

**MODEL TEST PAPER FOR NOVEMBER 2016 EXAM (MOST LIKELY) - 3****Question 1**

1. Discuss whether transfer pricing provisions under the Income-tax Act, 1961 are attracted in respect of the following cases -
- XY Ltd., an Indian company, has two units, X & Y. Unit X, which commenced business two years back, is engaged in the development of a highway project, for which purpose an agreement has been entered into with the Central Government. Unit Y is carrying on the business of trading in steel. Unit Y transfers steel of the value of 80 lakhs to Unit X for 68 lakhs.
  - Transfer of industrial design by X Ltd., an Indian company, to Y Inc., a US company, which guarantees 20% of the borrowings of X Ltd.
  - Marketing management services provided by LMN Inc., a French company to MNO Ltd., an Indian company. LMN Inc. is a "specified foreign company" as defined in section 115BBD, in relation to MNO Ltd.
  - Ms. Poorna, a resident Indian, is a director of ABC Ltd, an Indian company. ABC Ltd. pays salary of 22 lakhs per annum to Manasi, who is Ms. Poorna's daughter.
  - Purchase of equipment by A Ltd., an Indian company, from B Inc., a Japanese company. A Ltd. is the subsidiary of B Inc.

**[5 marks]**

2. The details given hereunder relate to US citizens, Mr. Fredrick Trotiville (aged 28), a US football player and his sister, Ms. Susan Trotiville (aged 22), a singer, for the A.Y. 2016-17-

	<b>Particulars</b>	<b>Mr. Fredrick Trotiville</b>	<b>Ms. Susan Trotiville</b>
(1)	Participation in football tournaments in India	25 lakhs	
(2)	Winnings from lotteries in India (net)	69,100	
(3)	Contribution of an article relating to the sport of football in a sports magazine in India	21,000	
(4)	Performance in a music show in India		3 lakhs

With reference to the provisions of the Income-tax Act, 1961, you are required to –

- Compute the total tax liability of Mr. Frederick Trotiville and Ms. Susan Trotiville for the A.Y.2016-17, assuming that both of them are non-residents.
- Discuss whether the above income are subject to deduction of tax at source.

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(iii) Explain whether it is necessary for them to file their return of income for A.Y.2016-17.

[6 marks]

3. Ramesh is the karta of Ramesh (HUF) in which the other members are his wife Padma, major son Guru and a minor daughter Champaka. The following details of this HUF, resident in India, pertaining to the year ended 31<sup>st</sup> March 2016 are made available to you:

- a) Rent (at Rs.10,000 p.m.) received from a flat in Salem is Rs. 1,10,000. Rent of Rs. 10,000 for the month of March 2015 was received in April 2016. Property tax paid Rs. 10,000. Bank loan of Rs. 10,00,000 was taken for construction of this flat, bearing interest at 10%. Rs. 8,000 interest is in arrears pertaining to this year, which was paid by the HUF in May 2016 only. Principal repayment during the year was Rs. 48,000.
- b) Ramesh represents the HUF in a partnership firm M/s. Ashok & Co. engaged in turmeric business. The firm has paid interest of Rs.1,80,000 to the HUF computed at 15%. For the services rendered by Ramesh to this firm as the lone working partner, the firm has paid him a remuneration of Rs. 1,50,000 as per the provisions of the partnership deed. The "Book Profit" of the firm in terms of Sec. 40(b) is Rs. 1,35,000.
- c) The HUF is also running two businesses, as narrated below:

i) Retail Trade in Foodgrains:

A rough book account book alone is maintained. Expense bills/ vouchers are not properly maintained. The total turnover is Rs. 38 lakhs. The net profit as per the rough account is Rs. 2,41,000. This has been arrived at after considering a penalty of Rs. 9,000 levied by sales tax authorities for misuse of "C" Forms.

ii) Business of Civil construction :

Cash received from contractee Rs. 31,00,000

Value of materials supplied by contractee Rs. 7,00,000

- d) The HUF has received dividend of Rs. 90,000 from shares held in a foreign company.
- e) Tuition fees of Rs. 20,000 were paid for the purpose of part-time education of Ms. Champaka in an Indian college.
- f) The following sums have been paid by the HUF in respect of life insurance premium:

Policy holders Name	Insurer	Premium (Rs.)	Late fees (Rs.)
Mrs. Padma	LIC	30,000	5,00
Guru	IRDA-APPROVED private insurer	42,000	1,500

Part of the above premium was paid from out of Agricultural Income of Rs. 60,000 derived from agricultural land situated in Colombo.

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You are required to compute total income of Ramesh (HUF) for AY 2016-17, showing clearly the computation under proper heads of Income. You are also required to indicate with reasons any item is to be considered in the hands of Ramesh(individual).

[9 marks]

### Question 2

1. Examine the following transactions and discuss whether the transfer price declared by the following assesseees, who have exercised a valid option for application of safe harbour rules, can be accepted by the Income-tax Authorities –

Sr. No	Assessee	International transaction	Aggregate value of transactions entered into in the P.Y.2015-16	Declared Operating Margin	Operating Expense
(1)	A Ltd., an Indian company	Provision of system support services to X Inc., which is a “specified foreign company” in relation to A Ltd.	Rs. 600 crore	Rs. 90 crore	Rs. 450 crore
(2)	B Ltd., an Indian company	Provision of data processing services with the use of information technology to Y Inc., its foreign subsidiary.	Rs. 400 crore	Rs. 62 crore	Rs. 300 crore
(3)	C & Co., a partnership firm registered under the Partnership Act, 1932	Provision of contract R & D services relating to development of internet technology, to XYZ & Co., a foreign firm, which holds 12% interest in C & Co.	Rs. 100 crore	Rs. 20 crore	Rs. 70 crore
(4)	D Ltd., an Indian company	Provision of contract R & D services relating to generic pharmaceutical drug, to ABC Inc., a foreign company which guarantees 15% of the total borrowings of D Ltd.	Rs. 50 crore	Rs. 9 crore	Rs. 30 crore
(5)	Sole proprietary	100% export of	Rs. 12 crore	Rs. 1 crore	Rs. 10 crore

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	concern of Mr. E, solely engaged in the original manufacture and export of automobile transmission and steering parts.	automobile transmission and steering parts to LMN LLP, a foreign LLP, controlled by Mr. E jointly with his relatives.			
(6)	F. Ltd an Indian company, solely engaged in the original manufacture and export of non-core auto components.	100% export of non-core auto components to GKG Inc., a foreign company. F Ltd. appoints two-thirds of the Board of Directors of GKG Inc.	Rs. 12 crore	Rs. 1 crore	Rs. 10 crore

In all the above cases, it may be assumed that the Indian entity which provides the services assumes insignificant risk. It may also be assumed that the foreign entities referred to above are non-resident in India.

Would your answer change, if in any of the cases mentioned above, the foreign entity is located in a notified jurisdictional area?

[6 marks]

2. Syena a company incorporated in Mauritius is a wholly owned subsidiary of Syena Inc UK. Syena UK enters into a share transfer agreement with Synergy Pte, a Singapore company to transfer the shares of its subsidiary (Syena Mauritius). The agreement has been entered in UK. Synergy Singapore has provided the sale consideration in USD from its UK bank account.

Syena Mauritius has certain tangible/intangible assets located in India. Further, the following information is provided.

Particulars	Situation 1	Situation 2	Situation 3
Date of transfer	June 25, 2015	June 25, 2015	June 25, 2015
Last date of accounting period of Syena Mauritius	December 31, 2014	December 31, 2014	December 31, 2014
Book value of assets of Syena Mauritius on June 25, 2015			
- Located in India	Rs. 56 crores	Rs. 57 crores	Rs. 10 crores
- Located outside India	Rs. 58 crores	Rs. 59 crores	Rs. 8 crores

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Book value of assets of Syena Mauritius on December 31, 2014			
- Located in India	Rs. 60 crores	Rs. 60 crores	Rs. 11 crores
- Located outside India	Rs. 40 crores	Rs. 40 crores	Rs. 4 crores

Syena Mauritius has liabilities (pertaining to these assets) which are situated in India and outside India. There is no amalgamation or demerger of Syena UK and Synergy Singapore. Syena Inc. owns (individually and along with its associated enterprises) more than 5% shares in Syena Mauritius during 12 months ending on the date of transfer. However, Syena Inc. does not hold the right of management or control in relation to Syena Mauritius at any time during 12 months ending on the date of transfer. Assume that book value of assets is equal to their fair market value.

Determine whether capital gain arising to Syena Inc UK on sale of shares of Syena Mauritius is taxable in India.

**[10 marks]**

### Question 3

1. A Ltd., an Indian company, receives the following dividend income during the P.Y. 2015-16.
  - (i) from shares held in XYZ Inc., a foreign company, in which it holds 25% of nominal value of equity share capital – Rs.80,000;
  - (ii) from shares held PQR Inc., a foreign company, in which it holds 30% of nominal value of equity share capital – Rs. 1,85,000.
  - (iii) from shares held in LMN Inc., a foreign company, in which it holds 55% of the nominal value of equity share capital – Rs.2,15,000
  - (iv) from shares held in Indian subsidiaries, on which dividend distribution tax has been paid by such subsidiaries – Rs.90,000.

A Ltd. has paid remuneration of Rs.18,000 for realizing dividend, the breakup of which is as follows Rs.4,000 (XYZ Inc.)

Rs.9,000 (PQR Inc.)

Rs.5,000 (Indian subsidiaries)

The business income of A Ltd. computed under the provisions of the Act is Rs.40 lakh. Compute the total income and tax liability of A Ltd., ignoring MAT. Assuming that A Ltd. has distributed dividend of Rs.4,20,000 in February 2016 compute the additional income-tax payable by it under section 115-O.

**[8 marks]**

2. Following are the details of income provided by Mr. Singh, the assessee for the financial year ended 31<sup>st</sup> March, 2016:
  - (i) Rental income from property at Bangalore - 3 lakhs, Standard Rent - 2,50,000, Fair Rent - 2,80,000.
  - (ii) Municipal and water tax paid during 2015-16: Current year 35,000, Arrears -1,50,000.

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(iii) Interest on loan borrowed towards major repairs to the property: 1,50,000.

(iv) Arrears of rent of 30,000 received during the year, which was not charged to tax in earlier years.

Further, the assessee furnished following additional information regarding sale of property at Chennai :

- (i) Mr. Singh's father acquired a residential house in April 1992 for 25,000 and thereafter gifted this property to the assessee, Mr. Singh on 1<sup>st</sup> March, 1993.
- (ii) The property, so gifted, was sold by Mr. Singh on 10<sup>th</sup> June 2015. The consideration received was 25,00,000.
- (iii) Stamp duty charges paid by the purchaser at the time of registration @ 13% (as per statutory guidelines) was 3,90,000.
- (iv) Out of the sale consideration received:
  - (a) On 2/1/2016, the assessee had purchased two adjacent flats, in the same building, and made suitable modification to make it as one unit. The investment was made by separate sale deeds, amount being 8,00,000 and 7,00,000, respectively.
  - (b) On 10/10/2015, 10 lakhs was invested in bonds issued by National Highways Authority of India, but the allotment of the bonds was made on 1.2.2016.

Compute Mr. Singh's taxable income for assessment year 2016-17. Cost inflation index:

F.Y. 1992-93 : 223; F.Y. 2015-16 : 1081

[8 marks]

### Question 4

1. Mr. X transferred his residential house to Y for Rs.10 lakh on 1<sup>st</sup> April, 2015. The value of the said house as per Stamp Valuation Authority was Rs.16 lakh. Mr. Y is a childhood friend of Mr. X.

Mr. X gifted a plot of land (purchased by him on 1<sup>st</sup> August, 2010) to Mr. Y on 1<sup>st</sup> July, 2015. The value as per Stamp Valuation Authority is Rs.8 lakh. Mr. Y sold the land on 1<sup>st</sup> March, 2016 at Rs.15 lakh. Compute the income of Mr. Y chargeable under the heads "Capital Gains" and "Income from other sources" for Assessment Year 2016-17.

Cost Inflation Index - 2010-11: 711; 2015-16: 1081

[4 marks]

2. The assessee had sold unit of an equity oriented fund on 29.9.2015 and 14.10.2015 and had shown the income earned as long-term capital gains. The aforesaid mutual fund instruments were purchased by the assessee on 29.9.2014 and 14.10.2014. The Assessing Officer treated the two gains as short-term capital gains on the ground that the instruments had not been held for a period of more than 12 months immediately preceding the date of transfer. The contention of the Revenue was that the asset must be held for a period of more than 36/12 months plus one day before the date when the transfer is made, to

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be treated as a long-term capital asset. In effect, the date on which the transfer is made has to be excluded. Discuss whether the contention of revenue is correct?

[3 marks]

3. You are engaged to carry out the tax audit of a firm u/s 44 AB and while carrying out this assignment; you are required to tackle the following issues:

- a) Duty of the auditor to report on a penalty or fine imposed on the firm.
- b) Expenditure incurred in respect of which payment has been made in a sum exceeding Rs. 20,000, otherwise than by an account payee cheque or bank draft.
- c) Sum payable as an employer by way of contribution to Provident Fund.
- d) Accounting ratio's in a trading concern.

[3 marks]

4. Discuss the validity of the action of the Income-tax authorities in the following cases:

- i. The AO rejected the claim of exemption u/s 10(23C) on the ground that the assessee, on educational institution, has made profits and did not exist solely for educational purpose [3 marks]
- ii. The CIT rejected an application for grant of approval u/s 80G(5) on the ground that the trust has failed to apply 85% of its income for charitable purpose.

[3 marks]

### Question 5

Laxmi Tea Limited is engaged in growing and manufacturing tea in Assam and West Bengal. The company's Profit & Loss Account for the year ended 31<sup>st</sup> March, 2016 shows a net profit of Rs. 550 lacs after debiting or crediting the following amounts:

- a) Depreciation Rs. 40 lacs.
- b) Interest amounting to Rs. 2 lacs on term loan from a bank for purchase of machinery for one of its tea factories.
- c) Repairs to factory building amounting to Rs. 15 lacs for which a sum of Rs. 10 lacs was withdrawn from Tea Deposit account maintained with National Bank for Agricultural and rural Development (NABARD) as per Section 33AB of the Income-tax Act.
- d) Profit from sale of green tea leaves plucked in own gardens Rs. 20 lacs.
- e) Stamp duty and registration charges paid Rs. 5 Lakhs towards issue of shares. Further, the net profit included Rs. 25 Lakh being interest income on share application money which was kept in a separate bank account and repaid to the subscriber, along with amount of application money, to whom the shares were not allotted.
- f) Rs. 10 lacs, being sales tax dues of earlier years determined during the year on disposal of appeals by the appellate authority, for which the company has furnished a bank guarantee to the Commercial Tax Authority.

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- g) Rs. 5 lacs written off as bad in respect of a trade debt transferred from Saraswati Tea Ltd. in previous year 2013-14 pursuant to a scheme of amalgamation approved by the jurisdictional High Court.
- h) Rs. 2 lacs contributed to Employees' Welfare Trust.
- i) Interest on inter-corporate deposit Rs. 1 lac and Rs. 1.50 lacs for February, 2016 and March 2016 respectively, for which tax deducted at source was paid to the Central Government in June, 2016.
- j) For monitoring the quality of tea manufactured, the company purchased the standardized software (which was embedded in a hardware) from the foreign company. The company paid Rs. 30 Lakh but failed to deduct TDS thereon.
- k) The company has made a cash payment for various purchases made and expenditures incurred mentioned as under:
- On 04/06/2015 – Rs. 5 Lakh (Due to strike by bank)
  - On 05/06/2015 – Rs. 7 Lakh (Due to cash demanded by the supplier)
  - On 26/01/2016 – Rs. 10 Lakh
- Further, payments were made to transport contractor for hiring of lorry to transport tea:
- On 07/05/2015 – Rs. 50,000
  - On 08/01/2016 – Rs. 75,000
  - On 02/03/2016 – Rs. 32,000
- l) Rs. 5 Lakh was contributed to university, approved and notified u/s 35(1)(ii).
- m) Donation was made to political party of Rs. 25 Lakh by way of cheque.
- n) Upfront one time interest paid of Rs. 10 Lakh on the debenture issued for 5 years instead of regular interest@18% p.a.

Following additional information are furnished by the management:

- i. Depreciation as per Tax Audit Report under Section 44AB Rs. 55 lacs.
- ii. One financial institution converted arrear interest of Rs. 10 lacs into a new loan in financial year 2014-15, which is repayable in five annual installments. The company has paid Rs. 2 lacs towards the installment due or the financial year 2015-16 in February, 2016.
- iii. A sum of Rs. 250 lacs deposited in NABARD on 15<sup>th</sup> June, 2016 as per provision of Section 33AB.
- iv. Rs. 15 Lak is the long standing liability standing in the balance sheet.

Compute total income of the company for the Assessment Year 2016-17 stating the reasons for each item. Ignore provision relating to Minimum Alternate Tax.

**[16 marks]**



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### Question 6

Whether the action of the Income-tax Authorities is valid in the following cases.

- i) Notice issued u/s 148 on the basis of Survey Operation which did not indicate that the income chargeable to tax has escaped assessment. **[2 marks]**
- ii) Notice u/s 148 was issued to the company on the ground that the provision for doubtful debts and provision for depletion of long term investment debited to the P/L account were unascertained liabilities and hence to be added back in computing the Book profit. Subsequently, during the pendency, by retrospective amendment, it was provided to add back any amount set aside as provision for diminution in the value of asset. **[3marks]**
- iii) AO makes reassessment on fresh ground (Found during the course of reassessment) when the original reason recorded for reopening the assessment did not survive. **[3marks]**
- iv) Notice u/s 148 issued to the deceased assessee was issued prior to the limitation period (S.149), however notice u/s 148 was issued to the legal heirs after the limitation period. **[2 marks]**
- v) The AO made enquiries on certain aspects for which requisite documents were furnished by the assessee on being satisfied by the document placed, the AO accepted the declared income without any further discussion and passed the order u/s 143(3) without mentioning the enquiries made by him. The CIT, initiate the proceedings u/s 263 on the basis of non-mention or non-discussion of enquiry by the AO. **[2 marks]**
- vi) The department challenged the order of CIT (A), on the matter relating to allowability of deduction u/s 80IB, before the ITAT. During the pendency of the appeal, the CIT issues the notice u/s 263 disallowing the deduction u/s 80 IB. **[2 marks]**
- vii) The CIT was directed by ITAT to grant registration to the assessee Trust u/s 12 AA. Subsequently the assessee made application before the CIT u/s 264 to revise the order u/s 143 (3) passed by the AO so as to allow the benefit of exemption u/s 11. The CIT directed the AO to compute the Income in terms of the order u/s 264. Thereafter the CIT issued notice u/s 263 to revise the order of AO passed by him in consequences of the direction issued u/s 264. **[2 marks]**