

FINAL EXAMINATION

GROUP III

(SYLLABUS 2008)

SUGGESTED ANSWERS TO QUESTIONS

JUNE 2011

Paper- 14 : INDIRECT AND DIRECT TAX MANAGEMENT

Answer Question No. 1 which is compulsory and any five questions from the rest.

Q. 1. (a) Fill up the blanks in the following sentence by using appropriate words/phrases given in the brackets : [2×8=16]

- (i) The basic exemption from income tax for women assessee resident in India below the age of 65 years is _____ (Rs. 1,90,000, Rs. 2,40,000, Rs. 1,60,000).
- (ii) The basic rate of income tax for firms is _____ (35%, 30%, 40%).
- (iii) The specified turnover limit for getting compulsory tax audit done of a business u/s 44AB of Income Tax Act, 1961 is _____ (Rs. 40 lakhs, Rs. 50 lakhs, Rs. 60 lakhs).
- (iv) The specified turnover limit for getting compulsory tax audit done for a profession u/s 44AB of Income Tax Act, 1961 is _____ (Rs. 10 lakhs, Rs. 15 lakhs, Rs. 20 lakhs).
- (v) The provisions of section 115JAA pertaining to credit in respect of minimum alternative tax paid _____ (shall/shall not) apply to a limited liability partnership which has been converted from a private limited or unlimited public company under the Limited Liability Partnership Act, 2008.
- (vi) Tax deducted at source by a person not being an office of a Government, from income which is paid in the month of March, or credited in the month of March should be deposited by _____ (7th April/30th April/15 April).
- (vii) As per section 35(C) (2A) of Central Excise Act, the validity or stay granted by CESTAT for recovery of duty, interest and penalty is for _____ (180/365) days.

Answers To Questions — TXM

If it is found that customs duty is not levied, short levied or erroneously refunded, the Customs Officer u/s 28 of Customs Act, can issue a show cause notice within _____ (six/twelve) months demanding duty or interest.

(b) State whether the following statements are true or false. If false give the correct statement. If true give the reason in brief : [3×3=9]

- (i) Person claiming refund of excise duty and interest paid on such duty should make application to AC/DC within six months of relevant date.
- (ii) Excise duty cannot be levied on immovable property.
- (iii) Process of mixing and grinding amounts to manufacture.

Answer 1. (a)

- (i) Rs. 1,90,000
- (ii) 30%
- (iii) Rs. 60 lakhs
- (iv) Rs. 15 lakhs
- (v) Shall not
- (vi) 30th April
- (vii) 180 days
- (viii) Six

Answer 1. (b)

- (i) **False.** Application to be made, within **One year** of relevant date.
- (ii) **True.** As opposed to movable goods, immovable goods/property cannot be brought to the market place and sold. In DCM case it was held by the Supreme Court, that to be called goods, the article must be capable of being bought and sold in the market.
- (iii) **True.** Because a new produce emerges therefrom.

Q. 2. (a) M/s. Engineers Ltd. is a Works Contractor providing works contract services to M/s BKAY Ltd. and already crossed the threshold limit under service tax laws. The Company quoted an amount of Rs. 10 lakhs for a construction contract. It is agreed that if M/s. BKAY Ltd. supplied the steel and cement, the contract amount will be reduced on the agreed basis. M/s. BKAY Ltd. supplied steel and cement of Rs. 1 lakh for use in the construction activities as a result the contract amount reduced to Rs. 9 lakhs. Further M/s. Engineers Ltd. had supplied goods worth Rs. 2 lakhs under a separate agreement which was also used while providing above works contract service. M/s. Engineers Ltd., the Service Provider preferred to pay service tax under composition scheme. Please find out :

- (i) What is the gross amount chargeable to Service Tax Laws? [3]
- (ii) What is the Service Tax payable under Composition Scheme by Engineers Ltd. [2]
- (iii) Can M/s. Engineers Ltd. avail cenvat credit also? [2]

(b) M/s. Ajay Security Services Ltd., a Company while signing a contract for providing taxable service on dated 15th June, 2010 has received Rs. 1,00,000 by an account payee cheque as advance. On dated 14th November, 2010 an amount of Rs. 5,00,000 has been received through credit card while providing the service and another Rs. 5,00,000 by a pay order after completion of service on 18th March, 2011. Above amount is inclusive of service tax as applicable and over and above threshold limit of exemption available under service tax law.

- (i) What would be the total service tax liability for the financial year 2010-11? [2]
- (ii) What is the value of taxable Service? [2]
- (iii) What would be the due date of payment of service tax electronically through internet banking? What would be the amount of service tax payable on different due dates? [2]
- (iv) If the entire service tax is deposited on dated 14th April, 2011 what would be the interest liability. [2]

Answer 2. (a)

- (i) From 7th July 2009, If the Contractor intends to avail composition scheme, it is required to add the value of material supplied free by the Contractee/service receiver to gross amount charged. Similarly if any materials are used under works contract and shown as a sale by the Contractor/service provider, value of such material is required to be added to gross amount for payment of service tax.

So the value of material supplied by M/s BKAY Ltd. & M/s Engineers Ltd are to be taken to arrive at the Gross Value chargeable to tax. So the gross value of contract is Rs. 12 lakhs (calculated as follows)

	Rs. In lakhs
Value of contract Rs. 10 lakh less Rs. 1 lakh material supplied by BKAY Ltd.	9.00
Value of material supplied by BKAY Ltd.	1.00
Value of material supplied by Engineers Ltd.	2.00
Total	12.00

- (ii) Service Tax under composition scheme is 4.12% (Service Tax @ 4% + 2% education cess + 1% SAH education cess) of the gross amount charged under Works Contract (Composition Scheme for Payment of Service Tax) Rules 2007. So the Service tax payable is Rs. 49,440/-
- (iii) As per rule 3(2) of Works Contract (Composition Scheme for Payment of Service Tax) Rules 2007, M/s Engineers Ltd. Cannot avail cenvat credit on inputs. But they can avail cenvat of input services & capital goods.

Answer 2. (b)

- (i) Total Service Tax Liability for the financial year 2010-11

Date	Particulars	Amount Rs.
15th June 2010	Advance received by an account payee cheque	1,00,000
14th Nov. 2010	Amount received on providing service through credit card	5,00,000
18th March 2011	Amount received on completion of service by a pay order	5,00,000
	Total Value of taxable service Service	11,00,000

Service Tax & Education cess (@ 10.3% included in Rs. 11,00,000) 1,02,720
(Rs. 11,00,000 * (10.3%/110.3%))

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- (ii) Value of Taxable Service is (Rs. 11,00,000 - Rs. 1,02,720) = Rs. 9,97,280
 (iii) The amount of Service tax & due dates of payment are as follows. (Amount in Rs.)

Date of Receipt	Amount received	Service tax (10.3%)	Value of taxable service	Due date of payment
15th June 2010	1,00,000	9,338	90,662	6th July 2010
14th Nov. 2010	5,00,000	46,691	4,53,309	6th December 2010
18th March 2011	5,00,000	46,691	4,53,309	31st March 2011

- (iv) If entire tax is deposited on 14th April 2011 the interest liability is as follows.

Due date of payment	Service tax (10.3%)	No. of days up to 14th April 2011	Interest Payable (Rs.)
6th July 2010	9338	281	938
6th December 2010	46,691	129	2145
31st March 2011	46,691	14	233
Total			3316

Note :

- As per section 75 of Service Tax Act interest @ 13% per annum (calculated on days basis) is payable for delayed period. Since the due date is 6th July 2010, 6th December 2010 and 31st March 2011, then the days calculated from 7th July 2010, 7th December 2010 and 1st April 2011.
- Money includes any cheque, pay order, currency, promissory note, letter or credit, draft, traveler's cheque, money order, postal remittance and other similar instruments but does not include currency that is held for its numismatic value.
- Gross amount charged includes payment by credit card, cheque, deduction from account and any form of payment by issue of credit notes / debit notes and book adjustment.

Q. 3. (a) An excisable product is covered under provision of the Standards of Weights & Measures Act, 1976 and falls in the category of specified goods subject to excise duty on the basis of retail price. From the particulars compute (rounded to nearest rupee) :

- Assessable value.
- Excise duty & Cess payable.

MRP printed on the package is Rs. 10,640. The price is inclusive of excise duty @ 10% and education and secondary and higher education cess at the applicable rates as per Finance Act, 2010. The product is eligible for an abatement of 38%. [5+4]

- (b)** Briefly explain the following with reference to Central Excise Laws :

- Is it compulsory to pay tax through PLA after forfeiture of facility of payment by installments?

Answer
 (i) & (ii)
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- (ii) Can an assessee claim refund of money deposited in PLA, when there is a provision of unjust enrichment? [2+2]
- (c) (i) An exemption notification under Central Excise Act was issued on 22nd December, 2010. The same was published in Official Gazette on 2nd January, 2011. From which date the notification is effective? [1]
- (ii) KSK Ltd. a manufacturer dispatched rubber products to Mr. X from factory at Pune after payment of duty. The goods were rejected by the buyer as found defective and sent back to the manufacturer for rectification. Can Mr. X avail cenvat credit? [1]

Answer 3. (a)

(i) & (ii) Assessable value & duty payable.

For levying Central Excise duty on the basis of MRP value under section 4A of the Central Excise Act works out as follows :

MRP printed on the package = Rs. 10,640 per unit.

Excise duty is 10% on Assessable Value

Education and Secondary & Higher Education cess is 2% & 1% of Central Excise duty.

Assessable Value = $(100\% - 38\%) = 62\%$ of MRP.

Central Excise duty = $10\% \times 62\% = 0.062$

Education Cess SAH = $10\% \times 3\% \times 62\% = 0.00186$

Total = 0.06386

Central Excise = $10\% = 10.00$

Education Cess = $2\% = 0.20$

SAH = $1\% = 0.10$

10.30%

Assessable value - $62\% \times 10.30\% = 0.06386$

MRP for Section 4A = Rs. 10,640 = Rs. 10,001

1.06386

Abatement permitted @ 38% = Rs. 3801

Assessable value = Rs. 6200

Excise Duty @ 10% = Rs. 620

Education Cess @ 2% = Rs. 12.40

SAH Education cess @ 1% = Rs. 6.20

Total Duty & Cess = Rs. 638.60

Education & SAH = Rs. 18.60

Answer 3. (b)

- (i) Yes it is compulsory to pay tax through PLA after forfeiture of facility of payment by installments. The assessee will have to pay duty through PLA before clearance of goods and cannot utilize cenvat credit for payment of duty for that period.
- (ii) Money deposited in PLA is only for payment of duty. The assessee is required to make debit entry in PLA on monthly basis. So the money belongs to the assessee. He can get refund of duty at any time. There is no time limit for such refund & no unjust enrichment is applicable to such deposits.

Answer 3. (c)

- (i) The effective date of exemption notification is 22nd December 2010 that is the date of issue & not the date of publication.
- (ii) Yes. As per rule 16 of the central excise rules, assessee can avail credit of duty paid on such returned goods.

Q. 4. (a) Briefly explain the term 'Export' for the purpose of duty drawback under section 75 of the Customs Act, 1962. Is duty drawback available if the goods do not reach the destination? [5]

(b) Computation of duty drawback: Discuss whether any duty drawback is admissible under section 75 in the following cases and if yes, what is the quantum of such duty drawback? [10]

FOB value of exported goods (Rs.)	Rate or amount of drawback	Market price of goods (Rs.)	Value of Imported material used in goods (Rs.)
(i) 1,00,000	0.75% of FOB value	80,000	50,000
(ii) 49,000	1% of FOB value	50,000	30,000
(iii) 60,000	0.80% of FOB value	70,000	35,000
(iv) 3,000	1.5%	3,100	2,500
(v) 2,00,000	40% of FOB value	1,50,000	1,20,000
(vi) 1,00,000 (2,000 kgs)	Rs. 30 per kg.	55,000	40,000
(vii) 4,00,000	3.5% of FOB value	4,60,000	4,50,000
(viii) 4,20,000	4% of FOB value	4,10,000	3,00,000 *

* In case of (viii), the Central Government has specified a minimum value-addition to be achieved @ 40% of imported material in terms of FOB value.

Answer 4. (a)

As per Rule 2(c) of the customs, Central Excise Duties and Service Tax Drawback Rules, 1995, "Export" means :

- (i) Taking out of India to a place outside India, or
- (ii) Taking out from a place in Domestic Tariff Area to a Special Economic Zone, and
- (iii) Includes loading of provisions or store or equipment for use on board a vessel or aircraft proceeding to a foreign port.

Drawback-When export goods get destroyed in "transit" :

For the purpose of export, 'India' includes territorial waters of India. Therefore, if export goods are destroyed while in transit, before they cross the territorial waters of India, then, there would be no 'export', as the goods did not move out of India.

However, if the goods are destroyed in high seas (i.e., beyond territorial water of India), then, for the purposes of drawback, the export shall be completed; and the same shall be eligible for drawback.

Answer 4. (b)

The admissibility or otherwise of duty drawback in the aforesaid cases is as follows :

- (i) **Drawback Admissible Rs. 750** : Even if the rate of drawback is less than 1% of FOB value of goods, drawback will be admissible because the amount of drawback i.e. 0.75% of Rs. 1 lakh i.e. Rs. 750, exceeds Rs. 500.
- (ii) **Drawback Admissible Rs. 490** : Even if the amount of drawback does not exceed Rs. 500, drawback will be admissible because it is 1% or more of the FOB value of the goods.
- (iii) **Drawback Inadmissible** : The drawback will not be admissible because it is less than 1% of the FOB value of the goods and its amount (0.8% of 60,000 i.e. 480) is less than Rs. 500.
- (iv) **Drawback Inadmissible** : Even if the drawback is 1.5% of FOB value, drawback will be inadmissible as the amount thereof is 1.5% of 3,000 i.e. Rs. 45, which is less than Rs. 50.
- (v) **Drawback Admissible Rs. 50,000** : The amount of drawback i.e. 40% of 2,00,000 i.e. Rs. 80,000 shall be restricted to 1/3rd of the Market price of the goods i.e. 1/3rd of 1,50,000 i.e. Rs. 50,000. Hence, the amount of drawback admissible shall be Rs. 50,000.
- (vi) **Drawback Inadmissible** : In this case the market price of the goods Rs. 55,000 is less than the amount of drawback i.e. 2,000 kgs × Rs. 30 i.e. Rs. 60,000. Hence, no drawback shall be allowed.
- (vii) **Drawback Inadmissible** : No drawback shall be allowed in this case, as the export value i.e. FOB value of the goods is less than the value of imported material used therein.
- (viii) **Drawback Admissible Rs. 16,800** : Minimum value-addition of 40% of imported material i.e. 40% of Rs. 3,00,000 amounts to Rs. 1,20,000. Since FOB value of the goods is Rs. 4,20,000 i.e. the criteria of minimum value-addition has been achieved so, drawback allowable = 40% of 4,20,000 = Rs. 16,800.

Q. 5. (a) A, an unit in SEZ, received services as covered u/s 65(105) from various service provider in relation to the authorized operation in the SEZ. At the time of making payment, service provider ask it to pay the service tax, however, it argues that service tax is not liable on taxable services provided to it. Now, you are approached to confirm the contention of A with the following details:

<i>Place where such services consumed</i>	<i>Amount (Net of tax)</i>	
(i) Within the SEZ	Rs. 5,00,000	
(ii) Partially within the SEZ and partially out of the SEZ	Rs. 3,00,000	
(iii) Wholly out of the SEZ	Rs. 6,00,000	[6]

(b) A show cause notice demanding customs duty was issued in case of clearances made by a 100% Export Oriented Undertaking (EOU) to Domestic Tariff Area (DTA). Is the show cause notice defective in law? [2]

(c) Detail the provisions for registration of dealers under section 7 of CST Act, relating to

(i) Compulsory Registration

(ii) Voluntary Registration and indicate the benefits of certificate of registration.

[7]

Answer 5. (a)

Notification No. 9/2009 dated 3.3.2009 as amended by Notification No. 15/2009 dated 20.5.2009 states that if taxable services provided to SEZ units are consumed partially or wholly outside SEZ then exemption is granted by way of refund. Accordingly, A is required to pay service tax on services received in relation to authorized operation which was consumed partially or wholly outside SEZ. Thus, A is required to pay service tax as given below :

Particulars	Working	Tax (in Rs.)
Services consumed within the SEZ	Exempted	Nil
Services consumed partially within the SEZ and partially out of the SEZ	Rs. 3,00,000 * 10%	30,000
Services consumed wholly out of SEZ	Rs. 6,00,000 * 10%	<u>60,000</u>
Service Tax before cess		90,000
Add : Education cess	Rs. 90,000 * 2%	1,800
Add : Secondary higher education cess	Rs. 90,000 * 1%	900
Service Tax to be paid to the parties		<u>92,700</u>

However, such service tax shall be claimed as refund by A subject to fulfillment of certain condition.

Answer 5. (b)

Yes, the show cause notice issued is defective in law as in respect of clearances made by a 100% export oriented undertaking (EOU) to domestic tariff area (DTA), the duty to be paid by the 100% EOU is the duty of excise and not customs duty. Therefore show cause notice using the word 'customs duty' instead of 'central excise duty' is not maintainable. Similar view was expressed in the case of CCE v. Suresh Synthetics (2007)216 EL T 662(SC).

Answer 5. (c)

(1) Registration of dealers is under Sec 7 of CST Act. As per Sec 7(1), every dealer liable to pay CST has to register himself with S.T. authority. This is Compulsory registration. It can be said in brief that registration under CST is required when interstate sale is to (a) Govt. and (b) registered dealer for which he is registered. No registration is necessary if interstate sale is to unregistered dealer or to a registered dealer in respect of goods for which he is not registered

Sec 20 states that registered dealer means a dealer who is regd u/s 7 of CST Act. Regn under CST is to be done by State Sales Tax authorities who are authorised for the purpose by Central Govt.

(2) There can be voluntary registration [sec 7(2)]. Any dealer liable to pay ST under ST law of the state or where there is no such law in force, any dealer having a place of business in the state or part of it as the case may be, may, notwithstanding that he is not liable to pay tax under CST Act, apply for registration to the authority referred to in Sec 7(1) and every such application shall contain such particulars as may be prescribed.

As per Sec 7(3), the authority concerned if satisfied that the application is in conformity with the provisions of CST Act, he shall register the applicant and grant him a certificate of registration in form prescribed, which shall specify the class/classes of goods for the purpose of Sec 8 (1). Application fee payable by way of Court fee stamps. Application to be signed by proprietor, one of the partners of firm, karta of HUF or Director or Principle officer of a company. Only one certificate even if he has more than one place of business in the same state. Additional places have to be endorsed on the certificate.

Registering Authority can ask for proper security from the applicant for (a) realization of taxes due & (b) Proper custody and use of forms (like C, E, F, and H etc) which are supplied by sales tax authorities for use by the dealer. It may be in the form of surety, execution of bond or by deposit in Govt. securities or by way of cash deposit. Security demanded should be reasonable and for good and sufficient reasons. It can be forfeited if CST due is not paid or blank sales forms supplied, are misused.

(3) Benefit of Certificate

- (1) By obtaining required declaration forms from the dept. and using them, the dealer can make interstate purchase @ 4%.
- (2) Dealer can also obtain form which will enable him to claim total exemption in respect of subsequent sales as laid down by sec 6(2).

Failure to get registered prevents a dealer from effecting interstate sale.

Q. 6. (a) M/s. PIONEER INFRA & CO., a partnership firm consisting of three partners, X, Y and Z is engaged in the business of civil construction. The firm gets the following by way of contract receipts during previous year 2010-11 (Asst. Year 2011-12) : [9]

Contract work for supply of labour	Rs. 30,00,000
Value of material supplied by contractor	Rs. 8,00,000
Total value of contract	Rs. 38,00,000

Each partner of the firm entitled to draw Rs. 2,500 per month by way of salary as authorized by the terms of the partnership deed. An amount of Rs. 1,00,000 interest is paid to Partner Z on the capital contributed of Rs. 5,00,000. Profit as per books of accounts before deduction of salary to partners and interest to Partner Z is Rs. 2,50,000. Compute.

- (i) Total income of the firm applying provisions of Sec. 44AD of the Income Tax Act, 1961.
- (ii) Total tax payable.

(b) Samir furnishes the following particulars for the compilation of his Wealth Tax Return for Assessment Year 2011-12 :

- (i) Gifts of jewellery made to wife from time to time aggregating Rs. 80,000. Market value on valuation date Rs. 3,00,000.
- (ii) Flat purchased under installment payment scheme in 1979 for Rs. 9,50,000. Used for purposes of his residence and market value as on 31.03.2011 (installment remaining unpaid Rs. 80,000) Rs. 10,00,000.
- (ii) Urban land transferred to minor handicapped child value on 31.03.2011 Rs. 5,00,000.

Examine how you will deal with these items, make suitable assumptions required.

[3]

- (c) Explain the treatment under Sec. 6 of Wealth Tax Act in respect of value of assets and debts located outside India of (a) an individual or HUF not resident in India and (b) a company not resident in Indian. [3]

Answer 6. (a)

(i) Computation of Income of M/s PIONEER INFRA & CO for Asst. Year 2011-12

Particulars	Amount in Rs.
Income from business of civil construction (8% of Rs. 30 lakhs)	2,40,000
Less : Expenses	1,50,000
Salary & Interest paid to partners permitted under Sec 40(b)	
Salary to partners is Rs. 90,000 (Rs. 2500×3×12)	
Interest to partner @ 12% on Rs. 5,00,000 = Rs. 60,000	
Less : Other expenses - No other expenses are allowed while computing income under section 44AD	Nil
Income from Civil Construction	90,000
Other Income	Nil
Gross Total Income	90,000
Deduction under Chapter VIA	Nil
Net Taxable Income	90,000

(ii) Tax Payable = Rs. 90,000 * 30.90% (Income Tax @30% + Education Cess @3%) = Rs. 27,810.

Answer 6. (b)**Computation of Wealth of Mr. Samir**

Particulars	Taxable	Reasons
Gift of Jewellery made to wife	Rs. 3,00,000	Deemed asset u/s 4. Fair Market Value of the Jewellery is taxable
Flat used for residence	Nil *	Taxable as an asset u/s 2(ea) but the Assessee can claim exemption u/s 5(vi). So full value for the asset is exemption from tax.
Urban Plot in the hands of the Minor.	Nil	Asset held by the minor who is handicapped u/s 80 U, clubbing provisions does not apply.

* Since the asset is exempt, Liability of Rs. 80,000 being unpaid installment is not deductible.
Since the total Wealth is below taxable limit, Mr. Samir is not liable to pay any Wealth Tax.

Answer 6. (c)

Under Sec 6 of W.T. Act :

In computing the net wealth of :

- (a) an individual who is not a citizen of India or
- (b) an individual or HUF not resident in India of
- (c) an individual or a HUF resident but not ordinarily resident in India or
- (d) a company not resident in India.

during the year on the valuation date, the value of the assets and debts located outside India shall not be taken into account.

N. B. The residential status is determined as per the provisions of the Income Tax Act, 1961.

Q. 7. The Profit & Loss Account of Mr. A. Basu for the previous year 2010-11 is given below :

Particulars	Rs.	Particulars	Rs.
Cost of goods sold	16,00,000	Sales	34,70,000
Salaries	9,00,000	Rent of staff quarters	3,00,000
Rent of business premises, owned by the assessee	2,50,000	Sale price of Machinery block on 31.03.2011	5,00,000
Repairs and renewals	1,40,000		
Income Tax paid	60,000		
Excise Duty paid	1,00,000		
Sales Tax payable	2,00,000		
Legal expenses	3,00,000		
Municipal taxes payable for staff quarters	10,000		
Provision for bad debts	60,000		
Contingency reserve	1,00,000		
Employers contribution to recognized fund	50,000		
Net profit	5,00,000		
	<u>42,70,000</u>		<u>42,70,000</u>

Additional Information :

(i) Salaries include :

- (a) Rs. 1,20,000 was paid outside India to an employee, "resident" in India but neither tax was deducted nor tax has been paid thereon,
 - (b) Rs. 90,000 was paid in India to an employee "resident" in India but neither tax deducted therefrom nor paid thereon.
- (ii) Excise Duty of Rs. 50,000 for the assessment year 2010-11 was paid on 1st January, 2011, but it was not included in the profit & loss A/c.

- (iii) Sales Tax amounting Rs. 1,30,000 was paid on 30th May, 2011 and the balance was proposed to be paid on 1st August, 2011, the due date of furnishing return of income is 31st July, 2011.
- (iv) Repairs/renewals include remodeling and renovation of revenue nature costing Rs. 80,000. The balance is capital expenditure.
- (v) Legal expenses include :
- (a) Lawyer fee of Rs. 50,000 paid by single bearer cheque to K, nephew of the proprietor. The Assessing Officer disallowed a sum of Rs. 10,000, being found in excess of the desired qualifications;
- (b) Gift of Rs. 1,20,000, made to wife, a tax-adviser, but disallowed by the A.O.
- (vi) Employers contribution include :
- (a) Rs. 30,000 credited to their account on due date under Provident Fund rules;
- (b) Rs. 20,000 not credited to their account and proposed to be credited in October, 2011.
- (vii) Commission receipts of Rs. 2,00,000 have not been credited to the profit and loss account as their recovery seems to be doubtful.
- (viii) WDV of machinery on 01.04.2010 was Rs. 6,50,000.
- (ix) WDV of business premises and staff quarters as on 01.04.2010: Rs. 10,00,000 and Rs. 30,00,000 respectively. Depreciation @ 10% on business premises and @ 5% on staff quarters.
- Compute taxable profits for the previous year 2010-11, A. Y. 2011-12 [15]

Answer 7.

Mr. A Basu

Computation of Business Profits for the Assessment Year 2011-12

Particulars	Rs.	Rs.
Net profit as per profits and loss a/c		5,00,000
Add : Inadmissible Expenses :		
(i) Rent of business premises owned by the assessee (sec, 30)	2,50,000	
(ii) Remodelling and renovation, being repairs of capital nature	60,000	
(iii) Income tax paid [Sec.40(a)(ii) not allowable]	60,000	
(iv) Sales tax remaining unpaid up to due date of furnishing return of income.	70,000	
(v) Legal expenses includes :		
(a) Gift made to wife, Sec. 37(1)	1,20,000	
(b) Fees paid to lawyer (being a relative) Sec 40A (2)	10,000	
(c) Fees paid other than by crossed a/c payee cheque, net of disallowance under 40A(2) of 10,000/-. Balance Rs. 40,000/- being exceeding Rs. 20,000/- disallowed u/s 40A(3)	40,000	
(vi) Salaries paid outside India to a 'resident' employee without TDS [Sec. 40(a)(iii)]	1,20,000	

(vii) Salaries paid in India to a resident employee without TDS below taxable limit.	—	
(viii) Municipal tax payable for staff quarters [Sec. 43B]	10,000	
(ix) Provision for bad debts [Sec. 36]	60,000	
(x) Contingency reserve [Sec. 37(1)]	1,00,000	
(xi) Employers contribution credited to their account after due date.	20,000	
(xii) Commission receipts which have accrued during the year but recovery seems doubtful, not written off, not credited to P & L a/c	2,00,000	11,20,000
		16,20,000
Less : Inadmissible receipts/ admissible claims :		
(i) Excise duty (Sec. 43B) allowable on payment	50,000	
(ii) Sale price of machine, being capital receipts	5,00,000	
(iii) Depreciation :		
(a) staff quarters 5% of 30,00,000	1,50,000	
(b) Business Premises : 10% of 10,00,000	1,00,000	8,00,000
Taxable business profits		8,20,000

Note : Sale of machinery block: Sale of machinery block results into short-term capital loss of Rs. 1,50,000 (Rs. 6,50,000 – Rs. 5,00,000) under Sec 50.

No capital loss, whether short-term or long-term, can be set-off against any income. It is to be carried forward for next 8 assessment years.

Q. 8. (a) J. Inc. of Korea and CD Ltd. an Indian Company are associated enterprises. CD Ltd. manufactures Cell Phones and sells them to J.K. & F. Inc., a Company based at Nepal. During the year CD Ltd. supplied 2,50,000 Cellular Phones to J. Inc. Korea at a price of Rs. 3,000 per unit and 35,000 units to J. K. & F. Inc. at a price of Rs. 5,800 per unit. The transactions of CD Ltd. with J.K. & F. Inc. are comparable subject to the following considerations :

Sales to J. Inc. are on FOB basis, sales to J.K. & F. Inc. are on CIF basis. The freight and insurance paid by J. Inc. for each unit @ Rs. 700. Sales to J.K. & F. Inc. are under a free warranty for two years whereas sales to J. Inc. are without any such warranty. The estimated cost of executing such warranty is Rs. 500. Since J. Inc.'s order was huge in volume, quantity discount of Rs. 200 per unit was offered to it. Compute the Arm's Length Price and the subsequent amount of Increase in the total Income of CD Ltd., if any. [10]

(b) State the methods of computing Arm's Length Price under section 92C of the Income Tax Act, 1961. [5]

Answer 8. (a)

Computation of Arm's Length Price of Products sold to J Inc. Korea by CD Ltd.

Particulars	Rs.	Rs.
Price per Unit in a Comparable Uncontrolled Transaction		5,800
Less : Adjustment for Differences		
(a) Freight and Insurance charges	700	
(b) Estimated Warranty Costs	500	
(c) Discount for Voluminous Purchase	200	(1,400)
Arm's Length Price for cellular Phone sold to J. Inc. Korea		4,400

Computation of Increase in Total Income of CD Ltd.

Particulars	Rs.
Arm's Length Price per Unit	4,400
Less : Price at which actually sold to J Inc. Korea	(3,000)
Increase in Price per Unit	1,400
No of Units sold to J Inc. Korea	2,50,000
Increase In Total Income of CD Ltd. (2,50,000 × Rs. 1,400)	Rs. 35 Crores

Answer 8. (b)

Methods of Computation [Section 92C] : The arm's length price in relation to an International transaction shall be determined by any of the following methods.

- (1) Comparable Uncontrolled Price Method,
- (2) Resale Price Method,
- (3) Cost plus Method,
- (4) Profit Split Method,
- (5) Transactional Net Margin Method,
- (6) Such other method as may be prescribed by the Board.