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# Answer to PTP Intermediate Syllabus 2012\_June 2014\_Set 3

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## Paper 7 - Direct Taxation

### Section A

(Question No. 1 is compulsory and any four from Question No. 2 to 6]

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

(i) State the difference between foregoing of salary and surrender of salary?

(ii) Explain the taxability of arrears of rent.

(iii) Myriad Enterprises Ltd. incurs ₹1,00,000 towards promoting family planning amongst its employees, in the previous year 2013-14. State the quantum of deduction allowable under Section 36(1)(ix) of the Income Tax Act, 1961, in the current year and the number of years, in which such deduction is allowable,

(iv) State the head of income, under which the salary payable to a Member of Parliament, is chargeable to tax under the provisions of the Income Tax Act, 1961?

(v) How is the period of holding calculated, in case of transfer of a security by a depository (i.e a demat account)?

(vi) State the taxability of advance salary and advance against salary?

(vii) An individual, who is an Indian resident, may hold two different citizenships simultaneously. Explain, whether the determination of residential status of an individual in India, is affected by citizenship of an individual?

(viii) Distinguish between Tax Deducted at Source and Tax Collected at source.

[1x8]

(b) Choose the correct alternative:

(i) Vinod Mehta, an Indian resident, is provided with furnished accommodation from February, 2014, by his employer. The value of furniture amounts to ₹95,000. The actual hire charges paid by his employer, for the furniture is ₹6,000 p.a. The value of furniture to be included along with value of unfurnished house for A.Y 2014-15 is:

(a) ₹6,000

(b) ₹9,500

(c) ₹19,000

(d) ₹1,000

(ii) Somlata, an Indian resident, received ₹1,00,000 in December 2013 towards recovery of unrealized rent, which was deducted from actual rent during previous year 2012-13. The amount taxable under Section 25AA of the Income Tax Act, 1961 would be:

(a) ₹1,00,000

(b) ₹70,000

(c) ₹60,000

(d) ₹90,000

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- (iii) The W.D.V of a block (plant and machinery, rate of depreciation 15%) as on 01.04.2013 is ₹6,40,000. A machinery costing ₹1,00,000 was acquired on 10.08.2013, but put to use on 10.11.2013. During February 2014, part of this block was sold for ₹4,00,000. The depreciation for A.Y 2014-15 would be-
- (a) ₹51,000
  - (b) ₹42,250
  - (c) ₹43,500
  - (d) ₹1,11,000
- (iv) Mr. Deepak Sharma (aged 66 years), an Indian resident, paid medical insurance premium of ₹ 19,000 by cheque and ₹1,000 by cash during June 2013 under a Medical Insurance Scheme of the General Insurance Corporation. The above sum was paid for insurance of his own health. He would be entitled to a deduction under Section 80D of a sum of-
- (a) ₹20,000
  - (b) ₹19,000
  - (c) ₹15,000
  - (d) ₹22,000
- (v) Abhinav (aged 40 years), has to file a return of income, if gross total income is in excess of-
- (a) ₹ 1,50,000
  - (b) ₹ 2,00,000
  - (c) ₹ 1,60,000
  - (d) ₹1,80,000

[1x5]

### Solution:

#### (1) (a)

- (i) Waiver by an employee of his salary is "**foregoing of salary**". Once salary accrues, subsequent waiver shall not absolve him from liability to income tax.

If any employee surrenders his salary to the Central Government under the Voluntary Surrender of Salaries (Exemption from Taxation) Act, 1961, the salary so surrendered, would not be included in computing his taxable income, irrespective of the nature of the organisation, in which the assessee is employed.

- (ii) Section 25B of the Income Tax Act, 1961 provides that the amount received by way of arrears of rent (in respect of property, buildings or land appurtenant thereto, of which the assessee is a owner) shall be taxable under the head "Income from House Property", as the income of the previous year in which such income is received. 30% of such amount received, shall be allowed as deduction from such income.

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- (iii) Under Section 36(1)(ix) of the Income Tax Act, 1961 Myriad Enterprises Ltd. can avail a deduction of ₹20,000 in the current year. Deduction for the balance amount of expenditure on promoting family planning amongst its employees, can be availed by the assessee-company for the succeeding 4 years.
- (iv) The salary payable to a Member of Parliament is chargeable to tax under the head "Income from other Sources", as per the provisions of the Income Tax Act, 1961.
- (v) The period of holding shall be computed from the date on which the securities were credited to the demat account and will end with the date of transfer (sale). The first-in-first-out (FIFO) method will be adopted for determining the period of holding.
- (vi) Advance salary is taxable when it is received by the employee, whether such advance salary is due or not. If the rate of tax, at which the advance salary is taxed, is higher than the rate of tax to which the assessee is normally assessed, then, relief under Section 89 can be granted to the assessee.

Advance against Salary is different from advance salary. It is generally adjusted against his salary over a specified time period. It cannot be taxed as salary.

- (vii) An Indian national may or may not be resident in India. Similarly, a foreign national may be resident in India. Citizenship and residential status are two different concepts. Citizenship of an individual, does not affect the determination of the residential status of an individual. Section 6 of the Income Tax Act, 1961 lays down the test for determining the residential status of an individual. Residential status is determined based on the number of days, an individual actually stays in India during the previous year.
- (viii) Tax deduction at source (TDS) means any tax which has been deducted at source by the payer at the time of accrual or payment to the payee. Tax is largely deducted on expense and not supply of goods.

Tax Collected at Source is effected by the seller from the buyer at the time of debiting the amount to the account of the buyer or at the time of receipt of amount, whichever is earlier.

(b)

(i) (d) ₹1,000

**REASON:** While computing the value of perquisite of rent-free furnished accommodation, provided by the employer, the value of furniture shall be the actual hire charges payable (whether paid or payable), if furniture is hired by the employer.

Value of furniture, to be included in the value of rent-free furnished accommodation  
= ₹6,000 × 2/12 = ₹1,000

(ii) (a) ₹1,00,000

**REASON:** Section 25AA of the Income Tax Act, 1961 provides that, the receipt of unrealized rent of an earlier year, in the current year, shall be deemed to

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be income chargeable under the head "Income from House property", in the year of its receipt.

(iii) (c) ₹43,500

**REASON:**

**Computation of depreciation to be charged for the A.Y 2014-15**

Particulars	Amount (₹)
W.D.V of a block (plant and machinery), as on 01.04.2013	6,40,000
Less: Sale of part of block	4,00,000
	2,40,000
New machine acquired on 10.08.2013	1,00,000
<b>Depreciation on block of assets:</b>	
(i) On ₹ 2,40,000 @ 15% = ₹ 36,000	
(ii) On ₹ 1,00,000 @ 15% × ½ = ₹ 7,500	
	43,500

(iv) (b) ₹ 19,000

**REASON:** Section 80D of the Income Tax Act, 1961 allows a deduction of ₹20,000 to a senior citizen (whether resident/ non-resident or Indian citizen/ foreign citizen), on account of payment of medical insurance premium, provided that, such payment is made by any mode other than cash, and such payment is out of the income chargeable to tax.

In the given case, the assessee- Mr. Deepak Sharma, being a senior citizen, is eligible for claiming deduction under Section 80D of the Income tax act, 1961, of an amount up to ₹ 20,000. However, the assessee has paid part of the medical insurance premium in cash (₹1,000). To the extent, such premium has been paid in cash, the expenditure shall stand disallowed. Mr. Deepak Sharma shall be entitled to claim a deduction under Section 80D of a sum of ₹ 19,000.

(v) (b) ₹ 2,00,000

**REASON:** If non-agricultural income of an individual/ HUF is equal to or less than the exemption limit, then he may not submit his return of income.

(2)

(a) Mr. Rakesh Kumar, an Indian resident individual, is employed in a PSU. He furnishes the following particulars for the previous year 2013-14:

Particulars	Amount (₹)
(i) Salary income for the year	17,25,000
(ii) Salary, pertaining to the financial year 2009-10, received during the previous year 2013-14	80,000
(iii) Assessed income for the financial year 2009-10	2,40,000

Compute the relief available to the assessee under Section 89 of the Income Tax Act, 1961 and the tax liability for the assessment year 2014-15.

The rates of income tax for the assessment year 2010-11 are:

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	Tax Rate (%)
On first ₹1,60,000	Nil
On ₹1,60,000 - ₹3,00,000	10
On ₹3,00,000 - ₹5,00,000	20
Above ₹5,00,000	30
Education Cess	3

(b) Explain briefly the applicability of Section 22 for chargeability of income tax for:

- (i) House Property situated in foreign country
- (ii) House Property with disputed ownership

(c) When is a deduction under Section 35D of the Income Tax Act, 1961 allowed?

[7+4+2]

Solution:

(a) Computation of relief under Section 89 of Mr. Richard Brown for the A.Y 2014-15

Particulars	₹	₹
<b>Assessment Year 2014-15</b>		
Salary Income for the year excluding arrears		17,25,000
Add: Arrears for the financial year 2009-10		80,000
<b>Gross Salary (including arrears)</b>		<b>18,05,000</b>
<b>Computation of tax on ₹ 18,05,000</b>		
On first ₹2,00,000- Nil	Nil	
On next ₹3,00,000- 10%	30,000	
On next ₹5,00,000- 20%	1,00,000	
On balance ₹8,05,000- 30%	2,41,500	<b>3,71,500</b>
<b>Add: Education Cess @ 2%</b>	7430	
<b>Add: Senior and Higher Education Cess@1%</b>	3715	<b>11,145</b>
<b>(A) Tax on total income including arrears</b>		<b>3,82,645</b>
<b>Gross Salary excluding arrears</b>	17,25,000	
<b>Computation of tax on ₹ 17,25,000</b>		
On first ₹2,00,000- Nil	Nil	
On next ₹3,00,000- 10%	30,000	
On next ₹5,00,000- 20%	1,00,000	
On balance ₹7,25,000- 30%	2,17,500	
	3,47,500	
Education Cess @2%	6,950	
SHEC@ 1%	3,475	
<b>(B) Tax on total income excluding arrears</b>		<b>3,57,925</b>
<b>(C) Difference between (A) and (B)</b>		<b>24,720</b>

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Total Income assessed	2,40,000	
Add: Arrears relating to the financial year 2009-10	80,000	
	3,20,000	<b>3,20,000</b>
<b>Computation of tax for A.Y 2010-11</b>		
<b>(D) Tax on Total Income (including arrears)</b>		
On first ₹1,60,000- Nil	Nil	
On next ₹1,40,000- 10%	14,000	
On balance ₹ 20,000- 20%	4,000	
	18,000	
Education Cess @ 3%	540	<b>18,540</b>
<b>(E) Tax on Total Income (excluding arrears)</b>		
On first ₹1,60,000- Nil		
On balance ₹ 80,000- 10%	8,000	
Education Cess @ 3%	240	<b>8,240</b>
<b>(F) Difference between (D) and (E)</b>		<b>10,300</b>
<b>(G) Relief available under Section 89</b>		
<b>[Difference between (C) and (F)]</b>		<b>14,420</b>

(b) Applicability of Section 22 for chargeability of income tax for:

1. **House property in a foreign country-** A resident assessee is taxable under section 22 in respect of annual value of a property situated in a foreign country. A resident but not ordinarily resident or non-resident is taxable in respect of income of such property situated abroad, if income is received in India during the Previous Year.

If tax incidence is attracted under section 22 in respect of a house property situated abroad, annual value will be computed as if the property is situated in India, as held in the decision of the Madras High Court in *CIT vs. R. Venugopala Reddiar* [1965] 58 ITR 439.

2. **Disputed ownership-** If title of ownership of a house property is under dispute in a court of law, the decision as to who is the owner rests with the Income-tax Department. The assessment cannot be held up for such dispute. Generally, a person who receives the income or who enjoys the possession of the house property as owner, though his claim is under dispute, is assessable to tax under section 22.

(c) The deduction is allowed under **Section 35D** of the Income Tax act, 1961, only in case of an Indian company or a person (other than company) resident in India. The deduction is in respect of the expenditure incurred after 31.3.1970 and expenditure may be of the type which was incurred —

- (i) before the commencement of the business, or
- (ii) after the commencement of his business, in connection with the extension of existing industrial unit.

Deduction of qualified amount is allowed in 5 equal installments beginning with the Previous Year in which the business is commenced.

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(3)

- (a) Fortune Enterprises Ltd. is running two industrial undertakings. Unit A is located in Special Economic Zone (SEZ) and Unit B is located in a Domestic Tariff Area [DTA]. The details pertaining to the previous year 2013-14, are as follows:

Particulars	₹ (in lacs)	
	Unit A	Unit B
Domestic Turnover	25	250
Export Turnover	300	Nil
Gross Profit	50	25
Less: Expenses and depreciation	17.50	12.50
Profits derived from the unit	32.50	12.50
The brought forward business loss pertaining to Unit B is ₹ 5 Lacs.		

- (b) Compute the business income of the assessee for the A.Y 2014-15, assuming that the financial year 2013-14 falls within the first 5 year period commencing from the year of production of articles by Unit A.
- (c) Define the term 'substantial interest'. State the situations in which the term assumes importance.
- (d) The book profits of Star Heights Ltd., for the previous year 2013-14 computed in accordance with Section 115JB is ₹ 37.50 Lakhs. If the total income computed for the same period as per the provisions of the Income Tax Act, 1961 is ₹ 7.50 Lakhs, compute the tax payable by the company in the Assessment Year 2014-15. Is Star Heights Ltd. eligible for any tax credit? If so, for how many years, shall Star Heights Ltd. avail such tax credit?

[5+5+3]

**Solution:**

(a)

**Computation of business income of Fortune Enterprises Ltd. for the A.Y 2014-15**

Particulars	₹ (in lacs)
Aggregate of profits earned from the two units	75
<b>Less:</b> Exemption under Section 10AA [NOTE 1]	30
	<b>45</b>
<b>Less:</b> Brought forward business loss	5
<b>TOTAL BUSINESS INCOME</b>	<b>40</b>

**Working Note:**

**Computation of exemption under Section 10AA in respect of the Unit A located in SEZ**

Particulars	₹ (in lacs)
Domestic Turnover of Unit S	25
Export Turnover of Unit S	300
Total Turnover of Unit S	325

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Profit derived from Unit A	32.50
<b>Exemption under Section 10AA</b>	
$\text{Profit of Unit A} \times \frac{\text{Export Turnover of Unit A}}{\text{Total Turnover of Unit A}}$	
$= 32.50 \text{ Lacs} \times \frac{300 \text{ Lacs}}{325 \text{ Lacs}}$	<b>30</b>

(b) Section 2(32) of the Income Tax Act, 1961 defines the term substantial interest as follows:

“Person who has a substantial interest in the company,

(i) in relation to a company, means a person who is the beneficial owner of shares, not being shares entitled to a fixed rate of dividend whether with or without a right to participate in profits, carrying not less than twenty per cent of the voting power.

(ii) In the case of a non-corporate entity, a person can be said to have substantial interest if 20% or more share of profit is held.”

In the following situations, the term ‘substantial interest’ assumes importance:

(i) Taxability of deemed dividend under Section 2(22)(e).

(ii) Disallowance of excessive or unreasonable expenditure under Section 40A(2) to an individual who has a substantial interest in the business or profession of the assessee, and

(iii) Clubbing of salary income of spouse, under Section 64(1)(ii) in respect of remuneration received by spouse from a concern in which the individual has a substantial interest.

(c)

**Computation of tax payable in the Assessment Year 2014-15 by Star Heights Ltd.**

Particulars	Amount (₹)
(A) Tax on total income computed in accordance with the provisions of the Income tax act, 1961	
= ₹7.50 Lakhs × 30%	2,25,000
(B) Income tax @ 18.5% of the book profits	
= ₹37.50 Lakhs × 18.5%	6,93,750
Since, the tax payable on book profits exceed the tax payable on total income computed in accordance with the provisions of the Income Tax act, 1961, therefore Star Heights Ltd. is liable to pay Minimum Alternate Tax.	
Tax payable on book profit	6,93,750
Add: Surcharge	Nil
Add: Education Cess @ 2%	13,875



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Add: Senior and higher Education Cess @ 1%	6937.50
<b>(C) TAX PAYABLE IN THE ASSESSMENT YEAR 2014-15</b>	<b>7,14,562.50</b>
<b>(D) TAX CREDIT AVAILABLE TO THE COMPANY [(A)- (B)]</b>	<b>4,68,750</b>
<p style="margin-left: 40px;">Tax credit shall be available to Star Heights Ltd. for ten succeeding assessment years for set-off against the tax payable on total income during such period. If the credit is not so set off, it shall lapse.</p>	

(4)

- (a) Sanjay, an Indian resident (aged 45 years), owned a residential house in Indore. It was acquired by Sanjay, on 15.10.1986 for ₹7,00,000. It was sold for ₹ 70,00,000 on 09.11.2013. The State Stamp Valuation Authority fixed the value of property to be at ₹75,00,000. The assessee paid 2% of the sale consideration as brokerage for the sale of the said property.

Sanjay acquired a residential house in Mumbai on 15.12.2013 for ₹15,00,000 and deposited ₹4,00,000 on 10.04.2014 in the capital gain bond of Rural Electrification Corporation Ltd. (RECL). He deposited ₹5,55,000 on 10.07.2014 in the Capital Gain Deposit Scheme in a nationalized bank for construction of additional floor on the residential house property acquired in Mumbai.

Compute:

- i. the capital gain chargeable to tax in the hands of Mr. Sanjay for the assessment year 2014-15.
- ii. the income tax payable by Mr. Sanjay, assuming that there is no other source of income chargeable to tax.

Cost inflation Index: Financial year 1986-87= 140, Financial Year 2013-14= 939

- (b) Briefly discuss the tax treatment of Limited Liability Partnership under the Income Tax Act, 1961.
- (c) Compute the total income of Mr. Virendra Pratap, for the Assessment Year 2014-15, assuming that he is:
- (i) Resident and ordinarily resident
  - (ii) Resident but not ordinarily resident
  - (iii) Non-resident

The following particulars pertain to the Previous Year 2013-14:

Particulars	₹
1. Short-term capital gain on sale of shares in Indian Company, received in United Kingdom	20,000
2. Dividend from a German company received in Germany	15,000
3. Rent from a property in Jordan, received in the Bank of Jordan, was remitted to India, through approved banking channels	80,000

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4. Dividend from Pure Ltd., an Indian company	4,000
5. Agricultural income from land in Haryana	30,000

[5+3+5]

**Solution:**

**(a) Computation of capital gains in the hands of Mr. Sanjay for the A.Y 2014-15**

Particulars	₹	₹
Deemed Sale consideration (under Section 50C)		75,00,000
Less: Brokerage @ 2% of ₹70,00,000		1,40,000
<b>Net Sale Consideration</b>		<b>73,60,000</b>
<b>Less: Indexed Cost of Acquisition</b> (₹ 7,00,000 × 939/140)		<b>46,95,000</b>
<b>Long Term Capital Gain on sale of property situated in Indore</b>		<b>26,65,000</b>
<b>Less:</b>		
<b>Exemption under Section 54 in respect of –</b>		
(i) Residential house acquired in Mumbai on 15.12.2013	15,00,000	
(ii) Amount deposited in Capital Gains Deposit Scheme on 10.07.2014 (before the due date of filing return)	5,55,000	
	20,55,000	
<b>Less:</b>		
<b>Deduction under Section 54EC</b>		
Amount deposited in RECL Bonds on 10.04.2014 (within six months from the date of transfer)	4,00,000	
		<b>24,55,000</b>
<b>Long Term Capital Gain</b>		<b>2,10,000</b>

**Computation of tax liability of Mr. Sanjay for A.Y 2014-15**

Particulars	Amount (₹)
Tax on ₹ 10,000 @ 20% (Long term capital gain of ₹ 2,10,000 as reduced by basic exemption limit of ₹2,00,000)	2,000
Less: Rebate under Section 87A	2,000
<b>Total tax liability</b>	<b>Nil</b>

- (b)** The tax treatment of the Limited Liability Partnerships (LLPs), as contained in the provisions of the Income Tax Act, 1961 are discussed in the following points:
- (i)** The taxation scheme of the LLPs, in the Income Tax Act, 1961, is on the same lines, as applicable for partnerships. Accordingly, tax liability would be attracted in the hands of the LLP and tax exemption would be available to the partners.
- (ii)** The rate of income-tax applicable to the LLPs is 30% of the total income.

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- (iii) The provisions of Section 40(b) requiring payment of remuneration only to working partner, in accordance with the terms of the partnership deed for a period commencing on or after the date of the partnership deed, shall be applicable to LLPs as well.
- (iv) Expenditure in relation to interest, in excess of 12% per annum and salary exceeding the prescribed percentage of book profit, shall stand disallowed.
- (v) Presumptive Tax Scheme u/s 44AD is not applicable to LLP.
- (vi) Unlike a company, LLP is not subject to Minimum Alternate Tax (MAT), Dividend Distribution Tax (DDT) and Wealth Tax.

(c)

**Computation of total income**  
**Assessee : Mr. Virendra Pratap**

Assessment Year: 2014-15	Previous Year: 2013-14		
Particulars	Resident and ordinarily resident	Resident but not ordinarily resident	Non-resident
1. Short-term capital gain on sale of shares in Indian Company, received in United Kingdom	20,000	20,000	20,000
2. Dividend from a German company received in Germany	15,000	---	---
3. Rent from a property in Jordan, received in the Bank of Jordan, was remitted to India, through approved banking channels [NOTE 1]	56,000	---	---
4. Dividend from Pure Ltd., an Indian company [NOTE 2]	---	---	---
5. Agricultural income from land in Haryana [NOTE 3]	---	---	---
<b>TOTAL INCOME</b>	<b>91,000</b>	<b>20,000</b>	<b>20,000</b>

**NOTE:**

1. Assuming that the rent collected is the gross annual value of the property, a deduction of 30% under Section 24 of the Income Tax Act, is made.

Rent received (assumed as gross annual value)	₹ 80,000
Less: Deduction under Section 24 (30% of ₹ 80,000)	₹ 24,000
Income from house property	₹ 56,000

2. Dividend from Indian company is exempt under Section 10(34).
3. Agricultural income is exempt under Section 10(1).

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(5)

- (a) Dr. Mrityunjay Dwivedi, a resident individual, (aged 55 years) is a medical practitioner. The details relating to the previous year 2013-14, as contained in the Receipts and Payments Account, has been furnished as follows:

### Receipts and Payments Account

Dr.			Cr.
Receipts	Amount (₹)	Payments	Amount (₹)
To balance b/f	1,00,000	By commercial vehicle A/c [Commercial Vehicle purchased before 01-10- 2013]	6,00,000
To sale of medicines A/c	5,00,000	By Drawings A/c	3,00,000
To Consultation Fees A/c	1,00,000	By Surgical equipments A/c [Surgical equipments purchased before 01-10- 2013]	1,00,000
To Fees received on visit A/c	4,00,000	By Loan A/c [Installment paid including interest of ₹44,666]	2,42,000
To Honorarium A/c	50,000	By Medical Insurance Premium A/c	32,000
To Family Pension A/c	2,80,000	By Housing loan A/c [Installment paid including principal component of ₹96,000]	2,16,000
To Interest received on Savings Bank Account A/c	10,000	By Advance Tax A/c	40,000
To Lottery Winnings A/c (net after deduction of TDS @ 30%)	50,000	By purchase of medicines A/c	55,000
To Agricultural Income A/c	1,00,000	By payment for medical journal A/c	15,000
To Share of income from HUF A/c	1,50,000	By Vehicle expenses A/c	45,000
To Loan from bank A/c	3,00,000	By Bank Deposit A/c [Bank deposit done in bank for 5 years]	2,00,000
		By Balance c/f	1,95,000
	20,40,000		20,40,000

Other relevant information is as under:

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1. The self-occupied property of Mr. Dwivedi was constructed in 1998, with a loan from LIC Housing of ₹10,00,000 out of which ₹6,00,000 was still due. The assessee made an arrangement of refinancing from SBI on 01-04-2013 at the rate of 10%. One-fourth of the portion of the house is used for purposes of running clinical establishment.
2. She invested in term deposit of ₹2,00,000 in Bank of Baroda on 01-07-2013 for a period of 5 years in the name of his minor daughter at 10% per annum.
3. The commercial vehicle was purchased on 01-07-2013 for ₹6,00,000, It was partly financed by a loan of ₹3,00,000. One-fourth use of the vehicle is estimated to be for personal purposes.
4. Medical Insurance Premium of ₹16,000 was paid by the assessee for himself and ₹16,000 was paid for the dependent mother, aged 74 years (who is an Indian resident).
5. The share from HUF's income amounted to ₹50,000.

Compute the total income of Mr. Mritunjay Dwivedi, ignoring depreciation on building, for the A.Y 2014-15.

- (b) Ramchandran doing textiles business furnishes you the following information:  
Total turnover for the financial year:

	₹
2012 -2013	1,10,00,000
2013 – 2014	92,00,000

State whether the provisions of tax deduction at source are attracted for the following expenses incurred during the previous year 2013 – 2014:

	₹
Interest on term loan paid to Indian bank	95,000
Advertisement expenses to Sita (two individual payments of ₹30,000 and ₹40,000)	70,000
Factory rent paid to Alok	1,90,000
Brokerage paid to Balaram, a sub – broker	8,000

[10+3]

Solution:

- (a) Computation of total income  
Assessee: Mr. Mritunjay Dwivedi

	Previous Year: 2013-14			
Assessment Year: 2014-15	₹	₹	₹	₹
<b>Income from house property:</b>				
Annual value of self-occupied house		Nil		
Less: Interest on loan [₹45,000, being 3/4 <sup>th</sup> of ₹60,000] (Restricted to ₹30,000)		(30,000)	(30,000)	

## Answer to PTP Intermediate Syllabus 2012\_June 2014\_Set 3

<b>Income from profession:</b>				
Sale of medicine	5,00,000			
Consultation fees	1,00,000			
Visiting fee	4,00,000			
Total income		10,00,000		
<b>Less: Expenses</b>				
Medicine purchased	55,000			
Medical journal	15,000			
Vehicle expenses (3/4 <sup>th</sup> )	33,750			
Interest on Loan (3/4 <sup>th</sup> )	33,500			
Interest on housing loan (1/4 <sup>th</sup> )	15,000			
<b>Depreciation</b>				
Surgical instrument (15% of ₹1,00,000)	15,000			
Vehicle (3/4 <sup>th</sup> of 15% of ₹6,00,000)	67,500			
<b>Total expenses</b>		2,34,750		
			7,65,250	
<b>Income from other sources</b>				
Family Pension	2,80,000			
Less: Deduction under section 57(iia)				
33 $\frac{1}{3}$ % or ₹15,000, which is lower	15,000	2,65,000		
Honorarium			50,000	
Saving bank interest			10,000	
Interest on bank FD in the name of minor daughter [₹2,00,000 x 10% x 9/12]	15,000			
Less: Exempt under section 10(32)	1,500	13,500		
Winning from lottery			50,000	
			3,88,500	
<b>Gross total Income</b>				
				11,23,750
Less: Deductions under Chapter VI – A				
<b>Under section 80C</b>				
Repayment of housing loan (96,000 x $\frac{3}{4}$ )			72,000	
<b>Under section 80D</b>				
Medical Insurance Premium				
Own (allowed to the extent of ₹ 15,000)		15,000		
Mother (Senior Citizen, hence fully allowed since Premium is less than ₹20,000)		16,000		
		31,000	31,000	
<b>Under section 80TTA</b>				
Interest on deposit in a saving account of bank			10,000	113,000
Total deduction				
<b>Total income</b>				<b>10,10,750</b>

### Notes:

1. Since the residential house was constructed before 01.04.1999, the deduction for interest is restricted to ₹30,000.
2. Since  $\frac{1}{4}$  th portion of house is used for business purposes, therefore,  $\frac{1}{4}$  th share of interest paid is deductible while computing business income.

## **Answer to PTP Intermediate Syllabus 2012\_June 2014\_Set 3**

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3. Agricultural income is exempt under section 10(1) and share of income from HUF is exempt under section 10(2).
4. Term deposit of ₹2,00,000 in the name of minor daughter does not qualify for deduction under section 80C. However, principal repayment of housing loan (3/4<sup>th</sup>) would qualify for deduction under section 80C. Therefore the deduction under section 80C would be ₹72,000 (i.e. 3/4<sup>th</sup> of ₹96,000).
5. Depreciation @ 15% has been provided on surgical instruments. It is also possible to assume that the surgical instruments mentioned in the question are life- saving medical equipment (for example, surgical laser) and therefore, eligible for depreciation @ 40%.

**(b)** Since the turnover of Mr. Ramchandran for F.Y.2012-13, i.e., ₹110 lakhs, has exceeded the monetary limit of ₹100 lakhs prescribed under section 44AB, he has to comply with the tax deduction provisions during the financial year 2013-14, subject to, however, the exemptions provided for under the relevant sections for applicability of TDS provisions.

**(i) Interest paid on term loan to Indian Bank**

TDS under section 194A is not attracted in respect of interest paid to a banking company.

**(ii) Advertisement expenses to Sita (two individual payments of ₹30,000 and ₹40,000)**

Under section 194C, the provisions for tax deduction at source would not be attracted if the amount paid to a contractor does not exceed ₹30,000 in a single payment or ₹ 75,000 in the aggregate during the financial year. Therefore, provisions for deduction of tax at source under section 194C are not attracted in respect of payment of ₹30,000 to Sita.

However, payment of ₹40,000 to Sita would attract TDS@1% under section 194C, since it exceeds ₹30,000.

**Note** - The tax to be deducted would be ₹ 400, being 1% of ₹40,000.

**(iii) Factory rent of ₹ 1,90,000 paid to Alok**

Tax has to be deducted under section 194-I as the rental payment exceeds ₹1,80,000.

**Note**- The tax to be deducted is ₹19,000, being 10% of ₹1,90,000.

**(iv) Brokerage of ₹8,000 paid to Balaram, a sub-broker**

Tax has to be deducted @10% under section 194-H as the brokerage exceeds ₹ 5,000 during the F.Y. 2013-14.

**Note** - The tax to be deducted is ₹800, being 10% of ₹ 8,000.

**(6)**

**(a) Mr. John, (aged 68 years) is an Indian resident, who has a Gross Total Income of ₹5,36,480 . This includes long term capital gain of ₹90,000 and short-term capital gain of ₹16,000. The Gross Total Income also includes interest income of ₹24,000 from savings bank deposits with banks. The assessee has invested ₹1,20,000 in PPF and also paid a medical insurance premium of ₹15,000. ₹18,000 was contributed to Public Charitable Trust, eligible for deduction**

## Answer to PTP Intermediate Syllabus 2012\_June 2014\_Set 3

under Section 80G by way of an account payee cheque. Compute the total income and tax thereon, of Mr. John, for the Assessment Year 2014-15.

(b) Mr. Satish submits the following details of his income for the assessment year 2014-15:

Particulars	₹
Income from salary	6,00,000
Loss from house property	(80,000)
Income from sugar business	1,00,000
Loss from iron ore business (b/f)(discontinued in 2007-08)	(2,40,000)
Short term capital loss	(1,20,000)
Long term capital gain	80,000
Dividend	10,000
Lottery Winnings	1,00,000
Winnings from card games	12,000
Agricultural Income	40,000
Long term capital Gain on sale of shares	20,000
Short term Capital Loss under Section 111A	20,000
Bank Interest	10,000

Calculate gross total income and losses to be carried forward for the A.Y 2014-15.

[6+7]

Solution:

(a) **Computation of total income and tax liability**  
Assessee: Mr. Satish

Assessment Year: 2014-15

Previous Year: 2013-14

Particulars	₹	₹
Gross Total Income including long term capital gain		5,36,480
Less: Long Term Capital gain		90,000
		<b>4,46,480</b>
<b>Less: Deductions under Chapter VI-A</b>		
<b>Under Section 80C:</b> PPF Deposit	1,00,000	
<b>Under Section 80D:</b> Medical Insurance premium (it is assumed that, the premium is paid by otherwise than by cash)	15,000	
<b>Under Section 80G: [Note 1 &amp; Note 2]</b>	9,000	
<b>Under Section 80TTA: [Note 3]</b>	10,000	<b>1,34,000</b>
<b>Total income (excluding long term capital gains)</b>		<b>3,12,480</b>
<b>Total income (including long term capital gains)</b>		<b>4,02,480</b>
<b>Tax on total income (including long term capital gains of ₹90,000)</b>		
20% of ₹90,000	18,000	
Tax on balance ₹3,12,480		
Upto ₹2,00,000 - Nil		
Next ₹1,12,480 @ 10% - ₹11,248	11,248	<b>29,248</b>
<b>Add: Education Cess @2%</b>	584.96	
<b>Add: Senior and Higher Education cess @1%</b>	292.48	<b>877.44</b>
<b>TAX PAYABLE ON TOTAL INCOME</b>		<b>30,125.44</b>



## Answer to PTP Intermediate Syllabus 2012\_June 2014\_Set 3

**NOTE:**

**1. Computation of deduction under Section 80G**

Particulars	₹
Gross Total income (excluding long term capital gains)	4,46,480
<b>Less: Deductions under Section 80C, 80D and 80TTA</b>	1,25,000
	3,21,480
10% of the above	32,148
Contribution made	18,000
Lower of the two eligible for deduction under Section 80G	18,000
Deduction under Section 80G- 50% of ₹18,000	9,000

2. Deduction under Section 80G is allowed only if amount is paid by any mode other than cash, in case of amount exceeding ₹10,000. Therefore the contribution made to public charitable trust is eligible for deduction since it is made by way of an account payee cheque.
3. Deduction of up to ₹ 10,000 under Section 80TTA is allowed, inter alia to an individual assessee, if the gross total income includes interest income from deposits in a saving account with bank.

**(b) Computation of Gross Total Income of Mr. Satish for the A.Y 2014-15**

Particulars	₹	₹
<b>Salaries:</b>		
Income from salary	6,00,000	
<b>Income from house property</b>		5,20,000
Loss from house property	(80,000)	
<b>Profits and Gains of Business of profession:</b>		
Income from sugar business	1,00,000	
Less: Brought forward loss from iron ore business	(2,40,000)	---
<b>Balance business loss of ₹1,40,000 carried forward to A.Y 2015-16</b>		
<b>Capital Gains</b>		
Long term capital gain	80,000	
Less: Short term capital loss	(1,20,000)	---
<b>Capital Losses to be carried forward:</b>		
i. Short Term Capital Loss of ₹40,000 to be carried forward		
ii. Short term Capital Loss under Section 111A, of ₹20,000 to be carried forward		
<b>Income from other sources:</b>		
Lottery Winnings	1,00,000	
Winnings from card games	12,000	
Bank Interest	10,000	1,22,000
<b>GROSS TOTAL INCOME</b>		<b>6,42,000</b>
<b>Losses to be carried forward to A.Y 2015-16</b>		
i. Loss of ₹1,40,000 from iron-ore business		

## Answer to PTP Intermediate Syllabus 2012\_June 2014\_Set 3

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ii. Short term Capital Loss of ₹40,000

iii. Short term Capital Loss under Section 111A, of ₹20,000 to be carried forward

### NOTES:

1. Dividend Income is exempt under Section 10(34), assuming that dividend is received from a domestic company.
2. Agricultural Income is exempt under Section 10(1).
3. Long term Capital gain, on which STT is paid is exempt under Section 10(38).
4. It is presumed that, loss from iron-ore business relates to the previous year 2007-08, the year in which the business is discontinued.

### Section B (Answer all the questions)

(7) (a) State whether wealth tax is chargeable in respect of net wealth of the following persons under the Wealth Tax Act, 1957:

- (i) Holder of an impartible estate
- (ii) Association of Persons
- (iii) Partnership firms.

[3 x1]

(b) Examine the taxability of the following assets held on valuation date in the context of provisions in the Wealth Tax Act, 1957.

- (i) A house property owned by Mrs. Sumitra was transferred without consideration to Miss Sita on 12-02-2014. Subsequently, Miss Sita got married to the son of Mrs. Sumitra on 15-03-2014. The value of the house on 31-03-2014 is ₹ 75 Lakhs.
- (ii) Pristine Enterprises has a guest house situated at 40 kilometers from the local limits of Delhi Municipal Corporation.

[2 x1]

**Solution: (a)**

- (i) **Holder of an impartible estate:** Holder of an impartible estate is chargeable to wealth tax. Section 4(6) provides that the holder of an impartible estate is deemed to be the individual owner of all properties, comprised in the estate.
- (ii) **Association of Persons:** Association of Persons is not chargeable to wealth tax. When the shares of the members are determinate or known, then members of an AOP are liable to wealth tax in respect of their share in the property of the AOP.
- (iii) **Partnership firms:** Partnership firms are not chargeable to wealth tax. Wealth Tax is payable by individuals, HUF and companies only. All other persons are not chargeable to wealth

## **Answer to PTP Intermediate Syllabus 2012\_June 2014\_Set 3**

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**(b)**

- (i)** Since, the asset owned by Mrs. Sumitra was transferred to Miss Sita, before the marriage of Miss Sita to the son of Mrs. Sumitra, Miss Sita could not be considered the daughter-in-law of Mrs. Sumitra, at the time of transfer of the said asset. Hence, the property transferred to Miss Sita cannot be clubbed with the net wealth of Mrs. Sumitra, by invoking provisions of Section 4(1)(a). It shall be included in the net wealth of Miss Sita, who can opt to claim exemption under Section 5(vi) in respect of the same.
- (ii)** A guest house, regardless of distance, is always an 'asset', under the Wealth Tax Act, 1957. Hence, the guest house located within 40 Kms from the Delhi Municipal Corporation, shall be taxable as an asset, in the hands of Pristine Enterprises, under the provisions of the Wealth tax Act, 1957

**EITHER**

**(8)(a) Explain the chargeability of wealth tax.**

**(b) Explain, how assessee liable to pay wealth tax can minimize their wealth tax liability?**

**[2 + 3]**

**Solution:**

**(a)** Section 3 of the Wealth Tax Act 1957 is the charging section in respect of Wealth Tax.

Wealth Tax is payable at the rate of one percent on the net wealth exceeding ₹ 30,00,000, on the valuation date. No surcharge or education cess is payable. It is payable by every individual, HUF and company.

According to Section 2(q), "valuation date" is 31st March immediately preceding the assessment year.

**(b)** Assessee liable to pay wealth tax can minimize their wealth tax liability through adoption of the following measures:

- (i)** By avoiding investments in taxable assets like jewellery, motor cars and other unproductive assets.
- (ii)** Where investments in taxable assets cannot be avoided, investment in the said assets could be made out of loans or debts may be incurred in relation thereto, by way of furnishing a security for the loan so that such debts could be claimed as deduction in computing net wealth.
- (iii)** For example, if a company intends to purchase house property, for its use by the Directors/ Managers/ Secretary, as their residential accommodation, or by any other employee having substantial interest in the company, the same can be acquired by raising loans thereon.

**OR**

**(8) A firm consisted of two partners Mukesh & Suresh, having 3:2 profit sharing ratio. Mukesh contributed ₹ 15,00,000 and Suresh contributed ₹ 5,00,000 to the firm's capital. The assets of the firm are as under:**

## Answer to PTP Intermediate Syllabus 2012\_June 2014\_Set 3

- (i) Value of assets located outside India - ₹ 30 lakhs.
- (ii) Value of assets located in India - ₹ 75 lakhs.
- (iii) Debts incurred in relation to assets in India - ₹ 5 lakhs.

Determine the value of interest of the partners in the firm under the Wealth Tax Act 1957.

[5]

Solution:

### Computation of net wealth of the firm

(₹ in lakhs)

Particulars	₹	₹
Value of assets located outside India		30
Value of assets located in India	75	
Less: Debts incurred in relation to assets in India	5	70
Net Wealth of the firm		100

### Value of partner's interest in the assets of the firm

(₹ in lakhs)

Particulars	Mukesh (₹)	Suresh (₹)
Net assets of the firm to the extent of capital contribution by the partners. (Net assets to the extent of ₹ 20 Lakhs to be divided in the proportion of capital contribution of the partners)	15	05
Balance of the net wealth of the firm to be apportioned in the profit sharing ratio of the firm (₹ 80 Lakhs to be apportioned in the ratio of 3:2)	48	32
Value of interest of partners in the net wealth of the firm	63	37

**NOTE-** As per Section 4(1)(b) of the Wealth Tax Act 1957, in computing the net wealth of an assessee, who is a partner in a firm, the value of his interest in the assets of the firm determined in the manner laid down in Schedule III shall be included.

As per rule 16 of Schedule III, the net wealth of the firm on the valuation date shall first be determined as if it were the assessee.

Thereafter, that portion of the net wealth of the firm as is equal to the amount of its capital shall be allocated amongst the partners in the proportion in which capital has been contributed by them.

The remaining portion of net wealth of the firm shall be allocated among the partners in accordance with the agreement of partnership or, in the absence of such agreement the ratio in which the partners are entitled to profits.

### Section C (Answer all the questions)

(9) Answer the following questions:

- (a) State the point of time, when the taxes paid outside India become eligible for claiming tax credit in India?
- (b) Define the term 'tax haven'?

## Answer to PTP Intermediate Syllabus 2012\_June 2014\_Set 3

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- (c) Distinguish between 'international transaction' and 'cross border transaction'?
- (d) State the event in which the Transfer Pricing Officer is referred to in an international transaction?
- (e) When is a foreign company considered to be resident in India?

[1x5]

**Solution:**

- (a) The credit for taxes paid overseas should be allowed in the year in which the foreign taxed income is doubly taxed in India.
- (b) '**Tax Havens**' are countries that employ explicit policies designed to attract international trade oriented activities by minimisation of taxes and reduction or elimination of other restrictions on business operations.
- (c) A transaction between two associated enterprises, at least one of which is a non-resident, shall be considered as an '**international transaction**'.

A transaction is considered as a '**cross-border transaction**', if it originates in one country and gets concluded in another country.

A cross border transaction may or may not be an international transaction, within the meaning of Chapter X. Moreover, a transaction, which is not a cross border transaction, may still be an international transaction, within the meaning of Chapter X.

- (d) Where any person, being the assessee, has entered into an international transaction [or specified domestic transaction] in any previous year, and the Assessing Officer considers it necessary or expedient so to do, he may, with the previous approval of the Commissioner, refer the computation of the arm's length price in relation to the said international transaction [or specified domestic transaction] under section 92C to the Transfer Pricing Officer.
- (e) A foreign company is considered to be resident in India, only if during the relevant previous year, the control and management of its affairs is situated wholly in India.

**EITHER**

- (10) (a) Discuss the tax incentives available to Foreign Institutional Investors (FIIs), under the provisions of Section 115AD of the Income Tax Act, 1961.

- (b) Ms. Jennifer D' Souza, an individual resident Indian, aged 62 years, frequently visits a foreign university to deliver lectures and receives honorarium of ₹ 3,35,000 for the same. Tax of ₹ 33,500 was deducted in the foreign country. India did not have any double taxation avoidance agreement with that foreign country. The particulars of income earned in India are stated as follows:

- (i) In India, her total income amounted to ₹ 10,20,000.
- (ii) Contribution to the Public Provident fund - ₹ 140000.
- (iii) Contribution to the approved Pension Fund of LIC- ₹ 64,000.
- (iv) Contribution to Central Government Health Scheme during the previous year- ₹36000.
- (v) Payment of medical Insurance premium, for mother (who is not dependent on her) - ₹ 21,000.

## Answer to PTP Intermediate Syllabus 2012\_June 2014\_Set 3

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Compute the tax liability of Ms. Jennifer D' Souza for the Assessment Year 2014-15.

- (c) State the conditions to be fulfilled by an assessee for claiming relief in respect of the income arising in those countries with which India does not have any Double Taxation Avoidance Agreement?
- (d) The transfer price adopted for an international transaction of sale of goods by an Indian Company during the financial year 2013-14 is ₹ 35 lakhs, whilst the Arm's Length Price determined using the most appropriate method are ₹ 32 Lakhs and ₹ 42 lakhs. With reference to transfer pricing provisions, discuss whether any adjustment is required. The rate of permissible variation prescribed by the Central Government may be assumed to be, 2% of the transfer price for this class of international transaction.

[5+7+4+4]

OR

- (10) (a) Sterling Machine Works Ltd., an Indian company declared an income of ₹ 450 crores. However, this income was declared before taking into account the following adjustments:
- (i) 25,000 machines were sold to Diamond Industries Ltd at a price, which is lower than the normal transaction price by \$250 per car. Diamond Industries Ltd. holds 35% shares in Sterling Machine Works Ltd.
- (ii) Wellington Ltd. was paid a royalty of \$ 2,40,00,000, for use of its technical know-how. However, another Indian company had paid \$ 2,00,00,000 as royalty to Wellington Ltd. for a similar transaction. Sterling Machine Works Ltd. was completely dependent on the technical knowhow supplied by Wellington Ltd., for the manufacture of the machineries.
- (iii) Beijing Finance Ltd. extended a loan of Euro 850 crores to Sterling Machine Works Ltd., carrying an interest @10% p.a, which was outstanding in the books of Sterling Machine Works Ltd. as on 31.03.2014. Beijing Finance Ltd. had extended a loan of similar amount to another Indian company @ 9% p.a. Total interest paid for the year was Euro 85 crores. The total assets of Sterling Machine Works Ltd. as on 31.03.2014 was ₹ 100,000 crores.

The value of 1\$ and 1 Euro may be taken to be ₹62 and ₹82 respectively.

With reference to the provisions of the Act, analyse the nature of transactions, and determine the income of the company chargeable to tax for the A.Y 2014-15.

- (b) Explain, when shall a transaction entered into with a person other than an associated enterprise be deemed as a transaction between two associated enterprises?
- (c) State the purposes for which the Central Government as per Section 90 of the Income Tax Act, 1961 can enter into an agreement with any foreign country.
- (d) "Multiple year data can be used for determination of Arm's Length Price in an international transaction." Explain.

## Answer to PTP Intermediate Syllabus 2012\_June 2014\_Set 3

(e) Explain the factors to be considered in selection of the most appropriate method in respect of the transfer pricing provisions relating to international transactions.

[6+2+5+2+5]

**Solution:**

(a) Section 115AD specifies special rates of Income Tax to Foreign Institutional Investors (FIIs), in respect of the following incomes. The specified income and the applicable rate of tax has been specified in the following table:

INCOME	APPLICABLE RATE OF TAX
Income (other than dividend covered under Section 115-O) in respect of securities listed in a recognized stock exchange in India (other than units covered under section 115AB)	20%
Any short term capital gain arising on transfer of: (i) securities covered under Section 111A (ii) other securities	15% 30%
Any long term capital gain arising on transfer of such securities	10%

The following exceptions are applicable to the FIIs, for whom special rates have been prescribed under Section 115AD of the Income Tax Act, 1961:

- (i) Deductions under Section 28 to Section 44C and Section 57 are not available to this class of assesseees.
- (ii) The benefit of computing Capital Gain in foreign currency, as provided by the first proviso to Section 48 and the benefit of indexation, as provided by the second proviso to Section 48 are not applicable for this class of assesseees, in respect of long term capital gain.
- (iii) Deductions under Section 80C to Section 80U are not applicable.

(b)

**Computation of tax liability of Ms. Jennifer D' Souza for the Assessment Year 2014-15**

Assessee: Ms. Jennifer D' Souza		Assessment Year: 2014-15		Previous Year: 2013-14	
Particulars				₹	
Indian Income				10,20,000	
Foreign Income				3,35,000	
<b>Gross Total Income</b>				<b>13,55,000</b>	
Less: Deductions					
Deposit in PPF	[Section 80C]	1,40,000			
Contribution to approved Pension Fund of LIC	[Section 80CCC]	64,000			

## Answer to PTP Intermediate Syllabus 2012\_June 2014\_Set 3

	2,04,000	
The aggregate deduction under Sections 80C, 80CCC and 80CCD(1) has to be restricted to ₹1,00,000 <b>[Section 80CCE]</b>	1,00,000	1,00,000
Contribution to Central Government Health Scheme. <b>[Section 80D]</b> (Under Section 80D, the maximum deduction allowed to a senior citizen is ₹20,000)	20,000	20,000
Medical insurance premium paid for mother <b>[Section 80D]</b>	20,000	20,000
<b>GROSS DEDUCTIONS</b>		<b>1,40,000</b>
<b>TOTAL INCOME</b>		<b>12,15,000</b>
<b><u>TAX ON TOTAL INCOME</u></b>		
Income Tax payable	1,34,500	
Education Cess @ 2%	2,690	
Secondary and Higher Education Cess@ 1%	1,345	138,535
<b>Average rate of tax in India</b> [ ₹1,38,535/12,15,000 x 100]		11.41%
<b>Average rate of tax in foreign country</b> [ ₹33,500/3,35,000 x 100]		10%
Rebate under Section 91 shall be limited to the lower of average Indian tax rate or average foreign tax rate		
<b>Hence, rebate under Section 91 shall be = (₹335000 x 10%)</b>		33,500
<b>Tax payable in India (₹ 2, 43,080- ₹ 33500)</b>		2,09,580

(c) The following conditions are required to be fulfilled by an assessee, for claiming relief in respect of income earned in those countries, with which India does not have any Double Taxation Avoidance Agreement:

- (i) The assessee is a resident in India during the relevant previous year.
- (ii) The income accrues or arises to him outside India during that previous year.
- (iii) Such income is not deemed to accrue or arise in India during the previous year.
- (iv) The income in question has been subjected to income tax in the foreign country in the hands of the assessee.
- (v) The assessee has paid such tax in the foreign country.
- (vi) There is no agreement under Section 90 for the relief or avoidance of double taxation between India and the other country where the income has accrued or arisen.

(d) The proviso to Section 92C(2) provides that Arm's Length Price shall be taken to be the arithmetical mean of prices, where more than one price is determined by the most appropriate method.

However, if the arithmetical mean, so determined, is within such percentage of transfer price, as prescribed by the Central Government, then, the transfer price shall be deemed to be the arm's length price and no adjustment is required to be made.



## Answer to PTP Intermediate Syllabus 2012\_June 2014\_Set 3

In the given case, the arithmetical mean of prices is = ₹(32 Lakhs + 42 Lakhs)/2  
= ₹37 Lakhs.

Variation permitted as percentage of transfer price = ₹35 Lakhs x 2% = ₹70,000

The Arithmetic Mean is ₹ 37 Lakhs and the permissible variation is ₹70,000 (2% of the transfer price). Thus, the Arithmetic Mean is not within the prescribed limit of the transfer price.

Hence, the Arm's Length Price shall be ₹ 37 Lakhs.

OR

- (a) The provisions of Chapter X of the Act relate to the determination of the Arm's Length Price , in case of any income arising from an international transaction involving two or more associated enterprises. The term 'Associated Enterprise' has been defined in Section 92A.

With reference to the provisions of Section 92A of the Income Tax Act 1961, the transactions of Sterling Ltd. has been analysed as follows:

Transaction of Sterling Ltd. with	Whether transacting party an associated enterprise or not?	Supporting statutory provision
Diamond Industries Ltd.	Associated Enterprise	As per Section 92A(2)(a), a company holding shares carrying more than 26% of the voting power of another company, shall be deemed to be "Associated Enterprises".
Wellington Ltd.	Associated Enterprise	Wellington Ltd. and Sterling Industries Ltd. have been considered as "Associated Enterprises", by virtue of Section 92A(2)(g).
Beijing Finance Ltd.	Associated Enterprise	Beijing Finance Ltd. and Sterling Industries Ltd. have been considered as "Associated Enterprises", by virtue of Section 92A(2)(c), since this company has financed an amount which is more than 51% of the book value of the total assets of Sterling Ltd.

### Determination of the total income of Sterling Machine Works Ltd. after necessary adjustments

Particulars	Amount (₹ in crores)
Income of Sterling Machine Works Ltd. prior to adjustments	450
Add: Difference arising out of adjustments in the value of international transactions	
(i) Difference in price of machinery supplied to Diamond Industries Ltd. ( 25,000 cars x ₹62 x \$ 250)	38.75

## Answer to PTP Intermediate Syllabus 2012\_June 2014\_Set 3

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(ii) Difference in excess payment of royalty to Wellington Ltd. (\$ 40,00,000 x ₹62)	24.80
(iii) Difference in excess interest paid on loan from Beijing Finance Ltd. (Euro 850 crores x 1/100 x ₹82)	697
<b>TOTAL INCOME</b>	1210.55

(b) Section 92B(2) of the Income Tax act 1961 provides that, a transaction entered into by an enterprise with a person other than associated enterprise shall, be deemed to be a transaction entered into between two associated enterprises, if the following circumstances prevail:

- (i) There exists a prior agreement in relation to the relevant transaction between such other person and the associated enterprise; or
- (ii) The terms of the relevant transaction are determined in substance between such other person and the associated enterprise.

(c) The purposes for which the Central Government can enter into an agreement with the Government of a country outside India or any specified territory outside India have been stated as follows:

- (i) granting of relief in respect of income on which income tax has been paid both in India and in the other country or specified territory; or
- (ii) granting of relief in respect of income tax chargeable under this Act and under the corresponding law in force in that country or specified territory outside India, to promote mutual economic relations, trade and investment.
- (iii) the avoidance of double taxation of income under the Income Tax Act 1961 and under the corresponding law in force in the other country or specified territory;
- (iv) exchange of information for the prevention of evasion or avoidance of income tax chargeable under this act or under the corresponding law in force in that country or specified territory or investigation of cases of such evasion or avoidance;
- (v) recovery of income tax under the Income Tax act, 1961 of India and under the corresponding law in force in the other country, or the specified territory, as the case may be.

(d) Rule 10B of the Income Tax Rules, 1962, has prescribed the methods of determining Arm's Length Price under Section 92C.

**As per Rule 10B (4)**, the use of the data relating to the financial year in which such international transaction has been entered into, must be considered, for comparing an uncontrolled transaction with the relevant international transaction. Data for earlier years may also 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.

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Multiple –year data can be used for comparing an uncontrolled transaction with the relevant international transaction, only if the circumstances prevailing in the previous years, influence the determination of transfer price in the relevant financial year.

- (e)** Rule 10C of the Income Tax Act 1961 contains provisions relating to selection of the most appropriate method for transfer pricing, in respect of international transaction. The method has to be chosen with respect to the facts and the circumstances of each particular international transaction. That method has to be chosen, which provides the most reliable measure of an arm's length price in relation to the international transaction. For the purpose of selecting the most appropriate method, the following factors should be taken into account:
- (i) the nature and class of the international transaction;
  - (ii) the 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 risk assumed by such enterprises;
  - (iii) the availability, coverage and reliability of data necessary for application of the method;
  - (iv) the degree of comparability existing between the international transaction and the uncontrolled transaction and between the enterprises entering into such transactions;
  - (v) the extent to which reliable and accurate adjustments can be made to account for differences, if any, between the international transaction and the comparable uncontrolled transaction or between the enterprises entering into such transactions;
  - (vi) the nature, extent and reliability of assumptions required to be made in application of a method.