

Paper 7- Applied Direct Taxation

Question 1

- (a) Explain the cases, where the income of the previous year is assessable in the previous year itself instead of the assessment year.
- (b) Mr. Anand & Mr. Vijay earned the following incomes during the previous year 2014-15. Mr. Anand is settled in Germany since 1995 and Mr. Vijay is settled in Mumbai. Compute the total income for the Assessment Year 2015-16.

Sl. No	Particulars	Amount (₹)	
		Mr. Anand	Mr. Vijay
1.	Interest on Canada Development Bonds (only 50% of interest received in India)	70,000	80,000
2.	Dividend from a British Company, received in London	56,000	40,000
3.	Profit from a business in Nagpur, but managed directly from London	2,00,000	2,80,000
4.	Short Term Capital gain on sale of shares of an Indian Company, received in India	1,20,000	1,80,000
5.	Income from a business in Chennai	1,60,000	1,40,000
6.	Fees for technical service rendered in India, but received in Germany	2,00,000	---
7.	Interest on savings bank deposit in UCO Bank, Delhi	14,000	24,000
8.	Agricultural income from a land situated in Andhra Pradesh	1,10,000	90,000
9.	Rent received in respect of house property at Bhopal	2,00,000	1,20,000
10.	Life Insurance Premium paid	---	60,000

Solution to Question 1(a)

The income of an assessee for a previous year is charged to income-tax in the assessment year, following the previous year. However, in certain cases, the income is taxed in the previous year in which it is earned. These exceptions have been made to protect the interests of revenue. The exceptions are as follows:

- (i) Where a ship, belonging to or chartered by a non-resident, carries passengers, livestock, mail or goods shipped at a port in India, the ship is allowed to leave the port only when the tax has been paid or satisfactory arrangement has been made for payment thereof. 7.5% of the freight paid or payable to the owner or the charterer or to any person on his

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behalf, whether in India or outside India on account of such carriage is deemed to be his income which is charged to tax in the same year in which it is earned.

- (ii) Where it appears to the Assessing Officer that any individual may leave India during the current assessment year or shortly after its expiry and he has no present intention of returning to India, the total income of such individual for the period from the expiry of the respective previous year up to the probable date of departure from India is chargeable to tax in that assessment year,
- (iii) If an AOP/BOI etc. is formed or established for a particular event or purpose and the Assessing Officer apprehends that AOP/BOI is likely to be dissolved in the same year or, in the next year, he can make assessment of the income up to the date of dissolution as income of the relevant assessment year.
- (iv) During the current assessment year, if it appears to the Assessing Officer that a person is likely to charge, sell, transfer, dispose of or otherwise part with any of his assets to avoid payment of any liability under this Act, the total income of such person for the period from the expiry of the previous year to the date, when the Assessing Officer commences proceedings, is chargeable to tax in that Assessment Year.
- (v) Where any business or profession is discontinued in any assessment year, the income of the period from the expiry of the previous year up to the date of such discontinuance may, at the discretion of the assessing Officer, be charged to tax in that assessment year.

Solution to Question 1(b)

Computation of total income of Mr. Anand and Mr. Vijay for the Assessment year 2015-16

Sl. No	Particulars	Note No.	Amount (₹)	
			Mr. Anand	Mr. Vijay
1.	Interest on Canada Development Bonds	2	35,000	80,000
2.	Dividend from a British Company, received in London	3	NIL	40,000
3.	Profit from a business in Nagpur, but managed directly from London	2	2,00,000	2,80,000
4.	Short Term Capital gain on sale of shares of an Indian Company, received in India	2	1,20,000	1,80,000
5.	Income from a business in Chennai	2	1,60,000	1,40,000
6.	Fees for technical service rendered in India, but received in Germany	2	2,00,000	---
7.	Interest on savings bank deposit in UCO Bank, Delhi	2	14,000	24,000
8.	Agricultural income from a land situated in	4	NIL	NIL

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	Andhra Pradesh			
9.	Rent received in respect of house property at Bhopal	5	1,40,000	84,000
GROSS TOTAL INCOME			8,69,000	8,28,000
10.	Less: Deductions under Chapter Vi-A (i) Section 80C- Life Insurance Premium paid (ii) Section 80TTA	6	10,000	60,000 10,000
TOTAL INCOME			8,59,000	3,44,000

NOTE:

1. Mr. Anand is a non-resident, since he is settled in Germany, since, 1995. Mr. Vijay is resident and ordinarily resident, since, he is settled in Mumbai.
2. In case of a resident, his global income is taxable as per Section 5(1) of the Income Tax act, 1961. However, as per Section 5(2) of the Income Tax act, 1961, in case of a non-resident, only the following incomes are chargeable to tax:
 - (i) Income received or deemed to be received in India; and
 - (ii) Income accruing or arising or deemed to accrue or arise in India.

Therefore, fees for technical services rendered in India would be taxable in the hands of Mr. Anand, even though, he is a non-resident.

Accordingly, interest on Canada Development Bond would be fully taxable in the hands of Mr. Vijay, whereas only 50%, which is received in India is taxable in the hands of Mr. Anand.

3. Dividend received from a British Company in London, by Mr. Anand, is not taxable, since it accrues and is received outside India. However, dividend received by Mr. Vijay is taxable, since he is a resident. Exemption under Section 10(34) would not be available in respect of dividend received from a foreign company.
4. Agricultural income from a land situated in India is exempt under Section 10(1) of the Income Tax act, 1961, in the case of both residents and non-residents.
- 5.

Particulars	Mr. Anand (₹)	Mr. Vijay (₹)
Rent Received	2,00,000	1,20,000
Less: Deduction under Section 24 @ 30%	60,000	36,000
Net Income from House Property	1,40,000	84,000

The net income from house property shall be taxable in the hands of both Mr. Anand and Mr. Vijay, since the accrual and receipt of the same are in India.

6. In the case of an individual, interest up to ₹10,000 from savings account, with inter alia, a bank is allowable as deduction under Section 80TTA of the Income Tax Act, 1961.

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Question 2

- (a) What are the conditions to be fulfilled by a Charitable Trust under Section 12A of the Income Tax Act, 1961, for applicability of exemption provisions contained in Sections 11 and 12 of the Act?
- (b) Mr. Avay Chawhan retired from the services of M/s Erudite Ltd. on 31.01.2015, after completing service of 30 years and one month. He had joined the company on 01.01.1985, at the age of 30 years and received the following on his retirement:
- (i) Gratuity ₹6,00,000. He was covered under the Payment of Gratuity Act, 1972.
 - (ii) Leave encashment of ₹3,30,000 for 330 days leave balance in his account. He was credited 30 days leave for each completed year of service.
 - (iii) As per the scheme of the company, he was offered a car which was purchased on 01.02.2012, by the company for ₹5,00,000. Company had recovered ₹2,00,000 from him for the car. Company depreciates the vehicles at the rate of 15% on Straight Line method.
 - (iv) An amount of ₹3,00,000 as commutation of pension for 2/3 of his pension commutation.
 - (v) Company presented him a gift voucher worth ₹6,000 on his retirement.
 - (vi) His colleagues also gifted him a LCD TV worth ₹50,000 from their own contribution.

Following are the other particulars:

- (i) He has drawn a basic salary of ₹20,000 and 50% dearness allowance per month for the period 01.04.2014 to 31.03.2015.
- (ii) Received pension of ₹5,000 per month for the period 01.02.2015 to 31.03.2015 after commutation of pension.

Compute his taxable salary from the above for the Assessment Year 2015-16.

Solution to Question 2(a)

Conditions for applicability of Section 11 and Section 12 [Section 12A]

(1) The provisions of section 11 and section 12 shall not apply in relation to the income of any trust or institution unless the following conditions are fulfilled, namely:—

- (a) the person in receipt of the income has made an application for registration of the trust or institution in the prescribed form and in the prescribed manner to the [Principal

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Commissioner or] Commissioner before the 1st day of July, 1973, or before the expiry of a period of one year from the date of the creation of the trust or the establishment of the institution, whichever is later and such trust or institution is registered under section 12AA.

Provided that where an application for registration of the trust or institution is made after the expiry of the period aforesaid, the provisions of sections 11 and 12 shall apply in relation to the income of such trust or institution,—

- (i) from the date of the creation of the trust or the establishment of the institution if the [Principal Commissioner or] Commissioner is, for reasons to be recorded in writing, satisfied that the person in receipt of the income was prevented from making the application before the expiry of the period aforesaid for sufficient reasons;
- (ii) from the 1st day of the financial year in which the application is made, if the [Principal Commissioner or] Commissioner is not so satisfied.

Provided further that the provisions of this clause shall not apply in relation to any application made on or after the 1st day of June, 2007;

- (aa) the person in receipt of the income has made an application for registration of the trust or institution on or after the 1st day of June, 2007 in the prescribed form and manner to the [Principal Commissioner or] Commissioner and such trust or institution is registered under section 12AA;
- (b) where the total income of the trust or institution as computed under this Act without giving effect to [the provisions of section 11 and section 12 exceeds the maximum amount which is not chargeable to income-tax in any previous year], the accounts of the trust or institution for that year have been audited by an accountant as defined in the Explanation below sub-section (2) of section 288 and the person in receipt of the income furnishes along with the return of income for the relevant assessment year the report of such audit in the prescribed form duly signed and verified by such accountant and setting forth such particulars as may be prescribed.]

(2) Where an application has been made on or after the 1st day of June, 2007, the provisions of sections 11 and 12 shall apply in relation to the income of such trust or institution from the assessment year immediately following the financial year in which such application is made.

Provided that where registration has been granted to the trust or institution under section 12AA, then, the provisions of sections 11 and 12 shall apply in respect of any income derived from property held under trust of any assessment year preceding the aforesaid assessment year, for which assessment proceedings are pending before the Assessing Officer as on the date of such registration and the objects and activities of such trust or institution remain the same for such preceding assessment year.

Provided further that no action under section 147 shall be taken by the Assessing Officer in case of such trust or institution for any assessment year preceding the aforesaid assessment year only for non-registration of such trust or institution for the said assessment year.

Provided also that provisions contained in the first and second proviso shall not apply in case of any trust or institution which was refused registration or the registration granted to it was cancelled at any time under section 12AA.

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Solution to Question 2(b)

Computation of Gross Total Income of Mr. Avay Chawhan, for the A.Y 2015-16

Particulars	Note No.	Amount (₹)
Basic Salary (₹20,000 × 10)		2,00,000
Dearness Allowance = 50% of Basic Salary		1,00,000
Gift Voucher	1	6,000
Transfer of car	2	56,000
Gratuity	3	80,769
Leave Encashment	4	1,30,000
Uncommuted Pension (₹5000 × 2)		10,000
Commuted Pension	5	1,50,000
TAXABLE SALARY		7,32,769

NOTE:

- As per Rule 3(7)(iv) of the Income Tax Rules, the value of any gift or voucher or token in lieu of gift received by the employee or by member of his household not exceeding ₹5,000 in aggregate during the previous year is exempt. In this case, the amount was received on retirement and the sum exceeds the limit of ₹5,000. Therefore, the entire amount of ₹6,000 is taxable as a perquisite.
- The taxable value of perquisite under Rule 3(7)(viii), in respect of transfer of car, has been computed as follows:

Particulars	Amount (₹)
Purchase Price as on 01.02.2012	5,00,000
Less: Depreciation @ 20%	1,00,000
WDV as on 31.01.2013	4,00,000
Less: Depreciation @ 20%	80,000
WDV as on 31.01.2014	3,20,000
Less: Depreciation @ 20%	64,000
WDV as on 31.01.2015	2,56,000
Less: Amount received	2,00,000
Value of perquisite	56,000

3. Taxable Gratuity

Particulars	Amount (₹)	Amount (₹)
Gratuity received		6,00,000
Less: Exemption under Section 10(10) – Least of the following		
(i) Notified Limit	10,00,000	
(ii) Actual Gratuity	6,00,000	
(iii) $15/26 \times 30,000 \times 30$	5,19,231	5,19,231
Taxable Gratuity		80,769

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4. Taxable Leave Encashment

Particulars	Amount (₹)	Amount (₹)
Leave Salary received		3,30,000
Less: Exemption under Section 10(10AA) – Least of the following		
(i) Notified Limit	3,00,000	
(ii) Actual Gratuity	3,30,000	
(iii) 10 months × ₹20,000 (assuming that dearness allowance does not form part of pay for retirement benefit)	2,00,000	
(iv) Cash equivalent of leave of credit (330/30 × 20,000)	2,20,000	2,00,000
Taxable Leave Encashment		1,30,000

5. Commuted Pension

Particulars	Amount (₹)	Amount (₹)
Amount received		3,00,000
Less: Exemption under Section 10(10A) = 1/3 [3,00,000×3/2]		1,50,000
Taxable Amount		1,50,000

6. The taxability provisions under Section 56(2)(vii) are not attracted in respect of LCD TV received from colleagues, since television is not included in the definition of property therein.

Question 3

- (a) Mr. Gyan Dinesh, an Indian resident individual, is employed in a PSU. He furnishes the following particulars for the previous year 2014-15:

Particulars	Amount (₹)
(i) Salary income for the year	20,00,000
(ii) Salary, pertaining to the financial year 2009-10, received during the previous year 2014-15	1,00,000
(iii) Assessed income for the financial year 2009-10	3,00,000

Compute the relief available to the assessee under Section 89 of the Income Tax Act, 1961 and the tax liability for the assessment year 2015-16.

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

	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

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- (b) Mr. Patik owns a house property whose Municipal Value, Fair Rent and Standard Rent are ₹1,00,000, ₹1,30,000, ₹1,14,000, respectively. During the financial year 2014-15, one-third of the portion of the house was let out for residential purpose at a monthly rent of ₹9,000. The remaining two-third portion was self-occupied by him. Municipal Tax @ 11% of municipal value was paid during the year.

The construction of the house began in June 2007 and was completed on 31.05.2010. Mr. Patik took a loan of ₹1,00,000 on 01.07.2007 for the construction of the building.

He paid interest on loan @ 12% per annum and every month such interest was paid.

Compute the income from house property of Mr. Sourav for the A.Y 2014-15.

Solution to Question 3 (a)

Computation of relief under Section 89 of Mr. Gyan Dinesh for the A.Y 2015-16

Particulars	₹	₹
Assessment Year 2015-16		
Salary Income for the year excluding arrears		20,00,000
Add: Arrears for the financial year 2009-10		1,00,000
Gross Salary (including arrears)		21,00,000
Computation of tax on ₹ 21,00,000		
On first ₹2,50,000- Nil	Nil	
On next ₹2,50,000- 10%	25,000	
On next ₹5,00,000- 20%	1,00,000	
On balance ₹11,00,000- 30%	3,30,000	4,55,000
Add: Education Cess @ 2%	9,100	
Add: Senior and Higher Education Cess@1%	4,550	13,650
(A) Tax on total income including arrears		4,68,650
Gross Salary excluding arrears	20,00,000	
Computation of tax on ₹20,00,000		
On first ₹2,50,000- Nil	Nil	
On next ₹2,50,000- 10%	25,000	
On next ₹5,00,000- 20%	1,00,000	
On balance ₹10,00,000- 30%	3,00,000	
	4,25,000	
Education Cess @2%	8,500	
SHEC@ 1%	4,250	
(B) Tax on total income excluding arrears		4,37,750
(C) Difference between (A) and (B)		30,900

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Total Income assessed	3,00,000	4,00,000
Add: Arrears relating to the financial year 2009-10	1,00,000	
	4,00,000	
Computation of tax for A.Y 2010-11		
(D) Tax on Total Income (including arrears)		
On first ₹1,60,000	Nil	
On next ₹1,40,000 @ 10%	14,000	
On balance ₹1,00,000 @ 20%	20,000	
	34,000	
Education Cess @ 3%	1,020	35,020
(E) Tax on Total Income (excluding arrears)		
On first ₹1,60,000	Nil	
On balance ₹1,40,000 @ 10%	14,000	
Education Cess @ 3%	420	14,420
(F) Difference between (D) and (E)		20,600
(G) Relief available under Section 89 [Difference between (C) and (F)]		10,300

Solution to Question 3 (b)

Computation of income from house property of Mr. Patik for the A.Y 2015-16

Particulars	Amount (₹)	Amount (₹)
Income from House Property		
I. Self-Occupied Property (Two-third)		
Net Annual Value		Nil
Less: Deduction under Section 24(b) Interest on Loan [Note] [₹18,600 × 2/3]		12,400
Loss from self-occupied property		(12,400)
II. Let-Out Portion (Two-third)		
Gross Annual Value:		
(a) Actual rent received [₹9,000 × 12 months]	1,08,000	
(b) Annual Letting Value, shall be the higher of municipal valuation or, fair rent, but restricted to standard rent [₹1,14,000 × 1/3]	38,000	
		1,08,000
Less: Municipal Taxes [₹1,00,000 × 11% × 1/3]		3,667
Net Annual Value		1,04,333
Less: Deductions under Section 24		
(a) 30% of NAV	31,300	
(b) Interest on loan (₹18,600 × 1/3)	6,200	
		37,500
Income from House Property		66,833

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NOTE:

Interest for the year (01.04.2014 to 31.03.2015) = 12% of ₹1,00,000 = ₹12,000.

Pre-construction period interest = 12% of ₹1,00,000 for 33 months (from 01.07.2007 to 31.03.2010) = ₹33,000.

Pre-construction period interest, to be allowed in 5 equal annual installments of ₹6,600 from the year of completion of construction i.e from F.Y 2010-11 till 2014-15.

Therefore, total interest deduction under Section 24 of the Income Tax Act, 1961

= ₹12,000 + ₹6600 = ₹18,600

Question 4

- (a) M/s XYZ & Co., a sole proprietary concern is converted into a company XYZ Ltd. with effect from 29.11.2014. The written down value of assets as on 01.04.2014, is as follows:

ITEMS	RATE OF DEPRECIATION	WDV AS ON 01.04.2014(₹)
Building	10%	4,50,000
Furniture	10%	1,50,000
Plant and Machinery	15%	3,00,000

Further, on October 15, 2014 M/s XYZ & Co. purchased a plant for ₹2,00,000 (rate of depreciation 15%). After conversion, the company added another plant worth ₹1,50,000 (rate of depreciation 15%).

Compute the depreciation available in the Assessment Year 2015-16, to:

- (i) M/s XYZ & Co.
(ii) XYZ Ltd.

- (b) Mr. Abhishek has furnished the following particulars relating to payments made towards scientific research for the year ended 31.03.2015:

Sl. No	Particulars	Amount (₹ in Lakhs)
(i)	Payments made to TER Research Ltd. for scientific research (TER Research Ltd. is an approved research institution)	40
(ii)	Payments made to P.Q.R College for scientific research (P.Q.R College is an approved research institution)	30
(iii)	Payments made to S.T.U College	20

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(iv)	Payments made to National Laboratory	16
(v)	Machinery purchased for in-house scientific research	50
(vi)	Salaries paid to research staff engaged in in-house scientific research	24

Compute the amount of deduction available under Section 35 of the Income Tax Act, 1961 while arriving at the business income of the assessee.

Solution to Question 4(a)

In the case of conversion of sole proprietary concern into a company as per Section 47(xiv) of the Income Tax Act 1961, the depreciation would be first calculated for the whole year assuming that no succession had taken place. Thereafter, the depreciation should be apportioned between the sole proprietary concern and the company in the ratio of the number of days for which the assets were used by them. It is assumed that in this case, the conditions specified under Section 47(xiv) are satisfied.

Computation of depreciation allowable to M/s. XYZ & Co. for A.Y 2015-16

Block of Asset	Particulars	Amount (₹)	Amount (₹)
Building	WDV as on 01.04.2014	4,50,000	
	Depreciation for the P.Y 2014-15 (10%)		45,000
Furniture	WDV as on 01.04.2014	1,50,000	
	Depreciation for the P.Y 2014-15 (10%)		15,000
Plant & Machinery	WDV as on 01.04.2014	3,00,000	
	Add: Additions during the year	2,00,000	
		5,00,000	
	Depreciation for the P.Y 2014-15 (10%) = ₹[(3,00,000 × 15%) + (2,00,000 × 15% × 1/2)] = ₹(45,000 + 15,000)		60,000
	[Depreciation on new machinery is restricted to 50% of eligible depreciation, since the asset is put to use for less than 180 days.]		
Total Depreciation for the year			1,20,000
Proportionate Depreciation allowable to M/s XYZ & Co. for 242 days			
	On existing assets (from 01.04.2014 to 28.11.2014) = ₹(1,05,000 × 242/365)	69,616	
	On new Machine = ₹(15,000 × 45/168]	4,018	73,634

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Computation of depreciation allowable to XYZ Ltd. for A.Y 2015-16

Particulars	Amount (₹)
Depreciation on assets on conversion	
Proportionately for 123 days i.e. after conversion period = ₹(1,05,000 × 123/365) + ₹(15,000 × 123/168] = ₹(35,384 + 10,982)	46,366
Depreciation on assets brought after conversion	
Since, the assets have been put to use for less than 180 days, depreciation shall be charged at 50% of the normal rate. Depreciation charged = ₹(1,50,000 × 15% × ½]	11,250
Depreciation allowable to XYZ & Co. Ltd	57,615

NOTE:

It has been assumed that XYZ & Co. Ltd. and its predecessor, is/ was not engaged in manufacturing processes or in the business of generation and distribution of power. Hence, additional depreciation has not been provided for.

Solution to Question 4(b)

Computation of deduction allowed to Mr. Abhishek under Section 35 of the Income Tax Act, 1961

Particulars	Section	Note no.	Amount paid (₹ in Lakhs)	Percentage of Weighted Deduction	Amount of Deduction (₹ in Lakhs)
Payment for scientific research:	35(1)(ii)				
(i) TER Research Ltd			40	175%	70
(ii) P.Q.R College			30	175%	52.50
Payment made to S.T.U College	Nil	1	20	Nil	Nil
Payment made to National Laboratory	35(2AA)	3	16	200%	32
In-House Research					
(i) Capital Expenditure	35(1)(iv), 35(2)	2	50	100%	50
(ii) Revenue Expenditure	35(1)(i)	2	24	100%	24

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Deduction allowed under Section 35 of the Income Tax Act, 1961.					228.50

NOTE:

- 1. Payment to S.T.U College:** It is assumed that, S.T.U College is not an approved research institution. Therefore, payment to S.T.U College is not eligible for deduction under Section 35 of the Income Tax Act, 1961.
- 2. Deduction for in-house research and development:** Since, Mr. Abhishek is an individual (a non-corporate assessee), he would be entitled to claim a deduction of 100% of the revenue expenditure incurred and 100% of the capital expenditure incurred, in respect of the in-house research and development, under Section 35 of the Income Tax Act, 1961.
- 3. Payment to National Laboratory:** The percentage of weighted deduction under Section 35(2AA), in respect of amount paid to National Laboratory is 200%.

Question 5

- (a) Dilshan & Pritam, a partnership firm consisted of two partners D & K. The partnership firm reported a net profit of ₹14,00,000, before deduction of the following items:
- (1) Salary of ₹40,000 each per month was payable to two working partners of the firm (as authorized by the deed of partnership).
 - (2) Depreciation on plant and machinery under Section 32 of the Income Tax Act, 1961 (computed) ₹3,00,000.
 - (3) Interest on capital at 15% per annum (as per the partnership deed). The amount of capital eligible for interest ₹ 10,00,000.

Compute:

- (i) Book Profit of the firm under Section 40(b) of the Income Tax Act, 1961.
- (ii) Allowable working partner salary for the assessment year 2015-16, as per Section 40(b) of the Income Tax Act, 1961.

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(b) Kishor is a person carrying on profession as film artist. His gross receipts from profession are as under:

Financial Year 2012-13: ₹2,30,000.

Financial Year 2013-14: ₹3,60,000.

Financial Year 2014-15: ₹4,20,000.

What is his obligation regarding maintenance of books of accounts for each Assessment Year under Section 44AA of the Income-Tax Act, 1961?

Solution to Question 5(a)

(i) Computation of Book Profit of the firm under Section 40(b) of the Income Tax Act, 1961

Particulars	Amount (₹)	Amount (₹)
Net profit of the firm		14,00,000
Less:		
(i) Depreciation under Section 32 of the Income Tax Act, 1961	3,00,000	
(ii) Interest @ 12% p.a. [being the maximum allowable as per Section 40(b)] (₹10,00,000 × 12%)	1,20,000	4,20,000
Book Profit		9,80,000

(ii) Salary actually paid to working partners = ₹ 40,000 × 2 × 12 = ₹9,60,000.

As per the provisions of Section 40(b)(v) of the Income Tax Act, 1961, the maximum allowable salary for the working partners for the A.Y 2015-16, has been computed as follows:

Particulars	Amount (₹)
On the first ₹3,00,000 of book profit [(₹1,50,000 or 90% of ₹3,00,000) whichever is more].	2,70,000
On the balance of book profit [60% of (₹9,80,000 - ₹3,00,000)]	4,08,000
Book Profit	6,78,000

Hence, allowable working partner's salary for the A.Y 2015-16, as per the provisions of Section 40(b)(v) of the Income Tax Act, 1961 is ₹6,78,000.

Solution to Question 5(b)

Section 44AA(1) of the Income Tax Act, 1961 requires every person carrying on any profession, notified by the Board in the Official Gazette (in addition to the professions already specified therein), to maintain such books of account and other documents as

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may enable the Assessing Officer to compute his total income in accordance with the provisions of the Income Tax act, 1961.

Thus, a person carrying on a notified profession shall be required to maintain specified books of accounts:

- (i) If his gross receipts in all the three years immediately preceding the relevant previous year has exceeded ₹1,50,000; or
- (ii) If it is a new profession which is setup in the relevant previous year, it is likely to exceed ₹1,50,000 in that previous year.

In the present case, Mr. Kishor is a person carrying on a profession as a film artist, which is a notified profession. Since, his gross receipts have exceeded ₹1,50,000 in all the three previous years, the requirement under Section 44AA to compulsorily maintain the prescribed books of account is as are prescribed by rule 6F, is applicable to him.

Question 6

- (a) Somnath, an Indian resident (aged 45 years), owned a residential house in Bangalore. It was acquired by Somnath, on 15.10.1986 for ₹8,40,000. It was sold for ₹ 70,00,000 on 09.11.2014. 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.

Somnath acquired a residential house in Chennai on 15.12.2014 for ₹2,00,000 and deposited ₹4,00,000 on 10.04.2015 in the capital gain bond of Rural Electrification Corporation Ltd. (RECL). He deposited ₹5,55,000 on 10.07.2015 in the Capital Gain Deposit Scheme in a nationalized bank for construction of additional floor on the residential house property acquired in Chennai.

Compute the capital gain chargeable to tax in the hands of Mr. Somnath for the assessment year 2015-16.

Cost inflation Index: Financial year 1986-87= 140, Financial Year 2014-15= 1024

- (b) Mr. Jagmohan furnishes the following data for the previous year ending 31.03.2015:

1. 10,000 unlisted Equity shares of CD Ltd., were sold on 31.05.2014 at ₹500 per share.
2. The above shares were acquired by Mr. Jagmohan in the following manner:
 - (i) 5000 shares were gifted to him on 01.06.1980. The Fair Market Value as on 01.04.1981, per share was ₹ 50.

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- (ii) 2,000 bonus shares were issued by CD Ltd. on 21.07.1985.
 (iii) 3,000 shares were acquired at ₹125 per share on 01.02.1994.

3. A residential house was purchased on 01.05.2015, for ₹25 Lakhs, out of the sale proceeds of the shares. Mr. Jagmohan was already owning a residential house, before the purchase of this house.

Compute the capital gain chargeable to tax in the hands of Mr. Jagmohan for the assessment year 2015-16.

Cost inflation Index: Financial year 1993-94= 244, Financial Year 2014-15= 1024

Solution to Question 6(a)

(a) Computation of capital gains in the hands of Mr. Somnath for the A.Y 2015-16

Particulars	₹	₹
Deemed Sale consideration (under Section 50C)		75,00,000
Less: Brokerage @ 2% of ₹70,00,000		1,40,000
Net Sale Consideration		73,60,000
Less: Indexed Cost of Acquisition (₹8,40,000 × 1024/140)		61,44,000
Long Term Capital Gain on sale of property situated in Bangalore		12,16,000
Less: Exemption under Section 54 in respect of –		
(i) Residential house acquired in Chennai on 15.12.2014	2,00,000	
(ii) Amount deposited in Capital Gains Deposit Scheme on 10.07.2015 (before the due date of filing return)	5,55,000	
	7,55,000	
Less: Deduction under Section 54EC Amount deposited in RECL Bonds on 10.04.2015 (within six months from the date of transfer)	4,00,000	9,55,000
Long Term Capital Gain		2,61,000

Solution to Question 6(b)

Computation of taxable capital gain of Mr. Jagmohan for the A.Y 2015-16

Particulars	Amount(₹)	Amount(₹)
Sale consideration received on sale of 10,000 shares		50,00,000

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Less: Indexed Cost of Acquisition		
(i) 5,000 Shares received as gift (5,000 × ₹50 × 1024/100)	25,60,000	
(ii) 2,000 Bonus Shares received	Nil	
(iii) 3,000 shares purchased on 01.12.1994 (3,000 × ₹125 × 1024/244)	15,73,770	41,33,770
Long Term Capital Gain		8,66,230
Less: Exemption under Section 54F (₹8,66,230 × ₹25,00,000 / ₹50,00,000)		4,33,115
Taxable Long Term Capital Gain		4,33,115

NOTE:

Exemption under Section 54F of the Income Tax Act, 1961 can be availed by the assessee subject to fulfillment of the following conditions:

1. The assessee should not own more than one residential house on the date of transfer of the long term capital asset;
2. The assessee should purchase a residential house within a period of 1 year before or two years after the date of transfer or construct a residential house within a period of 3 years from the date of transfer of the long term capital asset.

In this case, the assessee fulfilled the two conditions mentioned above. Therefore, he is entitled to exemption under Section 54F.

Question 7

(a) Smt. Priya reports the following transactions :

- (i) She received gifts on the occasion of her marriage on 18.07.2014 of ₹2,40,000. It includes gift of ₹40,000 received from non-relatives.
- (ii) Her mother's maternal uncle gifted her a cheque of ₹45,000, on her birthday, on 01.08.2014.
- (iii) On 01.12.2014, she acquired a vacant site from her friend at ₹1,25,000. The State Stamp Valuation Authority fixed the value of the site at ₹2,00,000 for stamp duty purpose.
- (iv) She bought 100 equity shares of a listed company from another friend for ₹70,000. The value of share in the stock exchange on the date of purchase was ₹1,20,000.

Determine the amounts chargeable to tax in the hands of Smt. Priya for the A.Y 2015-16.

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- (b) Explain the provisions relating to “dividend stripping”, as contained in the provisions of Section 94(7) of the Income Tax act, 1961.

Solution to Question 7(a)

Sl. No	Particulars	Amount(₹)
(i)	Gift of ₹2,40,000 received on the occasion of her marriage is not taxable, since gifts received by an individual on the occasion of marriage is excluded under Section 56(2)(vii), even if the same are received from non-relatives.	Nil
(ii)	Even though mother's maternal uncle does not fall within the definition of 'relative' under Section 56(2)(vii) of the Income Tax Act, 1961, gift of ₹45,000 received from him by cheque is not chargeable to tax, since the aggregate sum of money received by Smt. Priya without consideration from non-relatives (other than on the occasion of marriage) during the previous year 2014-15 does not exceed ₹50,000.	Nil
(iii)	Purchase of land for inadequate consideration on 01.12.2014 would attract the provisions of Section 56(2)(vii) of the Income Tax Act, 1961. Where any immovable property is received for consideration which is less than the stamp duty value of the property by amount exceeding ₹50,000, the difference between the stamp duty value and consideration is chargeable to tax in the hands of the individual. Thus, in the given case ₹75,000 is taxable in the hands of Smt. Priya.	75,000
(iv)	Since, shares are included in the definition of “property” and difference between the purchase value and fair market value of shares is ₹50,000, it shall not be taxed under Section 56(2)(vii) of the Income Tax Act, 1961.	Nil
Amount chargeable to Tax		75,000

Solution to Question 7(b)

According to Section 94(7) of the Income Tax Act, 1961, where:

- (a) Any person buys or acquires any securities or units within a period of three months prior to the record date; and
- (b) Such person sells or transfers such securities within a period of three months after such record date or transfers such units within a period of nine months after such record date; and

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(c) the dividend or income on such securities or units received or receivable by such person is exempt from tax,

then, the loss, if any, arising to him on account of such purchase or sale of securities or units, to the extent such loss does not exceed the amount of dividend or income received or receivable on such securities or units, has to be ignored for purposes of computing his income chargeable to tax.

Question 8

(a) Mr. Kumar and his wife Mrs. Anchal furnish the following information:

Sl. No	Particulars	Amount(₹)
(i)	Salary income of Mrs. Anchal	5,00,000
(ii)	Income of minor son 'B', who suffers from disability specified in Section 80U	1,20,000
(iii)	Income of minor daughter Sonam from dance performances	90,000
(iv)	Income from profession of Mr. Kumar	8,00,000
(v)	Cash gift received by Sonam, on 02.10.2014, from friend of Mrs. Anchal, on winning of dance competition	48,000
(vi)	Income of minor married daughter Neha from company deposit	40,000

Compute the total income of Mr. Kumar and Mrs. Anchal for the A.Y 2015-16.

(b) Mr. Amal submits the following details of his income for the A.Y. 2015-16:

Particulars	₹
Income from salary	8,00,000
Loss from house property	(80,000)
Income from sugar business	1,00,000
Loss from iron ore business (b/f)(discontinued in 2008-09)	(2,40,000)
Short term capital loss	(1,20,000)
Long term capital gain	80,000
Dividend	10,000
Lottery Winnings	1,50,000
Winnings from card games	24,000
Agricultural Income	80,000
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 2015-16.

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Solution to Question 8(a)

Computation of total income of Mr. Kumar and Mrs. Anchal for the A.Y 2015-16

Particulars	Note No.	Amount(₹)	Mr. Kumar	Mrs. Anchal
Salaries				5,00,000
Profits and Gains of Business or Profession			8,00,000	
Income from other sources:				
Interest from company deposit earned by minor daughter	1	40,000		
Less: Exemption under Section 10(32)		1,500	38,500	
Total Income			8,38,500	5,00,000

Notes:

1. The clubbing provisions are attracted, even in respect of income of minor married daughter. The income of the minor will be included in the income of that parent, whose total income is greater. Hence, the income of Neha from company deposit shall be clubbed in the hands of Mr. Kumar and exemption under Section 10(32) of the Income tax act, 1961 of ₹ 1,500 per child shall be allowed in respect of such income.
2. Under Section 56(2)(vii) of the Income Tax Act, 1961, cash gifts received from any person(s) exceeding ₹50,000 during the year in aggregate is taxable. Since, cash gift received by Sonam, from friend of Mrs. Anchal, on winning of dance competition, does not exceed ₹50,000, the same is not taxable.
3. The income of Miss. Sonam and minor son suffering from disability under Section 80U, shall not be clubbed with the income of their parents, because, the following are not included in the income of the parents, by virtue of the provisions of the Income Tax Act, 1961:
 - (i) The income of the minor children suffering from any disability specified in Section 80U and,
 - (ii) The income derived by the minor from manual work or from any activity involving exercise of his talent, skill or specialized knowledge or experience.

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Solution to Question 8(b)

Computation of Gross Total Income of Mr. Amal for the A.Y 2015-16

Particulars	₹	₹
Salaries:		
Income from salary	8,00,000	
Income from house property		7,20,000
Loss from house property	(80,000)	
Profits and Gains of Business of profession:		
Income from sugar business	1,00,000	
Less: Brought forward loss from iron ore business	(2,40,000)	---
Balance business loss of ₹1,40,000 carried forward to A.Y 2016-17		
Capital Gains		
Long term capital gain	80,000	---
Less: Short term capital loss	(1,20,000)	
Capital Losses to be carried forward:		
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		
Income from other sources:		
Lottery Winnings	1,50,000	
Winnings from card games	24,000	
Bank Interest	10,000	1,84,000
GROSS TOTAL INCOME		9,04,000
Losses to be carried forward to A.Y 2016-17		
i. Loss of ₹1,40,000 from iron-ore business		
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 2008-09, the year in which the business is discontinued.

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Question 9

(a) Mr. Sumit, (aged 69 years) is an Indian resident, who has a Gross Total Income of ₹6,90,000. 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 ₹1,50,000 in PPF and also paid a medical insurance premium of ₹15,000. ₹20,000 was contributed to Public Charitable Trust, eligible for deduction under Section 80G by way of an account payee cheque. Compute the total income and tax thereon of Mr. Sumit, for the Assessment Year 2015-16.

(b) Ms. Madhuri, aged 55 years, is a Cost and Management Accountant in practice. She maintains her accounts on cash basis. Her Income and Expenditure account for the year ended March 31, 2015 reads as follows:

Dr.		Cr.		
Expenditure	(₹)	Income	(₹)	(₹)
Salary to staff	5,50,000	Fees earned:		
Stipend to apprentices	37,000	Audit	7,88,000	
Incentive to apprentices	3,000	Taxation services	5,40,300	
Office rent	24,000	Consultancy	2,70,000	15,98,300
Printing and stationery	22,000			
Meeting, seminar and Conference	31,600	Dividend on shares of Indian companies (Gross)		10,524
Purchase of car	80,000	Income from UTI		7,600
Repair, maintenance and petrol of car	4,000	Honorarium received from various institutions for valuation of answer papers		15,800
Travelling expenses	35,000	Rent received from residential flat let out		85,600
Municipal tax paid in respect of house property	3,000			
Net Profit	9,28,224			
	17,17,824			17,17,824

Other Information:

- (i) Allowable rate of depreciation on motor car is 15%.
- (ii) Value of benefits received from clients during the course of profession is ₹ 10,500.
- (iii) Incentives to apprentices represent amount paid to two apprentices for passing CMA Final Examination at first attempt.
- (iv) Repairs and maintenance of car include ₹ 2,000 for the period from 1-10-2014 to 30-09-2015.
- (v) Salary includes ₹ 30,000 to a computer specialist in cash for assisting Ms. Madhuri in one professional assignment.

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(vi) The total travelling expenses incurred on foreign tour was ₹ 32,000 which was within the RBI norms.

(vii) Medical Insurance Premium on the health of dependent brother and major son dependent on her amounts to ₹ 5,000 and ₹ 10,000, respectively, paid in cash.

(viii) She invested an amount of ₹ 10,000 in National Saving Certificate.

Compute the total income and tax payable of Ms. Madhuri for the Assessment Year 2015-2016.

Answer to Question 9 (a)

Computation of total income and tax liability

Assessee: Mr. Sumit
Assessment Year: 2015-16

Previous Year: 2014-15

Particulars	₹	₹
Gross Total Income including long term capital gain		6,90,000
Less: Long Term Capital gain		90,000
		6,00,000
Less: Deductions under Chapter VI-A		
Under Section 80C: PPF Deposit	1,50,000	
Under Section 80D: Medical Insurance premium (it is assumed that, the premium is paid by otherwise than by cash)	15,000	
Under Section 80G: [Note 1 & Note 2]	10,000	
Under Section 80TTA: [Note 3]	10,000	1,85,000
Total income (excluding long term capital gains)		4,15,000
Total income (including long term capital gains)		5,05,000
Tax on total income (including long term capital gains of ₹90,000)		
20% of ₹90,000	18,000	
Tax on balance ₹4,15,000		
Upto ₹3,00,000 - Nil		
Next ₹1,15,000 @ 10% - ₹11,500	11,500	29,500
Add: Education Cess @2%	590	
Add: Senior and Higher Education cess @1%	295	885
TAX PAYABLE ON TOTAL INCOME		30,385

NOTE:

1. Computation of deduction under Section 80G

Particulars	₹
Gross Total income (excluding long term capital gains)	6,00,000
Less: Deductions under Section 80C, 80D and 80TTA	1,25,000
	4,75,000

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10% of the above	47,500
Contribution made	20,000
Lower of the two eligible for deduction under Section 80G	20,000
Deduction under Section 80G- 50% of ₹20,000	10,000

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.

Solution to Question 9 (b)

Computation of total income and tax liability of Ms. Madhuri for the A.Y. 2015-16

Particulars	Amount(₹)	Amount(₹)
Income from house property (Working Note 1)		57,820
Profit and gains of business or profession (Working Note 2)		9,20,200
Income from other sources (Working Note 3)		15,800
Gross Total Income		9,93,820
Less: Deductions under Chapter VI-A (Working Note 4)		10,000
Total Income		9,83,820
Tax on total income		
Upto ₹ 2,50,000	Nil	
₹ 2,50,001 – ₹ 5,00,000 @10%	25,000	
₹ 5,00,001 – ₹ 9,83,820 @20%	96,764	1,21,764
Add: Education cess @ 2%		2,435
Secondary and higher education cess @ 1%		1,218
Total tax liability		1,25,417

Working Notes:

(1) Income from House Property

Particulars	₹	₹
Gross annual value under Section 23(1)	85,600	
Less: Municipal taxes paid	3,000	
Net Annual Value (NAV)	82,600	
Less: Deduction under Section 24 @ 30% of NAV	24,780	57,820

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Note - Rent received has been taken as the Gross Annual Value in the absence of other information relating to Municipal Value, Fair Rent and Standard Rent.

(2) Income under the head "Profits & Gains of Business or Profession"

Particulars	₹	₹
Net profit as per Income and Expenditure account		9,28,224
Add: Expenses debited but not allowable		
(i) Salary paid to computer specialist in cash disallowed under Section 40A(3), since such cash payment exceeds ₹ 20,000	30,000	
(ii) Amount paid for purchase of car is not allowable under Section 37(1) since it is a capital expenditure	80,000	
(iii) Municipal Taxes paid in respect of residential flat let out	3,000	1,13,000
		10,41,224
Add: Value of benefit received from clients during the course of profession [taxable as business income under Section 28(iv)]		10,500
		10,51,724
Less: Income credited but not taxable under this head:		
(i) Dividend on shares of Indian companies	10,524	
(ii) Income from UTI	7,600	
(iii) Honorarium for valuation of answer papers	15,800	
(iv) Rent received from letting out of residential flat	85,600	1,19,524
		9,32,200
Less: Depreciation on motor car @15% (See Note (i) below)		12,000
		9,20,200

Notes:

- (i) It has been assumed that the motor car was put to use for more than 180 days during the previous year and hence, full depreciation @ 15% has been provided for under Section 32(1)(ii).
- (ii) Incentive to apprentices for passing CMA Final examination in their first attempt is deductible under Section 37(1).
- (iii) Repairs and maintenance paid in advance for the period 1.4.2015 to 30.9.2015 i.e. for 6 months amounting to ₹ 1,000 is allowable since, Ms. Madhuri is following the cash system of accounting.
- (iv) ₹ 32,000 expended on foreign tour is allowable as deduction assuming that it was incurred in connection with her professional work. Since it has already been debited to income and expenditure account, no further adjustment is required.

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(3) Income from other sources

Particulars	₹	₹
Dividend on shares of Indian companies	10,524	Nil
Less: Exempt under Section 10(34)	10,524	
Income from UTI		Nil
Less: Exempt under Section 10(35)	7,600	
	7,600	
Honorarium for valuation of answer papers		15,800
		15,800

(4) Deduction under Chapter VI-A:

Particulars	₹
Deduction under Section 80C (Investment in NSC)	10,000
Deduction under Section 80D (See Notes (i) & (ii) below)	Nil
Total deduction under Chapter VI-A	10,000

Notes:

- (i) Premium paid to insure the health of brother is not eligible for deduction under Section 80D, even though he is a dependent, since brother is not included in the definition of "family" under Section 80D.
- (ii) Premium paid to insure the health of major son is not eligible for deduction, even though he is a dependent, since payment is made in cash.

Question 10

- (a) Compute the amount of tax deduction at source on the following payments made by M/s. Sovan Ltd. during the previous year 2014-15, as per the provisions of the Income Tax Act, 1961:

Sl. No	Date	Nature of Payment
(i)	01.10.2014	Payment of ₹2,00,000 to Mr. Manoj, a transporter, who is having PAN.
(ii)	01.11.2014	Payment of fee for technical services of ₹25,000 and royalty of ₹20,000 to Mr. Thaper, who is having PAN.
(iii)	30.06.2014	Payment of ₹25,000 to M/s ABC Ltd. for repair of building.
(iv)	01.01.2015	Payment of ₹2,00,000 made to Mr. Ashok for purchase of diaries made according to the specifications of M/s Sovan Ltd. However, no material was supplied to such diaries to Mr. Ashok by M/s. Sovan Ltd.

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(v)	01.01.2015	Payment of ₹1,80,000 made to Mr. Vishwas for compulsory acquisition of his house, as per law of the State Government,
(vi)	01.02.2015	Payment of commission of ₹6,000 to Mr. Anil.

(b) State in brief the applicability of tax deduction at source provisions, the rate and amount of tax deduction in the following cases for the previous year 2014-15:

(i) Winning by way of jackpot in a horse race ₹1,00,000.

(ii) Payment made by a firm to sub-contractor ₹3,00,000 with outstanding balance of ₹1,20,000 shown in the books as on 31.03.2015.

(iii) Rent paid for plant and machinery ₹1,50,000 by partnership firm having sales turnover of ₹2,00,000 and net loss of ₹15,000.

(iv) Payment made to Shane Watson, a cricketer, by a newspaper for contribution of articles ₹25,000.

Solution to Question 10 (a):

(i) No tax is required to be deducted at source under **Section 194C** by M/s Sovan Ltd. on payment to transporter Mr. Manoj, provided he furnishes his PAN to M/s Sovan Ltd.

(ii) As per **Section 194J** of the Income Tax Act, 1961, liability to deduct tax is attracted only in case the payment made as fees for technical services and royalty, individually exceed ₹30,000 during the financial year. In the given case, since, the individual payments for fee of technical services ₹25,000 and royalty of ₹20,000, is less than ₹30,000 each, there is no liability to deduct tax at source. It is assumed that no other payment towards fees for technical services and royalty were made during that year to Mr. Thaper.

(iii) Provisions of **Section 194C** are not attracted in this case, since the payment for repair of building on 30.06.2014 to M/s. ABC Ltd is less than the threshold limit of ₹30,000.

(iv) According to **Section 194C** of the Income Tax Act, 1961, the definition of "work" does not include the manufacturing or supply of product according to the specification by customer in case the material is purchased from a person other than the customer.

Therefore, there is no liability to deduct tax at source in respect of payment of ₹2,00,000 to Mr. Ashok, since the contract is a contract for 'sale'.

(v) As per **Section 194LA** of the Income Tax Act, 1961, any person liable for payment to a resident, any sum in the nature of compensation or consideration on account of

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compulsory acquisition under any law, of any immovable property, is responsible for deduction of tax at source if such payment or aggregate amount of such payments, to the resident during the financial year exceeds ₹2,00,000.

In the given case, no liability to deduct tax at source is attracted as the payment does not exceed ₹2,00,000.

(vi) As per Section 194H of the Income Tax Act, 1961, any person (other than an individual or HUF), who is responsible for paying commission or brokerage to a resident shall deduct tax at source, if the amount of such income or, the aggregate of the amounts of such income credited or paid during the financial year exceeds ₹5,000.

Since, the commission payment made to Mr. Anil exceeds ₹5,000, the provisions of Section 194H are attracted.

The tax to be deducted at source shall be = ₹6,000 × 10% = ₹600.

Solution to Question 10 (b):

(i) Provisions for tax deduction at source under Section 194BB of the Income Tax Act, 1961 @ 30% are attracted if the amount exceeds ₹5,000 in respect of income arising by way of winning a jackpot in horse races.

Tax to be deducted = ₹1,00,000 × 30% = ₹30,000.

(ii) Provisions for tax deduction at source under Section 194C of the Income Tax Act, 1961 are attracted in respect of payment by a firm to a sub-contractor. Under Section 194C of the Income Tax Act, 1961 tax is deductible at the time of credit or payment, whichever is earlier @ 1%, if the payment is made to an individual or HUF and 2% for others.

Assuming that the sub-contractor to whom the payment has been made is an individual and the aggregate amount credited during the year is ₹4,20,000, tax is deductible @ 1% on ₹4,20,000.

Tax to be deducted = ₹4,20,000 × 1% = ₹4,200.

(iii) As per Section 194-I of the Income Tax Act, 1961, tax is to be deducted at source @ 2% on payment of rent for plant and machinery, only if the payment exceeds ₹1,80,000 during the financial year. Since, rent of ₹1,50,000 paid by a partnership firm does not exceed ₹1,80,000, tax is not deductible.

(iv) Under Section 194-E the person responsible for payment of any amount to a non-resident sportsman for contribution to articles relating to any game or sport in India in a newspaper shall deduct tax at source @ 20%. Further, since Shane Watson is a non-

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resident, education cess @ 2% and secondary and higher education cess @ 1% on TDS would also be added.

Therefore, tax to be deducted = ₹25,000 × 20.60% = ₹5,150.

Question 11

- (a) In certain cases, unexplained cash credit, unexplained investment, unexplained money or unexplained jewellery etc. is detected by the Assessing Officer. What is the previous year for charging such income to tax? Explain.
- (b) Mcmillan, an international cricket player visits India for 100 days in every financial year. This has been his practice for the past 10 financial years. Find out his residential status for the assessment year 2015-16.

Solution to Question 11 (a)

There are many occasions when the Assessing Officer detects cash credits, unexplained investments, unexplained expenditure etc, the source for which is not satisfactorily explained by the assessee to the Assessing Officer. The Act contains a series of provisions to provide for these contingencies:

- (i) **Cash Credits [Section 68]:** Where any sum is found credited in the books of the assessee and the assessee offers no explanation about the nature and source or the explanation offered is not satisfactory in the opinion of the Assessing Officer, the sum so credited may be charged as income of the assessee of that previous year.

Further, any explanation offered by a closely held company in respect of any sum credited as share application money, share capital, share premium or such amount, by whatever name called, in the accounts of such company shall be deemed to be not satisfactory unless the person, being a resident, in whose name such credit is recorded in the books of such company also explains, to the satisfaction of the Assessing Officer, the source of sum so credited as share application money, share capital, etc. in his hands.

Otherwise, the explanation offered by the assessee-company shall be deemed as not satisfactory, consequent to which the sum shall be treated as income of the company. However, this deeming provision would not apply if the person in whose name such sum is recorded in the books of the closely held company is a Venture Capital Fund (VCF) or a Venture Capital Company (VCC) registered with SEBI.

- (ii) **Unexplained Investments [Section 69]:** Where in the financial year immediately preceding the assessment year, the assessee has made investments which are not recorded in the books of account and the assessee offers no explanation about the nature and the source of investments or the explanation offered is not satisfactory, the value of the

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investments are taxed as income of the assessee of such financial year.

(iii) Unexplained money etc. [Section 69A]: Where in any financial year the assessee is found to be the owner of any money, bullion, jewellery or other valuable article and the same is not recorded in the books of account and the assessee offers no explanation about the nature and source of acquisition of such money, bullion etc. or the explanation offered is not satisfactory, the money and the value of bullion etc. may be deemed to be the income of the assessee for such financial year. Ownership is important and mere possession is not enough.

(iv) Amount of investments etc., not fully disclosed in the books of account [Section 69B]: Where in any financial year the assessee has made investments or is found to be the owner of any bullion, jewellery or other valuable article and the Assessing Officer finds that the amount spent on making such investments or in acquiring such articles exceeds the amount recorded in the books of account maintained by the assessee and he offers no explanation for the difference or the explanation offered is unsatisfactory, such excess may be deemed to be the income of the assessee for such financial year.

For example, if the assessee is found to be the owner of say 300 gms of gold (market value of which is ₹50,000) during the financial year ending 31.3.2014 but he has recorded to have spent ₹30,000 in acquiring it, the Assessing Officer can add ₹20,000 (i.e. the difference of the market value of such gold and ₹30,000) as the income of the assessee, if the assessee offers no satisfactory explanation thereof.

(v) Unexplained expenditure [Section 69C]: Where in any financial year an assessee has incurred any expenditure and he offers no explanation about the source of such expenditure or the explanation is unsatisfactory the Assessing Officer can treat such unexplained expenditure as the income of the assessee for such financial year. Such unexplained expenditure which is deemed to be the income of the assessee shall not be allowed as deduction under any head of income.

(vi) Amount borrowed or repaid on hundi [Section 69D]: Where any amount is borrowed on a hundi or any amount due thereon is repaid other than through an account-payee cheque drawn on a bank, the amount so borrowed or repaid shall be deemed to be the income of the person borrowing or repaying for the previous year in which the amount was borrowed or repaid, as the case may be.

However, where any amount borrowed on a hundi has been deemed to be the income of any person, he will not be again liable to be assessed in respect of such amount on repayment of such amount. The amount repaid shall include interest paid on the amount borrowed.

Unexplained money, investments etc. to attract maximum marginal rate of tax @30% [Section 115BBE]

(i) In order to control laundering of unaccounted money by availing the benefit of basic

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exemption limit, the unexplained money, investment, expenditure, etc. deemed as income under Section 68 or Section 69 or Section 69A or Section 69B or Section 69C or Section 69D would be taxed at the maximum marginal rate of 30% (plus surcharge and cesses).

- (ii) No basic exemption or allowance or expenditure shall be allowed to the assessee under any provision of the Income-tax Act, 1961 in computing such deemed income

Solution to Question 11 (b)

Determination of Residential Status of Mr. Mcmillan for the A.Y. 2015-16:-

Period of stay during previous year 2014-15 = 100 days.

Calculation of period of stay during 4 preceding previous years (100 x 4=400 days)

2013-14	100 days
2012-13	100 days
2011-12	100 days
2010-11	100 days
Total	400 days

Mr. Mcmillan has been in India for a period more than 60 days during previous year 2014-15 and for a period of more than 365 days during the 4 immediately preceding previous years. Therefore, since he satisfies one of the basic conditions under Section 6(1) of the Income Tax Act, 1961. This implies, he is a resident for the assessment year 2015-16.

Computation of period of stay during 7 preceding previous years = 100 x 7=700 days

2013-14	100 days
2012-13	100 days
2011-12	100 days
2010-11	100 days
2009-10	100 days
2008-09	100 days
2007-08	100 days
Total	700 days

Since his period of stay in India during the past 7 previous years is less than 730 days, he is a not-ordinarily resident during the assessment year 2015-16.

Therefore, Mr. Mcmillan is a resident but not ordinarily resident during the previous year 2014-15 relevant to the Assessment Year 2015-16.

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Note:

A not-ordinarily resident person is one who satisfies any one of the conditions specified under Section 6(6) of the Income Tax Act, 1961, i.e.,

- (i) If such individual has been non-resident in India in any 9 out of the 10 previous years preceding the relevant previous year, or
- (ii) If such individual has during the 7 previous years preceding the relevant previous year been in India for a period of 729 days or less.

In this case, since Mr. Mcmillan satisfies condition (ii), he is a not-ordinary resident for the A.Y. 2015-16.

Question 12

- (a) International Stark Ltd. has one undertaking in Special Economic Zone (SEZ) and another at Domestic Tariff Area. Following are the details for the financial year 2014-15:

	Amount (₹ in Lakhs)	
	Unit in SEZ	Unit in Domestic Tariff Area
Total Sales	300	200
Export Sales	250	180
Net Profit	140	110

Compute the quantum of eligible deduction under Section 10AA for A.Y 2015-16 in the following situations:

- (i) Both the units were set up and began manufacturing from 25.07.2007.
 - (ii) Both the units were set up and began manufacturing from 10.04.2011.
- (b) Mr. Arun employed with Power Ltd. on a basic salary of ₹10,000 p.m. He is also entitled to dearness allowance @ 100% of basic salary, 50% of which is included in salary as per terms of employment. The company gives him house rent allowance of ₹ 6,000 p.m. which was increased to ₹ 7,000p.m. with effect from 1.01.2015. He also got an increment of ₹ 1,000p.m. in his basic salary with effect from 1.02.2015. Rent paid by him during the previous year 2014-15 is as under:

April and May, 2014 - Nil, as he stayed with his parents
June to October, 2014 - ₹6,000 p. m. for an accommodation in Ghaziabad
November, 2014 to March, 2015 - ₹ 8,000p.m. for an accommodation in Delhi.

Compute his gross salary for assessment year 2015-16.

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Solution to Question 12 (a)

As per Section 10AA of the Income Tax Act, 1961, in computing the total income of Regal Industries Ltd. from its unit located in a Special Economic Zone (SEZ), which begins to manufacture or produce any article or thing on or after 01.04.2005, there shall be allowed a deduction of 100% of the profit derived from export of such article or thing for the first five year period commencing from the year of manufacture or production of articles or things by the Unit in SEZ and 50% of such profits for further five years subject to fulfillment of other conditions specified in Section 10AA of the Income Tax Act, 1961.

(i) If unit in SEZ were set up and began manufacturing from 25.07.2007:

Since it is the 8th year of operation of the eligible unit, it shall be eligible for deduction up to 50% of the profit of such unit, assuming all the other conditions specified in Section 10AA are fulfilled.

Quantum of eligible deduction under Section 10AA of the Income Tax Act, 1961

$$\begin{aligned} &= \text{Profits of unit of SEZ} \times \frac{\text{Export Turnover of Unit in SEZ}}{\text{Total Turnover of Unit in SEZ}} \times 50\% \\ &= ₹[140 \text{ Lakh} \times 250 \text{ Lakh}/300 \text{ Lakh} \times 50\%] \\ &= ₹58.33 \text{ Lakh.} \end{aligned}$$

(ii) If unit in SEZ were set up and began manufacturing from 10.04.2011:

Since it is the 4th year of operation of the eligible unit, it shall be eligible for deduction up to 100% of the profit of such unit, assuming all the other conditions specified in Section 10AA are fulfilled.

Quantum of eligible deduction under Section 10AA of the Income Tax Act, 1961

$$\begin{aligned} &= \text{Profits of unit of SEZ} \times \frac{\text{Export Turnover of Unit in SEZ}}{\text{Total Turnover of Unit in SEZ}} \times 100\% \\ &= ₹[140 \text{ Lakh} \times 250 \text{ Lakh}/300 \text{ Lakh} \times 100\%] \\ &= ₹116.67 \text{ Lakh.} \end{aligned}$$

Solution to Question 12(b)

Computation of Gross salary of Mr. Arun for A.Y. 2015-16

Particulars	₹
Basic salary [(₹ 10,000 x 10) + (₹ 11,000 x 2)]	1,22,000
Dearness Allowance (100% of basic salary)	1,22,000
House Rent Allowance (See Note below)	21,300
Gross Salary	2,65,300

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Note: Computation of Taxable House Rent Allowance (HRA)

	April-May (₹)	June-Oct (₹)	Nov-Dec (₹)	Jan (₹)	Feb-March (₹)
Basic salary per month	10,000	10,000	10,000	10,000	11,000
Dearness allowance (included in salary as per terms of employment) (50% of basic salary)	5,000	5,000	5,000	5,000	5,500
Salary per month for the purpose of computation of house rent allowance	15,000	15,000	15,000	15,000	16,500
Relevant period (in months)	2	5	2	1	2
Salary for the relevant period (Salary per month x relevant period)	30,000	75,000	30,000	15,000	33,000
Rent paid for the relevant period	Nil	30,000 (₹6,000 x 5)	16,000 (₹8,000 x 2)	8,000 (₹8,000 x 1)	16,000 (₹8,000 x 2)
House rent allowance (HRA) received during the relevant period (A)	12,000 (₹6,000 x 2)	30,000 (₹6,000 x 5)	12,000 (₹6,000 x 2)	7,000 (₹7,000 x 1)	14,000 (₹7,000 x 2)
Least of the following is exempt [u/s 10(13A)]					
1. Actual HRA received	12,000	30,000	12,000	7,000	14,000
2. Rent paid - 10% of salary	N.A.	22,500	13,000	6,500	12,700
3. 40% of salary (Residence at Ghaziabad: June to Oct, 2014)	N.A.	30,000 (40% x ₹75,000)			
50% of salary (Residence at Delhi: Nov'14 – March'15)			15,000 (50% x ₹30,000)	7,500 (50% x ₹15,000)	16,500 (50% x ₹33,000)
Exempt HRA (B)	Nil	22,500	12,000	6,500	12,700
Taxable HRA (Actual HRA – Exempt HRA) (A – B)	12,000	7,500	Nil	500	1,300

Taxable HRA (total) = ₹ 12,000 + ₹ 7,500 + ₹ 500 + ₹ 1,300 = ₹ 21,300

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Question 13

- (a) Two brothers Rakesh and Dinesh are co-owners of a house property with equal share. The property was constructed during the financial year 1998-1999. The property consisted of eight identical units and is situated at Mangalore.

During the financial year 2014-15, each co-owner occupied one unit for residence and the balance of six units were let out at a rent of ₹12,000 per month per unit. The municipal value of the house property is ₹9,00,000 and the municipal taxes are 20% of municipal value, which were paid during the year. The other expenses were as follows:

- (i) Repairs - ₹40,000.
- (ii) Insurance Premium paid - ₹15,000.
- (iii) Interest payable on loan taken for construction of house - ₹3,00,000.

One of the let out units remained vacant for four months during the year.

Rakesh could not occupy his unit for six months, as he was transferred to Hyderabad. He does not own any other house.

Compute the income under the head "Income from House Property", for Mr. Rakesh and Mr. Dinesh.

- (b) Mr. Rohit, a non-resident, operates an aircraft between New York and Mumbai. For the financial year ended 31.03.2015, he received the amounts as under:

- (i) For carrying passengers from Mumbai ₹60 Lakhs.
- (ii) For carrying passengers from New York ₹75 Lakhs received in India.
- (iii) For carrying of goods from Mumbai ₹25 Lakhs.

The total expenditure incurred by Mr. Rohit for the purposes of the business for the financial year 2014-15 was ₹1.4 crores.

Compute the income of Mr. Rohit under the head "Profit and Gains of Business or Profession" for the financial year ended 31.03.2015, relevant to the A.Y 2015-16.

Solution to Question 13(a)

Computation of income from house property for the A.Y 2015-16

Particulars	Rakesh (₹)	Dinesh (₹)
Income from House Property		
I. Self-Occupied Portion (25%)		

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Annual Value	Nil	Nil
Less: Deduction under Section 24(b)		
Interest on loan taken for construction ₹37,500 (being 25% of ₹1.5 Lakh) restricted to a maximum of ₹30,000 for each co-owner, since the property was constructed before 01.04.1999	30,000	30,000
Loss from self occupied property	(30,000)	(30,000)
II. Let-out Portion (75%) [Note]	1,25,850	1,25,850
Income from House Property	95,850	95,850

Working Note:

Let-out Portion (75%)		
Gross Annual Value		
Higher of:		
(i) Municipal Value (75% of ₹9 Lakh)	6,75,000	
(ii) Actual Rent [(₹12,000 × 6 × 12) – (₹12,000 × 1 × 4)]	8,16,000	8,16,000
Less: Municipal taxes (75% × 20% × ₹9 Lakh)		1,35,000
Net Annual Value		6,81,000
Less: Deduction under Section 24		
(i) 30% of NAV	2,04,300	
(ii) Interest on loan taken for house (75% of ₹3 Lakh)	2,25,000	4,29,300
Income from let-out portion		2,51,700
Share of each co-owner (50%)		1,25,850

Solution to Question 13(b)

Under Section 44BBA, in case of an assessee, being a non-resident, engaged in the business of operation of aircraft, a sum equal to 5% of the aggregate of the following amounts shall be deemed to be his business income:

- (i) The amount paid or payable, whether in or out of India, to the assessee on account carriage of passengers, goods, etc. from any place in India; and
- (ii) The amount received or deemed to be received in India by the assessee on account of carriage of passengers, goods etc. from any place outside India.

Hence, the income of Mr. Rohit, chargeable to tax in India under the head "Profits and Gains of Business or Profession" is determined as under:

Particulars	Amount(₹)
(i) For carrying passengers from Mumbai	60,00,000
(ii) For carrying passengers from New York	75,00,000

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(iii) For carrying of goods from Mumbai	25,00,000
	1,60,00,000

Hence, income from business computed on presumptive basis as per Section 44BBA is ₹8,00,000, being 5% of ₹1,60,00,000.

Question 14

- (a) From the following particulars of Mr. Gautam, for the previous year ended 31.03.2015, compute the income chargeable under the head "Income from other Sources":

Sl. No	Particulars	Amount (₹)
(i)	Director's fees from a company	10,000
(ii)	Interest on bank deposits	3,000
(iii)	Income from undisclosed sources	12,000
(iv)	Winnings from lotteries (Net)	35,000
(v)	Royalty on a book written by him	9,000
(vi)	Lectures in seminars	5,000
(vii)	Interest on loan given to relative	7,000
(viii)	Interest on debentures of a company (listed in a recognized stock exchange) net of taxes	3,600
(ix)	Interest on Post Office Savings Bank Account	500
(x)	Interest on Government Securities	2,200
(xi)	Interest on Monthly Income Scheme of Post Office	33,000

He paid ₹1,000 for typing the manuscript of book written by him.

- (b) Mr. Ansh has estates in Rubber, Tea and Coffee, from which he derives income. He has also a nursery wherein he grows and sells plants. For the previous year ending 31.03.2015, he furnishes the following particulars of his income from estates and sale of plants. You are requested to compute the taxable income for the A.Y 2015-16:

SL. No	Particulars	Amount(₹)
(i)	Manufacture of Rubber	5,00,000
(ii)	Manufacture of Coffee grown and cured	3,50,000
(iii)	Manufacture of Tea	7,00,000
(iv)	Sale of plants from nursery	1,00,000

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Solution to Question 14(a)

Computation of Total Income of Mr. Gautam, chargeable under the head "Income from other Sources" for the A.Y 2015-16

Particulars	Amount (₹)	Amount (₹)
Director's fees from a company		10,000
Interest on bank deposits		3,000
Income from undisclosed sources (taxable @ 30% under Section 115BBE)		12,000
Winnings from lotteries (Net) (taxable @ 30% under Section 115BB)	35,000	
Add: T.D.S @ 30%[35,000 × 30/70]	15,000	50,000
Royalty on a book written by him	9,000	
Less: Expenses	1,000	8,000
Lectures in seminars		5,000
Interest on loan given to relative		7,000
Interest on debentures of a listed company	3,600	
Add: TDS @ 10% [3,600 × 10/90]	400	4,000
Interest on Post Office Savings Bank Account (exempt under Section 10(15) of the Income Tax Act, 1961)		Nil
Interest on Government Securities		2,200
Interest on Monthly Income Scheme of Post Office		33,000
Income from other sources		1,34,200

NOTE: It has been assumed that royalty income has not been charged under the head "Profits and Gains of Business or Profession", and accordingly the same has been charged under the head "Income from other sources".

Solution to Question 14(b)

Computation of Taxable Income of Mr. Ansh, for the A.Y 2015-16

SL No	Particulars	Business Income Amount (₹)	Agricultural Income Amount (₹)
(a)	Income from manufacture of Rubber (Rule 7A)	1,75,000	3,25,000

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	Business Income is 35% of ₹5,00,000 Agricultural Income is 65% of ₹5,00,000		
(b)	Income from growing and curing of coffee (Rule 7B) Business Income is 25% of ₹3,50,000 Agricultural Income is 75% of ₹3,50,000	87,500	2,62,500
(c)	Income from manufacture of Tea (Rule 8) Business Income is 40% of ₹7,00,000 Agricultural Income is 60% of ₹7,00,000	2,80,000	4,20,000
(d)	Income from sale of plants in nursery is agricultural income	Nil	1,00,000
TOTAL INCOME		5,42,500	11,07,500

NOTE:

Explanation 3 to Section 2(1A) provides that the income derived from saplings or seedlings grown in a nursery would be deemed to be agricultural income whether or not, the basic operations were carried out.

Question 15

- (a) Mr. Om Prakash started a proprietary business on 01.04.2013 with a capital of ₹5,00,000. During the financial year 2013-14, his business incurred a loss of ₹2,00,000. His wife, Mrs. Rajni, gave him a gift of ₹5,00,000 on 01.04.2014, to help him overcome his financial difficulties in business, which was immediately invested by him in his business. He earned a profit of ₹4,00,000 during the year 2014-15. Compute the amount to be clubbed in the hands of Mrs. Rajni for the A.Y 2015-16. If the amount was given by Mrs. Rajni, as loan to Mr. Om Prakash, would the amount be clubbed in the hands of Mrs. Rajni.
- (b) Mr. Shivam holding 28% of equity shares in a company, took a loan of ₹5,00,000 from the same company. On the date of granting the loan, the company had accumulated profit of ₹4,00,000. The company is engaged in some manufacturing activity.
- (i) Is the amount of loan taxable as deemed dividend in the hands of Mr. Shivam, if the company is a company in which the public is substantially interested?
- (ii) What would be the answer, if the lending company is a private limited company (i.e. a company in which the public are not substantially interested)?

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Solution to Question 15(a)

Section 64(1)(iv) of the Income Tax Act, 1961 provides for the clubbing of income in the hands of the individual, if the income earned is from the assets (other than house property) transferred directly or indirectly to the spouse of the individual, otherwise than for adequate consideration or in connection with an agreement to live apart.

Accordingly, the amount of income to be clubbed in the hands of Mrs. Rajni for the A.Y 2015-16, has been computed as under:

Particulars	Mr. Om's capital contribution (₹)	Capital Contribution out of gift of Mrs. Rajni (₹)	Total (₹)
Capital as on 01.04.2014	₹3,00,000 (₹5,00,000- ₹2,00,000)	₹5,00,000	₹8,00,000
Apportionment of Profit	$(4,00,000 \times 3/8)$ =1,50,000	$(4,00,000 \times 5/8)$ =2,50,000	4,00,000

Therefore, the income to be clubbed in the hands of Mrs. Rajni for the A.Y 2015-16 is ₹2,50,000.

In case, Mrs. Rajni had given the same amount as loan to Mr. Om, then clubbing provisions would not be attracted.

Solution to Question 15(b)

Any payment by a company, other than a company in which the public are substantially interested, of any sum by way of advance or loan to an equity shareholder, being a person who is the beneficial owner of shares not less than 10% of the voting power, is deemed as dividend under Section 2(22)(e), to the extent the company possesses accumulated profits.

- (i) The provisions of Section 2(22)(e), however will not apply where the loan is given by a company in which the public are substantially interested. In such case, the loan would not be taxable as deemed dividend in the hands of Mr. Shivam.
- (ii) However, if the loan is taken from a private company (i.e. a company in which the public are substantially interested), which is a manufacturing company and not a company where lending of money is a substantial part of the business of the company, then the provisions of Section 2(22)(e) of the Income Tax Act, 1961 would be attracted., since Mr. Shivam holds more than 10% of the equity shares of the company.

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The amount chargeable as deemed dividend cannot, however exceed the accumulated profits held by the company on the date of giving the loan. Therefore, the amount taxable as deemed dividend in the hands of Mr. Shivam, would be limited to the accumulated profit i.e., ₹4,00,000 and not the amount of loan which is ₹5,00,000.

Question 16

(a) The gross total income of Mr. Anup for the Assessment Year 2015-16, was ₹12,00,000. He has made the following investment/payments during the year 2014-15.

	Particulars	₹
1.	L. I. C premium paid (Policy value ₹ 1.00,000) (taken on 1.04.2007)	25,000
2.	Contribution to Public Provident Fund (PPF)	25,000
3.	Repayment of housing loan to Indian Bank	50,000
4.	Payment made to L. I. C. pension fund	20,000
5.	Medical insurance premium for self, wife and dependent children	18,000
6.	Mediclaime premium for parents (aged over 80 years)	30,000

Compute eligible deduction under Chapter VI- A for the Assessment Year 2015-16.

(b) Explain how contributions to political parties are deductible in the hands of corporate and non- corporate assesseees under the income-tax law.

Solution to Question 16 (a)

Computation of eligible deduction under Chapter – VIA of the Income Tax Act, for Mr. Anup for A.Y. 2015-16

Particulars	₹	₹
Deduction under Section 80C		
LIC premium paid ₹ 25,000 [Limited to 20% of policy value, since policy has been taken before 1.04.2012 (20% x ₹ 1,00,000)]	20,000	
Contribution to P.P.F.	25,000	
Repayment of housing loan to Indian Bank	50,000	
	95,000	
Deduction under Section 80CCC		
Payment to LIC Pension Fund	20,000	
	1,15,000	1,15,000

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Deduction under Section 80D		
Payment of medical insurance premium ₹18,000 for self, wife and dependent children. Deduction limited to ₹15,000.	15,000	
Medical insurance premium paid for parents ₹ 30,000 (limited to ₹ 20,000, being the limit applicable for senior citizens)	20,000	35,000
Eligible deduction under Chapter VIA		1,50,000

Solution to Question 16 (b)

Section 80GGB provides for deduction of any sum contributed in the previous year by an Indian company to a political party.

Section 80GGC provides for deduction of any sum contributed by any other person to a political party. However, this deduction will not be available in respect of sum contributed by a local authority and every artificial juridical person, wholly or partly funded by the Government.

It may be noted that cash donations to political parties would not qualify for deduction under Section 80GGB and Section 80GGC.

Deduction under Sections 80GGB and 80GGC would be available in respect of contributions made to a political party registered under Section 29A of the Representation of the People Act, 1951.

Note: For the purpose of Section 80GGB, the word "contribute" shall have the same meaning assigned to it under Section 293A of the Companies Act, 1956, which provides that –

- (a) a donation or subscription or payment given by a company to a person for carrying on any activity which is likely to effect public support for a political party shall also be deemed to be contribution for a political purpose;
- (b) the expenditure incurred, directly or indirectly, by a company on advertisement in any publication (being a publication in the nature of a souvenir, brochure, tract, pamphlet or the like) by or on behalf of a political party or for its advantage shall also be deemed to be a contribution to such political party or a contribution for a political purpose to the person publishing it.

However, it may be noted that as per Section 37(2B), no allowance shall be allowed in respect of expenses incurred by him on advertisement in any souvenir, brochure, tract or the like published by any political party. It is only after computation of gross total income, contribution to a registered political party is allowed as deduction under Section 80GGB to a company.

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Question 17

(a) Mr. Khan carries on his own business. An analysis of his trading and profit & loss for the year ended 31-3-2015 revealed the following information:

- (1) The net profit was ₹ 11,20,000.
- (2) The following incomes were credited in the profit and loss account :
 - (i) Dividend from UTI: ₹ 22,000.
 - (ii) Interest on debentures: ₹ 17,500.
 - (iii) Winnings from races: ₹ 15,000.
- (3) It was found that some stocks were omitted to be included in both the opening and closing stocks, the value of which were:
Opening stock: ₹ 8,000.
Closing stock: ₹ 12,000.
- (4) ₹ 1,00,000 was debited in the profit and loss account, being contribution to a University approved and notified under Section 35(1)(ii).
- (5) Salary includes ₹ 20,000 paid to his brother which is excess, as compared to market standards, to the extent of ₹ 2,500.
- (6) Advertisement expenses include 15 gift packets of dry fruits costing ₹ 1,000 per packet presented to important customers.
- (7) Total expenses on car was ₹ 78,000. The car was used both for business and personal purposes. $\frac{3}{4}$ th is for business purposes.
- (8) Miscellaneous expenses included ₹ 30,000 paid to Roadtravel Co., a goods transport operator in cash on 31-1-2015 for distribution of the company's product to the warehouses.
- (9) Depreciation debited in the books was ₹ 55,000. Depreciation allowed as per Income-tax Rules, 1962 was ₹ 50,000.
- (10) Drawings ₹ 10,000.
- (11) Investment in NSC ₹ 15,000.

Compute the total income of Mr. Khan for the A.Y 2015-16.

(b) Raunak Bajaj doing textiles business furnishes you the following information:

Total turnover for the financial year:

	₹
2013 -2014	1,25,00,000
2014 – 2015	92,00,000

State whether the provisions of tax deduction at source are attracted for the following expenses incurred during the previous year 2014 – 2015:

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	₹
Interest on term loan paid to Alliance bank	95,000
Advertisement expenses to Rupa (two individual payments of ₹25,000 and ₹45,000)	70,000
Factory rent paid to Ansh	2,00,000
Brokerage paid to Deepak Singh, a sub – broker	10,000

Solution to Question 17 (a)

Computation of total income of Mr. Khan for the A.Y. 2015-16

Particulars	₹
Profits and gains of business or profession (Working Note 1)	10,46,500
Income from other sources (Working Note 2)	32,500
Gross Total Income	10,79,000
Less: Deduction under Section 80C (Investment in NSC)	15,000
Total Income	10,64,000

Working Notes:

1. Computation of profits and gains of business or profession

Particulars	₹	₹
Net profit as per profit and loss account		11,20,000
Add: Expenses debited to profit and loss account but not allowable as deduction		
Salary paid to brother disallowed to the extent considered unreasonable [Section 40A(2)]	2,500	
Motor car expenses attributable to personal use not allowable (₹ 78,000 x ¼)	19,500	
Depreciation debited in the books of account	55,000	
Drawings (not allowable since it is personal in nature) [Note (iii)]	10,000	
Investment in NSC [See Note (iii)]	15,000	1,02,000
Add: Under statement of closing stock		12,22,000
		12,000
		12,34,000
Less: Under statement of opening stock		8,000
		12,26,000
Less: Contribution to a University approved and notified under Section 35(1)(ii) is eligible for weighted deduction @ 175%. Since only the actual contribution (100%) has been debited to profit and loss account, the additional 75% has to be deducted.		75,000

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Less: Incomes credited to profit and loss account but not taxable as business income		11,51,000
Income from UTI [Exempt under Section 10(35)]	22,000	
Interest on debentures (taxable under the head "Income from other sources")	17,500	
Winnings from races (taxable under the head "Income from other sources")	15,000	54,500
		10,96,500
Less: Depreciation allowable under the Income-tax Rules, 1962		50,000
		10,46,500

Notes:

- (i) Advertisement expenses of revenue nature, namely, gift of dry fruits to important customers, is incurred wholly and exclusively for business purposes. Hence, the same is allowable as deduction under Section 37.
- (ii) Disallowance under Section 40A(3) is not attracted in respect of cash payment of ₹ 30,000 to Road Travel Co., a goods transport operator, since, in case of payment made for plying, hiring or leasing goods carriages, an increased limit of ₹ 35,000 is applicable (i.e. payment of upto ₹ 35,000 can be made in cash without attracting disallowance under Section 40A(3)).
- (iii) Since drawings and investment in NSC have been given effect to in the profit and loss account, the same have to be added back to arrive at the business income.

2. Computation of "Income from other sources"

Particulars	₹
Interest on debentures	17,500
Winnings from races	15,000
	32,500

Note:

The following assumptions have been made in the above solution:

1. The figures of interest on debentures and winnings from races represent the gross income (i.e., amount received plus tax deducted at source).
2. As per the question, depreciation as per Income-tax Rules, 1962 is ₹ 50,000. It has been assumed that, in the said figure of ₹ 50,000, only the proportional depreciation (i.e., 75% for business purposes) has been included in respect of motor car.

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Solution to Question 17 (b)

Since the turnover of Mr. Raunak Bajaj for F.Y.2013-14, i.e., ₹125 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 2014-15, subject to, however, the exemptions provided for under the relevant Sections for applicability of TDS provisions.

(i) Interest paid on term loan to Alliance Bank

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

(ii) Advertisement expenses to Rupa (two individual payments of ₹25,000 and ₹45,000)

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 ₹25,000 to Rupa.

However, payment of ₹45,000 to Rupa would attract TDS@1% under Section 194C, since it exceeds ₹30,000.

Note - The tax to be deducted would be ₹450, being 1% of ₹45,000.

(iii) Factory rent of ₹2,00,000 paid to Ansh

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

Note- The tax to be deducted is ₹20,000, being 10% of ₹2,00,000.

(iv) Brokerage of ₹10,000 paid to Deepak Singh, a sub-broker

Tax has to be deducted @10% under Section 194-H as the brokerage exceeds ₹ 5,000 during the F.Y. 2014-15.

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

Question 18

(a) Explain with brief reasons whether the return of income can be revised under Section 139(5) of the Income-tax Act, 1961 in the following cases:

- (i) Belated return filed under Section 139(4),**
- (ii) Return already revised once under Section 139(5).**
- (iii) Return of loss filed under Section 139(3).**

(b) Mr. Ashish (aged 48) owned 6 heavy goods vehicles as on 01.04.2014. He acquired 2 more heavy goods vehicles on 1.7.2014. He is solely engaged in the business of plying goods vehicles on hire since financial year 2009-10.

He did not opt for presumptive provision contained in section 44AE for the financial year 2013-14. His books were audited under section 44AB and the return of income was filed

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on 5.8.2014. He has unabsorbed depreciation of ₹ 70,000 and business loss of ₹ 1,00,000 for the financial year 2013-14.

Following further information is provided to you:

- (i) Deposited ₹ 20,000 in Tax Saver Deposit with UCO Bank in the name of married son.
- (ii) Paid medical insurance premium of ₹ 23,000 for his parents (both aged above 70) by means of bank demand draft.
- (iii) Paid premium on life insurance policy of his married daughter ₹ 25,000. The policy was taken on 1.04.2013 and the minimum sum assured is ₹ 2,00,000.
- (iv) Repaid principal of ₹ 40,000 and interest of ₹ 15,000 to Canara Bank towards education loan of his daughter, who completed B.E. two years ago. She is employed after completion of her studies.

Assuming that Mr. Ashish has opted for presumptive provision contained in section 44AE of the Income-tax Act, 1961, compute the total income of Mr. Ashish for the assessment year 2015-16.

Solution To Question 18(a)

Any person who has furnished a return under Section 139(1) or in pursuance of a notice issued under Section 142(1) can file a revised return if he discovers any omission or any wrong statement in the return filed earlier. Accordingly,

- (i) A belated return filed under Section 139(4) cannot be revised. Only a return furnished under Section 139(1) or in pursuance of a notice issued under Section 142(1) can be revised.
- (ii) A return revised earlier can be revised again as the first revised return replaces the original return. Therefore, if the assessee discovers any omission or wrong statement in such a revised return, he can furnish a second revised return within the prescribed time i.e. within one year from the end of the relevant assessment year or before the completion of assessment, whichever is earlier.
- (iii) A return of loss filed under Section 139(3) is deemed to be return filed under Section 139(1), and therefore, can be revised under Section 139(5).

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Solution to Question 18(b)

Computation of total income of Mr. Ashish for the A. Y. 2015-16

Particulars	₹	₹
Income from business of plying goods vehicle (Note 1)		6,75,000
Less: Brought forward business loss of financial year 2013-14 (Note 2 & 3)		1,00,000
Gross Total Income		5,75,000
Less: Deduction under Chapter VI-A		
Section 80C		
Life insurance premium paid for insurance of married daughter (Note 5)	20,000	
Section 80D		
Medical insurance premium paid for parents (Note 6)	20,000	
Section 80E		
Interest paid towards education loan taken for studies of his daughter (Note 7)	15,000	55,000
Total Income		5,20,000

Working Notes:

(1) Computation of income from business of plying goods vehicles under section 44AE.

Particulars	₹
6 heavy goods vehicle held throughout the year (₹ 7,500 x 6 x 12)	5,40,000
2 heavy goods vehicle - held for 9 months (₹ 7,500 x 2 x 9)	1,35,000
Income under section 44AE	6,75,000

(2) As per Section 44AE, any deduction allowable under the provisions of sections 30 to 38 shall be deemed to have been already allowed. Therefore, the unabsorbed depreciation of ₹ 70,000 shall not be allowed as a deduction since it is covered by section 32.

(3) Brought forward business loss of ₹ 1,00,000 shall be allowed as deduction, by virtue of section 72, as it is allowed to be carried forward for 8 assessment years following the assessment year to which it relates, since the return for A.Y. 2014-15 was filed before the due date specified under section 139(1).

(4) Fixed deposit in the name of married son does not qualify for deduction under section 80C.

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- (5) Premium paid for insurance on the life of any child of the individual, whether married or not, qualifies for deduction under section 80C. In respect of policies issued on or after 1.04.2013, only premium paid to the extent of 10% of "minimum capital sum assured" qualifies for deduction under section 80C. Therefore, out of the life insurance premium of ₹ 25,000 paid for insurance policy of married daughter, only ₹ 20,000 (being 10% of ₹ 2,00,000) is allowed as deduction under section 80C.
- (6) Deduction is allowed under section 80D for payment made for medical insurance of parents. Medical insurance premium paid for insuring the health of a person who is a senior citizen i.e. of age 60 years or more, qualifies for deduction under section 80D, subject to a maximum of ₹ 20,000. Hence, deduction of ₹ 20,000 is provided to Mr. Ashish, as his parents are senior citizens.
- (7) It is only the payment of interest on education loan which qualifies for deduction under section 80E. Deduction under section 80E is allowed in respect of interest on loan taken for education of children of the individual even if they are not dependent. Principal repayment of the education loan is not eligible for deduction under section 80E.

Question 19

- (a) Enumerate the circumstances in which an individual assessee is empowered to sign and verify his return of income under Section 139 by himself or otherwise by an authorized signatory.
- (b) Ms. Salini, an individual resident Indian, aged 62 years, frequently visits foreign countries to conduct motivational seminars and receives honorarium of ₹4,00,000 for the same. Tax of ₹ 40,000 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 ₹12,00,000.
 - (ii) Contribution to the Public Provident fund - ₹ 1,50,000.
 - (iii) Contribution to the approved Pension Fund of LIC- ₹70,000.
 - (iv) Contribution to Central Government Health Scheme during the previous year- ₹36,000.
 - (v) Payment of medical Insurance premium, for mother (who is not dependent on her) – ₹21,000.

Compute the tax liability of Ms. Salini for the Assessment Year 2015-16.

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Solution to Question 19(a)

The following table enumerates the specific circumstances and the authorized signatories empowered to sign and verify the return of income of an individual assessee filed under Section 139(1), in each such circumstance:

Sl. No.	Circumstance	Return of income, to be signed by
(i)	Where he is absent from India	1. The individual himself; or 2. Any person duly authorized by him in this behalf holding a valid power of attorney from the individual (such power of attorney should be attached to the return of income).
(ii)	Where he is mentally incapacitated from attending to his affairs	1. His guardian; or 2. Any other person competent to act on his behalf.
(iii)	Where, for any other reason, it is not possible for the individual to sign the return	Any person duly authorized by him in this behalf, holding a valid power of attorney from the individual (such power of attorney should be attached to the return of income).
(iv)	In circumstances, not covered above.	The individual himself

Solution to Question 19(b)

Computation of tax liability of Ms. Salini for the Assessment Year 2015-16

Assessee: Ms. Salini

Assessment Year: 2015-16	Previous Year: 2014-15	
Particulars	₹	
Indian Income		12,00,000
Foreign Income		4,00,000
Gross Total Income		16,00,000
Less: Deductions		
Deposit in PPF [Section 80C]	1,50,000	
Contribution to approved Pension Fund of LIC [Section 80CCC]	70,000	
	2,20,000	
The aggregate deduction under Sections 80C, 80CCC and 80CCD(1) has to be restricted to ₹1,50,000 [Section 80CCE]	1,50,000	1,50,000
Contribution to Central Government Health Scheme. [Section 80D]		

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(Under Section 80D, the maximum deduction allowed to a senior citizen is ₹20,000)	20,000	20,000
Medical insurance premium paid for mother [Section 80D]	20,000	20,000
GROSS DEDUCTIONS		1,90,000
TOTAL INCOME		14,10,000
<u>TAX ON TOTAL INCOME</u>		
Income Tax payable	2,43,000	
Education Cess @ 2%	4,860	
Secondary and Higher Education Cess@ 1%	2,430	2,50,290
Average rate of tax in India [₹2,50,290/14,10,000 x 100]		17.75%
Average rate of tax in foreign country [₹40,000/4,00,000 x 100]		10%
Rebate under Section 91 shall be limited to the lower of average Indian tax rate or average foreign tax rate		
Hence, rebate under Section 91 shall be = (₹4,00,000 x 10%)		40,000
Tax payable in India (₹2,50,290- ₹ 40,000)		2,10,290

Question 20

(a) The Profit & Loss Account of Royal Industries Ltd. for the previous year 2014-15, shows a net profit of ₹70 Lakhs after accounting for the following items:

- (i) Depreciation of ₹40 Lakhs, was charged in the Profit and Loss Account. This amount included additional depreciation of ₹10 Lakhs on revalued assets. The amount of depreciation chargeable under Section 32 of the Income Tax Act, 1961, amounted to ₹30 Lakhs.
- (ii) Interest of ₹10 lakhs due to a financial institution, was not paid before the due date of filling return of income.
- (iii) Provision for doubtful debts was made at ₹1 lakh.
- (iv) Provision for unascertained liabilities amounted to ₹1 lakh.
- (v) ₹6 lakhs was transferred to the General Reserve.
- (vi) Net Agricultural Income amounted to ₹20 lakhs.
- (vii) ₹5 lakhs was withdrawn from reserve created during the financial year 2011-12.

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(Book profit was increased by the amount transferred to such reserve in Assessment year 2012 – 13.)

Other Information:

Brought forward loss and unabsorbed depreciation as per books are ₹16 Lakhs and ₹15 Lakhs, respectively.

Compute Minimum Alternate Tax under Section 115JB of the Income Tax Act, 1961 for the A.Y. 2015 – 16.

(b) Mr. Raghav, an Indian resident, is a free-lance management consultant. He was paid ₹70,000 on 1st September, 2014 towards fees for his professional services, without deducting tax at source. Later on, a further sum of ₹50,000, was due to him on 1st March, 2015, from which tax of ₹12,000 was deducted at source. The tax so deducted, was deposited on 26th June, 2015. Compute interest payable by the deductor under Section 201(1A) of the Income Tax Act, 1961.

Solution to Question 20(a)

Computation of Book Profit under Section 115JB of the Income tax Act, 1961

Assessee: Royal Industries Limited

Assessment Year: 2015-16

Previous Year: 2014-15

Particulars	₹	₹
Net Profit as per Profit and Loss account		70,00,000
Add: Net Profit to be increased by the following amounts as per Explanation 1 to section 115JB		
Transfer to general reserve	6,00,000	
Provision for unascertained liabilities	1,00,000	
Provision for doubtful debts	1,00,000	
Depreciation charged in the Profit and Loss Account (including the depreciation charged on revalued assets)	40,00,000	48,00,000
		1,18,00,000
Less: Net Profit to be reduced by the following amounts as per Explanation 1 to Section 115JB		
Amount transferred from reserve and credited to profit and loss account [since the book profit was increased by the amount transferred to such reserve in the Assessment Year 2011 –12]	5,00,000	

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Depreciation, as per Section 32 of the Income Tax Act, 1961	30,00,000	
Net Agricultural Income [Exempt under section 10 (1)]	20,00,000	
Loss brought forward (₹16 lakhs) or unabsorbed depreciation (₹15 lakhs) as per books, whichever is less	15,00,000	70,00,000
Book Profit for computation of MAT under section 115JB		48,00,000

Computation of Minimum Alternate Tax (MAT) under Section 115JB of the Income Tax Act, 1961

Particulars	₹	₹
18.50% of book profit (18.5% of ₹48,00,000)		8,88,000
Add: Education cess @ 2%	17,760	
Secondary and higher education cess @ 1%	8,880	26,640
Minimum Alternate Tax payable under Section 115JB		9,14,640
Note – Explanation 1 to section 115JB does not require adjustment of interest not paid before due date of filing return of income, while computing book profit.		

Solution to Question 20(b)

Section 194J of the Income Tax Act, 1961 provides for deduction of tax at source @ 10%, in respect of fees for professional services. Since, there is delay in deduction and deposit of tax, interest under Section 201(1A) is attracted.

As per the provisions of Section 201(1A), if a person, who is liable to deduct tax at source, fails to deduct tax at source or after deducting such tax, fails to pay the tax required by the Act, then he is liable to pay interest as follows:

- (i) 1% for every month or part of month, on the amount of such tax from the date on which such tax was deductible to the date on which such tax is actually deducted.
- (ii) 1.5% for every month or part of the month on the amount of such tax from the date on which such tax was deducted to the date on which tax is actually paid.

Therefore, in the given case, interest under **Section 201(1A)** would be computed as follows:

Particulars	Computation	Amount (₹)
1% on tax deductible, but not deducted	1% on ₹7,000 for 7 months	490
1.5% on tax deducted, but not deposited	1.5% on ₹12,000 for 4 months	720
TOTAL		1,210

Thus, interest payable by the person liable to deduct tax at source, amounts to ₹1,210.

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Question 21

- (a) Packer Limited engaged in both manufacturing operations and construction business, has the following immovable properties as on 31st March, 2015. Compute the net wealth of Packer Limited, as on 31.03.2015, stating reasons for inclusion or, exclusion of items, in the computation of net wealth:
- (i) A plot of agricultural land in Bengaluru was acquired on 01.01.2013, for conversion into non-agricultural land to be used for opening a new factory. The approval of the Karnataka State Government for conversion into industrial land was obtained on 01.11.2014. The development activity for conversion was in progress on 31.03.2014. The value of land as on 31.03.2015 was ₹ 88 Lakh. A loan of ₹ 68 Lakh was taken to acquire the plot of agricultural land in Bengaluru.
 - (ii) A building is under construction in Pune. The land on which the building is constructed is of the value of ₹53 Lakh, as on 31.03.2015.
 - (iii) A farm house is situated at a distance of 30 Kilometers from the local limits of Bhopal Municipal Corporation. The value of the farm house stood at ₹65 Lakh on 31.03.2015.
 - (iv) A guest house is situated at a distance of 40 Kilometers from the local limits of Bengaluru Municipal Corporation. The value of the guest house stood at ₹75 Lakh on 31.03.2015.
 - (v) Three residential flats (of value ₹35 Lakh each) were purchased in Mumbai, in the financial year 2007-08, for the purpose of resale.
 - (vi) Packer Limited held shares of group companies, break up value of which is ₹ 12 Lakh.
 - (vii) Cash at office, which was not accounted for, in the books of accounts of Packer Ltd., amounted to ₹ 5.5 Lakh. Cash in hand (as per cash book) stood at ₹5 Lakh.
 - (viii) Packer Ltd. held motor cars, of value ₹ 43 Lakh, on 31.03.2015. Among these cars, it possessed an imported car (which was used for hire purposes) worth ₹ 32 Lakh.
 - (ix) Packer Ltd. acquired 125 acres of land in Pune township on 15.05.2014 for construction of commercial complex. The value of land on 31.03.2015, stood at ₹150 Lakh. For acquiring this land, Packer Ltd. borrowed an amount of ₹100 Lakh.
 - (x) Packer Ltd. provided residential flats of 950 square feet each, to its two employees. One of the employees received a remuneration of ₹12 Lakh per annum. The other employee received a remuneration of ₹8Lakh per annum. The value of each flat as on 31.03.2015, stood at ₹44Lakh.

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(b) Mr. Rajesh, an individual, furnishes the following information, relating to the assets and liabilities as on 31.03.2015:

Sl. No	Particulars	Amount (₹)
(i)	Plot of land at Mumbai, comprising an area of 1200 square meters, (on which building has been constructed without the approval of the appropriate authority).	50,00,000
(ii)	Building constructed on land at Mumbai, without the approval of the appropriate authority, and used for his business purposes.	20,00,000
(iii)	Two residential house properties, (one of the house properties is used for the purpose of business, by Mr. Rajesh)	10,00,000 (each)
(iv)	Urban Land was purchased in August 2011 located in Pune, in the name of his son who is suffering from a disability specified under Section 80U of the Income Tax Act, 1961. The age of his son on 31.03.2015 was 17 years.	5,00,000
(v)	House located in Ahmedabad, shown in his wealth-tax return for the A.Y 2014-15 at ₹50 Lakh was sold on 20.03.2015 for ₹60 Lakh, but the sale deed thereof was executed on 03.04.2015.	55,00,000
(vi)	Motor cars held as stock-in-trade.	75,00,000
(vii)	Gold jewellery brought into India from Singapore, where he was residing, on his return to India on 01.11.2010, for permanently residing in India.	12,00,000
(viii)	Jewellery made of platinum.	18,00,000
(ix)	Jewellery gifted to wife from time to time, were available with her on the valuation date. The jewellery was acquired for ₹10 Lakhs.	35,00,000 (Fair Market Value)
(x)	Interest in the coparcenary property of the Hindu Undivided Family, of which he is a member.	25,00,000
(xi)	Cash in hand, recorded in the books of account.	10,00,000
(xii)	Fixed Deposits in a co-operative bank.	20,00,000
Liabilities		
(xiii)	Loan borrowed for marriage of daughter	12,00,000
(xiv)	Loan borrowed for construction of building at Mumbai	10,00,000

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The minor married daughter of Mr. Rajesh holds a plot of land at Bhopal, valued at ₹40 Lakhs. The amounts stated against the assets, except cash in hand, are the values determined as per Section 7 of the Wealth Tax Act, 1957 read with Schedule III thereto.

Compute the net wealth of Mr. Rajesh, as on the valuation date 31.03.2015.

State the reasons for inclusion, or exclusion of the various items.

Solution to Question 21 (a):

Assessee: Packer Limited

Valuation Date: 31.03.2015

Assessment Year: 2015-16

Computation of Net Wealth

Sl. No.	Particulars	Note	Amount (₹)	Amount (₹)
ASSETS (as per the definition of "Assets", under Section 2(ea) of the Wealth Tax Act, 1957)				
(i)	Plot of agricultural land in Bengaluru	1		88,00,000
(ii)	Building under construction in Pune.	2		NIL
(iii)	Farm house situated at a distance of 30 Kilometers from the local limits of Bhopal Municipal Corporation.	3		NIL
(iv)	Guest house situated at a distance of 40 Kilometers from the local limits of Bengaluru Municipal Corporation.	4		75,00,000
(v)	Three residential flats in Mumbai, purchased for the purpose of resale.	5		NIL
(vi)	Shares of group companies	6		NIL
(vii)	Cash in office, not accounted for in the books of account	7	5,50,000	
	Cash in hand, recorded in the cash book		NIL	5,50,000
(viii)	Motor Cars	8	43,00,000	
	Less: Imported cars used for hiring purposes		32,00,000	11,00,000
(ix)	125 acres of land, acquired in Pune township, for construction of commercial complex	9		NIL
(x)	Residential flats provided to employees	10		44,00,000

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(A) TOTAL ASSETS			2,23,50,000
LESS:	Liabilities		
(i)	Debts incurred for acquisition of land in Bengaluru	1	68,00,000
(ii)	Debts incurred for land acquired in Pune Township, for the construction of commercial complex	9	NIL
(B) TOTAL LIABILITIES			68,00,000
(C) NET WEALTH [(A)- (B)]			1,55,50,000

NOTE:

1. A plot of agricultural land in Bengaluru is chargeable to wealth tax, on the valuation date 31.03.2015, since it is an urban land within the definition of 'Asset', under Section 2(ea) of the Wealth Tax Act, 1957.

Unused land held for industrial purposes for a period of two years is not included in the definition of urban land held for industrial purposes. However, this exception does not apply in this case, as the period of two years has elapsed from the acquisition of the agricultural land in Bengaluru. The period of holding shall be reckoned from the date of acquisition, and not from the date of receipt of approval for conversion, from the State Government. Therefore, plot of agricultural land, in Bengaluru, is an 'asset', as on 31.03.2015.

Debts incurred for acquisition of land in Bengaluru, shall be admissible as a deduction, from the value of the agricultural land in Bengaluru, in the computation of the net wealth of the assessee.

2. Building under construction is an incomplete building which, neither falls within the meaning of 'building', nor within the meaning of urban land under Section 2(ea) of the Wealth Tax Act, 1957. An incomplete building cannot be used for residential or commercial purposes, or for the purposes of maintaining a 'guest house'. Hence, it is not an asset chargeable to wealth tax, as on the valuation date 31.03.2015. This position, regarding the taxability of building under construction, under the Wealth Tax provisions was established in the case of CIT v. Smt. Neena Jain (2011) 330 ITR 157.
3. Farm house, situated at a distance of 30 Kilometers from the local limits of Bhopal Municipal Corporation, is not chargeable to wealth tax. A farm house situated beyond 25 Kms from the local limits of a municipality shall not be chargeable to wealth tax.
4. A guest house, regardless of its distance from the municipal corporation is always chargeable to wealth tax.
5. Three residential flats purchased in Mumbai, in the financial year 2007-08, for the purpose of resale, shall not be chargeable to wealth tax. Though, building or land appurtenant

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thereto, is an asset under Section 2(ea) of the Wealth Tax Act, 1957, any house for residential or commercial purposes, which forms part of stock-in-trade is specifically excluded from the scope of 'building'.

6. Shares are not included in the definition of 'Asset', under Section 2(ea) of the Wealth Tax Act, 1957. Hence, shares of group companies, held by Packer Ltd., shall not be included in the computation of the 'net wealth' of Packer Ltd.
7. In case of persons, other than individual and HUFs, any amount not recorded in the books of account, is an asset, under Section 2(ea) of the Wealth Tax Act, 1957. Hence, the amount of ₹5.50 Lakh, which is not accounted for by Packer Ltd., shall be included in the computation of the net wealth of Packer Ltd. Cash-in-hand as per cash book, is not an asset chargeable to wealth tax.
8. Motor Cars are chargeable to wealth tax. Only, the car used by Packer Ltd, for purposes of hiring, shall be exempt from the levy of wealth tax.
9. Since, Packer Ltd. is engaged in construction business, land acquired in Pune Township on 15.05.2014 for construction of commercial complex, shall constitute part of the stock-in-trade. Hence, land acquired in Pune Township, for construction of commercial complex, shall not be an 'asset' under Section 2(ea) of the Wealth Tax Act, 1957. Debts incurred for acquisition of land in the township, shall also not be allowed as deduction.
10. Residential flat provided by Packer Ltd. for residential purposes, to one of his employees, whose annual remuneration is of ₹12 Lakh, shall be chargeable to wealth tax. The other residential flat, provided to his employee, whose annual remuneration is of ₹8 Lakh, shall not be chargeable to wealth tax.

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Solution to Question 21(b):

Assessee: Mr. Rajesh

Valuation Date: 31.03.2015

Assessment Year: 2015-16

Computation of Net Wealth

Sl. No.	Particulars	Note	Amount (₹)	Amount (₹)
ASSETS (as per the definition of "Assets", under Section 2(ea) of the Wealth Tax Act, 1957)				
(i)	Plot of land in Mumbai.	1		50,00,000
(ii)	Building constructed on land at Mumbai, without the approval of the appropriate authority.	2		NIL
(iii)	Residential house properties.	3		NIL
(iv)	Urban Land was purchased in Pune, in the name of his son who is suffering from a disability specified under Section 80U of the Income Tax Act, 1961.	4		NIL
(v)	House located in Ahmedabad, which has already been sold.	5		NIL
(vi)	Motor cars held as stock-in-trade.	6		NIL
(vii)	Gold jewellery brought into India from Singapore	7		NIL
(viii)	Jewellery made of platinum.	8		18,00,000
(ix)	Jewellery gifted to wife	9		35,00,000
(x)	Interest in the coparcenary property of the Hindu Undivided Family	10		NIL
(xi)	Cash in hand, in excess of ₹50,000	11		9,50,000
(xii)	Fixed Deposits in a co-operative bank	12		NIL
(A) TOTAL ASSETS				1,12,50,000
LESS:	Liabilities			
(xiii)	Loan borrowed for marriage of daughter	13		NIL
(xiv)	Loan borrowed for construction of building at Mumbai	14		NIL
(B) TOTAL LIABILITIES				NIL
(C) NET WEALTH [(A)- (B)]				1,12,50,000

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NOTE:

1. Plot of land at Mumbai, comprising an area of 1200 square meters, (on which building has been constructed without the approval of the appropriate authority), is an asset under Section 2(ea) of the Wealth Tax Act, 1957, and is therefore, included in the computation of the net wealth of the assessee. Since, the plot of land comprises an area of more than 500 square meters, it is not eligible for exemption under Section 5(vi) of the Wealth Tax Act, 1957.
2. Building constructed on land at Mumbai, without the approval of the appropriate authority, is not an asset under Section 2(ea) of the Wealth Tax Act, 1957, since the building is being used for the purposes of business.
3. The assessee owns two residential house properties. One of the house property shall be exempt from the levy of wealth tax. This is so because, a house used exclusively for residential purpose is treated as an 'Asset' under Section 2(ea) of the Wealth Tax Act, 1957, but is exempt under Section 5(vi) of the Wealth Tax Act, 1957.

The other house property shall also be exempt from the levy of wealth tax, because, the residential property is used for the purposes of business.

4. Urban Land is an asset, by virtue of Section 2(ea)(v) of the Wealth Tax Act, 1957. However, since, the same is in the name of his minor son, who suffers from a disability specified under Section 80U of the Income Tax Act, 1961, the clubbing provisions are not applicable as per Section 4(1)(a)(ii) of the Wealth tax Act, 1957.
5. The house property, located in Ahmedabad, was sold during the year and is, therefore, not an asset of the assessee, but is an asset of the beneficial owner, since ownership of the property passes on sale of property and execution of sale deed only confirms the act of the parties.
6. Motor cars held as stock-in-trade do not fall within the meaning of the definition of an 'Asset', under Section 2(ea) of the Wealth Tax Act, 1957, and hence, is not chargeable to wealth tax.
7. Gold jewellery brought into India on 01.11.2010, from Singapore is exempt under Section 5(v) of the Wealth Tax Act, 1957, for seven successive assessment years, beginning with the Assessment Year 2011-12.
8. Jewellery made of platinum, is an asset under Section 2(ea) of the Wealth Tax Act, 1957, and is, therefore, included in the net wealth.
9. The fair market value of the Jewellery gifted to wife, will be included in the computation of the net wealth of Mr. Rajesh, as per the provisions of Section 4(1)(a)(i), read with Rule 18 of Schedule III of the Wealth Tax act, 1957.

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10. Interest in the coparcenary property of the Hindu Undivided Family, of which Mr. Rajesh is a member, is exempt under Section 5(ii) of the Wealth Tax Act, 1957.
11. Cash in hand, in excess of ₹50,000, is includible in the net wealth of an individual, whether such cash is recorded in the books of account, or not.
12. Fixed Deposits in a co-operative bank do not constitute 'assets' within the meaning of Section 2(ea) of the Wealth Tax Act, 1957, and is hence, not included in the computation of the net wealth of the assessee.
13. Loan borrowed for marriage of daughter, is not deductible, since, only loans in relation to assets (under Section 2(ea) of the Wealth Tax Act, 1957) are deductible.
14. Since, building constructed in Mumbai, is used for business purposes, it is excluded from the computation of the net wealth of the assessee. Hence, the loan taken for construction of such property shall also not be admissible as a deduction.
15. Assets held by a minor married daughter are not includible in the computation of the net wealth of the any parent under Section 4(1)(a)(ii) of the Wealth Tax Act, 1957. Hence, the value of plot of land at Bhopal, held by the minor married daughter, does not form part of the net wealth of Mr. Rajesh.

Question 22

(a) In light of the provisions of the Wealth Tax Act, 1957, answer the following questions:

(i) A Cooperative Society formed for the purpose of construction of residential flats for its members acquired a large area of urban land for ₹5 crores. The society had a membership of 10 members, all having equal share. The Assessing Officer proposes to tax urban land in the hands of the society.

1. What is meant by urban land?
2. Is the action of the Assessing Officer correct?

(ii) A company incorporated outside India is not liable to wealth tax in India. Discuss.

(iii) Define "Net wealth" under the Wealth-tax Act, 1957.

(iv) An Association of Persons (AOP), comprising of two members Raju and Patik, owns an urban land valued at ₹70 Lakh, on the valuation date 31.03.2015. The share of the members in this AOP is not known. Examine the tax implications under the Wealth Tax Act, 1957.

(b) With reference to the provisions of the Wealth Tax Act, 1957, discuss the tax treatment in

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the following situations:

- (i) There is a private specific trust in which the shares of the beneficiaries are certain. Mr. Sourav and Mr. Gaurav are the trustees. The beneficiaries are all minors and the trust holds assets as envisaged by Section 2(ea) of the Wealth Tax Act, 1957. Mr. Vijay, the father of the minor children also has taxable net wealth. In whose hands should the Assessing Officer complete the assessment of the trust?
- (ii) Mr. Pratap gifted ₹40,00,000 on 10.01.2015, to his wife, which his wife utilized for purchase of jewellery on 31.01.2015. The fair market value of such jewellery as on 31.03.2015 was ₹50,00,000. Mr. Pratap claims that since his wife has not held the sum of ₹40,00,000 (which he gifted to her) on 31.03.2015, no amount is includible in the net wealth of Mr. Pratap. Examine the claim of Mr. Pratap.
- (iii) Mona, an 8-year old child artist, acting in films, accumulated income of ₹40 Lakhs, over a short span of time. The same was put into securities by her father, who is also her guardian. Securities were sold in the Previous Year 2014-15 resulting in capital gain of ₹10 Lakh, which was invested in a plot of land in urban area. The Assessing Officer proposes to include the value of the land in computation of net wealth of the father under Section 4(1) on the valuation date. Is the proposition of the Assessing Officer justified in law?
- (iv) Mr. X gifted a gold chain worth ₹1,00,000 to the adopted minor child of his son. On 31st March, 2014, the net wealth of Mr. X is ₹60 Lakhs, whereas the net wealth of Mr. X's wife is ₹70 Lakhs. Besides, the net wealth of Mr. X's son is ₹45 Lakhs, while the net wealth of Mr. X's daughter-in-law is ₹60 Lakhs. In whose net wealth, shall the value of the gifted chain will be included.
- (v) Vivek gifted a house property valued at ₹150 Lakhs to his wife on 01.04.2015 in an agreement to live apart. In whose hands, the said property will be assessed to wealth tax in the A.Y 2015-16?
- (c) With reference to the provisions of the Wealth Tax Act, 1957, answer the following questions:
- (i) What are the cases where it is deemed that net wealth has escaped assessment under Section 17 of the Wealth Tax Act, 1957?
- (ii) Can a Valuation Officer issue summons, enforcing attendance and provision of evidence on oath, to the seller of a building, for which reference under Section 16A has been made by the Wealth Tax Officer?

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Solution to Question 22.(a)

- (i) Urban Land is included in the definition of the 'assets' under Section 2(ea)(v) of the Wealth tax Act, 1957.

"Urban land" means –

- 1) Land situated in any area which is comprised within the jurisdiction of a municipality or a cantonment board and which has a population of not less than 10,000, according to the last preceding census of which relevant figures have been published before the valuation date.
- 2) Land situated in any area, within the distance, measured aerially, in relation to the range of population according to the last preceding census as shown hereunder -

Shortest aerial distance from the local limits of a municipality or cantonment board referred to in item (a)	Population according to the last preceding census of which the relevant figures have been published before the first day of the previous year.
(1) ≤ 2 kilometers	Is more than 10,000, but not exceeding 1,00,000
(2) ≤ 6 kilometers	Is more than 1,00,000, but not exceeding 10,00,000
(3) ≤ 8 kilometers	Exceeding 10,00,000

However, the following are specifically excluded from the definition of "urban land" –

- 1) Land classified as agricultural land in the records of the Government and used for agricultural purposes;
 - 2) Land on which construction of building is not permissible under any law for the time being in force in the area in which such land is situated;
 - 3) Land occupied by a building which has been constructed with the approval of the appropriate authority;
 - 4) Any unused land held by the assessee for industrial purposes for a period of two years from the date of its acquisition by him;
 - 5) Any land held by the assessee as stock-in-trade for a period of ten years from the date of its acquisition by him.
2. No wealth tax can be levied on a co-operative society as Section 45 of the Wealth Tax Act, 1957 specifically excludes co-operative societies from the meaning of wealth tax. Therefore, the action of the Assessing Officer proposing to tax urban land in the hands of the society is incorrect.

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- (ii) Under Section 2(h) of the Wealth-tax Act, 1957, a company shall have the same meaning as assigned to it in clause (17) of Section 2 of the Income-tax Act, 1961. As per Section 2(17), a company means, inter alia, any Indian company or any body corporate incorporated by or under the laws of a country outside India.

Therefore, a company incorporated outside India will be liable to wealth tax in respect of assets located in India and which are subject to wealth tax under Section 2(ea) of the Wealth-tax Act, 1957.

- (iii) Section 2(m) of the Wealth Tax Act, 1957, defines 'net wealth' to mean the amount by which the aggregate value, computed in accordance with the provisions of the Wealth-tax Act, 1957, of all the assets, wherever located, belonging to the assessee on the valuation date (including assets required to be included under Section 4 in his net wealth as on that date under the Act), is in excess of the aggregate value of all the debts owed by the assessee, on the valuation date which have been incurred in relation to the said assets.

- (iv) The tax implications of an asset, owned by an Association of Persons (AOP), under the Wealth Tax Act, 1957 are as follows:

1. As per Section 3 of the Wealth Tax Act, 1957, only individuals, Hindu Undivided Family and Companies are liable to wealth tax. Therefore, an AOP is not chargeable to wealth tax.
2. However, as per Section 4(1)(b), the value of interest of a member of an AOP, in the assets of the AOP is to be included in the net wealth of the assessee. Schedule III lays down the manner of determination of the value of such interest.
3. Section 21AA deals with a situation, where the shares of the members of the AOP are indeterminate or unknown, Where the assets chargeable to wealth tax are held by an AOP and the individual shares of the members are indeterminate or unknown on the date of formation or at any time thereafter, wealth tax is levied in the like manner and to the same extent as applicable to an individual.

Since, the shares of members of the AOP is unknown, therefore, the urban land shall be assessed to wealth tax in the hands of the AOP in the like manner and to the same extent as applicable to an individual.

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Solution to Question 22. (b)

(i) Section 3 of the Wealth Tax Act, 1957 holds an 'individual' to be a taxable entity. As per the General Clauses Act, 'individual' includes "individuals" as well as trustees of a trust. In this case, Mr. Sourav and Mr. Gaurav are trustees of the trust. Hence, the trustees of the trust shall be chargeable to wealth tax, only in respect of those assets held by the trust, which have been included in the definition of 'Assets', under Section 2(ea) of the Wealth Tax Act, 1957.

(ii) Section 4(1)(a) of the Wealth Tax Act, 1957 provides that the value of assets which are transferred, directly or indirectly, otherwise than for adequate consideration or in connection with an agreement to live apart, by a husband to his wife or vice-versa, are to be clubbed in the hands of the transferor, whether the assets are held in the form in which they are transferred or otherwise.

The Supreme Court has, in CWT v. Kishan Lal Bubna (1993) 204 ITR 600, held that where the assessee transfers money and the transferee utilizes that money to acquire an asset, it is the value of that asset on the valuation date, which is relevant for the purposes of computing the net wealth of the assessee. Where the 'asset' transferred by the assessee, is disposed off by the transferee and the sale proceeds thereof, is utilised by the transferee, to acquire another 'asset', the value of such asset shall be included in the computation of the net wealth of the assessee.

In view of this position, the claim of Mr. Pratap is not valid. The value of the gold jewellery as per Schedule III on the valuation date 31.03.2015 is includible in the net wealth of Mr. Pratap for A.Y 2015-16. Therefore, ₹ 50,00,000, being the fair market value of gold jewellery as on 31.03.2015 is includible in the net wealth of Mr. Pratap under Section 4(1)(a) of the Wealth Tax act, 1957.

(iii) As per Section 4(1)(a)(ii) of the Wealth tax Act,1957, the value of the asset held by a minor child on the valuation date will be included in the net wealth of that parent, whose net wealth (excluding the assets of the minor child so includible) is greater. However, assets acquired by the minor child out of income from activity involving, inter alia, appreciation of her talent, being income referred to in the proviso to Section 64(1A), would be taxable in the hands of the minor and not included in the hands of the parent.

In this case, however, the above exception to the clubbing provision under Section 4(1)(ii) does not apply to the plot of land in urban area, since the same has been purchased out of capital gains of ₹10 Lakhs from sale of the original asset, namely, securities. It is only the securities which were purchased out of income earned from application of talent of the minor child.

Therefore, the value of the urban land, which is an asset under Section 2(ea) of the Wealth tax Act, 1957, is includible in the net wealth of the father on the valuation date. The proposition of the Assessing Officer is justified in law.

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It has been assumed, that Mona is not suffering from any disability, specified under Section 80U of the Income Tax Act, 1961. Also, in the absence of information about the income of Mona's mother, it has been assumed that, Mona's income shall be clubbed in the hands of her father.

- (iv) As per Section 4(1)(a)(ii) of the Wealth tax Act, 1957, the assets held by the minor child (including step child/ adopted child, not being a married daughter) will be included in the net wealth of that parent, whose net wealth (excluding the assets of the minor child so includible) is greater.

In the given problem, the value of the gold chain of adopted minor grandson of Mr. X, (which was transferred to the minor grandson by Mr. X), shall be included in the net wealth of the mother of the adopted minor child, because the net wealth of the mother of the minor child exceeds that of the father of the minor child.

- (v) The property gifted by Vivek to his wife, in an agreement to live apart, is not an asset to be included as a deemed asset in the net wealth of Mr. Vivek and accordingly, should be taxed in the hands of the wife of Mr. Vivek.

However, the transfer has taken place by way of gift on 01.04.2015 and accordingly, on the valuation date 31.03.2015, the house property was owned by Mr. Vivek and therefore, the same would be assessed to wealth tax in the hands of Mr. Vivek for the A.Y 2015-16. Thereafter, the property would be assessable in the hands of the wife.

Solution to Question 22 (c):

- (i) The provisions of Section 17 of the Wealth Tax Act, 1957 are attracted, if the net wealth chargeable to wealth tax has escaped assessment, whether by reason of under-assessment or assessment at too low a rate, or otherwise.

The following are the cases where it would be deemed that net wealth, chargeable to tax has escaped assessment under Section 17 of the Wealth Tax Act, 1957-

1. Where no return of net wealth has been furnished by the assessee, although his net wealth or the net wealth of any other person in respect of which he is assessable on the valuation date exceeds the maximum amount not chargeable to tax, i.e ₹30,00,000;
2. Where a return of net wealth has been furnished by the assessee, but no assessment has been made, and the Assessing Officer notices that the assessee has understated the net wealth or claimed excessive exemption or deduction in the return.

- (ii) Section 38A(1) of the Wealth Tax Act, 1957 empowers the Valuation Officer to enter any land, building or other place belonging to or occupied by any person in connection with

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whose assessment, a reference has been made under Section 16A of the Wealth Tax Act, 1957 or inspect any asset in respect of which a reference has been made under that Section. This provision also empowers the Valuation Officer to require any person in charge or in occupation, or possession of such aforesaid asset, to survey or inspect the asset or estimate its value or inspect any books of account etc., which may provide necessary information for valuation.

If the assessee, so required by the Valuation Officer, to afford him necessary facilities for inspection, refuses to do so or, evades such obligation, the Valuation Officer, may by virtue of this Section, invoke powers under Section 37(1) and issue summons enforcing the attendance of any person and examine him on oath.

Question 23

- (a) Mr. Kishan Kumar has a house property in Mumbai, which was lying vacant for the last 3 years. He constructed the property in 1991 at a cost of ₹60 Lakhs. He has let out the same at a monthly rent of ₹60,000 for a period of three years with effect from 01.01.2015. The quarterly corporation tax is ₹ 60,000. He took a premium of ₹1,80,000 from the tenant and also security deposit of ₹ 1,50,000. The house was constructed on a land measuring 4,000 sq ft. It has three floors each measuring 960 sq ft. Compute the value of the house property for wealth tax purposes as at the valuation date 31.03.2015.
- (b) Mr. Subendu is an individual, aged 45 years. His father settled a property in trust giving whole life interest therein to Mr. Subendu. The income from the property for the years 2011-12 to 2014-15 was ₹1,20,000; ₹128,000; ₹1,40,000; ₹152,000, respectively. The expenses incurred each year were ₹4,000; ₹8,000; ₹10,000; ₹12,000, respectively. Calculate the value of life interest of Mr. Subendu in the property so settled on the valuation date 31.03.2015, by assuming the factor to be 9.267.
- (c) A firm consisted of two partners A & B, having 3:2 profit sharing ratio. 'A' contributed ₹7,50,000 and 'B' contributed ₹2,50,000 to the firm's capital. The assets of the firm are as under:
- (i) Value of assets located outside India - ₹ 15 lakhs.
 - (ii) Value of assets located in India - ₹ 37.50 lakhs.
 - (iii) Debts incurred in relation to assets in India - ₹ 2.50 lakhs.
- Determine the value of interest of the partners in the firm under the Wealth Tax Act 1957.

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Solution to Question 23 (a)

**Computation of value of the house property for wealth tax purposes as on the valuation date
31.03.2015**

Particulars	Amount(₹)	Amount(₹)
COMPUTATION OF ACTUAL RENT AND ANNUAL RENT		
Actual Rent for three months (₹60,000 × 3 months)	1,80,000	
Add: Adjustment for premium received from tenant (₹1,80,000/3) × 3/12	15,000	2,00,625
Add: 15% p. a for security deposit [(15% of ₹1,50,000)×3/12]	5,625	
(A) ACTUAL RENT FOR THREE MONTHS		2,00,625
(B) ANNUAL RENT [(A) × 12/3]		8,02,500
COMPUTATION OF NET MAINTAINABLE RENT		
Gross Maintainable Rent, being the Annual Rent	8,02,500	
Less: Corporation Tax [₹ 60,000 × 4]	2,40,000	
Less: 15% of Gross Maintainable Rent	1,20,375	4,42,125
(C) NET MAINTAINABLE RENT		4,42,125
(D) CAPITALISED NET MAINTAINABLE RENT [(C) × 12.5]		55,26,563
(E) COST OF ACQUISITION		60,00,000
(F) CAPITALIZED VALUE IS THE HIGHER OF (D) OR, (E)		60,00,000
(G) Add: Premium		
(i) Aggregate Area	4000 sq. ft	
(ii) Specified Area (60%)	2400 sq. ft	
(iii) Built up Area	960 sq. ft	
(iv) Unbuilt Area	3040 sq. ft	
(v) Excess of unbuilt area over specified area	640 sq. ft	
% of excess area on aggregate area	16%	
(vi) Premium to added when excess (as calculated above) is 16% [40% of ₹60,00,000]		24,00,000
(H) Value of house property for wealth tax purposes		84,00,000

Solution to Question 23 (b):

The valuation of life interest of Mr. Subendu, in the property settled by his father is governed by Rule 17 of Schedule III of the Wealth Tax Act, 1957. The average annual income of the last three years is to be considered for the purpose of valuation. The expenses of the last three years are also to be taken on an average, by restricting it to 5 percent of the average annual income.

Particulars	Amount (₹)	Amount(₹)
Average annual income of the last three years		

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$\frac{\text{₹}(1,28,000+1,40,000+1,52,000)}{3}$	1,40,000	
Less: Average of annual expenses restricted to 5% of average annual income		
(i) Average of annual expenses = $\frac{\text{₹}(8,000+10,000+12,000)}{3} = \text{₹}10,000$.		
(ii) 5% of Average Annual Income = 5% of ₹1,40,000 = 7,000	7,000	
Net Average Annual income	1,33,000	1,33,000
Value of life interest = Net Average Annual Income × 9.267		12,32,511

Solution to Question 23 (c):

Computation of net wealth of the firm

Particulars	(₹ in lakhs)	
	₹	₹
Value of assets located outside India		15
Value of assets located in India	37.50	
Less: Debts incurred in relation to assets in India	2.50	35
Net Wealth of the firm		50

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

Particulars	(₹ in lakhs)	
	A (₹)	B (₹)
Net assets of the firm to the extent of capital contribution by the partners. (Net assets to the extent of ₹10 Lakhs to be divided in the proportion of capital contribution of the partners)	7.50	2.50
Balance of the net wealth of the firm to be apportioned in the profit sharing ratio of the firm (₹40 Lakhs to be apportioned in the ratio of 3:2)	24	16
Value of interest of partners in the net wealth of the firm	31.50	18.50

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.

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Question 24

- (a) Goodluck Ltd., an Indian company, exports apples to Nature Inc. for an amount of ₹ 40 Lakhs. Nature Inc. is located in a Notified Jurisdictional Area (NJA). Goodluck Ltd. charges ₹48 Lakhs and ₹ 50 Lakhs for the sale of similar goods to Alpine Inc and Iris Inc., respectively, which are not located in Notified Jurisdictional Area and both of them are not associated enterprises of Goodluck Ltd.

Assuming that the permissible variation notified by the Central Government for such class of international transaction is 3% of the transaction price, state the tax implications under Section 94A of the Income Tax Act, 1961, in respect of the above transaction by Goodluck Ltd, to Nature Inc.

- (b) Warner Ltd., an Indian Company supplied steel structures to its holding company- Rupert Ltd., UK during the previous year 2014-15. Warner Ltd also supplied the same product to another UK based company, Vincent Inc, an unrelated entity. The transactions with Rupert Inc are priced at Euro 500 per MT (FOB), whereas the transactions with Vincent Inc., are priced at Euro 800 per MT (CIF). Insurance and Freight amounts to Euro 300 per MT. Compute the Arm's Length Price for the transaction with Rupert Inc.

Solution to Question 24 (a)

As per Section 94A of the Income Tax Act, 1961, in case an assessee enters into any transaction where one of the parties thereto is located in the Notified Jurisdictional Area (NJA), then the parties to the transaction shall be treated as associated enterprises and the transaction shall be deemed to be an international transaction. The transfer pricing provisions would, therefore be attracted in such a case. However, the benefit of permissible variation between the transfer price and the arm's length price, as notified by the Central Government, shall not be available in such a case.

Since, Nature Inc. is located in a NJA, the transaction of export of apples, by the Indian company – Goodluck Ltd, would be deemed to be an international transaction and Nature Inc and Goodluck Ltd., would be deemed to be associated enterprises. Therefore, the provisions of transfer pricing would be attracted in this case.

The prices of ₹48 Lakhs and ₹50 Lakhs, charged for sale of similar goods to Alpine Inc. and Iris Inc. respectively, being independent entities located in a non-NJA country, can be taken into consideration for determining the Arm's Length Price (ALP) under the Comparable Uncontrolled Price (CUP) Method.

Since, more than one price is determined by the CUP Method, the ALP would be the arithmetical mean of such prices.

Therefore, ALP= ₹49,00,000, i.e., $[(₹48,00,000+₹50,00,000)/2]$

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Transfer Price = ₹40,00,000

Since the ALP is more than the transfer price, the ALP of ₹49 Lakhs would be considered for computing the income from the international transaction between Goodluck Ltd., and Nature Inc.

Solution to Question 24(b)

In the given situation, Warner Ltd, the Indian Company supplied steel structures to its holding company- Rupert Inc. Since, the foreign company, Rupert Inc., holds more than 26% shares in Warner Ltd, Warner Ltd and Rupert Ltd, shall be deemed to be associated enterprises, within the meaning of Section 92A of the Income Tax Act, 1961.

As Warner Ltd. supplies similar product to an unrelated entity- Vincent Inc, UK, the transactions between Warner Ltd., and Vincent Inc, can be considered as comparable uncontrolled transactions for the purpose of determining the arm's length price of the transactions between Warner Ltd., and Rupert Inc. Comparable uncontrolled Price Method of determination of Arm's Length Price would be applicable in this case.

Transactions with Rupert Inc. are on FOB Basis, whereas transactions with Vincent Inc. are on CIF basis. This difference has to be adjusted before comparing the prices.

Particulars	Amount (in Euro)
Price per MT of steel structures to Vincent Inc.	800
Less: Cost of insurance and freight per MT	300
Adjusted Price per M.T	500

Since the adjusted price for Vincent Inc., UK and the price fixed for Rupert Inc are the same, the arm's length price is Euro 500 per MT. Since, the sale price to related party (i.e. Rupert Inc.) and unrelated party is the same, the transaction with related party Rupert Inc, has also been carried at arm's length price.

Question 25

(a) Power Machine Works Ltd., an Indian company declared an income of ₹675 crores. However, this income was declared before taking into account the following adjustments:

(i) 37,500 machines were sold to Style Industries Ltd at a price, which is lower than the normal transaction price by \$375 per car. Style Industries Ltd. holds 35% shares in Power Machine Works Ltd.

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- (ii) Dreams Hardware Ltd. was paid a royalty of \$ 3,60,00,000 for use of its technical know-how. However, another Indian company had paid \$ 2,00,00,000 as royalty to Dreams Hardware Ltd. for a similar transaction. Power Machine Works Ltd. was completely dependent on the technical TER supplied by Dreams Hardware Ltd., for the manufacture of the machineries.
- (iii) Englo Finance Ltd. extended a loan of Euro 1,275 crores to Power Machine Works Ltd., carrying an interest @10% p.a, which was outstanding in the books of Power Machine Works Ltd. as on 31.03.2015. Englo Finance Ltd. had extended a loan of similar amount to another Indian company @ 9% p.a. Total interest paid for the year was Euro 127.50 crores. The total assets of Power Machine Works Ltd. as on 31.03.2015 were ₹ 1,50,000 crores.

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

With reference to the provisions of the Income Tax Act, 1961 analyse the nature of transactions, and determine the income of the company chargeable to tax for the A.Y 2015-16.

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

Solution to Question 25 (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 of the Income Tax Act, 1961.

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

Transaction of Power Machine Works Ltd. with	Whether transacting party an associated enterprise or not?	Supporting statutory provision
Style 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".
Dreams Hardware Ltd.	Associated Enterprise	Dreams Hardware Ltd. and Power Machine Works Ltd. have been considered as "Associated Enterprises", by virtue of Section 92A(2)(g).

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Englo Finance Ltd.	Associated Enterprise	Englo Finance Ltd. and Power 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 Power Machine Works Ltd.
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Determination of the total income of Power Machine Works Ltd. after necessary adjustments

Particulars	Amount (₹ in crores)
Income of Power Machine Works Ltd. prior to adjustments	675
Add: Difference arising out of adjustments in the value of international transactions	
(i) Difference in price of machinery supplied to Style Industries Ltd. (37,500 cars x ₹62 x \$ 375)	87.1875
(ii) Difference in excess payment of royalty to Dreams Hardware Ltd. (\$ 60,00,000 x ₹62)	37.20
(iii) Difference in excess interest paid on loan from Englo Finance Ltd. (Euro 1,275crores x 1/100 x ₹82)	1,045.50
TOTAL INCOME	1844.8875

The total income of Power Machine Works Ltd. chargeable to tax in the A.Y 2015-16 is ₹18,44,88,75,000.

Solution to Question 25(b):

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;

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- (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.

Question 26

- (a) Explain the meaning of “specified domestic transactions” which are subject to transfer pricing provisions?**
- (b) Sure Ltd., an Indian company, is engaged in manufacturing electronic components. 74% of the shares of the company are held by Sure Inc., incorporated in USA. Sure Ltd. has borrowed funds from Sure Inc. at LIBOR plus 150 points. The LIBOR prevalent at the time of borrowing is 4% for US\$. The borrowings allowed under External Commercial Borrowings Guidelines issued under the Foreign Exchange Management Act are LIBOR plus 200 basis points. Discuss whether the borrowing made by Sure Ltd. is at arm’s length (‘LIBOR’ means London Inter Bank Offer Rate).**

Solution to Question 26 (a):

The “specified domestic transactions”, which are subject to transfer pricing provisions, means any of the following transactions, not being an international transactions, namely-

1. Any expenditure in respect of which payment has been made or is to be made to a related person referred to in Section 40A(2)(b) of the Income Tax act, 1961;
2. Any transaction referred to in Section 80A of the Income Tax Act, 1961, i.e., inter-unit transfer of goods and services by an undertaking or unit or enterprise or eligible business to other business carried on by the assessee or vice versa, for consideration not corresponding to the market value on the date of transfer;
3. Any transfer of goods or services referred to in Section 80-IA(8) of the Income Tax Act, 1961, i.e., inter-unit transfer of goods or services between eligible business and other business, where the consideration for transfer does not correspond with the market value of goods and services;
4. Any business transacted between the assessee carrying on eligible business and other person as referred to in Section 80-IA(10) of the Income Tax Act, 1961;

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5. Any transaction, referred to in any other Section under Chapter VI-A or Section 10AA, to which provisions of Section 80-IA(8) , or Section 80-IA(10) of the Income Tax Act, 1961 are applicable; or
6. Any other transaction as may be prescribed.

However, the above mentioned transactions shall not be treated as specified domestic transaction in case the aggregate of such transactions entered into by the assessee in the previous year does not exceed a sum of ₹5 crore.

Solution to Question 26 (b):

One of the methods for determination of arm's length price in an international transaction is Comparable Uncontrolled Price (CUP) Method. Under the CUP Method, the price charged or paid for property transacted or services rendered in comparable uncontrolled transaction, or a number of such transactions, is identified. Such price is adjusted to account for differences, if any, between the international transaction and the comparable uncontrolled transaction or between the enterprises entering into such transactions, which could materially affect the price in the open market. The adjusted price so arrived at is taken to be an arm's length price in respect of the property transferred or services provided in the international transaction.

Sure Inc., USA and Sure Ltd., the Indian Company shall be deemed to be associated enterprises, since the former holds more than 26% voting power in the latter.

The arm's length rate of interest can be determined by using the CUP Method having regard to the rate of interest on External Commercial Borrowing permissible as per Guidelines issued under the Foreign Exchange management Act, 1999.

The interest rate permissible is LIBOR plus 200 basis points i.e., $4\% + 2\% = 6\%$, which can be taken as the arm's length rate. The interest rate applicable on the borrowing by Sure Ltd., India from Sure Inc. USA, is LIBOR plus 150 basis points i.e., $4\% + 1.5\% = 5.5\%$. Since the rate of interest, **(5.5%)** is less than the arm's length rate of 6%, the borrowing made by Sure Ltd. is not at arm's length. However, in this case the taxable income of Sure Ltd., India would be lower if the arm's length rate is applied. Hence, no adjustment is required since the law of transfer pricing will not apply if there is a negative impact on the existing profits.

Question 27

- (a) Grand Bell Inc., a US company has a subsidiary, Grand Ltd. in India. Grand Bell Inc. sells computer monitors to Grand Ltd. for resale in India. Grand Bell Inc. also sells computer monitors to Computer Wizards Ltd another computer reseller. It sells 75,000 computer monitors to Grand Ltd. at ₹16,500 per unit. The Price fixed for Computer Wizards Ltd is ₹15,000**

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per unit. The warranty in case of sale of monitors by Grand Ltd. is handled by Grand Ltd. However, for sale of monitors by Computer Wizards Ltd., Grand Bell Inc. is responsible for the warranty for 3 months. Both Grand Bell Inc. and Grand Ltd. offer extended warranty at a standard rate of ₹1,500 per annum. Based on these facts, discuss how the assessment of Grand Ltd. is going to be affected?

- (b) Discuss the concept of Arm's length price as envisaged in Section 92C of the Income-tax Act 1961. What are the methods under which the arm's length price, relating to an international transaction, is determined under Section 92C of the Income Tax Act, 1961?

Solution to Question 27 (a):

Grand Bell Inc., the foreign company and Grand Ltd., the Indian company are associated enterprises, since Grand Bell Inc. holds not less than 26% voting rights in Grand Ltd. (Being a subsidiary of Grand Bell Inc., more than 50% of the voting rights of Grand Ltd. would be held by Grand Bell Inc.).

Grand Bell Inc. sells computer monitors to Grand Ltd. for resale in India. Grand Bell Inc. also sells identical computer monitors to Computer Wizards Ltd., which is not an associated enterprise. The price charged by Grand Bell Inc. for a similar product transferred in comparable uncontrolled transaction is, therefore, identifiable. Therefore, Comparable Uncontrolled Price (CUP) method for determining arm's length price can be applied.

While applying CUP method, the price in comparable uncontrolled transaction needs to be adjusted to account for difference, if any, between the international transaction (i.e. transaction between Grand Bell Inc. and Grand Ltd.) and uncontrolled transaction (i.e. transaction between Grand Bell Inc. and Computer Wizards Ltd.) and the price so adjusted shall be the arm's length price for the international transaction.

For sale of monitors by Computer Wizards Ltd., Grand Bell Inc. is responsible for warranty for 3 months. The price charged by Grand Bell Inc. to Computer Wizards Ltd. includes the charge for warranty for 3 months. Hence arm's length price for computer monitors being sold by Grand Bell Inc. to Grand Ltd. would be:

Particulars	Quantity	Amount(₹)
Sale price charged by Grand Bell Inc. to Computer Wizards Ltd.		15,000
Less: Cost of warranty included in the price charged to CMI Ltd. (₹1,500 x 3 /12)		375
Arm's length price		14,625
Actual price paid by Grand Ltd. to Grand Bell Inc.		16,500
Difference per unit		1,875
No. of units supplied by Grand Bell Inc. to Grand Ltd.	50,000	
Addition required to be made in the computation of total income of Grand Ltd. (1,875 x 50,000)		9,37,50,000

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No deduction under chapter VI-A would be allowable in respect of the enhanced income of ₹9.375 crores.

Note: It is assumed that Grand Ltd. has not entered into an advance pricing agreement or opted to be subject to Safe Harbour Rules.

Solution to Question 27 (b):

"**Arm's Length Price**" is defined in Section 92F(ii) of the Income Tax act, 1961, to mean price which is applied or proposed to be applied in a transaction between persons other than associated enterprises, in uncontrolled conditions. Section 92C of the Income Tax Act, 1961 deals with the method to be adopted for determining the arm's length price and, the factors to be considered for applying a particular method.

Section 92C of the Income Tax Act, 1961 provides that the arm's length price in relation to, inter alia, an international transaction shall be determined by any of the following methods, being the most appropriate method, having regard to the nature of the transaction or class of transaction or class of associated persons or functions performed by such persons or such other relevant factors as the Board may prescribe, namely:-

- (a) comparable uncontrolled price method;
- (b) resale price method;
- (c) cost plus method;
- (d) profit split method;
- (e) transactional net margin method;
- (f) such other method as may be prescribed by the Board.

Accordingly, the Board vide Notification No, 18/2012 dated 23.05.2012 has prescribed that the other method for determination of the arms' length price in relation to an international transaction, shall be any method which takes into account the price which has been charged or paid, or would have been charged or paid, for the same or similar uncontrolled transaction, with or between non-associated enterprises, under similar circumstances, considering all the relevant facts.

Out of the above, the most appropriate method shall be selected in the manner as may be prescribed by the Rules. However, if more than one price is determined by the most appropriate method, then the arithmetical mean of such price shall be taken as arm's length price.

If the variation between the arm's length price determined and the price at which the transaction was actually undertaken does not exceed such percentage not exceeding 3% of the latter (i.e. the actual transaction price) as may be notified by the Central Government in the Official Gazette, then the price at which the international transaction was undertaken shall be deemed to be the arm's length price.

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Question 28

(a) With reference to the transfer pricing provisions of the Income Tax Act, 1961, answer the following questions:

(i) When shall a transaction be considered as an international transaction?

(ii) In what circumstances shall, a transaction entered into with a person other than an associated enterprise, be deemed as a transaction between two associated enterprises?

(b) With reference to the transfer pricing provisions of the Income Tax Act, 1961, discuss whether adjustment is required to be effected in the given situation:

The transfer price adopted for an international transaction of sale of goods by an Indian company during the financial year 2014-15 is ₹ 75 Lakhs, whilst the Arm's Length Price determined using the most appropriate method are ₹ 72 Lakhs and ₹ 84 Lakhs. The rate of permissible variation prescribed by the Central Government, for this class of international transaction, is 2% of the transfer price.

Solution to Question 28 (a)

(i) As per Section 92B of the Income Tax Act, 1961 an international transaction is one which satisfies the following criteria:

1. A transaction between two or more associated enterprise, either or both of whom are non-residents;
2. It is in the nature of purchase, sale or lease of tangible or intangible property, or provision of services, lending/borrowing money or any other transaction having a bearing on the profits, income, losses or assets of such enterprise;
3. It includes a transaction in the nature of a mutual agreement, or arrangement between two or more associated enterprise for the allocation or apportionment of any contribution, cost or expense incurred (or to be incurred) in connection with a benefit, service or facility provided (or to be provided) to any one or more of such enterprise.

(ii) As per the provisions of Section 92B (2) of the Income Tax Act, 1961 a transaction entered into by an enterprise with a person other than the associated enterprise, shall for the purposes of sub-Section (1), be deemed to be a transaction entered into between two associated enterprise if:

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1. There exists a prior agreement in relation to the relevant transaction between such other person and the associated enterprise; or
2. The terms of the relevant transaction are determined in substance between such other person and the associated enterprise.

Solution to Question 28 (b)

The proviso to Section 92C(2) of the Income Tax Act, 1961 provides that where more than one price is determined by the most appropriate method, the arm's length price (ALP) shall be taken to be the arithmetical mean of such prices.

However, if the arithmetical mean, so determined, is within such percentage of the transfer price notified 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.

The arithmetical mean of the prices = $(₹ 72 \text{ Lakhs} + ₹ 84 \text{ Lakhs})/2 = ₹ 78 \text{ Lakhs}$.

The rate of permissible variation prescribed by the Central Government is 2%.

Therefore, the amount of permissible variation prescribed by the Central Government = $₹75 \text{ Lakhs} \times 2\% = ₹1.50 \text{ Lakh}$.

Since, the variation between the arm's length price of ₹78 Lakhs and the transfer price of ₹75 Lakhs, is not within the limit of ₹ 1.50 Lakhs (2% of the Transfer Price), the arm's length price shall be ₹ 78 Lakhs.

Question 29

(a) Explain the legislative objective behind, bringing into existence the provisions relating to transfer pricing in relation to international transactions?

(b) Discuss, whether transfer pricing provisions of the Income Tax Act, 1961 are applicable to the following cases:

(i) Ms. Sarita, a resident Indian, is a director of Supro Enterprises Ltd., an Indian Company. Supro Enterprises Ltd. pays a salary of ₹60 Lakhs per annum to Mr. Pankaj, who is Ms. Sarita's son.

(ii) Grower Ltd. transferred process patents to TZ Ltd., an Australian company, in consideration of guarantee of 20% of the borrowings of Grower Ltd.

- (iii) SMG Ltd., an Indian company, sold tools and equipment to PMG Inc., a Danish Company. SMG Ltd. is the subsidiary of PMG Inc.

Solution to Question 29 (a)

The Central Government, brought into existence, the transfer pricing provisions, in relation to international transactions, with a view to regulate the multinational enterprises, which tend to allocate profits in different jurisdictions. The multi-national enterprises operating in India, normally tend to allocate their profits in different jurisdictions, by controlling prices in intra-group transactions.

Two or more entities, which belong to the same multi-national group can fix up their prices for goods and services and allocate profits among the enterprises within the group in such a way that, there may be either no profit or negligible profit in the jurisdiction in which the tax rates are higher and the substantial profits are booked in the tax haven. This may adversely affect a country's share of due revenue. The profits derived by such enterprises carrying on business in India can be controlled by the multi-national group, by manipulating the prices charged and paid in such intra-group transactions, which may lead to loss of tax revenue.

With a view to prevent the resultant loss of revenue (arising from the manipulation of prices by multi-national companies, in intra-group transactions), the Central Government introduced the transfer pricing provisions in the Finance Act, 2001. These provisions aimed at attaining a statutory framework which can lead to computation of reasonable, fair and equitable profits and tax in India, in the case of such multi-national enterprises.

Solution to Question 29(b)

- (i) The transaction falls within the meaning of 'specified domestic transaction', under Section 92BA of the Income Tax Act, 1961, since the salary payment has been made to a related person referred to in Section 40A(2)(b) i.e., relative (i.e. son) of Ms. Sarita, who is a director of Supro Enterprises Ltd. However, such a transaction would be treated as a 'specified domestic transaction, and shall attract transfer pricing provisions only if the aggregate of such transactions as specified in Section 92BA of the Income Tax Act, 1961, during the year by Supro Enterprises Ltd. exceeds a sum of ₹5 crore.
- (ii) The scope of the term "**intangible property**" has been amplified to include, inter alia, process patents, which is a technology intangible. Transfer of intangible property falls within the scope of the term 'international transaction'. Since, TZ Inc. guarantees more than 10% of the borrowings of Grower Ltd., TZ Inc. and Grower Ltd., are associated enterprises. Therefore, since transfer of process patents by Grower Ltd. to TZ Inc. is an international transaction between associated enterprises, the provisions of transfer pricing are attracted in the given case.

(iii) Sale of tangible property falls within the scope of 'international transaction'. Tangible property includes tools and equipment. PMG Inc. and SMG Ltd. are associated enterprises, since PMG Inc. is the holding company of SMG Ltd. PMG Inc. fulfills the condition of holding shares not carrying less than 26% of the voting power in SMG Ltd. Therefore, sale of equipment and tools by SMG Ltd., to PMG Inc. (a Danish Company), is an international transaction between associated enterprises, and consequently, the provisions of transfer pricing are attracted in this case.

Question 30

(a) Explain the applicability and computation of Arm's Length Price by Profit Split Method (PSM)?

(b) Alpha Ltd., an Indian company, sells computer monitor to its 100 per cent subsidiary Beta Inc. in United States @ \$ 75 per piece. Alpha Ltd. also sells its computer monitor to another company Eagle Inc. in United States @ \$ 120 per piece. Total income of Alpha Ltd. for the A.Y 2015-16 is ₹18,00,000, which includes sales made for 150 computer monitors to Eagle Inc. at \$50 per piece. Compute the arm's length price and taxable income of Alpha Ltd. 1\$, to be taken as equivalent to ₹ 60.

Solution to Question 30 (a)

Profit Split Method (PSM):

1. Applicability: This method aims to determine what division of total profits independent enterprise would expect in relation to the relevant transactions. The profits should be split on an economically valid basis that reflects the functions and risks of each of the parties. In order to apply this method, it is necessary to identify the total profit arising from the related party transactions and split that profit between the parties according to their respective contributions.

2. The manner of computation of Arm's Length Price, using Profit Split Method (PSM), has been enumerated as follows:

Relative contribution approach (Single tier allocation):

The steps involved in the application of this method are to :

- (i) determine the combined net profit of all associated enterprises engaged in the international transactions;
- (ii) evaluate relative contribution made by each of them with regard to :
 - (a) functions performed;
 - (b) assets employed;
 - (c) risks assumed;
 - (d) reliable external market data Warnerting how such contribution would be evaluated.

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- (iii) Split the combined net profit in proportion to the relative net contribution.
- (iv) The profit so apportioned is taken to arrive at the arm's length price in relation to the international transaction.

Alternative approach: Residual split method (Two-tier allocation):

A two-tier allocation may also be adopted as follows –

- (i) Partial allocation of the net profit to each enterprise so as to provide it with a basic return appropriate to the type of the international transaction entered into;
- (ii) the remainder of the net profit to be allocated on the basis of the evaluation of the relative contribution made; and
- (iii) the total net profit from such a two-tier allocation is taken to arrive at the arm's length price in relation to the international transaction.

Solution to Question 30 (b)

Computation of the Arm's Length Price and taxable income of Alpha Ltd.

Particulars	Amount (₹)
Arm's Length Price ($\$120 \times 150 \times ₹60$)	10,80,000
Income of Alpha Ltd.	18,00,000
Less: Sale Consideration received from Beta Inc. for 150 monitors	4,50,000
Add: Sale Consideration at ALP	10,80,000
Total Income	24,30,000
Since, no income is deemed to accrue or arise in India, taxable income in the hands of Alpha Ltd., is NIL .	