Paper-7 Direct Taxation

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

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

Working notes should form part of the answers.

Section A

[Answer all the Questions]

(1) Answer the following sub-divisions briefly in the light of the provisions of the Income-tax Act, 1961: [20 Marks]

(i) Can the Authority giving approval under the Act withdraw even though no such power is specifically vested with him under the Act? [1]

Answer:

Section 293C provides that Central Government, Board or Income Tax Authority who is vested with the powers to grant approval shall also have power to withdraw approval at any time after providing an opportunity of being heard to the assessee, even though the Act does not confer on him the specific right to withdraw the approval.

(ii) A Plantation company, holding several acres of land, sold trees of spontaneous growth. The Assessing Officer is of the opinion that there arise capital gains. Discuss. [1]

Answer:

Sale proceeds of spontaneous growth will not result in capital gains, as they do not bring in any profit or gain [Suman Tea & Plywood Industries Pvt. Ltd (1997) 226 ITR 34 (SC)]. However, the sale proceeds will be considered under the head "Income from Other Sources".

(iii) What will be the residential status of A Ltd. an Indian company managed from Paris? [1]

Answer:

Indian company will always be Resident of India even if it is managed from outside India. Hence, the status of A Ltd. is Resident.

(iv) K Ltd. incurred expenditure for acquiring know-how on 15th December, 2014. Is the deduction u/s 35AB available? Justify. [1]

Answer:

As the expenditure on know-how is incurred after 31st March, 1998, deduction u/s 35AB is not available. However, K Ltd. can claim depreciation u/s 32 against this amount.

(v) D Ltd., carrying on business of a five star hotel, claims that the building in which the business is carried on has been specifically designed and equipped and therefore must be treated as "Plant" for deduction of depreciation u/s 32. Will the claim be admissible? [1]

Answer:

According to section 43(3), "Plant" specifically excludes Tea Bushes or Livestock or Buildings or Furniture and Fittings. Hence, Hotel Building cannot be treated as "Plant" for the purposes of depreciation.

(vi) Chetan owns a plot of land acquired on 1.7.2009 for a consideration of ₹8 lakhs. He enters into an agreement to sell the property on 23.3.2015 for a consideration of ₹18 lakhs. In part performance of the contract, he handed over the possession of land on 26.3.2015 on which date, he received the full consideration. As on 31.3.2015, the sale was pending registration. Discuss liability of capital gains for the assessment year 2015-16 (no computation is required). [1]

Answer:

As per Sec. 2(47), transfer includes part performance of a contract of the nature specified in Sec. 53A of the Transfer of Property Act. In the given case, consideration was received by Chetan and the possession was handed over on 26.3.2015. Hence, the part performance condition is satisfied and Chetan will be liable for the capital gain for the assessment year 2015-16.

(vii) Mr. Khan has incurred long term capital loss of ₹50,000 during the previous year 2014-15. During the same year shares held in trust for minor son of Mr. Khan sold earning a long term capital gain of ₹2,50,000 which is not exempt. Can Mr. Khan set off the loss incurred by him against the gain on minor's account? [1]

Answer:

Mr. Khan will be entitled to set off the loss incurred by him against the gain on minor's account if the income of the minor is subject to clubbing with his income.

(viii) The Income-tax Act, 1961 provides for taxation of a certain income earned by Nandu. The Double Taxation Avoidance Agreement, which applies to Nandu, excludes the income earned by Nandu from the purview of tax. Is Nandu liable to pay tax on the income earned by him? Discuss. [1]

Answer:

Where any conflict arises between the provisions of the Double Taxation Avoidance Agreement and the Income-tax Act, 1961, the provisions of the Double Taxation Avoidance Agreement would prevail over those of the Income-tax Act. Nandu is, therefore, not liable to pay tax on the income earned by him.

(ix) State whether air conditioner, not used as stock in trade, is a capital asset. [1]

Answer:

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

(x) What will be the GAV, if the reasonable lettable value a house property is ₹72,000 but the actual rent of the property is ₹5,000 per month? [1]

Answer:

Annual value in this case is the reasonable lettable value i.e. ₹72,000 being higher than the actual rent of ₹60,000.

(xi) During the previous year 2014-15, Rathor earned ₹3,01,000 which includes ₹1,000 received by his son (aged 12 years) as an interest on 31.12.2014. Calculate the taxable income of Rathor. [1]

Answer:

Exemption u/s 10(32) is equal to actual income included in the hands of parent or ₹1,500, whichever is less. Hence, Exemption available to u/s 10(32) will be ₹1,000 only and Taxable Income of Rathor is ₹3,00,000.

(xii) X Ltd. incurred ₹5,00,000 for Agricultural Extension Project during the previous year 2014-15. State the allowability of that expenditure. [1]

Answer:

Allowable Expenditure on Agricultural Extension Project = Amount incurred × 150% = ₹5,00,000 × 150% = ₹7,50,000.

(xiii) Interest of ₹25,000 on Bank Fixed Deposits, received by minor son of Mrs. Ray. These Fixed Deposits were made by Mrs. Ray, out of his son's earnings from stage acting. Discuss the tax treatment in this case. [1]

Answer:

If the minor receives any income by exercise of labour, hard work, skill, knowledge or experience then such income shall not be clubbed. In the given case, the income of the minor son of Mrs. Ray, is from application of special talent, hence, shall not be clubbed in the hands of parents.

(xiv) Whether the following assets are "asset u/s 2(ea) of the Wealth Tax Act 1957?

a. **In the cash book of an individual/HUF opening balance as on the valuation date is ₹1,85,000 out of which the assessee deposits ₹1,35,000 in his current account with the Citi Bank before the closure of banking hours on the same day (no other inflow and outflow of cash as on the same day).**
b. **Residential house owned by a company and allotted to a part time director whose salary is ₹1,00,000 p.a.** **[2]**

Answer:

a. Since, at the time of valuation i.e. last moment of valuation date the cash balance is only ₹50,000 hence assets u/s 2(ea) shall be taken as Nil.
b. Yes, as the director is not a whole time director.

(xv) Discuss the manner of determination of arm's length price. **[2]**

Answer:
The manner of determination of arm's length price referred to in section 92CC(1), may include the methods referred to in section 92C(1) (i.e. 6 methods) or any other method, with such adjustments or variations, as may be necessary or expedient so to do.

(xvi) What is the period of validity of advance pricing agreement? **[1]**

Answer:
The agreement referred to in section 92CC(1) shall be valid for such period not exceeding five consecutive previous years as may be specified in the agreement.

(xvii) State the power of Transfer Pricing Officer for the purpose determining arm's length price? **[2]**

Answer:
The Transfer Pricing Officer may, for the purposes of determining the arm's length price under this section, exercise all or any of the powers specified in clauses (a) to (d) of section 131(1) or section 133(6) or survey under section 133A. Thus, TPO shall now have power to conduct on the spot enquiry and verification.

2. Answer any four Questions [4 ×13 = 52]

(a)(i) The following are the particulars of income of Mr. P for the previous year 2014-15:

Particulars	₹
(a) Rent from a property in Delhi received in USA	**80,000**
(b) Income from a business in USA controlled from Delhi	**1,20,000**
(c) Income from a business in Bangalore controlled from USA	**1,80,000**
(d) Rent from a property in USA received there but subsequently remitted to India	**60,000**
(e) Interest from deposits with an Indian company received in USA	**20,000**
(f) Profits for the year 2013-14 of a business in USA remitted to India during the previous year 2014-15 (Not taxed earlier)	**75,000**
(g) Gift received from his parents.	**45,000**

Compute his income for the assessment year 2015 –16 if he is:

(i) Resident and ordinarily resident in India,
(ii) Not ordinarily resident in India,
(iii) Non-resident in India. [6]

Solution:

Particulars	Resident and ordinarily resident	Not Ordinarily resident	Non-Resident
(1) Income earned/deemed to a accrue/arise in India			
Rent from property in Delhi	80,000	80,000	80,000
Income from business in Bangalore	1,80,000	1,80,000	1,80,000
Interest from Indian company	20,000	20,000	20,000
(2) Income earned and received outside India, form a business controlled from India			
Income from business in U. S. A.	1,20,000	1,20,000	-
(3) Income earned and received outside India other than (2)			
Rent from property in U. S. A	60,000		
	4,60,000	4,00,000	2,80,000

1. Profits of 2013-14 are not income of the previous year 2014-15 and hence cannot be included in the income for assessment year 2015-16.
2. Gifts received are capital receipts and are not regarded as income.

(a)(ii) Tarun is employed with ABC Ltd. on a monthly salary of ₹25,000 per month. The company provides him with the following benefits:

I. **A company owned accommodation is provided to him in Delhi.**
II. **The company has given him a housing loan of ₹5,00,000 on which it charges interest @6% per annum. The entire loan is still outstanding. (Assume the interest charged by SBI is 10% p.a.)**

III. The company gave him a gift worth ₹15,900 on his 50th birthday on 21.10.2014.

IV. He is allowed to use the video camera belonging to the company. The company had purchased this camera for ₹60,000 on 1.5.2010. This camera was sold to him on 1.8.2014 for ₹30,000

V. The company had purchased a car on 16.7.2011 for ₹2,50,000. This car is sold to Tarun on 14.7.2014 for ₹80,000. The car was not being used by Tarun.

VI. The company pays the telephone bills of ₹24,000 for the telephone installed at the residence of Tarun.

Compute the Gross income from salary of Tarun for the assessment year 2015-16. [7]

Solution:

	₹	₹
Salary (₹25,000 × 12)		3,00,000
Value of accommodation (15% of salary)		45,000
Value for housing loan (4% of ₹5,00,000)		20,000
Gift in kind on birthday (₹ 15,900 - 5,000)		10,900
Value for use of video camera for 4 months $\left(60,000 \times \frac{10}{100} \times \frac{4}{12}\right)$		2,000
Benefit of sale of camera		
W.D.V. on basis of straight line method (₹60,000 - 18,000 depreciation for 3 completed years)	42,000	
Lew: Amount recovered	30,000	12,000
Benefit on sale of car W.D.V. (see note)	1,60,000	
Less: Consideration paid	80,000	80,000
Payment of telephone bills		(Exempt)
Gross income from salary		4,69,900

Note.—The car has been used from 16.7.2011 to 14.7.2014 and the completed years in this case are two. Therefore, the WDV shall be determined as under:

	₹
Original cost	2,50,000
Less: Depreciation for first year @20%	50,000
W.D.V.	2,00,000
Less: Depreciation for second year	40,000
	1,60,000

(b)(i) Sourav owns a house property in Delhi. From the particulars given below compute the income from house property for the assessment year 2015-16.

	₹
Municipal value	**2,00,000**
Fair rent	**2,52,000**
Standard rent	**2,40,000**

Actual rent (per month)	**23,000**
Municipal taxes	**20% of municipal value**
Municipal taxes paid during the year	**50% of tax levied**
Expenses on repairs	**20,000**
Insurance premium	**5,000**

Sourav had borrowed a sum of ₹12,00,000 @10% p.a. on 1.7.2012 and the construction of the property was completed on 28.2.2014. [6]

Solution:

Gross annual value shall be higher of the following two:

		₹	₹
(a)	Expected rent [Municipal value (₹2,00,000), Fair rent (₹2,52,000) whichever is higher, but limited to standard rent (₹2,40,000)	2,40,000	
(b)	Actual rent received/receivable (₹23,000 × 12)	2,76,000	
	∴ Gross annual value		2,76,000
	Less Municipal taxes paid [50% of (20% of ₹2,00,000)]		20,000
Less: Deductions u/s 24			2,56,000
(a)	Statutory deduction @ 30%	76,800	
(b)	Interest on borrowed money (see note below)	1,38,000	2,14,800
	Income from house property		41,200

Notes:

(1) Interest for pre-construction period
Pre-construction period shall be from 1.7.2012 to 31.3.2013 i.e. 9 months

Interest for 9 months = 12,00,000 × $\frac{10}{100} \times \frac{9}{12} = 90,000$

1/5 of ₹90,000	18,000
(2) Interest for previous year (10% of ₹12,00,000)	1,20,000
	1,38,000

(b)(ii) A company makes a slump sale of one of its divisions on 1.8.2014 for ₹20,00,000. The W.D.V. of the block of assets being plant and machinery carrying 15% depreciation was ₹12,00,000. The company has acquired a new machinery X on 5.7.2014 for ₹3,00,000 and sold machinery Y on 30.12.2014 for ₹9,00,000. The plant and machinery which were transferred under the slump sales were acquired at actual cost of ₹14,00,000. The amount of depreciation allowed on such plant and machinery was as under:
Actual depreciation upto assessment year 1988- 89 ₹2,40,000.

Depreciation for assessment years 1989-90 to 2014-15 (assuming that these were the only machines in that block) ₹4,50,000.
Compute the W.D.V. for the purpose of charging current year depreciation. [7]

Solution:

	₹	₹	₹
W.D.V. of the block as on 1.4.2014 (I)			12,00,000
Additions during the year for 180 days or more (II)			3,00,000
			15,00,000
Less: Sold during the year (III)			9,00,000
Balance WDV before Slump Sale			6,00,000
Less: Assets transferred in Slump Sale			
Actual cost		14,00,000	
Less: depreciation upto A.Y. 1988-89	2,40,000		
Depreciation upto A.Y. 2014-15	4,50,000	6,90,000	
WDV of the assets sold in slump sale is ₹7, 10,000, but deduction will be limited to WDV calculated as per step I + step II - step III i.e. ₹6,00,000		7,10,000	6,00,000
W.D.V. for the purpose of charging depreciation			Nil

The deduction of asset sold in the slump sale cannot exceed the W.D.V. calculated as per Step I + Step II - Step III. Further, there will be no short-term capital gain as per section 50 as the sale price of assets exclusive of slump sales is less than W.D.V. However, there will be capital gain on slump sale as per section 50B discussed later under chapter on capital gain and the W.D.V. of the assets sold in slump sale for computing capital gain under section 50B in that case shall be ₹6,00,000.

(c)(i) A holds 5,000 shares (10%/of total share holding) in X Ltd. which he had purchased on 5.3.1994 for ₹2,00,000. The company went into liquidation on 16.7.2014 and paid a sum of ₹ 50 per share in cash and an asset whose market value as on the date of distribution i.e. 28.9.2014 was ₹6,40,000 to A. The accumulated profits of the company were ₹5,00,000.

(a) Compute the income of A for the assessment year 2015-16 assuming that he has no other income.

(b) Compute the capital gain chargeable to tax if the asset X is sold by A for ₹7,00,000 on 28.3.2015. [8]

Solution:

Computation of Capital Gain of A assessment year 2015-16

(a) Capital Gain on transfer of shares

	₹	₹
Full value of consideration for capital gain (₹2,50,000 + 6,40,000)	8,90,000	
Less: Proportionate amount of deemed dividend (10% of ₹4,27,369)	42,737	8,47,263
Less: Indexed cost of acquisition – (₹2,00,000 ×1024) ÷ 244		8,39,344
Long-term capital gain		7,919
Income from other sources		
Deemed dividend (₹42,737)		exempt
Total Income		7,919

(b) Capital gain on transfer of asset X

Full value of consideration	7,00,000
Less: Cost of acquisition (Market value as on date of distribution)	6,40,000
Short-term capital gain	60,000

The accumulated profits of the company are ₹5,00,000 and the company has to pay dividend tax @ 16.995% (15% + 10% surcharge + 2% education cess + SHEC @ 1%) on the amount of dividend distributed or paid. Hence, the amount to be distributed plus tax @ 16.995% on such amount should be ₹5,00,000.

Hence, the amount of tax shall be ₹5,00,000 × $\frac{16.995}{116.995}$ = 72,631

∴ the amount available for distribution is ₹5,00,000 – 72,631 = ₹4,27,369

Tax on ₹4,27,369 @ 16.995% is ₹72,631.

(c)(ii) X, a German national, came to India for the first time on 1.7.2008. During the period from 1.7.2008 to 31.3.2015, he stayed in India as follows—from 1.7.2008 to 31.10.2008; from 1.5.2008 to 31.10.2010; from 1.11.2010 to 31.12.2010 and from 1.7.2013 to 31.8.2014. During the previous year ended on 31.3.2015, X's income consisted of: (a) business in India: ₹40,000; (b) interest from an Indian company: ₹2,000; (c) dividends from non-Indian companies received in Germany but remitted to India: ₹5,000; (d) business in Germany (controlled from India): ₹25,000; (e) income from house property in Germany: ₹8,000. Determine, giving full reasons, the gross total income of X for the assessment year 2015-16 after ascertaining his 'residence' for the purpose of income-tax. [5]

Solution:

Stay in India during previous year 2014 –15	Days
1.4.2014 to 31.8.2014 (30 + 31 +30 + 31 +31)	153
Stay in India during 4 years preceding the previous year	
2013-14(31+31+30 + 31+30 + 31 +31+28 + 31)	274
2012 – 13	Nil
2011 – 12	Nil
2010 – 11 (30 + 31)	61
	333

Hence, he does not satisfy any condition for being a resident

Therefore he is a Non-resident

Taxable Income

	₹
(i) Business Income	40,000
(ii) interest from an Indian Company	2,000
	42,000

(d)(i) The income of X, who is totally blind, for the previous year 2014-15, is as under:

		₹
(i)	**Income from house property**	**1,82,000**
(ii)	**Income from interest on loan**	**27,000**
(iii)	**Income from interest on bank deposits under recurring**	**10,000**
(iv)	**Long-term capital gains**	**1,20,000**

He is eligible for deduction of ₹10,000 u/s 80C on account of PPF and ₹50,000 under section 80U. Compute his tax liability. [5]

Solution:

Particulars	₹
Gross Total Income (without long-term capital gains)	2,19,000
Less: Deductions u/s 80C and 80U (10,000 + 50,000)	60,000
Total income (without LTCG)	1,59,000
Tax on total income (₹1,59,000 + 91,000 shifted from LTCG)	Nil
Tax on long-term capital gain @ 20% on ₹29,000 (1,20,000 - 91,000)	5,800
Tax payable	5,800
Less: Rebate u/s 87A	2,000
	3,800
Add: Education cess & SHEC - @ 3%	114
Total tax payable	3914
Tax rounded off	3910

(d)(ii) Ms. S who draws a salary of ₹20,000 p.m. received the following gifts during the previous year 2014-15:

(i) Gift of ₹5,00,000 on 16.4.2014 from a friend.
(ii) Gift of jewellery fair market value of which is ₹3,00,000 on 17.5.2014 from her fiancee.
(iii) Gifts of ₹51,000 each received from her 4 friends on the occasion of her marriage on 21.10.2014.
(iv) Gift of ₹1,00,000 on 22.11.2014 from her mother's sister.
(v) Gift of ₹60,000 on 25.11.2014 from her father's brother.
(vi) Gift of ₹50,000 from her husband's friend on 1.12.2014.
(vii) Gift of ₹21,000 on 15.12.2014 from her mother's friend.
(viii) Gift of ₹26,000 on 25.12.2014 from her brother's father in law.
(ix) Gift of ₹1,21,000 from her husband's brother.
(x) Gift of ₹26,000 from her employer.
(xi) Scholarship of ₹1,20,000 from a charitable institution registered under section 12AA.
(xii) He has purchased a immovable property from B who is not his relative from a sum of ₹24,50,000. The stamp duty value of the property is ₹26,00,000.
(xiii) She purchased bullion for ₹4,40,000 whose fair market value is ₹4,85,000.
(xiv) Gift of immovable property from her friend whose stamp duty value is ₹5,00,000.

Compute her total income for the assessment year 2015-16. [8]

Solution:

		₹	₹
Income under the head salary			
Salary (20,000 × 12)		2,40,000	
Add: cash gift from employer		26,000	
		2,66,000	
Less: Deduction		Nil	2,66,000
Income from other sources			
(1)	Gift of money	₹	₹
(i)	Gift from a friend is includable	5,00,000	
(ii)	Gifts received from her 4 friends are exempt as they have been received on the occasion of her marriage	-	
(iii)	Gift from her mother's sister is exempt as the donor is covered in the definition of relative	-	
(iv)	Gift from father's brother is exempt as the donor covered in the definition of relative	-	
(v)	Gift of ₹50,000 from her husband's friend on 01.12.2014 is taxable as aggregate sum of money received during the year exceeds ₹50,000	50,000	
(vi)	Gift of ₹21,000 from her mother's friend is includable as aggregate sum of money received during the year exceeds ₹50,000	21,000	
(vii)	Gift from her brother's father in law is taxable as the donor is not covered in the definition of relative	26,000	
(viii)	Gift from her husband's brother is exempt as the donor is covered in the definition of relative	-	

(ix)	Gift from her employer is taxable as income from salary	-	
(x)	Gift in the form of scholarship from charitable institution registered u/s 12AA	exempt	
(2)	Gift of moveable property - Gift of jewellery is taxable	3,00,000	
(3)	Moveable property acquired for inadequate consideration - Difference between fair market value of movable property and purchase price does not exceed ₹50,000	Not taxable	
(4)	Gift of immovable property - Gift of immovable property received from her friend	5,00,000	
(5)	Immovable property acquired for inadequate consideration - Difference between stamp duty value and purchase price	1,50,000	15,47,000
	Total income		18,13,000

(e)(i) Mrs. Satya Yadav received the following amounts during financial year 2014 –15:

	₹
Gross Salary	**5,30,000**
Family Pension (₹10,000 × 12)	**1,20,000**
Income of a minor child	**49,000**
Accumulated balance in PF of her husband after his death	**1,00,000**
Gratuity received after the death of husband	**1,00,000**

Calculate taxable income of Mrs. Satya Yadav and tax liability for the assessment year 2015-16.

[6]

Solution:

Computation of taxable income of Mrs. Satya Yadav for the assessment year 2015-16 Income from Salary

	₹	₹
Gross salary	5,30,000	
Less: Deduction	Nil	5,30,000
Income from other sources		
Family pension	1,20,000	
Less: Deduction u/s 56 1/3 or ₹ 15,000 whichever is less	15,000	1,05,000
Income of a minor child	49,000	
Less: Exemption u/s 10(32)	1,500	47,500
Gross total income		6,82,500
Tax payable		66,500
Add: Education cess & SHEC - @ 3%		1,995
Tax rounded off		68,500

Note.—Accumulated balance in PF and amount of gratuity received after the death of husband is exempt from tax as it is assumed to be within the limit prescribed by section 10(10).

(e)(ii) M, who was born on 4.01.1950 submits the following information:

Particulars	₹
1. Rent from house (per month)	**25,000**
2. Municipal taxes paid during the previous year	**20,060**
3. Long-term capital gains on sale of gold	**1,00,000**
4. Interest on bank deposits (gross)	**44,150**
5. Term deposit made during the year in a schedule bank for six years	**20,000**

Compute the Total Income and tax liability of M for assessment year 2015-16. **[7]**

Solution:

	₹	₹
Income from house property:		
Actual rent	3,00,000	
Less: Municipal taxes (paid)	20,000	
	2,80,000	
Less: Statutory deduction @ 30%	84,000	1,96,000
Long-term capital gain: On sale of gold		1,00,000
Income from other sources: Interest on bank deposits		44,150
Gross Total Income		3,40,150
Less: Deduction u/s 80C		20,000
Total Income		3,20,150
Computation of tax:		
Tax on Total Income of ₹2,20,150 + 79,850 shifted from LTCG		Nil
Tax on long-term capital gains @ 20% on ₹20,150 (₹1,00,000 - 79,850)		4,030
Tax payable		4,030
Less: Rebate u/s 87A		2,000
		2,030
Add: Education cess & SHEC - @ 3%		61
Tax (round off)		2,090

Section B

3. Answer any two Questions [1 × 8 = 8]

(a)(i) Dream Company Ltd. has let-out a premise with effect from 1.10.2014 for monthly rent of ₹1.5 lakh. The lease is valid for 10 years and the tenant has made a deposit equivalent to 3 months rent. The tenant has undertaken to pay the municipal taxes of the premises amounting to ₹ 2 lakh. What will be the value of the property under Schedule III of the Wealth Tax Act for assessment to wealth tax? [4]

Solution :

Assessee: Property Company Ltd. Valuation Date: 31.3.2015 Assessment Year : 2015-16

Computation of Value of Let-out Property

Actual Annual Rent Receivable - ₹ 1,50,000 × 12 Months	18,00,000
Add: Municipal Taxes borne by the Tenant	2,00,000
GROSS MAINTAINABLE RENT	20,00,000
Less: Municipal Taxes levied by the Municipal Authority	2,00,000
Less: 15% of Gross Maintainable Rent ₹ 20,00,000 × 15%)	3,00,000
NET MAINTAINABLE RENT	15,00,000

(a)(ii) 'X' received a vacant site under his father's will. The value of the site on 31.3.2015 is ₹15 Lakhs. As per terms of the 'Will' in the event 'X' wants to sell the site he should offer it to his brother for sale at ₹10 Lakhs. 'X', therefore, claims that the value of the site should be taken at ₹10 Lakhs as at 31.3.2015. Is the claim correct? [4]

Solution :

1. As per Rule 21 of Schedule III to the Act, the **price or other consideration for which** any property may be **acquired by or transferred to any person under the terms of a deed of trust** or through or under any restrictive agreement in any instrument of transfer **shall be ignored** for the purpose of determining the value under the provisions of the Schedule.
2. In view of the above, the value of the site should be taken as ₹ 15 Lakhs and not as ₹ 10 Lakhs.
3. Therefore, **claim of X is incorrect.**

(b) Net wealth of firm consisting of three partners Bidyut, Kingshuk and Deepak in 2:2:1 and a capital contribution of ₹17 Lakhs, ₹13 Lakhs, and ₹12 Lakhs respectively is as under –

(a) Value of assets located outside India	**₹ 30,00,000**
(b) Value of assets located in India	**₹ 80,00,000**
(c) Debts incurred in relation to assets in India	**₹ 40,00,000**

Determine the value of interest of the partners in the firm under the Wealth Tax Act, 1957. [8]

Solution :

Assesses : Bidyut, Kingshuk & Deepak Valuation Date : 31.3.2015 Assessment Year: 2015-16

Computation of net wealth of the Firm

Particulars	₹	₹
Value of Assets located in India	80,00,000	
Less: Liability in relation to assets in India	40,00,000	40,00,000
Value of Assets located outside India		30,00,000
Net Wealth of the Firm		70,00,000

Computation of Interest of the Partner in the net wealth of the Firm (Amount in ₹)

Particulars	Bidyut	Kingshuk	Deepak
To the extent of Capital Contribution	17,00,000	13,00,000	12,00,000
Balance (Net Wealth-Capital Contribution) in Profit sharing ratio since dissolution ratio is not given	11,20,000	11,20,000	5,60,000
Interest of the Partner in the Net Wealth of the Firm	28,20,000	24,20,000	17,60,000

Computation of the Interest of the Partner in the net wealth of the Firm on the basis of location of assets:

(Interest of the Partner in the Firm **apportioned** in the ratio of **4:3)**

Particulars	Bidyut	Kingshuk	Deepak
Assets Located Inside India	16,11,429	13,82,857	10,05,714
Assets Located Outside India	12,08,571	10,37,143	7,54,286
Interest of the Partner in the Net Wealth of the Firm	28,20,000	24,20,000	17,60,000

Section C

4. Answer any two Questions [2 × 10 = 20]

(a) What are the steps to be followed for determining Arm's Length Price of an international transaction? [10]

Answer:

The following are the steps to be followed:-

Step 1: Selection of comparable companies
Step 2: Use of different filters
Step 3: Screening of comparables based on FAR Taxation of International Transactions
Step 4: Use of Power under Indirect Tax laws
Step 5: Adjustments
Step 6: 5% Safe Harbour

The steps may be enumerated as follows:

Step 1: Selection of Comparable Companies

The first step for doing this study is to select comparable companies. This can be selected in the following four ways:-

a. Industry-wise selection
b. Product-wise selection
c. NIC Code-wise selection
d. Segment-wise selection

The data relating to the financial year in which the international transaction has been entered into must be used in analyzing the comparability of an uncontrolled transaction with an international transaction.

Step 2: Use of different filters

Once there is a selection of comparable companies, the next step is to filter these companies with the use of quantitative and qualitative filters. The following filters are also used sometimes:

a. Companies whose data is not available for the relevant year
b. Companies for which sufficient financial data is not available to undertake analysis
c. Different financial year filter
d. Turnover filter
e. Service Income filter
f. Export filter
g. Diminishing Loss filter
h. Related party filter
i. Companies that had exceptional year/(s) of operation
j. Employee cost filter
k. Onsite and offsite filter
l. Fixed Asset filter
m. Research & Development Expense filter
n. Income Tax filter

Step 3: Screening of comparables based on FAR

Comparability of an international transaction with an uncontrolled transaction shall have to be judged with relevance to the following factors:

a. The specific characteristics of the property transferred or services provided in either transaction;
b. FAR Analysis- the (F) functions performed, taking into account (A)assets employed or to be employed or the (R) risks assumed by the respective parties to the transactions;
c. The contractual terms (whether or not such terms are formal or in writing) of the transactions which lay down explicitly or implicitly how the responsibilities, risks and benefits are to be divided between the respective parties to the transactions;
d. Conditions prevailing in the markets in which the respective parties to the transactions operate, including the geographical location and size of the markets, overall economic development and level of competition and whether the markets are wholesale or retail.

There may arise situation, where it requires further analysis of the following factors:-

(i) Is there a public issue in the relevant year or previous year?
(ii) Are the entity's profits exempted from tax?
(iii) Is there any merger/de-merger, etc., during the relevant time?

(iv) Is the depreciation policy different?
(v) Is there a wide difference between various segments' profitability?
(vi) Is the area of operation, i.e. geography different?
(vii) Is the volume of operation different?

Step 4: Use of power under Indirect Tax Laws

This power is usually used by the Revenue Department/Authorities, with a special reference to Sec. 133(6) of the Income Tax Act, 1961. The authorities may exercise such powers for getting details which are generally not available in the annual reports of the companies. This power is used more in the earlier years.

Step 5: Adjustments

Based on specific characteristics of the property transferred or the services rendered in either transaction and the contractual terms (whether or not such terms are formal or in writing) of the transactions which lay down explicitly or implicitly how the responsibilities, risks and benefits are to be divided between the respective parties to the transactions. The following enterprise level and transaction level adjustments are suggested:

a. Functional differences
b. Asset differences
c. Risk differences
d. Geographical location
e. Size of the market
f. Wholesale or retail market
g. The laws and governmental orders in force
h. Cost of labour
i. Cost of capital in the markets
j. Overall economic development
k. Level of competition
l. Accounting practices

However, in practice the following adjustments are provided:

(i) Working capital adjustment
(ii) Risk adjustment
(iii) Volume/geographical/depreciation/idle capacity/first year operation, etc.

Step 6: 5% Safe Harbour

a. If the application of the MAM (Most Appropriate Method) leads to determination of more than one price, the arithmetical mean of such prices shall be taken to be the Arm's Length Price (ALP) in relation to the international transaction.
b. If the ALP so determined is within +/- 5% range of international transaction price, then no adjustments are required
c. If the ALP is not within +/- 5% range of the international transaction price, then adjustments are required for the whole difference between the ALP and international transactions and benefit of 5% will not be available.

However, the Finance Act, 2012 has fixed the upper limit of safe harbor as 3%.

(b)(i) M Ltd. an Indian company sells computer monitor to its 100% subsidiary N Ltd. in United States @ $70 per piece. M Ltd. also sells its computer monitor to another Company P Ltd. in United States @ $90 per piece. Total income of M Ltd. for the assessment year 2015-16 is ₹15,00,000 which includes sales made for 120 computer monitor @ $70 to N Ltd. Compute the arm's length

price and taxable income of M Ltd and N Ltd. The rate of one dollar may be assumed to be equivalent to ₹50 for the sake of simplicity. [4]

Solution:

Arm's length price ($90 x 120 x ₹50) = ₹5,40,000

Income of M Ltd.:

Particulars	₹
Income as per books of account	15,00,000
Less: Sale consideration 120 monitor sold to N Ltd.(recorded price)	4,20,000
Add: Sale consideration at arm's length price	5,40,000
Taxable income	16,20,000

Income of N Ltd.:

As no income is deemed to accrue or arise in India, nothing is taxable in the hands of Q Ltd.

(b)(ii) Khana Ltd. is an Indian Company engaged in the business of developing and manufacturing industrial components. Its Canadian Subsidiary ProTech Inc. supplies technical information and offers technical support to Khana Ltd. for manufacturing goods, for a consideration of €1,00,000 per year. Income of Khana Ltd. is ₹90 Lakhs. Determine the Taxable Income of Khana Ltd. if ProTech charges €1,30,000 per year to other entities in India. What will be the answer if ProTech charges €60,000 per year to other entitles. (Rate per Euro may be taken at ₹50) [6]

Solution:

Computation of Total Income of Khana Ltd.

Particulars	₹	₹
When Price Charged for Comparable Uncontrolled Transaction	€1,30,000	€60,000
Price actually paid by Khana Ltd. [€1,00,000 x 50]	50,00,000	50,00,000
Less: Price charged in Rupees (under ALP)		
[€1,30,000 x 50]	65,00,000	
[€60,000 x 50]		30,00,000
Incremental Profit on adopting ALP [A]	(15,00,000)	20,00,000
Total Income before adjusting for differences due to Arm's Length Price	90,00,000	90,00,000
Add: Difference on account of adopting Arm's Length Price [if (A) is positive]	Nil	20,00,000
Total Income of Khana Ltd	90,00,000	1,10,00,000

Note: As per Sec. 92(3), Taxable Income cannot be reduced on applying ALP. Therefore, difference on account of ALP which reduces the Taxable Income is ignored.

(c)(i) When can enterprises be deemed to be "Associated Enterprises"? [6]

Answer:

Two enterprises shall be deemed to be associated enterprises, if, at any time during the previous year, any of the following conditions are attracted -

A. **Shareholding:** One enterprise holds, directly or indirectly, shares carrying not less than 26% of shares/voting power in the other enterprise.
B. **Shareholding by same person:** Any person or enterprise holds, directly or indirectly, shares carrying not less than 26% of the voting power in each of such enterprises, or
C. **Loans:** A loan advanced by one enterprise to the other enterprise constitutes not less than 51% of the book value of the total assets of the other enterprise, or
D. **Guarantee:** One enterprise guarantees not less than 10% of the total borrowings of the other enterprise, or
E. **Management Control:** More than half of the board of directors or members of the governing board, or one or more executive directors or executive members of the governing board of one enterprise, are appointed by the other enterprise, or
F. **Control by same person:** More than half of the directors or members of the governing board, or one or more of the executive directors or members of the governing board, of each of the two enterprises are appointed by the same person or persons, or
G. **Know-how relationship:** The manufacture or processing of goods or articles or business carried out by one enterprise is wholly dependent on the use of know-how, patents, copyrights, trade-marks, licences, franchises or any other business or commercial rights of similar nature, or any data, documentation, drawing or specification relating to any patent, invention, model, design, secret formula or process, of which the other enterprise is the owner or holder of exclusive rights, or
H. **Purchase relationship:** 90% or more of the raw materials and consumables, required for the manufacture or processing of goods or articles carried out by one enterprise, are supplied by the other enterprise, or by persons specified by the other enterprise and the prices and other conditions relating to the supply are influenced by such other enterprise, or
I. **Sale relationship:** The goods or articles manufactured or processed by one enterprise, are sold to the other enterprise or to persons specified by the other enterprise and the prices and other conditions relating thereto are influenced by such other enterprise, or
J. **Control through relatives of individual:** Where one enterprise is controlled by an individual, the other enterprise is also controlled by such individual or his relative or jointly by such individual and relative of such individual, or
K. **Control through members of HUF:** Where one enterprise is controlled by HUF, the other enterprise is controlled by a member of such HUF, or by a relative of a member of such HUF, or jointly by such member and his relative, or
L. **Control through Firms etc.:** Where one enterprise is a Firm/AOP/BOI, the other enterprise holds not less than 10% interest in such Firm /AOP/BOI, or
M. **Other relationships:** There exists between two enterprises, any relationship or mutual interest, as prescribed.

(c)(ii) "The Arm's Length Principle, although survives upon the international consensus, does not necessarily mean that it is perfect" – Discuss. [4]

Answer:

The Arm's Length Principle, although survives upon the international consensus, does not necessarily mean that it is perfect. There are difficulties in applying this principle in a number of situations that are as follows:

A. The most serious problem is the need to find transactions between independent parties which can be said to be exact compared to the controlled transaction.
B. It is important to appreciate that in a Multinational Enterprise system, a group first identifies the goal and then goes on to create the associated enterprise and finally, the transactions entered into. This procedure obviously does not apply to independent enterprises. Due to these facts, there may be transactions within a Multinational Enterprise group which may not be between independent enterprises.
C. Further, the reductionist approach of splitting a Multinational Enterprise group into its component parts before evaluating transfer pricing may mean that the benefits of economies of scale, or integration between the parties, is not appropriately allocated between the Multinational Enterprise group.
D. The application of the arm's length principle also imposes a burden on business, as it may require the Multinational Enterprise to do things that it would otherwise not do (i.e. searching for comparable transactions, documenting transactions in detail, etc).
E. Arm's length principle involves a lot of cost to the group.