of completion of construction	01.03.2007	01.03.1992
Municipal tax paid	10,000	20,000
Repairs	5,000	---
Collection charges	4,800	4,800
Insurance premium paid	2,000	2,000
Interest on money borrowed for construction	30,000	11,000

R had borrowed a sum of ₹ 3,00,000 @ 10% per annum on 01.01.2006 for construction of House – A. the entire loan is still outstanding through interest is being paid every year.

The particulars of Property –C are as under:

Date of completion of construction	01.03.1993
Date of purchase by R	01.05.1994
	₹
Municipal Value	1,60,000
Rent of Unit – P	3,000 p.m.

Rent of Unit – S	**3,000 p.m.**
Municipal tax paid	**20,000**
Other expense:	
Repair of Unit – P	**5,000**
Repair of Unit – Q	**10,000**
Collection charges of Unit - P	**3,000**
Collection charges of Unit – S	**2,400**
Insurance premium of house property	**3,000**
Interest on money borrowed for purchase of house	**40,000**
Lease rent of land of house property	**5,000**

Compute the income of R under the head 'Income from house property' for the assessment year 2015-16. [10]

Solution:

Property – A

Gross Annual Value

Higher of the following two:

		₹	₹
(a)	Expected rent i.e., Municipal value (₹ 50,000) or Fair rent (₹ 70,000) whichever is higher but limited to standard rent i.e., ₹ 54,000		
(b)	Actual rent received/receivable (₹ 5,000 x 12)		60,000
Less: Municipal taxes paid			10,000
Net Annual Value			50,000
Less: Deductions u/s 24			
(a)	Statutory deduction @ 30%	15,000	
(b)	Interest on money borrowed (Current year interest ₹ 30,000 Pre-construction interest, nil as five years are over)	30,000	45,000
Income from house property A			5,000

Property – B

Gross Annual Value

Higher of the following two:

		₹	₹
(a)	Expected rent ₹ 75,000		
(b)	Actual rent received/receivable ₹ 72,000		75,000
Less: Municipal taxes paid			20,000
Net Annual Value			55,000
Less: Deductions u/s 24			
(a)	Statutory deduction @ 30%	16,500	
(b)	Interest on money borrowed	11,000	27,500
Income from property B			27,500

Property – C
Unit P (Let out for residential purposes throughout the previous year).
Gross Annual Value shall be higher of the following two:

		₹	₹
(a)	Expected rent (1/4 of municipal value ₹ 1,60,000) = ₹ 40,000		
(b)	Actual rent received/receivable ₹ 36,000		40,000
Less: Municipal taxes (1/4 of property)			5,000
Net Annual Value			35,000
Less: Deductions u/s 24			
(a)	Statutory deduction @ 30%	10,500	
(b)	Interest (1/4)	10,000	20,500
			14,500
Unit-Q (Used for own business)			Nil
Unit-R (Used for own residence)			
Annual Value			Nil
Less: Interest on money borrowed (1/4th of ₹ 40,000)			10,000
Income from Unit R			(-) 10,000

Unit – S
As it is part of the year let out and part of the year self,-occupied, it will not get benefit of self-occupation for residential purposes. The annual value of this unit will be determined as per section 23(1).

Gross annual value which shall be higher of the following two:

		₹	₹
(a)	Expected rent i.e., ₹ 40,000		
(b)	Actual rent received/receivable ₹ 27,000		40,000
Less: Municipal taxes paid			5,000
Net Annual Value			35,000
Less: Deductions u/s 24			
(a)	Statutory deduction @ 30%	10,500	
(b)	Interest	10,000	20,500
Income from unit S			14,500

Therefore, income from house property C = 14,500 + 14,500 – 10,000 = ₹ 19,000.
Aggregate of income from the three house properties = 5,000 + 27,500 + 19,000 = ₹ 51,500.

Unit-Q of property –C is used for own business. Therefore, it will be covered under the head 'Profit and gains of business or profession', where the income of this property will be taken as Nil but deductions for actual expenses on account of municipal-tax, repairs, insurance premium, interest, etc. shall be allowed. In fact, depreciation on such units will also be allowed.

(ii) Mr. P filed a return of income for assessment year 2014-15 on 31.7.2014. He later files a revised return on 15.12.2014 declaring a loss of ₹1,00,000. Can the loss be allowed to be carried forward? [2]

Solution:

As per the decision in Dhampur Sugar Mills Ltd., the revised return substitutes the original return. Since the original return was filed within the due date, the revised return of loss shall be deemed to have been filed within the due date and as such the loss of ₹1,00,000 shall be allowed to be carried forward.

(iii) The total income of Mr. Thakur for the assessment year 2015-16 is ₹1,01,20,000. Compute the tax payable by Mr. Thakur for the assessment year 2015-16. [3]

Solution:

		₹
Tax on ₹ 1 crore On first ₹2,50,000 Next ₹2,50,000 – 10% Next ₹5,00,000 – 20% Balance ₹90,00,000 – 30%		 Nil 25,000 1,00,000 27,00,000
		28,25,000
Tax on ₹1,20,000 which is above ₹1 crore ₹1,20,000@30%		 36,000
Total tax		28,61,000
Additional income above ₹1 crore Tax payable	1,20,000 36,000	
Balance income	84,000	
Surcharge on ₹28,61,000 @ 10% - 2,86,100		
∴ surcharge in this case shall be ₹84,000 or ₹2,86,100 whichever is less (due to marginal relief)		84,000
Tax including surcharge		29,45,000
Add: Education cess & SHEC @3%		88,350
		30,33,350

(c) (i) Compute the deduction allowed under section 80C and the net-tax payable by A from the following information submitted by him for the assessment year 2015-16:

		(₹)
1	**Gross Salary**	**4,50,000**
2	**Royalty (Gross)**	**27,000**
3	**Expenses allowable from royalty**	**5,000**
4	**Interest on fixed deposits with bank (gross)**	**13,000**
5	**LIP on his own life (sum assured ₹ 20,000) policy issued on 01.04.2013**	**6,000**
6	**LIP on the life of his wife**	**2,000**
7	**LIP on the life of his major son (not dependent on A)**	**2,500**
8	**LIP on the life of dependent brother**	**2,000**
9	**Contribution to a Recognised Provident Fund**	**20,000**

10	**Amount deposited in PPF Account**	**65,000**
11	**Contribution to ULIP**	**3,000**
12	**Repayment of housing loan taken from LIC (principal amount ₹ 23,000 and interest ₹ 30,000)**	**53,000**
13	**Subscription to National Saving Certificate IXth issue**	**25,000**
14	**Amount incurred on the education of:**	
	(a) Child X ₹ 14,000	
	(b) Child Y ₹ 7,000	
	(c) Child Z ₹ 5,000	
15	**Term deposit for 5 years with a schedule bank**	**20,000**
16	**Five year time deposit in Post Office**	**15,000**

He has taken the loan from LIC for construction of a residential house property which was completed in 2012 and which is being utilized by A from his own residence. [8]

Solution:

	₹	₹	₹
Income from Salaries			
Gross Salary		4,50,000	
Less: Deduction under section 6		Nil	4,50,000
Income from house property			
Annual Value (being self occupied)		Nil	
Less: Deduction u/s 24			
Interest on money borrowed for construction		30,000	(-) 30,000
Income from Other Sources			
(i) Royalty	27,000		
Less: Expenses	5,000	22,000	
(ii) Interest on fixed deposits with bank		13,000	35,000
Gross Total Income			4,55,000
Less: Deduction s u/s 80C to 80U			
U/s 80C (see working note)			1,50,000
Total Income			3,05,000
Tax on Total Income			
Tax on ₹ 3,05,000			5,500
Less: Rebate under section 87A			2,000
			3,500
Add: Education cess & SHEC - @ 3%			105
Tax (rounded off)			3,610

Working note for deduction allowable under section 80C

	₹
LIP on own life (Limited to 10% of sum assured)	2,000
LIP on life of wife	2,000
LIP on life of major son	2,500
LIP on life of brother	---

Contribution of RPF	20,000
Contribution to RPF	65,000
Contribution to PPF	3,000
Contribution to ULIP	
Repayment of housing loan (Principal amount ₹ 23,000)	23,000
Subscription to National Saving Certificate IXth issue	25,000
Which will subscribe to eligible issue of capital	
Tuition fee of children allowed only for 2 children (₹ 14,000 + 7,000)	21,000
Term deposit for 5 years with a schedule bank	20,000
Five year time deposit with Post Office	15,000
	1,98,500

But deduction limited to ₹ 1,50,000.

(ii) X (42 years) gives the following information for the previous year 2014-15:

(1) On 01.12.2014, he get gift of House A from his friend B (stamp duty value is determined at ₹6,00,000).

(2) On 03.12.2014, he gets gift of House B from C (who is father-in-law of his elder brother) (stamp duty value is ₹40,000, however, current market value is ₹65,000).

(3) On 07.12.2014, X purchases a second hand car for ₹ 70,000 from D (market value is however, ₹3,00,000).

(4) On 14.12.2014, X purchases a work of art for ₹5,00,000 from E (fair market value is ₹5,30,000).

(5) On 20.12.2014, X purchases jewellery for ₹7,00,000 from F (fair market value is ₹7,25,000). F is not a registered dealer.

(6) On 21.12.2014, X purchases a painting for ₹4,00,000 from G (who is brother of Mrs. X) (fair market value is ₹7,00,000).

(7) On 24.12.2014, X purchase a commercial property for ₹75,00,000 from H (fair market value is ₹90,00,000).

(8) On 25.12.2014, X gets a gift of 100 preference shares in A Ltd. from J (on 25-12-2014, stock exchanges are closed, the lowest quotation on the immediate preceding working day in National Stock Exchange is ₹45).

(9) On 25.01.2015, X gets a gift cheque of ₹1,00,000 from his friend L on his birthday.

(10) On 28.01.2015, minor son of X gets the gift of ₹55,000 from elder brother of X's grandfather).

(11) X contributes ₹10,000 in the public provident fund account of his dependent mother.

Determine the amount of net income of X for the assessment year 2015-16. [5]

Solution:

Computation of total income of X for assessment year 2015-16

	₹
Income from other sources (See note below)	8,08,500
Gross total income	8,08,500

Less: Deductions U/s 80C (Contribution of PPF account of mother not eligible)	---
Total Income	8,08,500

Note: - Treatment of gifts received shall be as under:

		₹	₹
I.	Immovable property received without consideration		
	(i) Gift of house A from friend (stamp duty value)	6,00,000	
	(ii) Gift of house B (stamp duty value ₹ 40,000, being less than ₹ 50,000) (Value of each property should be taken separately)	Not taxable	6,00,000
II.	Immovable property acquired for inadequate consideration		
	Purchase of commercial property for inadequate consideration (₹ 90,00,000 – 75,00,000)		15,00,000
III.	Movable property received without consideration		
	Gift of preference shares (market value ₹ 4,500) (Aggregate value of gift of movable property does not exceed ₹ 50,000)		Not taxable
IV.	Movable property acquired for inadequate consideration (Taxable if aggregate value exceeds ₹ 50,000)		
	(i) Purchase of car (not a property within the meaning of section 56(2)(vii)	Not taxable	
	(ii) Purchase of work of art (₹ 5,30,000 FMV – 5,00,000 purchase price)	30,000	
	(iii) Purchase of jewellary (₹ 7,25,000 – ₹ 7,00,000)	25,000	
	(iv) Purchase of painting (not taxable as brother of wife is a relative)	---	55,000
V.	Gift of money		
	(i) Gift from friend	1,00,000	
	(ii) Gift received by minor son (₹ 55,000 less exempt ₹ 1,500)	53,500	1,53,500
	Income from other sources		23,08,500

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

Answer:

Under section 10(10BC) any compensation received on account of disaster by an Individual or his Legal Heir from the Central or State Governments or Local Authority is exempt.

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

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

(d) (i) An Assessing Officer makes a best judgment assessment for failure to comply with a notice u/s 143(2), without any further notice to the Assessee. What are the remedies available to him? [4]

Answer:

1. Principle: U/s 144, where the Assessee does not comply with the terms of notice u/s 143(2), then the AO, after giving an opportunity of being heard to the Assessee, may make a best judgment assessment.
2. Conclusion: If notice as required u/s 144 is not given, then the Best Judgment Assessment shall be invalid.
3. Remedies available to the Assessee against Best Judgment Assessment without any notice to him –
   (a) Appeal u/s 246A: The Assessee may prefer an appeal against the said judgment.
   (b) Remedy u/s 264: The Assessee an also seek revision of the order u/s 264.
   However, the Assessee can resort to any one of the above remedies, and not both.

(ii) From the following particulars, calculate the taxable income for the assessment year 2015-16.

	₹
Salary per month	**16,000**
Dearness Allowance per month	**6,000**
Medical bill reimbursed (out of which ₹ 14,000 is treatment of specified ailment in a hospital approved by the Principal Chief Commissioner or Chief Commissioner)	**42,000**
Free telephone at residence	**12,000**
House Rent Allowance per month (Rent Paid ₹ 15,000 p.m. for a house in Delhi)	**10,000**

House property is let out on a monthly rent of ₹ 2,000. The annual value of the house property is ₹ 30,000. Municipal tax paid is ₹ 1,800 for whole year. Re-payment of house building loans taken from friends is ₹ 5,000 and from Life Insurance Corporation is ₹ 9,000 (which includes ₹ 6,000 on account of interest)

	₹
Interest on Savings Bank A/c	**44,000**
Interest on P.P.F. A/c.	**2,000**
Income from units of Unit Trust of India	**800**
Life Insurance Premium	**6,000**
Contribution to Public Provident Fund	**6,000**
Deposit in account under national Savings Scheme, 1992	**10,000**
Interest accrued on (NSC VIII Issue)	**34,000**

The construction of the building was completed on 01.01.1992. [8]

Solution:

Computation of Taxable Income for the assessment year 2015-16

	₹	₹	₹
1. Income from salary			
Basic Pay		1,92,000	

Dearness Allowance		72,000	
Medical reimbursement (₹ 42,000 – 15,000 – 14,000)		13,000	
House rent allowance (₹ 1,20,000 – 96,000) See note below		24,000	
Taxable Salary		3,01,000	
Less: Deduction		Nil	
Taxable Salary			3,01,000
2. Income from House Property			
Annual Value (Actual rent or Annual ratable value whichever is higher)			30,000
Less: Municipal Taxes Paid		1,800	
		28,200	
Less: (i) Standard deduction @ 30%	8,460		
(ii) Interest on amount borrowed for construction	6,000	14,460	13,740
Income from other sources:			
1. Interest on Savings Bank A/c		44,000	
2. Dividends on Units of UTI		Exempt	
3. Interest accrued on NSC VIII Issue		34,000	78,000
Gross Total Income			3,92,740
Less: Deduction u/s 80C		59,000	
Deduction u/s 80TTA		10,000	69,000
Total income			3,23,740

Deduction u/s 80C
Qualifying amount

1	Life Insurance Premium	6,000
2	Public Provident Fund	6,000
3	Interest accrued on NSC	34,000
4	National Savings Scheme, 1992	10,000
5	Repayment of housing loan to LIC	3,000
		59,000

House rent allowance shall be exempt to the extent of minimum of the following 3 limits:
(i) ₹ 1,20,000
(ii) ₹ 1,80,000 – 19,200 = ₹ 1,60,800
(iii) ₹ 96,000 (50% of salary i.e., ₹ 1,92,000)

1. Interest on loan taken for construction of house property will be allowed as deduction under the head 'Income from House Property' from annual value. On the other hand, repayment of principal amount to LIC will be eligible for deduction u/s 80C. Repayment of loan to a friend will not be eligible for deduction.
2. Interest on Public Provident Fund is fully exempt.
3. Interest accrued on NSC IX issue will be included under the head 'Income from other sources' and will also quality for deduction u/s 80C.

(iii) The Assessment was made u/s 143(1) for AY 2010-2011. The Assessee has received a notice u/s 148 on 06.04.2013 for re-opening of assessment. Can the Assessee challenge the legality of notice on the ground of change of opinion? [3]

Answer:

Intimation u/s 143(1) cannot be considered as completion of assessment in respect of any previous year. Further, section 147 provides for income escaping assessment, even when the original assessment under other sections has been carried out, provided notice is served on the Assessee within the due date specified u/s 149, i.e. 4 years from the end of the relevant assessment year.

Hence, the Assessee cannot contest the validity of notice based on the change of opinion since the assessment u/s 143(1) cannot be considered as the conclusion of matters in respect of relevant Assessment Year.

(e) (i) R was working with X Ltd. on a salary of ₹ 60,000 p.m. He resigned on 31.07.2014 and joined Y Ltd. w.e.f. 01.08.2014 on a salary of ₹ 70,000 p.m. Compute the tax deductible by X Ltd. and Y Ltd. assuming he submitted the details of salary drawn and tax deducted at source by X Ltd. along with a company of Form 16 to Y Ltd. on 01.08.2014 itself. [6]

Solution:

Tax to be deducted by X Ltd.

	₹	Tax to be deducted at source (₹)
Salary for the month of April paid in May	60,000	*5,923
Salary for the month of May paid in June	60,000	5,923
Salary for the month of June paid in July	60,000	5,923
Salary for the month of July paid on 31st July 2014	60,000	Nil**
Total tax deducted		17,769
*Total salary ₹ 60,000 × 12 = 7,20,000		
Tax on ₹ 7,20,000		69,000
Add: Education cess & SHEC @ 3%		2,070
		71,070

Tax deductible per month 71,070/12 = ₹ 5,923

** The employer has deducted tax at source for the first three months of April to June 2014 by estimating the salary for the whole year. Since, the employee has resigned on 31.07.2014, there is no need to deduct tax at source at the time of payment of salary for the month of July 2014 as already excess amount of tax has been deducted at source, as the total salary from X Ltd. was only ₹ 2,40,000 for the aforesaid four months.

Tax to be deducted by Y Ltd. assuming details of the salary drawn from the previous employer has been submitted in Form No. 12B

	₹
Salary drawn from X Ltd. ₹ 60,000 × 4	2,40,000
Salary to be drawn from Y Ltd. ₹ 70,000 × 8	5,60,000
Total salary	8,00,000
Less: Deduction	Nil

Tax on ₹ 8,00,000	8,00,000
Add: Education cess & SHEC @ 3%	85,000
	2,550
Less: Tax deducted by X Ltd. [₹ 5,923 + 5,923 + 5,923]	87,550
Total tax to be deducted by Y Ltd.	17,769
	69,781
Tax to be deducted every month ₹ 69,781/8	8,723

(ii) The Total Income of Mrs. A, resident in India, compute for assessment year 2015-16 is ₹ 3,20,000 which includes long-term capital gains of ₹ 30,000 and winning of lotteries ₹ 20,000 and short-term capital gain covered under section 111A ₹ 10,000. Compute the tax payable assuming his agricultural income for the previous year war ₹ 2,50,000. [4]

Solution:

	₹	₹
Step - 1		
Add: Agricultural income and non-agricultural income (₹2,50,000 + ₹3,20,000)		5,70,000
Tax on above income		
(i) Tax on long-term capital gain of ₹ 30,000 @ 20%	6,000	
(ii) Tax on lottery income of ₹ 20,000 @ 30%	6,000	
(iii) Tax on short-term capital gain covered under section 111A 15% of ₹10,000	1,500	
(iv) Tax on balance income of ₹ 5,10,000 (including agricultural income)	27,000	40,500
Step – 2		
Add minimum exemption limit to agricultural income (₹ 2,50,000 + ₹ 2,50,000)		5,00,000
Tax on ₹ 5,00,000		25,000
Step – 3		
Tax on non-agricultural income		
Tax under Step 1 – Tax under Step 2 (₹ 40,500 – ₹ 25,000)		15,500
Less: Rebate u/s 87A		2,000
		13,500
Add: Education cess & SHEC - @ 3%		405
Total tax payable (round off)		13,910

(iii) Ramamurthy Public Charitable Trust [Registered u/s 12A of the Income Tax Act, 1961] furnishes the following data for Previous Year ending 31.03.2015 -

Particulars	(₹ Lakhs)
1. Income from Engineering College affiliated to University [Gross Receipts ₹ 100 Lakhs]	10
2. Income from Properties held in Trust [out of this ₹ 2 Lakhs was not received during the year	
3. (i.e. received on 07.04.2015) and ₹ 3 Lakhs was received only on the last day of the year]	26
4. Net Income from Business held under Trust (incidental to the main objects) as per Books	2
5. Amount spent on free scholarship, free meals and free medical relief	9
6. Repayment of loan taken for construction of Health care Centre	3

You are required to:

(i) Compute the taxable income of the Trust for the Assessment Year 2015-2016 [Assume that option is exercised under explanation to Sec. 11(1)]

(ii) Advise how the taxability on the computed income could be minimized or reduced. [5]

Solution:

Assessee: Ramamurthy Public Charitable Trust Prev. Year: 2014-2015 Assessment Year:2015-2016

Computation of Taxable Income

Particulars	₹	₹
Income from Engineering College affiliated to University	10,00,000	
Less: Exempt u/s 10(23C) as Gross Receipts do not exceed ₹ 1 Crore	(10,00,000)	NIL
Income from Property Held in Trust		26,00,000
Net Income from Business Held in Trust		2,00,000
Gross Receipts		**28,00,000**
Less: Maximum Permissible Accumulation @ 15% of Gross Receipts		(4,20,000)
Amount to be applied		**23,80,000**
Less: Amount actually applied by Trust		
Free Scholarship, Meals and Medical Relief	9,00,000	
Repayment of Loan taken for construction of Health Care Centre	3,00,000	(12,00,000)
Less: Amount deemed to be applied (Note 2)		
Income received on the last date of the previous year **(Note 4)**	3,00,000	
Income not received during the previous year **(Note 5)**	2,00,000	(5,00,000)
Taxable Income of the Trust		**6,80,000**

Note:

1. Repayment of Debt incurred for the purpose of Trust shall be treated as an application [Janmaboomi Press Trust 242 UR 457 (Kar.)]. Hence, Repayment of Loan taken for construction of Health Care Centre treated as application.
2. Assumed that Notice is given to the Assessing Officer before the due date of filing return u/s 139(1).
3. Income from Business incidental to main objects of trust assumed to be applied for "other objects of general public utility."
4. This amount has to be actually applied for charitable / religious purpose in F.Y. 2015-2016.
5. This amount has to be actually applied for charitable / religious purpose in F.Y. 2015-2016 or F.Y. 2016-2017.

3. Answer any two questions [2×10 = 20]

(a) What are the documents require to be maintained in respect of International Transactions? [10]

Answer:

Documents to be maintained in respect of International Transactions

A. DOCUMENTS: Under Rule 10D, every person who has entered into an International Transaction shall keep and maintain the following information and documents:

1. Ownership Details: Description of the ownership structure of the Assessee Enterprise with details of Shares or other ownership interest held therein by other Enterprises.
2. Group Details: Profile of the Multinational Group of which the Assessee Enterprise is a part, along with the Name, Address, Legal Status and Country of tax residence of each of the Enterprises comprised in the Group with whom international transactions have been entered into by the Assessee, and ownership linkages among them.
3. Business Details: Broad description of the business of the Assessee, and the industry in which the Assessee operates, and of the business of the Associated Enterprises with whom the Assessee has transacted.
4. International Transaction Details: Nature and terms (including prices) of international transactions entered into with each Associated Enterprises, details of property transferred or services provided and the quantum and the value of each such transaction or class of such transaction.
5. Functional Details: Description of the functions performed, risks assumed and assets employed or to be employed by the Assessee and by the Associated Enterprises involved in the international transaction.
6. Details of Factors influencing International Transactions: Record of the economic and market analyses, forecasts, budgets or any other financial estimates prepared by the Assessee for the business as a whole, and for each division of product separately, which may have a bearing on the international transactions entered into by the Assessee.
7. Uncontrolled Transactions Details: Record of Uncontrolled Transactions taken into account for analysing their comparability with the international transactions entered into, including a record of the nature, terms and conditions relating to any Uncontrolled Transaction with third parties which may be of relevance to the pricing of the international transactions,
8. Comparability Details: Record of the analysis performed to evaluate comparability of uncontrolled transactions with the relevant international transaction,
9. Details of Method selected for ALP: Description of the methods considered for determining the ALP in relation to each international transaction or class of transaction, the method selected as the most appropriate method, along with explanations as to why such method was so selected and how such method was applied in each case,
10. Details of Computation of ALP: Record of the actual working carried out for determining the ALP, including details of the comparable data and financial information used in applying the most appropriate method and adjustments, if any, which were made to account for differences between the international transaction and the comparable uncontrolled transactions, or between the Enterprises entering into such transactions,
11. Assumptions: Assumptions, policies and price negotiations, if any, which have critically affected the determination of the ALP,
12. Adjustments: Details of the adjustments, if any, made to Transfer Price, to align them with ALP determined under these Rules, and consequent adjustment made to the Total

Income for tax purposes,

13. Other relevant details: Any other information, data or document, including information or data relating to the associated enterprise, which may be relevant for determination of the ALP.

B. FRESH DOCUMENTS:

1. No Significant Change: Where an international transaction continues to have effect for more than one previous year, fresh documentation need not be maintained separately unless there is a significant change in -
   (a) Nature or Terms of the international transaction,
   (b) Assumptions made,
   (c) Any other factor which could influence the Transfer Price.
2. Significant Change: In case of any significant change, fresh documents required to bring out the impact of the change on the international transaction should also be maintained.

C. SUPPORTING DOCUMENTS: The information specified above should be supported by authentic documents, which may include the following -

1. Official Publications, Reports, Studies and Database from the Government of the country of residence of the Associated Enterprise, or of any other country,
2. Reports of Market Research Studies carried out and Technical Publications brought out by institutions of national or international repute,
3. Price Publications including Stock Exchange and Commodity Market Quotations,
4. Published Accounts and Financial Statements relating to the business affairs of the Associated Enterprises,
5. Agreements and Contracts entered into with Associated Enterprises or with Unrelated Enterprises in respect of transactions similar to the international transactions,
6. Letters/other correspondence documenting any terms negotiated between the Assessee and the Associated Enterprise,
7. Documents normally issued in connection with various transactions under accounting practices followed.

(b) (i) Boulevard Inc. a French Company, holds 40% of Equity in the Indian Company Vista 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 ₹ 1,250. 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 Vista Technologies Ltd. [5]

Solution:

1. Computation of Arms Length Gross Profit Mark Up

Particulars	%	%
Normal GP Mark Up	4 7	50 (11)
Less: Adjustment for Differences [14% of 50%]		
(a)Technical Support from Boulevard 8% of Normal GP [8% of 50%]		
(b)Quantity Discount 14% of Normal GP		
		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 $\frac{\text{Cost}}{\text{100 - Arms' Length Mark up}} = \frac{₹18,00,000}{100\% - 40\%}$	30,00,000
Less: Actual Billing to Boulevard [2,000 Hours × ₹ 1,250]	(25,00,000)
Therefore, increase in Total Income of VTL	5,00,000

(ii) Kio Japan and AB Ltd, an Indian Company are Associated Enterprises. AB Ltd manufactures Cellular Phones and sells them to Kio Japan and Geel, a Company based at Beijing. During the year AB Ltd supplied 2,50,000 Cellular Phones to Kio Japan at a price of ₹ 3,000 per unit and 35,000 units to Geel at a price of ₹ 4,800 per unit. The transactions of AB Ltd with Kio and Geel are comparable subject to the following considerations -

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

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

(c) Since Kio'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 Kio Japan by AB Ltd

Particulars	₹	₹
Price per Unit in a Comparable Uncontrolled Transaction		4,800
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 Kio Japan		3,400

2. Computation of Increase in Total Income of AB Ltd

Particulars	₹
Arm's Length Price per Unit	3,400
Less: Price at which actually sold to Kio Japan	(3,000)
Increase in Price per Unit	400
No. of Units sold to Kio Japan	2,50,000
Therefore, increase in Total Income of AB Ltd (2,50,000 × ₹ 400)	₹ 10 Crores

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

Answer:

Consequences of Non-Compliance with Regulations

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

272A(2)(a)	Failure to comply with a notice issued u/s 94(6) regarding furnishing of information relating to securities.	₹ 100/day of default.	JOT/JDIT/ Higher Authority

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

Exception from penalties:

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