Paper-7 – Direct Taxation

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

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

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

All the questions relate to the assessment year 2015-16, unless stated otherwise.

Working notes should form part of the answers.

Answer all questions.

Question No 1. Answer all the questions [2 x 10 = 20]

(i) Mr. Pratap is an employee of ABC Ltd. getting a salary of ₹ 40,000 per month which is 'due' on the last day of the month but is paid on the 7th of next month. He is paid the salary of April, 2015 and May, 2015 in advance in March, 2015. What will be his gross income for the assessment year 2015-2016? [2]

Answer:

Salary is taxable on "due or receipt" basis, whichever is earlier. Salary paid in advance in the months of March, 2015 for the months of April and May, 2015 will be included in the income of the previous year 2014-15 because the same has been paid in March, 2015 although it is not 'due.' The gross income shall be as under:

	₹
Salary for the months April, 2014 to March, 2015 (40,000 × 12) Advance salary of April and May, 2015 received in March, 2015 (40,000 × 2)	4,80,000 80,000
	5,60,000

(ii) Star Ltd. imported machinery from Germany on 27.8.14 at a cost of ₹ 60 crores. Customs Duty paid @ 20%. Government granted subsidy of ₹ 35 crores. The entire logisitics was supported by Nexgen Courier Ltd., an Indian Company. Total Service charges paid to them ₹ 30 lacs (Pre-acquision cost) including service tax of ₹ 3,70,800.

Compute Actual Cost, if assessee, avail CENVAT credit. [2]

Solution:

Assessee: Star Ltd. **Previous Year: 2014-15**

Computation of Depreciation and Written Down Value

Particulars	**Amount** (₹ crores)
Cost of Purchase	60.000
Add: Customs Duty @ 20% on ₹60 crores	12.000
Add: Service charges (Being pre-acquisition cost)	0.300
Less: Government subsidy granted	35.000
Less: CENVAT Credit (Service Tax paid included in the payment made to Naxgen Courier Ltd.)	0.03708
Actual Cost for the purpose of charging depreciation	37.26292

(iii) An individual practicing as a chartered engineer is in receipt of fees from a company, which had retained him for purposes of valuation of properties. The total fee agreed upon between the parties was ₹50,000.

The engineer was paid the following amounts by the company:
30.01.2015 - ₹12,000 (advance of fees)
20.03.2015 - ₹20,000 (towards completion of work)
15.04.2015 - ₹18,000 (balance of fees on completion of work).
Discuss the obligation for tax deduction at source. [2]

Solution:

Computation of deduction of tax at source:

Date of payment	Amount (₹)	Aggregate Amount (₹)	Justification
30.01.2015	12,000	12,000	No TDS is deducted because aggregate amount does not exceed ₹30,000 during the year.
20.03.2015	20,000	32,000	The aggregate amount of ₹32,000 is liable to pay tax as the aggregate payment exceeds ₹30,000 during the previous year 2014-15.
15.04.2015	18,000	50,000	No TDS is deducted because aggregate amount does not exceed ₹30,000 during the year.

(iv) X Ltd lets out its property to Y. Y sub-lets it. How is the sub-letting receipt will assessed in the hands of Y? [2]

Answer:

If sub-letting is in the ordinary course of business, such Income is taxable under the head "Profits and Gains of Business or Profession". Otherwise, it will be taxable under the head "Income from Other Sources".

(v) Anirudh is a Regional Sales Manager of A Ltd. He is paid salary plus commission based on volume of sales effected by him. Anirudh claimed that the expenses incurred by him for earning the commission should be allowed as deduction. Discuss the validity of his claim. [2]

Answer:

1. Commission paid to the Assessee was with reference to the volume of sales to encourage the Employee to effect a higher volume of sales.
2. Such Commission is in addition to Salary, and would also form part of Salary and hence no deduction was allowable in respect of any expenditure incurred to earn the commission.

(vi) Mr. Ravi, an IAS Officer, was posted to USA by the Government of India on 11.07.2014 for a period of 3 years. He was paid salary of ₹ 3 Lakhs for the period 01.04.2014 to 01.07.2014 and of ₹12 Lakhs for period upto 31.03.2015. He left India for USA in the night of 10.07.2014 and did not come even for a day until 31.03.2015. Examine the taxability of the above Income. [2]

Answer:

1. Principle:
   (a) U/s 9 (1) (iii), Salaries paid by Government of India to an Indian Citizen for services rendered outside India shall be deemed to accrue or arise in India, and is hence taxable in India, irrespective of whether he is a Resident or Non-Resident in India during the Relevant Previous Year.
   (b) U/s 10 (7), Allowance or perquisites provided by the government of India to an Indian Citizen for services rendered outside India, is fully exempt from tax.
2. Conclusion: In the above case, the entire salary of ₹15 lakhs of Mr. Ravi who appointed by the government of India is taxable in India as salaries u/s 9(1) (iii).

(vii) Explain the concept of marginal Relief? [2]

Answer:

1. Marginal Relief is a reduction from the Tax Payable by the Assessee.
2. Relief from Tax Payable shall be given, where the Tax Payable together with Surcharge exceeds the Income earned by an Assessee in excess of ₹ 1 Crore. Such Relief is known as Marginal Relief.
3. The principle in Marginal Relief is that the Additional Amount of Income Tax Payable with Surcharge in excess of Income over ₹1 Crore, should not be more than the amount in excess of ₹ 1 Crore.

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

Answer:

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

(ix) What are the methods in computation of arm's length pricing in relation to International Transaction/specified Domestic Transactions? [1]

Answer:

Methods of Computation [Sec.92C & Rule 10B]: ALP in relation to an International Transaction / Specified Domestic Transaction shall be determined by any of the following methods -

(a) Comparable Uncontrolled Price Method,
(b) Resale Price Method,
(c) Cost Plus Method,
(d) Profit Split Method,
(e) Transactional Net Margin Method,
(f) Other method prescribed by CBDT. (Note)

(x) What are the modes of transfer of Intangible Assets under Internal transactions? [2]

Answer:

General Rule: The following general rules of ALP shall apply to Intangible Property Transactions between Associated Enterprises.

Transferor ALP = Price at which a Comparable Independent Enterprise would be willing to transfer the property.

Transferee ALP = price that a Comparable Independent Enterprise would be prepared to pay, depending on the value and usefulness of the intangible property to the Transferee in its business.

Transfer Mode: Either – (i) through outright sale, or (ii) by a Royalty under a licensing agreement.

(xi) People Housing Ltd is engaged in the business of constructing residential and commercial properties. One of the building properties was included in the closing stock in Balance Sheet. The said building was let out for a monthly rent as suitable buyers could not be found. All other buildings had been sold by the company. State with reasons whether the income by way of rent from the unsold property is assessable as income from business or income from house property. [1]

Answer:

For a company in real estate business, with the object of buying and developing landed properties, the income from unsold property let-out is taxable under the head Income form House Property.

Rental income received by People Housing Ltd is chargeable to tax as "Income from House Property".

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

(a)(i) The following is the income of Shri Sudhir Kumar for the previous year 2014 – 15:

	₹
A. Profits from business in Iran received in India.	**5,00,000**
B. Income from house property in Iran received in India.	**1,20,000**
C. Income from house property in Sri Lanka deposited in a bank there.	**1,80,000**
D. Profits of business established in Sri Lanka deposited in a bank there, this business is controlled in India (out of ₹2,00,000 a sum of ₹1,00,000 is remitted in India).	**2,00,000**
E. Income from profession in India but received in England	**2,40,000**
F. Profits earned from business in Kanpur.	**1,60,000**
G. Income from agriculture in England, it is all spent on the education of children in London.	**2,70,000**

From the above particulars ascertain the taxable income of Shri Sudhir Kumar for the previous year 2014-15, if Shri (i) a resident and ordinarily resident, (ii) not ordinarily resident, and (iii) a non-resident. [5]

Solution:

Taxable Income of Shri Sudhir Kumar for the previous year 214 – 15

		R & OR (₹)	RNOR (₹)	NR (₹)
(1)	**Income received in India wherever accrues**			
	(i) Profit from business in Iran received in India.	5,00,000	5,00,000	5,00,000
	(ii) Income from house property in Iran received in India	1,20,000	1,20,000	1,20,000
(2)	**Income accrued in India wherever received**			
	(i) Profit earned from business in Kanpur.	1,60,000	1,60,000	1,60,000
	(ii) Income from profession in India but received in England.	2,40,000	2,40,000	2,40,000
(3)	**Income accrued and received outside India**			
	(i) Income from house property in Sri Lanka deposited in bank there.	1,80,000	-	-
	(ii) Profit of business established in Sri Lanka deposited there, business being controlled from India.	2,00,000	2,00,000	-
	(iii) Income from agriculture in England.	2,70,000	-	-
	Total Income	16,70,000	12,20,000	10,20,000

(ii) Value of unfurnished accommodation (computed) ₹ 70,000. Cost of furniture provided by the employer ₹1,00,000. Hire charges of furniture (other than those owned by employer) provided in the accommodation ₹1,500 p.m. Amount recovered from employee ₹ 1,000 p.m. Compute taxable value of perquisite. [3]

Solution:

Computation of Taxable Value of Perquisite – related to furnished accommodation

Particulars	**Amount (₹)**
Value of unfurnished accommodation [given]	70,000
Add: Value of furniture provided	
(i) 10% p.a. of original cost of such furniture	10,000
(ii) Hire charges of furniture	18,000
	98,000
Less : Amount recovered from the employee (₹ 1,000 x 12)	(12,000)
Taxable Value of perquisite – related to furnished accommodation	**86,000**

(iii) XYZ Ltd incurred expenditure amounting to ₹3,00,000 in connection with the issue of rights shares and ₹2,00,000 in connection with the issues of Bonus shares during the year ending 31.3.2015. The company seeks your opinion in the matter of eligibility for deduction of the expenditure incurred from its business profits for the assessment year 2015-16. [2]

Solution:

Right Issue Expenses ₹3,00,000: Expenditure incurred by the assessee on the issue of right shares is an inadmissible expenditure u/s 37. [Motor Industries Co. Ltd. 173 ITR 374 (Kar.)].

Bonus Issue Expenses ₹2,00,000: expenditure in connection with the issue of bonus shares constitute revenue expenditure and deductible u/s 37. [General Insurance Corporation 205 CTR 280 (SC)].

(iv) Prayag Power Projects is a power generating unit. On 1.4.2012, it purchased a plant of ₹ 60,00,000, eligible for depreciation @15% on SLM. Compute balancing charge or terminal deprecation assuming the plant is sold on 21.4.2014 for : (a) ₹ 10,50,000 (b) ₹35,00,000 (c) ₹ 48,00,000 (d) ₹65,00,000. (Ignore the provision of additional Depreciation) [5]

Solution :

Computation of Terminal Depreciation or Balancing Charge, Capital Gain.

Particulars	A	B	C	D
W.D.V. as on 1.4.2014	42,00,000	42,00,000	42,00,000	42,00,000
Less: Sale Proceeds	10,50,000	35,00,000	48,00,000	65,00,000
Balance	31,50,000	7,00,000	(6,00,000)	(23,00,000)
Terminal Depreciation	31,50,000	7,00,000	NIL	NIL
Balancing Charge	NIL	NIL	6,00,000	18,00,000
Short term capital Gain	NIL	NIL	NIL	5,00,000
Computation of Depreciation:				
Original cost	60,00,000			
Less: Depreciation for the year 2012-13	9,00,000			
WDV as on 1.4.2013	51,00,000			
Less : Depreciation for the year 2013-2014	9,00,000			
WDV as on 1.4.2014	42,00,000			

(b)(i)For the previous year 2014–15, the business income of Shyam Ltd. before allowing expenditure on family planning is ₹2,00,000. The company had incurred the following expenditure on family planning amongst its employees during the previous year 2014-15:

(1) Revenue expenses on family planning ₹1,10,000.
(2) Capital expenditure on family planning ₹6,00,000.

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

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

Solution:

	₹	₹
Profits before deduction of expenditure on family planning		2,00,000
Less: revenue expenses	1,10,000	
Capital expenditure (1/5th of ₹6,00,000, ₹1,20,000 but allowed to the extent of business income)	90,000	2,00,000
Business income		Nil

Income from other sources	20,000	
Less unabsorbed capital expenditure of family planning	20,000	
Gross Total Income		Nil

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

	₹	₹	₹
Profit before deduction of expenditure on family planning		2,00,000	
Less: revenue expenses	2,15,000		
1/5th capital expenditure	1,20,000		
	3,35,000		
Deduction limited to business income		2,00,000	Nil
Balance family planning expenditure	1,15,000		
Set off against income from other sources	20,000		
Unabsorbed family planning expenditure carried forward	95,000		
Income from other sources		20,000	
Less: Set off family planning expenditure		20,000	Nil
Gross total income			Nil

(ii) HUM Bros., an HUF, started an undertaking in "Special Economic Zone" during the Previous Year 2009-2010. From the following particulars relating to the Previous Year 2014-2015, compute the Total Income for the Assessment Year 2015-2016:

	₹ (in lakh)
(i) Total Turnover	**60**
(ii) Export Sales	**50**
(iii) Business Profits	**30**
(iv) Receipt of convertible foreign exchange in India up to 30th September 2015	**32**
(v) Convertible foreign exchange kept outside India with the permission of RBI for importing a new machinery	**8**
(vi) Receipt of convertible foreign exchange in December 2015	**6**
(vii) Convertible foreign exchange received for reimbursement for freight, insurance attributable to export	**4**

[3]

Solution :

Computation of Total Income

	₹ (in lakhs)
Business Profits	30
Less : Deduction for Export Profits : (30 × 40) ÷ 60 [Sec. 10AA]	20
Total Income	10

Note :

1. Convertible foreign exchange received in December, 2015 has not been included in Export turnover, because it is received after the prescribed time limit without approval of the competent authority.
2. Convertible foreign exchange kept outside India with the permission of RBI is included in Export turnover.
3. Reimbursement of freight and insurance in convertible foreign exchange is not included in Export turnover.

(iii) Sweet Ltd. grows sugarcane to manufacture sugar. The data for the financial year 2014-15 is as follows :

Cost of cultivation of sugarcane	**₹ 9,00,000**
Market value of sugarcane when transferred to factory	**₹ 15,00,000**
Other manufacturing cost	**₹ 9,00,000**
Sales of sugar	**₹ 37,50,000**
Salary of Managing Director who looks after all operations of the Company	**₹ 4,50,000**

Determine its Business Income and Agricultural Income. [3]

Solution :

(1) Business Income :

Sales of Sugar	₹ 37,50,000
Less: Market value of sugarcane when transferred to factory	₹ 15,00,000
Other manufacturing cost	₹ 9,00,000
Salary of Managing Director	₹ 4,50,000
	₹ 9,00,000

(2) Agricultural Income :

Market value of sugarcane when transferred to factory	₹ 15,00,000
Less: Cost of cultivation	₹ 9,00,000
	₹ 6,00,000

(iv) Shri Shyam Temple Trust (Regd.) derived ₹ 7,00,000 income from the property held under charitable trust during the Previous Year 2014-2015. About 40% of the income has been received by the end of the financial year. The trust could spend ₹60,000 for charitable purposes during the year 2014-2015 and 40% receipts, received by the year end in 2014-2015, are being planned to be applied for charitable purposes during the Previous Year 2015-2016. Compute its income for the said two years if the amount planned to be spent during Previous Year 2015-2016 for charitable purposes is ₹ 1,00,000. [4]

Solution :

(a) Computation of Taxable Income of Charitable Trust: PY 2014-2015/AY 2015-2016

Particulars		₹
Income from property held under Trust		7,00,000
Less: 15% set apart for future application for charitable purposes		1,05,000
Balance		5,95,000
Less : Income applied for charitable purposes during the year 2014-2015		60,000
Balance		5,35,000
Less: Income realised by the close of the Previous Year—40% of ₹ 7,00,000		2,80,000
Taxable Income		2,55,000
(b) Previous Year : 2015-2016/A.Y. 2016-2017		
Amount set apart in 2014-2015 to be applied for charitable purposes in 2015-2016 =	2,80,000	
Less: Amount applied for charitable purposes =	1,00,000	
Taxable Income	1,80,000	

(c)(i) Compute the capital gain in the following cases:

(1) (a) P commenced a business on 15.04.1991. The said business is sold by P on 18.04.2014 and he received ₹12,00,000 towards goodwill.

(b) What will be your answer in the above case, if P had acquired the goodwill for this business for a consideration of ₹2,00,000.

(2) R has been living in a rented accommodation since May 1994 and he is paying a rent of ₹500 per month. The landlord got the house vacated from R on 16.07.2014 and paid a sum of ₹5,00,000 for vacating the house.

(3) S is a Chartered Accountant practicing in Delhi since January 1983. He transfers the practice to another Chartered Accountant Y on 15.07.2014 and charges ₹5,00,000 towards goodwill.

(4) R purchased tenancy right on 01.04.1979 for ₹1,60,000. The same was sold by him on 14.08.2014 for ₹20,00,000. Fair market value of tenancy right as on 01.04.1981 was ₹2,50,000. [5]

Solution:

(1)

		₹
(a)	Sale Consideration	12,00,000
	Less: Indexed cost of acquisition (Self generated)	Nil
	Long-term capital gain	12,00,000
(b)	Sale Consideration	12,00,000
	Less: Indexed cost of acquisition – ₹2,00,000$\times\frac{1,024}{199}$	10,29,146
	Long-term capital gain	1,70,854

(2)

	₹
Sale Consideration	5,00,000
Less: Indexed cost of acquisition (Since self generated)	Nil
Long-term capital gain	5,00,000

(3) Since the asset transferred is goodwill of a profession and not of business, it is treated as self-generated asset and there is no capital gain on self-generated asset.

(4)

	₹
Sale Price	20,00,000
Less: Indexed cost of acquisition – ₹1,60,000$\times\frac{1,024}{100}$	16,38,400
Long-term capital gain	3,61,600

In case of tenancy right, the option to assume market value as on 01.04.1981 is not allowed.

(ii) The written down value of a block of asset as on 1.4.2014 was ₹8,00,000. An asset of the same block was acquired during the year for ₹3,00,000. Thereafter, all the assets of the block are sold for ₹12,00,000. Compute the depreciation for the assessment year 2015-16 and also indicate if there is any short-term capital gain/loss. [2]

Solution:

(i) As the entire block of assets is sold, the block ceases to exist at the end of previous year, hence section 32 is not applicable.

(ii) Computation of short-term capital gain/loss [Section 50]

	₹
Consideration price of block sold	12,00,000
Less: Cost of acquisition (WDV of block plus asset purchased during the previous year) (₹8,00,000 + ₹3,00,000)	11,00,000
Short-term capital gain	1,00,000

(iii) Mr. Shahil purchased a piece of land on 4.1.1978 for ₹50,000. This land was sold by him on 2.9.2014 for ₹14,00,000. The market value of the land as on 1.4.1981 was ₹1,20,000. Expenses on transfer were 2% of the sale price. Compute the capital gain for the assessment year 2015-16. [2]

Solution:

Computation of capital gain for the assessment year 2015-16

	₹	₹
Sale consideration		14,00,000
Less: Expenses on transfer	28,000	
Index cost of acquisition [(₹1,50,000 × 1,024)÷100	12,28,800	12,56,800
Long-term capital gain		1,43,200

(iv) A has 2 motor cars which are used by him exclusively for his personal purposes. The cost of the cars was ₹1,50,000 and ₹1,80,000. The first car was transferred by him on 5.1.2015 to a firm in which he is a partner as his capital contribution. The market value of the car as on 5.1.2015 is ₹1,00,000, but it was recorded in the books of account of the firm at ₹2,00,000. Compute the capital gain if any, chargeable for the assessment year 2015-16.

[2]

Solution:

Since the car is a movable property and was used by A for his personal purposes only, it will be treated as a personal effect. As personal effect is not a capital asset, there will be no capital gain.

(v) Mr. Rahul, has computed his Gross Total Income for the assessment year 2015-16 which amounted to ₹4,70,000. It includes ₹3,70,000 on account of long-term capital gain. He has deposited ₹1,20,000 in a PPF during the previous year. Compute the tax payable by Mr. Rahul, a resident in India assuming that he is less than 60 years of age. [4]

Solution:

	₹
Gross Total Income exclusive of income taxable at special rate Less: Deduction under section 80C, limited to ₹1,00,000 being total income exclusive of long-term capital gain	1,00,000 1,00,000
	Nil
Add: Long-term capital gain	3,70,000
Taxable income	3,70,000
Tax on total income exclusive of long-term capital (Nil + ₹2,50,000 shifted from LTCG)	Nil
Tax on Long-term capital gain @ 20% on ₹1,20,000 (₹3,70,000 – ₹2,50,000 shifted	

to other income)	24,000
Tax payable	24,000
Less: Rebate under section 87A	2,000
	22,000
Add: Education cess & SHEC @ 3%	660
Total tax payable	22,660

(d)(i) From the following details, compute the Gross Total Income of Mr. A for the assessment year 2015–16:

	₹
1. Taxable income from salary	**80,000**
2. Income from house property House 'A' (let out)	**(-) 95,000**
House 'B' (Self – occupied , interest on borrowed money)	**(-) 9,000**
3. Short–term capital gain	**12,000**
4. Loss from long- term assets	**25,000**
5. Interest on securities (gross)	**10,000**

[4]

Solution:

		₹	₹	₹
1.	Taxable income from salary		80,000	
	Less: Loss under the head house property set off		80,000	Nil
2.	Income from property A (let out)		(-) 95,000	
	House B self occupied		(-) 9,000	
			(-) 1,04,000	
	Less: Set off from salary	80,000		
	Set off short term capital gain	12,000		
	Set off from income other sources	10,000	1,02,000	
	Balance loss carried forward		2,000	Nil
3.	Income from capital gain:			
	Short-term capital gain		12,000	
	Less: Loss under the head house property set off		12,000	Nil
	Long-term capital loss to be carried forward		(-) 25,000	
4.	Income from other sources:			
	Interest on securities		10,000	
	Less: Loss under the head house property set off		10,000	Nil
	Gross total income			Nil

Loss from long-term capital assets cannot be set off against short-term capital gain or income under other heads of income. Such a loss of ₹25,000 which could not be adjusted in the assessment year 2014-15 will be carried forward to the subsequent assessment years. Loss from house property amounting to ₹2,000 shall be carried forward.

(ii) Chakarvarti is a Cost Accountant drawing following salary and allowances:

- **Basic pay** **20,000 p.m.**
- **Dearness allowance** **1,000 p.m.**
- **City Compensatory allowance** **100 p.m.**
- **House Rent allowance** **750 p.m.**
- **Reimbursement of cost of travel and course fee to attend a seminar at Ooty** **5,500**

- **Bonus at 20% of salary including Dearness allowance is also received. He is given a motor car (below 1.6 ltr,) and is entitled to use it for both office and private purposes. His employer also pays ₹400 p.a. on a Personal Accident Insurance Policy consistent with its policy of insuring all its employees. Deductions have been made from his salary as follows:**
  - **Contribution to a recognized provident fund ₹ 1,000 p.m. and contribution to an approved superannuation fund ₹ 400 p.m.**

  There are matching contributions for both by the employer.
- **Chakarvarti was in receipt of the following from a partnership firm where he was sharing one-third of the profits:**
- **₹ 45,000 as share of profits.**
- **₹ 30,000 as salary from the firm.**
- **₹ 20,000 as commission there from.**
- **He was a member of an association of persons from where he was paid ₹ 50,000 as share of profits. The association is chargeable to tax at the maximum marginal rate of tax.**
- **He donated ₹ 25,000 to National Foundation for Communal Harmony.**
- **Chakarvarti's minor son earned ₹35,000 by way of interest on public deposit in a company.**
- **Chakarvarti received ₹ 700 as interest in savings bank account in a (non-nationalised) scheduled bank. He pays ₹ 3,200 p.a. as life insurance premium.**
- **Chakarvarti is living in his own house. Annual value as fixed by Municipal Corporation is ₹ 7,200, while half year's tax is ₹ 900. He pays ₹ 100 as insurance on this property besides ₹ 3,600 as interest on ₹30,000 on mortgage, of this property. The borrowing was partly (₹ 20,000) for acquiring the house and the balance (₹10,000) for purchasing a home air-conditioner for the house.**
- **Chakarvarti received a gift valuing ₹ 4,900 on the occasion of the silver jubilee of the company. It is stated that a uniform amount was paid to each employee on this occasion.**

Compute the assessee's total income for the assessment year 2015 – 16. [7]

Solution:

		₹	₹
Income from Salary			
(a)	Salary @ ₹20,000 per month	2,40,000	
(b)	Dearness allowance @ ₹1,000 p.m.	12,000	
(c)	City Compensatory Allowance @ ₹100 p.m.	1,200	
(d)	Bonus at 20% of 2,52,000 (2,40,000 + 12,000)	50,400	
(e)	House rent allowance @ ₹750	9,000	
(f)	Use of car (1,800 × 12)	21,600	
	Gross salary Less: Deduction	3,34,200 Nil	3,34,200
Income from House Property			
	Annual value of self –occupied house	Nil	
	Interest on borrowings allowed	2,400	
	Loss from property		(-) 2,400
Profits and gains from business or profession			
(a)	Share of profit is not taxable in his hands		
(b)	Salary and commission (30,000 – 1,500)		50,000
Income From Other sources			
(a)	Bank interest	700	

(b)	Interest on public deposit to minor son (35,000 – 1,500)	33,500	34,200
	Gross Total Income		4,16,000
(I)	Deduction u/s 80C (see Note)	20,000	
(II)	Deduction u/s 80G: Donation for national Foundation for Communal harmony	25,000	45,000
	Total Income		3,71,000
Amount on which deduction u/s 80C is allowed			
•	Employee's contribution to Provident Fund Employee's contribution to superannuation fund Life Insurance Premium		12,000 4,800 3,200
			20,000

1. Since the assessee lives in his own house, house rent allowance is taxable.
2. Share of profit from the Association of Persons in this case will not be taxed in the hands of Chakarvarti as the AOP has paid tax at the maximum marginal rate. It will also not be included in Total Income.

(iii) The estimated Gross Total Income of Mr. Jay is ₹8,45,000 which includes ₹1,00,000 on account of LTCG earned on 16.09.2014. Compute the Advance Tax Payable by Mr. Jay, assuming ₹11,000 has been deducted at source during the financial year 2014-15.
[4]

Solution:

	₹
Estimated tax Liability with LTCG On ₹7,45,000 On LTCG of ₹1,00,000 @ 20%	 74,000 20,000
	94,000
Add: Education cess & SHEC @ 3%	2,820
	96,820
Less: TDS	11,000
	85,850
Estimated Tax Liability without LTCG Tax on ₹7,45,000 = ₹74,000 + ₹2,220	 76,220
Less: TDS	11,000
	65,220
Tax payable on 1st installment i.e. by 15.09.14 30% of ₹65,220	 19,566
Tax payable on 2nd installment i.e. by 15.12.2014 (by including LTCG) 60% of ₹85,820 = 51,492 – ₹19,566	 31,926
Tax payable on 4th installment i. e. by 15.03.2015 100% of ₹85,820 – [₹19,566 + 31,926]	 34,328

(e)(i) Mr. khan, has accumulated profits of ₹3,00,000 excluding capitalized profits i.e. bonus shares of ₹1,00,000 issued in the past. The company distributed assets of ₹2,50,000 to the shareholder. Compute the amount taxable as dividend if the market value of the asset on the date of the distribution is:

A. ₹2,00,000
B. ₹3,50,000
C. ₹4,50,000 **[3]**

Solution:

The amount deemed to be dividend shall be taxable in the hands of the company as it is exempt in the hand of the shareholders. The company shall be liable to pay distribution tax @15% plus surcharge @7.5% plus education cess @2% plus SHEC @ 1% on the market value of the asset on the date of distribution subject to the maximum extent of the accumulated profits, whether capitalized or not.

Thus, the amount deemed to be dividend shall be:

A. ₹2,00,000
B. ₹3,50,000
C. ₹4,00,000

(ii) Sudhir was the Karta of HUF. He died leaving behind his major son Ganesh, his widow, his grandmother and brother's wife. Can the HUF retain its status as such or the surviving persons become co-owners? [3]

Solution:

Income-tax law does not require that there should be at least two male members to constitute an HUF [Gowli Buddanna vs. CIT (1966) 60 ITR 293 (SC)]. The expression "Hindu Undivided Family" used in the Act should be understood in the sense in which it is understood under the Hindu personal law. The expression "Hindu Undivided Family" under the Income-tax Act is known as "Joint Hindu Family", under the Hindu personal law. A 'Joint Family' may consist of a single male member and the widows of the deceased male members. The property of the Hindu joint family does not cease to be an HUF property merely because that the HUF, consist of one male member at a given point of time, exercising the proprietary rights over the property of HUF property.

(iii) If an assessment is remanded back to Assessing Officer, can he introduce new sources of income for assessment? [3]

Answer:

Where the assessment is set aside by the Tribunal and the matter remanded to the Assessing Officer, it is not open to him to introduce into the assessment new sources of income so as to enhance the assessment. Any power to enhance is confined to the old sources of income which were the subject matter of appeal [Kartar Singh vs.CIT (1978) 111 ITR 184 (P &H)].

(iv) Can assessee follow different method of accounting for different businesses? [3]

Answer:

If an assessee is carrying on more than one business, he can follow cash system of accounting for one business and mercantile system (accrual system) of accounting for other business. Similarly, if he had more than one sources of income under the head Income from Other Sources, he can follow accrual system for one source of income under the head Income from Other Sources, and cash system for other sources of income.

(v) An assessee filed a return of income on 31.8.2015 in respect of Assessment Year 2015-16 disclosing an income of ₹5 lakhs from business. It was not accompanied by proof of payment of tax due on self-assessment. Discuss the validity of such a return. [3]

Answer :

As per Explanation to sub-section (9) of section 139 a return is regarded as defective unless it is accompanied by proof of tax deducted at source, advance tax and tax on self-assessment, if any, claimed to have been paid. Therefore, the return is prima facie defective. It is not invalid at that stage.

On receipt of the return, the Assessing Officer has to intimate the defect to the assessee and give him an opportunity to rectify the defect within a period of 15 days from the date of such intimation or within such further period which, on application by the assessee, he may, in his discretion, allow. If the defect is not rectified within the said period, the return will be treated as an invalid return and the provisions of the Income-tax Act shall apply, as if the assessee has failed to furnish the return.

Also, it may be noted that section 140A(3) says that if an assessee fails to pay tax or interest on self assessment he shall be deemed to be an assessee in default in respect of the tax or interest or both remaining unpaid and all the provisions of the Act shall apply accordingly.

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

(a) "Mingle Engineering Ltd", a Korean Non Resident Company, had entered into an agreement for designing, fabricating, hook-up and commissioning of a platform in Bombay High with "Crude Oil India Ltd" an Indian Company. The agreement entered into was in two parts, one for the value to be charged for fabrication of structure in Korea for ₹20 Crores (having element of Profit in it of ₹ 2 Crores) and other for the Installation and Commissioning of the structure in Bombay High for ₹15 Crores (having element of Profit in it of ₹1.5 Crores). The Korean Company will also be setting up an Office in India for the activity of installation and commissioning of the platform which is likely to be completed in 9 months.

On these facts, you are required to answer -

(A) Whether the office of Mingle Engineering Ltd. to be opened in India be considered as its "Permanent Establishment"/ "Business Connection"?

(B) The amount of profits, if any, of the Non-Resident Company subject to tax in India.

(C) The Income subject to Tax in India, when the ALP of the fabrications of structure is determined at ₹ 19 Crores. [10]

Solution:

1. **Permanent Establishment**: The Korean Company for the purpose of commissioning of the platform in Bombay High Seas shall be having an office in India for a period of around 9 months. Maintaining of an Office by the Non-Resident in India for the conduct of its business shall be treated as a 'Permanent Establishment'
2. **Principles of Taxation**: In a contract for fabrication, designing, hook-up and commissioning of platform in Bombay High, fabrication work was completed in Korea. PE was established in India after fabrication but before installation. Hence, profits relating to fabrication in Korea are not taxable in India, but income relating to installation is taxable.
3. **Conclusion:**

(a) Variation = $\frac{\text{Computed ALP - Actual Price}}{\text{Acutal Price}}$ = $\frac{19-20}{20}$ = 5% (absolute % is taken, being Cost %)

(b) Since, the above variation exceeds the permissible 3% limit, the difference of ₹ 1

Crore being excessive payment / cost is disallowed.

(c) So, Profits attributable to the PE are only ₹1.5 Crores relating to activity of commissioning, hook up and installation of the platform in Bombay High, which is being conducted / supervised from the Office in India.

(d) The profits of ₹ 2 Crores relating to the fabrication work of the platform is not taxable in India, because the completed structure is to be supplied from Korea. Such profits are not attributed to the PE, because the work of fabrication was completed in Korea prior to coming into existence of the PE connection in India. However, Income there from is subject to ALP.

(b)(i) Mobeaux LLP of Poland and Vamsi Ltd of India are Associated Enterprises. Vamsi imports 1000 compressors for Air Conditioners from Mobeaux at ₹ 7,500 per unit and these are sold to Winland Cooling Solutions Ltd at ₹11,000 per unit Vamsi had also imported similar products from De-Heat Ltd and sold outside at a Gross Profit of 20% on Sales.

Mobeaux offered a Quantity Discount of ₹ 1,500 per unit. De-Heat could offer only ₹ 500 per unit as Quantity Discount. The Freight and Customs Duty paid for imports from Poland had cost Vamsi ₹ 1,200 a piece. In respect of purchase from De-Heat, Vamsi had to pay ₹ 200 only as Freight Charges.

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

Solution:

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

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

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

Particulars	₹
Price at which actually bought from Mobeaux LLP of Poland Less: Arms Length Price per unit under Resale Price Method	7,500 (6,800)
Decrease in Purchase Price per Unit	700
No. of Units purchased from Mobeaux	1,000
Therefore, increase in Total Income of Vamsi (1,000 Units × ₹ 700)	**₹ 7,00,000**

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

Solution:

1. Associated Enterprises: Two Enterprises shall be deemed to be associated enterprises, if, at any time during the Previous Year, one Enterprise holds, directly or indirectly, shares carrying not less than 26% of shares/voting power in other enterprise. Hence, EF Ltd. and EF Inc. are Associated Enterprises.

2. Transaction Value:

(a) The Transaction Value shall be determined on the basis of Arm's Length Price (ALP) under Uncontrolled Transaction in case of transactions between Associated Enterprises.

(b) However, ALP is not applicable if the computation of Income / Expense / Interest u/s 92(1) or determination of Cost or Expense allocated or apportioned or contributed u/s 92(2), has the effect of - (i) reducing the Income chargeable to tax, or (ii) increasing the Loss, computed on the basis of entries made in the Books of Account.

3. Determination of ALP:

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

4. Conclusion:

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

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

(c)(i) VKS International Ltd, the Assessee, has sold goods on 12.01.2015 to L Ltd. located in a Notified Jurisdictional Area (NJA), for ₹ 10.5 Crores. The sale price of identical goods sold to an unfamiliar customer in New York during the year was ₹ 11.5 Crores. While the second sale was on CIF basis, the sale to L Ltd was on F.O.B. basis. Ocean Freight and Insurance amount to ₹ 20 Lakhs.

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

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

Solution:

1. Computation of Arm's Length Price of Products sold to L Ltd by VKS International Ltd.

Particulars	₹ Crores	₹ Crores
Price in a Comparable Uncontrolled Transaction		11.5
Less: Adjustment for Differences -		
(a) Freight and Insurance Charges	(0.20)	
(b) After-Sales Support services	(0.14)	(0.34)
Arm's Length Price Sales to L Ltd.		11.16

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

Particulars	₹ Crores
Arm's Length Price as above	11.16
Less: Price at which actually sold to L Ltd	10.50
Therefore, increase in Total Income of VKS International Ltd.	0.66

Note:

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

(ii) Speedy Motors Ltd, an Indian Company, declared Income of ₹20 Crores computed in accordance with Chapter IV-D but before making any adjustments in respect of the following transactions for the year ended on 31.03.2015:

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

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

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

Briefly explain the provisions of the Act affecting all these transactions and compute Taxable Income of Speedy Motors Ltd for A.Y.2015-2016 assuming that the value of 1$ and of 1 EURO was ₹ 42 and ₹ 67, respectively, throughout the year. [5]

Solution:

1. Analysis:

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

2. Computation of total Income

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

Particulars		₹ in Crores	₹ in Crores
Income as computed under Chapter IVD (before adjustments)			20.00
Add: Adjustments for International transactions			
• Excess Payment of Royalty of $ 5,00,000	($ 5,00,000 × ₹ 42)	2.10	
• Excess Interest Paid on Loan of EURO 5 Crores	(€67 × 5 Crores × 2 ÷100)	6.70	
• Difference in Price of Van @ $100 each for 7,000 Vans	($100 × 7,000 × ₹ 42)	2.94	11.74
Taxable Profits and Gains from Business or Profession			31.74