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**CA FINAL NOVEMBER 2016 EXAM**

**DIRECT TAXES**

**Test Code - F N J 6 0 2 4**

**BRANCH - (MUMBAI) (Date :17.07.2016)**

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Answer-1 (a) :

**Computation of Book Profit of XYZ Limited under section 115JB**

Particulars	Rs.	Rs.
Net Profit as per profit and loss account	75,00,000	
<b>Add: Net Profit to be increased by the following amounts as per Explanation 1 to section 115JB</b>		
Transfer to General Reserve	5,00,000	
Provision for unascertained liabilities	2,00,000	
Provision for doubtful debts	1,00,000	
Depreciation	<u>24,00,000</u>	<u>32,00,000</u>
		1,07,00,000
<b>Less: Net Profit to be reduced by the following amounts as per Explanation 1 to section 115JB</b>		
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 2014-15]	3,00,000	
Depreciation (excluding revaluation)	20,00,000	
Net Agricultural Income [Exempt under section 10(1)]	6,00,000	
Loss brought forward (Rs. 12 lakhs) or unabsorbed depreciation (Rs. 10 lakhs) as per books, whichever is less	<u>10,00,000</u>	<u>39,00,000</u>
<b>Book Profit for computation of MAT under section 115JB</b>		<b>68,00,000</b>

(5 Marks)

**Computation of Minimum Alternate Tax (MAT) under section 115JB**

Particulars	Rs.	Rs.
18.50% of book profit (18.5% of Rs. 68 lakh)		12,58,000
Add: Education cess @ 2%	25,160	
Secondary and higher education cess @ 1%	<u>12,580</u>	<u>37,740</u>
<b>Minimum Alternate Tax payable under section 115JB</b>		<b>12,95,740</b>

**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.

(3 Marks)

Answer-1 (b) :

**(i) Computation of total income of the AOP for A.Y. 2016-17**

Particulars	Rs.
Profit & gains of business (See Working Note below)	3,12,300
Long term capital gain	6,40,000
Income from other sources [Dividend is exempt under section 10(34)]	-
<b>Total income</b>	<b>9,52,300</b>

(2 Marks)

**Working Note - Computation of profits and gains of business**

Particulars	Rs.	Rs.
Net profit as per profit & loss account		5,24,300
Add: Inadmissible payments		
Interest to members T & Q (Rs. 48,300 + Rs. 35,700)	84,000	
Advertising [Disallowance under section 40A(3) (100% of Rs. 30,000 being a cash payment)]	30,000	
Remuneration to members T & Q (Rs. 1,30,000+Rs.1,70,000)	3,00,000	
Sales tax penalty (See Note 3 below)	<u>39,000</u>	<u>4,53,000</u>
		9,77,300
Less: Income not taxable under this head		
Dividend from Indian companies	25,000	
Long term capital gain	<u>6,40,000</u>	<u>6,65,000</u>
<b>Profits and gains of business</b>		<b>3,12,300</b>

(3 Marks)

**(ii) Computation of tax liability of the AOP for A.Y.2016-17**

Particulars	Rs.	Rs.
Long-term capital gain (Rs. 6,40,000 @ 20%)		1,28,000
Other income (Rs. 3,12,300 @ 30%)		<u>93,690</u>
<b>Tax on total income</b>		<b>2,21,690</b>
Add: Surcharge @12%		<u>26,602</u>
		<b>2,48,293</b>
Add: Education cess @2% and SHEC @ 1%		<u>7,449</u>
<b>Total tax due</b>		<b>2,55,742</b>

(3 Marks)

**Notes:**

1. Since one of the members has individual income more than the basic exemption limit, the AOP will be assessed at the maximum marginal rate.  
Since the AOP is taxed at maximum marginal rate, the share income of members is not taxable in their hands individually.
2. Since the employer's contribution to PF has been paid during the previous year itself, it is allowable as deduction.
3. Penalty imposed for delay in filing sales tax return is not deductible since it is on account of infraction of the law requiring filing of the return within the specified period. – CIT v. Ratanchand Bholanath (S.S) (1986) 160 ITR 500 (M.P.)

**(iii) Tax implication in the hands of members T & Q for the A.Y.2016-17**

Members of the AOP have to pay tax on their total income taking into account savings/ investments etc. The share income from AOP is not taxable in their personal assessment.

**Answer-2 (a) :**

Since XYZ Inc. is located in a NJA, the transaction of provision of technical services by the Indian company, A Ltd., would be deemed to be an international transaction and XYZ Inc. and A Ltd. would be deemed to be associated enterprises. Therefore, the provisions of transfer pricing would be attracted in this case.

The price of Rs. 42 lakhs charged for similar services from PQR Inc, being an independent entity located in a non-NJA country, can be taken into consideration for determining the arm's length price (ALP) under Comparable Uncontrolled Price (CUP) Method. Since the ALP is more than the transfer price, the ALP of Rs. 42 lakhs would be considered as the income arising from the international transaction between A Ltd. and XYZ Inc.

**(2 Marks)**

**Answer-2 (b) :**

A resident can make an application to the Authority of Advance Ruling to seek an advance ruling in the following cases:

- (i) Section 245N(b)(iia) enables a resident referred in section 245N(a)(iia) falling within any such class or category of persons as may be notified by the Central Government to make an application to Authority for Advance Rulings. Such notified resident applicant can seek ruling in relation to his tax liability arising out of a transaction which has been undertaken or is proposed to be undertaken by **such applicant**, and such determination shall include the determination of any question of law or of fact specified in the application.

A resident in relation to his tax liability arising out of one or more transactions valuing Rs. 100 crore or more in total which has been undertaken or proposed to be undertaken would be an applicant for this purpose.

**(2 Marks)**

- (ii) Section 245N(b)(iii) enables a resident falling within any such class or category of persons as may be notified by the Central Government to make an application for Advance Ruling. Such notified resident applicant can seek ruling in respect of issues relating to computation of total income which is pending before any income-tax authority or the Appellate Tribunal. Such a resident applicant can make an application to seek determination or decision by the AAR on a question of law or a question of fact relating to such computation of total income specified in the application.

"Public sector companies" as defined in section 2(36A) of the Income-tax Act, 1961 have been notified as applicant for this purpose.

**(2**

**Marks)**

- (iii) A resident can also make an application seeking advance ruling in relation to the tax liability of a non-resident arising out of a transaction undertaken or proposed to be undertaken by him with such non-resident.

**(1 Mark)**

**Answer-2 (c) :**

An assessee may, at any stage of a case relating to him, make an application in the prescribed form and manner to the Settlement Commission under section 245C. "Case" means any proceeding for assessment which may be pending before an Assessing Officer on the date on which such application is made. Thus, the basic condition for making an application before the Settlement Commission under section 245C is that there

must be a proceeding for assessment pending before an Assessing Officer on the date on which the application is made.

A proceeding for assessment or reassessment or recomputation under section 147 shall be deemed to have commenced from the date on which a notice under section 148 is issued.

In this case, Mr. Amit cannot approach the Settlement Commission merely due to his apprehension that assessment of earlier years may be reopened, since there is no case pending before an Assessing Officer.

Therefore, he has to wait for the Assessing Officer to issue notice under section 148. Thereafter, he can make an application to the Settlement Commission under section 245C, since there would be a "case pending" before the Assessing Officer on that date.

Another basic condition to be satisfied for making an application is that the additional amount of income-tax payable on the income disclosed in the application should exceed Rs. 10 lakh, and such tax and interest thereon which would have been paid had the income disclosed in the application been declared in the return of income should be paid on or before the date of making the application and proof of such payment should be attached with the application.

If the Settlement Commission is satisfied that Mr. Amit has co-operated in the proceedings and made true and full disclosure of his income and the manner in which it has been derived, it may, subject to such conditions as it may think fit to impose, grant to Mr. Amit-

- (i) immunity from prosecution for any offence under the Income-tax Act, 1961 / Wealth-tax Act, 1957, where the proceedings for such prosecution have been instituted on or after the date of receipt of application under section 245C; and
- (ii) immunity from imposition of penalty under the Income-tax Act, 1961, either wholly or in part, with respect to the case covered by the settlement.

This is the benefit that may accrue to Mr. Amit, if he approaches the Settlement Commission.

**(5 Marks)**

**Note:** Where a notice under section 148 is issued for any assessment year, a proceeding under section 147 shall be deemed to have commenced on the date of issue of such notice and the assessee can approach the Settlement Commission for other assessment years as well, even if notice under section 148 for such other assessment years has not been issued but could have been issued on date. However, a return of income for such other assessment years should have been furnished under section 139 or the response to notice under section 142.

**Answer-3 (a) :**

**Computation of taxable capital gains for A.Y. 2016-17**

Particulars	Rs.
Gross consideration	90,00,000
Less: Expenses on transfer (1% of the gross consideration)	<u>90,000</u>
Net consideration	89,10,000

Less: Indexed cost of acquisition (Rs. 24,36,000 × 1081/406)	<u>64,86,000</u>
	24,24,000
Less: Exemption under section 54GB (Rs. 24,24,000 × Rs. 60,00,000 / Rs. 89,10,000)	<u>16,32,323</u>
<b>Taxable capital gains</b>	<b>7,91,677</b>

(3 Marks)

**Deemed cost of new plant and machinery for exemption under section 54GB**

Particulars	Rs.	Rs.
(1) Purchase cost of new plant and machinery acquired in July, 2016		65,00,000
Less: Cost of office appliances, i.e., computers	6,00,000	
Cost of vehicles, i.e., cars	8,00,000	
Cost of air-conditioners installed at the residence of Mr. Akash	<u>1,00,000</u>	<u>15,00,000</u>
		50,00,000
(2) Amount deposited in the specified bank before the due date of filing of return		<u>10,00,000</u>
<b>Deemed cost of new plant and machinery for exemption under section 54GB</b>		<b>60,00,000</b>

(2 Marks)

**Answer-3 (b) :**

- (i) Explanation 3 to section 2(1A) provides that the income derived from saplings or seedlings grown in a nursery shall be deemed to be agricultural income, whether or not the basic operations were carried out on land. Accordingly, the income of Rs. 75,000 derived by Anand Nursery from the sale of seedlings grown without carrying out all the basic operations on land shall be treated as agricultural income and exempt from tax under section 10(1).

(2 Marks)

- (ii) Section 10(26AAA) exempts the income which accrues or arises to a Sikkimese individual from any source in the State of Sikkim and the income by way of dividend or interest on securities. Therefore, the income of Mr. Gaitonde from a business located in Sikkim and interest income on the securities/bonds of Government of Rajasthan shall not be subject to tax.

(2 Marks)

**Answer-4 (a) :**

Section 2(15) defines charitable purpose to include relief of the poor, education, medical relief, yoga, preservation of environment (including watersheds, forests and wildlife) and preservation of monuments or places or objects of artistic or historic interest and the advancement of any other object of general public utility. However, advancement of any other object of general public utility would not be a charitable purpose, if it involves carrying on of any activity in the nature of trade, commerce or business or, any activity of rendering of any service in relation to any trade, commerce or business, for a fee or cess or any other consideration, irrespective of the nature of use or application of the income from such activity or the retention of such income, by the concerned entity.

Advancement of any other object of general public utility would continue to be a charitable purpose, if the total receipt from any activity in the nature of trade, commerce or business, or any activity of rendering any service in relation to any trade, commerce or business does not exceed 20% of the total receipts of the trust

in the previous year, and such activity is undertaken in the course of actual carrying out of such advancement of any other object of general public utility.

**(1 Mark)**

(i) The Supreme Court has, in *Thiagarajar Charities vs. Addl. CIT (1997) 225 ITR 1010*, observed that cottage industry is associated with the idea of a small, simple enterprise industry in which employees work in their own houses or in a small place, gathered together for the purpose, using their own equipments and is usually found in rural areas or so carried on, by the poorer section of the society. In substance, the activity of rural reconstruction and upliftment of masses through cottage industry is to afford relief to the poor and consequently, it is for charitable purpose.

**(2 Marks)**

(ii) The welfare of industrial workers with a stipulation that the workers of settlor of trust have preference over others would also constitute charitable purpose within the meaning of section 2(15). The Patna High Court has, in *CIT v. Tata Steel Charitable Trust (1993) 203 ITR 764*, observed that exemption under section 11(1) can be availed only if the following conditions are satisfied –

- (1) the trust is created for a charitable purpose; and
- (2) no part of the income of such trust ensures or has been used or applied directly or indirectly for the benefit of any person referred to in section 13(3).

The list of persons contained in section 13(3) does not include employees of the settlor of the trust. Section 13(3)(d), which includes any relative of the author, can have no application because relative means a person connected by birth or marriage with another person. A person having relationship pursuant to a contract like that of an employer and an employee cannot be said to be a relative. The High Court concluded that it was immaterial that any employee of the settlor of the trust had acquired any benefit out of the income of the trust as an ordinary member of the community. Therefore, the application of part of the income of the trust for the benefit of the employees of the settlor cannot disentitle the trust from claiming exemption under section 11.

**(3 Marks)**

**Answer-4 (b) :**

**Computation of tax payable by Tarun Shipping Company Ltd. for the A.Y.2016-17**

Particulars	Rs.
Tonnage income (See Working Note below)	89,86,600
Tax @ 30%	26,95,980
Add: Surcharge (Not applicable as the income is below Rs. 100 Lacs)	<u>Nil</u>
	26,95,980
Add: Education cess and SHEC @ 3%	<u>80,879</u>
<b>Total tax payable</b>	<b>27,76,859</b>

**(2 Marks)**

**Working Note**

Since the income under tonnage tax scheme is lower than the normal income of Rs. 90.50 Lacs, the tonnage tax scheme is taken for computing tax payable.

**Computation of Tonnage Income [Section 115VG]**

Particulars	Ship I Rs.	Ship 2Rs.
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First 1,000 tons (1000 x 70/100)	700	700
Next 9,000 tons (9,000 x 53/100)	4,770	4,770
Next 15,000 tons (15,000 x 42/100)	6,300	6,300
Balance [(22,500/800) x 29/100]	<u>6,525</u>	<u>232</u>
	<b>18,295</b>	<b>12,002</b>

(2 Marks)

Tonnage income	Rs.
Ship 1 (18,295 × 360)	65,86,200
Ship 2 (12,002 × 200)	<u>24,00,400</u>
	<b>89,86,600</b>

(1 Mark)

**Note:** Tonnage is to be rounded off to the nearest multiple of 100 tons. Hence, the first vessel will pay for 47,500 tons and the second for 25,800 tons.

As per section 115VF, the tonnage income computed under section 115VG would be deemed to be the profits chargeable under the head "Profits and gains of business or profession". This is, however, subject to fulfillment of the conditions mentioned below in the next paragraph. Then, the relevant shipping income referred to in section 115-VI(1), which includes the profit from core shipping activity (i.e. Rs. 90.50 Lacs) and the profit from incidental activity (Rs. 15,000), shall not be chargeable to tax.

The following are the conditions to be fulfilled by the company for applicability of the tonnage tax scheme -

- (i) An option to get assessed under Chapter XII-G has to be filed by the company.
- (ii) The company is required to credit to a reserve account called Tonnage Tax Reserve Account, at least 20% of the book profits derived from its core and incidental activities to be utilized before the expiry of a period of 8 years for acquisition of a new ship for the purposes of the business of the company. Until the acquisition of a new ship, the amount can be utilized for the purposes of the business of operating qualifying ships. However, the amount should not be used for distribution of dividends or profits or for remittance outside India as profit or for creation of assets outside India.

**Answer-5 (a) :**

Transfer fees received by a co-operative housing society, whether from outgoing or from incoming members, is not liable to tax on the ground of principle of mutuality where the predominant activity of such co-operative society is maintenance of property of the society. It was so held by the Bombay High Court in *Sind Co-op Housing Society v. ITO* (2009) 317 ITR 47.

Further, section 28(iii), which provides that income derived by a trade, professional or similar association from specific services performed for its members shall be treated as business income, can have no application since the co-operative housing society is not a trade or professional association.

Therefore, Rs. 3 lacs received as transfer fees by Pandey Co-operative Housing Society from its transferor members and its transferees, is not chargeable to tax.