Paper 7 - Direct Taxation

Full Marks – 100 **Time – 3 Hours**

Section A

(Question No. 1 is COMPULSORY and any FOUR from Question Nos. – 2 to 6]

1.

(a) Rinku left India for the first time on 28th December, 2005. During the financial year 2012-13 she came to India once on 27th September for a period of 45 days. Determine her residential status for the assessment year 2013-14.

Answer:

As Rinku does not satisfy any of the basic conditions laid down in Section 6 of the Income Tax Act, 1961, she is a non-resident for the assessment year 2013-14.

(b) Determine the amount of taxable pension if Amit receives a monthly pension of ₹50,000 from the Government.

Answer:

The uncommuted monthly payment of pension received from the Government will be fully taxable.

(c) An asset, used for scientific research purposes, purchased on 01.06.2009 at a cost of ₹8,00,000. It was sold on 31.08.2012 for ₹9,00,000 – State the tax implications.

Answer:

₹8,00,000, incurred to acquire scientific research asset, will be allowed as deduction in A.Y. 2010-11. The asset is sold for ₹9,00,000 on 31.08.2012. The original deduction of ₹8,00,000 will be charged as business income and excess over the cost ₹1,00,000 will be chargeable as capital gain in A.Y. 2013-14.

(d) X Ltd. paid Excise Duty for the previous year 2012-13 on 07.10.2013. In which assessment year, will it be allowed?

Answer:

X Ltd. paid tax after the due date for filling return of income, deduction will be allowed only in the year of actual payment i.e. previous year 2013-14 relevant to assessment year 2014-15.

(e) What will be the residential status of Luft Ltd. an Indian company managed from Berlin?

Answer:

As Luft Ltd. is an Indian company, it will always be Resident in India even if it is managed from Berlin i.e. outside India.

(f) Aloke took a loan of ₹25 lakhs on 31.12.2012 from Bonbon Ltd., in which he is a shareholder having substantial interest. The Company was having free reserves of ₹30 lakhs. The Assessing Officer wants to consider the amount as deemed divided. Is the contention of the Assessing Officer valid?

Answer:

In the given case, entire loan amount of ₹25 lakhs will be deemed to be dividend in the hands of Aloke u/s 2(22)(e), as he has substantial interest in the company and the company has free reserve of ₹30 lakhs.

(g) During the previous year 2012-13, Nirmal earned ₹2,01,000 which includes ₹1,000 received by his son (aged 12 years) as an interest on 31.12.2012. Calculate the taxable income of Nirmal.

Answer:

Exemption u/s 10(32) is equal to actual income included in the hands of parent or ₹1,500, whichever is less. Hence, Exemption available to u/s 10 (32) will be ₹1,000 only and Taxable Income of Nirmal is ₹2,00,000.

(h) State whether air conditioner, not used as stock in trade, is a capital asset.

Answer:

Air conditioner, for personal use, is included in the term personal effects and hence, not a capital asset.

(i) Who has the authority to appoint Commissioner of Income Tax (Appeals)?

Answer:

Central Government has the authority to appoint Commissioner of Income Tax (Appeals).

(j) What will be the first previous year for Asha, who started her business on 19th March, 2013?

Answer:

The first previous year for Asha, who started her business on 19th March, 2013, will be 2012-13.

(k) What will be the GAV, if the reasonable lettable value a house property is ₹60,000 but the actual rent of the property is ₹4,000 per month?

Answer:

Annual value in this case is the reasonable lettable value i.e. ₹60,000 being higher than the actual rent of ₹48,000.

(l) Chabi borrowed ₹20,00,000 on 01.04.2004 to repair a house used for own residence. She paid ₹2,00,000 as interest on that amount on 31.01.2013. Find out the interest deductible u/s 24 for the assessment year 2013-14.

Answer:

As the amount is borrowed for repairing the house property used for residential purposes, the interest deductible u/s 24 for the assessment year 2013-14 will be restricted to ₹30,000 only.

(m) A company wants to file its return of income for the assessment year 2013-14 manually. Can it do so? If not, then in which mode it can file its return of income?

Answer:
The company cannot file its return of income manually. It has to file its return of income electronically.

[13×1]

2.
(a) Samir furnishes the following information regarding his income for the previous year 2012-13. He asks you to determine his taxable income and unabsorbed depreciation

Particulars	**₹**
Business Income (before depreciation)	**20,00,000**
Depreciation allowable as per Income Tax Act	**29,00,000**
Income from other sources	**8,00,000**

Answer:
Statement showing determination of Taxable Income and Unabsorbed Depreciation of Samir for the assessment year 2013-14 relating to the previous year 2012-13

Particulars	**₹**
Business Income (before depreciation)	20,00,000
Less: Depreciation to the extent of profits	20,00,000
[A]	NIL
Income from other sources	8,00,000
Less: Unabsorbed Depreciation for the current year [₹29,00,000 – ₹20,00,000] already absorbed under business head limited to the extent of income available	8,00,000
[B]	NIL
Taxable Income [A+B]	**NIL**
Balance to be carried forward to next year as Unabsorbed Depreciation	**1,00,000**

(b) Sri Ltd. owns two machines, Machine A and Machine B in a block. Depreciated value of the block on 1st April, 2010 is ₹3,38,000. He purchased Machine C for ₹1,00,000 on 23rd October, 2010. It transferred Machine C to Fatima for ₹1,20,000 on 31.10.2012. Fair market value of Machine C as on the date of transfer was ₹65,500. From 01.11.2012, Fatima gave Machine C on lease to Sri Ltd. at a rent of ₹2,500 per month. Find out the "actual cost" for the purpose of computing depreciation in the hands of Fatima?

Answer:

Particulars	**₹**
Cost of acquisition Machine C on 23rd October, 2010	1,00,000
Less: Depreciation for the previous year 2010-11 (1,00,000 × 15% × 50%)	7,500
Written Down Value on 1st April, 2011	92,500
Less: Depreciation for the previous year 2011-12 (92,500 × 15%)	13,875
Written Down Value on 1st April, 2012	78,625

"Actual Cost" of Machine C in the hands of Fatima will be ₹78,625.

Note: Rate of depreciation is assumed to be @ 15% on WDV.

(c) Discuss the taxability of cash gifts of ₹30,000 received by Mr. Roy during the previous year 2012-13 from each of the following:
(i) by his neighbour;
(ii) by employer;
(iii) by one of his patients;

(iv) by his sister on the occasion of his daughter's marriage; and
(v) in contemplation of death.

Answer:
(i) Gift from neighbour (being not relative) will be fully taxable as income from other sources.
(ii) Gift from employer will be fully taxed as income from salaries.
(iii) Gift from one of his patients will also be fully taxable as professional income.
(iv) Gift from his sister will be fully exempt since it is on the occasion of marriage.
(v) Gift in contemplation of death will be fully exempt.

[4+4+5]

3.
(a) Sunil (38 years), a resident individual, incurs the following expenditure during the previous year 2012-13:

Particulars	Actual Expenditure	Amount reimbursed by	
		Insurance Company	Employer
Medical treatment of Sunil in a Government hospital	**30,000**	**10,000**	**10,000**
Medical treatment of his wife, Suman in a hospital recognized by Chief Commissioner	**15,000**	**5,000**	**7,000**

In the above two cases, diseases are specified in the rules made by the Board.
During the previous year 2012-13, Sunil earned ₹4,50,000 as his salary income. Find out the net income of Sunil for the assessment year 2013-14.

Answer:

Particulars	₹
Salary received	4,50,000
Perquisite in respect of medical treatment of Sunil and his wife, Suman	Nil
Gross Salary	4,50,000
Lee: Standard Deduction	Nil
Income from Salary	4,50,000
Other Income	Nil
Gross Total Income	4,50,000
Less: Deduction under Chapter VIA	
Section 80DDB (As per Note)	8,000
Net Income	**4,42,000**

Note:
The amount deductible is as follows:
Actual Expenditure (i.e. ₹30,000 + ₹15,000); or
₹40,000 (not being a senior citizen),
Whichever is less.
₹40,000 is deductible if nothing is recovered from the insurance company or employer. From the amount deductible (i.e. ₹40,000 in this case), the amount received from insurance company as well as employer shall be deducted. Therefore, ₹40,000 – ₹15,000 – ₹17,000 i.e. ₹8,000 is deductible.

(b) SD Ltd., a company providing telecommunication service, obtained a telecom licence on 01.04.2010 for a period of 10 years at a cost of ₹15,00,000. It transferred the licence on 28th December, 2012 for (i) ₹8,00,000 and (ii) ₹15,70,000. Compute the amount chargeable to tax for both the situations separately.

Answer:

Particulars	₹
Cost of licence which was paid 01.04.2010	15,00,000
Less: Amount written off during the previous years 2010-11 and 2011-12	3,00,000
Written down value of telecom licence on 1st April, 2012	12,00,000

Statement showing the computation of amount chargeable to tax in case of transfer of telecom licence

Particulars	Sale Consideration	
	₹8,00,000	**₹15,70,000**
	₹	₹
Sale Proceeds	8,00,000	15,70,000
Less: Written down value on 1st April, 2012	12,00,000	12,00,000
Surplus / (Deficit)	(4,00,000)	3,70,000
Amount deductible during the previous year 2012-13 u/s 35ABB(2)	4,00,000	—
Business Income	—	3,00,000
Sale Proceeds	8,00,000	15,70,000
Less: Cost of acquisition	15,00,000	15,00,000
Short Term Capital Gains	(7,00,000)	70,000

Note:

I. Amount chargeable to tax during the previous year 2012-13 as notional business income, it cannot exceed the amount of deduction claimed in earlier years u/s 35ABB.

II. In case, the telecom licence is sold at ₹8,00,000, SD Ltd. can claim short term capital loss of ₹7,00,000, apart from claiming deduction u/s 35ABB of ₹4,00,000.

(c) Romit, an individual, has personal income of ₹6,00,000 for the previous year 2012-13. He is also a member of a Hindu Undivided Family, which has an income of ₹3,00,000 for the previous year 2012-13. Out of the income of the family, Romit got ₹1,00,000, as his share in the income of the family. Show the status of the income from taxability point of view.

Answer:

Romit is liable to pay tax only on his personal income of ₹6,00,000. His share of ₹1,00,000 from HUF is exempt in the hands of Romit under section 10(2) irrespective of the fact whether the family is chargeable to tax or not. The HUF is liable to tax in respect of its income of ₹3,00,000.

[5+6+2]

4.

(a) W Ltd., an Indian company, owns an industrial undertaking which started production during 2011-12. On 31st March, 2012, it has 90 workmen out of which 10 are casual workmen. On 1st June, 2012, the company appointed 20 regular workmen at a monthly wages of ₹3,000 per month per worker. Find out the amount of deduction u/s 80JJAA for the assessment year 2013-14.

Answer:

W Ltd. owns an existing industrial undertaking. 30% of wages payable to newly appointed "regular workmen" in excess of initial 100 workmen would be the amount of deduction u/s 80JJAA. No deduction is, however, available if number of newly appointed regular workmen is lower than 10% of the strength of workmen as on the last day of the preceding year. In this case, the company has 90 workmen on 31st March, 2012. 10% of it comes to 9. In other words, deduction u/s 80JJAA is not available if number of newly appointed "regular workmen" is 8 or less than 8. In this case, the company has appointed 20 regular workmen during the previous year 2012-13. Therefore, deduction is available u/s 80JJAA. However, no deduction is available in respect of wages payable to initial 100 workmen.

90 workmen as on 1st April, 2012	No deduction u/s 80JJAA
10 regular workmen appointed on 1st June, 2012	No deduction u/s 80JJAA
10 regular workmen appointed on 1st June, 2012	Deduction would be available u/s 80JJAA

Therefore, the amount of deduction u/s 80JJAA is ₹90,000 [30% (₹3,000 × 10 months × 10 regular workmen)]. Besides, wages payable to all workmen would be deductible u/s 37(1).

(b) State whether the following transactions can be considered as transfer:

(i) A house transferred by way of will to stepson

(ii) Bonus shares given by a company to its shareholders

(iii) Giving the right to use the asset

(iv) A piece of land transferred by a holding company to its subsidiary company in which the holding company holds 90% of the total shares of the subsidiary company

(v) Giving away jewellery for a piece of land

(vi) Getting money in lieu of shop in a shopping complex

(vii) A building is transferred under a scheme of amalgamation

Answer:

(i) Any transfer by will is not transfer. Hence, the transfer of the house property by way of will to stepson will not be considered transfer as per section 47(iii).

(ii) Issue of Bonus share is not transfer. Hence, Bonus shares given by a company to its shareholders will not be considered transfer.

(iii) Giving the right to use the asset is not a transfer as asset since, it is only hired.

(iv) In the given case, the land has been transferred by a holding company to its subsidiary company in which the holding company holds 90% of the total shares of the subsidiary company. Since, the subsidiary company is not a 100% subsidiary, it does not satisfy the conditions of section 47(iv) and hence, it is a transfer.

(v) Exchange of jewellery with land is transfer of both.

(vi) In the given case, money being consideration of shop, hence it is considered as a transfer.

(vii) A building is transferred under a scheme of amalgamation will not be considered as a transfer as per section 47(vi).

[6 + (7×1)]

5.

(a) Abhi (35 years), a salaried employee, drawing a salary of ₹6,00,000 during the previous year 2012-13. During the year he contributes ₹60,000 towards public provident fund. The information is submitted by Abhi in respect of Loss incurred from let out house property of ₹15,000 to his employer, Aditya Ltd.

You are required to calculate amount of tax to be deducted by Aditya Ltd.

Answer:

Statement showing computation of the amount of tax to be deducted by Aditya Ltd. during the previous year 2012-13

Particulars	₹
Salary	6,00,000
Income from house property	(15,000)
Gross Total Income	5,85,000
Less: Deduction under Chapter VI-A	
Under Section 80C – contribution towards Public Provident Fund	60,000
Total Income	5,25,000
Tax on Total Income	35,000
Add: Education cess and SHEC @3%	1,050
Tax Payable	36,050
Tax Deducted by Aditya Ltd.	**36,050**

(b) Raju, his wife and two sons are employed independently. Raju and his wife are not senior citizens. During the previous year 2012-13, Raju paid mediclaim insurance of ₹5,000 for self, ₹4,000 for his wife, ₹3,000 each for both of his sons and ₹14,000 for each of his parents who are senior citizens. Calculate the amount of deduction allowable u/s 80D.

Answer:

Amount of deduction u/s 80D

Particulars	₹
Premium in respect of wife	4,000
Premium for himself	5,000
Premium in respect of children (not dependent)	Nil
Total [₹9,000 or ₹15,000 whichever is lower]	9,000
Add : Premium in respect of parents (senior citizens) ₹28,000 restricted to maximum of ₹20,000	20,000
Deduction available u/s 80D	**29,000**

(c) Neel is engaged in the manufacturing business. He incurred a loss of ₹1,50,000 during the previous year 2012-13. Is he required to file return of income? Justify your answer.

Answer:

Neel is required to file his return of income u/s 139(3) for the assessment year 2013-14 within due date without which he cannot carry forward the loss to the next assessment years for claiming deduction.

(d) Discuss the powers of Income Tax Authorities to disclose information.

Answer:

The information received or obtained by the Income Tax Authority in performance of functions under this Act, may be furnished by the Board or any designated Income Tax Authority by a specific or general order.

Following are the person to whom information has to be furnished:

(i) Any officer, authority or body performing functions under law relating to the imposition of any tax, duty or cess or to dealings in foreign exchange.

(ii) Any officer, authority or body performing functions under any law, notified by the Central Government in public interest.

Chief Commissioner, Director General, Additional Commissioner, Additional Director, Joint Commissioner and Joint Director are the designated officers.

Procedure for disclosure of information is as follows:

(i) The prescribed authority can file an application to Chief Commissioner or Commissioner in prescribed Form No. 46.
(ii) If the Income Tax Authority is satisfied that in public interest such information has to be furnished to the applicant, then he may furnish such information in Form No. 47.
(iii) The decision made by the Chief Commissioner or Commissioner shall be final.

Disclosure of particulars by public servants in contravention of above provisions shall attract imprisonment up to 6 months and fine u/s 280(1). Proceedings shall be initiated with the approval of Central Government.

(e) The power of rectification of assessment order is discretionary. Discuss the correctness.

Answer:

Any mistake apparent on record, whether it is a mistake of fact or law, and not disputable one, should be rectified provided all other conditions prescribed u/s 154 are satisfied. Hence, rectification of assessment order is mandatory and not discretionary.

[3+3+1+4+2]

6.

(a) Z Ltd. (a foreign company), A (a resident individual) and B (a resident individual) are three members of an AOP sharing profit in the ratio of 5:2:3. Personal incomes of A and B are ₹20,000 and ₹10,000 respectively. However, Z Ltd. has no other personal income. Taxable income of the AOP for the assessment year 2013-14 is ₹2,00,000 which includes Long Term Capital Gains of ₹50,000. Calculate amount of tax payable by the AOP, if it applies maximum marginal rate.

Answer:

Particulars	Amount of Income	Shares of partnes		
		Z Ltd.	A	B
	₹	₹	₹	₹
Long Term Capital Gains	50,000	25,000	10,000	15,000
Other Income	1,50,000	75,000	30,000	45,000

In this case, ₹75,000 (being shares in other income pertaining to Z Ltd.) is chargeable to tax at a rate higher than 30.90%. Consequently tax liability of the AOP will be determined as under:

Particulars	₹
Tax on ₹75,000 (41.2% of ₹75,000)	30,900
Tax on Long Term Capital Gains (20.60% of ₹50,000)	10,300
Tax on balance income [30.90% of ₹(2,00,000 – 75,000 – 50,000)]	23,175
Total Tax Payable	**64,375**

(b) Gurmit sold an agricultural land for ₹70,00,000 on 1st July, 2012, which was purchased by him on 28th March, 1998 for ₹6,90,000. On 15th July, 2012, he purchased another agricultural land for ₹5,00,000 and he deposited ₹4,00,000 in the Deposit Account on 30th July, 2012. Determine the taxable amount of Capital Gains.

Answer:

Statement showing computation of Taxable amount of Capital Gains for the assessment year 2013-14

Particulars	₹	₹
Sale proceeds		70,00,000
Less: Indexed cost of acquisition (i.e. ₹6,90,000 × 852 ÷ 331)		17,76,073
Capital Gains		52,23,927
Less: Exemption u/s 54B		
Cost of acquiring agricultural land	5,00,000	
Amount deposited in the Deposit Account	4,00,000	9,00,000
Long Term Capital Gains		43,23,927

Note: Gurmit can utilise the amount deposited in Deposit Account for acquiring agricultural land at any time before 1st July, 2014. The amount not utilised before that date will be chargeable to tax as Long Term Capital Gains for the assessment year 2015-16.

(c) R is employed by S Ltd., a garment manufacturing company, at a salary of ₹30,000 per month. Besides, he has been provided the following perquisites-

(i) Mobile telephone expenses incurred by S Ltd. ₹6,000 p.a. approximately.

(ii) Rent free house owned by S Ltd. in Delhi.

(iii) Club facility on which S Ltd. incurred ₹12,000 during the previous year 2012-13. R paid ₹500 per month for availing the club facility to S Ltd.

Calculate his taxable income.

Answer:

Particulars	₹
Salary [₹30,000 × 12 months]	3,60,000
Add: Value of perquisites-	
Mobile telephone expenses (Not a perquisite)	Nil
Rent free house (15% of Salary)	54,000
Club facility [₹12,000 – (₹500 × 12)]	6,000
Taxable Income from Salary	**4,20,000**

[5+5+3]

Section B

(Answer ALL the Questions)

7.

(a) Do you consider motor boats, used in fishing business, as an asset u/s 2(ea)?

Answer:

Motor boats, used in fishing business, are not asset u/s 2(ea) of the Wealth Tax Act, as it is used for commercial purposes.

(b) Som gifted a house property to his wife on 01.03.2012. They entered into an agreement to live apart on 05.06.2012. In whose hands the property will be assessed to Wealth Tax in A.Y. 2013-14?

Answer:

Since, Som transferred the house property, without any consideration, not for an agreement to live apart, the house property will be assessed to Wealth Tax in A.Y. 2013-14 in the hands of Som.

[1+1]

8.

(a)

(i) Mr. Sinha has following assets and liabilities on 31.03.2013

Particulars	₹
Gold Bars	**10,00,000**
Share on Indian companies	**15,00,000**
Residential house at Agra	**19,00,000**
Residential house at Delhi	**45,00,000**
Commercial building used for own business	**1,20,00,000**
Jewellery	**10,00,000**
Boat	**6,00,000**
Car for personal use	**8,00,000**
Bank Deposits	**10,00,000**
Cash in Hand	**4,50,000**
Loan taken to purchase Gold Bars	**3,00,000**
Loan taken to purchase house at Agra	**9,00,000**
Loan taken to purchase house at Delhi	**21,00,000**
Loan taken to purchase Boat	**3,00,000**
Loan taken to purchase Jewellery	**5,00,000**

Calculate the amount of wealth tax payable by him for the assessment year 2013-14.

Answer:

Assessee: Wise Ltd. **Valuation Date: 31.03.2013** **Assessment Year: 2013-14**

Computation of Taxable Wealth

Nature of asset	₹	Reason
Gold Bars	10,00,000	Asset u/s 2(ea)
Share on Indian companies	Nil	Not an asset u/s 2(ea)
Residential house at Agra	19,00,000	Asset u/s 2(ea)
Residential house at Delhi	Nil	One residential property is exempted
Commercial building used for own business	Nil	Not an asset u/s 2(ea)
Jewellery	10,00,000	Asset u/s 2(ea)
Boat	6,00,000	Asset u/s 2(ea) [Assumed not used for business purpose]
Car for personal use	8,00,000	Asset u/s 2(ea)
Bank Deposits	Nil	Not an asset u/s 2(ea)
Cash in Hand	4,00,000	Asset in excess of ₹50,000
Total Assets	**57,00,000**	
Less: Debt incurred in relation to assets:		
Loan taken to purchase Gold Bars	3,00,000	
Loan taken to purchase house at Agra	9,00,000	
Loan taken to purchase Boat	3,00,000	

Loan taken to purchase Jewellery	5,00,000	
Taxable Net Wealth	**37,00,000**	
Less: Basic Exemption Taxable	30,00,000	
Net Wealth	7,00,000	
Tax Payable @1%	7,000	

(ii) Jubin made a cash gift of ₹5,00,000 to his wife, Sania. Sania bought jewellery with that money. The value of such jewellery as on 31.03.2013 was ₹12,00,000. What would be the implication of this in the net wealth computation of Jubin for the assessment year 2013-14?

Answer:

In case the original asset transferred is converted in another asset, the value of the converted asset on the valuation date shall be clubbed in the hands of the transferor.
Therefore, the value of the jewellery of ₹12,00,000 shall be chargeable to Wealth Tax in the hands of Jubin for the assessment year 2013-14.

[6+2]

or

(b)

(i) State the persons for whom the Wealth Tax Act is not applicable or are exempted?

Answer:

The Wealth Tax Act is not applicable to the following persons:

I. Company registered u/s 25 of the Companies Act, 1956
II. Any Co-operative Society
III. Any Social Club
IV. Any Political Party
V. Any Mutual Fund u/s 10(23D) of IT Act

In addition to above, an association for promoting cricket, registered under Trusts Act, Societies Registration Act and entitled for exemption u/s 10(23), is exempt from wealth tax u/s 5 of the Wealth Tax Act.

(ii) Sunrise Real Estate Limited, a widely held company, owns the following assets as on 31.03.2013 -

(A) Two office flats at Delhi purchased in the year 2008 for resale	**1,25,00,000**
(B) Land at Kolkata purchased in 2010 on which a residential complex consisting of 28 flats, to be sold on ownership basis, is under construction for last 15 months	**3,05,00,000**
(C) Shares of different companies	**10,00,000**
(D) Cash at construction site	**5,50,000**
(E) Residential flat in occupation of the company's whole-time director drawing a salary of ₹4,90,000 p.a.	**15,00,000**

Calculate the net wealth of Sunrise Real Estate Limited.

Answer:

Assessee: Shalini **Valuation Date: 31.03.2013** **Assessment Year: 2013-14**

Computation of Taxable Wealth

Nature of asset	₹	Reason
Two office flats at Delhi purchased in the year 2008 for resale	—	House property held as stock in trade – not an asset u/s 2(ea)
Land at Kolkata purchased in 2010 on which a residential complex consisting of 28 flats, to be sold on ownership basis, is under construction for last 15 months	—	Urban land held as stock in trade for a period less than 10 years – not an asset u/s 2(ea)
Shares of different companies	—	Shares of different companies – not an asset u/s 2(ea)
Cash at construction site	—	Any amount recorded in the books of account is not an asset u/s 2(ea)
Residential flat in occupation of the company's whole-time director drawing a salary of ₹4,90,000 p.a.	—	Gross Annual Salary of Whole Time Director is less than ₹10 Lakhs p.a. – not an asset u/s 2(ea).
Total	**Nil**	

[3+5]

Section C
(Answer ALL the Questions)

9.

(a) Following is one of the method for determination of Arm's Length Price-
(A) Net Transactional Margin Method
(B) Transactional Split Margin Method
(C) Transactional Net Margin Method
(D) Comparable Transactional Margin Method

Answer: (C) Transactional Net Margin Method

(b) Rule that define the most appropriate method is-
(A) 10D
(B) 10E
(C) 10C
(D) 10F

Answer: (C) 10C

(c) Prescribed documents, in relation to International Transactions, shall be kept and maintained from the end of the relevant assessment year for a period of –
(A) 7 years
(B) 8 years
(C) 9 years
(D) 10 years

Answer: (B) 8 years

(d) The rules in which the Income Tax Authorities shall accept the transfer price declared by the assessee is called-
(A) Safe Harbour Rules
(B) Safe and Secure Rules
(C) Safety Measure Rules
(D) Safety Rules

Answer: (A) Safe Harbour Rules

(e) In case of failure to file report in Form No. 3CEB before due date, penalty will be levied of-
(A) ₹15,000
(B) ₹25,000
(C) ₹50,000
(D) ₹1,00,000

Answer: (D) ₹1,00,000

[5×1]

10.
(a)
(i) When is an uncontrolled transaction comparable to an International Transaction?

Answer:
The comparability of an international transaction with an uncontrolled transaction shall be judged with reference to the following –

I. Specific characteristics of the property transferred or services provided in either transaction,
II. Functions performed, taking into account assets employed and risks assumed by the respective parties,
III. Contractual terms of the transactions which lay down the manner of division of responsibilities, risks and benefits between the parties thereto, and
IV. Market conditions including geographical location, size of the markets, regulations and laws of the Government, costs of labour and capital in the markets, overall economic development, level of competition and whether the markets are wholesale or retail.

An uncontrolled transaction shall be comparable to an international transaction if -

I. None of the differences, if any, between the transactions being compared, or between the enterprises entering into such transactions are likely to materially affect the price or cost charged or paid in or the profit arising from such transactions in the open market, or
II. Reasonably accurate adjustments can be made to eliminate the material effects of such differences.

Time period of data compared:

I. The uncontrolled transaction and international transaction should pertain to the same financial year.
II. Data relating to the prior two years could be used, if such data reveals facts which could have an influence on the determination of transfer prices in relation to the transactions being compared.

(ii) How do you determine Arm's Length Price under Resale Price Method?

Answer:

Resale Price Method is applied when a property purchased or service obtained from an associated enterprise is resold to an unrelated enterprise. This method is suitable in cases where goods are resold within a short period of purchased and influenced of other factors is found to be minimal.

Arm's Length Price under Resale Price Method can be determined using the following steps:

Step I: Identify the price at which property purchased or service obtained by the enterprise from an associated enterprise is resold or are provided to an **unrelated enterprise.**

Step II: Reduce the normal GP margin accruing to the enterprise or to an unrelated enterprise from the purchase and resale of the same or similar property or from obtaining and providing the same or similar services, in a comparable uncontrolled transaction(s).

Step III: Reduce expenses incurred by the enterprise in connection with the purchase of property or obtaining of services.

Step IV: Adjust for functional and other differences, including differences in accounting practices, if any, between the international transaction and the comparable uncontrolled transactions, or between the enterprises entering into such transactions, which could materially affect the amount of gross profit margin in the open market.

Step V: Arm's Length Price = Step I **Less** Step II & III **Add / Less** Step IV.

(iii) Briefly describe the conditions that are needed to be satisfied for the applicability of the Arm's Length Price in the International Transactions.

Answer:

The conditions that are needed to be satisfied for the applicability of the Arm's Length Price in the International Transactions are as follows:

(1) **Two or more enterprises:** International transaction is subjected to the Arm's Length Price only in case of transaction between two entities.

(2) **Enterprises should be regarded as associated enterprises:** The provisions regarding taxation of international transaction apply if the two enterprises are associated enterprises.

(3) **International transaction should be carried out by the associated enterprises:** An international transaction should be carried out by the associated enterprises. To constitute an international transaction, it should be:

   I. A transaction between two or more associated enterprises (either or both are non-residents) in nature of purchase, sale or lease of intangible property, or provision of services, or lending or borrowing money.

   II. A transaction between two or more associated enterprises (either or both are non-residents) having bearing on the profits, income, losses or assets of such associated enterprises.

   III. Mutual agreement or arrangement between two or more associated enterprises for allocation or apportionment of; or contributing to, any cost or expense incurred (or to be incurred) regarding a benefit, service or facility provided (or to be provided) to any one or more of such associated enterprise.

(iv) List the duties of an assessee in respect of International Transactions.

Answer:

(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 Arm's Length Price:** Description of the methods considered for determining the Arm's Length Price 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 Arm's Length Price:** Record of the actual working carried out for determining the Arm's Length Price, 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 Arm's Length Price.
12. **Adjustments:** Details of the adjustments, if any, made to transfer price to align them with arm's length prices 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 Arm's Length Price.

(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 data base 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.

[4+5+3+8]

or

(b)

(i) A Ltd., an Indian company, engaged in the business of developing and manufacturing industrial components. Its subsidiary, B Ltd., a US company supplies technical information and offers technical support to A Ltd. for developing goods, for a consideration of $50,000 p.a. If B Ltd. normally charges $75,000 p.a. for the same and the income of A Ltd. is ₹85,00,000 after deducting the payment made to B Ltd., calculate taxable income of A Ltd.

Answer:

Price charged for Comparable Uncontrolled Transaction is $75,000

Particulars	Amount
Price actually paid by A Ltd.	$50,000
Less: Price charged Normally	$75,000
Decremental Profit on adopting Arm's Length Price	$25,000
Total Income before adjusting for differences due to Arm's Length Price	₹85,00,000
Add: Difference on Account of adopting Arm's Length Price	Nil
Total Income of A Ltd.	₹85,00,000

Note: Section 92(3) provides that taxable income cannot be reduced on applying Arm's Length Price. So, difference on account of Arm's Length Price is ignored.

(ii) What do you mean by the term "Deemed ALP"?

Answer:
If the variation between the Arm's Length Price and the price at which the international transaction has been undertaken does not exceed the notified % of the actual price, then the actual price at which the international transaction has been undertaken shall be deemed to be Arm's Length Price.

(iii) Explain the computation of Arm's Length Price using Comparable Uncontrolled Price Method.

Answer:
Comparable Uncontrolled Price Method is applied when a price is charged for a product or service. This is essentially comparison of prices charged for the property or services transferred in a controlled transaction to a price charged for a property or services transferred in a comparable uncontrolled transaction. The bedrock of this method is the identification of an identical transaction, in a situation where a price charged for products or services between unrelated parties. While applying comparable uncontrolled price, the comparability between controlled and uncontrolled transaction should not be only judged from the point of product comparability; but should also take into consideration, the effect on price of other broader business functions. Even minor differences in contractual terms could affect the amount charged in an uncontrolled transaction.

Arm's Length Price can be determined using Comparable Uncontrolled Price Method in the following steps:

Step I: Identify the price charged/ paid for property transferred or services provided in a **comparable uncontrolled transaction(s)**.

Step II: Adjust the price derived in Step I above **for differences**, if any, which could materially affect the price in the open market:

A. between the international transaction and the comparable uncontrolled transactions, or
B. between the enterprises entering into such transactions.

Step III: Arm's Length Price = Step I **Add/Less**: Step II

(iv) Briefly explain the procedure for determination of Arm's Length Price by the Assessing Officer.

Answer:
92C(3) provides that during the course of any proceeding for the assessment of income, on the basis of material / information / document in his possession, the Assessing Officer may determine the Arm's Length Price (ALP) on the basis of the available material / information / document, if he is of the opinion that -

I. the **price** charged or paid in an international transaction has **not been determined** as per the prescribed manner,
II. any **information and document** relating to an international transaction **have not been kept and maintained** by the assessee in the prescribed manner as per Sec. 92D(1),
III. the **information** or data used in computation of the arm's length price is **not reliable or correct,**
IV. the **assessee has failed to furnish, within the specified time,** any information or

document which he was required to furnish by a notice issued u/s 92D(3).

However, before such determination, the Assessing Officer should give the assessee, an opportunity of being heard. This should be done by giving him a show cause notice, specifying the date and time of hearing.

When the ALP is determined by the Assessing Officer -

I. Total Income of the assessee shall be computed on the basis of such determined ALP.
II. **No deduction** shall be allowed **u/s 10A/10B/10AA or under Chapter VIA** on the enhanced income.
III. **Income of another associated enterprise** to whom payments are made after TDS, shall **not be recomputed** on the basis of the revised ALP determined by the Assessing Officer.
IV. **Penalty provisions** relating to non-compliance are also **applicable.**

The Assessing Officer shall accept the Arm's Length Price determined by the taxpayer, if such price is up to 5 per cent less or more than the price determined by the Assessing Officer. [Circular No. 12/2001 dated 23.08.2001 251 ITR 15 (Stat.)]. However, Finance Act, 2012 has been reduced this percentage to 3%.

(v) How is income or expenditure on International Transactions computed?

Answer:

Section 92 provides for the computation of income from international transactions - based on Arm's Length Price (ALP).

For all enterprises	For associated enterprises
In case of International Transactions, I. Income arising there from II. Expense or interest allowable there-against shall be computed having regard to the **Arm's Length Price.**	In case of international transactions on the basis of mutual agreement or arrangement for: I. allocation of, or II. apportionment of, or III. contribution to any cost or expense in connection with a benefit, service or facility provided to one or more enterprises, such cost or expense shall be determined based on **Arm's Length Price.**

However, the provisions of Sec. 92 do not apply 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 -

1. Reducing the income chargeable to tax or
2. Increasing the loss, as the case may be,

computed on the basis of entries made in the books of account.

(vi) "Every person, proposing to enter into an Advance Pricing Agreement, shall make a request for pre-filing consultation" – Discuss.

Answer:

Rule 10(H) provides that every person proposing to enter into an Advance Pricing Agreement shall, by an application in writing, make a request for a pre-filing consultation. The request for pre-filing consultation shall be made in Form No. 3CEC to the Director General of Income Tax (International Taxation). On receipt of the request in Form No. 3CEC, the team shall hold pre-filing consultation with the person referred to in

Rule 10G. The competent authority in India or his representative shall be associated in pre-filing consultation involving bilateral or multilateral agreement.

The pre-filing consultation shall, among other things,-

I. determine the scope of the agreement;
II. identify transfer pricing issues;
III. determine the suitability of international transaction for the agreement;
IV. discuss broad terms of the agreement.

However, the pre-filing consultation shall not bind the Board or the person to enter into an agreement or initiate the agreement process.

[4+1+4+4+4+3]