SUGGESTED ANSWERS

TO

QUESTIONS

SET AT THE

INSTITUTE'S EXAMINATIONS

MAY, 1996 – NOVEMBER, 2005

A COMPILATION

PROFESSIONAL EDUCATION
(COURSE – II)

PAPER – 5 : INCOME TAX AND CENTRAL SALES TAX

BOARD OF STUDIES
THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA

CONTENTS

CHAPTER 1

BASIC CONCEPTS

Question 1

Choose the correct answer with reference to the provisions of the Income-tax Act, 1961.

(i) ***Surcharge of 10% is payable by an individual where the total income exceeds :***
- ***(a)*** ***Rs.7,50,000***
- ***(b)*** ***Rs.8,50,000***
- ***(c)*** ***Rs.10,00,000***
- ***(d)*** ***None of these*** ***(1 Mark) (May 2005)***

(ii) ***Additional surcharge (Education cess) of 2% is payable on***
- ***(a)*** ***Income-tax***
- ***(b)*** ***Income-tax plus surcharge, if any***
- ***(c)*** ***Surcharge***
- ***(d)*** ***Not payable by any assessee***

(1 Mark) (May 2005)

Answer

(i) **(c)** i.e. when the income exceeds Rs.10,00,000

(ii) **(b)** i.e. income tax plus surcharge if any

Question 2

Write short notes on: "Income accruing" and "Income due". Can an income which has been taxed on accrual basis be assessed again on receipt basis? ***(6 Marks) (May 2005)***

Answer

'Accrue' refers to the right to receive income, whereas 'due' refers to the right to enforce payment of the same. For e.g. salary for work done in December will 'accrue' throughout the month, day to day, but will become 'due' on the salary bill being passed on 31st December or 1st January. Similarly, on Government securities, interest payable on

specified dates arise during the period of holding, day to day, but will become due for payment on the specified dates.

Income which has been taxed on accrual basis cannot be assessed again on receipt basis, as it will amount to double taxation. For example, when a loan to a director has already been treated as dividend under section 2(22)(e) and later dividend is declared, distributed and adjusted against the loan, the same cannot be treated as dividend income again.

Question 3

Write short notes on: Association of persons (5 Marks) (Nov.98)

Answer

When persons combine together for promotion of joint enterprise they are assessable as association of persons (AOP) when they do not in law constitute a partnership.

In order to constitute an association, persons must join in a common purpose, common action and the object of the association must be to produce income. It is not enough that the persons receive the income jointly. Co-heirs, co-legatees or co-donees joining together for a common purpose or action would be chargeable as an association of persons.

Question 4

(i) Short notes on Diversion of Income
(6 Marks) (May 2001)

(ii) State the essentials of the concepts of:
(a) Diversion of income
(b) Application of income
(6 Marks) (May 99)

Answer

Diversion of income : The principle of diversion of income first arose for consideration in *CIT v Sitaldas Tirathdas (1961) 41 ITR 367 (SC)*. The Supreme Court held that there is a difference between an amount which a person is obliged to apply out of his income and an amount which by the very nature of the obligation cannot be said to be part of the income of the assessee. Where, by virtue of the obligation, income is diverted before it reaches the assessee, it is deductible but where the income is required to be applied in order to discharge an obligation after the same reaches the assessee, the

same consequences in law do not follow. The first is a case in which the income never reaches the assessee, who even if he were to collect it, does so on behalf of the person to whom it is payable. The second is the case of an obligation to pay a portion of one's income which has been received and is thereafter applied.

The principle laid down in Sitaldas Tirathdas's case has been further explained in *Moti Lal Chhadamall Jain v CIT 190 ITR 1*. The Apex Court explained that the obligation flowing out of an antecedent and independent title effectively slices away a part of the corpus of the right to receive the income and so it would be a case of diversion. Where the obligation is gratuitous and is self-imposed, it is only an application of income. Examples of diversion by over riding title are -

Right of maintenance of dependants or of coparceners on partition.

Right under a statutory provision.

A charge created by a decree of a Court of Law.

Application of income : An obligation to apply income which has accrued or has arisen or has been received, amounts to merely the application of income. Therefore the essentials of the concept of application of income under the provisions of Income-tax Act are :

(a) Income accrues to the assessee ;

(b) Income reaches the assessee ;

(c) Income is applied to discharge an obligation self imposed or gratuitous.

Question 5

An employee instructs his employer to pay a certain portion of his salary to a charity and claims it as exempt as it is diverted by over riding charge/title – Comment.

(2 Marks) (Nov.2003)

Answer

In the instant case, it is an application of income and in the nature of foregoing of salary. According to the Supreme Court judgment in *CIT v. L.W. Russel (1964) 52 ITR 91*, the salary which has been foregone after its accrual in the hands of the employee is taxable. Hence, the amount paid by the employer to a charity as per the employee's directions is taxable in the hands of the employee.

Question 6

Write short notes on: Basis of charge.

(6 Marks) (May 1999)

Answer

Section 4 of the Income-tax Act provides that income-tax shall be charged (a) for any assessment year at the rate or rates specified in the annual Finance Act for that year (b) in respect of the total income of the previous year of every person.

Thus income-tax is levied for every assessment year at rates specified in the relevant Finance Act.

The liability to tax arises by virtue of the charging section alone and it arises at the close of the previous year, though quantification of the amount payable is postponed. It therefore follows, that the liability to tax is not dependent upon assessment. In respect of income chargeable to tax, tax shall be deducted at source or paid in accordance with the relevant provisions. Further, though the Finance Act naturally prescribes the rates of tax, in respect of certain incomes, the Income-tax Act itself has prescribed specific rates. For example, Section 112 in the case of long term capital gains @ 20%; Section 115BB in the case of winnings from lotteries, etc @ 30%.

Question 7

What does the term "substantial interest" denote under Income-tax Act? (4 Marks) (May 99)

Answer

The term `substantial interest' is relevant under the Income-tax Act, 1961.Section 2(32) says that in relation to a company means a person who is the beneficial owner of shares, not being shares entitled to a fixed rate of dividend, whether with or without a right to participate in profits, carrying not less than 20% of the voting power. In the case of a non-corporate entity, a person can be said to have substantial interest if 20% or more share or profit is held by him.

Question 8

Define the term "assessee" and state in this connection the different classes of assessees under the Income-tax Act, 1961.

A single letter of enquiry was issued by the Income-tax Department to Mr. Shoumik of Pune. In this letter there was no specific mention of any provision of the Income-tax Act. Can Mr. Shoumik be treated as an "assessee" under the Income-tax Act ? (6 Marks)(Nov.98)

Answer

Assessee means a person by whom any tax or any other sum of

money is payable under the Act. It includes every person in respect of whom any proceeding has been taken for the assessment of his income or assessment of fringe benefits. It includes a person who is assessable in respect of the income of any other person or of the loss sustained by him or by such other person or of the amount of refund due to him or to such other person.

This term also includes every person who is deemed to be an assessee or an assessee in default under any provision of this Act.

Under the Income-tax Act, the different classes of assessees are : (a) Individual, (b) Hindu undivided family, (c) Partnership firms, (d) Companies, (e) Association of Persons (AOP) or body of individuals (BOI) whether incorporated or not (f) Local Authority, and (g) every artificial juridical person not falling within any of the preceding category.

According to sec 2(7) of the Income-tax Act, 1961, where any proceeding is initiated against a person according to the relevant provisions of the Act, such a person is termed as an "assessee". It is to be noted here that a simple enquiry letter issued by the Income-tax Department to a person without reference to any specific provision of the Act does not constitute any proceeding under the Act and as such the person cannot be treated as an "assessee" within the ambit of section 2(7) of the Act. In the given problem, Mr. Shoumik cannot therefore, be treated as an "assessee".

Question 9

What are the exceptions to the general rule that income of the previous year alone is taxed in an assessment year? Discuss.

(6 Marks) (May 1998)

What are the exceptions to the rule that the income of the previous year is chargeable to tax in the immediately following assessment year? (3 Marks)(May 2001)

Answer

The general rule is to tax the income of the previous year in the assessment year. However, there are exceptions to the general rule and the income is chargeable to tax in the previous year itself, without waiting for the completion for the previous year. The following provisions are the exceptions to the general rule.

Shipping business of non-resident (Section 172): Where a ship, belonging to or chartered by a non-resident carries passengers, livestock, mail or goods, shipped at a port in India, the ship is allowed to leave the port only when the tax has been paid or

satisfactory arrangement has been made for payment thereof. At 7.5% of the freight paid or payable to the owner or the charterer or to any person on his behalf whether in India or outside India on account of such carriage is deemed to be the income which is charged to tax in the same year.

Persons leaving India (Section 174): Where it appears to the Assessing Officer that any individual may leave India during the current assessment year or shortly after its expiry and he has no intention of returning to India, the total income of such individual upto the probable date of departure from India is chargeable to tax in that year itself.

AOP or BOI formed for a particular event or purpose (section 174A): Where an AOP or BOI is formed or established for a particular purpose is likely to be dissolved in the same year it is formed or established or immediately after such assessement year, the total income of such association or body or juridical person for the period from the expiry of the previous year for that assessment year up to the date of dissolution shall be chargeable to tax in that assessment year.

Persons likely to transfer property to avoid tax (Section 175): During the current assessment year if it appears to the Assessing Officer that a person is likely to charge, sell, transfer, dispose of or otherwise part with any of his assets to avoid payment of any liability under this Act, the total income of such person for the period from the expiry of the previous year for that assessment year to the date when the Assessing Officer commences proceedings under this section, is chargeable to tax in that assessment year.

Discontinued business (Section 176): Where any business or profession is discontinued in any assessment year, the income of the period from the expiry of the previous year for the assessment year up to the date of such discontinuance may at the discretion of the Assessing Officer, be charged to tax in that assessment year.

Question 10

Write short notes on: Company in which the public is substantially interested.

(6 Marks) (May 1998)

Answer

This term is defined by Section 2(18) of the Act. A company is one covered by Section 2(18) if it fulfills one or more of the following conditions:

It is a company owned by the Government or the Reserve Bank of India or in which not less than 40% of the shares are held either severally or jointly by the Government or the RBI or a corporation owned by the RBI.
It is a company registered under Section 25 of the Companies Act, 1956;
It is a company having no share capital and having regard to its objects, nature and composition of its membership and other relevant conditions, it is declared by the CBDT as a company in which the public are substantially interested.
It is a mutual benefit finance company, i.e., is a company which carries on as its principal business, the acceptance of deposits from its members and is declared by the Central Government under section 620A of the Companies' Act, 1956 as a Nidhi or Mutual Benefit Society;
It is a company wherein equity shares carrying not less than 50% of the voting powers have been allotted unconditionally and were held beneficially throughout the previous year by one ore more co-operative societies;
It is not a private company as defined in under the Companies Act and its equity shares on the last day of the previous year is listed in a recognized stock exchange in India, or equity shares in the company carrying not less than 50% of the voting powers have been allotted unconditionally to or acquired unconditionally by and were throughout the previous year beneficially held by the Government, a corporation established by a Central, State or provincial Act or any company to which section 2(18) applies or its subsidiary if the whole of the share capital of such subsidiary company has been held by the parent company or its nominees throughout the previous year.
In the case of Indian companies mainly engaged in the construction of ships or in the manufacture or processing of goods or in mining or in the generation or distribution of electricity or any other form of power, the requirement is 40% instead of 50% specified in (v) and (vi) above.

Question 11

Tanmay Ice-cream Private Limited gives you the following details for the accounting year ended 31st March, 1999 :
Paid up equity share capital is divided into shares of Rs.10 each.
Sarvashri Ray Gandhi, Dikesh Ranka, Prasant Shroff and Tanmay Shah are registered shareholders, each holding 10,000 equity shares

fully paid up.

Reserves of accumulated profits on 1st April, 1998 were Rs.40 lakhs.

Current year's surplus was Rs.10 lakhs.

Current liabilities and provisions at year end amounted to Rs.1 lakh.

Fixed assets consisted of only one item, viz., office buildings (at cost) of Rs.11 lakhs.

Preliminary expenses not written off (at year end) Rs.40,000.

Current assets on 31st March, 1999 amounted to Rs.30 lakhs.

Loans and advances granted in the year and outstanding at year end were Rs.13,60,000.

These included :

(a) trade deposit of Rs.1 lakh given to Ray Gandhi. He supplied a `softy' ice machine in April, 1999 and the advance was adjusted against the cost of machinery supplied ;

(b) loan of Rs.3 lakhs given to Dikesh Ranka on 10th January, 1999, out of which Rs.1 lakh was repaid by him on 30th March, 1999.

(c) loan of Rs.3 lakhs given to Smt. Kanta Prasant Shroff at the specific request of Shri Prasant Shroff;

(d) loan of Rs.4 lakhs to Tanmay Shah (H.U.F.) who are the beneficial owners of shares registered in the name of Tanmay Shah.

Required :

Discuss the tax implications of the above transactions in the hands of:

Shareholders and

Tanmay Ice-cream Private Ltd.

(7 Marks)(May 99)

Answer

Loans to shareholders of closely held companies to the extent the said company possesses accumulated profits are to be treated as "deemed dividend" under section 2(22) (e) of the Income-tax Act. Each of the shareholders in the present case holds an equal interest viz. 25% of the equity capital of the company and thus come within the scope of the above statutory provision.

(i) Trade deposit of Rs.1,00,000 to Ray Gandhi adjusted against the supply of machinery/goods does not amount to dividend. The trade deposit represents deposit in the ordinary course of its business by the company.

(ii) Rs.3,00,000 given to Dikesh Ranka will be deemed to be dividend. Even though Rs.1,00,000 had been repaid by the shareholder by the end of the accounting year, the deeming is for the distribution and the availability of accumulated profits. In the present case the entire advance of Rs.3,00,000 will be taxed as deemed dividend. It is not exempt under section 10(33) in the hands of the shareholder.

(iii) Rs.3,00,000 given to Smt. Kanta will also be treated as deemed dividend since the advance was made at the specific request of the beneficial shareholder viz. Shri Prasant Shroff.

(iv) The amount of loan given to Tanmay Shah (HUF) is also liable to tax as deemed dividend as beneficial ownership of shares in the company vest in HUF and it is only registered in the name of Tanmay Shah. Section 2(22)(e) covers any person who is beneficial owner of shares having substantial interest in the company..

Thus in the following cases, shareholders will be assessed for deemed dividend in respect of the amounts received as given below:

Dikesh Ranka	**Rs.3,00,000**
Prasant Shroff	**Rs.3,00,000**
Tinmay Shah	**Rs.4,00,000**

In the hands of the company, there will be no tax liability under section 115-O, since that section does not include any distribution under section 2(22) (e) as dividend for its coverage. Also it may be noted that the company has accumulated profits much more than the amount advanced as loan to various shareholders.

Question 12

(i) Describe the following exempt incomes which do not form part of the total income under the Income-tax Act, 1961:

Casual and Non-recurring Receipts (3 Marks)(Nov.99)

(ii) Write short notes on: Casual and Non-recurring receipts (6 Marks) (Nov.96)

Answer

The Finance Act, 2002 has omitted section 10(3) which earlier provided exemption in respect of incomes which are casual and non-recurring in nature. However, from the assessment year 2003-04 onwards there is no exemption for casual and non-recurring incomes.

CHAPTER 2

RESIDENCE AND SCOPE OF TOTAL INCOME

Question 1

When is an individual/HUF said to be "Resident and ordinarily Resident" under the Income tax Act, 1961?

(6 Marks) (Nov.2003)

Answer

Individual – **An individual is said to be a resident in India in any previous year if he fulfills any one of the following two basic conditions :**

(i) He is in India during the previous year for a period of periods amounting in all to 182 days or more.

(ii) He is in India for a period or periods amounting in all to 60 days or more during the previous year and 365 days or more during 4 years immediately preceding the relevant previous year.

Exception – **If an Indian citizen leaves India for the purpose of employment or as a member of crew of an Indian ship or if an Indian citizen or person of Indian origin who is residing outside India and comes to India on a visit in a previous year, he would be considered as resident in India in that year only if he has been in India in that year for 182 days or more instead 60 days referred to in, (ii) above.**

Resident and Ordinarily Resident : **If an individual satisfies any one of the basic conditions and none of the following additional conditions will be treated as 'resident and ordinarily resident'.**

Additional conditions :

(i) He has been non-resident in India in 9 out of 10 previous years preceding the relevant previous year ; or

(ii) He has been in India for a period of 729 days or less during 7 previous years immediately preceding the relevant previous year.

Thus in brief, an individual fulfilling any one of the basic conditions and none of the additional conditions will be "Resident and ordinarily resident".

HUF: **If the control and management of the affairs of the HUF is wholly or partly situated in India and if the manager of the HUF does not satisfy any of the following two additional conditions, the HUF shall be considered as resident and ordinarily resident –**

(i) He has been non resident in India in 9 out of 10 previous years preceding the relevant previous year ; and

(ii) He has been in India for a period of 729 days or less during the 7 previous years preceding the relevant previous year.

Question 2

G, an American citizen, is appointed by a multi-national company to its branch in New Delhi in 1994. G has never been to India before this appointment. He arrives in Bombay on 15th April, 1994 and joins the New Delhi office on 20th April, 1994. His wife and children join him in India on 20th October, 1994. The company allotted him a leased residence for purposes of his stay. This residence is occupied by him from the beginning of October, 1994.

On 10th February, 1995, he is transferred by his employer, on deputation basis, to be the regional chief of his employer's operations in South East Asia having headquarters in Hongkong. He leaves New Delhi on 11th February and arrives in Hongkong on 12th February, 1995. G leaves behind his wife and children in India till 14th August, 1996, when they leave along with him for Hongkong. G had come to India earlier on 15th June, 1996, on two months' leave. The members of the family occupied the residence till date of departure to Hongkong.

At the end of the period of deputation, G is reposted to India and joins the New Delhi office of his employer as chief of Indian operations on 1st February, 1998.

In what residential status G will be assessable, for the various years, to income tax in India?

(9 Marks) (May 98)

Answer

The period of stay of G for various years is given below (by adding 9 years to make it relevant for the assessment year 2007-08).

Accounting Year	*Assessment Year*	*Period of stay (in days)*

2003-04	2004-05	303
2004-05	2005-06	--
2005-06	2006-07	60
2006-07	2007-08	59

G is a non-Indian citizen and arrives in India for the first time on 15th April. 2003 though he joins duty on 20th April, his period of residence in India will commence from 15th April. He leaves India on 11th February, 2004. His stay in India amounts to 303 days in the year 2003-04.

G arrives in India for a second time on 15th June, 2005 and stays till 14th August, 2005 a period of 60 days in the year 2005-06.

G arrives for a third time in India on 1st February, 2007. His stay in India in the year 2006-07 is for a period of 59 days.

Under section 6(1) of the Act, an individual is said to be resident in India in any previous year if he satisfies one of the following basic conditions:

(i) is in India in the previous year for a period of 182 days or more ;

(ii) is in India for a period of 60 days or more in the previous year and 365 days or more during the four years preceding the previous year.

The exceptions provided in the explanation to section 6(1) will not apply to G since he is not an Indian citizen.

A person will be considered to be 'not ordinarily resident' if he satisfies any of the following two additional conditions viz ;

(i) he has been a non resident in India in 9 out of 10 previous years preceding the relevant previous year ; or

(ii) he has been in India for a period of 729 days or less in 7 previous years preceding the relevant previous year.

Maintenance of a residence in India or the stay of the wife and children in India are not relevant for determining the residential status of G.

In the above background, G's case will be decided as under :

(i) Assessment year 2004-05 : has been in India for 303 days. He will be a resident under the basic conditions. Since he does not satisfy either of the additional conditions to become ordinarily resident, he will be a "resident but not ordinarily resident" for this year.

(ii) Assessment year 2005-06 : has not been in India at all ; though his wife and children continue to reside in New Delhi, he will be a non-resident for this year.

(iii) Assessment year 2006-07 : has been in India for 60 days. He satisfies one limb of the basic condition but having been in India for period (s) amounting to 302 days only in the four previous years preceding this year and not 365 days, he will be non-resident for this year.

(iv) Assessment year 2007-08 : has been in India for 59 days. Since the total stay in India during four years preceding assessment year 2007-08 does not exceed 365 days (amounts to 362 days) and has not been in India for 60 days in the current year, he will be a non-resident for this year also.

Question 3

In the leap year 1999-2000 (Previous year), a sailor has remained on ship for a private company owning ocean going ships as follows :

(1) Outside the territorial waters of India for 183 days.

(2) Inside the territorial waters of India for 183 days.

Is he considered to be resident or not for the Assessment Year 2001-02 (Previous Year 1999-2000). Comment.

(3 Marks) (Nov.2002)

Answer

An individual is treated as a resident in India in any previous year if he fulfills any of the following two conditions laid down in section 6(1):

(a) He is in India for a period or periods amounting to 182 days or more in that year; or

(b) In the preceding four years, he has been India for 365 days or more, and has been in India for 60 days or more in that year.

In the given case, period of stay in India is more than 182 days. Therefore, the sailor is treated as a resident in India for the assessment year.

Question 4

State the activities and operations, income from which is not deemed to accrue or arise in India.

(4 Marks) (Nov.2005)

Answer

Explanation 1 to section 9(1)(i) lists out income which shall not be deemed to accrue or arise in India. They are given below:

1. In case of a business of which all the operations are not carried out in India [Explanation 1(a) to section 9(1)(i)]

   In the case of a business of which all the operations are not carried out in India, the income of the business deemed to accrue or arise in India shall be only such part of income as is reasonably attributable to the operations carried out in India. Therefore, it follows that such part of income which cannot be reasonably attributed to the operations in India is not deemed to accrue or arise in India.

2. Purchase of goods in India for export [Explanation 1(b) to section 9(1)(i)]

In the case of a non-resident, no income shall be deemed to accrue or arise in India to him through or from operations which are confined to the purchase of goods in India for the purpose of export.

3. Collection of news and views in India for transmission out of India [Explanation 1(c) to sec.9(1)(i)]

In the case of a non-resident, being a person engaged in the business of running a news agency or of publishing newspapers, magazines or journals, no income shall be deemed to accrue or arise in India to him through or from activities which are confined to the collection of news and views in India for transmission out of India.

4. Shooting of cinematograph films in India [Explanation 1(d) to sec.9(1)(i)]

In the case of a non-resident, no income shall be deemed to accrue or arise in India through or from operations which are confined to the shooting of any cinematograph film in India, if such non-resident is –

(i) an individual, who is not a citizen of India or

(ii) a firm which does not have any partner who is a citizen of India or who is resident in India ; or

(iii) a company which does not have any shareholder who is a citizen of India or who is resident in India.

Question 5

How is royalty defined under Section 9 of the Income-tax Act ? (6 Marks) (Nov 2000)

Answer

Explanation 2 to section 9(1)(vi) deals with the term 'royalty'.
Royalty means consideration (including any lump sum consideration but excluding any consideration which would constitute income by way of capital gains) for the following –

(i) the transfer of all or any rights in respect of a patent, invention, model, design, secret formula or process or trade mark in similar property,

(ii) the imparting of any information covering the working of or the use of a patent, invention, model, design, secret formula or process or trade mark or similar property,

(iii) the use of any patent, invention, model, design, secret formula or trade mark or similar property,

(iv) the imparting of any information regarding technical, industrial, commercial or scientific knowledge, experience or skill,

(v) the use or right to use any industrial, commercial or scientific equipment but not including amounts referred to in section 44 BB.

(vi) the transfer of all or any rights in respect of any copyright literary artistic or scientific work, including films or video tapes for use in connection with radio broadcasting but not consideration for the sale, distribution or exhibition of cinematographic films or

(vii) the rendering of services in connection with activities referred to in sub-clause (i) to (iv), (iva) and (v) of section 9(1).

Question 6

Under what circumstances a non-resident is liable to tax on dividend income?(2 Marks)(Nov.97)

Answer

Any dividend declared by a domestic company on which dividend distribution tax is paid under section 115-O is exempt under section 10(34). Where the dividend declared is not covered by section 115-O, it is chargeable to tax. Hence, both resident and non-resident assessees are chargeable to tax in respect of dividends which are not covered by section 115-O. It is worth noting that deemed dividend dealt with in section 2(22)(e) is not covered by section 115-O, hence is taxable in the hands of both resident and non-resident assessees.

Question 7

(i) Write a short note on the term `Business connection' under the Income-tax Act, 1961.

(6 Marks) (Nov.2004)

(ii) How the following concept is defined under section 9 of the Income-tax Act, 1961? Income arising from business connection in India (4 Marks) (Nov.2001)

(iii) Write short notes on: Business connection (6 Marks) (May 1997)

Answer

Explanation 2 to section 9(1)(i) explains the term 'business connection' as follows :

(i) `Business connection' shall include any business activity carried out through a person acting on behalf of the non-resident.

(ii) The person acting on behalf of non-resident must have an authority which is habitually exercised in India to conclude contracts on behalf of the non-resident.

However, if his activities are limited to the purchase of goods or merchandise for the non-resident, this provision will not apply.

(iii) Where the person has no such authority, but habitually maintains in India, a stock of goods or merchandise from which he regularly delivers goods or merchandise on behalf of the non-resident, a business connection is established.

(iv) Business connection is also established where he habitually secures orders in India, mainly or wholly for the non-resident. Further, there may be situations when other non-residents control the above-mentioned non-resident. Secondly, this non-resident may also control other non-residents. Thirdly, all other non-residents may be subject to the same common control as that of the non-resident. In all the three situations, business connection is established.

"Business connection", however, shall not be held to be established in cases where the non-resident carries on business through a broker, general commission agent or any other agent of an independent status, if such a person is acting in the ordinary course of his business.

Question 8

How is the following concept defined under section 9 of the Income-tax Act, 1961? Apportionment of profit

(4 Marks) (Nov.2001)

Answer

Apportionment of profit: **This is related to the computation of income accruing or arising in India in the following cases:-**

(i) In the case of business, in respect of which all operations are not carried out in India, income shall be deemed to accrue or arise in India as is attributable to the operations carried out in India. (Explanation 3 to section 9(1)(i).

(ii) In cases where the income attributable to operations carried out in India cannot be ascertained, rule 10 of the Income-tax Rules, 1962 provides as below -

  (a) at such percentage of the turnover so accruing or arising as the Assessing Officer may consider to be reasonable, having regard to the facts and circumstances of the case ; or

  (b) any amount which bears the same proportion to the total profits and gains of the business of the assessee (computed in accordance with the provisions of the Act) as the receipts so accruing or arising bear to the total receipts of the business ; or

  (c) in such other manner as the Assessing Officer may deem suitable.

CHAPTER 3

INCOME WHICH DO NOT FORM PART OF TOTAL INCOME

Question 1

Mr. A is a resident Indian. During the F.Y. 2004-05, interest of Rs.92,000 was credited to his Non-resident (External) Account with the SBI. Rs.20,000 being interest on fixed deposit with SBI was credited to his savings bank account during this period. He also earned Rs.4,000 as interest on this savings account. Is Mr. A required to file return of income ?
What will be your answer, if he owns one shop in Mumbai of area 130 sq.ft. ?

(4 Marks)
(Nov.2005)

Answer

Computation of total income of Mr. A for A.Y. 2007-08

Particulars	*Rs.*
Income from other sources **Interest earned from Non-resident (External) Account [Exempt u/s 10(4)(ii), assuming that Mr.A has been permitted by RBI to maintain the aforesaid account]**	**NIL**
Interest on bank fixed deposit	**20,000**
Interest on savings bank account	**4,000**
Total Income	24,000

An Individual is required to furnish a return of income u/s.139(1) if his total income exceeds the maximum amount not chargeable to tax i.e. Rs.1,00,000. Hence, Mr. A is not required to file a return of income as his total income is below Rs.1,00,000.
The question of Mr.A occupying / owning a shop area of 130 sq.ft in Mumbai, does not make any difference as the return filing based on

economic criteria scheme known as one by six scheme has been discontinued from the assessment year 2006-07.

Question 2

Briefly explain about aggregation of agricultural income for rate purposes. How will income-tax be computed where an individual derives agricultural as well as non-agricultural income ?

(5 Marks) (May 2005)

Answer

Agricultural income is exempt from tax under section 10(1). However, it is to be included for determining the rate at which non-agricultural income is chargeable to tax. This is provided for in the Finance Act of each year. The procedure for computation of tax payable on non-agricultural income after aggregation of agricultural income is as follows–

(i) Aggregate the agricultural income with non-agricultural income and determine the tax payable on such amount.

(ii) Aggregate the agricultural income with the basic exemption limit (i.e. Rs.1,00,000) and determine the tax payable on such amount.

(iii) The difference between the tax computed in step (i) and step (ii) will be the tax payable in respect of non-agricultural income.

The income-tax so arrived at by the method of aggregation described above, has to be reduced by rebate under Chapter VIII-A (now consists of section 88-E only) and it is to be increased by surcharge, wherever applicable and education cess.

In the case of assessees such as partnership firms, companies etc, whose income is chargeable to tax at a flat rate, aggregation of agricultural income has no effect. In the case of every individual, HUF, AOP or BOI and every artificial juridical person, the Finance Act prescribes slab rates of income-tax and in such cases agricultural income has to be aggregated for rate purposes.

If the non-agricultural income does not exceed the basic exemption limit, then the agricultural income need not be aggregated. No tax will be payable by the assessee in such a case. Further, aggregation of agricultural income for rate purposes is not required if the agricultural income does not exceed Rs.5,000 during the previous year.

Question 3

Choose the correct answer with reference to the provisions of the Income-tax Act, 1961.

For an employee in receipt of hostel expenditure allowance for his three children, the maximum annual allowance exempt under Section 10(14) is

(a) Rs.10,800

(b) Rs.7,200

(c) Rs.9,600

(d) Rs.3,600

(1 Mark) (May 2005)

Answer

(b) **i.e. Rs.7,200 [300 ? 12 ? 2 (children)]**

Question 4

Write short notes on: Exceptions under section 10(10D) as regards exemption of any sum received under a life insurance policy. (6 Marks) (May 2005)

Answer

Section 10(10D) provides that any sum received under a life insurance policy, including the sum allocated by way of bonus on such policy should not be included in the total income of the recipient.

However, there are certain exceptions to the exemption under section 10(10D), which are briefed hereunder –

(i) Any sum received under section 80DD(3) or under section 80DDA(3); or

(ii) Any sum received under a Keyman insurance policy; or

(iii) Any sum received under an insurance policy issued on or after 1.4.2003 in respect of which the premium payable for any of the years during the term of the policy exceeds twenty per cent of the actual capital sum assured. However, such sum received under such policy on the death of a person, shall continue to be exempt.

For the purpose of calculating the actual capital sum assured the following shall not be taken into account.

(a) the value of any premiums agreed to be returned; or

(b) any benefit by way of bonus or otherwise, over and above the sum actually assured, which is to be or may be received under the policy by any person.

Question 5

Mr. Tony had estates in Rubber, Tea and Coffee. He derives income from them. He has also a nursery wherein he grows and sells plants. For the previous year ending 31.3.2004, he furnishes the following

particulars of his sources of income from estates and sale of Plants. You are requested to compute the taxable income for the Assessment year 2004-2005:

		Rs.
(i)	*Manufacture of Rubber*	*5,00,000*
(ii)	*Manufacture of Coffee grown and cured*	*3,50,000*
(iii)	*Manufacture of Tea*	*7,00,000*
(iv)	*Sale of plants from Nursery*	*1,00,000*

(5 Marks) (Nov.2004)

Answer

Computation of taxable income of Mr.Tony for A.Y.2007-08

	Particulars	***Business Income***	***Agricultural Income***
		Rs.	***Rs.***
(a)	Income from manufacture of rubber (Rule 7A)		
	Business income is 35% of Rs.5,00,000	1,75,000	
	Agricultural income is 65% of Rs.5,00,000		3,25,000
(b)	Income from growing and curing of coffee (Rule 7B)		
	Business income is 25% of Rs.3,50,000	87,500	
	Agricultural income is 75% of Rs.3,50,000		2,62,500
(c)	Income from manufacture of tea (Rule 8)		
	Business income is 40% of Rs.7,00,000	2,80,000	
	Agricultural income is 60% of Rs.7,00,00		4,20,000
(d)	Income from sale of plants in nursery is agricultural income, assuming that plants from nursery were grown on land in the nursery	Nil	1,00,000
	(CIT v. Soundarya Nursery 241 ITR 350 (Mad)		
		5,42,500	11,07,500

Question 6

State the provisions relating to the exemption in respect of long-term capital gains on transfer of listed Equity Shares. (4 Marks) (Nov.2004)

Answer

Section 10(38) says that any income arising from the transfer of a long term capital asset being equity shares in a company or a unit of an equity oriented fund is exempt from tax, subject to following conditions.

(a) The transaction of sale is entered into after the introduction of securities transaction tax ; and

(b) Such transaction is chargeable to securities transaction tax.

The proviso to section 10(38) says that the income though exempt from tax is to be taken into account while computing book profit and income tax payable under section 115 JB (applicable for companies).

Question 7

(i) Write short notes on: `Encashment of Earned Leave' and its taxability under the Act.

(6 Marks) (Nov.2004)

(ii) Exemption in respect of encashment of leave salary (5 Marks) (May 2003)

Answer

Any encashment of leave salary received by an employee while he is in service is fully taxable.

If he gets encashment at the time of leaving the service (including resignation) he can avail this exemption under section 10(10AA).

Section 10(10AA) deals with the taxability of encashment of earned leave under the Income-tax Act, 1961.

Central/State Government employees: In the case of Central/State Government employees, any amount received as cash equivalent of leave salary in respect of period of earned leave at the credit, at the time of retirement is exempt from tax.

Non-Government employees: In the case of non-Government employees, leave salary is exempt from tax to the extent of the least of the following:

(a) Cash equivalent of the leave salary (on the basis of average of last 10 months salary) in respect of the period of earned leave standing to the credit of employee at the time of retirement, whether on superannuation or otherwise. For this purpose earned leave entitlement cannot exceed 30 days for each completed year of service; or

(b) 10 months salary (on the basis of average of last 10 months salary); or

(c) Rs.3,00,000 (being the amount specified by the Government); or

(d) The amount of leave encashment actually received at the time of retirement.

'Salary' means basic salary and includes dearness allowance, if the terms of employment so provide. It also includes commission based

on a fixed percentage of turnover achieved by an employee as per the terms of contract of employment.

When an employee gets leave salary from two or more employers in the same previous year, the maximum amount exempt from tax cannot exceed the limits prescribed.

Question 8

(i) Write short notes on: Taxability of Retrenchment Compensation received by Workmen. (6 Marks) (May 2002)

(ii) Describe the following exempt incomes which do not form part of the total income under the Income-tax Act, 1961: Retrenchment Compensation. (3 Marks) (Nov.99)

Answer

As per section 10(10B), any compensation received by a workmen at the time of retrenchment is exempt to the extent of the lowest of the following:

(i) any amount calculated in accordance with the provisions of section 25F(b) of the Industrial Disputes Act, 1947; or

(ii) Such amount as notified by the Government i.e Rs.5,00,000; or

(iii) The actual amount received.

Under the Industrial Disputes Act, 1947 the workman is entitled to retrenchment compensation equal to 15 days average pay for every completed year of continuous service or any part thereof in excess of six months.

Any compensation in excess of aforesaid limits is taxable as salary or profits in lieu of salary. However, the aforesaid limit is not applicable in cases where compensation is paid under any scheme approved by the Government, having regard to the need for extending special protection to the workmen in the undertaking to which the scheme applies.

For the purposes of this clause, compensation received at the time of closing down of an undertaking or transfer of ownership or management of the undertaking shall be deemed to be retrenchment compensation.

Question 9

What tax benefits are derived by an Industrial Undertaking, which is established in Free Trade Zone? Enumerate the conditions which are required to be satisfied by such a unit.

(9 Marks) (May 2000)

Answer

Profits and gains derived by an undertaking which begins to manufacture or produce articles or things or computer software in any special economic zone is eligible for deduction under section 10A. The quantum of deduction is as under:

(a) 100% of the profits derived from export of such articles or things or computer software for five consecutive assessment years beginning with the assessment year in which the undertaking begins to manufacture or produce such articles or things or computer software.

(b) 50% of such profits and gains for further two consecutive assessment years.

(c) Not exceeding 50% of the profits for the next three consecutive assessment years subject to the amount debited to profit and loss account and credited to Special Economic Zone Re-investment Allowance Reserve Account.

The following conditions have to be satisfied -

(a) The undertaking must commence production or manufacture of articles or things or computer software after 01-04-2003 in any special economic zone.

(b) It should not have been formed by the splitting up or the reconstruction, of a business already in existence.

(c) It is not formed by the transfer to new business of machinery or plant used for any purpose. However, any machinery or plant so transferred to the new business if does not exceed 20% of the total value of machinery or plant then it would be deemed that this condition has been complied with by the undertaking.

(d) No deduction is admissible unless the return of income is furnished on or before the due date specified in section 139(1).

(e) An assessee may make a declaration in writing for any assessment year for not applying the provisions of section 10A and such declaration must be furnished before the due date for filing the return specified in section 139(1).

Question 10

Describe the following exempt income which do not form part of the total income under the Income-tax Act, 1961: House Rent Allowance (3 Marks) (Nov.9

Answer

As per section 10(13A) any special allowance specifically granted to an employee by his employer to meet the expenditure actually incurred on payment of rent in respect of residential accommodation occupied by the assessee, is exempt as prescribed in Rule 2A of the Income-tax Rules, 1962.

(i) Actual amount of such allowance received by the assessee in respect of the relevant period; or

(ii) The amount by which the expenditure actually incurred by the assessee in payment of rent in respect of residential accommodation occupied by him exceeds one-tenth of the amount of salary due to the assessee in respect of the relevant period ; or

(iii) An amount equal to

  (a) Where such accommodation is situated at Bombay, Calcutta, Delhi or Madras: one-half of the amount of salary due to the assessee in respect of the relevant period ; and

  (b) Where such accommodation is situated at any other place: Two–fifth of the amount of salary due to the assessee in respect of the relevant period.

- the least of (i), (ii) or (iii) is eligible for deduction.

Question 11

Rajesh Kumar, an Indian citizen, is posted in the Indian High Commission at London during the previous year 1997-98. His emoluments consist of basic pay of Rs.7,000 per month and overseas allowance of Rs.2,000 per month. Besides, he is entitled to air fare for going from and coming to India and also to free use of Government's car at London. He has no taxable income except salary income stated above. His employer did not deduct tax at source. Rajesh Kumar argues that (i) he is not liable to pay tax on salary earned and received outside India since he is a non-resident during the previous year 1997-98 and (ii) even if any tax is due, it is the duty of his employer to deduct tax at source and as such he has no responsibility to pay the tax. Discuss whether his contention is correct. Will it make any difference if Rajesh Kumar is a foreign citizen? Give reasons. (5 Marks) (Nov.98)

Answer

According to the deeming provision of section 9(1) (iii) of the Income-tax Act, 1961, salaries payable by the Government to a citizen of India for service outside India is income deemed to accrue or arise in India and taxable in India. But any allowance or perquisites paid or allowed as such outside India by the Government to a citizen of India for rendering services outside India would not be taxable in India [Section 10(7)].

Hence Rajesh Kumar is chargeable to tax in respect of salary i.e., basic pay but not in respect of allowance and perquisites and his taxable salary would be Rs.84,000 (7000 x 12).

As the taxable limit for an individual assessees for the assessment year 2007-08 is Rs.1,00,000 there is no obligation on the employer to deduct tax at source on salary income under section 192 of the Income-tax Act, 1961.

If Rajesh Kumar is not a citizen of India, the deeming provisions of section 9 (1) (iii) will not be applicable and even if the salary exceeds Rs.1,00,000 nothing would be taxable in India for A.Y. 2007-08.

Question 12

From the following information, compute taxable income for the assessment year 1998-99.

	Rs.
Income from business – letting cycles on hire	***40,000***
Lease rent received from lands given to tenants for agricultural operations	***48,000***
Sale of agricultural produce (landlord's share)	***30,000***
Sale proceeds of agricultural lands situated in a village	***1,20,000***
Fixed deposit interest received from companies on deposits made of sale proceeds of land	***18,000***
Dividends (received in April, 1997) from an Indian company having rubber plantations	***6,000***
Salary received as a partner from a firm manufacturing tea	***36,000***
Payment of government tax on agricultural lands	***6,000***
Expenses on power, irrigation cess and farm labour	***10,000***
Purchase of seeds	***1,000***
Tractor hire charges (for agricultural operations)	***2,500***

Your answer must indicate reasons for the treatment given to the items mentioned above.

(9 Marks) (May 1998)

Answer

Computation of income from agriculture.

Lease rent from agricultural lands [Section 2(1A)(a)]		**48,000**
Sale of agricultural produce [Section 2(1A)(b)(iii))		**30,000**
Salary from firm dealing with agriculture (Salary to partners really represents share of income from the firm and since part of the income of the firm is agricultural, that part will be treated as agricultural income in the hands of the partners) – 60% of Rs.36,000		**21,600**
		99,600
(Also refer to Note at the end of the answer)		
***Less* : Expenses**		
Government tax	**6,000**	
Power, Irrigation cess etc	**10,000**	
Purchase of seeds	**1,000**	
Tractor hire charges	**2,500**	
		19,500
Note**: These expenses are directly relatable to agricultural operations and hence are deducted to arrive at the net agricultural income**		
		80,100

Sale of agricultural land is realisationof a capital asset and since the lands are situated in a village, they apparently do not fall under the definition of capital asset liable to capital gains taxation. Hence the receipt is on capital account

Non agricultural income :

Income from Business:

Cycle hire charges	**40,000**
Salary from firm (non –agricultural part – 40%)	**14,400**
Other sources:	
Dividends from Plantation company – exempt U/s.10(33)	**Nil**
Interest on fixed deposit with companies:	
(This income is taxable and does not bear the character of agricultural income. The immediate source of income is the deposits. The character of the source for the deposits is not to be taken into account)	**18,000**
Total income liable to tax	72,400

Tax payable will be 'nil' as the non–agricultural income is less than the basic limit of Rs.1,00,000 for the assessment year 2007-08.

Note :

1. The underlying assumption is that the firm from which salary is received as a partner is also growing tea. An alternative view can be taken with respect to salary received as a partner. Rule 8 of the Income-tax Rules, 1962 provides for determination of income from the manufacture of tea where income is derived from the sale of tea grown and manufactured by the seller in India. Therefore, where a firm derives income only from manufacturing tea, no portion of the income can be considered to be agricultural income and hence Rule 8 has no application. Salary received as a partner from such a firm is to be treated as business income vide section 28(v).
2. It is possible to make assumptions in regard to population of the village and accordingly treat the sale proceeds of the agricultural lands situated in India as liable for capital gains.

Question 13

(i) What are the benefits available to a 100% Export Oriented unit (E.O.U.). Discuss the eligibility conditions for availing such benefits under section 10 B of the Income-tax Act, 1961. *(6 Marks) (Nov.99)*

(ii) Write short notes on: Exemption of income of 100% export-oriented undertakings.

(6 Marks) (May 1998)

Answer

As per section 10B, 100% of profits and gains derived by an assessee from a 100% export oriented undertaking from the export of articles or things or computer software is deductible for 10 consecutive assessment years beginning with the assessment year

in which the undertaking begins to manufacture or produce articles or things or computer software. The assessee must satisfy the following conditions.

(i) It manufactures or produces any article or thing during the previous year ;

(ii) It has not been formed by the splitting up, or the reconstruction of, a business already in existence ;

(iii) It is not formed by the transfer to a new business of machinery or plant previously used for any purpose. Further, where the total value of plant or machinery transferred to the new unit does not exceed 20% of the total value of plant or machinery used in the new business, this condition will be deemed to have been complied with.

(iv) For the purpose of getting deduction under this section the assessee must furnish his return of income on or before the due date specified in section 139(1).

Further, in computing the depreciation allowance on any assets in the assessment years, following the relevant assessment years, the written down value of the assets will be computed as if the assessee had claimed and had been allowed the depreciation in accordance with the provisions of the Act during each one of the assessment years.

The term 100% EOU means an undertaking which has been approved as such by the Board appointed in this behalf by the Central Government in exercise of the powers conferred by section 14 of Industries (Development and Regulation) Act, 1951 and the rules made thereunder.

No deduction will be allowed under section 80-IA or section 80-IB in relation to profits and gains of the undertaking coming under the provisions of section 10B.

Question 14

Write short note on: Income of professional association *(6 Marks) (Nov.97)*

Answer

As per section 10(23A) any income of an association or institution established in India having as its object the control, supervision, regulation or encouragement of the profession of law, medicines, accountancy, engineering or architecture or any other profession specified by the Central Government may specify in this behalf, from time to time, by notification in the official gazette is exempt from tax. However, income under the following heads are chargeable to tax.

(i) Income under the head "Income from house property"

(ii) Income received from rendering any specific service; and

(iii) Income by way of interest/dividend derived from its investments.

Question 15

Income from a farm building is considered as agricultural income if certain conditions are fulfilled. State those conditions. *(6 Marks) (May 1996)*

Answer

Income from any farm building which satisfies the following conditions would be treated as agricultural income and would consequently be exempt from tax:

(i) The building should be on or in the immediate vicinity of the agricultural land.

(ii) The building should be owned and occupied by the receiver of the rent or revenue of any such land or occupied by the cultivator or the receiver of rent in kind of any land with respect to which or the produce of which agricultural process mentioned in section 2(1A)(b) (ii) and (iii) is carried on

(iii) The receiver of the rent or revenue or the cultivator or the receiver of rent in kind should by reason of his connection with such land require it as a dwelling house or other out building.

(iv) The land should either be assessed to land revenue in India or subject to a local rate assessed and collected by the officers of the Government as such.

(v) Where the land is not so assessed as stated above, or is not subject to local rate, the building should not be situated in any area as comprised within the jurisdiction of a municipality or a cantonment board and which has a population of not less than 10,000 or it should not be within 8 kilometers from the local limits of such municipality or cantonment board as the Central Government may, by notification in the official gazette, specify in this behalf.

Question 16

(i) *Explain the provisions relating to tax exemption to political parties. What are the obligations of the political parties under the provisions of Income Tax Act, 1961?*

(6 Marks) (May 1996)

(ii) *The Income-tax Act grants exemption from tax to political parties in respect of their income. The incomes so exempt be stated, as per the provisions of the Act.*

(4 Marks) (Nov.2004)

Answer

Section 13A of the Income-tax Act grants exemption from tax to political parties in respect of their income specified below :

(i) Income from house property ;

(ii) Income from other sources ;

(iii) Income by way of voluntary contributions received by the political parties from any person ; and

(iv) Capital gains.

The aforesaid four categories of income would qualify for exemption without any monetary or other limit and the income so exempted would not even be includible in the total income of the political party for purposes of assessment. The incomes, if any, derived by the political party by way of profits and gains of business and profession would not, however, qualify for tax exemption.

The tax exemption will be applicable only if the following conditions are fulfilled.

(i) The political part must be registered under section 29A of the Representation of the People Act, 1951. A political party not registered will not be eligible for the exemption. The treasurer of such political party or any other person must submit for every financial year a report under section 29C(3) of the Representation of People Act, 1951. Otherwise, exemption shall not be available to the political party for such financial year.

(ii) The political party must keep and maintain such books of account and other documents as would enable the Assessing Officer to properly deduce its income therefrom.

(iii) The political party must keep and maintain such records in respect of each such voluntary contribution which is in excess of Rs.20,000/- with details of the amount received, the name and address of the person who has made the contribution.

(iv) The accounts of the political party must be audited by a chartered accountant who is authorised under section 288 of the Income-tax Act to appear as an authorised representative in Income-tax proceedings before any Income-tax authority.

Political parties are under an obligation to file their return of income as per the provisions of section 139(4B) and should also apply to the Assessing Officer for the allotment of a permanent account number.

Question 17

Write short note on: Keyman Insurance Policy *(6 Marks) (May 97)*

Answer

Explanation to section 10(10D) says 'Keyman Insurance Policy' means a life insurance policy taken by a person on the life of another person who is or was an employee of the first mentioned person or is or was connected in any manner whatsoever with the business of the first mentioned person.

Any sum received under an insurance policy, including the sum allocated by way of bonus on such policy, is exempt from tax. But this exemption does not apply to any sum received under a keyman insurance policy.

Therefore, the sum received under a keyman insurance policy including the sum allotted by way of bonus on such policy is taxable. Section 2(24)(xi) covers directly the receipt of sum under a keyman insurance policy within the definition of income. Also, as per section 17(3) any sum received by an employee under the Keyman Insurance Policy is deemed to be profits in lieu of salary.

Similarly, for persons on receipt of income from business, profession or vocation, any sum received under a keyman insurance policy, including bonus, has been deemed to be income chargeable under the head "Profits and gains of business or profession" – Section 28 Clause (vi).

Question 18

John is employed in a public company and is paid a sum of Rs.6,00,000 on Voluntary Retirement from service. The normal age of retirement in the company is 60 and John, who was 45 at the time of retirement had completed 20 years of service. His monthly salary at the time of retirement was as follows :

	Rs.
Basic pay	*10,000*
Dearness allowance (50 p.c. includible for pension)	*6,000*
H.R.A.	*3,000*
Conveyance allowance	*800*

What is the amount of compensation taxable under the Act? *(7 Marks) (Nov.2000)*

Answer

Under section 10(10C) read with Rule 2BA the compensation received by an employee at the time of voluntary retirement from service is exempt to the extent prescribed under the guidelines issued by the Government and approved by the Chief Commissioner/Director General of Income-tax. The limits prescribed under the guidelines are the lowest of the following :-

(i) 3 months `salary for each completed year of service :

Salary for this purpose includes dearness allowance if the terms of employment so provide but not other allowances or perquisites i.e.,

Rs.10,000 + 3,000 = 13,000

Salary = 13,000 x 3 x 20 (years) = Rs.7,80,000

(ii) Actual compensation received Rs.6,00,000

(iii) Monetary limit Rs.5,00,000

Hence, a sum of Rs.5 lakhs will be exempt and the balance of Rs.1,00,000 will be taxed.

Question 19

Sub-section (33) of section 10 exempts from tax income by way of dividends referred to in Section 115-O from the purview of taxation. What are the types of dividends, which are not covered by the exemption ? *(8 Marks) (Nov.2000)*

Answer

Note: Section 10(34) deals with exemption of dividends which are referred to in section 115-O from the assessment year 2004-05. Hence, the answer to the question must be by making reference to section 10(34) read with section 115-O.

What is covered by section 115-O is the amount declared, distributed or paid by a domestic company by way of dividend (whether interim or otherwise) on or after 1-4- 2003, whether out of current or accumulated profits. Therefore it is the distributed profits of domestic companies, which, prima facie, are covered by section 115-O. The Explanation to section 115-O makes it clear that the expression "dividend" shall have the meaning assigned to dividend in clause (22) of section 2 but not including sub-clause(e) thereof.

From a conjoint reading of the above, the dividends which do not enjoy the exemption conferred by section 10(34) are as under :

(i) Dividends declared, distributed or paid by a non-domestic company ;

(ii) Dividend covered by section 2(22)(e).

Section 2(22)(e) covers -

(i) any payment by a company, other than a company in which the public are substantially interested, of any sum (whether representing a part of assets of the company or otherwise), by way of loan or advance to a shareholder who is the beneficial owner of shares (not being shares entitled to a fixed rate of dividend whether with or without a right to participate in profits) holding not less than 10% of the voting power, or to a concern in which the shareholder is a member or partner and in which he has a substantial interest, or

(ii) any payment by such company on behalf of or for the individual benefit of any such shareholder,

to the extent to which the company possesses accumulated profits in either of the above two situations.

However the above does not extend to an advance or loan made to a shareholder or the interested concern of the shareholder, by a company in the ordinary course of its business, where the lending of money is a substantial part of the business of the company.

Question 20

State the conditions for claiming exemption in the case of an infra-structural company.

(6 Marks) (May 2004)

Answer

Section 10(23G) providing exemption to infrastructure capital company or infrastructure capital fund has been omitted by the Finance Act, 2006 w.e.f. the assessment year 2007-08.

If an entity is engaged in infrastructure development, it is eligible for deduction under section 80-IA. Students may note that the question seeks 'exemption' in the case of infrastructural company and not 'deduction' and hence the provisions of section 80-IA could not be referred here.

Question 21

Write short notes on : Venture capital fund *(5 Marks) (Nov.98)*

Answer

Income of venture capital fund set up to raise funds for investment in venture capital undertakings is exempt from tax under section 10(23FB).

The expression "venture capital fund" has been defined to mean a fund, operating under a trust deed registered under the provisions of

the Registration Act, 1908, or operating as a venture capital scheme made by the Unit Trust of India established under the Unit Trust of India Act, 1963 and which has been granted a certificate of registration under the Securities and Exchange Board of India Act, 1992 and regulations made thereunder and which fulfils the conditions as may be prescribed with the approval of Central Government, by Securities and Exchange Board of India by notification in the official gazette.

Thus the following conditions are to be satisfied.

(a) The fund should be operating under a trust deed duly registered under the Indian Registration Act, 1908 or operating as a venture capital scheme made by UTI.

(b) The fund should have obtained certificate of registration and SEBI Act, 1992 and

(c) It must fulfill the condition as may be specified by SEBI, with the approval of the Central Government.

CHAPTER 4

CHARITABLE OR RELIGIOUS TRUSTS AND INSTITUTIONS

Question 1

State whether True or False, with reasons, having regard to the provisions of the Income-tax Act, 1961 (Answers without reasoning will not be given any mark) -

Where the Commissioner of Income-tax is satisfied that the activities of the charitable trust, which has been accorded registration is not genuine, he can cancel the registration by passing an order in writing. (2 Marks) (Nov.2005)

Answer

True. As per section 12AA(3), the Commissioner has power to cancel the registration of the trust, by passing a written order, where he is satisfied, inter alia, that the activities of the trust are not genuine. However, the trust should be given a reasonable opportunity of being heard.

Question 2

When a charitable trust can avail benefits under section 11 & 12 of the Income Tax Act, 1961 ? (6 Marks)(May 2004)

Answer

A charitable trust can avail the benefits under section 11 & 12 of the Act if it satisfies the following conditions –

(i) The trust has been granted registration by the Commissioner of Income-tax under section 12AA of the Income-tax Act on an application in the prescribed form (Form 10A) before the expiry of one year from the date of its creation.

(ii) The property from which income is derived should be held under a trust or other legal obligation.

(iii) The property should be held for charitable or religious purposes. According to section 2(15), charitable purpose includes relief of the poor, education, medical relief and the advancement of any other object of general public utility.

(iv) In the case of a charitable trust created on or after 1.4.1962, the further conditions are:

(a) the trust should not be created for the benefit of a particular religious community or caste ;

(b) no part of the income should enure, directly or indirectly, for the benefit of the settlor or other specified persons ; and

(c) the property should be held wholly for charitable purposes.

The conditions mentioned in (b) and (c) would also apply to religious trusts created on or after 1.4.1962.

(1) Where the total income of the trust without giving effect to sections 11 & 12 exceeds Rs.50,000, then the accounts of the trust have to be audited and an audit report in Form No.10B must be filed along with the return of income.

(2) At least 85% of the income is required to be applied for the approved purposes.

(3) 15% of the income, which can be accumulated or set apart, should be invested or deposited in the forms or modes specified in section 11(5).

Question 3

When is the business income of a Charitable Trust eligible for exemption under the Act?

(5 Marks) (May 2002)

Answer

As per the provisions of section 11(4A) of the Income-tax Act, the profits and gains of a charitable trust from business shall be exempt on the fulfillment of the following conditions.

(a) The income from the business carried on by the trust or the institution, must be incidental to the attainment of the objectives of the trust or institution ; and

(b) Separate books of account are maintained by the trust or institution in respect of such business.

If both the above conditions are satisfied, then only the trust or institution shall be entitled for exemption for its business income.

"Property held under Trust" will include a business undertaking and where a claim is made that the income of any such undertaking shall not be included in the total income, the Assessing Officer, shall have the power to determine the income of such undertaking in accordance with the provisions of the Act and where the income so determined is in excess of the income as shown in the accounts of the undertaking such excess shall be deemed to be applied for purposes other than charitable or religious purposes [Section 11(4)].

Question 4

Write short notes on: Accumulation of income in case of Charitable Trusts.

(6 Marks) (May 2000)

Answer

An accumulation not exceeding 15% of the income is permissible. The balance 85% has to be spent or applied for charitable purposes in India being the purpose for which the trust was created. For computing this 15%, voluntary contributions referred to in section 12 shall be deemed to be part of the income. The accumulation in excess of 15% is allowed for application towards objects of the trust in the succeeding 5 years.

If, however, the minimum 85% cannot be applied in a particular year due to non-receipt of the income or for any other reason, the trust can exercise the option of carrying it forward for application in the subsequent year.

Conditional accumulation of income is also permissible under section 11(2). For this purpose a notice has to be given in writing to the Assessing Officer about the fact of accumulation and the period (not exceeding 5 years) for which the income is to be accumulated.

Question 5

Discuss the provisions of Income-tax Act on the taxability of income from property wholly held for religious purposes.

Is any deduction permissible under the Act on any donation paid to such a trust? Discuss.

(6 Marks) (May 99)

Answer

Section 11(a) recognises a religious purpose. It is distinct from a charitable purpose. Private religious trusts do not get exemption u/s 11, but public religious trusts get exemption u/s 11. Restrictive provisions of section 13 are not to be contravened.

However, section 80G shuts out public trusts of religious nature, because Explanation 3 states that charitable purpose does not include any religious purpose.

Section 80G(5)(ii) says that the deduction is allowable only in respect of donations for charitable purpose (but not to religious trust).

Thus while section 11 exempts income from property held under trust for charitable or religious purposes, section 80G allows deduction only in respect of donations for charitable purposes.

Question 6

Which are the prohibited category of persons resulting in denial of

exemption to charitable Trusts?

(6 Marks) (Nov.97)

Answer

Section 13(3) gives the list of persons, whose use or application of the income or property of a charitable trust or religious trust or institution directly or indirectly would result in the denial of the exemption contemplated in section 11. The said persons are as follows:

(i) The author of the trust or the founder of the institution.

(ii) Any person who has made a substantial contribution to the trust or institution i.e. any person whose total contribution upto the end of relevant previous year exceeds Rs.50,000.

(iii) Where the author, the founder or the person making a substantial contribution (i.e. above Rs.50,000) is HUF, any member of the family.

(iv) Any trustee of the trust or manager (by whatever name called) of the institution.

(v) Any relative of any such author, founder person, member, trustee or manager as referred to in (i), (ii), (iii), (iv) above.

The expression 'relative' in relation to an individual means (a) spouse of the individual, (b)brother or sister of the individual, (c) brother or sister of the spouse of the individual, (d) any lineal ascendant or descendent of the individual (e) any lineal ascendant or descendant of the spouse of the individual (f) spouse of the person referred to before and (g) any lineal ascendant or descendant of a brother or sister of either the spouse of the individual,

(vi) Any concerns in which any of the persons referred to in the preceding clauses have substantial interest.

CHAPTER 5

INCOME FROM SALARIES

Question 1

Write short note on valuation of paid holidays for perquisite purposes under section 17(2).

(6 Marks) (Nov.2005)

Answer

(i) The value of travelling, touring, stay and any other expenses paid for or borne or reimbursed by the employer for any holiday availed by the employee or any member of his household shall be the sum equal to the amount of the expenditure incurred by the employer in that behalf. This provision applies in respect of trips other than those exempt under section 10(5) read with Rule 2B.

(ii) If the facility is maintained by the employer, and is not available uniformly to all employees, the value of benefit shall be taken to be the value at which such facilities are offered by other agencies to the public.

(iii) Where the employee is on official tour and the expenses are incurred in respect of any member of his household accompanying him, the amount of expenditure so incurred shall also be a fringe benefit or amenity.

(iv) However, if the official tour is extended as a vacation, the value of such fringe benefit will be limited to the expenses incurred in relation to such extended period of stay or vacation.

(v) The amount so determined as above shall be reduced by the amount, if any, paid by or recovered from the employee for such benefit or amenity.

Question 2

Distinguish between foregoing of salary and surrender of salary. *(2 Marks) (Nov.2003)*

Answer

Foregoing of salary **– Waiver by an employee of his salary is foregoing of salary. Once salary accrues, subsequent waiver does not absolve him from liability to income-tax.**

Surrender of salary **– If any employee surrenders his salary to the Central Government under the Voluntary Surrender of Salaries**

(Exemption from Taxation) Act, 1961, the surrendered salary would not be included in computing his taxable income, whether he is a private sector/public sector or Government employee.

Question 3

What are the deductions permitted under the Income-tax Act, 1961 in the computation of income under the head 'Salaries'? Discuss. *(6 Marks) (May 1998)*

Answer

The deductions permitted under section 16 of the Act are :

Entertainment Allowance – In the case of a government employee, the deduction will be the least of the following – 20% of salary or Rs.5,000 or the actual allowance, whichever is less. For other employees, no deduction is allowable.

Employment tax or profession tax : If the employee has paid any tax on employment levied under any law, he will be allowed deduction from gross salary equal to the amount of actual payment.

Question 4

Write short note on : Specified Employee *(6 Marks) (Nov.97)*

Answer

As per section 17(2)(iii) the following person shall be "specified employee".

(i) An employee who is a director of a company. It is immaterial whether he is a full time director or a part-time director, whether he is a nominee of management, workers, Govt. or financial institution. It is also not material whether or not he is a director throughout the previous year.

(ii) An employee who has a substantial interest in the company. A person has a substantial interest in a company if he is a beneficial owner of equity shares carrying 20% or more of the voting power of the company. For determining whether a person has a substantial interest in a company, it is the beneficial ownership that is relevant rather than the legal ownership.

(iii) An employee (not covered by above) whose income chargeable under the head 'salaries' (excluding all benefits or amenities not provided by way of monetary payment) exceeds Rs.50,000.

For computing the limit of Rs.50,000, the following items have to be excluded/deducted.

1. All non-monetary benefits and
2. Monetary benefits which are not taxable u/s.10

Where salary is received from more than one employer during the relevant previous year, the aggregate salary from all the employers is to be considered for determining the above ceiling limit of Rs.50,000.

Question 5

Enumerate the special allowances or benefits which are exempt from tax in the case of persons holding an office or employment of profit under section 10(14) and the conditions subject to which the exemption will be available. *(9 Marks)(May 97)*

Answer

The special allowances or benefits of the following types are exempt from tax under Rule 2BB read with Section 20(14) :

(a) any allowance granted to meet the cost of travel on tour or on transfer.

(b) any allowance granted on tour or for the period of journey in connection with the transfer, to meet the ordinary daily charges incurred by an employee on account of absence from his normal place of duty.

(c) any allowance granted to meet the expenditure incurred on conveyance in the performance of duties of an office or employment of profit, provided free conveyance is not provided by the employer. This would mean if free conveyance is provided, allowance granted to meet the expenditure on conveyance is not exempt.

(d) any allowance granted to meet the expenditure incurred on a helper where such helper is engaged for the performance of duties of an office or employment of profit.

(e) any allowance granted for encouraging the academic, research and training pursuits in educational and research institutions.

(f) any allowance granted to meet the expenditure incurred on the purchase or maintenance of uniform for wear during the performance of the duties of an office or employment of profit.

(g) Any allowance granted to meet the personal expenses of an assessee at the place where the duties of his office or employment of profit are performed or at the place where the individual resides or to compensate him for the increased cost of living as may be prescribed to the extent prescribed.

The conditions to be satisfied for claiming exemption under section 10(14) are:

(i) The allowance should be granted specifically to meet expenses wholly, necessarily and exclusively incurred in the performance of duties of an office or employment.

(ii) The allowance should not be in the nature of a perquisite within the meaning of section 17(2).

(iii) The expenditure is allowable only to the extent to which such expenses are actually incurred.

(iv) The allowance referred to in clause (g) should not be in the nature of a personal allowance granted to remunerate or compensate the holder of the office for performing duties of a special nature unless the allowance is related to the place of posting on residence.

Question 6

What is profit in lieu of salary and under what head is this chargeable to tax?

(3 Marks)(Nov.2002)

Answer

Section 17(3) deals with "Profit in lieu of Salary" and it includes the following

(i) The amount of compensation due to or received by an assessee from his employer or former employer at or in connection with (a) termination of employment ; or (b) modification of the terms and conditions of employment.

(ii) Any payment due to or received by the assessee from his employer or former employer or from provident fund or any other fund or any sum received under Keyman Insurance Policy including the sum allocated by way of bonus on such policy. However, it does not include exempted payments from superannuation fund, gratuity, commuted pension, retrenchment compensation, house rent allowance, contribution to PF and interest accrued thereon.

(iii) Any amount due to or received, whether in lumpsum or otherwise, by an assessee from any person before his joining any employment with that person or after cessation of his employment with that person.

Profits in lieu of salary is taxable under the head "Salaries".

Question 7

Under what circumstances and to what extent is the provision of medical facilities or assistance by an employer not treated as a perquisite in the hands of an employee?

(6 Marks)(Nov.2000)

Answer

The provision of medical facilities/assistance will amount to perquisite but the value thereof will be exempt if the following conditions are satisfied :

(i) The value of any medical treatment provided in any hospital maintained by the employer is exempt.

(ii) Any sum paid by the employer towards expenditure actually incurred by an employee on his medical treatment or the medical treatment to any member of his family.

(a) in any hospital maintained by government or any local authority or any other hospital approved by the government.

(b) in respect of prescribed disease or ailments in any hospital approved by the Chief Commissioner of Income-tax.

(iii) Premium paid by an employer to effect or keep in force an insurance on the health of the employee or any member of his family.

(iv) Any sum paid by the employer in respect of expenditure incurred by the employee on his medical treatment or the medical treatment of any member of his family to the extent to which it does not exceed Rs.15,000 per year.

(v) Any expenditure incurred or paid by the employer on medical treatment of the employee or any member of his family outside India and

(a) Travel and stay outside India of the employee or any member of his family for such treatment.

(b) Travel and stay abroad of one attendant who accompanies the patient in connection with treatment.

These are subject to the following conditions:

(A) The expenditure on medical treatment and stay shall be excluded from perquisite only to the extent permitted by R.B.I. and

(B) The expenditure on travel shall be excluded from perquisite only in the case of employees whose gross total income does not exceed Rs.2 lakhs (before including the said expenditure).

Question 8

Mr. X and and Mr. Y are working for M/s. Gama Ltd. As per salary fixation norms, the following perquisites were offered :

(i) For Mr. X, who engaged a domestic servant for Rs.500 per month, his employer reimbursed the entire salary paid to the domestic servant i.e. Rs.500 per month.

(ii) For Mr. Y, he was provided with a domestic servant @ Rs.500 per month as part of remuneration package.

You are required to comment on the taxability of the above in the hands of Mr. X and Mr. Y, who are not specified employees. *(3 Marks)(May 2003)*

Answer

In the case of Mr. X, it becomes an obligation which the employee would have discharged even if the employer did not reimburse the same. Hence, the perquisite will be covered under section 17(2)(iv) and will be taxable in the hands of Mr. X. This is taxable in the case of all employees.

In the case of Mr. Y, it cannot be considered as an obligation which the employee would meet. The employee might choose not to have a domestic servant. This is taxable only in the case of specified employees covered by section 17(2)(iii). Hence there is no perquisite element in the hands of Mr. Y.

Question 9

From the following particulars furnished by Mr. X for the year ended 31.3.2005, you are requested to compute his total income and tax payable for the assessment year 2005-06.

(a) Mr. X retired on 31.12.2004 at the age of 58, after putting in 25 years and 9 months of service, from a private company at Mumbai.

(b) He was paid a salary of Rs.25,000 p.m. and house rent allowance of Rs.6,000 p.m. He paid rent of Rs.6,500 p.m. during his tenure of service.

(c) On retirement, he was paid a gratuity of Rs.3,50,000. He was not covered by the payment of Gratuity Act. His average salary in this regard may be taken as Rs.24,500. Mr. X had not received any other gratuity at any point of time earlier, other than this gratuity.

(d) He had accumulated leave of 15 days per annum during the period of his service ; this was encashed by Mr. X at the time of his retirement. A sum of Rs.3,15,000 was received by him in this regard. His average salary may be taken as Rs.24,500.

(e) After retirement, he ventured into textile business and incurred a loss of Rs.80,000 for the period upto 31.3.05.

(f) Mr. X has invested Rs.22,500 in recognized provident fund, Rs.40,000 in public provident fund and Rs.37,500 in National Savings Certificates. (15 Marks)(May 2005)

Answer

Assuming the facts relate to previous year 2006-07, computation of income for the assessment year 2007-08 is made.

Computation of total income of Mr.X for A.Y.2007-08

	Rs.	***Rs.***	***Rs.***
Income from Salaries			
Basic salary (Rs.25,000 x 9 months)			**2,25,000**
House rent allowance			
Actual amount received		**54,000**	
***Less* : Exemption us.10(13A)**		**36,000**	
			18,000

Least of the following			
(i) HRA actually received	54,000		
(ii) Rent paid in excess of 10% of salary (Rs.6,500 – Rs. 2,500) x 9 months	36,000		
(iii) 50% salary	1,12,500		
Gratuity			
Actual amount received		3,50,000	
Less: Exemption U/s.10(10)(iii)		3,06,250	
			43,750
Least of the following			
(i) Actual amount received	3,50,000		
(ii) Half month average salary for each year of completed service (1/2 x 24,500 x 25)	3,06,250		
(iii) Statutory limit	3,50,000		
Leave encashment			
Actual amount received		3,15,000	
Less : Exemption u/s.10(10AA)		2,45,000	
			70,000
Least of the following			
(i) Actual amount received	3,15,000		
(ii) 10 months average salary (24,500 x 10)	2,45,000		
(iii) Cash equivalent of unavailed leave calculated on the basis of maximum 30 days for every year of actual service rendered to the employer from whose service he retired (see note 2 below)	3,06,250		
(iv) Statutory limit	3,00,000		

Gross Salary			**3,56,750**
Profits and gains of business or profession			
Business loss of Rs.80,000 to be carried forward as the same cannot be set off against salary income.			**Nil**
Gross Total income			**3,56,750**
***Less* : Deduction U/s.80C**			
RPF	**22,500**		
PPF	**40,000**		
NSC	**37,500**		
			1,00,000
Total income			**2,56,750**
Tax on total income			**27,025**
***Add* : Education cess @ 2%**			**540**
Tax payable			**27,565**

Note –

(1) No surcharge is leviable since total income is less than Rs.10 lakhs

(2) The leave entitlement of Mr.X as per his employer's rules is not given in the question. It is assumed that the leave entitlement of Mr.X as per his employer's rules is 30 days credit for each year of service. Since Mr.X had accumulated 15 days per annum during the period of his service, he would have availed/taken the balance 15 days leave every year.

Leave entitlement of Mr.X on the basis of 30 days for every year of actual service rendered by him to the employer	**= 30 days/year x 25 = 750 days**
***Less*:Leave taken /availed by Mr.X during the period of his service**	**= 15 days/year x 25 = 375 days**
Earned leave to the credit of Mr.X at the time of his	**375 days**

retirement **Cash equivalent of earned leave to the credit of Mr.X at the time of his retirement**	**= 375 X 24,500 /30 = Rs.3,06,250**

Mr.X is entitled, as per Rule 21A(3), to claim relief under section 89 in respect of gratuity received by him in excess of the limits prescribed under section 10(10)(iii).

Question 10

(i) Smt. Savita Rani was born on 01.07.1938. She is a Deputy Manager in a Company in Mumbai. She is getting a monthly salary and D.A. of Rs.45,000 and Rs.12,000 respectively. She also gets a House Rent Allowance of Rs.6,000 per month. She is a member of Recognised P.F. wherein she contributes 15% of her salary and half D.A. Her employer also contributes an equal amount.

(ii) She is living in the house of her minor son in Mumbai.

(iii) During the previous year 2003-2004 her minor son has earned an income of Rs.30,000 (computed) as rent from a House Property, which had been transferred to him by Smt. Savita Rani without consideration a few years back.

(iv) During the previous year 2003-2004 she sold Government of India Capital Indexed Bonds for Rs.1,50,000 on 30.09.2003, which she purchased on 01.07.2000 for Rs.80,000 (Cost inflation index – F.Y. 2000-2001-406 and for the F.Y. 2003-2004-463).

(v) Her employer gave her an interest free loan of Rs.1,50,000 on 01.10.2003 to one of her son's wife for the purchase of an Alto Maruti Car. Nothing has been repaid to the company towards the loan.

(vi) During the previous year 2003-2004 she paid Rs.15,000 by cheque to GIC towards Medical Insurance Premium of her dependent mother.

Compute the taxable income and tax liability of Mrs. Savita Rani for the A.Y. 2004-2005.

(14 Marks)(Nov.2004)

Answer

All the above facts have to be considered as pertaining to previous year relevant to the assessment year 2007-08 and accordingly the solution is prepared.

Computation of taxable income and tax liability of Smt. Savita Rani for A.Y. 2007-08.

	Rs.	*Rs.*

Income from salary		
Basic salary (45,000 ? 12)		**5,40,000**
DA (12000 ? 12)		**1,44,000**
House Rent allowance (full taxable)		**72,000**
Employer's contribution to RPF in excess of 12% is taxable as salary income.		
12% of salary is Rs.82,080. Employer's contribution is 15% of (salary plus 50% of D.A.), which is Rs.91,800.		
Excess contribution is (Rs.91,800 – Rs.82,080)		**9,720**
Perquisite in respect of interest free loan (See Note 1 below) Rs.1,50,000 x 8% x ½		**6,000**
Net Salary		7,71,720
Income from house property (of which Smt.Savita Rani is the deemed owner) – See Note 2 below		**30,000**
Long term Capital Gain:		
Sale consideration of GOI capital indexed bonds	**1,50,000**	
***Less*: Indexed cost of acquisition**		
(80,000 x 519* / 406*)	**1,02,270**	
*** Purchased on 01.07.2000. Transferred on 30.9.2006**		**47,730**
Gross Total Income		8,49,450
Deduction U/s.80C – in respect of RPF contribution	**91,800**	
Deduction U/s.80D – Medi claim – Senior citizen	**15,000**	
		1,06,800
Total Income		7,42,650
Income tax payable on long term capital gains:		
(i) 20% on Rs.47,730 or	**9,546**	
(ii) 10% of Rs.70,000 (u/s.112)	**7,000**	
Tax on long term capital gain – whichever is		**7,000**

less **Income tax payable on income other than LTCG** **(i.e. Rs.7,42,650 – 47,730) i.e. Rs.6,94,920**		**1,46,476**
		1,53,476
***Add* : Education cess @ 2%**		**3,070**
Total tax payable		**1,56,546**

Notes –

1. The rate of interest charged by SBI as on 1.4.2006 in respect of car loan is 8%, which is relevant for determining the perquisite value for A.Y. 2007-08.
2. As per section 27, any property transferred to the minor child without adequate consideration would be deemed to be the property of the assessee. Therefore, the income from house property of Rs.30,000 (computed) is to be assessed in the hands of Smt. Savita Rani.

Question 11

Mr. A is provided with two cars, to be used for official and personal work, by his employer ABC Ltd. The following information is available from the company records :

	Car 1	Car 2
	Rs.	***Rs.***
Cost of the car	***6,00,000***	***4,00,000***
Running and maintenance	***40,800***	***28,000***
(Borne by the company)		
Salary of driver (Borne by the company)	***24,000***	***24,000***

The taxable monetary emoluments of Mr.A are Rs.90,000. Compute the taxable 'Perk' in respect of Cars, on the assumption car 2, is exclusively used by 'A'. (4 Marks) (Nov.2004)

Answer

With the introduction of Chapter XII-H by the Finance Act, 2005 relating to income tax on fringe benefits, the expenditure towards car maintenance, driver's salary and depreciation provided to the employee by the employer is chargeable to fringe benefit tax only.
The employee receiving such benefits from the employer is not liable to pay tax as this facility is not liable for perquisite valuation and Rule 3 has also been amended accordingly.

Question 12

Ramesh retired as General manager of XYZ Co. Ltd. on 30.11.2003 after rendering service for 20 years and 10 months. He received Rs.3,00,000 as gratuity from the employer. (He is not covered by Gratuity Act, 1972).

His salary particulars are given below :

Basic pay	***Rs.10,000 per month up to 30.6.2003***
Basic pay	***Rs.12,000 per month from 1.7.2003***
Dearness allowance (Eligible for retirement benefits)	***50% of basic pay***
Transport allowance	***Rs.1,500 per month***

He resides in his own house. Interest on monies borrowed for the self occupied house is Rs.24,000 for the year ended 31.03.2004.

From a fixed deposit with a bank, he earned interest income of Rs.18,000 for the year ended 31.03.2004.

Compute taxable income of Ramesh for the year ended 31.03.2004 (9 Marks)(May 2004)

Answer

Let us assume that the facts relate to previous year 2006-07 and accordingly compute income for the assessment year 2007-08.

Computation of taxable income of Ramesh for the assessment year 2007-08

Income from salary		
Basic pay : April to June (10,000 ? 3)		**30,000**
Basic pay : July to November (12,000 ? 5)		**60,000**
Dearness allowance @ 50% basic pay		**45,000**
Transport allowance Rs.1500 ? 8 less exemption @ Rs.800 per month (12,000 – 6,400)		**5,600**
Gratuity		
(i) Statutory limit Rs.3,50,000		
(ii) Half month average salary Rs.8,100 ? 20 yrs = 1,62,000		
(iii) Actual amount received = Rs.3,00,000		
Least of the above is exempt. Balance is taxable		**1,38,000**

		2,78,600
Income from House property: Self occupied – ALV	**Nil**	
***Less*: Interest on monies borrowed u/s.24**	**24,000**	
Income from house property		**(24,000)**
Income from other sources: Fixed deposit interest		**18,000**
Gross total income		**2,72,600**
Note 1:		
Average salary of 10 months preceding the date of retirement is to be computed :		
Basic pay 10,000 x 6	**60,000**	
Basic pay 12,000 x 4	**48,000**	
Total	**1,08,000**	
***Add*: 50% DA – eligible for retirement benefits**	**54,000**	
	1,62,000	
Average salary : 1,62,000/10	**16,200**	
Half month average salary 16,200 / 2	**8,100**	

Question 13

Shri Hari is the General Manager of ABC Ltd. From the following details compute the taxable income for the Assessment year 2003-04 :

Basic salary	***Rs.20,000 per month***
Dearness allowance	***30% of basic salary***
Transport allowance	***Rs.2,000 per month***
Motor car running and maintenance charges fully paid by employer	***Rs.36,000***

(The motor car is owned and driven by employee Hari. The engine cubic capacity is below 1.60 litres. The motor car is used for both official and personal purpose by the employee)

Expenditure on accommodation in hotels while touring on official duties met by the employer.	*Rs.30,000*
Loan from recognised provident fund (maintained by the employer)	*Rs.40,000*
Value of lunch provided by the employer during office hours.	
Cost to the employer	*Rs.12,000*
Residence telephone bill for Hari paid by the employer	*Rs.15,000*
Computer (cost Rs.50,000) kept by the employer in the residence of Hari from 1.10.02	
Hari made the following payments:	
Medical insurance premium : Paid in cash	*Rs.2,000*
Paid by cheque	*Rs.3,200*

(12 Marks)(Nov.2003)

Answer

Let us assume the facts relate to previous year relevant to the assessment year 2007-08 and accordingly prepare the answer.

Computation of taxable income of Shri Hari for the A.Y. 2007-08

Particulars	*Rs.*	*Rs.*
Basic salary (20,000 x 12)		**2,40,000**
Dearness allowance @ 30%		**72,000**
Transport allowance	**24,000**	
***Less* : Exemption u/s.10(14) (read with Rule 2 BB @ Rs.800 p.m.) (See Note 1)**	**9,600**	
		14,400
Motor car maintenance borne by employer – not a perquisite. However, the employer to pay fringe benefit tax on the expenditure		**Nil**
Expenditure on accommodation while on official duty not a perquisite and hence not chargeable to tax		**Nil**
Loan from recognized provident – not		**Nil**

chargeable to tax		
Value of lunch provided during working hours – not chargeable to tax		**Nil**
Residence telephone bill – not chargeable to tax		**Nil**
Computer provided in the residence of employee by the employer – not chargeable to tax (Rule 3(7)(vii))		**Nil**
Gross Salary		**3,26,400**
***Less* :Deduction under chapter VI-A**		
Deduction u/s.80 D in respect of medical insurance premium paid by cheque	**3,200**	
Premium paid in cash not eligible for deduction	**Nil**	
		3,200
Taxable income		**3,23,200**

Note – **It is assumed that the transport allowance is for the purpose of commuting between the place of residence and place of duty.**

Question 14

Mrs. Lakshmi aged about 66 years is a Finance Manager of M/s. Lakshmi & Co., Pvt. Ltd., based at Calcutta. She is in continuous service since 1954 and receives the following salary and perks from the company during the year ending 31.03.2002.

(i) Basic Salary (50,000 x 12) = Rs.6,00,000

(ii) D.A. (20,000 x 12) = Rs.2,40,000

(iii) Bonus – 2 months basic pay.

(iv) Commission – 0.1% of the turnover of the company. The turnover for the F.Y. 2001-02 was Rs.15.00 crores.

(v) Contribution of the employer and employee to the PF Account Rs.3,00,000 each.

(vi) Interest credited to P.F. Account at 9.5% - Rs.60,000.

(vii) Rent free unfurnished accommodation provided by the company for which the company pays a rent of Rs.70,000 per annum.

(viii) Entertainment Allowance – Rs.30,000.

(ix) Children's education allowance to meet the hostel expenditure of three children – Rs.5,000 each.

She makes the following payments and investments :

(i) Premium paid to insure the life of her major son – Rs.15,000.

(ii) Medical Insurance premium for self – Rs.5,000 ; Spouse – Rs.5,000.

(iii) Donation to a public charitable institution registered under 80G Rs.2,00,000.

(iv) LIC Pension Fund – Rs.12,000.

(v) Determine the tax liability for the Assessment Year 2002-03. (15 Marks)(Nov.2002)

Answer

Let us assume that the facts relate to previous year relevant to the assessment year 2007-08 and accordingly prepare the solution.

Computation of Total Income of Mrs. Lakshmi for A.Y. 2007-08

		Rs.
Income from salary		
Basic salary		**6,00,000**
Dearness allowance		**2,40,000**
Bonus		**1,00,000**
Commission (calculated as percentage of turnover)		**1,50,000**
Entertainment allowance		**30,000**
Children's hostel allowance (See Note 1)	**15,000**	
Less : **Exemption (300 x 12 x 2)**	**7,200**	
		7,800
Rent free unfurnished accommodation		
(Refer working Note 1)		**70,000**
Excess contribution to PF by employer		
(Refer working Note 2)		**1,81,200**
Gross salary		**13,79,000**
Less : **Deduction U/s.80 C**		
LIC	**15,000**	
PF	**3,00,000**	
Deduction U/s.80 CCC in respect of LIC pension fund limited to	**10,000**	
	3,25,000	

Deduction limited to Rs.1,00,000 as per Sec.80CCE		1,00,000
Total income before deduction u/s.80 G		12,79,000
Deduction u/s.80 G : Limited to 10% total income		
Rs.1,27,900. Deduction @ 50%		63,950
Total income		12,15,050
Tax on total income		3,02,515
Add : Surcharge @ 10%		30,251
		3,32,766
Add : Education cess @ 2%		6,655
Total tax liability		3,39,421

Working Notes:

1. **Value of rent free unfurnished accommodation**

Basic salary	6,00,000
Dearness allowance	2,40,000
Bonus	1,00,000
Commission @ 1% of turnover	1,50,000
Entertainment allowance	30,000
Children's hostel allowance	7,800
Gross Salary	11,27,800
It is assumed that D.A. forms part of pay of retirement benefits and population is more than 4 lakhs as per 2001 census	
20% of salary	2,25,560
Actual rent paid by the company	70,000
The least of the above is chargeable perquisite.	

2. **Employer's contribution to P.F. in excess of 12% of salary**

Employer's contribution	3,00,000
Less : 12% of salary, DA & commission	
12% of Rs.9,90,000	1,18,800
	1,81,200

Question 15

Mr. Vignesh, Finance Manager of KLM Ltd., Mumbai, furnishes the following particulars for the financial year 2002-03.

(i) *Salary Rs.46,000 per month*

(ii) *Value of medical facility in a hospital maintained by the company Rs.7,000*

(iii) *Rent free accommodation owned by the company*

(iv) *Housing loan of Rs.6,00,000 at the interest rate of 5% p.a. (No repayment made during the year).*

(v) *Gifts made by the company on the occasion of wedding anniversary of Mr. Vignesh Rs.4,750.*

(vi) *A wooden table and 4 chairs were provided to Mr. Vignesh at his residence (dining table). This was purchased on 1.5.99 for Rs.60,000 and sold to Mr. Vignesh on 1.8.2002 for Rs.30,000.*

(vii) *Personal purchases through credit card provided by the company amounting to Rs.10,000 was paid by the company. No part of the amount was recovered from Mr.Vignesh.*

(viii) *An ambassador car which was purchased by the company on 16.7.99 for Rs.2,50,000 was sold to the assessee on 14.7.02 for Rs.80,000.*

Other income received by the assessee during the previous year 2002-03.

		Rs.
(a)	***Interest on Fixed Deposits with a company***	***5,000***
(b)	***Income from specified mutual fund***	***3,000***
(c)	***Interest on bank deposits of a minor married daughter***	***3,000***
(d)	***Income from UTI received by his handicapped minor son***	***1,200***
(e)	***Contribution to LIC towards premium u/s 80CCC***	***10,000***
(f)	***Deposit in PPF Account made during the year 2002-03***	***75,000***
(g)	***Bonds of ICICI (Tax savings) eligible for tax rebate***	***25,000***

Compute the taxable income of Mr. Vignesh and the tax thereon for the Assessment year 2003-04. (15 Marks)(May 2003)

Answer

Let us assume that all the facts in the question relate to previous year relevant to the assessment year 2007-08 and accordingly answer the question.

The date of purchase of dining table in point (vi) of the question is taken as 01.05.2003 and sale to assessee as 01.08.2006.

Similarly, date of purchase of car by the company to be taken as 16.07.2003 and sale to employee as 14.07.2006.

Computation of taxable income of Mr. Vignesh for the Assessment Year 2007-08

		Rs.
Income under the head "salaries"		
Salary [46000 x 12]		**5,52,000**
Medical facility [in the hospital maintained by the company exempt]		
Rent free accommodation		
[Rule 3(1)] – 20% of salary is taxable		**1,10,400**
Use of dining table for 4 months		
[60,000 x 10 /100 x 4 /12]		**2,000**
Valuation of perquisite of interest on loan		
[Rule 3(7)(i)] – 9% is taxable which is to be reduced by actual rate of interest charged i.e. [9% - 5% = 4%]		**24,000**
Gift given on the occasion of wedding anniversary Rs.4,750 liable for FBT in the hands of the employer. Not taxable in the hands of employee.		**Nil**
Perquisite on sale of dining table cost	**60,000**	
***Less*: Depreciation on straight line method @ 10% for 3 years**	**18,000**	
W.D.V	**42,000**	
***Less*: Amount paid by the assessee**	**30,000**	
		12,000

Purchase through credit card – not being a privilege but covered by section 17(2)(iv)		10,000
Original cost of car	2,50,000	
Less: Depreciation from 16.7.03 to 15.7.2004 @ 20%	50,000	
	2,00,000	
Less : Depreciation from 16.7.2004 to 15.7.05 @ 20% on WDV	40,000	
Value as on 14.07.2006	1,60,000	
Less : Amount received from the assessee	80,000	
		80,000
Gross salary		7,90,400

Computation of taxable income			
(a)	Income from salaries		7,90,400
(b)	Income from other sources		
	(i) Interest on fixed deposit with a company	5,000	
	(ii) Income from specified mutual fund exempt under section 10(35)	Nil	
	(iii) Interest received by minor daughter (3,000 -1500)	1,500	
	(iv) Income from UTI received by a handicapped minor son (Assuming that the disability is of the nature specified in section 80 U, section 64(1A) is not applicable - exempt U/s.10(35)	Nil	6,500
	Gross total income		7,96,900
	Less: Chapter VI-A deductions		
	Section 80 C – PPF & ICICI bonds	1,00,000	
	Section 80 CCC – LIC	10,000	

	Overall deduction limited to Rs.1 lakh as per section 80 CCE		**1,00,000**
	Total Income		**6,96,900**
	Tax on above income of Rs.6,96,900		**1,59,070**
	Add **: Education cess @ 2%**		**3,180**
	Total tax liability		**1,62,250**

Note –

(i) It is presumed that the housing loan was availed on 1.4.2006.

(ii) Under Rule 3(7)(viii), while calculating the perquisite value of benefit to the employee arising from the transfer of any movable asset, the normal wear and tear is to be calculated in respect of each completed year during which the asset was put to use by the employer. In the given case the third year of use of ambassador car is completed on 15.7.2006 where as the car is sold to the employee on 14.7.2006. The solution worked out above provides for wear and tear for only two years. Provision can also be made for the third year of wear and tear by giving a suitable note to that effect.

Question 16

The particulars of income of Mrs. K. aged 55 years for the financial year 2000-2001 are given below:

		Rs.
(1)	***Gross salary received from M/s.ABC Ltd for the year***	***4,00,000***
(2)	***Rental income received from a commercial complex Per mensem***	***Rs.12,000***
(3)	***Arrears of rent received from the complex, which were not charged to tax in any earlier years***	***30,000***
(4)	***Interest paid on loan taken for the purchase of a house from a scheduled bank for use as own residence***	***1,20,000***
(5)	***Repayment of instalments of loan taken from the bank for the purchase of the above property***	***60,000***

(6)	***Deposits in Public provident fund account***	
	(i) Out of an earlier loan taken from PPF a/c	***20,000***
	(ii) Out of current year's income	***40,000***
(7)	***Investment made in units of Mutual fund approved by the board Under section 88 (2) clause (xvii) of the I.T.Act***	***40,000***

Compute the Total Income of Mrs. K and the tax payable thereon in respect of Assessment Year 2001-2002. (15 Marks)(May 2001)

Answer

Computation of Total income of Mrs.K

I	**Income from salary (gross)**		**4,00,000**
II	**Income from house property**		
	(a) Let out property:		
	Net annual value rent receivable from commercial complex (Rs.12,000 x 12)	**1,44,000**	
	Less **: Deduction U/s.24 @ 30%**	**43,200**	
			1,00,800
	Arrears of rent (chargeable to tax under new section 25B)	**30,000**	
	Less **:Deduction U/s.25B @ 30%**	**9,000**	
			21,000
	(b) Self occupied property:		
	Annual value	**Nil**	
	Less **:Interest paid on loan taken for self occupied property [see Note below]**	**1,20,000**	
			(1,20,000)
	Income from house property		**1,800**
Summary			
I.	**Income from salary (net)**		**4,00,000**
II	**Income from house property**		**1,800**
	Gross total income		**4,01,800**

	Less : Deduction U/s.80 C		
	Deposit in PPF out of current year's income	40,000	
	Deposit in PPF out of earlier loan	20,000	
	Repayment of loan taken for purchase of self occupied property restricted to	60,000	
	Investment in units of mutual fund	40,000	
		1,60,000	
	Deduction limited to		1,00,000
	Total income		3,01,800
	Tax thereon		37,040
	Add : Education cess @ 2%		741
	Total tax payable		37,781

Note – **It is assumed that the property was acquired with loan taken after 1.4.1999. Accordingly, the maximum amount of deduction permissible towards interest is Rs.1,50,000.**

Question 17

Determine the value of perquisite in the following cases with brief reasons for your answer.

(1) Motor car (cubic capacity of engine below 1.60 litres) owned by employer and provided to employee since 1.04.2003. It is partly used for official and personal purposes by the employee. Expenditure fully met by the employer Rs.25,600. (Car is self-driven by the employee). (3 Marks)(May 2004)

(2) 100 shares allotted to an employee under ESOP scheme on 1.09.2003 by a limited company (the share allotment scheme is in accordance with the guidelines issued by the Central Government). Market value of each share on the date of allotment is Rs.70.

(3 Marks)(May 2004)

Answer

(1) From the A.Y.2006-07 provision of motor car by the employer to the employer is not a perquisite chargeable to tax in the hands of employee. The employer however has to pay fringe benefit tax in respect of the expenditure towards motor car provided to the employee. Hence, perquisite chargeable in this case would be `nil'.

(2) As per the proviso to section 17(2), the value of any benefit provided by a company free of cost or at a concessional rate to its employees by way of allotment of shares,

debentures or warrants, directly or indirectly, under any Employees' Stock Option Plan or Scheme of the company offered to such employees in accordance with the guidelines issued in this behalf by the Central Government shall not be chargeable as perquisite. Hence, in this case, allotment of shares to an employee under ESOP scheme is not chargeable to tax as perquisite, since the share allotment scheme is in accordance with the guidelines issued by the Central Government.

CHAPTER 6

INCOME FROM HOUSE PROPERTY

Question 1

Ownership itself is the criteria for assessment under the head income from house property. Discuss. *(4 Marks)(Nov.2004)*

Answer

Section 27 of the Income-tax Act, 1961 enumerates certain cases, where the legal ownership may vest with one person whereas the taxability is cast on another person who is deemed to be the owner. In these specific cases, the charge of tax is on the deemed owner and not on the legal owner. The exceptions are given below:

(i) In case of transfer of house property to spouse or minor child (not being a married daughter) without adequate consideration - transferor is the deemed owner.

(ii) Holder of an impartible estate – shall be deemed to be the individual owner of all the properties comprised in the estate.

(iii) A member of a co-operative society/company/AOP to whom a building or part thereof is allotted or leased under a house building scheme – shall be deemed to be the owner of building or part thereof.

(iv) A person who is allowed to take or retain possession of any building or part thereof is the deemed owner if such possession is obtained in part performance of a contract of the nature referred to in section 53A of the Transfer of Property Act, 1882 – shall be deemed to be the owner of such building or part thereof.

(v) Acquisition of rights in or with respect to any building or part thereof, whether by way of admitting as a member of or by way of transfer of shares in cooperative societies or company or other association of persons etc. – person acquiring such rights shall be the deemed owner.

Therefore, legal ownership itself is not the criteria for assessment of income under the head "Income from house property".

Also the provisions of section 25AA and 25B dealing with receipt of unrealised rent and arrear rent could also fall in this category. The receipt is considered as income under the head 'house property'

though the recipient may not have legal ownership of the property to which the receipt relates.

Question 2

How is income from self-occupied property or property meant for owner occupation, but remaining wholly or partly unoccupied computed ? Discuss. (6 Marks)(May 1998)

Answer

Income from property is calculated on the basis of annual value determined as per section 23 of the Act.

Annual value of a single house occupied by an assessee for own residence will be taken at nil.

The income from a property not actually occupied by the owner due to reasons specified below will also be taken as nil, if the following conditions are satisfied –

(i) the assessee retains a single property for own occupation ;

(ii) the house cannot actually be occupied by him due to the employment, business or profession being carried on at any other place and he has to reside at that other place in a building not belonging to him;

In the computation of income from such a property, the owner i.e. assessee is not entitled to any deduction under section 24 except in respect of interest on monies borrowed for acquisition, construction, repair, renewal or reconstruction of such property. The quantum of deduction is Rs.30,000 in respect of capital borrowed before 01-04-1999 and Rs.1,50,000 in the case of borrowings made on or after 01-04-1999.

Question 3

Under what conditions will unrealised rent be allowed as a deduction in computing income from property. (6 Marks)(Nov.96)

Answer

Under Rule 4 of the Income-tax Rules, if the rent payable by a tenant cannot be recovered by the owner of the house, such unrealised rent is deductible subject to the following conditions.

(a) the tenancy is bonafide ;

(b) the defaulting tenant has vacated the premises or steps have been taken to evict him from the property.

(c) The defaulting tenant is not in occupation of any other property of the assessee.

(d) The assessee has taken all reasonable steps to institute legal proceedings for the recovery of the unpaid rent or satisfies the A.O. that legal proceedings will be useless.

Question 4

In the following cases state the head of income under which the receipt is to be assessed and comment.

(1) X let out his property to Y. Y sublets it. How is sub-letting receipt to be assessed in the hands of Y.

(2) Y has built a house on a leasehold land. He has let out the property and claims income from house property under "Other sources" and deducted expenses on repairs, security charges, insurance and collection charges in all amounting to 40% of receipts.

(3) Z uses his property for his own business. Can be claim depreciation ?

(3 Marks)(Nov.2002)

Answer

(1) Sub-letting receipt in the hands of Y can be assessed as "Income from Other Sources" or as "Profits and gains from business or profession" depending upon the facts and circumstances of each case. It is not assessable as income from house property.

(2) It is assessable as "Income from house property" since ownership of land is not a pre-requisite for assessment of income under this head. 30% of Net Annual Value is allowed as a deduction under section 24.

(3) Where the assessee uses his property for business, it is not assessable as property income. He is entitled to depreciation under section 32(1)(ii) on the building.

Question 5

Discuss the tax liability in respect of arrears of rent. *(3Marks)(Nov.2002)*

Answer

Where the assessee receives any amount by way of arrears of rent in respect of any property consisting of buildings or land appurtenant thereto of which he is the owner, the amount so received shall be chargeable to tax under the head "Income from House Property". It shall be charged to tax as the income of the previous year in which such rent is received even if the assessee is no longer the owner of such property. In computing the income chargeable to tax in respect of the arrears so received, 30% shall be allowed as a deduction and

consequently 70% alone shall be chargeable to tax. The deduction of 30% is irrespective of the actual expenditure incurred.

Question 6

Discuss the following issues relating to Income from house property.

(i) Income earned by residents from house properties situated in foreign countries.

(ii) Properties which are used for agricultural purposes. *(3 Marks)(May 2003)*

Answer

(i) In case of resident individual, his global income is taxable in India. Therefore, income earned by residents from house properties situated in foreign countries is taxable in India.

If the income from house properties situated outside India is chargeable to tax in India the annual value of such property would be computed as if the property is situated in India. Further, municipal taxes paid under the laws of that country can also be deducted while arriving at the Annual Value of the property. In other words, if income from property is taxable in India then there is no difference between Indian properties and foreign properties. The Madras High Court in *CIT v. Venugopala Reddiar [1965] 58 ITR 439* observed that while computing taxable income, no distinction should be made between a house property situated in India and a house property situated abroad.

(ii) If the property is used for agricultural purposes, the annual value of such property would be treated as "Agricultural Income" as per section 2(1A)(c) of the Act and it is exempt under section 10(1) of the Act. If the house property is used for purpose other than agriculture the annual value of such property cannot be treated as agricultural income.

Question 7

Discuss the treatment of unrealised rent and its recovery in subsequent years.

(3 Marks)(May 2003)

Answer

Explanation 1 to section 23 says that the amount of rent which the owner cannot realize shall not be taxed / included while determining the annual value of the property. Rule 4 prescribes the condition which are to be satisfied for excluding the unrealised rent from income and the conditions are given below:

(a) The tenancy must be bonafi de

(b) The defaulting tenant has vacated or steps have been taken to compel him to vacate the property.

(c) The defaulting tenant is not in the occupation any other property of the assessee and

(d) The assessee has taken all reasonable steps to institute legal proceedings for the recovery of unpaid rent or satisfies the AO that the legal proceedings would be useless.

Section 25AA says that the unrealised rent when realised it is chargeable to tax as income under the head 'house property'. Whether or not the assessee is the owner of the property at the time of receipt of unrealised rent, it is chargeable to tax as income from house property on deemed basis. No deduction is allowable against such unrealised rent, realised by the assessee.

Question 8

Write short notes on: Income from self-occupied property *(6 Marks)(Nov.2000)*

Answer

Under section 23(2), where the property consisting of a house or part of a house is in the occupation of the owner for his own residence, the annual value thereon shall be taken to be NIL, provided it is not let out during any part of the previous year and no other benefit is derived therefrom.

Where a person has more than one house in his occupation for purposes of his residence, the exemption will apply to only one house at the assessee's option to be specified by him. Where the assessee owns a residential house which he cannot occupy due to the reason that he has to reside in a building not belonging to him at another place owing to his employment or profession, the annual value of such unused property shall be taken as NIL provided such house is not actually let out and no other benefit was derived by him. Since the annual value of a property used by an assessee for the purpose of his residence is NIL, no deduction, shall be allowed under section 24 except the interest payable on any borrowed capital used for acquiring, repairing, renovating or constructing the property. The monetary limit in respect of interest is Rs.30,000 where the loan is borrowed before 31.03.1999 and where the loan is borrowed for acquisition or construction of the property after 01.04.1999, the limit for deduction towards interest is Rs.1,50,000.

Question 9

Arvind commenced construction of a residential house intended exclusively for his residence, on 1.11.1998. He raised a loan of Rs.5,00,000 at 16 per cent interest for the purpose of construction 1.11.1998. Finding that there was an over-run in the cost of construction he raised a further loan of Rs.8,00,000 at the same rate of interest on 1.10.1999. What is the interest allowable under section 24, assuming that the construction was completed by 31.3.2000? (7 Marks)(May 2000)

Answer

Let us assume that the construction began on 01-11-2005 and the first loan was obtained on 01-11-2005 and the second loan on 01-10-2006. The date of completion of construction is taken as 31-03-2007. Since the house was for self-occupation only, the annual value of the property would be 'nil' under section 23(2). The interest allowable for the current year has to be considered with respect to both the loans.

Interest on loan borrowed after 1.4.1999 is eligible for deduction subject to a maximum of Rs.1,50,000 in the case of self occupied property.

Pre-construction interest (upto 31.3.2006) (5,00,000 x 16% x 5 / 12)	**33,333**
This is to be allowed over 5 years beginning with assessment year 2007-08. Amount allowable for each year	**6,667**
Interest eligible for deduction for the assessment year 2007-08	
Pre-construction period interest : One-fifth of Rs.33,333	**6,667**
Interest on first loan : Current year interest : 5,00,000 @ 16%	**80,000**
Interest on second loan : 8,00,000 @ 16% X 6/12	**64,000**
Total interest	**1,50,667**
Limited to	**1,50,000**

Therefore, interest allowable under section 24 would be Rs.1,50,000.

Question 10

Mr.Ramesh owns a house property which is let out. During the previous year ending 31.3.2002 he receives (i) arrears of rent of Rs.30,000 and (ii) unrealised rent of Rs.20,000.

You are requested to

(a) state, how they should be dealt with as per the provisions of the Act, and

(b) compute the income chargeable under the head "Income from house property".

(6 Marks)(May 2002)

Answer

(a) As per provisions of section 25B, arrears of rent will be charged to tax as income from house property in the previous year in which such rent is received, after deducting a sum equal to 30% of such amount. The taxability shall be there whether Mr.Ramesh remains as the owner of the property in the concerned year or not. In this case, it shall be taxed as income from house property in the year of receipt of such arrear rent.

(b) As per the provisions of section 25AA, the unrealised rent when received, it shall be deemed to be the income chargeable under the head "Income from house property" and shall be charged to tax in the year of receipt. In this case also, the taxability shall be there, irrespective of the fact whether Mr.Ramesh is the owner of property or not in the year of receipt. The section does not provide for any deduction thereunder.

Computation of income from house property

	Rs.
Arrears of rent	**30,000**
***Less* : Deduction @ 30% of Rs.30,000/-**	**9,000**
	21,000
***Add* : Unrealised rent received**	**20,000**
Income from house property	**41,000**

Question 11

Mr. A and B constructed their houses on a piece of land purchased by them at New Delhi. The built up area of each house was 1,000 sq.ft. ground floor and an equal area in the first floor. A started construction on 1-04-01 and completed on 31-03-02. B started the construction on 1-04-01 and completed the construction on 30-06-02. A occupied the entire house on 01-04-02. B occupied the ground floor on 01-07-02 and let out the first floor for a rent of Rs.15,000 per month. However, the tenant vacated the house on 31-12-02 and B occupied the entire house during the period 01-01-03 to 31-03-03.

Following are the other information

(i)	***For rental value of each unit (ground floor /first floor)***	***Rs.1,00,000 per annum***
(ii)	***Municipal value of each unit (ground floor / first floor)***	***Rs.72,000 per annum***
(iii)	***Municipal taxes paid by***	***A – 8,000*** ***B – 8,000***
(iv)	***Repair and maintenance charges paid by***	***A – 28,000*** ***B – 30,000***

A has availed a housing loan of Rs.20 lakhs @ 12% p.a. on 01-04-01. B has availed a housing loan of Rs.12 lakhs @ 10% p.a. on 01-07-01. No repayment was made by either of them till 31-03-03. Compute income from house property for A and B for the previous year 2002-03 (A.Y. 2003-04). *(12 Marks)(Nov.2003)*

Answer

Let us assume as below:

	Mr.A	Mr.B
Date of commencement	**01.04.2005**	**01.04.2005**

Date of completion	**10.04.2006**	**30.06.2006**
Occupation	**10.04.2006**	**01.07.2006**
Let out period	**Self occupied**	**01.07.2006 to 31.12.2006**
Self occupation of let out portion		**01.01.2007 to 31.03.2007**
Loan availed on	**01.04.2005**	**01.07.2005**

Computation of income from house property of Mr.A for A.Y. 2007-08

Particulars	***Rs.***	***Rs.***
Annual value is nil (since house is self occupied)		**Nil**
***Less* : Deduction u/s.24(b)**		
Interest paid on borrowed capital Rs.20,00,000 @ 12%	**2,40,000**	
Pre-construction interest Rs.2,40,000 / 5	**48,000**	
	2,88,000	
As per second proviso to section 24(b), interest deduction restricted to		**1,50,000**
Loss under the head "income from house property" of Mr.A		**(1,50,000)**

Computation of income from house property of Mr.B for A.Y.2007-08

Particulars	***Ground floor (Self occupied)***	***First floor***
Gross annual value (See note below)	**Nil**	**90,000**
***Less* :Municipal taxes (for first floor)**		**4,000**
Net annual value (A)	**Nil**	**86,000**
***Less* : Deduction u/s.24**		
(a) 30% of net annual value		**25,800**
(b) interest on borrowed capital		
Current year interest		

12,00,000 x 10% = 1,20,000	**60,000**	**60,000**
Pre-construction interest		
12,00,000 x 10% x 9/12 = 90,000		
90,000 allowed in 5 equal instalments		
90000 / 5 = Rs.18,000 per annum	**9,000**	**9,000**
Total deduction u/s.24 (B)	**69,000**	**94,800**
Income from house property (A)-(B)	**(69,000)**	**(8,800)**

Loss under the head "income from house property" of Mr.B (both ground floor and first floor)
(77,800)

Note – **Computation of Gross Annual Value (GAV) of first floor of B's house – If a single unit of property (in this case the first floor of B's house) is let out for some months and self-occupied for the other months, then the annual letting value (ALV) of the property for the whole year shall be taken into account for determining the annual value. The ALV for the whole year shall be compared with the actual rent and whichever is higher shall be adopted as the annual value. In this case, the actual rent shall be the rent for the period for which the property was let out during the previous year.**
The Annual Letting Value (ALV) is the higher of fair rent and municipal value. This should be considered for 9 months since the construction of property was completed only on 30.6.06.

Annual letting value =	**Rs.75,000 being higher of** **Fair rent = 1,00,000 x 9 /12 = Rs.75,000** **Municipal value = 72,000 x 9/12 = Rs.54,000**
Actual rent =	**Rs.90,000 (Rs.15,000 p.m. for 6 months from July to December)**

Gross annual value = Rs.90,000 (being higher of ALV of Rs.75,000 & actual rent of Rs.90,000)

Question 12

Pritam occupied two flats for his residential purposes, particulars of which are as follows:

	Flat 1	***Flat 2***

	Rs.	Rs.
Municipal valuation	***90,000***	***45,000***
Fair rent	***1,20,000***	***40,000***
Fair rent under Rent Control Act	***80,000***	***Not available***
Municipal taxes paid	***10%***	***10%***
Fire Insurance	***1,000***	***600***
Interest payable on capital borrowed for purchase of flat	***40,000***	***Nil***

Income of Pritam from his proprietary business - Pritam warehousing corporation is Rs.6,50,000.

Determine the taxable income and tax liability for the assessment year 1999-2000, on the assumption that he contributes Rs.80,000 towards the public provident fund.

You are informed that Pritam could not occupy Flat 2 for two months commencing from December 1,1998 and that he has attained the age of 65 on 23rd August, 1998.

(14 Marks)(Nov.99)

Answer

Taking the above facts as relating to previous year relevant to the assessment year 2007-08, the taxable income of Pritam is determined as under:

As Pritam has occupied both for his own residential purpose, one flat (according to his own choice) will be treated as self occupied property and the other flat will be treated as "deemed to have been let out" property. Assuming that Pritam has exercised his option to treat Flat 1 as self occupied property. Flat 2 will be treated as "deemed to have been let out" property.

Taxable income will, therefore, be determined as under :

		Rs.
Gross annual value (higher of municipal value or fair rent)		**45,000**
***Less*: Municipal taxes (10% of 45000)**		**4,500**
Net annual value		**40,500**
Less: Deductions under section 24 @ 30%		**12,150**
Income from Flat 2		**28,350**

Flat 1 (self occupied property)		
Annual value u/s.23		**Nil**
Less: Interest on borrowed capital (Note 1)		**40,000**
Income from house property		**(11,650)**
Computation of Taxable income		
Income from proprietary business		**6,50,000**
Income from house property		**(11,650)**
Gross Total income		**6,38,350**
***Less*: Deduction U/s.80 C in respect of PFF contribution**	**Note (2)**	**80,000**
Total income or		**5,58,350**
Tax payable on Rs.5,58,350		**1,05,505**
***Add*: Education cess @ 2%**		**2,110**
Tax payable		**1,07,615**

Note 1: It is assumed that the capital was borrowed for purchase of property after 1-4-1999.

Note 2: PPF contribution in more than one eligible account could exceed Rs.70,000 and it is assumed that the entire contribution is eligible for deduction.

Question 13

Mr. Rahul Jadav furnishes the following particulars relating to his house properties and other incomes and expenditure for the year 1997-98 :

(i) First House : This house is taken by him on lease for 10 years which is let to a tenant, for his residence, at a monthly rent of Rs.2,400

He has incurred the following expenses during this year :

Lease rent	*Rs.1,000 per month*
Salary of Durban	*Rs.200 per month*
Interest on loan taken to pay for the acquisition of the lease	*Rs.200 per month*

(ii) Second House : This house was constructed by him in 1988, but was transferred to his wife in 1992 out of love and affection. He, however, continues to stay in this house with his wife till date. He has taken a loan for the construction of this house for which interest of Rs.6,000 becomes due for the year, but had not been paid by him. He has paid repair expenses of Rs.1,000 during the year.

(iii) Taxable income from business for this year amounts to Rs.64,000.

Compute gross total income of Mr. Rahul Jadav for the assessment year 1998-99.

(9 Marks)(Nov.98)

Answer

Computation of total income of Rahul Jadav for the assessment year 2007-08

	Rs.	***Rs.***
(A) Income from House property		
(i) First House :		
Not assessed under this head as Mr.Rahul Jadav is not the owner of this house – it is assessed under the head "Income from other sources [Note – 1]		**Nil**
(ii) Second House: Self occupied hence ALV		**Nil**
***Less*: Deduction U/s.24 in respect of interest on**		**6,000**

monies borrowed			
Income from house property			(6,000)
(B) Income from business			
Taxable business income			64,000
(C) Income from other sources:			
Rent received from first house (Rs.2400 X 12)		28,800	
Less : Actual expenses incurred			
Lease rent	12,000		
Salary to Durban	2,400		
Interest on loan borrowed Rs.200 pm	2,400		
		16,800	
			12,000
Total income			70,000

Note :

(1) As Mr. Jadav has taken the first house on lease, he is not treated as owner of this house for the purpose of charging income under the head income from house property. As the lease period is less than 12 years he is not a deemed owner as provided in section 27 (iii) (b).

(2) As second house is transferred to his wife without adequate consideration and without any agreement to live apart, Mr. Yadav is treated as deemed owner of the property as per section 27(i) for the purpose of charging income under the head income from house property.

Question 14

Ram owned a house property at Madras which was occupied by him for the purpose of his residence. He was transferred to Bombay in June, 1996 and therefore he let out the property with effect from 1st July, 1996 on a monthly rent of Rs.3,000. The corporation tax payable in respect of the property was Rs.6,000 of which 50 per cent was paid by him before 31.3.97. Interest on money borrowed for the construction of the property amounted to Rs.20,000. Compute the income from house property for the assessment year 1997-98.

(6 Marks)(May 1997)

Answer

Ram's income from house property will be computed as under :-

Annual rental value Rs.3,000 X 12		**36,000**
***Less*: Corporation tax paid**		**3,000**
Annual value		**33,000**
***Less*: Deduction U/s.24 @ 30%**	**9,900**	
Interest on monies borrowed	**20,000**	
		29,900
Income from house property		**3,100**

Note: **Since the property was self occupied for part of the year and let out for part of the year, it has to be treated as deemed let out property. In the absence of fair rent or standard rent, the annual value is determined only based on the actual rent received.**

Question 15

Mr. A, a senior citizen, has furnished the following particulars relating to his house properties :

	House I	***House II***
Nature of occupation	***Self occupied Rs.***	***Let out Rs.***
Municipal valuation	***60,000***	***1,20,000***
Fair rent	***90,000***	***1,50,000***
Standard rent	***75,000***	***90,000***
Actual rent per month		***9,000***
Municipal taxes paid	***6,000***	***12,000***
Interest on capital borrowed	***70,000***	***90,000***

Loan for both houses were taken on 1.4.1998. House II remained vacant for 4 months.

Besides the above two houses, A has inherited during the year an old house from his grand father. Due to business commitments, he sold the house immediately for a sum of Rs.250 lakhs. The house was purchased in 1960 by his grand father for a sum of Rs.2 lakhs. However, the fair market value as on 1.4.1981 was Rs.20 lakhs. With the sale proceeds, A purchased a new house in March, 2002 for a sum of Rs.100 lakhs and the balance was used in his business.

The other income particulars of Mr. A besides the above are as follows (Assessment Year 2002-03)

Business loss	***Rs. 2 lakhs***
Income from other sources (Bank interest)	***Rs.1 lakh***
Investments made during the year : PPF	***Rs.70,000***
ICICI Infrastructure Bond	***Rs.30,000***
Cost inflation index (F.Y. 2001-02)	***426***

Compute total income of Mr.A and his tax liability for the assessment year 2002-03

(12 Marks) (Nov.2002)

Answer

Let us assume that the housing loan was taken on 01.04.1998 and the inherited property was sold in the previous year relevant to the assessment year 2007-08. The reinvestment in purchase of new house is assumed as March 2007.

Computation of Total Income and Tax liability of Mr. A for A.Y. 2007-08

	Rs	Rs.
1. Income from house property – House I	**(30,000)**	
- House II	**(48,000)**	
(See working note 1)		**(78,000)**
2. Profits and gains of business		**(2,00,000)**
3. Capital gains – long term (See working note 2)		**1,30,00,000**
4. Income from other sources – Bank interest		**1,00,000**
Gross total income		**1,28,22,000**
***Less* : Deduction under chapter VI-A**		
Deduction U/s.80 C		**1,00,000**
Total income		**1,27,22,000**
Tax liability		
Total income other than long term capital gain is Nil.		
Hence long term capital gain is reduced by basic limit of Rs.1.85 lakhs and only on the resultant tax is computed.		
On long term capital gains of Rs.1,25,37,000 @ 20%		**25,07,400**

Add :**Surcharge @ 10%**		**2,50,740**
		27,58,140
Education cess @ 2%		**55,163**
Total tax payable		**28,13,303**

Working notes

1. Calculation of income from house property

House I – Self occupied	Rs.
Annual value	**Nil**
Less **: Interest as per section 24(b)**	**30,000**
Loss from house property (House I)	**(30,000)**

Since the loan was taken before 1.4.99, deduction in respect of interest on capital borrowed will be restricted to Rs.30,000

House II - Let out		Rs.
Gross annual value		**72,000**
Less **:Municipal taxes**		**12,000**
Net annual value		**60,000**
Less **: Deductions u/s.24**		
30% of net annual value	**18,000**	
Interest on borrowed capital	**90,000**	
		1,08,000
Loss from house property (house II)		**(48,000)**

Note **– Interest on capital borrowed will be allowed in full for let out properties. As per section 23(1)(c), where the property or any part of the property is let and was vacant during the whole or any part of the previous year and owing to such vacancy the actual rent received or receivable by the owner in respect thereof is less than the annual letting value, then the actual rent received or receivable would be the**

Gross Annual Value of the property. In this case, the actual rent received is lesser than the annual letting value on account of vacancy and therefore, the actual rent received is taken as the Gross Annual Value.

2. Computation of Capital Gains

	Rs.	Rs.
Sale consideration	**2,50,00,000**	
Less **:Cost of acquisition**	**20,00,000**	
	2,30,00,000	
Less **: Exemption U/s.54**	**1,00,00,000**	
Taxable long term capital gain		**1,30,00,000**

Note -

1. As per the definition in the Explanation to section 48, "indexed cost of acquisition" means an amount which bears to the cost of acquisition the same proportion as the Cost Inflation Index for the year in which the asset transferred bears to the Cost Inflation Index for the first year in which the asset was held by the assessee or for the year beginning on the 1st April, 1981, whichever is later.
2. It has been assumed that the loss from house property and business loss have been set-off fully against long term capital gains. However, Rs.1 lakh relating to section 80C investments are deducted against "Income from other sources". The taxable income represents long term capital gains only and the tax liability is computed accordingly.

CHAPTER 7

PROFITS AND GAINS OF BUSINESS OR PROFESSION

Question 1

State whether True or False, with reasons, having regard to the provisions of the Income-tax Act, 1961 (Answers without reasoning will not be given any mark)

An existing assessee engaged in trading activities, can claim additional depreciation under Section 32(1)(iia) in respect of new plant acquired and installed in the trading concern, where the increase in value of such plant as compared to the approved base year is more than 10%.

(2 Marks)(Nov.2005)

Answer

False**. Additional depreciation can be claimed only in respect of eligible plant and machinery acquired and installed by an assessee engaged in the business of manufacture or production of any article or thing. However, in this case, the assessee is engaged in trading activities and the new plant has been acquired and installed in a trading concern. Hence, the assessee will not be entitled to claim additional depreciation under section 32(1)(iia).**

Question 2

Explain briefly the tax treatment of compensation received in restraint of trade, under section 28(va). *(9 Marks)(May 2005)*

Answer

Compensation received in restraint of trade is an income chargeable to tax under the head "Profits and gains of business or profession" as per the provisions of section 28(va). Also, section 2(24)(xii) covers any sum referred to in section 28(va).

It includes any sum whether received or receivable, in cash or kind, under an agreement for –

(a) not carrying out any activity in relation to any business; or

(b) not sharing any know-how, patent, copyright, trade mark, licence, franchise or any other business or commercial right of similar nature or information or technique likely to assist in the manufacture or processing of goods or provision for services.

However, clause (a) given above will not cover –

(a) any sum, whether received or receivable, in cash or kind, on account of transfer of the right to manufacture, produce or process any article or thing or right to carry on any business which is chargeable under the head "Capital gains".

(b) any sum received as compensation, from the multilateral fund of the Montreal Protocol on Substances that Deplete the Ozone Layer under the United Nations Environment Programme, in accordance with the terms of agreement entered into with Government of India.

In the above context, it is to be noted that

(i) "agreement" includes any arrangement or understanding or action in concert, whether or not the same is formal or in writing or whether it is intended to be enforceable by legal proceedings.

(ii) "service" would mean service of any description which is made available to potential users. It includes the provision of services in connection with business of any industrial or commercial nature such as accounting, banking, communication, conveying of news or information, advertising, entertainment, amusement, education, financing, insurance, chit funds, real estate, construction, transport, storage, processing, supply of electrical or other energy, boarding and lodging.

Question 3

What are intangible assets ? Give four examples. What is the rate of depreciation on a block of intangible assets ? *(4 Marks)(May 2005)*

Answer

Intangible assets are assets which are not corporeal i.e., not capable of being touched. Such assets are represented by rights of the persons through them.

According to Explanation 3(b) to section 32(1), the following are intangible assets –

(a) Know-how

(b) Patents

(c) Copyrights

(d) Trade Marks

(e) Licences

(f) Franchises

(g) any other business or commercial rights of similar nature.

They are to be depreciated at the rate of 25%, being the rate

prescribed in Part B of Appendix I of Income-tax Rules, 1962.

Question 4

Discuss 'Block of Assets' concept under the Income-tax Act, 1961 *(6 Marks)(Nov.99)*

Answer

As per section 2(11) "Block of assets" means a group of assets falling within a class of assets comprising –

(i) tangible assets, being buildings, machinery, plant or furniture;

(ii) intangible assets, being know-how, patents, copyrights, tradeMarks, licences franchises or any other business or commercial rights of similar nature, in respect of which the same percentage of depreciation is prescribed.

Each class of assets has been further divided into blocks with a particular rate of depreciation for each block. Intangible assets, however, have been grouped into one block only with a depreciation rate of 25%.

Question 5

State the situations under which the written down value of a "block of assets" will be reduced to nil. *(4 Marks)(Nov.98)*

Answer

There are two situations under which the written down value of a block of assets will be zero. Section 50 provides for this.

Situation 1 : Where the full value of the consideration received or accruing as a result of the transfer of the asset together with the full value of such consideration received or accruing as a result of the transfer of any other capital asset falling within the block of the assets during the previous year, exceeds the aggregate of the following amounts, namely:-

(i) expenditure incurred wholly and exclusively in connection with such transfer or transfers ;

(ii) the written down value of the block of assets at the beginning of the previous year ; and

(iii) the actual cost of any asset falling within the block of assets acquired during the previous year, such excess shall be deemed to be the capital gains arising from the transfer of short-term capital assets.

Situation 2 : Where any block of assets ceases to exist as such, for the reason that all the assets in that block are transferred during the previous year, the cost of acquisition of the block of assets shall be

the written down value of the block of assets at the beginning of the previous year, as increased by the actual cost of any asset falling within that block of assets, acquired by the assessee during the previous year and the income received or accruing as a result of such transfer or transfers shall be deemed to be the capital gains arising from the transfer of short-term capital assets.

	Situation 1	Situation 2
Opening WDV of plants (A,B & C)	**100**	**100**
***Add*: Acquired during the year (month of August) (D & E)**	**60**	**60**
	160	**160**
Transferred in March (all plants)		**120**
Transferred in March (plant A & B only)	**180**	
Short term capital gain (Loss)	**20**	**(40)**
Closing WDV (consisting of plant C,D & E)	**Nil**	
Closing WDV (no plant owned on the closing date)		**Nil**

Question 6

Is it mandatory for an assessee to claim depreciation under section 32 of the Income-tax Act ? (4 Marks)(Nov.2004)

Answer

According to Explanation 5 to section 32(1), inserted by the Finance Act, 2001 w.e.f. 1.4.2002, depreciation allowable under section 32(1) is mandatory and therefore shall be allowed, whether or not the assessee has claimed the deduction in respect of depreciation in computing his total income. Hence, from the assessment year 2002-03, claim of depreciation or the allowance of depreciation is mandatory.

Question 7

A car purchased by S on 10.8.1999 for Rs.3,25,000 for personal use is brought into the business of the assessee on 01.12.2003, when its market value is Rs.1,50,000.

Compute the actual cost of the car and the amount of depreciation for the Assessment year 2004-2005 assuming the rate of depreciation to be 20%. (4 Marks)(Nov.2004)

Answer

Let us assume the car was purchased on 10-08-2002 and it was introduced in to the business on 01.12.2006. (an uniform addition of 3 years)

In this case, car was purchased for personal use on 10.8.2002 for Rs.3,25,000 and subsequently brought into the business of the assessee on 1.12.2006. The "actual cost" of car is Rs.3,25,000.

Explanation 5 to section 43(1) provides for determination of "actual cost" of building used for private purposes subsequently brought into business. This Explanation does not apply to any other asset in as much as it refers only to buildings.

The admissible depreciation for A.Y.2007-08 is Rs.48,750 (i.e. 15% of Rs.3,25,000). As the car is not acquired during the previous year 2006-07, full depreciation is available for the year even if it is put to use for less than 180 days during the previous year. The condition of restricting depreciation to 50% of the prescribed percentage is only applicable for the year in which the asset is acquired by the assessee.

Question 8

Write short notes on: Additional depreciation *(6 Marks)(May 2005)*

Answer

Section 32(1)(iia) says that in the case of any new machinery or plant (other than ships and aircraft) acquired and installed after 31.3.2005 by an assessee engaged in the business of manufacture or production of any article or thing, a further sum equal to 20% of the actual cost of such machinery or plant shall be allowable as a deduction.

The additional depreciation is available to a new machinery or plant used in the manufacture or production of any article or thing.

Additional depreciation is not available in respect of the following assets :

(A) any machinery or plant

already used in India or outside India by any other person ; or

installed in office premises, residential accommodation in the nature of guest house ; or

the whole of the actual cost of which is allowed as deduction (whether by way of depreciation or otherwise) in computing the income under the head "Profits and gains of business or profession" of any one previous year.

(B) any office appliances or road transport vehicles.

- Additional depreciation will be taken into consideration for computing the WDV of the relevant block of assets.

Question 9

(i) Write short notes on the following : Carry forward and set off of depreciation

(6 Marks)(Nov.2001)

(ii) Write short notes on : Set off and carry forward of unabsorbed depreciation.
(6 Marks)(Nov.2000)

Answer

(a) Section 32(2) provides the manner in which the unabsorbed depreciation is to be carried forward and set off. If, as a result of inadequacy of profits and gains, full effect cannot be given to depreciation allowable under section 32(1) such portion of depreciation becomes unabsorbed depreciation.

(b) Such unabsorbed depreciation should be set off against the profits and gains, if any of any business or profession carried on by the assessee and assessable for that assessment year.

(c) If such unabsorbed depreciation cannot be wholly set off against business income, then the balance unabsorbed depreciation can be set off against income under any other head (except salary) for that assessment year.

(d) The balance unabsorbed depreciation shall be carried forward to the following assessment year and it would become depreciation of that year eligible for set off against any income (except salary).

(e) The unabsorbed portion shall be carried forward without any limitation for any number of years. Even unabsorbed depreciation of discontinued business is eligible for set off in the future assessment years.

(f) There is no time limit for carry forward of unabsorbed depreciation.

Question 10

Briefly discuss about the provisions relating to deductibility of interest on capital borrowed for the purpose of business or profession. *(4 Marks)(Nov.2005)*

Answer

Under section 36(1)(iii), deduction is allowed in respect of interest on capital borrowed for the purposes of business or profession while computing income under the head "Profits and gains of business or profession".

Capital may be borrowed for several purposes like for acquiring a

capital asset, or for paying off a trading debt or loss etc. The scope of the expression `for the purposes of business' is very wide. Explanation 8 to section 43(1) clarifies that interest relatable to a period after the asset is first put to use cannot be capitalized. Interest in respect of capital borrowed for any period from the date of borrowing to the date on which the asset was first put to use should, however, be capitalized in the case of extension of existing business or profession.

The proviso to section 36(1)(iii) provides that no deduction shall be allowed in respect of any amount of interest paid, in respect of capital borrowed for acquisition of a new asset or for extension of existing business or profession (whether capitalized in the books of account or not) for any period beginning from the date on which the capital was borrowed for acquisition of the asset, till the date on which such asset was first put to use.

Question 11

(i) Deductibility of contributions for Rural Development Programmes under section 35CCA.

(6 Marks)(Nov.2005)

(ii) State the provisions relating to expenditure by way of payment to institutions carrying rural development programmes. *(6 Marks)(May 2004)*

Answer

Under section 35CCA, any assessee who is carrying on a business/profession shall be allowed a deduction of the amount of the expenditure incurred by way of payment of any sum given below:

1. Payment to an association or institution, which has as its object the undertaking of any programme of rural development. Such payment must be used for carrying out any programme of rural development approved by the prescribed authority ; or
2. Payment to an association or institution, which has as its object the training of persons for implementing programmes of rural development ; or
3. Payment to a rural development fund set up and notified by the Central Government in this behalf ; or
4. Payment made to the National Urban Poverty Eradication Fund (NUPEF) set up and notified by the Central Government in this behalf.

Where a deduction under this section is claimed and allowed for any assessment year in respect of any such expenditure referred to above, no deduction in respect of such expenditure shall be allowed under any other provision of the Act for the same or any other assessment year.

Question 12

(i) Write short notes on : Amortisation of expenditure under voluntary retirement scheme.

(6 Marks)(May 2004)

(ii) Write short notes on: Amortisation of Expenditure under Voluntary Retirement Scheme.

(6 Marks)(May 2002)

Answer

As per the provisions of section 35DDA, where any expenditure is incurred by way of payment of any sum to an employee at the time of his voluntary retirement in accordance with any scheme or schemes of voluntary retirement, then one-fifth of the amount paid shall be deducted in computing the profit and gains of the business for the previous year and the balance shall be deducted in equal instalments in the four immediately succeeding previous years. In other words, the amount is deductible in five equal annual instalments. No deduction shall be allowed in respect of such expenditure under any other provision of the Income-tax Act. Further –

(a) If an undertaking of an Indian company, entitled to deduction under this section, is transferred to another Indian company in a scheme of amalgamation within five years, then the amalgamated company can claim the deduction which the amalgamating company would have claimed, if the amalgamation had not taken place ;

(b) Similarly, where an undertaking of an Indian company, entitled to deduction under this section, is transferred to another company in a scheme of demerger, the resulting company can claim the deduction which the demerged company would have claimed, if the demerger had not taken place ;

(c) Where there has been a reorganisation of business, such as succession of a firm by a company fulfilling conditions laid down in section 47(xiii) or a proprietary concern by a company fulfilling conditions laid down in section 47(xiv), then the successor company can claim the deduction which the predecessor firm or proprietary concern would have claimed, if the reorganisation had not taken place.

Since the deduction is allowed in the hands of the successor in the previous year in which the amalgamation, demerger or succession, as the case may be, takes place, the predecessor is not eligible for deduction in respect of the same.

Question 13

Write short notes on: Deduction for Bad Debts of a Business *(6 Marks)(May 97)*

Answer

A deduction for bad debts or part thereof which is written off as irrecoverable in the accounts of the assessee for the previous year is provided in section 36(1)(vii). However, this is subject to the conditions contained in section 36(2). The conditions to be satisfied before a deduction is allowed are :

(i) The debt or part thereof must have been taken into account in computing the income of the assessee of the previous year in which the amount is written off or of an earlier previous year or it represents money lent in the ordinary course of business of banking or money-lending.

(ii) If the amount ultimately recovered is less than the difference between the debt and the amount deducted, the deficiency shall be deductible in the previous year in which the ultimate recovery is made.

(iii) Where the debt is written off as irrecoverable in the accounts of an earlier previous year (being a previous year relevant to assessment year 1988-89 or earlier) and the A.O. has not allowed it on the ground that it has not become bad, such debt may be deducted.

(iv) When the debt relates to an advance made by a bank, the deduction shall be allowed only if the bank has debited the amount of such debt to the provision for bad and doubtful debts account made by the bank.

Question 14

(i) Deduction based on actual payment under section 43B of the Income Tax Act, 1961.

(5 Marks)(May 2003)

(ii) While computing income from business or profession certain deductions will be allowed only on actual payment. Discuss. *(7 Marks)(May 2002)*

(iii) Certain deductions are allowed under the head "Profits and Gains of business or profession" only on actual payments. Discuss the above with reference to the provisions under the Income-tax Act, 1961. *(9 Marks)(May 2000)*

(iv) Write short notes on: Certain deductions to be only on actual payment (Section 43B).

(6 Marks)(May 1998)

Answer

Deduction in respect of the following expenditure and/or payment shall be allowed only on payment basis and not on due basis even if the books of account are maintained on mercantile system of accounting.

(i) Any sum payable by way of a tax, duty, cess or fee by whatever name called under any law for the time being in force.

(ii) Any sum paid by an employer by way of contribution to any provident fund or a superannuation fund or any other fund for the welfare of the employees.

(iii) Any sum payable as bonus or commission to employees for services rendered.

(iv) Any sum payable as interest on any loan or borrowing from any public financial institution, or a State Financial Corporation or a State Industrial Investment Corporation, in accordance with the terms and conditions of the agreement governing such loan or borrowing.

(v) Any sum payable as interest on any loan or advances from a scheduled bank in accordance with the terms and conditions of the agreement governing such loan or advances.

(vi) Any sum payable by the employer in lieu of any leave at the credit of his employee.

However, if the above items are actually paid by the assessee on or before the due date for furnishing his return of income and the evidence of such payment is furnished by him along with the return, the deduction will be allowed.

Question 15

State the conditions to be satisfied for claiming deduction under section 37(1) of the Act.

(6 Marks)(May 2002)

Answer

An expenditure can be claimed as a deduction under section 37(1) provided the following conditions are satisfied.

(a) The expenditure must be in the nature of revenue expenditure and not a capital expenditure.

(b) The expenditure must be laid out or expended wholly and exclusively for the purposes of business or profession.

(c) The expenditure must not be in the nature of expenditure described in sections 30 to 36.

(d) The expenditure should not be in the nature of personal expenditure of the assessee.

(e) It has been further provided by the Explanation to the section that any expenditure incurred by the assessee for any purpose which is an offence or which is prohibited by law, will not be allowed as a deduction.

Question 16

(i) Expenditure involving cash payment exceeding Rs.20,000. (6 Marks)(May 2000)

(ii) State the cases when payment exceeding Rs.20,000 made otherwise than by a crossed cheque or by a crossed demand bank draft will not be disallowed. (6 Marks)(Nov.98)

Answer

Section 40A(3) has been amended by Taxation Laws (Amendment) Act, 2006 w.e.f. 10-08-2006. Now the legal requirement is, any payment in excess of Rs.20,000 has to be made by means of account payee crossed cheque or account payee bank draft.

If the payment in excess of Rs.20,000 is made otherwise than by account payee crossed cheque / draft then disallowance at 20% of the expenditure would apply.

Rule 6DD of the Income-tax Rules permits certain categories of payments under certain circumstances to be made otherwise than by crossed cheque or draft (account payee crossed cheque or draft w.e.f. 10-08-2006). Accordingly, the provisions of section 40 A (3) do not apply to payments made under prescribed circumstances. They are as follows :

1. Payments which are made to the Reserve Bank of India, State Bank of India or other banking institutions including co-operative banks and land mortgage banks, primary agricultural credit societies, Life Insurance Corporation of India, Unit Trust of India and certain specified institutions providing industrial finance.

2. Payments which, under contracts entered into before 1-4-1969, have to be made only in cash.

3. Payments made to the Central or State Government which, under the rules framed by the Government, are required to be made in legal tender.

4. Payments in village and towns having no banking facilities to persons ordinarily residing or carrying on business or profession in such village or towns.

5. Payments by way of book adjustments by the assessee in the account of the payee against moneys due to the tax-payer for any goods supplied or services rendered by him to the payee.

6. Payments made by –

   (i) any letter of credit arrangements through a bank

   (ii) a mail or telegraphic transfer through a bank.

   (iii) A book adjustment from any account in a bank to any other account in that or any other bank, and

   (iv) A bill of exchange made payable only to a bank.

7. Payments of terminal benefits such as gratuity, retrenchment compensation etc., to low paid employees (i.e., those whose annual salary does not exceed Rs.7,500/-) or to the members of their families.

8. Payments made to cultivators, growers or producers for the purchase of agricultural or forest produce, animal husbandry products (including hides and skins), products of dairy or poultry farming, or fish or fish products or products of horticulture or

apiculture or products of any cottage industry where the products are manufactured without the aid of power.

9. Where the payment is made by an assessee by way of salary to his employee after deducting the Income-tax from salary in accordance with the provisions of section 192 of the Income-tax Act, 1961 and when such employee.
   (A) is temporarily posted for a continuous period of fifteen days or more in a place other than his normal place of duty or on a ship, and
   (B) does not maintain any account in any bank at such place or ship.
10. Where the payment was required to be made on a day on which the banks were closed either on account of holiday or strike.
11. Where the payment is made by any person to his agent who is required to make payment in cash for goods or services on behalf of such person.

Question 17

Effect on computation of business income, when interest free loan is given to a sister concern.

(6 Marks) (May 2000)

Answer

Interest paid on loan borrowed for the purpose of business is allowed as a deduction under section 36(1)(iii) of the Income-tax Act. The words "for the purpose of business" are wider in connotation than the words "for the purpose of earning income".

Therefore, the interest paid on borrowings are allowed as a deduction in computing the business income. If interest free loan is given by the assessee to its sister concern, what effect it will have in computation of business income is dependent upon the facts of each case. If it is established that there is a nexus between the borrowing and lending, it can be held that borrowing is not for the purpose of business and interest paid thereon may be disallowed. All the receipted payments in the course of business go into the same kitty. If the nexus is absent and if there are adequate balances in the capital or lenders' accounts which are interest-free, it is quite reasonable to take a stand that loans are given to sister concern out of such interest-free funds. In such a situation there will be no adverse effect in the computation of business income.

Question 18

Write a brief note on deductibility of Family Planning Expenditure under the Income tax Act, 1961. *(3 Marks) (Nov.99)*

Answer

Any bona fide expenditure incurred by a company for the purpose of promoting family planning amongst its employees is allowable as deduction. If, such expenditure is of a capital nature, one-fifth of such expenditure is allowable as deduction for the previous year in which it was incurred and the balance is deductible in equal instalments in the next four years.

Any family planning expenditure which is not allowed as deduction due to inadequacy of profit, shall be carried forward and set off in the same manner as unabsorbed depreciation. Where any deduction is claimed and allowed under section 36(1)(ix), no deduction is again available in respect of the same expenditure under any other provision of the Act.

Question 19

(i) *Explain in brief the provisions relating to computation of profit from the business of civil construction under the Income-tax Act, 1961* *(7 Marks) (Nov.2001)*

(ii) *Write short notes on : Estimate of income of assessees engaged in Civil Construction.*

(6 Marks) (Nov.99)

Answer

Section 44AD provides for estimate of income of an assessee engaged in the business of civil construction. The income in such cases will be estimated at 8% of the gross receipts. However, if the assessee declares a higher income, then that will be his income. The provision shall apply only to such assessees whose gross receipts do not exceed Rs.40 lakhs. The assessee will be deemed to have been allowed all deduction sunder sections 30 to 38. Accordingly, the written down value of any asset utilized for the purpose of business shall be calculated, as if depreciation on the assets had actually been allowed. The assessee availing of this scheme will not be required to maintain any books of account under section 44AA and section 44AB.

If the assessee claims that the profits from the aforesaid business is lower than the income deemed in this provision (i.e. 8%), he shall maintain books of account as per section 44AA and get the accounts audited and furnish the audit report under section 44AB.

For the convenience of students, point wise answer is given below:

(1) The provisions of this section provide for arriving at presumptive profits of the business of civil construction or supply of labour for civil construction.

(2) It is provided that the profit declared in the return of income filed or a sum equal to 8% of the gross receipts paid or payable to the assessee during the previous year on account of such business, whichever is higher, shall be deemed to be profits and gains chargeable to tax.

(3) This section will not be applicable in the case of assessees whose gross receipt exceeds Rs.40 lakhs

(4) In case 8% of gross receipts is taken as profit, it will be presumed that the expenses allowable under sections 32 to 38 have been given full effect to, and no further deduction under those sections shall be allowed.

(5) Where the assessee is a firm, the remuneration allowable to partners shall be deducted out of income computed under this section subject to the limits specified in section 40(b).

(6) For arriving at the written down value of depreciable assets it will be presumed that full depreciation allowable under the Act has been calculated and effect has been given for each of the relevant assessment years.

(7) For calculating the monetary limits of turnover applicable to the assessee under section 44AA and 44AB, the gross receipts of the above business shall be excluded.

(8) An assessee may claim lower profits and gains than the amount specified above if he maintains such books of account or other documents as specified under section 44AA and gets his accounts audited. Such audit report has to be furnished under section 44AB.

Question 20

Write short notes on: Method of accounting as per section 145 of the Income-tax Act, 1961.

(6 Marks) (Nov.99)

Answer

Income chargeable under the head "profits and gains of business or profession" and income from "other sources" shall be computed in accordance with either cash or mercantile method of accounting, regularly employed by the assessee. Under the mercantile system, income and expenditure are recorded at the time of their occurrence during the previous year. Under the cash system, revenue and expenses are recorded only when they are received or paid.

The Central Government is empowered to notify in the Official Gazette. Accounting Standards to be followed by any class of assessees or in respect of any class of income. The Central Government has already notified two standards under its authority which are required to be adhered to, while following the mercantile method of accounting.

The Assessing Officer may make an assessment in the manner provided in section 144 when he is not satisfied about the correctness or completeness of the accounts of the assessee or when the method of accounting has not been regularly followed by the assessee or when the assessee does not follow the Accounting standards notified by the Central Government.

Question 21

What are the receipts to be excluded for computing "actual cost" of an asset under Income-tax Act ? (8 Marks) (May 99)

Answer

Explanations 9 and 10 to section 43(1) provides the exclusions to be made for computing actual cost of an asset. These are discussed below.

Explanation 9 says that the amount of duty of excise or the additional duty leviable under section 3 of the Customs Tariff Act, 1975 on an asset acquired on or after 1-3-94 will be reduced from the actual cost of the asset in respect of which credit is claimed and allowed on such asset under the Central Excise Rules, 1944. It will similarly be reduced from the actual cost of the asset for the purpose of allowing depreciation in relation to assessment year 1994-95 onwards.

To remove doubts about the treatment of subsidy received by a tax payer for setting up an industry etc., Explanation 10 to Section 43 (1) was introduced. Explanation 10 says that any subsidy, grant or reimbursement granted by the Central Government or a State Government or any authority established under any law or by any other person towards a portion of cost of the asset acquired by the assessee, shall be reduced from the actual cost of the asset for the purpose of allowing depreciation.

If the subsidy, grant or reimbursement is of such a nature that it is not directly relatable to any particular asset, the amount so received shall be apportioned in a manner that such portion of the subsidy, grant, etc., i.e. in the same proportion that such asset bears to all the assets in respect of or with reference to which the subsidy, grant etc. is so received, shall not be included in the actual cost of the asset.

Question 22

An assessee in the course of sale of its products collected sales tax from the purchasers and deposited the same with the Government. The provisions of sales tax laws under which the assessee deposited the amount collected were under challenge and ultimately were struck *down by the High Court. Consequently, the assessee received refund of a certain amount, but it did not refund the same to the customers. The assessing officer treated it as income under section 41(1) and made additions to income. The Tribunal, however, deleted the additions. State whether Tribunal's order is justified.* *(4 Marks) (Nov.98)*

Answer

The sales tax collected by the assessee had to be treated as trading receipt. Any payment of sales tax made by the assessee is deductible as expenditure.

If any deduction was given from that income or receipt and later on, the same was refunded to the assessee, the refund would have the character of revenue receipt. It has to be treated as a receipt on revenue account and had to be assessed as such. The amount of sales tax refunded to the assessee would be liable to tax as per provisions of section 41 (1).

The assessee, however, could claim deduction of sales tax refunded when such refund is actually made to the customers. Therefore, the Tribunal was in error in deleting the additions.

Question 23

Discuss the provisions of Income-tax Act that relate to amortisation of expenses for obtaining a licence to operate telecommunication services. *(6 Marks) (May 99)*

Answer

Section 35ABB deals with amortization of expenditures incurred for obtaining licence to operate telecommunication services. The amortisation will be allowable in the previous year in which the licence fee is actually paid and the subsequent previous year or years, during which the licence is in force. Where the licence fee is paid before commencement of business, it will be amortised beginning with the previous year in which such business is commenced.

If the licence is transferred (in full) and the proceeds of transfer (so far as they consist of capital sums) are less than the expenses remaining unallowed, a deduction equal to the unallowed expenses as reduced by the proceeds of the transfer, is deductible in the previous year in which the licence is transferred.

Where the licence is transferred and the proceeds of the transfer exceeds the amount of expenditure incurred remaining unallowed, so much of the excess (as does not exceed the difference between the expenditure incurred to obtain the licence and the amount of

such expenditure remaining unallowed) shall be chargeable to tax as profits and gains of the business in the previous year in which the licence is transferred.

Where the licence is transferred in part and the sale proceeds are less than the unallowed expenses, the deduction to be allowed will be arrived at by reducing the proceeds of transfer (so far as they consist of capital sums) from the unallowed expenses and dividing the balance by the number of unexpired previous years of the licence at the beginning of the previous year of the transfer.

Where the whole or any part of the licence is transferred and the proceeds of the transfer (so far as they consist of capital sums) are not less than the amount of unallowed expenses, then no deduction for such expenses shall be allowed u/s 35ABB(1), in respect of the previous year in which the licence is transferred or in respect of any subsequent year. However, where in a scheme of amalgamation, the amalgamating company sells or transfers the licence to the amalgamated company, being an Indian company, the proceeds will not be subject to income-tax or deduction as above. The amalgamated company will get deduction for unexpired portion of licence. It will also be subject to income-tax or deduction in case of transfer of licence, as if the amalgamating company had not transferred the licence.

The following table would explain the various situations

	A	B	C	D
Transfer of licence	Full	In Part	Full	In part
Licence period (years)	7	7	7	7
Acquisition cost	140	140	140	140
Deduction claimed so far (4 years)	80	80	80	80
Unamortised value	60	60	60	60
Sale price – current year	140	45	50	30
Amount remaining to be amortised		15		30
Amount deductible U/s.35ABB(3)			10	
Amount chargeable to tax as business income	80			
Amount to be amortised in remaining 3 years		5		10

Question 24

Briefly describe the provisions of the Income-tax Act that deal with the computation of business income on a presumptive basis in certain cases, in the cases of resident assessees.

(9 Marks) (Nov.98)

Answer

Normally a business income computation is made on an actual basis based on the books of account maintained by the assessee. Specific provisions exist in the Act to compel the assessee to maintain books of account prescribed by the Rules in situations where the sale/turnover/gross receipts exceed the prescribed limits. Failure to maintain such accounts will entail in the levy of a penalty.

However, to mitigate the harassment for small tax payers, the Act has provided for instances/cases where persons carrying on some types of business or calling have been relieved of the liability to maintain compulsory books of account and opt on a voluntary basis to have their business income computed in a presumptive manner. Three sections are relevant for the purpose of our present discussion and these are sections 44AD, 44AE and 44AF.

The common essentials of the scheme applicable to all the persons coming within the scope of the above sections are:

(i) The scheme is voluntary;

(ii) The assessee opting for the scheme will not be required to maintain the books of account prescribed under section 44AA;

(iii) Compulsory tax audit under section 44AB will not apply to these cases if the income offered is equal to or more than the presumptive limits prescribed in the statutory provisions;

(iv) The assessee can claim and produce evidence to prove that the profits and gains from the stated business are lower than the presumptive profits under the relevant sections whereupon tax audit under section 44AB has to be made.

All claims and deductions covered under section 30 to 38 will be deemed to have been allowed. The three relevant sections are :

(i) Profits and gains of civil construction contracts (Section 44AD) : This section applies to those engaged in the business of civil construction or supply of labour for such civil construction. The income will be estimated at a sum equal to 8% of the gross receipts paid or payable to the assessee in the previous year on account of such business. However, if an assessee were to declare a higher amount in his return of income, then that will be treated as his income. Such an estimate as per this provision will apply only where gross receipts in the construction business do not exceed Rs.40 lakhs. Deemed allowance of claims and deductions would include depreciation also. If the assessee offers income less than 8% of the gross receipt then the accounts have to be audited under section 44AB(c) and a report has to be furnished along with the return.

(ii) Profits and gains of business of plying, hiring or leasing goods carriages (Section 44AE): This scheme applies to persons owning not more than 10 goods carriages at any time during the previous year. The estimated income from each vehicle, i.e. in the case of a heavy goods vehicle it will be deemed to be Rs.3,500 for every month or part of a month during which the said vehicle is owned by the assessee in the previous year. Any higher income shown by the assessee in his return will be accepted and treated as his income. In the case of vehicles, other than a heavy goods vehicle, the estimated income per month or part thereof will be Rs.3,150 per vehicle. An assessee who declares his income to be less than the presumptive income, has to maintain books of account and it has to be audited as per section 44AB(c) of the Act.

(iii) Profits and gains of business of retail trade (Section 44AF): This section applies to an assessee engaged in retail trade of any goods or merchandise. 5% of the total turnover in the previous year will be deemed to be the profits and gains of business of retail trade. This section will not apply where the annual turnover exceeds Rs.40 lakhs. Where the business is run by a firm, the salary and interest paid to partners shall be deducted from the aforesaid computation subject to section 40(b).

Following points are also relevant:

(i) In the case of sections 44AD and 44AE also, where the assessee is a firm, the salary and interest paid to its partners shall be deducted subject to the conditions and limits specified in section 40(b).

(ii) The written down value of any asset used for this business shall be deemed to have been calculated as if the assessee had claimed and had been actually allowed the deduction in respect of the depreciation for each of the relevant assessment years.

(iii) Once the profits are presumptively assessed under section 44AD, 44AE, or 44AF, the gross receipts, or the income from the said business or the total turnover, as case may be, will be excluded for computing the monetary limits for the purpose of audit under section 44AB.

(iv) Where the assessee claims his income to be lower than the profits and gains presumptively assessed, he has to subject himself to tax audit under section 44AB.

Question 25

Cost of project for purpose of amortization *(5 Marks) (Nov 98)*

Answer

Explanation to section 35D(3) deals with "cost of the project"

For purpose of amortisation, the expression, "cost of the project" means –

(i) In the case of expenses incurred before the commencement of business, the actual cost of fixed assets, being land, buildings, leaseholds, plant, machinery, furniture, fittings and railway sidings (including expenditure on development of land and buildings), which are shown in the books of the assessee as on the last day of the previous year in which the business of the assessee commences;

(ii) After the commencement of business, in connection with the extension of industrial undertaking or in connection with the setting up of a new industrial unit, the actual cost of fixed assets being land, building, leaseholds, plant, machinery, furniture, fittings and railway sidings (including expenditure on the development of land and buildings) which are shown in the books of the assessee as on the last day of the previous year in which the extension of the industrial undertaking is completed or as the case may be, the new industrial unit commences production or operation, in so far as such assets have been acquired or developed in connection with the extension of the industrial undertaking or the setting up of the new industrial unit of the assessee.

Question 26

Who are the persons (and in what circumstances as well), who have to maintain compulsorily books of accounts ? What is the nature of such books and documents to be maintained ? Discuss. *(9 Marks) (May 1998)*

Answer

Any person carrying on a specified profession or a non-specified profession or business is required by the Income-tax Act to maintain prescribed books of account provided the income/turnover/gross receipts exceeded the prescribed limit.

Specified professions are legal, medical, engineering, architectural, accountancy, technical consultancy, interior decoration, authorised representatives, film artistes etc. A film artists will include an actor, cameraman, director, music director, dance director, singer, story-writer etc. and an authorised representative includes a person who represents another before any authority, tribunal etc. for a fee.

Section 44AA(i) requires every such person to keep and maintain such books of account and other documents as may enable the Assessing Officer to compute his total income in accordance with the provisions of the Act.

Rule 6F(2) prescribes certain books of account and other documents

to be maintained. Any such person will be required to maintain such books of account if total gross receipts in the profession exceeded Rs.1,50,000 in any one of the three previous years immediately preceding the previous year. If the profession has been newly set up in the previous year, books of account need not be maintained if the gross receipts in the profession for that year are not likely to exceed the said amount viz. Rs.1,50,000.

Non-specified profession: **Any person carrying on non-specified business or profession has to maintain such books and other documents as are prescribed which may enable the Assessing Officer to compute the total income, provided –**

(i) his income from profession/business exceeds Rs.1,20,000 or his total sales, turnover or gross receipts exceeds Rs.10 lakhs in any one of the three years immediately preceding the previous year ; or

(ii) his income in the case of profession/business newly set up in the previous year is likely to exceed Rs.1,20,000 or his total sales/turnover/gross receipts are likely to exceed Rs.10 lakhs during such previous year.

In addition to the above, a person carrying a business covered by sections 44AD, 44AE and 44AF claiming an income lower than those prescribed by those sections, must maintain books of account.

The following are the books and documents that are to be maintained : Cash book, journal (in case of those following mercantile system of accounting), ledger, carbon copies of bills (machine numbered) exceeding a value of Rs.25, original bills issued to the assessee and receipts in respect of expenditure of more than Rs.50 incurred.

Question 27

Briefly highlight the recent amendments relating to the tax audit provisions under section 44AB. *(4 Marks)(Nov.97)*

Answer

There has not been any recent amendment in section 44AB of the Income-tax Act. However, the reporting requirement has undergone change consequent to change in Form 3CD (being annexure to tax audit report in Form No.3CA/3CB). The following are the highlights of the changes brought in w.e.f. 10-08-2006.

(i) A certificate must be obtained from the assessee as regards payment of expenditure covered by section 40A(3). The certificate must state factually, whether the expenditures in excess of Rs.20,000 have been paid only by means of account payee crossed cheques or account payee crossed bank draft.

(ii) Similarly, in respect of loan or deposit accepted and repaid to the extent of Rs.20,000 or more during the previous year, a certificate has to be obtained as to whether the acceptance or repayment was made by account payee cheque or account payee bank draft.

Question 28

(i) Discuss the provisions of 44AB Audit under the Income-tax Act, 1961.

(6 Marks)(Nov.2002)

(ii) Write short notes on: Compulsory Tax Audit *(6 Marks)(May 1996)*

Answer

In the case of any person –

(a) carrying on business where the total sales, turnover or gross receipts exceeds Rs.40 lakhs ; or

(b) carrying on profession where the gross receipts exceed Rs.10 lakhs ; or

(c) carrying on the business referred to in section 44AD/44AE/44AF or section 44 BB or section 44 BBB and claiming his income from any such business to be lower than the income prescribed under the relevant section ;

the books of account for the relevant previous year are required to be audited by a chartered accountant before the due date specified under section 139(1) for filing return of income and the audit report obtained under this provision is required to be furnished by that date. If the audit report obtained under section 44AB is not filed along with the return of income then the Assessing Officer may treat the return of income as defective under section 139 (9).

Where any such person is required to get his accounts audited under any other law, it is sufficient if the person gets the accounts audited under such other law and furnishes a further report in the form prescribed under this section.

The specified date prescribed for this purpose is 31st October of the relevant assessment year.

It may be noted that the requirement of audit under section 44AB does not apply to a person who derives income of the nature referred to in section 44B/44BB/44BBA/44BBB.

Where an assessee's case is covered by section 44AD/44AE/44AF and the income offered is less than the stipulated percentage, audit of accounts and furnishing of audit report before the due date of filing the return in accordance with section 44AB becomes

mandatory.

Question 29

A non-resident is engaged in shipping business. The company also operates its ship in India. Explain how the income from the company's business operation in India is computed.

(6 Marks)(May 1996)

Answer

Section 44 B is a special provision for computing profits and gains of shipping business in the case of non-residents.

Where a non-resident is engaged in the business of operation of ships, the profits thereof are to be computed at 7½% of shipping revenue as detailed below. Such shipping revenue consists of the following amounts :

(i) The amount paid or payable (whether in or out of India) to the assessee or to any person on his behalf on account of carriage of passengers, livestock, mail or goods shipped at any port in India ; and

(ii) The amount received or deemed to be received in India by or on behalf of the assessee on account of the carriage of passengers, livestock, mail or goods shipped at any port outside India.

Section 44B makes it clear that the general rules of computation of income provided in sections 28 to 43A will not apply in such computation at all.

The Finance (No.2) Act, 2004 has inserted Chapter XII-G being an optional provision applicable for shipping companies. An assessee opting to offer income as per this chapter is governed by the provisions contained therein. The computation of tonnage income for each day of operation is on notional basis. The income so computed is chargeable to tax without any deduction notwithstanding the provisions of sections 28 to 43 C.

Question 30

(i) Income from business or profession is chargeable to tax, only if it is carried on during the previous year by an assessee. Give five examples of cases where the income is taxable even if the business or profession is not in existence during any previous year.

(5 Marks)(May 2001)

(ii) What are the exceptions to the rule that income from business can be assessed only if the business is carried on during the previous year. *(6 Marks)(Nov.96)*

Answer

The exceptions to the rule that income from business can be assessed only if is it is carried on during the previous year are :-

(1) Where an allowance or deduction has been made in the assessment for any year in respect of loss, expenditure or trading liability incurred by the assessee and subsequently the assessee has obtained in cash or in kind, any amount by way of remission or cessation of such loss, expenditure or trading liability, it shall be treated as business income of that year, irrespective of the fact whether the business is in existence or not. [Section 41(1)].

(2) Where any building, machinery, plant or furniture in respect of which depreciation has been allowed under section 32(1)(i) i.e. on straight line basis in the case of power undertakings is sold, discarded, demolished or destroyed and the moneys payable in respect of such assets, together with their scrap value exceeds the written down value, so much of the excess as does not exceed the difference between the actual cost and the w.d.v. shall be chargeable to tax as income from business or profession even though the business is not in existence. [Section 41(2)].

(3) Where an asset representing capital expenditure on scientific research is sold and the amount received together with the deduction allowed exceeds the amount of capital expenditure, such excess shall be taxable as business income of the previous year, in which the sale took place, even if the business is not in existence. [Section 41(3)]

(4) If a deduction has been allowed as a bad debt and subsequently the bad debt or a portion thereof is recovered, the amount allowed in excess, shall be charged as business income of the previous year in which it is recovered, even if the business is not in existence. [Section 41(4)].

(5) Where a business is discontinued, the income of the previous year upto the date of such discontinuance shall be assessed, even if the business is no longer carried on by the assessee. [Section 41(5)]

(6) Under section 35A(4) where the whole or any part of the rights is sold and the proceeds of the sale (so far as they consist of capital sums) exceed the amount of the cost of acquisition thereof remaining unallowed, so much of the excess as does not exceed the difference between the cost of acquisition of the rights and the amount of such cost remaining unallowed shall be chargeable to income-tax as income of the business of the previous year in which the whole or any part of the rights is sold. Explanation to the sub-section makes it clear that where the whole or any part of the rights is sold in a previous year in which the business is no longer is existence, the provisions of this sub-section shall apply as if the business is in existence in that previous year. Similarly, section 35 ABB(3) and Explanation to the sub-section provide for deeming the receipt as chargeable to tax even though business may not be in existence in that year.

Question 31

Enumerate the classes of receipts, deemed to be profits and gains of business or profession under Section 41. (9 Marks)(Nov.2000)

Answer

The provisions of section 41 are considered as deeming provisions for amounts to be taxed as income while computing the income from business. Therefore, it is said that they are deemed profits. The classes of receipts covered by the provisions of section 41 are broadly enumerated below :

(a) Where an allowance or deduction has been made in any assessment year in respect of any loss, expenditure or trading liability incurred by the assessee and in a subsequent year, the assessee or successor in business has obtained any benefit whether in cash or in any other manner whatsoever, any amount in respect of such loss or expenditure or any benefit in respect of such trading liability by way of remission or cessation, the amount so received or benefit obtained shall be charged to tax in the said year. Whether or not the original business continues to be in existence, the receipt is chargeable to tax. In case of remission or cessation, even if effected by a unilateral act of writing off of such liability by the assessee, the amount so written off is chargeable to tax [section 41(1)].

(b) In the case of an undertaking engaged in the generation or generation and distribution of power, when any building, machinery, plant or furniture owned by the assessee and used for the purpose of business in respect of which depreciation has been claimed under section 32(1)(i) is sold, discarded, demolished or destroyed, moneys payable in respect of such depreciable asset, together with the amount of scrap value exceeding the WDV, the excess shall be chargeable as business income of the year in which the moneys payable, become due [section 41(2)].

(c) Where there is sale of any asset representing expenditure of a capital nature on scientific research, without having been used for other purposes, the lower of the following is taxable as business income in the year of sale :

   (i) where the sale proceeds together with the total amount of deduction earlier allowed under section 35 in respect of such capital expenditure, exceeds the amount of capital expenditure, the excess, or

   (ii) deduction so allowed under section 35 earlier [section 41(3)].

(d) Any amount recovered by the assessee against bad debt earlier allowed as deduction under section 36(1)(vii) shall be taxed as income from business or profession in the year in which it is received, whether or not the original business or profession is in existence in that year [section 41(4)].

(e) Any amount withdrawn from special reserve created and maintained under section 36(1)(viii) by an eligible assessee in respect of which a deduction has been allowed earlier, shall be deemed to be the profits of the year of such withdrawal and these provisions will apply whether or not the business is in continuity at the time of withdrawal [section 41(4A)].

Question 32

Compensation is normally a capital receipt but there are certain receipts by way of compensation which are taxable as income from business. What are these?

(6 Marks)(May 97)

Answer

Normally, compensation receipts are treated as capital receipts, but certain types of receipts are taxable as income from business under section 28. These are :

(i) Compensation received by any person managing the whole or substantially the whole of the affairs of an Indian company in connection with the termination of management or a modification in the terms and conditions relating thereto.

(ii) Compensation received by any person managing the whole or substantially the whole of the affairs in India of any other company at or in connection with the termination of his office or modification of the terms and conditions relating thereto.

(iii) Compensation received by any person holding an agency in India for any part of the activities relating to the business of any other person in connection with the termination of the agency or modification of the terms and conditions relating thereto.

(iv) Compensation received by any person in connection with the vesting in the government or in any corporation owned or controlled by the government under any law in force of the management of any property or business.

(v) Any sum whether received or receivable in cash or kind under an agreement for not carrying out any activity in relation to any business or not sharing any know-how, patent, copyright, trade-mark, licence, franchise or any other business or commercial right is also taxable as income from business.

Question 33

Valuation of inventory under section 145A of the Income-tax Act. *(6 Marks)(Nov.2002)*

Answer

This section applies irrespective of section 145 of the Act laying down the method of accounting to be followed, to determine the income chargeable under the head `Profits and Gains from business or profession'. It applies only in respect of valuation of purchase and sale of goods and inventory.

The section lays down that the valuation should be in accordance with the method of accounting regularly employed and this should further be adjusted to include any amount actually paid or incurred

on any tax, duty, cess/fees for bringing the goods to the place of its location and condition as on the date of valuation. Further, the amount of duty etc., included in the above valuation shall include all amounts paid by way of tax, duty, cess, fee, etc., under any law for the time being in force notwithstanding any right arising as a consequence of payment, meaning thereby, any credit/set off or rebate etc.

Question 34

What is meant by Speculation Business? What are the transactions not deemed to be speculative transactions? *(6 Marks) (Nov.2000)*

Answer

According to Explanation 2 to section 28, where an assessee carries on speculative transactions which constitute a business, such business shall be considered as separate and distinct business. A speculative transaction is defined under section 43(5) to mean a transaction in which a contract for purchase or sale of a commodity including stocks or shares which is periodically or ultimately settled otherwise than by actual delivery or transfer of the commodity or scrips. Loss of speculative business cannot be set off against income from regular business or against income under any other head of income. It shall be carried forward and set off only against speculative income within 4 years succeeding the assessment year for which the loss was first computed.

Students may note that loss from any business however is eligible for set off against income from speculation business.

The following shall not be treated as speculative transactions :

(a) A contract in respect of raw materials or merchandise entered in the normal course of business to guard against loss due to price fluctuations.

(b) A contract in respect of stocks and shares entered into by a dealer or investor to guard against loss through price fluctuations.

(c) A contract entered into by a member of forward market or a stock exchange in the course of jobbing or arbitrage to guard against loss in the ordinary course and

(d) An eligible transaction in respect of trading in derivatives referred to in section 2(ac) of the Securities Contracts (Regulation) Act, 1956 carried out in a recognized stock exchange.

Question 35

Special provisions for computation of profits and gains of the business of plying, hiring or leasing goods carriages. *(6 Marks) (Nov.2000)*

Answer

Section 44AE is a special provision for computing profits and gains of business of plying, hiring or leasing goods carriages. The following are the features of this provision.

Section 44AE over ride the provisions of section 28 to 43C relating to computation of income and is applicable to assessees who own not more than ten goods carriages at any time during the year. The income of such business shall be deemed to be the aggregate of the profits and gains computed as under :

(a) Being a heavy goods vehicle, it shall be an amount equal to Rs.3,500 for every month or part of a month during which the heavy goods vehicle is owned by him during the previous year or an amount higher than the aforesaid amount as declared by him in his return of income.

(b) Other than a heavy goods vehicle, it shall be an amount equal to Rs.3,150 for every month or part of a month during which the goods carriage is owned by him during the previous year in or an amount higher than the aforesaid amount as declared by him in his return of income.

(c) All deductions under provisions of section 30 to 38 shall be deemed to have been allowed and no further deductions under these sections shall be allowed.

(d) However, where the assessee is a firm, the salary and interest paid to the working partners shall be deducted from the income so computed subject to the conditions and limits specified in section 40(b).

(e) The written down value of any asset used for the purpose of business shall be deemed to have been calculated as if the assessee had claimed and had been actually allowed deduction in respect of depreciation.

(f) The provisions of section 44AA and section 44AB shall not apply in so far as they relate to this business and in computing the monetary limit under the provisions, the gross receipts/business income from this business shall be excluded.

(g) However, if an assessee engaged in this business wants to show an income less than the one denoted earlier, he should maintain books of accounts and documents required under section 44AA(2), get his accounts audited and furnish his audit report under section 44AB.

Question 36

Mr. Sukhvinder is engaged in the business of plying goods carriages. On 1st April, 2004, he owns 10 trucks (out of which 6 are heavy goods vehicles). On 2nd May, 2004, he sold one of the heavy goods vehicles and purchased a light goods vehicle on 6th May, 2004. This new vehicle could however be put to use only on 15th June, 2004.

Compute the total income of Mr.Sukhvinder for the assessment year 2005-06, taking note of the following data :

	Rs.	Rs.
Freight charges collected		*8,70,000*
Less : Operational expenses	*6,25,000*	
Depreciation as per section 32	*1,85,000*	
Other office expenses	*15,000*	
		8,25,000
Net Profit		*45,000*
Other business and non – business income		*70,000*

(6 Marks) (May 2005)

Answer

Section 44AE would apply in the case of Mr. Sukhvinder since he is engaged in the business of plying goods carriages and owns not more than ten goods carriages at any time during the previous year.

Section 44AE provides for computation of business income of such assessees on a presumptive basis. The income shall be deemed to be Rs.3,500 from a heavy goods vehicle and Rs.3,150 from a vehicle other than a heavy goods vehicle - for every month or part the month during which such goods vehicle is owned by the assessee in the previous year or such higher sums as declared by the assessee in his return of income.

Mr. Sukhvider's business income calculated applying the provisions of section 44AE is Rs.4,02,850 (See Notes 1 & 2 below) and his total income would be Rs.4,72,850.

However, as per section 44AE(7), Mr. Sukhvinder may claim lower profits and gains if he keeps and maintains proper books of account as per section 44AA and gets the same audited and furnishes a report of such audit as required under section 44AB. If he does so, then his income for tax purposes from goods carriages would be Rs.45,000 instead of Rs.4,02,850 and his total income would be Rs.1,15,000.

Notes -

1. Computation of total income of Mr. Sukhvinder for A.Y. 2007-08

Particulars	*Presumptive income*	*Where books are maintained*
Income from business of plying goods		

carriages	**4,02,850**	**45,000**
[see Note 2 below]		
Other business and non business income	**70,000**	**70,000**
Total Income	**4,72,850**	**1,15,000**

2. Calculation of presumptive income as per section 44AE

Type of carriage	*No. of months*	*Rate per month*	*Amount*
(1)	*(2)*	*(3)*	*(4)*
4 light goods vehicle – held throughout the year	**12**	**3,150**	**1,51,200**
1 heavy goods vehicle – held upto 2nd May	**2**	**3,500**	**7,000**
5 heavy goods vehicle – held throughout the year	**12**	**3,500**	**2,10,000**
1 light goods vehicle – held from 6th May	**11**	**3,150**	**34,650**
		Total	**4,02,850**

Question 37

Dr. Krishna furnishes you the following information :

Income and Expenditure Account for the year ended 31st March 2004.

	Rs.		*Rs.*
To Medicines consumed	*2,42,000*	*By Fee receipts*	*8,47,500*
To Staff salary	*1,65,000*	*By Rent*	*27,000*
To Hospital consumables	*47,500*	*By Dividend from Indian companies*	*9,000*
To Rent paid	*60,000*		
To Administrative expenses	*1,23,000*		
To Net Income	*2,46,000*		
	8,83,500		*8,83,500*

(i) *Rent paid includes rent for his residential accommodation of Rs.30,000 (paid by cheque).*

(ii) *Hospital equipments (eligible for depreciation @ 25%)*

01.04.2003 Opening WDV Rs.5,00,000

07.12.2003 Acquired (Cost) Rs.2,00,000

(iii) *Medicines consumed include medicines (cost) Rs.10,000 used for Dr.Krishna's family.*

(iv) *Rent received – relates to a property situated at Mysore (Gross Annual Value). The municipal tax of Rs.2,000 paid in December, 2003 has been included in the "administrative expenses".*

(v) *He received Rs.5,000 per month as salary from Full Cure Hospital. This has not been included in the "fee receipts" credited to income and expenditure account.*

(vi) *He sold a vacant site in July, 2003 for Rs.5,00,000. It was inherited by him from his father in January, 1998. The site was acquired by his father in December, 1990 for Rs.1 ,50,000.*

(Cost inflation index 1990-91 = 182 ; 1997-98 = 331 and 2003-04 = 463)

Compute Dr. Krishna's taxable income for the year ended 31.03.2004.

(15 Marks) (May 2004)

Answer

Let us assume the facts given above relate to previous year 2006-07. In respect of vacant site the date of sale is taken as July 2006 and the date of inheritance and acquisition by his father are taken as given in the question.

Computation of taxable income of Dr.Krishna for the previous year ended 31.03.2007

Particulars	***Rs.***	***Rs.***
Income from Salaries		
Salary received @ Rs.5,000 per month		**60,000**
Income from house property		
Gross annual value	**27,000**	
***Less*: Municipal tax**	**2,000**	
Net annual value	**25,000**	
***Less*: Deduction U/s.24 @ 30%**	**7,500**	
		17,500

Income from business or profession		
Net income as per income & expenditure account	**2,46,000**	
***Add*: Rent paid to residence**	**30,000**	
Medicines consumed – personal use	**10,000**	
Municipal tax relating to let out property included in administrative expenses – disallowed	**2,000**	
	2,88,000	
***Less*: Depreciation (See working note 2)**	**90,000**	
Rent credited to income & expenditure account	**27,000**	
Dividend from Indian companies [Exempt u/s.10(34)]	**9,000**	
		1,62,000
Capital Gains (Long term capital gains)		
Sale consideration	**5,00,000**	
***Less*: Indexed cost acquisition (1,50,000 x 519/331]**	**2,35,196**	
		2,64,804
Gross Total income		**5,04,304**
***Less*: Deduction under chapter VIA – Section 80GG**		
Under section 80GG, rent paid would be allowable as a deduction to the extent of the last of the following		
(i) 25% of total income = 25% of Rs.2,39,500	**59,875**	
(ii) Excess of rent paid over 10% of total income (30,000 - 23,950)	**6,050**	
(iii) Rs.2,000 per month	**24,000**	
Least of the above		**6,050**
Total Income		**4,98,250**

Note –

1. Deduction under section 80GG is to be made from Gross Total Income. Gross Total Income as defined under section 80B(5) means the total income computed in accordance with the provisions of this Act, before making any deduction under

Chapter VI-A. Under section 112(2), Long term capital gains have to be reduced from Gross Total Income and Chapter VI-A deductions should be allowed as if the Gross Total income so reduced were the Gross Total Income of the assessee. Therefore, in this case, for the purpose of allowing deduction u/s 80GG, Gross Total Income = 5,04,304 – 2,64,804 = 2,39,500.

2. Depreciation on plant & machinery

	Rs.
On opening WDV of Rs.5,00,000 @ 15%	**75,000**
On equipment acquired Rs.2,00,000 @ 15%	**15,000**
(50% thereon, since acquired in December)	
	90,000

3. Since the property was acquired by Dr. Krishna through inheritance, the cost of acquisition to him will be the cost to the previous owner. However, indexation will be from the year in which the assessee (i.e., Dr. Krishna in this case) first held the asset i.e. F.Y. 1997-98.

4. It is assumed that Krishna resides outside Mysore. Hence, rent paid for his residence is eligible for deduction under section 80GG. If he remains in Mysore where he owns a property (let out) then he is not eligible for deduction under section 80GG towards rent paid. Also, solution can be prepared without allowing deduction under section 80GG.

Question 38

Gopichand Industries furnishes you the following information :

01.04.2002		***(Rupees)***
Block I	***Plant and machinery (consisting of 10 looms)*** ***Rate of depreciation 25% WDV***	***5,00,000***
Block II	***Buildings (consisting of 3 buildings) WDV*** ***Rate of depreciation 10%***	***12,50,000***
Acquired on 5.07.02 – 5 looms for		***4,00,000***

Sold on 7-12-02 – 15 looms for	***10,00,000***
Acquired on 10-01-03 – 2 looms for	***3,00,000***

Compute depreciation claim for the Assessment year 2003-04 *(5 Marks) (Nov.2003)*

Answer

Let us assume that the facts relate to previous year relevant to the assessment year 2007-08 and accordingly prepare the answer

Computation of depreciation for Gopichand Industries for A.Y.2007-08

Particulars	***Rs.***	***Rs.***
Block 1 : Plant & machinery (Rate of depreciation – 15%)		
WDV as on 1st April (10 looms)	**5,00,000**	
***Add* : Additions during the year 5 looms acquired on 5th July**	**4,00,000**	
2 looms acquired on 10th January	**3,00,000**	
	12,00,000	
***Less* : Assets sold during the year 15 looms sold on 7th December**	**10,00,000**	
W.D.V. as on 31st March (2 looms)	**2,00,000**	
Depreciation on Rs.2 lakhs @ 15% (limited to 50%)		**15,000**
Additional depreciation (See Note 2)		**20,000**
Block II:Buildings (Rate of depreciation – 10%)		
WDV as on 1st April (3 buildings)	**12,50,000**	
Depreciation on Rs.12,50,000 @ 10%		**1,25,000**
Total depreciation for the year		**1,60,000**

Note –

1. Closing balance of Block 1 : Plant and machinery represents the looms acquired on 10th January. These looms have been put to sue for less than 180 days during the previous year, and therefore, only 50% of normal depreciation is permissible.
2. Additional depreciation @ 20% of the cost of plant and machinery is available under section 32(1)(iia). In this case, the assessee is eligible for additional depreciation if it

is engaged in the business of manufacture or production of any article or thing and satisfies other conditions contained in the provision. The quantum of additional depreciation allowable would be :

2,00,000 x 20 % x 50% (put to use for less than 180 days) =	20,000

Question 39

From the following particulars furnished by Kiran for the previous year ending 31.03.2001 compute the taxable income for assessment year 2001-2002

(i) *He owns a house property at a metro city. The fair rental value per annum is Rs.27,000 and the municipal value Rs.24,000.*

(ii) *The house was let out from 1.4.2000 to 31.8.2000 at a monthly rent of Rs.2,100. From 1.9.2000 Kiran occupies for his residence (self).*

(iii) *Expenditure incurred on property and paid:*

- *(a)* *Municipal tax Rs.4,000*
- *(b)* *Fire insurance Rs.2,500*
- *(c)* *Land revenue Rs.4,600*
- *(d)* *Repairs* Rs.1,000

(iv) *Interest paid on borrowings for construction:*

- *(a)* *for the year Rs.21,600*
- *(b)* *Proportionate pre-construction interest Rs.12,960.*

(v) *Income from firm (PF A/c) as partner*

Salary	*25,000*
Interest on capital	*20,000*
Share income	*35,000*

(12 Marks) (Nov.2001)

Answer

Taking the above facts as applicable for the previous year relevant to the assessment year 2007-08, the solution is prepared.

Computation of total income

I. Income from house property (Schedule A)		**(18,460)**
II. Income from business (schedule B)		**45,000**
Total income		**26,540**
Schedule 'A' **Income from house property:** **Annual value**		

Municipal value		**24,000**	
Fair rent		**27,000**	
Actual rent (2100 X 5)		**10,500**	
Since the house property was let out for part of the year and self occupied for part of the year, actual rent or fair rent, whichever is higher is taken as annual value.		**27,000**	
***Less*: Municipal tax paid**		**4,000**	
Balance		**23,000**	
***Less*: Deductions U/s.24 @ 30%**	**6,900**		
Interest on borrowed capital :	**21,600**		
Pre-construction period paid during The year	**12,960**		
		41,460	
Income from house property		**(18,460)**	
Schedule 'B'			
Income from business (partner in Firm)			
Salary income from the firm			**25,000**
Interest income from the firm			**20,000**
(Taxable u/s.28 of the Act)			
Share income (exempt u/s10 of the Act)			**Nil**
			45,000

Note: **Since the property is let out for part of the year and self occupied for part of the year, it has to be taken as deemed let out property.**

Expenditures such as fire insurance, land revenue and repairs to building are not eligible for deduction. Except actual municipal tax paid and deduction on notional basis at 30% of the annual value, no other expenditure is allowable in computing income from property.

Question 40

Kishore Industries owned six machines which were in use in its business in March, 1998. Depreciation on these machines was available as "plant". The written down value of these machines at the end of previous year relevant to assessment year 1998-99 was Rs.6,50,000.

A new plant was bought for Rs.6,50,000 on 30th November, 1998. Three of the old machines were sold on 10th June, 1998 for Rs.9,00,000.

Required:

(i) Compute the claim to depreciation for assessment year 1999-2000 ;

(ii) Capital gains liable to tax for the same assessment year ;

(iii) If Kishore Industries had sold the three machines in June, 1998 for Rs.14,00,000,will there by any difference in your above working ? Explain. *(7 Marks)(May 99)*

Answer

Calculation of depreciation and capital gains in the hands of M/s. Kishore Industries :

(i) Calculation of depreciation

Depreciation is admissible on the basis of block of assets. Therefore to ascertain the amount of depreciation, the written down value and rate of depreciation should be ascertained.	
Written down value arrived at:	
Opening written down value of the block	**6,50,000**
***Add* : Additions during the year**	**6,50,000**
Block after additions	**13,00,000**
Deduct : Sale consideration of 3 machines	**9,00,000**
Written down value of block at the end of the year	**4,00,000**
The asset in the given case shall fall within the block of asset "Plant". Hence depreciation shall be allowed @ 15% for the assessment year 2007-08	
The depreciation has to be calculated on the block of Rs.4 lakhs @ ½ of 15% of the asset entered into the block was purchased in the month of November and was used for less than 180 days (Rs.4,00,000 X 15%) X 50%	**30,000**

(ii) There is no capital gain as per the provisions of Section 50 (1) of the Act, when the written down value of the block was not wiped out or not reduced to zero and there still remains value in the block on which depreciation has to be charged in the ensuing assessment year. Though the acquisition of the new asset took place after the sale of the old machinery which might result in a temporary surplus, calculations are to be made only at the end of previous year.

(iii) If the sale consideration of three machines were Rs.14.00 lakhs, there shall arise short term capital gain as per the provisions of Section 50 (2) of the Act, since the written down value of the block ceased to exist on which depreciation can be charged, and hence (a) there would be no depreciation chargeable for the year and (b) there would be short term capital gain as shown hereunder:

Written down value of block, after additions as shown above	**13,00,000**
Less **: Sale consideration**	**14,00,000**
Short term capital gain	**1,00,000**

Note: **The issue of additional depreciation has not been considered in the above working.**

Question 41

The following is the profit and loss account for the year ended 31st March, 1998 of Western Sugar Mills of which Shri Daga is the owner :

	Rs.		*Rs.*
To Manufacturing expenses	*7,01,000*	*By Sale of sugar and molasses*	*11,62,300*
To Excise duty	*92,795*	*By Rent from agricultural land*	*950*
To Establishment charges	*49,200*		
To Fine paid to excise department	*2,000*	*By Revenue from fisheries*	*4,000*
To Salary & wages	*1,21,445*	*By Sale proceeds from canes*	*6,05,055*
To General charges	*16,750*	*By Profit on sale of motor truck*	*3,230*
To Interest on bank loan	*21,000*		
To Daga's remuneration	*38,750*		
To Depreciation	*91,000*		
To Income tax	*25,000*		
To Cultivation expenses	*4,37,500*		

To Net Profit	***1,79,095***		
	17,75,535		***17,75,535***

Compute the income from business of Shri Daga from the Sugar Mill for the assessment year 1998-99 after taking the following information into consideration.

(i) Sale proceeds of cane include Rs.5,32,000 on account of cane produced and consumed in the factory and debited to manufacturing expenses, the average market price of such cane being Rs.6,00,000.

(ii) The motor truck sold during the year for Rs.7,230 was purchased in the past for Rs.19,000. Depreciation claimed in respect thereof in past assessments was Rs.15,000.

(iii) General charges include (a) Rs.2,000 being the legal expenses incurred in defending a suit regarding the company's title to certain agricultural lands and (b) Rs.10,000 paid to Shri Daga's son who is an employee in the Sugar Mill for a trip to Hawai to study modern methods of manufacture.

(iv) Depreciation in respect of all assets has been ascertained at Rs.50,000 as per Income Tax Rules. *(11 Marks)(Nov.98)*

Answer

Computation of income of Shri Daga for assessment year 2007-08.

	Rs.	***Rs.***
Net profit as per profit and loss account		**1,79,095**
Add **: Expenses disallowed:**		
Fines paid to Excise Department	**2,000**	
Daga's remuneration	**38,750**	
Depreciation treated separately	**91,000**	
Cultivation expenses, being agricultural expenses	**4,37,500**	
Income tax	**25,000**	
		5,94,250
		7,73,345
Less**: Expenses allowed:**		
Depreciation (As per Income-tax Rules)	**50,000**	
Manufacturing expenses (to the extent of such expenses undercharged on account of cane		

consumed difference between the market price and cost price of such cane (i.e. Rs.6,00,000 – Rs.5,32,000)	**68,000**	
		1,18,000
		6,55,345
***Less*: Income not taxable as business income**		
Rent from agricultural land, being agricultural income exempt under section 10(1)	**950**	
Revenue from fisheries, being income chargeable under the head "Income from other sources"	**4,000**	
Sale proceeds of cane, being agricultural income	**6,05,055**	
Profit on sale of Motor car being income chargeable as capital gains subject to the fulfillment of condition of section 50 (1) or 50(2)	**3,230**	
		6,13,235
Business income from Western Sugar Mills		**42,110**

Notes :

(1) All expenses incurred in defending a suit filed on the company's title to certain agricultural land is allowed as deduction as such expenses have bee incurred for protecting the existing asset.

(2) Amount paid to Daga's son for studying abroad on the modern methods of manufacture is allowed as deduction as it was incurred for the purpose of business.

Question 42

Roopen is a Chartered Accountant in practice. He is a resident and ordinarily resident in India. His Profit and Loss Account for the year ended March 31, 1996 reads as follows:

Expenses	***Rs.***	***Income***		***Rs.***
Salaries to paid staff	***4,25,000***	***Fees Earned :***		
Stipends to Articled Clerks	***10,500***	***Audit***	***5,10,400***	
Incentives to Articled clerks	***5,000***	***Taxation services***	***5,40,000***	
Rent	***24,000***	***Consultancy***		

		Services ***<u>4,62,000</u>***	
Printing & stationery	***5,600***		***15,12,400***
Contribution to Recognized Provident Fund	***30,000***	***Dividend on Shares of Indian Companies (Gross)***	***10,623***
Meeting, Seminar and Conference	***45,000***	***Income from Unit Trust of India***	***5,600***
Interest on loan	***56,000***	***Profit on Sale of Shares***	***15,620***
Books and Periodicals	***16,500***	***Honorarium received from***	
		Various institutes for valuation of answer papers	***6,230***
Postage, Telephone and Fax	***1,72,500***	***Rent received from residential flat let out***	***72,000***
Repairs, Maintenance and petrol for Car	***17,500***		
Depreciation :			
Car 7,500			
Computer 15,000			
Typewriter 4,500			
Furniture <u>2,500</u>			
	29,500		
Travelling expenses	***55,000***		
Municipal tax paid in respect of House Property	***1,000***		
Net Profit	***7,29,373***		
	16,22,473		***16,22,473***

Other Information :

(a) *Fees from consultancy services include Rs.1,40,000 received in US dollar from one company in Singapore for rendering professional service there (assume that the entire convertible foreign exchange was received within permitted period).*

(b) *Travelling expenses include Rs.20,000 incurred in connection with his visit to*

Singapore for rendering service as indicated in (a) above.

(c) *Included in meeting, seminar and conference expenses, a sum of Rs.18,000 incurred for entertaining various clients in hotels and clubs.*

(d) *Incentives to articled clerks represent amount paid to two articled clerks for passing intermediate examination at first attempt.*

(e) *1/4th of use of car is attributable to personal purposes.*

(f) *50% of loan was used for the purpose of construction of the house property and 50% of loan was used for purchasing office computer.*

(g) *Roopen follows accrual basis of accounting. Printing & Stationery include Rs.2,000 being the cost of some stationery items purchased in accounting year 1994-95 which was not provided for in that year due to oversight.*

(h) *The written down values of various assets as on 31.3.1995 are as follows :*

	Rs.
Car (acquired on 1.4.1991)	***81,920***
Computer (acquired on 15.12.1995 at cost of Rs.1,50,000)	***Nil***
Typewriter (acquired on 1.4.1993)	***15,000***
Furniture (acquired on 1.4.1993)	***25,000***

(a) *Salaries include Rs.25,000 paid to a computer specialist in cash for assisting Roopen in one professional assignment.*

(b) *Roopen paid life membership subscription of Rs.500 to Chartered Accountants' Benevolent Fund (recognized under Section 80G). The amount was debited to his Drawing Account.*

(c) *Shares sold were held for 8 months before sale.*

You are required to compute the total income of Roopen for assessment year 1996-97.

(25 Marks) (May 1996)

Answer

On the assumption that the facts given above relate to previous year relevant to the assessment year 2007-08 the solution is prepared.

Computation of Total Income for Assessment Year 2007-08

	(+)	(-)	
A. Profits and gains from business or profession	Rs.	Rs.	Rs.
Net profit as per profit and loss			**7,29,373**

account			
Depreciation	29,500	58,966	
Municipal tax for house property	1,000		
Dividend		10,623	
Income from Unit Trust of India		5,600	
Profit on sale of shares		15,620	
Honorarium received from Institutes for valuation of answer papers		6,230	
Rent from residential flat		72,000	
Entertainment expenses – allowed	---		
Incentives to article clerks for passing CA Examination at first attempt is allowable under section 37(1) as such payment would boost up the morale of the articled clerks and increase their loyalty to the employer. This is an expenditure laid out wholly and exclusively for the purpose of profession	--	---	
¼ th of repairs, maintenance and petrol for car is disallowed as the same is attributable to use for private purpose	4,375		
Printing and stationery relating to earlier year cannot be claimed as deduction now. Hence disallowed	2,000		
Payment to computer specialist in cash for a sum exceeding Rs.20,000 disallowed under section 40A(3) to the extent of 20%	5,000		
50% of interest on loan disallowed as 50% of loan was			

utilized for non-business purposes	**28,000**		
	69,875	**1,69,039**	**(99,164)**
Income from Business			**6,30,209**
B. Income from House property			
Rent		**72,000**	
***Less*: Municipal tax**		**1,000**	
		71,000	
***Less*: Deductions under section 24 @ 30%**	**21,300**		
Interest on loan	**28,000**		
		49,300	
			21,700
C. Capital Gain			
Short term capital gain (since the shares were held for not more than 12 months. Capital Gain is short term capital gain)			**15,620**
D. ncome from Other sources			
Dividend - Rs.10623 exempt U/s.10(34)		**Nil**	
Income from UTI – Rs.5,600 exempt U/s.10(35)		**Nil**	
Honorarium from various institutes for valuation of answer papers			**6,230**
Gross total income (A+B+C+D)			**6,73,759**
Deduction under Chapter VI-A			
Deduction under section 80 G in respect of the membership subscription to Chartered Accountants benevolent fund (50% of Rs.500)			**250**

Total Income			**6,73,509**

Working Note

Calculation of depreciation admissible under section 32

	Rs.
On car (15% of Rs.81,920)	**12,288**
On computer (1,50,000 X 60% = Rs.90,000). Assumed that it was acquired during the previous year i.e. on 15.12.2006	**45,000**
(Restricted to 50% thereof as the asset was used for not more than 180 days)	
On type writer (15% of Rs.15,000)	**2,250**
On furniture (10% of Rs.25,000)	**2,500**
	62,038
***Less*: 1/4th of depreciation on car attributable to private use**	**3,072**
	58,966

Question 43

A manufacturer of goods which are liable to excise duty maintains a separate account for excise duty collected and paid by him. The balance remaining in this account is carried to the balance sheet. The levy of Central Excise was disputed by the assessee and being successful, he received a refund of excise duty to the tune of Rs.10 lakhs which was credited to the Central Excise collection account. The Assessing Officer, taking the view that the provisions of Section 41(1) are attracted, brought the sum of Rs.10 lakhs to tax. The assessee disputes this levy on the ground that he had not claimed the payment of Central Excise as a deduction in arriving at his income and therefore the provisions of Section 41(1) are not attracted. Discuss the comparative merits of the two view points. (5 Marks)(May 97)

Answer

There are conflicting views on the applicability of section 41(1) in the circumstances stated in the question. Section 41(1) inter alia reads as follows :-

"Where an allowance or deduction has been made in the assessment

for any year in respect of loss, expenditure or trading liability incurred by the assessee (hereinafter referred to as the first – mentioned person) and subsequently during any previous year, -

(a) the first-mentioned person has obtained, whether in cash or in any other manner whatsoever, any amount in respect of such loss or expenditure or some benefit in respect of such trading liability by way of remission or cessation thereof …….…."

The first and most necessary ingredient for the application of section 41(1) is that an allowance or deduction must have been made previously while computing the taxable income. If an assessee has derived a tax benefit in an earlier year, it is considered logical that a refund of the deduction availed of earlier should be added to the income of the year in which it is received. In the instant case, hence it can be argued that under the system followed by the assessee, he has not secured any tax advantage and therefore the refund of duty is not taxable – *Tirunelveli Motor Bus Service Co.Pvt.Ltd. vs. CIT 78 ITR 55 (S.C.), Mahindra & Mahindra Ltd v. CIT 261 ITR 501 (Bom)*

The opposite view could be derived from the Apex Court decision in the case of *Chowringhee Sales Bureau P Ltd v. CIT 87 ITR 542* wherein it was held any tax collection is to be treated as trading receipt. Payment of the tax is correspondingly deductible. The amount of excise duty refunded to the assessee forms part of business receipt and hence is chargeable to tax.

Question 44

M/s. QQ & Co., a sole proprietary concern, was converted into a company on 31.8.2002. Before the conversion, the sole proprietary concern had a Block of Plant and Machinery (Rate of Depreciation 25%), whose WDV as on 1.4.2002 was Rs.3,00,000. On 1st April itself, a new plant of the same Block was purchased for Rs.1,20,000. After the conversion, the company has purchased the same type of Plant on 1.1.2003 for Rs.1,60,000.

Compute the depreciation that would be allocated between the sole proprietary concern and the successor company. (3 Marks)(May 2003)

Answer

Let us assume that the facts relate to the previous year relevant to the assessment year 2007-08 and accordingly prepare the answer.

Computation of depreciation in the case of transfer of business.

Depreciation is to be calculated as if there is no succession.

WDV as on 1st April	**3,00,000**
***Add* : Additions made before succession**	**1,20,000**

	4,20,000
Less **: Sale consideration of the asset sold**	**Nil**
	4,20,000
Depreciation @ 15%	**63,000**

Allocation of depreciation between sole proprietary concern and the successor company

The depreciation of Rs.63,000 is to be allocated in the ratio of number of days the assets were used by the sole proprietary concern and the company.

Ex – Sole proprietary concern

1st April to 31st August = 153 days

63,000 x 153 / 365 = 26,408

Successor company

63,000 minus 26,408 = 36,592 (i.e. Rs.63,000 x 212 /365)

Note: **The depreciation of Rs.12,000 [50% of 15% on Rs.1,60,000] in respect of asset purchased by the successor company on 1st January is fully allowable in the hands of the successor company.**

Question 45

Mr. Sivam, a retail trader of Cochin gives the following Trading and Profit and Loss Account for the year ended 31st March, 2003 :

Trading and Profit and Loss Account for the year ended 31.03.2003

	Rs.		***Rs.***
To Opening stock	***90,000***	***By Sales***	***12,11,500***
To Purchases	***10,04,000***	***By Income from UTI***	***2,400***
To Gross Profit	***3,06,000***	***By Other business receipts***	***6,100***
		By Closing stock	***1,80,000***
	14,00,000		***14,00,000***
To Salary	***60,000***	***By Gross profit b/d***	***3,06,000***
To Rent and rates	***36,000***		
To Interest on loan	***15,000***		

To Depreciation	***1,05,000***		
To Printing & stationery	***23,200***		
To Postage & telegram	***1,640***		
To Loss on sale of shares (Short term)	***8,100***		
To Other general expenses	***7,060***		
To Net Profit	***50,000***		
	3,06,000		***3,06,000***

Additional Information :

(i) *It was found that some stocks were omitted to be included in both the Opening and Closing Stock, the values of which were*

Opening stock	***Rs.9,000***
Closing stock	***Rs.18,000***

(ii) *Salary includes Rs.10,000 paid to his brother, which is unreasonable to the extent of Rs.2,000.*

(iii) *The whole amount of printing and stationery was paid in cash.*

(iv) *The depreciation provided in the Profit and Loss Account Rs.1,05,000 was based on the following information :*

The written down value of plant and machinery is Rs.4,20,000. A new plant falling under the same Block of depreciation of 25% was bought on 1.7.2002 for Rs.70,000. Two old plants were sold on 1.10.2002 for Rs.50,000.

(v) *Rent and rates includes sales tax liability of Rs.3,400 paid on 7.4.2003.*

(vi) *Other business receipts include Rs.2,200 received as refund of sales tax relating to 2001-02.*

(vii) *Other general expenses include Rs.2,000 paid as donation to a Public Charitable Trust.*

You are required to advise Mr. Sivam whether he can offer his business income under section 44AF i.e. presumptive taxation. *(15 Marks)(May 2003)*

Answer

Let us assume that the facts relate to previous year relevant to assessment year 2007-08 and accordingly compute the income of

Mr.Sivam.

Computation of business income of Mr. Sivam for the previous year 2007-08.

		Rs.	Rs.
Net Profit as per profit and loss account			**50,000**
***Add* :**	**Inadmissible expenses / losses**		
	Under valuation of closing stock	**18,000**	
	Unreasonable salary paid to brother (section 40A(2)	**2,000**	
	Printing and stationery paid in cash		
	[Section 40A(3)] 20% of Rs.23,200	**4,640**	
	Depreciation (considered separately)	**1,05,000**	
	Short term capital loss on shares	**8,100**	
	Donation to public charitable trust	**2,000**	
			1,39,740
			1,89,740
Less	Deductions items:		
	Under valuation of opening stock	**9,000**	
	Income from UTI	**2,400**	
	Refund of sales tax [Taxable u/s.41(1) – No adjustment necessary]	**--**	
			11,400
	Business income before depreciation		**1,78,340**
Less	**Depreciation (see note 1)**		**66,000**
			1,12,340

<u>Computation of business income as per section 44AF</u>

As per section 44AF, the business income would be 5% of turnover

12,11,500 x 5 /100 = Rs.60,575

The business income under section 44AF is Rs.60,575.

As the business income under section 44AF is

lower than the business income as per the normal provisions of the Act, it is advisable for Mr. Sivam to offer the business income under section 44AF of the Act.

Note 1

Calculation of depreciation

WDV of the block of plant & machinery as on the first day of previous year	**4,20,000**
***Add* :Cost of new plant & machinery**	**70,000**
	4,90,000
***Less* : Sale proceeds of assets sold**	**50,000**
WDV of the block of plant & machinery as on the last day of previous year	**4,40,000**
Depreciation @ 15%	**66,000**

Note : **No additional depreciation is allowable as the assessee is not engaged in manufacture or production of any article.**

Note 2

Since sales-tax liability has been paid before the due date of filing return of income under section 139(1), the same is deductible.

Question 46

Anand is a person carrying on profession as film artist. His gross receipts from profession are as under:

Financial year	**1998-1999**	**1,25,000**
Financial year	**1999-2000**	**1,60,000**
Financial year	**2000-2001**	**1,80,000**

Is he required to maintain any books of account under Section 44AA of the Income-tax Act? If so, what are these books? *(6 Marks)(May 2001)*

Answer

Section 44AA requires every person carrying on any profession, notified by the Board of the Official Gazette (in addition to the professions already specified) to maintain such books of account and other documents as may enable the Assessing Officer to compute his total income in accordance with the provisions of the

Income-tax Act. The CBDT has notified the profession of film artists as one such profession (S.O. No.17E/12-1-77). Hence section 44AA applies to Anand.

Sub-section (3) of section 44AA authorizes the Board to prescribe by rules, the books of account and other documents (including inventories) to be kept and maintained under sub-section (1), the particulars to be contained therein etc. The prescribed rule is Rule 6F, under which every person carrying on the specified profession, including a film artist, is required to maintain the books of account and other documents specified in sub-Rule (2).

However, under the proviso to Sub-Rule (1), nothing contained therein shall apply in the case of a person, if his gross receipts do not exceed Rs.1,50,000/- in any one of the three years, immediately preceding the previous year.

The significance of this rule is that if the gross receipts from profession do not exceed Rs.1,50,000 in any one of the previous 3 years, he is not required to maintain the books of account specified in sub-rule (2) of Rule 6F. Since in one of the three previous years the gross receipts are below Rs.1,50,000, the assessee is not required to maintain books of account and other documents as he is not governed by section 44AA.

Question 47

Discuss the tax implications of the following transactions in the case of a doctor running a nursing home :

		Rs.
(1)	Amount paid to a scientific research association approved by the Central Government and run by a drug manufacturing company	20,000
(2)	Amounts received from the employees of the nursing home as contributions towards provident fund for the month of March, 2000 paid to the PF Commissioner on 25th April, 2000	25,000
(3)	Repayment made in cash towards purchases of medicines	50,000
(4)	Repayment of loan taken from a bank for doing a post-graduate course in medicine – instalment	50,000
	Interest	10,000

(8 Marks) (May 2001)

Answer

(i). Under section 35(ii), 125% of the sums paid to scientific research association, which has as its object the undertaking of scientific research is deductible.

Deduction admissible = 20,000 + (1/4 x 20,000)

= Rs.25,000.

(ii) Under clause (x) of sub section 24 of section 2, any sum received by an assessee from his employees as contribution to any provident fund is deemed to be his income. Such income is deductible under section 36(1) (va) only if it is credited to the employees' account in the relevant fund by the due date.

Under Employees' Provident Fund Act, the due date for the payment of the contribution is the 15th of the month following the month for which the contribution is due. A grace period of 5 days is also allowed. Hence the payment of the employee's contribution for the P.F. Commissioner should have been made by 20th April. Since the payment has been made on 25th April, the deduction is not available.

(iii) Under section 40A(3) payments made in cash exceeding Rs.20,000 are not allowable in computing the income from business or profession. 20% of such expenditure is liable to be disallowed. Hence Rs.10,000 will be disallowed. It is assumed that the case is not covered by the exceptions under Rule 6DD.

(iv) Under section 80E, a deduction is admissible in the case of an individual towards any amount paid in the previous year by way of interest on loan taken from any financial institution for the purpose of pursuing his higher education. The purpose stated in the question is covered by the section. The deduction is allowable only towards payment of interest. The amount deductible under section 80-E would be Rs.10,000.

Question 48

From the following data, calculate the depreciation admissible to an individual carrying on business, for Assessment Year 2000-2001 ;

		Rs.
(i)	***Factory Building w.d.v.***	***5,00,000***
(ii)	***Plant and machinery w.d.v.***	***8,00,000***
	Addition:	
	30.06.99	***1,00,000***
	31.12.99	***1,00,000***
	Sales:	
	1.12.99	***6,00,000***

(iii)	***Computer***	
	Addition 1.1.2000	***60,000***
(iv)	***Furniture and fixtures w.d.v.***	***1,00,000***
(v)	***Motor car w.d.v.***	***60,000***

(7 Marks) (Nov.2000)

Answer

The additions and deletions given above are taken as occurring in the previous year relevant to the assessment year 2007-08 and accordingly depreciation is computed.

The depreciation is computed as shown below ***Rs.***

I Block	**Building w.d.v Rs.5,00,000 at 10%**		**50,000**
II Block	**Plant and machinery**		
	W.d.v	**8,00,000**	
	Additions	**2,00,000**	
		10,00,000	
	***Less*: Sales**	**6,00,000**	
	Balance	**4,00,000**	
	On 3,00,000 at 15%		**45,000**
	On Rs.1,00,000 at 15% X 50%		**7,500**
	(assuming used for less than 180 days)		
III BLOCK	**Computers (cost Rs.60,000) at 60% for less than 180 days (i.e. 30%)**		**18,000**
IV Block	**Furniture, fixtures w.d.v 1,00,000 at 10%**		**10,000**
V Block	**Motor car W.D.V 60,000 at 15%**		**9,000**
	Total depreciation admissible		**1,39,500**

Question 49

X is a dealer in shares. He hald 1,000 shares of Rs.100 each in AA Ltd., which he valued at cost on 31.3.1999. On 1.5.1999, he was offered 2 shares of BB Ltd. Of the face value of Rs.100 each in exchange of 1 share of AA Ltd. He accepted the offer. The said shares of BB Ltd. Were held in stock on 31.3.2000 and were valued by X at Rs.1,00,000 on the ground that he had not incurred any cost over and above what he had originally paid for shares of AA Ltd. Is he correct ?

(4 Marks) (Nov.2000)

Answer

X is a dealer in shares and hence shares form part of his stock in trade. The question relates to the valuation of shares in BB Ltd. held in stock as on 31st March. As per section 145, the income chargeable, inter alia, under the head "Profits and gains of business or profession" shall be either in accordance with cash or mercantile system of accounting.

Section 145A enjoins that notwithstanding anything contained in section 145, the valuation of inventory for the purposes of determining the income under the said head shall, inter alia, be in accordance with the method of accounting regularly followed by the assessee.

Thus in the case of X, the valuation of the shares in BB Ltd. as on 31st Match must be in accordance with the method of valuation regularly adopted by him. Where X has been consistently valuing the shares in the past either on cost basis or cost or net realizable value whichever is lower, the valuation adopted by X will be correct, as cost to X is Rs.1,00,000 only (as against the net realizable value, assumed as Rs.1,50,000).

Where X has been valuing shares on the basis of net realizable value, X's contention will fail, as then he has to value the shares at the net realizable value (here assumed as Rs.1,50,000). Thus the acceptance of the contention of X would depend upon the method of valuation of stock (i.e. shares here) adopted by him in the past.

Question 50

Write short notes on : Deductibility of Partners' Remuneration *(6 Marks) (May 1996)*

Answer

Remuneration payable to partners by a firm is allowable under section 37 subject to fulfillment of conditions and limits laid down in section 40(b).

Section 40(b) lays down the following conditions for allowability of partners' remuneration.

(i) No remuneration to a partner will be admissible unless he is a 'working partner'.

(ii) Remuneration to a working partner must be authorised by the instrument of partnership. There should be not only an authority therefore in the instrument of partnership itself, the amounts payable must also be specified, not necessarily in exact terms of money, but may be by prescribing a formula in the instrument, as to how it is to be computed/ arrived at.

Monetary Limit : No amount of remuneration in excess of the amount in accordance with the following limits is allowable as a deduction in computing the firm's income.

For professional firms :-

(a)	**On the first Rs.1 Lakh of the 'book- profit' or in case of a loss**	**Rs.50,000 or 90% of the 'book-profit', whichever is more**
(b)	**On the next Rs.1 lakh of the 'book –profit'**	**60% of the 'book-profit'**
(c)	**On the balance of 'book-profit'**	**40% of the 'book- profit'**

In case of other firms, Rs.75,000 shall be substituted for Rs.1 lakh given above.

For the purpose of section 40(b) `Book-profit' means the net profit, as shown in the profit and loss account for the previous year computed in the manner laid down in chapter IV-D as increased by the aggregate amount of the remuneration paid or payable to all the partners of the firm if such amount has been deducted in computing the net profit. (Explanation 3 to section 40(b)].

"Working partner' is defined as an individual who is actively engaged in conducting the affairs of the business or profession of the firm of which he is a partner. [Explanation 4 to section 40(b)].

"Remuneration" in this context embraces salary, bonus, commission or remuneration by whatever name called.

Question 51

The Director of a company was accompanied by his wife on a foreign tour undertaken by him for business purposes. It was claimed that her presence fulfilled a social purpose and facilitated transaction of business. What tests would you apply to decide whether the expenditure incurred on the wife in foreign travel is admissible as a deduction ?

(6 Marks) (Nov.96)

Answer

It is possible to take two views on this issue. 'One view is that such expenditure is not admissible on the following grounds:

(i) The provision under which the expenditure may be possibly claimed is section 37(1).

(ii) The onus of proving that the expenditure has been incurred for the purpose of the business of the company is on the company.

(iii) The expenditure under section 37(1) will qualify for deduction only if it is incurred wholly and exclusively for the purpose of business. "Wholly" refers to the quantum of expenditure and "exclusively" refers to the motive, objective.

(iv) The fulfillment of a social purpose and facilitation of business indirectly, without something more, do not fulfill these tests. Hence, the expenditure is not allowable.

However, in *Glaxo Laboratories (India) Ltd v. ITO 18 ITD 226 (Bom) (SB) and ITO v. A.F.Ferguson & Co 19 ITD 620 (Bom)* the travelling expenses of spouse were held to be admissible in as much as the business visit involved social aspects and the spouse accompanied the husband on grounds of commercial expediency and for business considerations.

Also, in *CIT v. Sundaram Clayton Ltd (240 ITR 271) (Mad)* it was held that the language employed in section 37 is flexible enough to permit wider interpretation whenever circumstances warrant and hence the travel expenditure of the spouse of its director if has contributed to the business of the assessee such expenditure cannot be disallowed.

Question 52

Expenditure incurred in connection with the increase of the authorised capital of a company and the issue of bonus shares by it is capital in nature. Discuss. (6 Marks) (Nov.96)

Answer

The expenditure incurred in connection with, raising the authorised share capital of a company changes the income-earning apparatus of the company. The capital base of the company is reinforced on a permanent basis by the increase of the authorised capital. A change in the income earning apparatus is brought about by the inflow of additional capital. Hence the expenditure is capital in nature.

Brook Bond India Ltd v. CIT 225 ITR 798 (SC).

On the other hand, by the issue of bonus shares, a portion of the revenue is transferred and shown as authorised capital. The profit

making apparatus or structure remains unchanged. There is no addition or alteration to it. The total funds available with the company remain the same. Hence, the expenditure incurred in connection with the issue of bonus shares will be revenue in nature. *Wood Craft Products Ltd v. CIT 204 ITR 545 (Cal).;* . The apex court in *CIT v. General Insurance Corporation (2006) 286 ITR 232 (SC)* has held that expenses by way of stamp duty and registration for issue of bonus shares as deductible expenditure.

Question 53

Jardine Ltd. is an existing Indian Company, which sets up a new industrial unit. It incurs the following expenditure in connection with the new unit:

	Rs.
Preparation of project report	***4,00,000***
Market survey	***5,00,000***
Legal and other charges for issue of additional capital required for the new unit	***2,00,000***
Total	***11,00,000***
The following further data is given:	
Cost of project	***30,00,000***
Capital employed in the new unit	***40,00,000***

What is the deduction admissible to the company under section 35D for Assessment Year 2000-2001? (6 Marks) (May 2000)

Answer

The deduction admissible under section 35D is one-fifth of the expenditure incurred for the project. This works out to Rs.2,20,000.

However, such expenditure should not exceed the following limits as prescribed in section (3):

(a) 5% of cost of the project or

(b) 5% of the capital employed in the new industrial undertaking (being a company) -- whichever is higher.

In this case

(a) 5% of the project cost is Rs.1,50,000 and

(b) 5% of the capital employed is Rs.2,00,000.

Hence, the expenditure eligible for amortization under section 35D would be Rs.2,00,000.

And the admissible deduction for the current assessment year is

2,00,000 x 1/5 = Rs.40,000.

CHAPTER 8

CAPITAL GAINS

Question 1

Fill in the blanks having regard to the provisions of the Income-tax Act, 1961:

Where a person transfers capital asset to a firm in which he becomes partner, the full value of consideration in the context of capital gain computation, will be..... (1 Mark) (Nov.2005)

Answer

The amount recorded in the books of account of the firm as the value of capital asset.

Question 2

State whether True or False, with reasons, having regard to the provisions of the Income-tax Act, 1961 (Answers without reasoning will not be given any mark):

Where an urban agricultural land owned by an individual, continuously used by him for agricultural purposes for a period of two years prior to the date of transfer, is compulsorily acquired under law and the compensation is fixed by the State Government, resultant capital gain is exempt.

(2 Marks) (Nov.2005)

Answer

False. **In this case, the compensation has been fixed by the State Government and hence the exemption will not be available. As per section 10(37), where an individual owns urban agricultural land which has been used for agricultural purposes for a period of two years immediately preceding the date of transfer, and the same is compulsorily acquired under any law and the compensation is determined or approved by the Central Government or the Reserve Bank of India, resultant capital gain will be exempt.**

Question 3

Choose the correct answer with reference to the provisions of the Income-tax Act, 1961.

(i) ***In respect of shares held as investment, while computing the capital gains, securities transaction tax paid in respect of sale of listed shares sold in a recognized stock exchange,***

- ***(a)*** ***Is deductible upto Rs.1,00,000***
- ***(b)*** ***Is deductible upto Rs.2,00,000***
- ***(c)*** ***Is deductible where capital gains is below Rs.5,00,000***
- ***(d)*** ***Is not deductible at all*** ***(1 Mark) (May 2005)***

(ii) ***For an individual who has derived short-term capital gains of Rs.40,000 from transfer of listed equity shares after 1.10.2004, with other income of Rs.20,000 (these two items above making up his total income), income-tax payable in respect of short-term capital gains is***

- ***(a)*** ***Rs.4,000***
- ***(b)*** ***Rs.8,000***
- ***(c)*** ***Rs.1,000***
- ***(d)*** ***None of the above***

(1 Mark) (May 2005)

Answer

(i) (d) **i.e. is not deductible at all.**

(ii) (d) **i.e. none of the above as the total income is below taxable limit.**

Question 4

Briefly discuss about the provisions relating to claiming of exemption in respect of short-term capital gains, in order to reduce tax liability. ***(4 Marks) (Nov.2005)***

Answer

Deduction under sections 54B, 54D and 54G can be claimed in respect of income from short term capital gains in order to reduce tax liability.

(i) Under section 54B, if an individual transfers his agricultural land which has been used by him or his parents for agricultural purposes for a period of two years immediately preceding the date of transfer and he purchases another agricultural land within a period of two years from the date of such transfer, the amount of capital gain or the actual amount invested in purchasing the new agricultural land whichever is lower, is allowed as exemption.

(ii) Under section 54D, deduction is allowable to any assessee, being an industrial undertaking on compulsory acquisition of land and building forming part of the industrial undertaking. Such land and building should have been used for the purpose of the business of the undertaking for at least two years immediately preceding the date of compulsory acquisition and another land or building should be purchased or constructed within a period of three years for the use of existing or newly set-up industrial undertaking. In such a case, the capital gain or the amount invested in the new land and building, whichever is lower, would go to reduce income from short term capital gains.

(iii) Section 54G exempts capital gain on transfer of assets, being machinery, plant, building or land, used for the business of an industrial undertaking situated in an urban area consequent to shifting of such industrial undertaking to any area other than an urban area. The assessee, being an industrial undertaking, should, within a period of one year before or three years after the date of transfer, purchase machinery, plant or acquire building or land or construct building and complete shifting to the new area. In such a case, the short term capital gain would be reduced to the extent of the cost of the new assets and expenses incurred for shifting the industrial undertaking.

Question 5

Write short notes on: De-merger
(6 Marks) (May 2001)

Answer

Under sub-section (19AA) of section 2 the expression "demerger" has been defined as under :

In relation to companies, it means the transfer pursuant to a scheme of arrangement under sections 391 to 394 of the Companies Act, 1956 by a demerged company of one or more of its undertakings to any resulting company in such a manner that

(i) all the property of the undertaking, being transferred by the demerged company, immediately before the demerger, becomes the property of the resulting company by virtue of the demerger.

(ii) all the liabilities relatable to the undertaking, being transferred by the demerged company, immediately before the demerger, become the liabilities of the resulting company by virtue of the demerger.

(iii) the property and the liabilities of the undertakings being transferred by the demerged company are transferred at values appearing in its books of account immediately before the demerger ;

(iv) the resulting company issues, in consideration of the demerger its shares to the shareholders of the demerged company on a proportionate basis ;

(v) the shareholders holding not less than three-fourths in value of the shares in the demerged company become shareholders of the resulting company by virtue of the demerger ;

(vi) the transfer of the undertaking is on a going concern basis ;

(vii) the demerger is in accordance with the conditions, if any, notified under sub-clause (5) section 72A by the Central Government.

Question 6

Computation of Capital Gains in the case of `Slump Sale' u/s 50B of the Income Tax Act, 1961.

(5 Marks) (May 2003)

Answer

Any profits and gains arising from the slump sale effected in the previous year shall be chargeable to tax as capital gain arising from transfer of long term capital assets and shall be deemed to be income of the previous year in which the transfer takes place.

Any profits and gains arising from such transfer of one or more undertakings held by the assessee for not more than 36 months shall be deemed to be short term capital gains.

The net worth of the undertaking or the division as the case may be, shall be deemed to be the cost of acquisition and the cost of improvement for purpose of section 48 and 49 in relation to capital assets of such undertakings or divisions transferred by way of such sale.

In the case of slump sale, every assessee shall furnish in the prescribed form, along with the return of income, a report of an accountant certifying that the net worth of the undertaking or division has been correctly arrived at in accordance with the provisions of this section.

Question 7

What types of transactions are included in the term 'transfer' in relation to a capital asset?

(6 Marks)
(Nov.97)

Answer

Section 2(47) defines the term "transfer". It is defined in an inclusive manner. The following transactions are included in the term 'transfer':

(i) The sale, exchange, relinquishment of the asset ;

(ii) The extinguishment of any rights therein ;

(iii) The compulsory acquisition thereof under any law ;

(iv) Conversion of capital asset into stock in trade of business by the assessee or such treatment by the owner of such asset ;

(v) Maturity or redemption of zero coupon bond ;

(vi) Part performance of the contract: Sometimes possession of an immovable property is given in consideration of part performance of a contract. For example: A enters into an agreement for the sale of his house. The purchaser gives the entire sale consideration to A. A hands over the complete rights of possession to the purchaser since he has realised the entire sale consideration. The above transaction is considered as transfer.

(vii) There are certain types of transactions which have the effect of transferring or enabling the enjoyment of an immovable property. For example: A person may become a member of a cooperative society, company or other association of persons which may be building houses/flats. When he pays an agreed amount, the society etc hands over possession of the house to the person concerned. No conveyance deed is registered. The above transaction is also covered by the term 'transfer'.

Question 8

Write short note on conversion of capital assets to stock-in-trade. (5 Marks) (May 200

Answer

A person who is the owner of a capital asset may convert the same or treat it as stock-in-trade of the business carried on by him. As per section 2(47)(iv), transfer includes such conversion or treatment of capital asset by the owner thereof, into stock-in-trade of a business carried on by him.

As per section 45(2), the profits or gains arising from the above conversion is chargeable to tax (as capital gains) as the income of the previous year in which such stock-in-trade is sold or otherwise transferred by him.

To compute such capital gains under section 48, the fair market value of the asset on the date of such conversion or treatment shall be deemed to be the full value of the consideration received as a result of such transfer. This will be assessable as capital gain.

The amount actually received on sale in excess/short of the fair market value will however be treated as a business income/loss.

The tax incidence however arises only in the year in which the stock-in-trade is sold by the assessee.

Question 9

Write short note on computation of capital gains in case of depreciable assets.

(5 Marks) (May 2000)

Answer

Section 50 provides for the computation of capital gains in the case of depreciable assets. Capital gain or loss in respect of depreciable asset would arise where (i) all the assets forming part of the block are transferred and (ii) the assets forming part of the block exist but the sale consideration far exceeds the block value of assets.

The capital gain or loss would be calculated in the following manner :

Where the full value of consideration received or accruing for the transfer of the asset plus full value of such consideration for the transfer of any other capital asset falling within the block of assets during the previous year exceeds the aggregate of

- expenditure incurred wholly and exclusively in connection with such transfer ;
- WDV of the block of assets at the beginning of the previous year ;
- the actual cost of any asset falling within the block of assets acquired during the previous year,

such excess shall be deemed to be the capital gains arising from the transfer of short-term capital assets.

Under section 50(2), where any block of asset ceases to exist for the reason that all assets in that block are transferred during the previous year, the cost of acquisition of the block shall be the written down value of the block at the beginning of the year as increased by the actual cost of any asset acquired during that previous year. The income accruing as result of such transfer shall be deemed to be short term capital gains arising from such transfer.

Question 10

When a reference to the Valuation Officer can be made u/s 55A of Income-tax Act, 1961?

(5 Marks) (Nov.2001)

(5 Marks) (Nov.98)

Answer

With a view to ascertaining the correct fair market value of capital asset the Assessing Officer may refer the valuation of the capital

asset to the Valuation officer. The reference may be in the following cases:

(a) Where the value of the asset as claimed by the assessee is in accordance with the estimate made by the registered valuer but the Assessing Officer is of the opinion that the value so claimed is less than its fair market value;

(b) Where the Assessing Officer is of the opinion that the fair market value of the asset as claimed by the assessee exceeds the value of the asset by more than 15% of the value of the asset as so claimed or by more than Rs.25,000.

(c) Where the Assessing officer is of the opinion that, having regard to the nature of an asset and relevant circumstances, it is necessary to make a reference to the valuation officer.

Students may note, presently section 142A inserted by the Finance (No.2) Act, 2004 with retrospective effect from 15-11-1972 has wider coverage for making reference to valuation officer.

Question 11

State the provisions relating to the computation of capital gains in the hands of shareholder of a company on distribution of assets upon liquidation. (6 Marks) (May 2002)

Answer

As per section 46(2) when a shareholder receives money or other assets at the time of liquidation of the company in which he is a shareholder, capital gains shall be determined as below:

(i) Find out the money received and the market value of other assets as on the date of distribution.

(ii) Find out the amount treated as dividend under section 2(22)(c) i.e. any distribution to the extent of accumulated profits of the company at the time of liquidation.

(iii) If such dividend arises after 31st May, 1997 the company shall pay the dividend distribution tax and the dividend will be exempt in the hands of shareholders under section 10(34).

(iv) The full value of consideration shall be the amount arrived at after deducting the amount assessed as dividend u/s.2(22)(c) from the aggregate of the money received and the fair market value of the other assets on the date of the distribution.

(v) From the consideration so arrived at, the cost of acquisition (after indexation where applicable) and the expenses relating to the transfer shall be deducted. In determining the period for which the shares have been held, the period subsequent to the date on which the company goes into liquidation shall be excluded (section 2(42A)- Explanation 1).

(vi) The balance amount shall be capital gains in the hands of the shareholder.

Question 12

What are the transactions not regarded as transfer as per section 47 under the Income Tax Act, 1961. (List at least six of such transactions). (6 Marks) (Nov.2003)

Answer

Transactions not regarded as transfer [Section 47]

The following transactions will not be regarded as transfer for the purposes of capital gains tax.

(i) Any distribution of capital asset on the total or partial partition of HUF.

(ii) Any transfer of capital asset under a gift or will or an irrevocable trust. However, it would not include transfer under gift or an irrevocable trust of a capital asset being shares or debentures or warrants allotted by a company to the employees under the ESOP scheme in accordance with the guidelines issued by the Central Government in this behalf.

(iii) Transfer of capital asset to its Indian subsidiary company by a holding company which holds whole of the share capital of the subsidiary company.

(iv) Transfer of capital asset by a subsidiary company to its holding company being an Indian company having whole of the share capital of the subsidiary company.

(v) Transfer of capital asset by the amalgamating company to the amalgamated company in a scheme of amalgamation, provided the amalgamated company (new company) is an Indian company.

(vi) Transfer of shares held in an Indian company by the amalgamating foreign company in a scheme of amalgamation to the amalgamated foreign company, if –

(a) at least 25% of the shareholders of the amalgamating foreign company continue to remain shareholders of the amalgamated foreign company, and

(b) such transfer does not attract tax on capital gains in the country in which the amalgamating company is incorporated.

(vii) Transfer of shares of the amalgamating company held by a shareholder in a scheme of amalgamation in consideration of the allotment of shares in amalgamated company. The amalgamated company must be an Indian company.

(viii) Transfer of capital asset by the demerged company to the resulting company in a scheme of demerger, provi ded the resulting company is an Indian company.

(ix) Transfer of capital asset, being a share of shares held in Indian company, by the demerged foreign company to the resulting foreign company, if –

(a) the shareholders holding not less than three-fourths in the value of the shares of the demerged foreign company continue to remain shareholders of the resulting foreign company ; and

(b) such transfer does not attract tax on capital gains in the country, in which the demerged foreign company is incorporated.

(x) Transfer or issue of shares by the resulting company in a scheme of demerger to the shareholders of the demerged company, provided such transfer or issue is made in consideration of demerger of the undertaking.

(xi) Any transfer of bonds or global depository receipts referred to in section 115AC(1) made outside India by a non-resident to another non-resident.

(xii) Any transfer of agricultural lands effected before 1.3.1970.

(xiii) Any transfer of capital asset being work of art, archaeological, scientific or art collection, book, manuscript, drawing, painting, photograph or print, to the Government or any University or the National Museum or National Art Gallery, National Archives or any other public museum notified by the Central Government.

(xiv) Any transfer by way of conversion of bonds or debentures, debenture stock or deposit certificates in any form, of a company into shares or debentures of that company.

(xv) Transfer made on or before 31.12.98 by a person (not being a company) by way of exchange of capital asset being membership of a recognized stock exchange to a company for shares of that company to which such membership is transferred.

(xvi) Transfer of any capital asset or intangible asset upon succession of firm by a company or succession of AOP or BOI by a company in the course of corporatisation of recognized stock exchange in India.

(xvii) Transfer of capital asset or intangible asset upon succession of a sole proprietary concern by a company as a result of which the business is transferred to such company.

Note – **The students are required to answer any 6 of the above points.**

Question 13

Special provision for full value of consideration in certain cases, in the context of capital gains liability.

(6 Marks) (Nov.2004)

Answer

Section 50C provides for deeming the guideline value for stamp duty as the full value of consideration, if the actual consideration is less than such value. This provision applies to transfer of land or building or both.

Where the consideration received or accruing as a result of transfer of capital asset, being land or building or both, is less than the value adopted or assessed by any authority of State Government (Stamp Valuation Authority), for the purpose of payment of stamp duty in respect of such asset, such value adopted or assessed shall be deemed to be the full value of the consideration received or accruing as a result of such transfer.

Further, where the assessee claims before an Assessing Officer that the value so adopted or assessed by the Stamp Valuation Authority exceeds the fair market value of the property as on the date of transfer, the Assessing Officer may refer the valuation of the capital asset to a valuation officer as defined in section 2(r) of the Wealth-tax Act, 1957. Such reference shall be made only if the stamp duty value has not been disputed in any appeal or revision before any authority, Court or High Court. If any such reference is made, the provisions of section 16A of the Wealth-tax Act shall apply with necessary modifications.

If the value ascertained by such valuation officer exceeds the value adopted or assessed by the stamp valuation authority, then the value adopted or assessed by the stamp valuation authority shall be taken as the full value of the consideration for computation of capital gains.

Question 14

Mr. Y submits the following information pertaining to the year ended 31st March, 2005.

(i) On 30.11.2004, when he attained the age of 60, his friends in India gave a flat at Surat as a gift, each contributing a sum of Rs.20,000 in cash. The cost of the flat purchased using the various gifts was Rs.3.40 lacs.

(ii) His close friend abroad sent him a cash gift of Rs.75,000 through his relative for the above occasion.

(iii) Mr. Y sold the above flat on 30.1.2005 for Rs.3.6 lacs. The Registrar's valuation for stamp duty purposes was Rs.3.7 lacs. Neither Mr. Y nor the buyer, questioned the value fixed by the Registrar.

(iv) He had purchased some equity shares in X Pvt. Ltd., on 5.2.2004 for Rs.3.5 lacs. These shares were sold on 15.3. 2005 for Rs.2.8 lacs.

You are requested to calculate the total income of Mr. Y for the assessment year 2005-06.

[Cost Inflation Index for F.Y. 2003-04 – 463 and F.Y. 2004-05 – 480] (6 Marks) (May 2005)

Answer

Taking the above facts as applicable for the previous year relevant to the assessment year 2007-08 the solution is prepared.

Computation of total income of Mr.Y for A.Y. 2007-08

Particulars	*Rs.*	*Rs.*	*Rs.*
Capital Gains			
Short term capitals (on sale of flat)			
(i) Sale consideration	**3,60,000**		
(ii) Stamp duty valuation	**3,70,000**		
Consideration for the purpose of capital gains as per section 50 C (stamp duty value, since it is higher than sale consideration)		**3,70,000**	
Less:Cost of acquisition [Cost to previous owner as per section 49(1)(ii)]		**3,40,000**	
			30,000
Long term capital loss on sale of equity shares of X Pvt Ltd			
Sale consideration		**2,80,000**	
Less:Indexed cost of acquisition (3,50,000 X 519 /497)		**3,65,490**	
Long term capital loss to be carried forward **(See Note 1 below)**		**85,490**	
Income from other sources:			
Gift received from a close friend (un related person) [See Note 2 below]			**75,000**
Total income			**1,05,000**

Note –

1. In the given problem, shares have been held for more than 12 months hence, constitute a long term capital asset. The loss arising from sale of such shares, is

therefore a long-term capital loss. As per section 70(3), long term capital loss can be set-off only against long-term capital gains. Therefore, long-term capital loss cannot be set-off against short-term capital gains. However, such long-term capital loss can be carried forward to the next year for set-off against long-term capital gains arising in that year.

2. Gifts in excess of Rs.50,000 from an unrelated person will be deemed as income and taxed as income from other sources [Section 56(2)(v)].

3. In the above solution it is assumed that all the friends of the assessee have pooled resources and gave gift of flat at Surat. Gift in kind is not covered by section 56(2)(v). It is possible to assume that his friends gave cash gift to Mr.Y and he had acquired the flat at Surat. In which case, the entire gift of Rs.3.40 lakhs received in the previous year relevant to the assessment year 2007-08 would be chargeable to tax.

Question 15

Mr. `X' furnishes the following data for the previous year ending 31.3.2004.

(a) Equity Shares of AB Ltd., 10,000 in number were sold on 31.5.2003, at Rs.350 for each share.

(b) The above shares of 10,000 were acquired by `X' in the following manner :

(i) Received as gift from his father on 1.6.1980 (5,000 shares) the market price on 1.4.81 Rs.50 per share.

(ii) Bonus shares received from AB Ltd. on 21.7.1984 (2,000 shares).

(iii) Purchased on 1.2.1993 at the price of Rs.125 per share (3,000 shares).

(c) Purchased one residential house at Rs.25 lakhs, on 1.9.2004 from the sale proceeds of shares.

(d) `X' is already owning a residential house, even before the purchase of above house.

You are required to compute the taxable capital gain. He has no other source of income chargeable to tax.
(Cost Inflation Index – Financial year 1992-93: 223; Financial year 2003-2004 : 463)

(6 Marks) (Nov.2004)

Answer

Let us assume that the shares were sold on 31.05.2006. All the shares obtained as gift, bonus and purchase are taken as given in the question without change of dates. The purchase of residential house is taken as 1.9.2006.
It is also assumed that the transaction of sale of shares is not exempt under section 10(38).

Computation of taxable capital gain of Mr. `X' for A.Y. 2007-08

Particulars	*Rs.*	*Rs.*
Sale consideration received on sale of 10,000 shares @ Rs.350 each		**35,00,000**
Less: Indexed cost of acquisition		
(a) 5,000 shares received as gift from father on 1.6.1980	**12,97,500**	
Indexed cost 5000 x 50 x 519 / 100		
(b) 2,000 bonus shares received from AB Ltd	**Nil**	
Bonus shares are acquired on 21.7.84 (i..e after the year 1980 when the original shares were purchased). Hence, the cost is Nil.		
(c) 3000 shares purchased on 1.2.1993 @ Rs.125 per share. The indexed cost is 3000 x 125 x 519/223	**8,72,760**	
		21,70,260
Long term capital gain		**13,29,740**
Less : Exemption under section 54 F (See Note 1 below)		
13,29,740 x 25,00,000 / 35,00,000		**9,49,815**
Taxable long term capital gain		**3,79,925**

Note –

(1) Exemption under section 54F can be availed by the assessee subject to fulfillment of the following conditions –

(a) The assessee should not own more than one residential house on the date of transfer of the long-term capital asset ;

(b) The assessee should purchase a residential house within a period of 1 year before or 2 years after the date of transfer or construct a residential house within a period of 3 years from the date of transfer of the long-term capital asset.

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

Question 16

Bala sold his vacant site on 21.09.2003 for Rs.7,00,000. It was acquired by him on 01.10.1994 for Rs.1,50,000.
The State stamp valuation authority fixed the value of the site at the time of transfer @ Rs.13,00,000.
Compute capital gains in the hands of Bala and give your reasons for computation.
Cost inflation index : (1994-95 = 259 and 2003-04 = 463)
(4 Marks) (May 2004)

Answer

Let us assume that the date of sale of vacant site as 21.09.2006. The date of acquisition is however not altered.

Computation of capital gains of Shri Bala for the A.Y.2007-08

	Rs.
Deemed sale consideration as per section 50 B	**13,00,000**
Less : Indexed cost of acquisition (1,50,000 X 519 /259)	**3,00,580**
Taxable long term capital gain	**9,99,420**

Note: **According to section 50C(1), where the consideration received or accruing as a result of the transfer of land or building or both is less than the value adopted or assessed by the State stamp valuation authority for the purpose of payment of stamp duty in respect of such transfer, then the value so adopted or assessed by the State stamp valuation authority shall be deemed to be the full value of the consideration received or accruing as a result of the transfer.**

In this case, since the consideration of Rs.7,00,000 received on transfer of land is less than the value of Rs.13,00,000 fixed by the State stamp valuation authority, the value adopted by the State stamp valuation authority is deemed to be the full value of consideration and capital gains is calculated accordingly.

Question 17

Ms.Vimla sold a residential building at Jodhpur for Rs.15,00,000 on 01-07-02.
The building was acquired for Rs.1,50,000 on 01-06-96.
She paid brokerage @ 2% at the time of sale of the building. She invested Rs.7 lakhs in purchase of a residential building in December

2002 and deposited Rs.2 lakhs in NABARD Capital Gains Bond in March, 2003.

Compute her taxable capital gain.

Cost inflation index

1996-97 - 305

2002-03 - 447

(4 Marks) (Nov.2003)

Answer

Let us assume that the building was sold on 01.07.2006. The date of acquisition remaining unchanged. The purchase of residential building (new) is taken as December 2006 and deposit in NHAI / REC is taken as March 2007.

Computation of taxable capital gain of Ms. Vimla for A.Y.2007-08

Particulars	***Rs.***	***Rs.***
Sale price of residential building	**15,00,000**	
Less : Brokerage @ 2%	**30,000**	
Net consideration		**14,70,000**
Less :Indexed cost of acquisition		
1,50,000 x 519 / 305		**2,55,246**
		12,14,754
Less: Deduction u/s.54 for purchase of new residential house in December 2006		**7,00,000**
Taxable long term capital gain		**4,14,754**

Note – **One of the conditions for claiming deduction u/s 54EC for the investment in REC/NHAI Capital Gains bonds is that the deposit should be made within 6 months from the date of transfer. In this case, the transfer took place on 1.7.06 and the 6 months period within which the deposit should be made for the purpose of section 54EC would expire by 1.1.07. The investment in REC/NHAI Capital Gains bonds was made only in March 2007. Therefore, the assessee is not eligible for section 54EC deduction.**

Students may note that at the time of preparing this solution, deposits could not be accepted by REC/NHAI as the prescribed limit of deposits have already been accepted by them. Hence if the new limit for acceptance and time limit for making deposit is extended beyond 6 months by the Government, the assessee would be eligible

for deduction under section 54 EC if the investment is made within the prescribed, extended time.

Question 18

Mr.Sunder furnishes the following particulars for the previous year ending 31.3.2002 and requests you to compute the taxable capital gain:

(i) He had a residential house, inherited from father in 1990, the fair market value of which as on 1.4.81 is Rs.5 lakhs.

(ii) In the year 1992-93, further construction and improvements costed Rs.6 lakhs.

(iii) On 10.5.2001 the house was sold for Rs.50 lakhs. Expenditure in connection with transfer Rs.50,000.

(iv) On 20.12.2001, he purchased a residential house for Rs.15 lakhs.

Cost inflation index:

1981-1982	*100*
1992-1993	*223*
2001-2002	*426*

(8 Marks) (May 2002)

Answer

On the assumption that the house was sold on 10-05-2006 and a residential house was acquired on 20-12-2006, the computation of capital gain for the assessment year 2007-08 is made.

Computation of taxable capital gains of Mr.Sunder for A.Y.2007-08

Net Sale consideration		
Sale price	**50,00,000**	
Less: **Expenses on sale**	**50,000**	
		49,50,000
Less :**Indexed cost of acquisition**		
(5,00,000 X 519* /172)**	**15,08,720**	
Indexed cost of improvement:		
(6,00,000 X 519 /223)	**13,96,410**	
		29,05,130
Long term capital gain		**20,44,870**
Less: **Exemption U/s.54**		
(Cost of purchase of new residential house)		**15,00,000**
Taxable long term capital gain		**5,44,870**

* **Cost inflation index of financial year 1989-90**

**** Cost inflation index of financial year 2006-2007**

Note: **As per section 49(1)(iii)(a) read with section 55(3), the cost of acquisition of an asset which is inherited shall be the cost for which the previous owner acquired it. Where the cost to the previous owner is not known the fair market value on the date on which the previous owner acquired it shall be taken as the cost. In the given question, in the absence of the above information, it is assumed that the previous owner acquired it before 1.4.1981 and the cost of acquisition is taken to be the FMV on 1.4.1981 i.e. Rs.5 lakhs**

Further, as per the definition of "indexed cost of acquisition" given in the Explanation to section 48, the cost of acquisition is to be indexed with reference to.

- the first year in which the assessee (i.e. Mr.Sunder) held the asset, or

- the financial year 1981-82

whichever is later.

In the question it is given that Mr.Sunder first held the asset in 1990 by way of inheritance. Since the month in which he acquired it is not given, the relevant year could be either 1989-90 or 1990-91, both of which are later than 1981-82. Therefore, the indexed cost of acquisition has to be computed with reference to the CII for 1989-90 or 1990-91 (as the case may be).

We have computed the taxable long term capital gain above by assuming that Mr.Sunder inherited the asset during financial year 1989-90 and thereafter applied cost inflation index of that year.

If it is assumed that Mr.Sunder inherited the asset during the year 1990-91, the cost inflation index for the year 1990-91 should be applied for determining the indexed cost of acquisition and the computation will change accordingly.

Question 19

Arjun furnishes the following particulars and requests your advice as to the liability to capital gains for the assessment year 2001-2002.

(i) Jewellery purchased by him on 10.03.1994 for Rs.1,05,000 was sold by him for a consideration of Rs.2,85,000 on 2.11.2000.

(ii) He incurred expenses:

(a) At the time of purchase Rs.2,000

(b) At the time of sale (for brokerage) Rs.4,000

(iii) He invested Rs.70,000 in bonds with National Highway Authority of India out of sale consideration.

On these facts:

(a) Compute the capital gains chargeable to tax.

(b) Whether Arjun would be entitled to any exemption?

Cost inflation Index Financial Year 1993-94 = 244

Cost inflation Index Financial Year 2000-01 = 406

(6 Marks) (Nov.2001)

Answer

Assuming that the sale of jewellery is made in the previous year 2006-07 and taking cost inflation index being 519, the solution is prepared.

Computation of capital gains chargeable to tax

	(Rs.)
Sale consideration of jewellery	**2,85,000**
Deduct: Expenses on transfer	**4,000**
	2,81,000
Less :Indexed cost of acquisition	
(1,07,000 ? 519 /244)	**2,27,595**
Long term capital gain	**53,405**
Less: Investment under section 54EC of the Act Rs.70,000. Deduction limited to	**53,405**
Capital gains chargeable to tax	**Nil**

Note 1: **It is assumed that Arjun has invested Rs.70,000 in bonds with NHAI within the specified time under section 54EC i.e. within 6 months from the date of transfer.**

Note 2: **Expenditures incurred at the time of purchase is included in the indexed cost of acquisition.**

Question 20

Raghavan owned a residential house at Madurai, the original cost of which was Rs.1,00,000. It was acquired on 1.9.1991. He sold the house on 1.6.1996 for Rs.8,00,000 and purchased another house on 30.5.1998 at Tiruchi for Rs.6,00,000. The second house at Tiruchi was sold by him for Rs.8,00,000 on 30.6.1999. Discuss the impact of these transactions with regard to assessment to capital gains.

Cost inflation index

1991-92	*- 199*
1996-97	*- 305*
1998-99	*- 351*
1999-00	*- 389*

(7 Marks) (May 2000)

Answer

Let us assume that the house at Madurai was acquired on 01-09-1998 and it was sold on 1-6-2003. The house at Tiruchi was acquired on 30-05-2005 and it was sold on 30-06-2006. (Adding 7 years uniformly for all the transactions).

Cost inflation index for the financial year 1998-99 - 351

Cost inflation index for the financial year 2003-04 - 463

The assessee purchased the first house on 1.9.1998 and sold it on 1.6.2003. Since the sale took place after 36 months, the gains arising therefrom will be long-term capital gains. The benefit of indexation will be available and the capital gains will be calculated as follows :

Computation of capital gain on the sale of first house at Madurai

	Rs.
Sale consideration (on 01-06-2003)	**8,00,000**
Less : Indexed cost of acquisition	
1,00,000 ´ 463 / 351	**1,31,910**
Long term capital gain	**6,68,090**
Less: Deduction u/s.54	
Residential building at Tiruchi acquired within 2 years after the transfer i.e. on 30-05-2005.	**6,00,000**
Taxable long term capital gain	**68,090**

Note : **Since the assessee had acquired property at Tiruchi subsequently, it is assumed that he has complied with the conditions of section 54 and hence the entire capital gain reinvested in construction or acquisition of another residential house is deducted under section 54.**

As the assessee has sold the house at Tiruchi on 30-06-2007, within three years after the date of acquisition, clause (i) of section 54(1) has to be applied.

Computation of capital gain on sale of house at Tiruchi

		Rs.
Sale consideration (on 30-06-2007)		**8,00,000**
Less : Cost of acquisition (on 30-05-2005)		
As the amount of capital gain (Rs.6,68,090) deducted earlier is greater than the cost of new residential house (Rs.6,00,000) purchased by the assessee, the cost of the new house sold within three years, shall be		**Nil**
Taxable short term capital gain		**8,00,000**

Question 21

A is a shareholder of X & Co. Ltd. holding 1,000 shares of the face value of Rs.10 each, allotted at the time of the company's incorporation in May, 1990. The company made a right issue in the ratio of 1:1 on 15.7.99 at a premium of Rs.40 per share. Instead of taking up the right, he renounced it in favour of `B' at a price of Rs.10 per share. What is the capital gain chargeable in the hands of `A' ? What will be the cost of the shares in the hands of `B' ?

(7 Marks) (May 2000)

Answer

`A' was offered 1,000 shares of X & Co. Ltd at a cost of Rs.50 per share (face value Rs.10 plus premium of Rs.40). He renounced the rights at a price of Rs.10 per share in favour of `B'.

The cost of acquisition of the right, in terms of section 55(2)(aa)(ii), will be Nil.

Therefore, the entire amount of Rs.10,000 received from B will be charged to capital gains tax. As the period of holding is less than 12 months, in respect of 'right to subscribe for right shares', it will be treated as short-term capital gain.

The cost of acquisition of shares in the hands of 'B' will be as under	Rs.
Amount paid to 'A' for acquiring right to subscribe for right shares	10,000
Amount paid to X & Co Ltd @ Rs.50 per share for 1000 shares	50,000
Cost of acquisition of 1000 shares	60,000

Question 22

In April, 1994, S subscribed to the first issue of equity capital of a public limited company (face value of each share was Rs.100) to the

extent of Rs.25,000. In 1996, the company converted the face value of its shares from Rs.100 to Rs.10 each. Half of the holding of the shares held by S was sold by him in October, 1997 for Rs.50,000. S had to pay a brokerage of 2% on sale.
(Cost inflation index for 1994-95 and 1997-98 may be taken as 259 and 313 respectively)
What is the nature of gains realised and compute the same. (6 Marks) (May 1998)

Answer

It is assumed as below:
Acquisition of shares April, 2003
Sale of part of holdings – October, 2006
It is assumed that the sale of shares is not exempt under section 10(38).
Asset held by the investor for more than 12 months. Hence, character of asset is a long term capital asset and any excess realisation will yield long term capital gains. In calculating such gains, the assessee will be entitled to refix the cost of acquisition by utilizing the cost inflation index.

Cost of purchase	**Rs.25,000**
Face Value	**Rs.100**
Hence no. of shares purchased	**250**

Conversion resulted in the face value being reduced from Rs.100 to Rs.10 per share ; hence the assessee's holdings of shares would have become 2500 shares of Rs.10 each, since there has been no change in actual cost.
Sale of half the holdings means, the investor had sold 1250 shares in October, 2006.

	Rs.
Sale proceeds realised	**50,000**
Less :Brokerage paid at 2%	**1,000**
Net realisation	**49,000**
Cost of acquisition:	
12,500 ? 519 / 463	**14,012**
Capital gains - Long term	**34,988**
Tax rate on long term capital gain (20% plus	

education cess)

Cost inflation index for 2006-07 = 519
Cost inflation index for 2003-04 = 463

The assessee has to compute capital gain without indexation and it would be Rs.36,500 in the above case. Tax thereon would be at 10% plus education cess [Section 112(1)]

Question 23

Arjun was holding 3000 shares in White Light Limited purchased by him on 8th August, 1994 at Rs.60 per share. He gifted these shares to his girl friend Chitrangada on 10th February, 1995. Arjun married Chitrangada on 1st March, 1995. Chitrangada was allotted bonus shares by the company at the rate of one share for every three shares held on 10th September, 1995. Chitrangada sold all the shares including the bonus shares on 31st March, 1996 at Rs.150 per share. State in whose hands capital gains on sale of shares is taxable. Also compute the capital gains.

Cost Inflation Index: 1994-95 = 259
1995-96 = 281

(8 Marks) (May 1996)

Answer

Assuming the shares gifted by Arjun to Chitrangada are listed shares and the transfer is made by Chitrangada through recognized stock exchange and securities transaction tax is paid on such transfer, the entire capital gain is exempt under section 10(38). Hence, the taxability of the gain does not arise.

If the shares are not listed and do not satisfy the conditions of section 10(38), then the computation of capital gain has to be made. The facts are to be changed in such a manner that it relates to the previous year relevant to the assessment year 2007-08.

The following assumptions are made.

(i) 08-08-2005 – 3000 shares were acquired by Arjun @ Rs.60 per share

(ii) 10-02-2006 – 3000 shares were gifted by Arjun to Chitrangada.

(iii) 01-03-2006 – Arjun marries Chitrangada

(iv) 10-09-2006 – company allots 1000 bonus shares – received by Chitrangada.

(v) 31.03.2007 – Chitrangada sold 4000 shares @ Rs.150 per share.

As per section 64(1)(iv) of the Income-tax Act in computing the total income of any individual, there shall be included all such income as arises directly or indirectly to the spouse of such individual from assets transferred directly or indirectly to the spouse by such individual otherwise than for adequate consideration or in connection with an agreement to live apart. For applying this clubbing provision the marital status must exist-both at the time of transfer of asset and at the time of accrual of income.

This view was taken by the Supreme Court in the case of *Philip Johan Plasket Thomas v. CIT 49 ITR 97*. Arjun gifted the shares to Chitrangada before marriage. Hence, section 64(1)(iv) shall not apply and capital gain on sale of shares is taxable in the hands of Chitrangada.

Computation of Capital Gains

Long-term Capital Gains (Original Shares)

3000 original shares are long-term capital assets, as they were held for a period exceeding 12 months before sale. Since shares were acquired by way of gift by Chitrangada, the period of holding of shares by Arjun shall be included in computing the period of holding of shares before sale by Chitrangada as per section 2(42A).

Sale proceeds of 3000 shares	**4,50,000**
Cost of acquisition 1,80,000	
[Cost to Arjun shall be treated as cost to Chitrangada as per Sec.49(1)]	
Indexed cost of acquisition (1,80,000 ? 519 /497)	**1,87,970**
Long term capital gain	2,62,030

Short term capital gain **(For Bonus Shares)**

As bonus shares were held for a period not exceeding 12 months before sale by Chitrangada, they are short term capital assets.

Sale proceeds of 1000 bonus shares	**1,50,000**
Cost of bonus shares	**Nil**
(Cost shall be deemed to be 'Nil' as per section 55(2)(aa)(iiia) introduced from assessment year 1996-97)	
Short term capital gain	**1,50,000**

Total capital gain	4,12,030

Note:

Cost inflation index for financial year 2005-06 – 497
Cost inflation index for financial year 2006-07 – 519

Question 24

Amin is the holder of 1,000 debentures of Amin Ltd. having a face value of Rs.1,000 each. The company has offered an option to the debenture-holders either to redeem the debentures at Rs.1,200 each or to convert the debentures into equity shares of equivalent value. The market value of the shares on the date of exercising the option is Rs.1,200 per share (face value Rs.1,000). What will be the tax consequences of the two options in the hands of the debenture-holder Amin ?

(4 Marks) (May 97)

Answer

The first option is redemption of debentures.

The second option is conversion of debentures into equity shares of the company.

If the first option is exercised, it would result in the levy of capital gains tax. Redemption has not been defined under the Companies Act but in common parlance, it means buy back, recover or convert into cash. Debentures are capital assets within the meaning of section 2(14). The question for consideration is whether redemption results in "transfer" as defined in section 2(47). Courts have held in the context of redemption of shares that it results in a transfer. Even if redemption is not considered as a sale, it will still result in the extinguishments of a right. The right in the debentures comes to an end on redemption. Hence there will be a capital appreciation of Rs.2 lakhs which can be appropriately indexed for cost and the capital gains arrived at.

By the second option, there will be no capital gain as section 47(x) covers conversion of debenture into shares as 'not to be regarded as transfer'.

Question 25

Mr. A. sold shares of a public limited company for Rs.5,00,000 on 1.10.2000, which had been acquired by him in October, 1984 for Rs.50,000. He wants to utilize the said amount of sale consideration for purchase or construction of a new residential house. He already owns one residential house at the time of sale of the shares i.e., on 1.10.2000. He has deposited Rs.4,00,000 under the Capital Gains

Deposit Account scheme with a specified bank on 30.4.2001. Ascertain the capital gain taxable in A's hands for Assessment Year 2001-2002 and advise him as to what further action he has to take to avail of the exemption :

Cost inflation index

1984-1985	***125***	
2000-2001	***406***	***(10 Marks)(May 2001)***

Answer

Assuming the assessee had transferred shares in the previous year relevant to the assessment year 2007-08 it is possible to approach the question in the following manner.

(a) Since Mr.A sold shares of public limited company, it would have been sold through stock exchange in India and securities transaction tax would have been paid on such transaction. In which case, the capital gain is exempt from tax under section 10(38) of the Act. In such case, no further explanation / advise is required to be given to the assessee.

(b) Assuming the assessee had not transferred the shares in a manner that securities transaction tax is paid / payable on such transaction and it is not exempt under section 10(38), the following can be the basis for advise to the assessee.

(i) Computation of capital gains.

Sale consideration	**5,00,000**
Less : Indexed cost of acquisition Rs.50,000 x 519 /125	**2,07,600**
Amount of long term capital gain	**2,92,400**
Less: Exemption u/s.54F	
Amount deposited in Capital Gains Account Scheme	
Rs.4,00,000 x long term capital gain / Rs.2,92,400	
Net sale consideration Rs.5,00,000	**2,33,920**
Taxable long term capital gain	**58,480**

Section 54F of the Income-tax Act, 1961 relates to capital gains arising from transfer of any long term capital asset, not being a residential house (called original asset) if the sale proceeds are utilized for purchase/construction of a residential house (called new asset) within the prescribed period and subject to fulfillment of conditions prescribed in the said section.

The proviso to sub-section (1) of the section provides that the said exemption will be available in a case where the assessee owns only

one residential house, other than the new asset, on the date of transfer of the original asset and does not acquire within one year or constructs within three years any residential house other than the new asset. The assessee in the present case will, therefore, be entitled to get deduction under section 54F of the Act.

However, Mr. A should note that he should utilize the amount deposited in Capital Gains Accounts Scheme for purchase/construction of residential house before expiry of 3 years from the date of transfer of shares, failing which, tax on capital gains attributable to the unutilized amount will be charged to tax in the year in which the three year period expires.

CHAPTER 9

INCOME FROM OTHER SOURCES

Question 1

Choose the correct answer with reference to the provisions of the Income-tax Act, 1961.

(i) Family pension received by a widow of a member of the armed forces where the death of the member has occurred in the course of the operational duties in the circumstances and subject to prescribed conditions, is

(a) Exempt upto Rs.3,00,000

(b) Exempt upto Rs.3,50,000

(c) Totally exempt under section 10(19)

(d) Totally chargeable to tax

(1 Mark) (May 2005)

(ii) Gift of Rs.5,00,000 received on 10th July, 2004 through account payee cheque from a non-relative regularly assessed to income-tax, is

(a) A capital receipt not chargeable to tax

(b) Chargeable to tax as income from other sources

(c) Chargeable to tax as business income

(d) Exempt upto Rs.25,000 and balance chargeable to tax as income from other sources. *(1 Mark) (May 2005)*

Answer

(i) (c) i.e. totally exempt under section 10(19)

(ii) (a) i.e. capital receipt not chargeable to tax as the receipt was obtained before insertion of section 56(2)(v) – which is effective from 01-09-2004. If the amount is received in the previous year relevant to the assessment year 2007-08, then it is taxable under the head 'other sources' without any deduction.

Question 2

Which of the deductions are not allowable under the head "Income from other sources"?

(6 Marks) (Nov.97)

Answer

The following are not allowable while computing the income under the head 'other sources':

(i) any personal expenses of the assessee,

(ii) any interest chargeable to tax under the Act which is payable outside India on which tax has not been paid or deducted at source.

(iii) Any amount taxable in India as 'salary' if paid or payable outside India and tax has not been paid thereon or deducted at source.

(iv) Any sum paid on account of wealth tax (section 40(a)(iia)).

(v) The provision relating to disallowance of payments to relatives and associate concerns, payment exceeding Rs.20,000 made otherwise than by account payee crossed cheques or drafts covered by section 40A(3).

(vi) Where the assessee is a foreign company and the provisions of section 44 D are applicable for business they shall apply in the same manner, for computing income under the head "other sources".

(vii) In the case of an assessee having income chargeable under the head "Income from other sources" no deduction in respect of any expenditure or allowance in connection with such income shall be allowed in computing the income by way of any winnings from lotteries, crossword puzzles, races including horse races, card games and other games of any sort or from gambling or betting of any form or nature whatsoever.

Question 3

When would the dividend income be taxed in the hands of a shareholder?

(6 Marks) (Nov.2002)

Answer

The provisions relating to the year of taxability of dividend are contained in section 8 of the Income-tax Act, 1961.

(a) Any dividend declared by a company or distributed or paid by it within the meaning of section 2(22) of the Act shall be deemed to be the income of the previous year in which it is so declared, distributed or paid, as the case may be.

(b) Any interim dividend shall be deemed to be the income of the previous year in which the amount of such dividend is unconditionally made available by the company to the member who is entitled to it.

Students may note that any dividend which is liable for dividend distribution tax covered by section 115-O (being a dividend declared by a domestic company) is exempt under section 10(34) and hence would not be chargeable to tax.

Question 4

Deductions allowable u/s 57 of the Income Tax Act, 1961, in respect of Income from other sources. *(6 Marks) (May 2003)*

Answer

(i) In the case of dividends (other than those which are covered by section 115-O) or interest on securities, any reasonable sum paid by way of commission or remuneration to a banker or any other person for realizing dividend or interest is deductible.

(ii) If the income is from letting of plant, machinery or furniture, the following shall be deducted :

(a) repairs (including current repairs)

(b) insurance

(d) depreciation

(iii) In respect of family pension, a sum equal to 33 1/3% of the pension or 15,000, whichever is less, shall be allowed as deduction.

(iv) Any other expenditure, not being a capital expenditure, incurred wholly, necessarily and exclusively in earning the income is deductible.

Question 5

From the following particulars, you are required to work out the tax payable by Mrs. Pinto, aged 70 years ; in respect of Assessment Year, 2000-2001 :

		Rs.
(i)	***Family pension Gross***	***75,000***
(ii)	***Income from House Property (Net)***	***24,000***
(iii)	***Income from other sources:***	
	(a) Interest on Bank Deposits	***15,000***
	(b) Income from horse racing	***20,000***
(iv)	***Capital gains on transfer of Land – Long term***	***15,000***
(v)	***Agricultural Income***	***25,000***
		1,74,000

(9 Marks) (Nov.2000)

Answer

Total income of Mrs.Pinto for the Assessment year 2007-08

			Rs.
I.	**Income from house property (Net)**		**24,000**
II.	***Income from other sources:***		
	Family Pension gross	**75,000**	
	***Less*: Deduction under section 57(iia)**	**15,000**	
			60,000
	Interest from Bank deposits		**15,000**
	Income from horse racing		**20,000**
III	**Long term capital gain**		**15,000**
V	**Total Income**		**1,34,000**
V	**Agricultural income**		**25,000**

Computation of tax payable

Income tax on total income of Rs.1,34,000 and agricultural income of Rs.25,000	**Nil**

Question 6

Bhurani, an Indian citizen, who was not resident in India, returned to India on 10.4.1996 for permanent residence. He had made investments in shares in Indian Companies and had also made deposits in public limited companies in India, out of moneys remitted in convertible foreign exchange. The details of his Indian income for financial year 1996-97 are as under :

Dividend income	***60,000***	***(TDS Rs.12,000)***
Interest on deposits in public companies	***70,000***	***(TDS Rs.7,000)***
Property income (net)	***50,000***	
Total Income	***1,80,000***	

The assessee seeks your advice on his tax liability, for assessment year 1997-98. What will be your advice? *(6 Marks) (May 1997)*

Answer

It is assumed that Bhurani returned to India on 10-04-2006, the details of income relate to the previous year 2006-2007, he is advised as under:

Bhurani was a non-resident prior to assessment year 2007-08. He became resident for Assessment Year 2007-08. Nevertheless, under Sec.115-H, the benefit of Chapter XII-A will continue to be applied to him in respect of investment income derived from foreign exchange assets of the nature referred to in sub clauses (ii), (iii), (iv) and (v) of Sec.115-C. In other words, in respect of interest on deposits on public companies, the rate of tax will be 20 %.

It is assumed that the dividend income is not covered by section 115-O hence is not exempt under section 10(34).

Status : Resident – Assessment Year 2007-08

Option 1. By applying the provisions of section 115-H read with section 115-E.

Total income	**1,80,000**
Tax on interest income (20% of Rs.70,000)	**14,000**
Tax on other income – regular rate of tax.	**1,000**
Total tax liability	**15,000**

Option 2 : Tax on total income of Rs.1,80,000 at regular rates of tax

Total income	**1,80,000**	
Tax on total income at regular rate		**11,000**

The assessee is advised to furnish to the Assessing Officer a declaration in writing alongwith the return under Sec.139 to the effect that the provisions of Chapter XII- will not apply to him in relation to his investment income accruing out of the foreign exchange asset.

Question 7

R retired from Government service in March, 1996 and got a sum of Rs.20 lakhs on account of retirement benefits. Out of the aforesaid sum R purchased on 26th April, 1996, two heavy goods vehicles for Rs.8 lakhs, four medium goods vehicles for Rs.4 lakhs and two light commercial vehicles for Rs.2 lakhs for the purpose of carrying on business of plying, hiring and leasing goods carriages. However R could actually start business of plying the aforesaid vehicles on 4th July, 1996, only though R had got the delivery of the aforesaid vehicles on the date of purchase itself. R had been keeping a full record of all receipts sand expenditure *incurred in a Diary in respect of the aforesaid business. However he did not maintain the regular books of accounts as also the vouchers in respect of the aforesaid business. As per R's Diary his gross receipts during the financial year ending 31st March, 1997 are Rs.1,77,600 and the sum total of the entire business expenditure (other than Depreciation) is Rs.52,100.*

R had inherited a house from his father in the year 1991 with the condition that R shall pay a sum of Rs.1000 per month to his ailing grandfather throughout his life, irrespective of the fact whether the said house was fetching any rent or not. During financial year 1996-97 R was able to let out this house only for eight months at a monthly rent of Rs.5,000. R has also furnished the following information in relation to this house.

	Rs.
Municipal taxes paid by the tenant during financial year 1996-97 based on municipal valuation of Rs.53,000	***5,300***
Insurance premium to insure the house, paid by the tenant during financial year 1996-97	***1,300***
Interest paid on loan taken for renovation of the house during financial year, 1996-97	***12,000***
Actual repair & renovation expenses incurred during financial year, 1996-97	***8,000***
Actual collection expenses while recovering the rent during financial year 1996-97	***400***
Water taxes levied and paid to Municipal corporation working under the State Government during financial year 1996-97	***400***

After inheriting the aforesaid house in the year 1991, R decided to sell his personal house which was being let out earlier, R finally sold his personal house on 4th April 1992, During assessment year, 1992-93 R was able to get a deduction of Rs.22,000 on account of unrealised rent in the assessment order under the head "Income from house property' in respect of his personal house. On 4th April, 1996, R was able to recover to unrealised rent of Rs.22,000, but R had to pay to sum of Rs.11,000 on account of Litigation expenses with the old tenant (including Advocate's fee) during financial year, 1996-97.

During financial year 1996-97, R received Rs.60,000 on account of pension from Government. R contributed the entire sum of Rs.60,000 in his PPF account during financial year 1996-97. R's PPF account was also credited with Rs.44,000 on account of interest during financial year 1996-97.

During financial year 1996-97, R also suffered long term capital loss on account of sale of shares on various dates, amounting to Rs.44,000.

R requires you to compute his total income for assessment year 1997-98. R also requires you to give reasons in respect of each and every item given above and further state the reliefs to which R is entitled to. *(25 Marks) (Nov 1997)*

Answer

Taking the above facts as occurring in the financial year 2006-2007, the total income of R is computed for the assessment year 2007-08.

Computation of total income of R for Assessment year 2007-08

Income from salaries : Pension			**60,000**
Income from house property: ALV			
Let out for 8 months and assumed as vacant for 4 months. Actual rent received		**40,000**	
***Less:* Municipal taxes paid by the tenant (not deductible). Municipal tax paid by owner deductible**		**400**	
		39,600	
***Less:* Deductions**			
Insurance premium is not deductible	**Nil**		
Annual charge – not deductible	**Nil**		
Interest paid to loan taken for renovation of house (assumed that the interest due and paid are same)	**12,000**		
30% of annual value U/s.24	**11,880**		
		23,880	
		15,720	
Notes : 1. The entire amount of recovery out of unrealised rent, having been already allowed as deduction is now chargeable to tax 2. R will not be allowed any deduction on account of litigation expenses 3. The entire amount received is taxable 4. The entire amount is chargeable to tax under the head "Income from house property' even though R had already sold his personal house in April, 1992		**22,000**	
			37,720
Income from business:			

Notes:		
1. It is a fit case where special provision for computation of income from business of plying, leasing or hiring trucks, on estimate basis as laid down in section 44 AE is to be applied since R is not the owner of more than 10 trucks.		
2. Accordingly, the business income will be estimated at the specified rates for every month or part of the month during which truck is owned by R (even if not used for business)		
3. The income from business is computed as under (12 months)		
In respect of two heavy goods vehicle @ Rs.3500 p.m	**84,000**	
In respect of four medium goods vehicles @ 3150 pm	**1,51,200**	
In respect of two light commercial vehicles @ 3150 pm	**75,600**	
		3,10,800

4. However, the aforesaid estimation scheme is optional. Assessee R can also claim and produce evidence to prove that the profits from the aforesaid business are lower than the estimated profits as computed above. Thereupon the AO shall proceed to make an assessment of the total income from business of plying trucks on the basis of regular assessment

5. In the case of R, who has not kept any vouchers in support of the Truck receipts & expenditure there is only one alternative left i.e. to opt for estimated business income in accordance with the provisions of section 44 AE (as per note 3)

6. The estimated income as computed vide note 3 above is comprehensive enough and accordingly all deductions permissible under section 30 to 38 including depreciation will be deemed as fully allowed while computing the income.

7. Accordingly, the W.D.V. of the depreciable assets under the I.T. Act will be calculated, wherever required, as if depreciation as applicable has been actually allowed.

Income from other sources:		
Interest income credited in PPF a/c	**44,000**	
***Less* : fully exempt u/s.10**	**44,000**	
		Nil
Loss on sale of long term capital assets Rs.44,000		
It is not eligible for set off against long term		

capital gain also as the long term capital gain from sale of shares is exempt U/s.10(38) and accordingly any loss form sale of shares will not be eligible for set off against any income.		
Gross total income		**4,08,520**
***Less:* Deduction U/s.80 C in respect of PPF deposit**		**60,000**
Total Income		**3,48,520**

Notes :

The assessee had not maintained books of account in respect of the business of plying, hiring and leasing goods carriages. If he had maintained books of account then his income from that business would have been Rs.1,25,500 (before depreciation) and his overall tax liability would have been very less.

CHAPTER 10

INCOME OF OTHER PERSONS INCLUDED IN ASSESSEE'S TOTAL INCOME

Question 1

Explain the circumstances under which income of other persons is included in the assessee's total income under sections 60 to 64 of the Income-tax Act, 1961. (15 Marks) (Nov.99)

Answer

Transfer of income without transfer of assets (section 60): If any person transfers the income from any asset without transferring the asset itself, such income is to be included in the total income of the transferor. "Transfer" includes any settlement, trust, covenant, agreement or arrangement. It is immaterial whether the transfer is revocable or irrevocable and whether it was made before the commencement of this Act or after its commencement.

Revocable transfer of assets (section 61): Where a person transfers any asset to any other person with a right to revoke the transfer, all income accruing to the transferee from the asset shall be included in the total income of the transferor.

Transfer irrevocable for a specified period (section 62): This is an exception to the general rule that in the case of revocable transfer of an asset, the income from such an asset is to be included in the total income of the transferor. If there is an irrevocable transfer of asset for a specified period, the income from such assets shall not be included in the total income of the transferor provided the following conditions are fulfilled.

(a) the transfer was made before 1st April, 1961 and was not revocable for a period exceeding six years ; or

(b) the transfer is made through a trust and is not revocable during the life time of the beneficiary ; or

(c) the transfer is not revocable during the lifetime of the transferee.

However, the transferor should not derive any direct or indirect benefit from such income in either case.

Income to spouse from a concern in which such individual has substantial interest [Section 64(1)(ii)] : All such income as arises directly or indirectly, to the spouse of an individual by way of salary, commission, fees or any other remuneration, whether in cash or in kind, from a concern in which such individual has substantial interest, shall be included in the total income of the individual. However, where the spouse possesses technical or professional qualifications and the income is solely attributable to the application of his/her technical or professional knowledge and experience, the income shall not be subjected to clubbing.

Income to spouse from the assets transferred [Section 64(1)(iv)]: Where any individual transfers, directly or indirectly, any assets (other than a house property) to the spouse otherwise than for adequate consideration or in connection with an agreement to live apart, any income that arises from such assets directly or indirectly shall be included in the income of the transferor. However, any income from the accretion of the transferred asset, is not to be clubbed with the income of the transferor.

Income to son's wife [Section 64(1)(vi)]: Where any individual transfers, directly or indirectly, any asset to his/her son's wife without adequate consideration, on or after 1.6.1973, the income from such asset shall be included in the total income of the transferor.

Transfer of assets for the benefit of the spouse [Section 64(1)(vii)]: Where a person transfers any asset directly or indirectly to a person or association of persons, without adequate consideration, the income from such asset is includible in the income of the transferor to the extent it is used by the transferee for the immediate or deferred benefit of the transferor's spouse.

Transfer of assets for the benefit of son's wife [Section 64(1)(viii)]: Where a person transfers any asset directly or indirectly to a person or association of persons without adequate consideration, the income from such asset is includible in the income of the transferor to the extent it is used by the transferee for the immediate or deferred benefit of the transferor's son's wife (i.e.daughter in law).

Clubbing of minor's income [Section 64(1A)]: All income which arises or accrues to a minor child (other than a minor child suffering from any disability specified in section 80U) shall be clubbed with

the income of parent whoever has higher total income before such inclusion.

However, any income derived by the minor from manual work or from any activity involving skill, talent or specialised knowledge or experience will not be subject to clubbing.

Income of the minor shall be included in the income of the parent whose total income excluding the income includible under this sub-section is greater, where the marriage of the minor's parent subsists, otherwise the income of the minor will be includible in the income of that parent who maintains the minor child in the relevant previous year.

Once the income of the minor is included in the total income of any one parent, clubbing of income of the minor with the same parent will continue in subsequent years also, unless the Assessing Officer is satisfied, after giving that parent an opportunity of being heard that it is necessary to club minors income in the total income of the other parent.

Where the income of an individual includes any income of minor child, then in respect of each minor child such individual shall be entitled to an exemption under section 10(32) of Rs.1500 or the amount includible under section 64(1A) of that minor child - whichever is less.

Income from the converted property [section 64(2]: Where an individual, being a member of Hindu Undivided Family, transfers his self-acquired property after 31st December, 1969 to the family for the common benefit of the family, or throws it into the common stock of the family, or transfers it directly or indirectly to the family otherwise than for adequate consideration, such property is known as converted property.

The income derived from the converted property or any part thereof, shall be included in the income of the transferor.

Question 2

What are the tax consequences in the following situations?

A is the Managing Director of a company. The company provides his mother with rent free accommodation at a cost of Rs.5,000 per month

(3 Marks) (Nov.96)

Answer

Under section 2(24)(iv) 'income' includes the value of any benefit or perquisite, whether convertible into money or not, obtained from a company either by a director or by a person who has a substantial

interest in the company, or by a relative of the director or such person, and any sum paid by any such company in respect of any obligation which, but for each payment, would have been payable by the director or other person aforesaid.

However, under general principles, the provision of rent free accommodation at a cost of Rs.5,000 per month to the mother of the Managing Director will constitute income in her hands and the same will be assessed as income from 'other sources'.

The following views of Karnataka High Court in *CIT v. S.Kannan (1994) 74 Taxman 353 (Kar)* support the above view:

Provision of section 2(24)(iv) only applies to cases where the value of the benefit has actually been obtained by the assessee from the company and not in respect of the value of the benefit derived by the assessee's relatives from the company in which he is a director.

Any benefit flowing from the company to the relatives of the director can be deemed as income in the hands of the recipient only and it cannot be automatically treated as benefit accruing to the director himself. There is no such further deeming fiction in section 2(24)(iv).

In the hands of the company, the provisions of section 40A(2) may be attracted to the extent to which the expenditure incurred is considered as excessive or unreasonable.

Question 3

Write short note on Clubbing of income of minor children in the hands of parent.

(5 Marks) (May 2003)

Answer

Income earned by a minor child would be clubbed in the hands of the parent. If both parents are having income, then income of minor child would be clubbed in the hands of that parent whose income is higher before clubbing the income of minor child.

Under the following situations the income of the minor child would not be clubbed in the hands of parent :-

(a) Income earned by minor child through manual work done by him.

(b) Income from activity involving application of his skill, talent or specialised knowledge and experience.

If the relationship of husband and wife does not subsist between the parents, the income of the minor child would be clubbed in the hands of the parent who maintains the child during the previous year. The parent is entitled to claim an exemption upto Rs.1,500 per

minor child if the income of the minor child is included in his total income.

Question 4

How is "dividend stripping" enforced by section 94(7) of the Income-tax Act, 1961?

(4 Marks) (May 2005)

Answer

According to section 94(7),where –

(a) any person buys or acquires any securities or units within a period of three months prior to the record date ; and

(b) such person sells or transfers such securities within a period of three months after such record date or transfers such units within a period of 9 months after such record date ; and

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

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

Question 5

Atmaram and Co. borrowed Rs.20,000 on hundi by an account payee cheque on 1.1.1996. The amount was repaid in cash on 1.10.1996 along with interest of Rs.3,000. What is the effect of the transaction in the assessment of Atmaram and Co.? (4 Marks) (May 97)

Answer

Under section 69D, where an amount is borrowed on hundi or repaid, otherwise than by an account payee cheque drawn on a bank, the amount so borrowed or repaid shall be deemed to be the income of the previous year in which the amount is borrowed or repaid as the case may be. The provisions of sec 69D apply to both sides of the transaction. In other words, both the borrowing and repayment should be by A/c payee cheques. The provisions of section 69D will not apply for the borrowal, but when the repayment is made in cash the provisions will apply. Further the amount repaid with interest is

covered by Explanation to sec 69D. The total amount of Rs.23,000 will be added as income of the assessee.

Question 6

Compute the total income of Mr. & Mrs. A from the following information.

		Rs.
(a)	*Salary income (computed) of Mrs.A*	*2,30,000*
(b)	*Income from profession of Mr.A*	*3,90,000*
(c)	*Income of minor son B from company deposit*	*15,000*
(d)	*Income of minor daughter C from special talent*	*32,000*
(e)	*Interest from bank received by C on deposit made out of her special talent*	*3,000*
(f)	*Gift received by C on 30.09.2004 from friend of Mrs.A*	*2,500*

Brief working is sufficient. Detailed computation under various heads of income is NOT required.

(7 Marks) (Nov.2005)

Answer

As per the provisions of section 64(1A) of the Income-tax Act, 1961, all the income of a minor child has to be clubbed in the hands of that parent whose total income (excluding the income of the minor) is greater. The income of Mr. A is Rs.3,90,000 and income of Mrs. A is Rs.2,30,000. Since the income of Mr. A is greater than that of Mrs. A, the income of the minor children have to be clubbed in the hands of Mr. A. It is assumed that this is the first year when clubbing provisions are attracted.

Income derived by a minor child from any activity involving application of his/her skill, talent, specialised knowledge and experience is not to be clubbed. Hence, the income of minor child C from exercise of special talent will not be clubbed.

However, interest from bank deposit has to be clubbed even when deposit is made out of income arising from application of special talent.

The total income of Mrs. A is Rs.2,30,000. The total income of Mr. A giving effect to the provisions of section 64(1A) is as follows :-

Computation of total income of Mr. A for the A.Y. 2007-08

Particulars	***Rs.***	***Rs.***

Income from profession		**3,90,000**
Income of minor son B from company deposit	**15,000**	
Less: Exemption u/s.10(32)	**1,500**	
		13,500
Income of minor daughter C		
From special talent – not be clubbed		
Interest from bank	**3,000**	
Gift of Rs.2,500 received from a non-relative on not taxable u/s.56(2)(v) being less than the limit specified.	**Nil**	
	3,000	
Less : Exemption u/s.10(32)	**1,500**	
		1,500
Gross Total Income		**4,05,000**

Question 7

A Proprietary Business was started by Smt. Rani in the year 2001. As on 1.4.2002 her capital in business was Rs.3,00,000.

Her husband gifted Rs.2,00,000 on 10.4.2002, which amount Smt. Rani invested in her business on the same date. Smt. Rani earned profits from her proprietory business for the Financial year 2002-2003, Rs.1,50,000 and Financial year 2003-2004 Rs.3,90,000. Compute the income, to be clubbed in the hands of Rani's husband for the Assessment year 2004-2005 with reasons.

(6 Marks) (Nov.2004)

Answer

Let us assume the facts as below:

(a) Business commenced by Rani in the year 2004.

(b) Capital on 01.04.2005 Rs.3,00,000

(c) Profit for the previous year 2005-06 Rs.1,50,000

(d) Profit for the previous year 2006-07 Rs.3,90,000

Decision to be made for clubbing the income for the assessment year 2007-08.

Section 64(1) of the Income-tax Act, 1961 provides for the clubbing of income in the hands of the individual, if the income earned is from the assets transferred directly or indirectly to the spouse of the individual, otherwise than for adequate consideration. In this case Smt. Rani received a gift of Rs.2,00,000 from her husband which she invested in her business. The income to be clubbed in the hands of Smt. Rani's husband for A.Y.2007-08 is computed as under :

Particulars	Smt.Rani's Capital Contribution	Capital Contribution Out of gift from husband	Total
	Rs.	Rs.	Rs.
Capital as at 1.4.2005	3,00,000	--	3,00,000
Investment on 10.04.2005 out of gift received from her husband		2,00,000	2,00,000
	3,00,000	2,00,000	5,00,000
Profit for F.Y. 2005-06 to be apportioned on the basis of capital employed on the first day of the previous year i.e. on 1.4.2005	1,50,000		1,50,000
Capital employed as at 1.4.2006	4,50,000	2,00,000	6,50,000
Profit for F.Y.2006-07 to be apportioned on the basis of capital employed as at 1.4.06 (i.e. 45 : 20)	2,70,000	1,20,000	3,90,000

Therefore, the income to be clubbed in the hands of Smt.Rani's husband for A.Y.2007-08 is Rs.1,20,000.

Question 8

Gupta, Karta of a joint family, invested Rs.1,00,000, towards share capital of 1,000 shares of Rs.100 each face value from family funds. He was appointed as Managing Director, because of the investment and was paid remuneration of Rs.1.50 lakhs per annum. What principles are to be applied to decide whether the remuneration is assessable as individual income or income of the family?

(4 Marks)

(Nov.2001)

Answer

From the facts given in the question, it is clear that Mr.Gupta, the karta of the joint family was appointed as Managing Director because of the investment made by the joint family. The principle for determining whether the remuneration received by the karta of a joint

family is whether the remuneration in substance is one of the modes of return made to the family because of the investment of the family funds in the business or it is a compensation for the service rendered by the individual coparcener. If the income is essentially earned as result of the funds invested, the fact that the karta or a coparcener has rendered some service would not change the character of the receipt. On the other hand, if it is essentially a remuneration for specific services rendered by the karta or coparcener, the fact that the services were availed of because he was a member of the family incidentally or because he had obtained the qualification shares out of family funds would not make the receipt the income of the family.

In the given case, it is clearly mentioned that the appointment of the karta as the Managing director was done because of the investment from family funds. Therefore, the income accruing therefrom are to be assessed in the hands of the HUF.

Question 9

Balu is the karta of a HUF, whose members derive income as given below.

	Rs.
(i) Income from Balu's own business	*50,000*
(ii) Mrs. Balu a dermatologist draws salary	*80,000*
(iii) Minor son Deepak (earning interest on fixed deposits with ABC Ltd which were gifted to him by his grandfather)	*15,000*
(iv) Minor daughter Priya gave a dance performance and received remuneration	*1,00,000*
(v) Deepak got winnings from lottery (Gross)	*2,00,000*

Explain how the above will be taxed

(10 Marks)
(Nov.99)

Answer

Taxable income of Balu, Mrs Balu and Ms.Priya

Taxable income of Balu	
Income from own business	50,000
Taxable income of Mrs.Balu	
Salary income	80,000

Since Mrs. Balu's taxable income is more than Balu's income, clubbing provisions with respect to minor's income will apply to her [as per Explanation to section 64(1A)]. Therefore, her total taxable income will be computed as below:

Own - taxable income		80,000
Interest income of minor son Deepak	15,000	
Winnings of minor son from lottery	2,00,000	
	2,15,000	
Less :Exclusion permissible U/s.10(32)	1,500	
		2,13,500
Taxable income of Mrs.Balu		2,93,500

Taxable income of Priya	
Income from profession (Dance performance)	1,00,000

Note **: Income for Priya arises out of an activity involving application of her talent and is therefore not to be included in the taxable income of her parents [Proviso to section 64(1A)]**

Question 10

Mr. Singh is a trader. Particulars of his income and those of the members of his family are given below. These incomes relate to the previous year ended 31st March, 1998 :

		Rs.
(i)	*Income from business – Mr.Singh's*	*90,000*
(ii)	*Salary derived from an educational institution by Mrs.Singh. She is the principal of the Institution*	*50,000*
(iii)	*Interest on company deposits derived by Master Deep Singh (minor son). These deposits were made in the name of Deep Singh by his father's father about 6 years ago*	*12,000*
(iv)	*Receipts from sale of paintings and drawings made by Minor Dipali Singh (minor daughter of Mr. and Mrs. Singh and noted child artiste)*	*60,000*
	Income by way of lottery earnings by Master Dipinder Singh (minor son of Mr.Singh)	*6,000*

Discuss whether the above will form part of the assessable income of any individual and also compute the assessable income of Mr. Singh. (9 Marks) (Nov.98)

Answer

(i) Mr. Singh's income from business is assessable in his hands.

(ii) Mrs. Singh's income is assessable in her hands. The clubbing provisions do not apply to salary income unless it is received from a firm in which the other spouse has substantial interest.

(iii) The income of minor sons Deep and Dipender will be clubbed with income of the parent whose total income is greater. Mr. Singh's income (Rs.90,000) is greater than the total income of Mrs. Singh (Rs.50,000). Hence the income of minor children will be clubbed in the hands of Mr.Singh.

(iv) The income of minor daughter Dipali from painting is chargeable in her hands. The clubbing provisions do not apply to minor child's income which is earned by her from manual work or activity involving application of her specialised knowledge, talent and experience.

Mr.Singh's total income

	Rs.	Rs.
Income from business		90,000
Add :Income of minor sons		
Minor son - Deep Singh	12,000	
Less: Exemption under section 10(32)		
(Equal to income or Rs.1500 - whichever is less)	1,500	
		10,500
Minor son – Dipinder	6,000	
Less: Exemption U/s.10(32)		
(Equal to income or Rs.1500 whichever is less)	1,500	
		4,500
Total Income		1,05,000

CHAPTER 11

SET OFF AND CARRY FORWARD OF LOSSES

Question 1

Fill in the blanks having regard to the provisions of the Income-tax Act, 1961 (All sub-divisions relate to the assessment year 2005-06) :

(i) The first item in the order of priority of set off as between current year capital expenditure on scientific research, current year depreciation and brought forward business loss is

(1 Mark) (Nov.2005)

Answer

Current year depreciation / current year capital expenditure on scientific research.

Question 2

Set off and carry forward of loss arising under the head "Income from other sources".

(6 Marks) (Nov.2005)

Answer

Section 74A deals with set off and carry forward of loss under the head "other sources". In the case of an assessee, being the owner of horses maintained by him for running in horse races, the amount of loss incurred by the assessee in such activity cannot be set-off against income from any other source other than the activity of owning and maintaining race horses in that year. However, such loss can be carried forward and set off against income from the same activity in any subsequent assessment year. No such loss can, however, be carried forward beyond 4 assesssment years from the end of the assessment year in which the loss was first computed. For this purpose, the "amount of loss incurred by the assessee in the activity of owning and maintaining race horses" means –

(i) in a case where the assessee has no income by way of stake money, the amount of revenue expenditure laid out or expended by him wholly and exclusively for the purposes of maintaining race horses ;

(ii) in a case where the assessee has income by way of stake money, the amount by which such income falls short of the amount of revenue expenditure laid out or expended by the assessee wholly and exclusively for the purposes of maintaining race horses.

Question 3

"Loss can be carried forward only by the person who has incurred the loss" – Discuss.

(4 Marks) (Nov.2005)

Answer

As per section 78(2), where any person carrying on business or profession has been succeeded in such capacity by another person otherwise than by inheritance, then the successor cannot have the loss of the predecessor carried forward and set off against his income. However, there are certain exceptions, which are briefed hereunder :

(a) Carry forward and set off of accumulated business loss of the amalgamating company against the income of the amalgamated company, if the amalgamation is within the meaning of section 72A.

(b) Carry forward and set off of accumulated business loss of the demerged company in the hands of the resulting company, in a scheme of demerger, subject to fulfillment of certain conditions which the Central Government may for this purpose notify, to ensure that the demerger is for genuine business purposes ;

(c) In the case of reorganisation of business, where a firm is succeeded by a company as per the provisions of section 47(xiii), or a sole proprietary concern is succeeded by a company as per the provisions of section 47(xiv), the accumulated loss of the firm or sole proprietor shall be deemed to be the loss of the successor company for the previous year in which the business reorganisation was effected and the carry forward provisions shall be applicable to the successor company ;

(d) Where a business carried on by one person is acquired by another person through inheritance, then the successor can carry-forward and set-off the loss of the predecessor against his income.

Question 4

State the conditions to be fulfilled by an Amalgamated Company for carry forward of the Accumulated losses and Unabsorbed depreciation of the Amalgamating Company.

(10 Marks) (Nov.2004)

Answer

Section 72A specifies the conditions to be satisfied by the amalgamated company for carry forward of the accumulated losses and unabsorbed depreciation of the amalgamating company. They are –

(1) The amalgamated company should hold continuously for a minimum period of 5 years from the date of amalgamation at least three-fourths of the book value of fixed assets of the amalgamating company acquired in a scheme of amalgamation.

(2) The business of the amalgamating company should be continued by the amalgamated company for a minimum period of 5 years from the date of amalgamation.

(3) The amalgamated company should fulfill the following other conditions prescribed in Rule 9C - to ensure the revival of the business of the amalgamating company or to ensure that the amalgamation is for genuine business purpose –

   (i) The amalgamated company owing an industrial undertaking of the amalgamating company by way of amalgamation, should achieve the level of production of at least 50% of the installed capacity (capacity as on the date of amalgamation) of the said undertaking before the end of four years from the date of amalgamation and continue to maintain the said minimum level of production till the end of 5 years from the date of amalgamation. However, the Central Government has the power to relax this condition on an application made by the amalgamated company.

   (ii) The amalgamated company should furnish to the Assessing officer a certificate in prescribed form (Form No.62) duly certified by a Chartered Accountant in this regard. This certificate should be furnished along with the return of income for the assessment year relevant to the previous year during which the prescribed level of production is achieved and for subsequent years falling within five years from the date of amalgamation.

In case where any of the above conditions are not complied with, the set-off of loss or allowance of depreciation made in any previous year in the hands of amalgamated company shall be deemed to be the income of the amalgamated company chargeable to tax for the year in which such conditions are not complied with.

Question 5

What are the consequences of demerger as to the accumulated loss and unabsorbed depreciation? *(6 Marks) (May 2004)*

Answer

As per the provisions of section 72A(4) of the Income-tax Act, 1961, where a demerger is effected, then the accumulated loss and

unabsorbed depreciation of the demerged company, shall be dealt with as given below :

(a) The accumulated loss or unabsorbed depreciation directly relatable to the undertaking transferred to the resulting company will be carried forward and set off by the resulting company.

(b) Where such unabsorbed depreciation and accumulated loss is not directly relatable to the undertaking transferred, then it can be apportioned in the same proportion in which the assets of the undertaking have been retained by the demerged company and transferred to the resulting company.

(c) The demerged company and the resulting company can carry forward and set off their respective share of business loss or unabsorbed depreciation.

The Central Government may notify conditions as it considers necessary to ensure that the demerger is for genuine business purposes.

Question 6

Write short notes on: Carry forward and set off of losses by closely held companies.

(6 Marks) (May 2004)

Answer

According to section 79, in the case of a company in which public are not substantially interested, the unabsorbed business loss relating to any assessment year can be carried forward and set-off against the income in a subsequent assessment year subject to the following condition.

As on the last day of the previous year in which the loss is sought to be set off, the shares of the company carrying not less than 51% of the voting power are continued to be held by the persons who held 51% of the total voting power on the last day of the previous year in which the loss was incurred. For example, if 60% of shareholders of the previous year 2003-04 continue to hold shares without interruption up to the previous year 2006-07 i.e. on 31.03.2007, then the loss of assessment year 2004-05 (previous year 2003-04) is eligible for set off against the income of the assessment year 2007-08.

This restriction is not applicable if the change in the said voting power takes place due to the death of a shareholder or gift by a shareholder to his relative. Further, the restriction placed under section 79 is not applicable where there is a change in the

shareholding of an Indian company which is a subsidiary of a foreign company as a result of amalgamation or demerger of a foreign company, provided 51% of the shareholders of the amalgamating or demerged foreign company continue to be shareholders of the amalgamated or the resulting foreign company.

Question 7

(i) Discuss about set off and carry forward of losses under the head Capital Gains.

(5 Marks) (Nov.2003)

(ii) Write short note on set off and carry forward of losses under the head "Capital Gains".

(6 Marks) (Nov.2002)

Answer

Where in respect of any assessment year, the net result of the computation under the head "Capital Gains" is a loss, whether short term/long term, then such loss shall be carried forward to the following assessment year to be set off in the following manner

(i) Where the loss is a short term capital loss, it shall be set off against any capital gains, short term or long term arising in that year.

(ii) Where the loss is a long term capital loss, it shall be set off only against long term capital gain arising in that year.

(iii) Whether the loss cannot be wholly so set off, the amount of loss not so set off shall be carried forward to the following assessment year and so on.

Both long-term capital loss and short-term capital loss can be carried forward under this section for a maximum up to 8 assessment years immediately succeeding the assessment year for which the loss was first computed.

Question 8

State the provision of Income-tax Act relating to carry forward and set off of losses from the activity of owning and maintaining race-horses. *(3 Marks) (Nov.98)*

Answer

As per section 74A(3) the amount of loss incurred by an assessee in any assessment year from the activity of owning and maintaining race horses shall be set off only against any income from the said activity in the same assessment year and unadjusted loss, if any, shall be carried forward for a maximum period of 4 years for set off against any income from the activity of owning and maintaining race horses carried on by the assessee during the relevant assessment

years. The activity of owning and maintaining race horses must be carried on by him in the previous year relevant for that assessment year in which such set off is claimed.

Question 9

Briefly discuss the provisions relating to losses from speculation business.

(7 Marks) (May 1996)

Answer

The expression "speculative transaction" is defined in section 43(5). Since speculation is deemed to be a business distinct and separate from any other business carried on by the assessee, the losses incurred in speculation can be neither set-off in the same year nor in the subsequent years against other income. Therefore, the losses sustained by an assessee in a speculation business can be carried forward to subsequent years and set off only against income from any speculation business carried on by the assessee.

Like any other business loss, the loss in speculation business can be carried forward. However, it can be carried forward only for a maximum period of four assessment years immediately succeeding the assessment year for which the loss was first computed. The loss in speculation may also include the loss on account of bad debts, irrecoverable profits and interest on borrowings.

With a view to discouraging companies (other than banking and investment companies) from indulging in speculation business or dealing in shares otherwise than in the ordinary course of their business, the Explanation to section 73 provides that in cases where any part of the business of a company other than an investment company or a banking or financing company consists of the purchase and sale of the shares of other companies, such a company shall, for the purpose of set-off and carry forward of the losses incurred in such business, be deemed to be carrying on speculation business to the extent to which the business consists of the purchase and sale of such shares. Thus companies engaged in the business of banking or the granting of loans and advances as their principal business would be exempted from the operation of this section because of the Explanation. Accordingly, both investment companies and banking companies would not be treated as carrying on speculation business in cases where they purchase and sell shares of other companies.

The effect of trading, non-banking or non-investment companies carrying on speculation business in regard to their purchase and sale of shares of other companies is that the loss incurred by them in those transactions must be set-off only against the income, if any, arising from similar transactions either in the same year or in the subsequent four years. This is because of the fact that under the Income-tax law speculation business must be deemed to be a business distinct and separate from other items of business carried on by the assessee and consequently the income or profit from this business must be accounted for separately and loss in speculation business would be allowed to be set off only against income from speculation. For this purpose, an investment company means a company whose gross total income consists mainly of income which is chargeable under the heads "income from the house property", "capital gains" and "income from the other sources".

Question 10

Mr. A furnishes you the following information for the year ended 31.03.2004.

(i)	***Income from plying of vehicles (computed as per books)***	***2,10,400***
	(He owned 5 heavy goods vehicles throughout the year)	
(ii)	***Income from retail trade of garments***	
	(Computed as per books) (Sales turnover Rs.21,70,000)	***75,000***
(iii)	***He has brought forward depreciation relating to A.Y. 2003-04***	***1,00,000***
(iv)	***He deposited Rs.1,00,000 into his PPF account on 6.1.04***	

Compute taxable income of Mr.A and his tax liability for the assessment year 2004-05 with reasons for your computation (6 Marks) (May 2004)

Answer

Let us assume that the facts relate to assessment year 2007-08 and compute the taxable income of the assessee.

Computation of total income of Mr. A for the A.Y. 2007-08.

Particulars	***Rs.***

Income from retail trade (See Note 1 below)	**75,000**
Income from plying of vehicles (See Note 2 below)	**2,10,400**
	2,85,400
***Less* : Set off of brought forward depreciation relating to A.Y. 2003-04**	**1,00,000**
Gross total income	**1,85,400**
***Less*: Deduction U/s.80C - Contribution to PPF**	**1,00,000**
Taxable income	**85,400**

Note –

1. **Income from retail trade**

   Presumptive business income under section 44AF is Rs.1,08,500 i.e. 5% of turnover of Rs.21,70,000. However, the income computed as per books is Rs.75,000 which is to be further reduced by the amount of unabsorbed depreciation. Since the income computed as per books is lower than the income deemed under section 44AF, the assessee can adopt the income as per books. However, he should maintain books of account as per section 44AA and get his accounts audited and furnish an audit report as required under section 44AB of the Act.

   The total unabsorbed depreciation is Rs.1,00,000. Out of this, Rs.75,000 can be set-off against income from retail trade. The balance of Rs.25,000 remains to be set-off from income from plying of vehicle.

2. **Income from plying of vehicles**

   Income calculated under section 44AE(1) would be Rs.3500 x 12 x 5 which is equal to Rs.2,10,000. However, the income from plying of vehicles as per books is Rs.2,10,400 less Rs.25,000, being the balance unabsorbed depreciation remaining to be set-off under section 32(2). Therefore, the income from plying of vehicles as per books is Rs.1,85,400, which is lower than the presumptive income of Rs.2,10,000 calculated as per section 44AE(1). Hence, the assessee can adopt the income as per books i.e. Rs.1,85,400, provided he maintains books of account as per section 44AA and get his accounts audited and furnishes an audit report as required under section 44AB.

It is to be further noted that in both the above cases, had presumptive income provisions come into operation, all deductions under sections 30 to 38, including depreciation would have been deemed to have been given full effect to and no further deduction under those sections would be allowable.

If the assessee opted for income to be assessed on presumptive basis, his total income would be as under:

Particulars	*Rs.*
Income from retail trade Rs.21,70,000 @ 5%	**1,08,500**
Income from plying of vehicles Rs.3,500 x 12 x 5	**2,10,000**
	3,18,500
***Less* : Set off of brought forward depreciation – not possible and it is deemed that it has been allowed and set off.**	**Nil**
Gross total income	**3,18,500**
***Less*: Deduction U/s.80C - Contribution to PPF**	**1,00,000**
Taxable income	**2,18,500**
Tax thereon	**18,700**
***Add* : Education cess @ 2%**	**374**
Total tax liability	**19,074**

Note:

If the assessee had not maintained books of account for the business of plying of vehicles or for retail trade, then he has to offer income only on presumptive basis given above.

It is assumed that the assessee has made deposit in more than one PPF account and the entire contribution is eligible for deduction under section 80C.

Question 11

Mr. Murali provides the following information for the year ending 31.03.2003.

(i)	***Sales (retail trade in garments)***	
	(no books of accounts maintained)	***Rs.32,00,000***
(ii)	***Rent from house property at Chennai***	***Rs.10,000 per month***
(iii)	***Vacant site lease rent***	***Rs.12,000***
(iv)	***Murali purchased 20,000 shares X Co Ltd who declared 1 :1 bonus on 1.01.2000***	
	Murali sold 1000 bonus shares in September,2002 for Rs.1,20,000	
(v)	***Received Rs.50,000 on 12.2.03, being amount due from Mr. X relating to electronic goods supplied by Murali's father,***	

which was written off as bad debt by his father in A.Y.2001-02 and allowed as deduction. Murali's father died in August, 2001

(vi)	***Brought forward business loss relating to discontinued automobile business of Murali relating to A.Y.2001-02***	***Rs.2,00,000***
(vii)	***Brought forward depreciation relating to discontinued automobile business of Murali***	***Rs.1,50,000***
(viii)	***Murali contributed Rs.15,000 to Prime Minister's National Relief Fund and Rs.10,000 to Heritage Charitable Trust enjoying exemption u/s.80 G***	

Compute taxable income of Mr.Murali for the previous year ended 31.03.2003. (A.Y.2003-04)

(15 Marks) (Nov.2003)

Answer

Let us assume that the facts relate to previous year relevant to assessment year 2007-08 and accordingly prepare the answer.

Computation of taxable income of Mr. Murali for the A.Y.2007-08

	Rs.	***Rs.***
Income from House property		
Annual value	**1,20,000**	
Less **:Deduction U/s.24 @ 30%**	**36,000**	
		84,000
Business income		
Retail trade in garments (books not maintained)		
Income computed u/s.44 AF @ 5% of the sales	**1,60,000**	
Amount received being a bad debt recovery (relating to the business of his father) is not chargeable to tax. Since section 41(4) does not contain any provision regarding taxability of bad debts recovered by a successor in business or legal heir, such amount cannot be taxed in the hands of the successor in business / legal heir	**Nil**	

***Less*:**		
Brought forward business loss relating to discontinued automobile business eligible for set off against income from retail trade business. However, the set off is limited to income from business only. The loss of Rs.2,00,000 will be set off to the extent of Rs.1,60,000 and the balance of Rs.40,000 will be carried forward to subsequent years for set off	**(1,60,000)**	
		Nil
Capital Gains		
Sale of bonus shares	**1,20,000**	
***Less*: Cost of acquisition u/s.55(2)(iiia)**		
(In case of bonus shares, the cost of acquisition is nil)	**Nil**	
Long term capital gain		**1,20,000**
Income from other sources : Vacant site lease rent		**12,000**
		2,16,000
***Less*: Unabsorbed depreciation relating to discontinued business can be carried forward and set off against any other income of the assessee. Hence the unabsorbed depreciation of Rs.1,50,000 will be eligible for set off u/s.32(2)**		**1,50,000**
Gross total income		**66,000**
***Less*: Chapter VI-A deduction**		
Contribution to Prime Minister's National Relief Fund 100%	**15,000**	
Heritage Charitable Trust		
Amount donated Rs.10,000. Qualifying amount in this case is restricted to 10% of Gross total income after providing all chapter VI-A deductions except section		

80G. In this case, there is no other deduction, therefore the amount is restricted to Rs.6,600, being 10% of Rs.66,000		
Eligible deduction = 50% of 6,600 = Rs.3,300	**3,300**	
		18,300
Taxable income		47,700

Question 12

From the following particulars of Mr.Naresh for the previous year ending 31.3.2002, compute the income under each head, and the taxable income with reasons and also explain the provisions of carry forward of such loss, that could not be absorbed:

		Rs.
I.	***Income from business (proprietary concerns):***	
	(a) Net adjusted profit from Textile Trade	***20,000***
	(b) Net adjusted Loss from Automotive Trade	***(-) 30,000***
	Loss : In shares trade (shares were never taken delivery)	***40,000***
II	***Negative income from house property***	***(-) 25,000***
III	***Capital gains :***	
	(a) Short term loss	***(-) 20,000***
	(b) Long term gain	***30,000***

(8 Marks) (May 2002)

Answer

		Rs.	***Rs.***
I.	**Income from property**		
	(Negative income) (Note 4)		**(25,000)**
II.	**Income from Business:**		
	Net profit form textile trade	**20,000**	
	Net loss from Automobiles (Note 1)	**(30,000)**	
			(10,000)
	Loss in shares traded		
	Speculative loss (note 2)	**(40,000)**	
III	**Income from capital gains:**		

Long term capital gain	**30,000**	
Short term capital gain	**(20,000)**	
		10,000
Taxable income		**NIL**

Alternatively, the loss from house property to the tune of Rs.10,000 can be set off against the capital gains of Rs.10,000. In that case, the amounts to be carried forward to the subsequent years would be as follows:

Loss from house property	**Rs.15,000**
Business loss	**Rs.10,000**

Notes :

(1) Section 70 of the Income-tax Act provides for set off of losses from one source against income from another source under the same head. Therefore, business loss from automotive business can be set off against business income from textile business.

(2) As per section 73, the loss from shares traded without delivery is a speculation loss and hence can only be adjusted against speculative profit. It should therefore be carried forward for being set off against speculative profits of future years.

(3) As per the provisions of section 71, where the net result of computation made for any assessment year, in respect of any head of income other than "capital gains" is a loss, the same can be set off against income from any other head. Hence in the given problem the net loss from business or the loss from house property can be set off against the income from capital gains.

(4) As per the provisions of section 71B, where the net result of computation under the head "Income from house property" is a loss and such loss cannot be set off against income under any other head for that assessment year then the assessee shall be entitled to carry forward such loss to be following assessment years. However, it can only be set off against the income under the head "House property" in the subsequent years.

(5) Loss from short term capital gain can be set off against long term capital gain as per section 74(1) and hence it is set off.

Question 13

Mr. Yeshwant submits the following information for the financial year ending 31st March, 1999. He desires that you should (a) compute the gross total income and (b) ascertain the amount of losses that can be carried forward:

I	***He has two houses***	***Rs.***
	(a) House No.1 – After all statutory deductions net	***36,000***

annual value

	(b)	***House No.II – current year loss***	***10,000***
	(c)	***Brought forward loss of assessment year 1994-95 of second house representing unadjusted interest on borrowed capital***	***30,000***
II	***He has three proprietary businesses:***		
	(a)	***<u>Textile business</u>***	
		(i) Discontinued from 31st October,1998- current year loss	***25,000***
		(ii) Brought forward business loss of the year 1994-95	***80,000***
	(b)	***<u>Chemical business</u>***	
		(i) Discontinued from 1st March, 1998- hence no profit/loss	***Nil***
		(ii) Bad debts allowed in earlier years recovered during this year	***30,000***
		(iii) Carried forward business loss for the assessment year 1997-98	***20,000***
	(c)	***<u>Leather Business:</u>***	
		(i) Profit for the current year	***70,000***
III	***(i)***	***Short term capital gains***	***20,000***
	(ii)	***Long term capital loss***	***15,000***

(14 Marks) (May 99)

Answer

The following assumptions are made for computing the income for the assessment year 2007-08.

(a) In house property the brought forward loss is taken as that of the assessment year 2004-05.

(b) In Textile business the discontinuance is from 31.10.2006 and brought forward business loss relates to the assessment year 2004-05.

(c) In chemical business discontinuance from 1st March 2005. The carried forward business loss relates to the assessment year 2003-04

Computation of Gross Total income

I.	**Income from property:**		
	House No. 1 [See Note 1]	**36,000**	
	House No. 2	**(10,000)**	
		26,000	
	Less **:Brought forward loss under the head house property Rs.30,000 but limited to**	**26,000**	
	Income from house property		**Nil**
II	**Profits and Gains of Business:**		
	(i) Textile business:		
	Current year loss (discontinued w.e.f. 31.10.06)	**(25,000)**	
	(ii) Chemical business:		
	Bad debts recovered taxable U/s.41(4) 30,000		
	C/Fwd business loss (20,000)	**10,000**	
	(iii) Leather business:		
	Current year profit	**70,000**	
	Business profit for the year	**55,000**	
	Brought forward loss of textile business of A.Y. 2004-05 Rs.80,000 but limited to [See Note 2]	**(55,000)**	
	Taxable business profits		**Nil**
III	**Capital Gains:**		
	Short term capital gains		**20,000**
	Long term capital loss can be set off only against long term capital gain and hence carried forward	**(15,000)**	
	Gross Total income		**20,000**

Notes :

1. In the above solution, it is assumed that `net annual value' of Rs.36,000 refers to the income from House No.1 after all deductions.

2. The carried forward business loss of Rs.80,000 from the textile business for A.Y.2004-05 will be set-off to the extent of available business income Rs.55,000. The balance loss of Rs.25,000 will be carried forward for set off in the future assessment years.

Question 14

From the following figures, you are required to compute the total income of 'X' for assessment year 1996-97:

Head of Income		***Income / Loss Rs.***
Income from Property	***(Loss)***	***10,000***
Capital Gains :		
Short term		***1,05,000***
Long term	***(Loss)***	***75,000***
Other sources		***10,000***

The assessee has unabsorbed depreciation of Rs.25,000 brought forward from 1990-91, when the business was closed and all assets disposed of. He has also paid interest on moneys borrowed for construction of property, relating to previous years relevant to assessment years 1993-94 and 1994-95 which have not been set off in the earlier years, of Rs.5,000 each.

(6 Marks) (Nov.96)

Answer

The first step is to make inter-source adjustment under section 70. There is a short term capital gain of Rs.1,05,000 and long-term capital loss of Rs.75,000. The long term capital loss cannot be set off against short term capital gain as per section 74(1)(b). The long term capital loss will have to be carried forward for set off against long term capital gains in the future assessment years.

The next step is to set off the loss of the current year under one head against the income of the current year under other heads.

Income from property	**(10,000)**
Capital gain - short term	**1,05,000**
Other sources	**10,000**
	1,05,000
***Less*: Unabsorbed depreciation of discontinued**	**25,000**

business	
Total Income	**80,000**

Note 1: **Brought forward loss from house property once it is carried forward to the following assessment year it can be set off only against income from house property assessable for that assessment year. The loss pertains to assessment years 1993-94 and 1994-95 which cannot be set off after the expiry of 8 assessment years following the assessment year in which the loss was first computed. Transitional provision contained in section 71 A is applicable only for the assessment year 1995-96 and 1996-97. Section 71 B is applicable in this case.**

Note 2: **Unabsorbed depreciation of discontinued business is eligible for set off against any other income except salary income.**

Question 15

Compute the tax liability of Mr. Madhavan for the Assessment year 2003-04 from the following particulars :

			Rs.
(i)	*Net house property income as computed under the head "Income from house property"*		*2,70,000*
(ii)	*Income from business before adjusting the following*		*90,000*
	(a)	*Carried forward business loss*	*70,000*
	(b)	*Current depreciation*	*30,000*
	(c)	*Carried forward unabsorbed depreciation*	*1,40,000*
(iii)	*Short term capital gain – jewellery*		*1,60,000*
(iv)	*Long term capital loss – shares*		*40,000*
(v)	*Long term capital gains – Debentures*		*2,00,000*
(vi)	*Dividend on shares held as stock in trade*		*10,000*
(vii)	*Divided from a company carrying on agricultural operation*		*12,000*
(viii)	*Income from growing and manufacturing coffee (cured and roasted)*		*1,00,000*

During the previous year 2002-03, the assessee has donated Rs.35,000 to an approved local authority for the promotion of family planning and purchased NSC VIII issue for Rs.1,00,000

(15 Marks) (May 2003)

Answer

Let us assume that the facts relate to previous year relevant to the assessment year 2007-08 and accordingly prepare the answer

Computation of taxable income of Mr. Madhavan for the A.Y 2007-08

		Rs.	Rs.
I.	Net income from house property		**2,70,000**
II.	Income from business		
	Income from business	**90,000**	
	Income from coffee (cured and roasted) @ 40%	**40,000**	
		1,30,000	
	***Less* :Current year depreciation – [Section 32(1)]**	**30,000**	
			1,00,000
III	Capital gains		
	Long term capital gain – debentures	**2,00,000**	
	***Less* :Long term capital loss – shares – not eligible for set off**	**Nil**	
	Short term capital gain – Jewellery	**1,60,000**	
			3,60,000
IV	Income from other sources		
	Dividends on shares (including shares in company carrying on agricultural operations)– exempt u/s.10(34)		**Nil**
			7,30,000
	***Less* : Brought forward business loss**	**70,000**	
	Brought forward depreciation	**1,40,000**	
			2,10,000
	Gross total income		**5,20,000**
	***Less* :Chapter VI-A deductions**		
	Deduction U/s.80C : NSC VIII issue purchase		**1,00,000**
			4,20,000
	(a) Section 80G – Donation to a local authority for family planning. Amount donated Rs.35,000 donation is to be restricted to 10% of gross total income as adjusted below		

Gross total income 4,20,000		
Less :Long term capital gain 2,00,000		
2,20,000		
Deduction limited to 10% gross total income Rs.22,000 @ 100%		22,000
Total income		3,98,000

Computation of tax liability after applying the aggregation of agricultural income with non-agricultural income

Agricultural income + non agricultural income = Total income = 60,000 + 3,98,000		4,58,000
Tax on LTCG of Rs.2,00,000 @ 20%	40,000	
Tax on the remainder at slab rate	27,400	
		67,400
Less : Tax on income of basic limit Rs.1,00,000 plus Rs.60,000 towards agricultural income. Tax on Rs.1,60,000		7,000
Tax liability		60,400
Add : Education cess @ 2%		1,208
Total tax liability		61,608

CHAPTER 12

DEDUCTIONS FROM GROSS TOTAL INCOME

Question 1

Fill in the blanks having regard to the provisions of the Income-tax Act, 1961 (All sub-divisions relate to the assessment year 2005-06):
Deduction under Section 80GGC in respect of contribution to approved political parties given by a local authority partly funded by the Government is……… (1 Mark) (Nov.2005)

Answer

Nil / Not allowed

Question 2

State whether True or False, with reasons, having regard to the provisions of the Income-tax Act, 1961 (Answers without reasoning will not be given any mark ; all sub-divisions relate to the assessment year 2005-06):
Where an individual repays a sum of Rs.30,000 towards principal and Rs.14,000 as interest in respect of loan taken from a bank for pursuing eligible higher studies, the deduction allowable under Section 80E is Rs.40,000, and not Rs.30,000 (principal component only).

(2 Marks) (Nov.2005)

Answer

False**. Deduction under section 80E is in respect of interest paid on education loan. Hence, the deduction will be limited to Rs.14,000.**

Question 3

Explain whether any deduction is available from the gross total income of a company in respect of any contribution given to a political party. (4 Marks) (May 2005)

Answer

Any sum contributed by an Indian company in the previous year to any political party shall be allowed as deduction under section 80GGB while computing its total income. For the purposes of this section, the word "contribute" has the meaning assigned to it under section 293A of the Companies Act, 1956. Accordingly,

(i) any donation/subscription/payment caused to be given by a company on its behalf or on its account to a person who is carrying on any activity which is likely to effect public support for a political party is deemed to be a contribution for political purpose.

(ii) any amount of expenditure incurred, directly or indirectly, by a company on advertisement in any publication (being a publication in the nature of a souvenir, brochure, tract, pamphlet or the like) by or on behalf of a political party or for its advantage shall also be deemed–

   (a) where such publication is by or on behalf of a political party, to be a contribution of such amount to such political party, and

   (b) where such publication is not by or on behalf of but for the advantage of a political party, to be a contribution for a political purpose.

Students may note that expenditure incurred by an assessee on advertisement in any souvenir, brochure, tract, pamphlet or the like published by a political party is not eligible for deduction as per section 37(2B). However, such contribution is now deductible under section 80GGB in the case of companies and under section 80GGC in the case of other assessees (except local authority and every artificial juridical person which wholly or partly funded by the Government)

Question 4

State the special provisions in respect of certain undertakings or enterprises in certain special category states as laid down under Section 80-IC of the Act. (10 Marks) (Nov.2004)

Answer

The special provisions in respect of certain undertakings or enterprises in certain special category states have been introduced with effect from A.Y. 2004-05 under section 80-IC of the Income-tax Act, 1961.

(i) This section allows tax holiday to the new undertakings or existing undertakings on their substantial expansion in the states of Himachal Pradesh, Uttaranchal, Sikkim and North Eastern States.

(ii) For this purpose, substantial expansion means, increase in the investment in plant and machinery by at least 50% of the book value of the plant and machinery (before taking depreciation in any year), as on the first day of the previous year in which the substantial expansion is undertaken.

(iii) The tax holiday in the states of Himachal Pradesh and Uttaranchal will be 100% for the first five assessment years and 25% (30% in case of a company) for the next five assessment years.

(iv) Tax holiday in the states of Sikkim and North-Eastern States will be 100% for ten assessment years commencing from the initial assessment year.

(v) For the purpose of exemption, two classifications have been made and the Thirteenth and Fourteenth Schedules have been inserted in the Income-tax Act. The said Schedules specify the list of articles and the States for the purpose of availing deduction under this section.

(vi) The first classification is applicable to undertakings or enterprises which manufacture or produce any article or thing, not being any article or thing specified in the 13th schedule (namely, tobacco, aerated beverages, pollution causing paper and paper products etc.) in any export processing zone or integrated infrastructure development center or industrial growth center or industrial estate or industrial park or software technology park or industrial areas or theme park in these States as notified by the Board.

(vii) The second classification is applicable to those undertakings or enterprises which manufacture or produce any article or thing specified in the 14th schedule only in these States without any specification of the specified zone, area etc.

(viii) The period during which the undertakings in different States should begin or should have began to manufacture or produce are given hereunder.

Himachal Pradesh and Uttaranchal	**From 7.1.03 and ending before 1.4.2012**
Sikkim	**From 23.12.02 and ending before 1.4.2012**
North-Eastern States	**From 24.12.97 and ending before 1.4.2007**

(ix) No benefit to these undertakings will be available under any of the sections in Chapter VI-A or Section 10A or Section 10B in relation to the profits and gains of such undertakings.

(x) While computing the total period of 10 years, the period for which the benefit under section 80-IB or under section 10C has already been availed, if any, shall also be included.

The other conditions are that it should not be formed by splitting or reconstruction of business already in existence, or by transfer to a new business of plant and machinery previously used for any purpose.

Question 5

Write short note on deduction in respect of royalty income on patents. (6 Marks) (Nov.2004)

Answer

Section 80RRB provides for deduction in respect of royalty income on patents.

1. Under this section, deduction is allowed to a resident individual in respect of income by way of royalty of a patent registered on or after 1.4.2003 under the patent Act, 1970. The quantum of deduction is the amount received by way of royalty or Rs.3 lakhs, whichever is less.
2. This deduction shall be available only to a resident individual who is registered as the true and first inventor of the invention, whose name is entered on the patent register as the patentee in accordance with the Patents Act, 1970. It includes the co-owner of the patent.
3. This deduction shall be restricted to the royalty income including consideration for transfer of rights in the patent or for providing information for working or use thereof in India.
4. The exemption shall not be available on any consideration for sale of product manufactured with the use of the patented process or patented article for commercial use.
5. In respect of any such income which is earned from sources outside India, the deduction shall be restricted to such sum as is brought to India in convertible foreign exchange within a period of 6 months or extended period as is allowed by the Reserve Bank of India.
6. For claiming this deduction, the assessee shall be required to furnish a certificate in the prescribed form signed by the prescribed authority, alongwith the return of income.
7. No deduction in respect of the same income will be allowed under any other provision of the Income-tax Act.
8. Where the patent is subsequently revoked or the name of the assessee is excluded from the patents register as patentee in respect of that patent, the deduction allowed during the period shall be deemed to have been wrongly allowed and the assessment shall be rectified under the provisions of section 155(17).

Question 6

State the provisions relating to the deduction in respect of repayment of loan taken for higher education. (5 Marks) (May 2004)

Answer

The Finance Act, 2005 has changed the method of deduction in respect of repayment of loan taken for higher education.

(i) Only interest on loan taken by individual for higher education to the extent it is actually paid is deductible.

(ii) The loan must have been taken from financial institution or any approved charitable institution for the purpose of pursuing higher education.

(iii) The term "higher education" would mean graduate or post graduate course in engineering, medicine, management or post graduate course in applied sciences or pure sciences including mathematics and statistics.

(iv) The deduction is for the first year in which the interest is paid and 7 subsequent assessment years in which any interest is actually paid.

(v) There is no monetary ceiling for the interest payment made by the assessee towards the education loan interest.

Question 7

How do you define infrastructure capital fund, set up for infrastructure facility?. Specify any three of such facilities.

(6 Marks) (Nov.2001)

Answer

Section 10(23G) providing exemption for infrastructure capital find has been omitted by the Finance Act, 2006 hence no exemption is available from the assessment year 2007-08 onwards.

Section 2(26B) however defines "infrastructure capital fund" as a fund operating under a trust deed registered under the provisions of the Registration Act, 1908 (16 of 1908) established to raise monies by the trustees for investment by way of acquiring shares or providing long term finance to any enterprise or undertaking wholly engaged in the business given below :

1. Undertakings engaged in developing or operating and maintaining or developing, operating and maintaining any infrastructure facility, which is owned by a company registered in India or by an authority or a board or a corporation or any other body established or constituted under any Central or State Act. This includes infrastructural facility mentioned in explanation to section 80-IA(4) and section 80-IAB(3).

2. An undertaking developing and building a housing project referred to in sub-section (10) of section 80-IB or a project for constructing a hotel of not less than three-star

category as classified by the Central Government or a project for constructing a hospital with at least one hundred beds for patients.

Section 80-IA(4) covers infrastructural facility as under :

(i) a road, highway, bridge, airport, port, rail system, a water supply project, irrigation project, water treatment system, solid waste management system, sanitation and sewerage system or any other public facility of similar nature as notified by the Board in the Official gazette.

(ii) An industrial undertaking set up for generation or generation and distribution of power.

(iii) A project for providing telecommunication services.

(iv) An undertaking for developing, developing and operating or maintaining and operating an industrial park.

Question 8

A, an individual, has written a book in English which has been approved by the State *Government of Maharashtra and prescribed as a text-book in colleges in that State. The publisher of the book paid A Rs.2,50,000 as lumpsum consideration for transfer of author's interests in the copyrights of the book to the publisher. The amount was paid to A in October, 1995.*

For the assessment year 1996-97, A claims a deduction under Section 80QQA. Will he succeed ?

Is A entitled to claim a deduction under Section 80Q of the Act ? Discuss.

(5 Marks) (May 99)

Answer

Section 80Q and section 80QQA have no application for the assessment year 2007-08.

For the assessment year 2007-08, provisions of section 80QQB could be considered subject to satisfaction of the conditions prescribed therein. In this case, Mr.A has written a book meant for colleges. If it is a text book for schools, it is not eligible for deduction under section 80QQB.

Since Mr.A has written text book for college he is eligible for a deduction of a lump sum amount received for assignment of his copyright of the book to the publisher. The quantum of deduction is (a) the amount received or (b) Rs.3 lakhs, whichever is less.

Hence, Mr.A can claim the entire amount of Rs.2,50,000 as deduction under section 80QQB and in result the income earned will not be subjected to tax.

Question 9

(i) What are the concessions available under the Income-tax Act to profits derived from infrastructure business? Discuss.
(9 Marks) (Nov.98)

(ii) State the provisions of section 80-IA of the Income-tax Act in relation to an assessee engaged in developing, maintaining and operating any infrastructure facility in India.
(11 Marks) (May 1996)

Answer

Where the gross total income of the assessee includes profits and gains derived from business as referred to in section 80-IA(4), the assessee is eligible for a deduction of an amount equal to 100% of the profits and gains for any 10 consecutive assessment years out of 15 years beginning from the year in which the enterprise develops and begins to operate any infrastructural facility.
Section 80-IA(4A) applies to any enterprise carrying on the business of (i) developing or (ii) operating and maintaining or (iii) developing, operating and maintaining any infrastructure facility which fulfills the following conditions:

(i) The enterprise is owned by an Indian company or by a consortium of such companies or by an authority or a board or a corporation or any other body established or constituted under any Central or State Act.

(ii) The enterprise has entered into an agreement with the Central Government or a State Government or a local authority or any other statutory body for (i) developing or (ii) operating and maintaining or (iii) developing, operating and maintaining a new infrastructure facility.

(iii) The enterprise started or starts operating and maintaining the infrastructure facility on or after 1.4.1995.

Where an infrastructural facility is transferred on or after 01-04-1999 by an enterprise which developed infrastructure facility to another enterprise for the purpose of operating and maintaining the infrastructure facility on its behalf in accordance with the agreement with the Central Government, State Government, Local authority or Statutory body, the transferee enterprise is eligible for deduction as would have been available to the transferor enterprise, if the transfer had not taken place.

As per Explanation to section 80-IA(4)(i) 'infrastructure facility' means –

(a) a road including toll road, a bridge or a rail system ;

(b) a highway project including housing or other activities being an integral part of the highway project ;

(c) a water supply project, water treatment system, irrigation project, sanitation and sewerage system or solid waste management system ;

(d) a port, airport, inland water way or inland port.

Question 10

A tax payer has a handicapped dependant and enquires from you whether he is eligible for tax relief. He intends to make provision by way of a deposit for the benefit of the handicapped dependant. Explain the scope of the relief and the conditions to which it is subject.

(9 Marks) (Nov.96)

Answer

Section 80DD says that an assessee being an individual or HUF who is a resident in India is eligible for a sum of Rs.50,000 as deduction from his gross total income, if the following conditions are satisfied.

(a) He incurred any expenditure for the medical treatment (including nursing) training and rehabilitation of a dependent, being a person with disability ; or

(b) He has paid or deposited any amount under the scheme framed in this behalf by the Life Insurance Corporation or any other insurer or the Administrator or the specified company approved by the Board in this behalf for the maintenance of a dependent, being a person with disability.

Where the dependent is a person with severe disability the quantum of deduction is Rs.75,000.

Dependent means –

(i) In the case of an individual, the spouse, children, parents, brothers and sisters of the individual or any of them ;

(ii) In the case of HUF, the member of the Hindu Undivided Family.

Disability "shall have the meaning assigned to it in section 2(i) of the Persons with Disabilities (Equal Opportunities, Protection of Rights and Full Participation) Act, 1995 and includes "autism", "cerebral palsy" and "multiple disability" referred to in clauses (a), (c) and (h) of section 2 of the National Trust for Welfare of Persons with Autism, Cerebral Palsy, Mental Retardation and Multiple Disabilities Act, 1999.

If the dependent predeceases the individual or HUF, the amount paid or deposited with the insurer shall be deemed to be the income of the assessee of the previous year in which such amount is received by the assessee and shall accordingly be chargeable to tax as the income of that previous year.

The assessee claiming deduction under this section must obtain a certificate in Form No.10-IA and furnish the same along with the return of income submitted under section 139 of the Act for the purpose of claiming deduction.

Question 11

Explain the deduction in respect of donations for Scientific Research and Development u/s.80GGA of the Income-tax Act, 1961.

(6 Marks) (May 2003)

Answer

Section 80GGA grants deduction in respect of donations made for scientific research or rural development etc. No deduction under this section would be allowed in the case of an assessee whose gross total income includes income under the head `Profit and gains of business or profession'. The whole of the amount of donation is eligible for deduction.

Qualifying amounts :

(i) Any sum paid by the assessee in the previous year to a scientific research association which has, as its object, the undertaking of scientific research.

(ii) Any sum paid to an approved university, college or other institution to be used for scientific research or for research in social science or statistical research.

(iii) Any sum paid to public sector company/local authority/association approved by National Committee for carrying out any eligible project or scheme. In this case, the assessee should furnish a certificate as required under section 35AC.

(iv) Any sum paid by the assessee to an association or institution which has as its object, the undertaking of any programme of rural development.

(v) Any sum paid to a rural development fund set up and notified under section 35CCA.

(vi) Any sum paid by the assessee in the previous year to National Urban Property Eradication Fund (NUPEF). In this case, the assessee should furnish a certificate as is required under section 35CCA.

Question 12

Total income of Mrs. Priti, aged 64, a resident of Mumbai for the financial year 2004-05 is Rs.1,10,500. It includes an income of

Rs.22,000 from the business of dealing in shares on which she has paid securities transaction tax of Rs.1,500. She has also deposited Rs.15,000 in her P.P.F. account with the State Bank of India. Compute her tax liability for the A.Y. 2005-06.

(6 Marks) (May 2005)

Answer

Computation of tax liability of Mrs. Priti for A.Y. 2007-08.

Particulars	***Rs.***	***Rs.***
Total income (before deduction under section 80C)		**1,10,500**
Less : Deduction under section 80C in respect of PPF deposit		**15,000**
Total income		**95,500**

As the total income less than the taxable limit, rebate under section 88E cannot be claimed.

Question 13

Mr.Manohar submits the following information for the year ending 31.3.2002 from his proprietary business.

		Rs.
Net Profit (as per Profit and Loss account)		***1,12,500***
The following expenditure was part of the debits to the Trading and Profit Loss account		
(i)	***He used goods for his personal use. The value was credited to sales Rs.25,000. The cost of which was Rs.20,000***	
(ii)	***Rent of residence, Rs.3,000 per month***	***36,000***
(iii)	***Payments in cash for purchases exceeding Rs.20,000***	***4,00,000***
(iv)	***Sales tax in dispute provided***	***20,000***
(v)	***Interest on term loan State Bank of India, paid in the month of May 2002***	***70,000***
The	***following amounts were credited to profit and loss Account:***	
(i)	***Agricultural income***	***50,000***
(ii)	***Income from Unit Trust of India (monthly income plan)***	***30,000***
(iii)	***Winnings from lottery gross (Tax deducted at source Rs.30,600)***	***1,00,000***

Compute the taxable income, assuming Mr.Manohar has no residential house. Give reasons for the claim under each head of income. (12 Marks) (May 2002)

Answer

Assuming the above facts as occurring in the previous year relevant to the assessment year 2007-08, the solution is prepared.

Computation of total income of Mr.Manohar for assessment year 2007-2008

Profits and Gains of Business or Profession Rs.

Net profit as per profit and loss account		**1,12,500**
Add: Items debited to P&L account and not allowable		
(i) Rent paid for residence	**36,000**	
(ii) Disallowance as per the provisions of section 40A(3) in the case of cash purchases (20% of Rs.4,00,000)	**80,000**	
(iii) Provision for disputed sales tax	**20,000**	
		1,36,000
		2,48,500
Deduct: Items not forming part of business income		
(i) In respect of goods used for personal use, the sales being credited in excess of cost.	**5,000**	
(ii) Agricultural income (See note ii)	**50,000**	
(iii) Income from unit trust of India (exempt U/s.10(35)]	**30,000**	
(iv) Winnings from lottery (chargeable under income from other sources)	**1,00,000**	
		1,85,000
		63,500
Income from other sources		
Winnings from lottery		**1,00,000**
Gross total income		1,63,500
Less: Deduction U/s.80 GG in respect of rent paid		
(i) Actual rent less 10% of total income (36,000 - 16,350)	**19,650**	

(ii) 25% of total income (25% of 163500)	**40,875**	
(iii) Quantum limit (2,000 X 12)	**24,000**	
Least of the above 3 limits		**19,650**
Total Income		1,43,850

Notes:

(i) Interest on term loan to State Bank of India since paid before the due date of filing the return and hence no disallowance under section 43B.

(ii) Agricultural income does not form part of total income but is included for rate purpose at the time of computation of tax.

Question 14

Raghav furnished the following particulars and requests you to compute his taxable income for the previous year ending 31.3.2002:

(i) Joined service on 1.10.2001, on a consolidated salary of Rs.15,000 per month.

(ii) He was paid Rs.30,000 in September 2001 so that he should not join elsewhere.

(iii) He contributed towards:

- *(i) Life insurance premium Rs.20,000*
- *(ii) National Savings certificates Rs.10,000 (5 Marks) (May 2002)*

Answer

The solution is prepared for the assessment year 2007-08 on the assumption that the facts relate to previous year relevant to that assessment year.

Computation of total income of Mr.Raghav for A.Y. 2007-08

Salary from October to March	
(Rs.15,000 p.m.´ 6 months)	**90,000**
Profits in lieu of salary u/s.17(3) (iii):	
Amount received in September from the employer before joining for employment	**30,000**
Income from salary	**1,20,000**
Less: Deduction U/s.80C in respect of Life insurance premium and NSC certificate	**30,000**
Total Income	**90,000**

Question 15

Mr.Pramod, a writer and a professional furnishes the following particulars for the previous year ended 31.03.2001.

(a)	*Royalty on books*	*42,000*
(b)	*Expenditure on books*	*8,000*
(c)	*Income from profession*	*1,30,000*
(d)	*Deposited in Public Provident Fund (15.3.2001)*	*80,000*

You are required to compute – (i) taxable income, (ii) tax payable for assessment year 2001-2002.

(5 Marks) (Nov.2001)

Answer

Computation of total income and tax payable by Mr.Promod

A. Income from profession			1,30,000
B. Income from royalty		42,000	
Less: Expenses	8,000		
			34,000
			1,64,000
Less: Deduction U/s.80QQB		34,000	
Deduction U/s.80C – PPF deposit		70,000	
			1,04,000
Total income			60,000
Tax thereon			Nil

Note: **It is assumed that the assessee is eligible for deduction under section 80QQB. The amount received is a lump sum consideration and hence the expenditures attributable for earning such income is deducted.**

Question 16

Anand is a retired Government Officer aged 65 years, who derived the following incomes in respect of financial year 1999-2000. He resides in Cochin :

Pension	***Rs. 90,000***
Interest from bank deposits	***Rs. 52,000***
Total Income	***Rs.1,42,000***

He has paid Rs.18,000 as premium to effect an insurance on his health and his dependent parents. He pays a rent of Rs.3,000 per month in respect of furnished accommodation. What is his eligibility for deduction under section 80GG? What are the conditions to be satisfied by him to qualify for the deduction?

(12 Marks) (May 2000)

Answer

Computation of Total Income of Anand for the purpose of deduction u/s 80G

	Rs.
Salary : Pension	90,000

Income from other sources : Bank interest	52,000
Gross total income	1,42,000
Less: Deduction under chapter VI-A : (other than section 80GG deduction)	
Deduction U/s.80D in respect of medi claim policy – being a senior citizen (It is presumed that medi claim policy premium is paid by cheque only)	15,000
Total income for the purposes of section 80GG	1,27,000

Permissible deduction under section 80GG :

The assessee is eligible for deduction and whether the accommodation is furnished or unfurnished makes no difference for the claim of deduction.

The deduction admissible is the least of the following :

(i)	Actual rent paid (3,000 ? 12)	36,000	
	Less: 10% of total income before deduction u/s 80GG	12,700	
			23,300
(ii)	Monetary limit not exceeding Rs.2,000 p.m.		24,000
(iii)	25% of total income before allowing the deduction i.e.25% of Rs.1,27,000		31,750

Least is Rs.23,300. This is the deduction allowable under section 80GG.

Conditions to be fulfilled for grant of deduction under section 80GG :

(i) The assessee should not receive any house rent allowance which is exempt under section 10(13A).

(ii) The assessee or his spouse or minor child or H.U.F. of which he is a member should not own any accommodation in the place in which the rental accommodation is occupied.

(iii) If the assessee owns any accommodation at any other place, such accommodation should not be of the nature, the annual value of which is determined under section 23(2)(a) or section 23(4)(a) – i.e. not being as self occupied property.

(iv) He should file a declaration in form 10BA along with the return of income.

Question 17

Following details are furnished by Sundaram, an Indian citizen for the year ending March 31, 1999

	Rs.
Salary (net of tax and Sundaram's contribution to provident fund)	*48,000*

Sundaram's contribution to provident fund	*4,950*
Employer's contribution to provident fund	*4,950*
Interest credited to provident fund (@ 3.75% per annum)	*14,000*
Leave Travel Allowance received	*3,600*
House rent allowance	*4,500*
(Rent paid on house in Hyderabad - Rs.4,500)	
Dividend's from ACC Ltd an Indian company (net of tax)	*2,500*
Dividend collection charge	*200*
Tax deduction at source on salary	*1,500*
Contribution to public provident fund	*4,000*
Contribution to National Laboratory approved U/s.35	*5,000*
Amount received on maturity of a keyman insurance policy	*6,000*

Sundaram acquired 2,000 shares of Rs.5 lakhs during 1984-85. Company allotted him equal value of bonus shares during 1990-91. Second bonus issue was made during March, 1998, when he received 1 bonus share for every 2 shares held by him. The entire shares held in the company have been sold by him during November, 1998 @ Rs.1,100 per share.

Inflation indexation for 1984-85 and 1998-99 may be taken as 125 and 351 respectively.

Determine the total income of Sundaram for the Assessment year 1999-2000.

(15 Marks) (Nov.99)

Answer

Taking the above facts as applicable for the previous year relevant to the assessment year 2007-08, the computations are made.

Income from salaries:

		Rs.
Net salary received		48,000
Add :Tax deduction at source		1,500
Add : Contribution of Sundaram to Provident fund a/c		4,950
		54,450
Add: Leave travel allowance (Note 1)	3,600	

Add : Taxable house rent allowance (Note 2)		4,500	
			8,100
Add : Profits in lieu of salary – amount received on maturity of keyman insurance policy			6,000
Taxable salary			68,550
Income from Capital gains:			
Sale consideration (2000+2000+2000) ? Rs.1100		66,00,000	
Less : Indexed cost of acquisition			
Original shares Rs.5,00,000 ? 519* /125 =	20,76,000		
First issue of bonus shares	Nil		
Second issue of bonus shares	Nil	20,76,000	
Taxable long term capital gain			45,24,000
Gross total income			**45,92,550**
Less : Deduction U/s.80C			
Contribution to provident fund		4,950	
Contribution to public provident fund		4,000	
			8,950
Total Income			**45,83,600**

*** Cost inflation index for the financial year 2006-07 – 519.**

Notes:

1. Leave travel allowance is exempt only if the conditions specified in section 10(5) read with Rule 2B are satisfied. Since no data has been given of the amount of expenditure actually incurred and the frequency of such leave travel allowance given by the employer to the employee, the whole of LTA is considered as taxable.
2. Calculation of taxable H.R.A.

Amount received		4,500
Less : Exempt u/s.10(13A):		
Least of the following		
(a) 40% of Rs.54,450	21,780	
(b) Actual HRA	4,500	
(c) Excess of rent paid over 10% of salary (Rs.54,450)	Nil	
		Nil
Taxable HRA		4,500

1. Interest credited to P.F. a/c at 3.75% of Rs.14,000 is exempt from tax, since the rate is less than 12%.
2. Contribution to National Laboratory under section 35 does not qualify for deduction under the head “salary”.
3. Dividends from ACC Ltd are exempt under section 10(34). Dividend collection charges are correspondingly not deductible.
4. It is assumed that the shared held by Sundaram and transferred during the year is not exempt U/s.10(38). The second bonus issue is assumed as obtained in March, 1998 but sold in the previous year 2006-07. The benefit of indexation is accordingly given.

Question 18

From the following data, you are required to find out the tax payable on self assessment by Mr.Bharat, a person above 65 years:

	Rs.
Pension	***63,000***
Interest on company deposits	***50,000***
Capital gain long term	***3,000***
Total	***1,16,000***

Investment in National Savings Certificate VIII series Rs.10,000 (6 Marks) (Nov.96)

Answer

Computation of Total income of Bharat for the assessment year 2007-08

Income from salary : Pension		**63,000**
Income from other sources : Interest on company deposits		**50,000**
Long term capital gains		**3,000**
Gross Total income		**1,16,000**
Less **: Deduction U/s.80 C: NSC VIII series**		**10,000**
	Total income	**1,06,000**
Tax on total income		**Nil**

Question 19

Calculate the deduction allowable under section 80GG to an assessee having the following income:

Rs.

Business income	*55,000*
Interest from bank and dividend income	*5,000*
Total income	*60,000*

Rent paid by him for a house occupied by him for the purpose of his residence Rs.1250 p.m.

(6 Marks) (Nov.96)

Answer

Total income			**60,000**
Deduction U/s.80GG in respect of rent paid:			
(a)	**Rent paid Rs.1250 ? 12**	**15,000**	
(b)	**10% of total income**	**6,000**	
Rent paid in excess of 10% of total income		**9,000**	
Excess of rent paid over 10% of total income is deductible. Further conditions are (i) the expenditure should not exceed Rs.2000 per month or (ii) 25% of total income whichever is less.			
In this case excess of rent paid over 10% of total income is less than the maximum ceilings prescribed. Hence deduction would be			**9,000**
Total income			**51,000**

Rs.9,000 is the deduction allowable under section 80GG.

Question 20

In respect of assessment year 1997-98, an author of text books furnishes the following particulars and requests you to work out his tax liability

1. Royalty from Printers Ltd on publication of books		*1,20,000*
2. Capital gains Long term		*60,000*
3. Other sources:		
(a) Interest on bank deposits	*12,000*	
(b) Dividend income	*3,000*	
(c) Income from units of UTI	*5,000*	
		20,000
Gross Total Income		*2,00,000*
Deductions : (i) Contribution towards:		
(a) LIC Pension scheme		*15,000*
(b) LIC premium		*10,000*
(ii) Contribution to public provident fund		*10,000*

(iii) *Investment in National Savings Certificates* *50,000*

(iv) *Medical Treatment of Handicapped Dependent relation* *20,000*

(7 Marks) (May 1997)

Answer

The tax liability of the author is computed as under

Income from royalty		1,20,000
Long term capital gain		60,000
Interest on bank deposit		12,000
Dividend income - exempt u/s.10(34)		Nil
Income from units of UTI – exempt U/s.10(35)		Nil
Gross total income		1,92,000
Less : Long term capital gains		60,000
		1,32,000
Less : Deduction allowable		
Deduction U/s.80 C in respect of NSC, PPF and LIC	70,000	
Deduction U/s.80 CCC in respect of LIC pension scheme	10,000	
Deduction U/s.80 DD in respect of dependant with disability	50,000	
		1,30,000
Total income (excluding long term capital gain)		2,000
Long term capital gain		60,000
Tax on total income (including long term capital gain)		Nil

Note: **It is assumed that the assessee's income from royalty does not satisfy the conditions of section 80QQB, hence no deduction is contemplated.**

It is assumed that the handicapped dependant relation has disability satisfying the conditions of section 80DD and the dependant is not a senior citizen and hence only Rs.50,000 is deducted.

Question 21

Discuss the allowability of the following :

(i) *Rajan has to pay to a hospital for treatment Rs.42,000 and spent nothing for life insurance or for maintenance of handicapped dependent.*

(ii) *Rajan has incurred for treatment Rs. Nil in the previous year and deposited Rs.25,000 with LIC for maintenance of handicapped dependant.*

(iii) Rajan has incurred Rs.20,000 for treatment and Rs.25,000 was deposited with LIC for maintenance of handicapped dependant. (3 Marks) (Nov.2002)

Answer

(i) The deduction of Rs.50,000 under section 80DD is allowed in full irrespective of the expenditure actually incurred/paid by the assessee. If the expenditure is incurred in respect of a dependant with severe disability, the deduction allowable is Rs.75,000.

(ii) The assessee Rajan (assumed to be resident in India) has deposited Rs.25,000 for maintenance of handicapped dependent. The assessee is, however, eligible to claim Rs.50,000 since the deduction of Rs.50,000 is allowed in full respective of the amount deposited with LIC. If the expenditure is incurred in respect of a dependant with severe disability, the deduction allowable is Rs.75,000.

(iii) Section 80DD allows a deduction of Rs.50,000 irrespective of the actual amount spent on maintenance of handicapped dependent and/or actual amount deposited with LIC. Therefore, the deduction will be Rs.50,000 even though the total amount incurred/deposited is Rs.45,000. If the dependant is a person with severe disability the quantum of deduction is Rs.75,000.

Question 22

For the Assessment year 2002-03, the Gross Total Income of Mr. Chaturvedi was Rs.1,68,240 which includes long-term capital gain of Rs.45,000 and Short-term capital gain of Rs,8,000. The Gross Total Income also includes interest income from Banks of Rs.12,000. Mr. Chaturvedi has invested in PPF Rs.60,000 and also paid a medical insurance premium Rs.11,000. Mr. Chaturvedi also contributed Rs.15,000 to Public Charitable Trust eligible for deduction under section 80G. Compute the total income and tax there on of Mr. Chaturvedi, who is 70 years old as on 31.3.2001. (12 Marks) (Nov.2002)

Answer

Computation of total income and tax payable by Mr. Chaturvedi

		Rs.
Gross total income including long term capital gain		1,68,240
Less : Long term capital gain		45,000
		1,23,240
Less : Deductions under chapter VI-A		
U/s.80C in respect of PPF deposit	60,000	
U/s.80D (it is assumed that premium is paid by cheque and being a senior citizen, he is eligible for enhanced deduction) Rs.15000 or	11,000	

actual, whichever is less.		
U/s.80G (see working note below)	2,612	
		73,612
Total income		49,628
Rounded off		49,630
Tax on Rs.49,630		Nil
Tax on long term capital gain of Rs.45,000		Nil

Working note:
Computation of deduction u/s.80G

Gross total income (excluding LTCG)	1,23,240
Less : Deduction u/s.80C and 80D	71,000
	52,240
10% of the above	5,224
Contribution made	15,000
Lower of the two eligible for 80 G deduction	5,224
Deduction u/s.80G – 50% of Rs.5224	2,612

Question 23

Mr. Ashok owns a property consisting of two block of identical size. The first block is used for business purposes. The other block has been let out from 1.4.2004 to his cousin for Rs.10,000 p.m. The cost of construction of each block is Rs.5 lacs (fully met from bank loan), rate of interest on bank loan is 10% p.a. The construction was completed on 31.3.2004. During the year ended 31.3.2005, he had to pay a penal interest of Rs.2,000 in respect of each block on account of delayed payments to the bank for the borrowings. The normal interest paid by him in respect of each block was Rs.42,000. Principal repayment for each block was Rs.23,000. An identical block in the same neighbourhood fetches a rent of Rs.15,000 per month. Municipal tax paid in respect of each block was Rs.12,000.
The income from business prior to adjustment towards depreciation on any asset is Rs.2,20,000. He follows Mercantile system of accounting.
Depreciation on equipments used for business is Rs.30,000.

On 23.3.2005, he sold shares of B Ltd., a listed share in BSE for Rs.2,30,000. The share had been purchased 10 months back for Rs.1,80,000. Security transaction tax paid may be taken as Rs.220.

Brought forward business loss of a business discontinued on 12.1.2004 is Rs.80,000. This loss has been determined in pursuance of a return of income filed in time and the current year is the seventh year.

The following payments were effected by him during the year :

(i) LIP of Rs.20,000 on his life and Rs.12,000 for his son aged 22, engaged as a software engineer and drawing salary of Rs.25,000 p.m.

(ii) Medi claim premium of Rs.6,000 for himself and Rs.5,000 for above son. The premiums were paid by cheque.

You are required to compute the total income for the assessment year 2005-06 and the tax payable. The various heads of income should be properly shown. Ignore the interest on bank loan for the period prior to 1.4.2004, as the bank had waived the same.

(16 Marks) (Nov.2005)

Answer

Computation of total income of Mr. Ashok for the A.Y.2007-08

Particulars	***Rs.***	***Rs.***	***Rs.***
Income from house property [See Note 1]			
House block 1used for business, hence ALV		**Nil**	
House block 2 let out. Fair rent		**1,80,000**	
***Less*: Municipal tax paid**		**12,000**	
Net annual value (NAV)		**1,68,000**	
***Less*:Deductions under section 24**			
(a) 30% of NAV	**50,400**		
(b) Interest on bank loan @ 10% on Rs.5,00,000	**50,000**	**1,00,400**	
			67,600
Profits and gains of business or profession **[See Note II]**			
Income prior to adjustment for depreciation		**2,20,000**	
***Less* : Depreciation : Equipments used for business**	**30,000**		
Depreciation on building Rs.5,00,000 @ 10%	**50,000**		
		80,000	
		1,40,000	
***Less*: Set off of brought forward business loss relating to discontinued business [See Note III]**		**80,000**	
			60,000
Capital Gains **[See note IV]**			
Short term capital gains from sale of listed shares			
Full value of consideration		**2,30,000**	

Less **: Cost of acquisition**		**1,80,000**	
			50,000
Gross Total Income			**1,77,600**
Less **: Deduction U/s.80C in respect of LIP Rs.32,000 and housing loan repayment in respect of II block Rs.23,000**	**55,000**		
Deduction U/s.80D (for self)	**6,000**		
			61,000
Total income			**1,16,600**

Computation of tax payable of Mr.Ashok A.Y 2007-08

	Rs.
Tax on total income of Rs.66,600 (excluding STCG) at normal rates	**Nil**
Tax on short – term capital gains [10 % of Rs.16,600]	**1,660**
Education cess @ 2%	**33**
Total tax payable	**1,693**

Notes :

I – On computation of Income from house property

(i) The annual value of the house property which is used for business would not fall under the head "Income from house property". Therefore, the annual value of the first block is not chargeable to tax under the head "Income from house property". However, depreciation there on at 10% has been claimed while computing the income from business.

(ii) As regards the second block, the sum for which the property may be reasonably expected to be let is Rs.15,000 per month. The Gross Annual Value (GAV) of the block is the higher of fair rent (i.e., Rs.15,000 p.m.) or the actual rent received (Rs.10,000 p.m.) Hence, the GAV of the second block is Rs.1,80,000 (i.e. Rs.15,000 p.m.)

(iii) Under section 24(b), interest on bank loan for construction of house is deductible. However, penal interest is not deductible. Assuming that the principal repayment of Rs.23,000 was made at the end of the year, interest due during the year in respect of the second block is Rs.50,000 (i.e. 10% of Rs.5 lakhs), which is allowable as deduction under section 24(b). It is also possible to solve the problem assuming that the interest of Rs.42,000 paid during the year represents the interest due.

II – On computation of Profits and gains of business or profession

(i) Mr. Ashok can claim depreciation @ 10% on the building used by him for business purposes. The depreciation on the first block is Rs.50,000 (being 10% of Rs.5,00,000) and depreciation on equipments used for business is Rs.30,000. Hence the depreciation allowable during the year is Rs.80,000.

(ii) Since Mr. Ashok follows mercantile system of accounting, outstanding bank interest would have been provided for already. It is possible to prepare the solution taking into account section 43 B of the Act.

III – On set off of business loss

As per section 72, business loss can be carried forward for a maximum of 8 assessment years and be set-off against business income. Therefore, since the current year is the seventh year only and since the loss has been determined in pursuance of a return of income filed in time, the brought forward business loss can be set-off against business income of the current year. It is not necessary that the business in respect of which the loss was incurred should be in existence for carry forward and set-off of loss of such business.

IV – On treatment of short-term capital gains (STCG)

The listed shares have been sold and securities transaction tax is paid, hence it is taxable at 10% as per section 111A. For the purpose of providing deduction under Chapter VI-A, the gross total income should be reduced by the STCG on listed shares.

V – On computation of deduction under section 80D

Deduction under section 80 C can be claimed in respect of life insurance premium paid for major son, even though he is not dependent on the assessee. However, deduction under section 80D cannot be claimed in respect of mediclaim premium paid for non-dependant son. Medi claim premium paid for self of Rs.6,000 is eligible for deduction.

Question 24

Write short note on gross total income *(6 Marks) (May 2002)*

Answer

Section 80B(5) defines 'gross total income' as the total income computed in accordance with the provisions of this Act, before making any deduction under Chapter VI-A.

Section 2(45) defines 'total income' as income computed in accordance with the provisions of the Act.

The total income is to be computed under 5 heads of income, namely:

(i) Salaries

(ii) Income from house property

(iii) Profits and Gains of Business or profession

(iv) Capital gains

(v) Income from other sources

For the purposes of computing the total income, no deduction shall be allowed in respect of expenditure incurred by the assessee in relation to income which does not form part of the total income under the Act. (Section 14A).

CHAPTER 13

REBATE AND RELIEF

Question 1

Choose the correct answer with reference to the provisions of the Income-tax Act, 1961.

(i) For an individual deriving total income of Rs.1,01,000, tax rebate under Section 88D is

(a) Rs.83,000

(b) Rs.82,000

(c) Rs.84,000

(d) None of the above

(1 Mark) (May 2005)

(ii) The maximum rebate allowable under section 88E to an individual deriving income of Rs.2,00,000 from taxable securities transactions, who has paid securities transactions tax of Rs.14,600 and whose average rate of income-tax is 8%, is

(a) Rs.16,000

(b) Rs.20,600

(c) Rs.14,600

(d) None of the above

(1 Mark) (May 2005)

Answer

(d) i.e. none of the above for the assessment year 2007-08

(c) i.e. Rs.14,600. The average rate of income tax when applied on income (i.e. Rs.16,000) or the STT paid (i.e. Rs.14,600), whichever is less, is the rebate under section 88E

Question 2

Following is the Profit & Loss account of Mr. A, a dealer in shares and securities for the year ended on 31st March, 2005.

	Rs.		***Rs.***
To Trading Expenses	***62,60,000***	***By Sales***	***72,54,000***
To Administrative Exp.	***1,05,000***	***By Interest on FD with Bank***	***16,500***
To Financial Expenses	***48,265***	***By Dividend from Indian Co.***	***64,360***
To Demat and Delivery charges	***4,350***	***By Interest on I.T.Refund (A.Y. 2004-05)***	***230***
To Securities Transaction Tax	***5,500***		
To Net Profit before depreciation	***9,11,975***		
	73,35,090		***73,35,090***

Compute the rebate available under Section 88E. *(7 Marks) (Nov.2005)*

Answer

Computation of rebate under section 88 E in case of Mr.A for A.Y.2007-08

Particulars	***Rs.***	***Rs.***
Profits and gains of business or profession		
Net Profit as per profit and loss account		**9,11,975**
Add **: Expenses not allowable : Securities transaction tax**		**5,500**
		9,17,475
Less**: Income not includible under this head**		
Interest on FD with bank	**16,500**	
Dividend from an Indian company	**64,360**	
Interest on income-tax refund	**230**	
		81,090

Income from business		**8,36,385**
Income from other sources		
Interest on fixed deposit with Bank	**16,500**	
Dividend from Indian company [exempt U/s.10(34)]	**Nil**	
Interest on income-tax refund	**230**	
		16,730
Total Income		**8,53,115**
Rounded off		**8,53,120**
Tax on total income		**2,05,936**
Average rate of income tax = 2,05,936 ? 100 /8,53,120		**24.139%**

Rebate under section 88E in respect of securities transaction tax – Where the total income of an assessee in a previous year includes any income, chargeable under the head "Profits and gains of business or profession", arising from taxable securities transactions, he shall be entitled to a deduction, from the amount of income-tax on such income arising from such transactions, to the extent of the lower of the following two amounts.

(1) Securities transaction tax paid i.e. Rs.5,500 in this case.

(2) Average rate of income tax x business income from such taxable securities transactions = 24.139% x Rs.8,53,120 = Rs.2,05,936

Therefore, rebate under section 88E = Rs.5,500

Note **: This problem has been solved on the assumption that the entire business income of Mr. A has arisen from taxable securities transactions.**

Question 3

Mr.Sai an employee furnished the following particulars for the previous year ending 31.3.2001

		Rs.
(a)	*Salary income as computed (after all deductions) for the year*	*1,52,000*
(b)	*During the year arrears of salary were received (not included in the above) relate to Financial year 1997-98*	*15,000*

(c) Assessed income of Financial year 1997-98 *66,000*

(d) On 25.3.2001, amount deposits in Public Provident Fund a/c *50,000*

You are requested to compute relief u/s.89(1) in respect of tax payable.

The rates for the assessment year 1998-99 are

On First Rs.40,000 – Nil

On Next Rs.20,000 – 10%

On Next Rs.60,000 – 20% *(6 Marks) (Nov.2001)*

Answer

Assuming the arrear is received in the previous year 2006-2007 relating to the financial year 1997-98, the solution is prepared.

Computation of relief under section 89 of the Income-tax Act.

A.Y. 2007-2008 :		***Rs.***	
1.	**Total income without arrears**	**1,52,000**	
	***Add* : Arrears of salary received**	**15,000**	
		1,67,000	
	***Less*: Deduction U/s.80 C in respect of PPF deposit**	**50,000**	
	Total income	**1,17,000**	
2.	**Tax on total income of Rs.1,17,000 (step No.1)**		
	Tax on Rs.1,17,000/-		**1,700**
3.	**Tax on Rs.1,02,000/ (without arrear)**		**200**
4.	**Difference of tax between step no.2 and 3**		**1,500**
5.	**A.Y.1998-99**		
	Tax on total income including arrears		
	Total income	**66,000**	
	***Add* : Arrears on accrual basis**	**15,000**	
		81,000	
	Tax on Rs.81,000 as per rates of tax of A.Y.1998-99	**6,200**	

6.	Tax on total income of Rs.66,000/ of A.Y.1998-99	3,200	
7.	Difference of tax between step no.5 & 6		3,000
8.	Amount of relief u/s.89 step no.4 minus step no.7		(1,500)

Note : **Because of the increase in basic exemption limit, the assessee is not gaining by seeking relief under section 89. If he is not seeking relief under section 89, his tax liability is only Rs.1,500. If he seeks application of section 89 he will have to pay Rs.3,000 which is not advantageous to him.**

CHAPTER 14

INCOME TAX AUTHORITIES

Question 1

Which are the provisions under the Income-tax Act, which may be relaxed by the Central Board of Direct Taxes to avoid genuine hardship ? (4 Marks) (May 2001)

Answer

The Board if it considers it necessary or expedient so to do, for the purpose of proper and efficient management of the work of assessment and collection of revenue may issue, from time to time whether by way of relaxation of the provisions of sections 115P, 115S, 115WD, 115WE, 115 WF, 115WG, 115WH, 115WJ, 115WK, 139, 143, 144, 147,148, 154, 155, 201(A), 210, 211, 234A, 234B, 234C, 271 and 273 or otherwise general or special orders in respect of any class of incomes or fringe benefits or class of cases, setting forth directions or instructions not being prejudicial to the assessee.

Such order or specific if it is necessary in the public interest so to do, has to published and circulated in the prescribed manner for general information.

Under clause (b) of sub-section (2) of section 119, the Board may, in any case or class of cases by general or special order authorize any income-tax authority (except C.I.T. Appeals) to admit an application or claim for any exemption, deduction or refund or such relief, after the expiry of the period specified for making such application and deal with the same on merits of the case. Under clause (c), similarly, the Board may by general or special order, relax the requirements of the provisions of Chapter IV or Chapter VI-A where the assessee has failed to comply with the said requirements for claiming deduction, subject to the following two conditions :

(i) the default in complying with the requirements of the relevant provisions was due to circumstances beyond the control of the assessee.

(ii) the assessee has complied with such requirements before the completion of the assessment.

Question 2

Write short note on powers of Income-tax authorities under section 131 as regards discovery, production of evidence, etc. *(6 Marks) (Nov.2005)*

Answer

Section 131 of the Income-tax Act, 1961 deals with the powers regarding discovery, production of evidence, etc.

The Assessing Officer, Joint Commissioner, Commissioner (Appeals), and Chief Commissioner or Commissioner shall have the same powers as are vested in a court under the Code of Civil Procedure, 1908 while trying a suit in respect of the following matters, namely –

(i) discovery and inspection ;

(ii) enforcing the attendance of any person, including any officer of a banking company and examining him on oath.

(iii) compelling the production of any books of account and other documents ; and

(iv) issuing commissions.

Further, the said income-tax authorities are vested with the power to impound or retain in their custody for such period as they may think fit, any books of account or other documents produced before them in any proceeding under the Act. However, an Assessing Officer or Assistant Director or Deputy Director shall not impound any such books of account or documents without recording reasons for so doing and shall not retain in his custody such books of account and documents for a period exceeding 15 days (excluding holidays) without the approval of the Director General or Chief Commissioner or Commissioner or Director of Income-tax.

Question 3

State the powers of an Assessing Officer with regard to survey u/s.133A of Income-tax Act, 1961 *(6 Marks) (Nov.2001)*

Answer

Powers of an Assessing Officer with regard to survey under section 133A are given below –

(1) An income-tax authority may enter may any place where business or profession is carried on, if such place is within the limits of the area assigned to him or is occupied by any person in respect of whom the Assessing Officer exercises jurisdiction or in respect of which he is authorised to do so by another income-tax authority who has jurisdiction. For this purpose, any other place where the books of account or other

documents or cash or stock or other valuable article relating to the business is kept, shall also be considered to be a place of business.

(2) The Income-tax authority may require the person attending the business or profession to afford necessary facilities to inspect books of account, or other documents, and to check and verify the cash, stock or other valuable article which may be available at that place.

(3) He may enter the place of business or profession only during the hours at which it is open for the conduct of business or profession. In the case of any other place, he may enter the place only after sunrise and before sunset.

(4) The Income-tax authority, cannot remove any books of account or other documents without recording his reasons for so doing. He cannot seize cash, stock or valuables from the place where he has entered for survey under section 133 A. The books impounded by the income-tax authority cannot be kept for a period exceeding 10 days (exclusive of holidays) without obtaining the approval of the Chief Commissioner or Director General, as the case may be.

(5) The Income-tax authority making survey under section 133A may record a statement from any person which may be useful for or relevant to, any proceeding under the Act. He may place marks of identification on the books of account or other documents inspected by him and make or cause to be made extracts or copies therefrom. He may also make an inventory of any cash, stock or other valuable article or thing checked or verified by him.

(6) The income-tax authority may ask a person to submit the necessary information relating to expenditure incurred in a particular ceremony or event.

Question 4

What are the powers of an income-tax authority in regard to survey covered by section 133A of the Income-tax Act ?

Does such a power extend to removal of books from the premises surveyed ? Discuss.

(9 Marks) (May 1998)

Answer

An Income-tax authority may enter any place within the limits of the area assigned to him or any place occupied by the assessee in respect of whom he exercises jurisdiction at which place business or profession is carried on. No residential premises can be surveyed under section 133A.

The authority has powers to require the proprietor, employee or any person connected with the business or profession :

(i) to afford him the necessary facility to inspect such books of account or document as he may require and which may be available at such place ;

(ii) to afford him the necessary facility to check and verify cash, stock or other valuable article or thing which may be found therein ; and

(iii) to furnish such information as he may require as to any matter which may be useful for or relevant to any proceeding under Income-tax Act.

Such a survey may be done only during the hours at which such a place is open for the conduct of business or profession and in the case of any other place only after sunrise and before sunset. The authority having the power to survey may also authorise any other income-tax authority to exercise such powers.
The authority may, if he so chooses, place marks of identification on the books of accounts or documents inspected by him and make or cause to be made extracts or copies of the same. He may make an inventory of any cash, stock or any valuable article or thing checked or verified by him and record a statement of any person which may be useful for or relevant to any proceeding under the Income-tax Act. Also, an income tax authority acting under the section may impound any books of account or other documents after recording his reasons for so doing. He cannot retain in his custody any such books of account or other documents for a period exceeding 10 days (exclusive of holidays) without obtaining the approval of the Chief Commissioner or Director General therefor, as the case may be.
W.e.f. 01-6-2003 no survey under section 133A could be made without obtaining the approval of Joint Director or Joint Commissioner, as the case may be.

Question 5

Section 119 empowers the Central Board of Direct Taxes to issue such orders, instructions and directions as it may deem fit, for the proper administration of the Act. What are the exceptions to this power? (2 Marks) (May 2001)

Answer

No order, instruction or direction shall be issued by the CBDT –

(a) to require any income-tax authority to make a particular assessment or to dispose of a particular case in a particular manner ; or

(b) to interfere with the direction of the Commissioner (Appeals) in the exercise of his appellate jurisdiction.

Question 6

A circular was issued by the Central Board of Direct Taxes on 1.10.1996, permitting a deduction, which was not authorised by law. On realizing the mistake, the circular was withdrawn after an interval of 2 years on 1.10.1998. During the intervening period, the

Assessing Officer passed an order on 1.4.1997 declining the deduction on the ground that it was consistent with law. Is he justified in doing so ? (3 Marks) (May 2001)

Answer

The issue whether a circular issued by the Central Board of Direct Taxes which is beneficial to the assessee but which is not authorised by law, is an issue over which there are a series of significant decisions. After a lot of judicial debate on this vital issue, the Supreme Court in *Kerala Financial Corpn. v. CIT (1994) 201 ITR 129* held that a Circular of the Board issued under section 119 has the power to issue orders, instructions or directions for the proper administration of the Income-tax Act, or for such other purposes specified in sub-section (2) of that section. *Such an order, instruction or direction however cannot over ride the provisions of the Act.* That would be destructive of the known principles of law as that would really amount to giving power to a delegated authority to even amend the provisions of law enacted by parliament. It is felt that the Hon'ble Supreme Court judgment in the Kerala Financial case states the correct principle of law.

Therefore, the order passed by the Assessing Officer in accordance with law is valid.

CHAPTER 15

ASSESSMENT PROCEDURE

Question 1

Fill in the blanks having regard to the provisions of the Income-tax Act, 1961 (All sub-divisions relate to the assessment year 2005-06) :

(i) The due date for filing of return under section 139(1) by a company having a turnover of less than Rs.40 lakhs is ……….. (1 Mark) (Nov.2005)

(ii) No order of assessment or reassessment shall be made under section 147 after the expiry of ……… from the end of ……. (½ + ½ Mark) (Nov.2005)

Answer

(i) 31st October of the assessment year.

(ii) 9 months; the financial year in which the notice under section 148 was served.

Question 2

Write short note on signatory to return of income filed by an individual and partnership firm

(6 Marks) (May 2005)

Answer

According to section 140, in the case of an individual, the following can sign the return of income :

1. The individual himself ;
2. Where he is absent from India, by the individual himself or by any other person duly authorised by him in this behalf ;
3. Where he is mentally incapacitated from attending to his affairs, by his guardian or any other person competent to act on his behalf ; and
4. Where, for any other reason, it is not possible for the individual to sign the return, by any person duly authorised by him in this behalf.

However, in case of (2) and (4) above, the person signing the return of income should hold a valid power of attorney from the individual to do so, which should be attached to the return.

In the case of partnership firm, the following can sign the return of income :

1. The managing partner.
2. If there is no managing partner or if the managing partner is not able to sign and verify the return for any unavoidable reason, then by any partner of the firm not being a minor.

Question 3

Write short note on signing and verification of returns of income. *(6 Marks) (Nov.96)*

Answer

Section 140 says the persons who should sign the return of income.

(a) In the case of an individual by the individual himself or where he is absent from India either by himself or by some person duly authorised by him. Where he is mentally incapacitated from attending to his affairs by his guardian or any other person competent to act on his behalf. Where for any other reason, it is not possible for the individual to sign his return, by any person duly authorised by him in this behalf. The person authorised to sign the return should attach the power of attorney along with the return of income.

(b) In the case of a HUF : By the karta or where the karta is absent from India or is mentally incapacitated - by any other adult member of such family.

(c) In the case of a company : By the managing director thereof or where for any unavoidable reason, such managing director is unable to sign the return, by any director thereof.

(d) Where the company is not resident in India : The return may be signed and verified by a person who holds a valid power of attorney from such company to do so, which shall be attached to the return.

(e) Where the company is being would up, whether under the orders of a court or other wise, by the liquidator as referred to in section 178(1).

(f) Where the management of the company has been taken over by the Central Government or any State Government under any law : The return shall be signed and verified by the principal officer thereof.

(g) In the case of a firm : By the managing partner or where for any unavoidable reason, the managing partner is unable to sign and verify, by any other partner, not being a minor.

(h) In the case of an association of persons : Any member of the association or the principal officer thereof;

(i) In the case of a local authority : By the principal officer thereof

(j) In the case of a political party: By the chief executive officer of such party (whether such chief executive officer is known as secretary or by any other designation).

(k) In the case of any other person : By that person or by some person competent to act on his behalf.

Question 4

What are the requisites for filing a revised return. *(5 Marks) (May 2004)*

Answer

Provisions of Section 139(5) of the Income-tax Act, 1961, deal with the filing of a revised return of income.

Any person who has furnished a return of income under section 139(1) or in response to a notice issued under section 142(1) can file a revised return if he discovers any omission or a wrong statement in the return filed earlier. Such revised return can be furnished at any time before the expiry of one year from the end of the relevant assessment year or before the completion of the assessment – whichever is earlier.

Where a belated return is filed u/s 139(4), the assessee cannot file a revised return u/s 139(5).

Question 5

Discuss the concept of a revised return under Income-tax Act. Can a return filed belatedly be revised? *(6 Marks) (May 1998)*

Answer

A return filed under section 139(5) is called a revised return. As per the provisions of this section, if any person, after furnishing a return under Section 139(1) or in response to a notice under section 142(1), discovers any omission or any wrong statement therein, he may furnish a revised return at any time before the expiry of one year from the end of the relevant assessment year or before the completion of assessment - whichever is earlier.

A belated return on the other hand is not a revised return but an original return filed late- beyond the time prescribed u/s 139(1) or Section 142(1) of the Act. It can be filed at any time before the end of one year from the end of the relevant assessment year and before the making of the assessment (same as in the case of a revised return).

A return filed u/s 139(4) cannot be revised u/s 139(5) [*Kumar Jagdish Chandra Sinha CIT (1996) 86 Taxman 122 (SC)*].

Question 6

(i) Rectification of mistake apparent from record. *(6 Marks) (May 2004)*

(ii) Write short note on: Rectification of mistakes apparent from record.

(6 Marks) (Nov.2001)

Answer

As per section 154, any mistake apparent from record can be rectified by an Income-tax authority by –

(a) amending any order passed by such authority under the Income-tax Act;

(b) amending any intimation or deemed intimation under section 143(1).

Mistake apparent on record could be a mistake of fact or a mistake of law.

The mistake apparent on record can be rectified by an income-tax authority either on its own motion or on an application made by the assessee to that effect.

The amendment of an order, which has the effect of enhancing an assessment or reducing the refund or otherwise increasing the liability of the assessee, shall not be made without giving a reasonable opportunity to the assessee of being heard.

Where any matter has been considered and decided in any proceeding by way of appeal or revision relating to an order, the authority passing such order may amend the order in relation to any matter other than the matter which has been so considered and decided.

The order making the amendment by an Income-tax Authority shall be in writing and it should be made within a period of 4 years from the end of the financial year in which the order sought to be amended was passed.

In respect of any application for rectification u/s 154 made by an assessee, the Income-tax Authority should make an order within 6 months from the end of the month in which the application was received by it, either by making the amendment or by refusing to allow the claim.

Question 7

Write short note on self-assessment tax under section 140A of the Income-tax Act, 1961.

(6 Marks) (Nov.2003)

Answer

(i) On the basis of any return required to be furnished under section 139 or section 142(1) or section 148 or section 115WD or section 115WH (relating to fringe benefit tax), as the case may be, the assessee is required to compute the tax payable by him after taking into account the amount of tax, if any, already paid. The assessee shall be liable to pay such tax together with interest payable under any provision of the Income-tax Act for any delay in furnishing the return or any default or delay in payment of advance tax, before filing the return and the return shall be accompanied by the proof of payment of such tax and interest [Section 140A(1)].

(ii) Where the amount paid by the assessee under section 140A(1) falls short of the aggregate of the tax and interest as aforesaid, the amount so paid shall first be adjusted towards the interest payable and the balance shall be adjusted towards the tax payable.

(iii) For the above purpose, interest payable under section 234A shall be computed on the amount of tax on the total income as per the return as reduced by the advance tax paid (if any) and further reduced by tax deducted or collected at source.

(iv) Interest payable under section 234B shall be computed on the assessed tax or on the amount by which the advance tax paid falls short of the assessed tax. For this purpose "assessed tax" means the tax on total income declared in the return as reduced by tax deducted or collected at source or any relief of tax claimed under sections 90 or 91 or any tax credit claimed under section 115JAA.

(v) After the regular assessment under section 143 or section 144 or section 153A or section 115 WE or section 115 WF has been made, any amount paid under sub-section (1) shall be deemed to have been paid towards such regular assessment or assessment as the case may be.

(vi) If any assessee fails to pay the whole or any part of such tax or interest or both in accordance with the provisions of section 140A(1), he shall be deemed to be an assessee in default in respect of the tax or interest or both remaining unpaid and all the provisions of the Income-tax Act shall apply accordingly.

Question 8

State the circumstances when income is deemed to have escaped assessment.

(6 Marks) (May 2002)

Answer

The provisions of section 147 deal with income escaping assessment. Explanation 2 to section 147 provides for the following situations when the income is deemed to have escaped assessment.

(a) The total income of the assessee or the total income of any other person in respect of which he is assessable under the Act during the previous year is above the maximum amount not chargeable to tax but no return of income has been furnished by the assessee.

(b) In a case where the return of income is filed, but the assessment has not been made and the assessee is found to have understated his income or claimed excessive loss, deduction, allowance or relief in the return filed.

(c) An assessment has been made but income chargeable to tax has been under - assessed or has been assessed at too low a rate, or any excessive loss or relief or depreciation allowance or any other allowance under the Act has been allowed.

Question 9

(i) Write short note on Summary Assessment. *(6 Marks) (May 2002)*

(ii) Summary assessment u/s 143(1) of the Income Tax Act, 1961. *(6 Marks) (May 2003)*

Answer

Section 143(1) provides that

(i) If any tax or interest is due on the basis of return filed under section 139, or in response to notice under section 142(1) after adjustment of and TDS, advance tax paid and any tax paid on self assessment and any amount paid otherwise by way of tax or interest, then, without prejudice to the provisions of section 143(2), an intimation shall be sent to the assessee specifying the sum so payable.

(ii) If any refund is due on the basis of such return, it shall be granted to the assessee.

(iii) Acknowledgement of the return shall be deemed to be intimation under sub-section (1), where either no sum is payable or no refund is due.

(iv) The intimation under section 143(1) shall not be sent after the expiry of 21 months from the end of the assessment year in which the income was first assessable.

Question 10

If a return of loss was not filed within the due date, what are the consequences?

(3 Marks) (Nov.2001)

Answer

Section 80 provides that certain losses which have not been determined in pursuance of a return filed in accordance with the provisions of section 139(3) shall not be carried forward and set off. Thus where a return of loss was not filed within the due date, the following losses cannot be carried forward and set off.

(a) Business loss – section 72(1)

(b) Speculation business loss – section 73(2)

(c) Losses from capital gains – section 74(1)

(d) Losses incurred in the activity of owning and maintaining race horses – section 74A(3)

Question 11

(i) Write short note on: Defective returns *(6 Marks) (Nov.2002)*

(ii) Write short note on: Defective or incomplete return of income under section 139(9).

(6 Marks) (Nov.99)

(iii) Write short notes on: Defective returns of income *(6 Marks) (May 98)*

Answer

As per section 139(9), in the following cases, a return will be considered defective -

(i) If the return is not accompanied by the annexures, statements etc, required to be attached to it and the columns relating to computation of income chargeable under each head of income, computation of gross total income and total income have not been filled in properly.

(ii) Where the accounts of the assessee have been audited, the return is not accompanied by copies of audited profit and loss account, balance sheet and a copy of the auditor's report.

(iii) Where the accounts of the assessee have been subjected to cost audit under section 233B of the Companies Act, the return is not accompanied by a copy of that audit report.

(iv) Where regular books are not maintained by the assessee, the return is not accompanied by a statement indicating the amount of turnover or gross receipts, gross profits, expenses and net profit of business/ profession and the basis on which such accounts have been computed as also the amounts of total sundry debtors, sundry creditors, stock in trade, cash balance as at the end of the previous year, etc.,

The following must also accompany the return:

A statement showing the computation of tax payable on the basis of the return, a copy of the report of audit done, if any, under section 44AB of the Act and the proof regarding tax deducted at source, advance tax and self assessment tax paid.

Where regular accounts are maintained by the assessee, copies of manufacturing account, trading account, profit and loss account or income and expenditure account, balance sheet must be sent with the return. In cases of proprietary business or firms, the personal account of the proprietor/partner must also be sent.

Question 12

What is a protective assessment under Income-tax law? What is the procedure followed for the recovery of tax in such cases? *(6 Marks) (May 99)*

Answer

A protective assessment is made in a case where there are doubts relating to the true ownership of the income. If there is an uncertainty about the taxing of an income in the hands of Mr. A or Mr. B, then at the discretion of the Assessing Officer, the same may be added in the hands of one of them on protective basis. This is to ensure that on finality, the addition may not be denied on the ground of limitation of time. Once finality regarding the identity of the tax payer to be taxed is established, the extra assessment is cancelled. But the Department cannot recover the tax from both the assessees in respect of the same income. Penalty cannot be imposed on the strength of a protective assessment.

Question 13

Write short note on power of Joint Commissioner to issue directions under Income-tax Act, 1961. *(6 Marks) (May 1999)*

Answer

Section 144A empowers the Joint Commissioner to issue directions in certain cases. The JCIT may on his own motion or on a reference being made to him by the Assessing Officer or on the application of an assessee, call for and examine the record of any proceeding in which an assessment is pending.

If he considers that, having regard to the nature of the case or the amount involved or for any other reason it is necessary or expedient so to do, he may issue such directions as he thinks fit for the guidance of the Assessing Officer to enable him to complete the assessment. Such directions shall be binding on the Assessing Officer.

However, no directions which are prejudicial to the assessee shall be issued without giving the assessee an opportunity of being heard.

This power is meant for guidance of the Assessing Officer and the assessee. The jurisdiction of the JCIT is co-extensive with that of the Assessing Officer and the JCIT cannot exercise jurisdiction on the matters on which the Assessing Officer has no jurisdiction.

Question 14

Write short notes on best judgment assessment. *(6 Marks) (May 1999)*

Answer

As per section 144(1) a best judgment assessment can be made by the Assessing Officer, if any person :

(a) Fails to make a return as required under Section 139(1) or has not filed a return under section 139(4) or section 139(5);

(b) Fails to comply with all the terms of a notice issued under section 142(1), or fails to comply with a direction for audit of accounts issued under section 142(2A) ; or

(c) Having made a return, fails to comply with all the terms of a notice issued under section 143(2) of the Act.

The Assessing Officer has to make the best judgment assessment after taking into account all the relevant material gathered and after giving the assessee an opportunity of being heard by issuing a show cause notice on the assessee as to why a best judgment assessment should not be made.
However, in cases where a notice under section 142 (1) has already been issued prior to the best judgment assessment, it will not be necessary to give the assessee an opportunity of being heard. It is also incumbent on the Assessing Officer to inform the tax payer the basis of his conclusion for arriving at "best judgment" income figures, viz, basis of assessment.

Question 15

Under what circumstances certain period is excluded while computing the time limit for completion of assessment / reassessment? (6 Marks) (Nov.97)

Answer

In computing the period of limitation for the purpose of completion of assessment or reassessment, the following periods shall be excluded.

(i) The time taken in reopening the whole or any part of the proceedings or in giving an opportunity to the assessee to be re-heard when there is a change in the incumbency of the office under section 129.

(ii) Any time during which assessment proceedings are stayed by an order or injunction of any court.

(iii) The period commencing from the date on which the Assessing Officer intimates the Central Government or the prescribed authority, the contravention of the provisions of section 10(21) or section 10(22B) or section 10(23A) or section 10(23B) or section 10(23C)(iv) or section 10(23C)(v) or section 10(23C)(vi) or section 10(23C) (via) under section 143(3)(i) and ending with the date on which the copy of the order withdrawing the approval or rescinding the notification, as the case may be, under those clauses is received by the Assessing Officer.

(iv) The period commencing from the date on which the Assessing Officer directs the assessee to get his accounts audited under section 142(2A) and ending with the last date on which the assessee is required to furnish a report of such audit under that sub-section.

(v) In a case where an application for settlement of a case has been rejected/ not allowed to be proceeded with, the period commencing from the date on which such application is made and ending with the date on which the order of the Settlement Commission is received by the CIT.

(vi) Where a declaration is made under section 158A by an assessee commencing from the date on which Assessing Officer received the declaration and ending with the date on which an order under section 158A(3) is made by the Assessing Officer. However, the period cannot exceed 60 days.

(vii) Where the assessee has made an application before the Authority for Advancing Rulings, the period commencing from the date on which the application is made and ending with the date on which the order rejecting the application is received by the Commissioner under section 245R(3).

(viii) Where the assessee makes an application before the Authority for Advancing Rulings, the period commencing from the date on which the application is made and ending with the date on which the ruling pronounced is received by the Commissioner under section 245R(7).

Question 16

Write short note on Notice under section 142(1) *(6 Marks) (Nov.97)*

Answer

For the purpose of making assessment, the Assessing Officer may serve on any person a notice u/s.142(1) in the following instances.

(i) If the assessee has not submitted a return of income within the time allowed u/s.139(1) or before the end of the relevant assessment year the Assessing Officer may require him to submit the return of income in the prescribed form on or before a date specified in the notice.

(ii) The Assessing Officer may ask the assessee to produce or cause to be produced, such accounts or documents as he may require. However, the Assessing Officer shall not require the production of any accounts relating to a period more than 3 years prior to the previous year.

(iii) The Assessing Officer may require the assessee to furnish in writing and verified in the prescribed manner information in such form on such points or matters including a statement of all assets and liabilities of the assessee, whether included in the accounts or not. However the previous approval of the Joint Commissioner shall be obtained before requiring the assessee to furnish a statement of all assets and liabilities not included in the accounts.

Question 17

Write short notes on : Audit under section 142(2A) *(6 Marks) (Nov.97)*

Answer

The Assessing Officer may direct the assessee to get his accounts audited by an accountant nominated by Chief CIT/CIT, even if accounts of the assessee have been audited under any other provision of this Act or under any other law, if the following conditions are satisfied.

(i) Such direction can be issued at any stage of the proceeding pending before the Assessing Officer, before the completion of such proceedings;

(ii) Such direction can be issued only if having regard to the nature and complexity of the accounts of the assessee and interest of the revenue, the Assessing Officer. is of the opinion that it is necessary to do so; and

(iii) Such direction can be issued only with the previous approval of Chief CIT/CIT. The audit report shall be furnished by the assessee within the period specified by the Assessing Officer.

(iv) The Assessing Officer has power to extent such period.

Failure to comply with a direction u/s.142(2A) to get books of accounts audited entails a best judgment assessment u/s.144. It will also result in penalty u/s.271(1)(b) which shall be in addition to tax payable a sum of Rs.10,000. Also, it is punishable under section 276D.

Question 18

Joseph engaged in profession filed his return of income for assessment year 1995-96 on 15th November, 1995. He disclosed an income of Rs.1,00,000 in the return. In February, 1996 he discovered that he did not claim certain expenses and filed a revised return on 3rd February, 1996 showing an income of Rs.80,000 and claiming those expenses. Is the revised return filed by Joseph acceptable? *(3 Marks) (May 1996)*

Answer

Joseph is engaged in profession. The due date for filing income tax return for assessment year 2007-08 as per section 139(1) of the Income-tax Act is 31st October, 2007 if his accounts are required to be audited under any law. The due date is 31st July,2007 if the accounts are not required to be audited under any law.

The return was filed beyond the due date prescribed in section 139(1). The return so filed is covered by section 139(4) and the time limit is one year from the end of the relevant assessment year. The Apex court in *Kumar Jagadish Chandra Sinha v. CIT 220 ITR 67 (SC)*

has held that a return filed under section 139(4) is not eligible for revision and hence a revised return cannot be filed.

Hence, the return filed by Joseph is not valid as the original return was not filed before the due date mentioned in section 139(1).

Question 19

Write short note on Regular Assessment *(6 Marks) (May 1996)*

Answer

Section 2(40) defines the term "Regular assessment" as the assessment made under section 143(3) or section 144.

The provision relating to regular assessment is contained in section 143(3) says that where a return of income has been made under section 139(including revised return submitted within permissible time) or in response to a notice under section 142(1), the Assessing Officer shall serve a notice on the assessee requiring him on a date specified therein either to attend his office or to produce or cause to be produced there, any evidence on which the assessee may rely in support of the return, if the Assessing Officer considers it necessary or expedient to do so. It is for the following reasons.

(i) The assessee has not understated his income, or

(ii) The assessee has not computed excessive loss, or

(iii) The assessee has not underpaid the tax in any manner.

A notice is served under section 143(2) within 12 months from the end of the month in which the return is furnished.

Where a regular assessment is made under section 143(3), any tax or interest paid by the assessee under section 143(1) shall be deemed to have been paid towards such regular assessment. If no refund is due on regular assessment or the amount refunded under section 143(1) exceeds the amount refundable on regular assessment, the whole or the excess amount so refunded shall be deemed to be tax payable by the assessee and the provisions of the Act shall apply accordingly.

Section 144 provides for best judgment assessment if the assessee fails to make the return required under section 139(1) or section 139(4) or section 139(5) or fails to comply with all the terms of a notice issued under section 142(1) or fails to comply with a direction issued under section 142(2A) or having made a return, fails to comply with all the terms of a notice issued under section 143(2). However, before making an assessment an opportunity of being

heard must be given to the assessee. A best judgment assessment consequent to failure of the assessee to comply with the notice issued under section 142(1) does not require giving of any such opportunity of hearing to the assessee.

Question 20

What do you understand by Permanent Account Number? Discuss the procedure for allotment of this number, and its use. *(9 Marks) (May 97)*

Answer

Every person who has not been allotted a permanent account number (PAN) shall make an application to the Assessing Officer for the allotment of such number.

The following are the categories of persons to whom it will apply :-

(i) A person whose total income exceeds the maximum amount not chargeable to tax.

(ii) A person carrying on any business or profession whose total sale, turnover or gross receipts exceeds Rs.5,00,000 in any previous year.

(iii) A person who is required to file a return of income in respect of a religious or charitable trust referred to in section 139(4A).

(iv) A person being an employer who is required to furnish a return of fringe benefits under section 115WD.

These persons are required to apply to the Assessing Officer for the allotment of a PAN. The Assessing Officer may also allot a PAN to any other person by whom tax is payable. The Board may by Notification in the Gazette may also specify the place or places and the dates from which a new series of PAN may be allotted and on such allotment, the earlier PAN will cease to have effect.

Every person allotted a PAN shall quote the same in all returns, challans and correspondence with any IT authority. The number should also be quoted in all documents relating to transactions as may be prescribed by the Board in the interest of revenue. Every person to whom a PAN is allotted is required to intimate his change of address or in the name or nature of the business on the basis of which a PAN was allotted to him.

Under section 272B if a person fails to comply with the provisions of section 139A, the Assessing Officer may levy penalty of Rs.10,000. However, before the levy of penalty an opportunity of being heard must be given to the assessee.

Question 21

Compare and contrast the provisions of tax audit as contained in Section 44AB of the Income-tax Act, with the provisions of a tax audit under Section 142(2A) of the Act.

(6 Marks) (May 2001)

Answer

(1) Turnover limit :The provisions of section 44AB apply to assessees whose sales, turnover or gross receipts exceed Rs.40 lakhs or to those who are carrying on a profession if the gross receipts exceed Rs.10 lakhs. The provisions of section 142(2A), on the other hand, apply to assessees, irrespective of their sales, turnover or gross receipt, if the Assessing Officer is of the opinion that it is necessary to have the accounts audited, having regard to the nature and complexity of the accounts and the interests of revenue.

(2) Choice of selecting auditor : An audit under section 142(2A) has to be conducted by a chartered accountant nominated by the Commissioner. In the case of a tax audit under section 44AB, the choice of the auditor is that of the tax payer.

(3) Audit report and details : The tax audit report under section 44AB is to be made in the form prescribed under the Rules and has to be furnished before the specified date. (Form 3CA and 3CD in the case of companies and Form 3CB and 3CD for other tax payers). On the other hand, the audit report under section 142(2A) will set forth such particulars prescribed in Form No.6B and such other particulars as the Assessing Officer may require. It has to be furnished, notwithstanding the fact that the accounts have been audited under any other law.

(4) Submission of report : The report under section 142(2A) has to be furnished within the period specified by the Assessing Officer, which may be extended on an application made by the assessee, provided the aggregate period does not in any case exceed one hundred and eighty days from the date on which the direction is received by the assessee to get his accounts audited. The report under section 44AB is to be furnished before 31st day of October of the assessment year annexed to the return of income or where the return is not filed before the date specified in section 139(1), the tax audit report has to be submitted to the Assessing Officer.

(5) Expenses of audit : The expenses of an audit under section 142(2A), including remuneration are fixed by the Commissioner and may be recovered as an arrear of land revenue. The expenses including remuneration of an audit under section 44AB are fixed by mutual agreement between the assessee and the auditor.

Question 22

An assessee filed a return of income on 31.8.2000 in respect of Assessment year 2000–2001 disclosing an income of Rs.3 lakhs from business. It was not accompanied by proof of payment of tax due on self-assessment. Discuss the validity of such a return.

(4 Marks) (Nov.2000)

Answer

As per Explanation to sub-section (9) of section 139 a return is regarded as defective unless it is accompanied by proof of tax deducted at source, advance tax and tax on self-assessment, if any, claimed to have been paid. Therefore, the return is prima facie defective. It is not invalid at that stage. On receipt of the return, the Assessing Officer has to intimate the defect to the assessee and give him an opportunity to rectify the defect within a period of 15 days from the date of such intimation or within such further period which, on application by the assessee, he may, in his discretion allow. If the defect is not rectified within the said period, the return will be treated as an invalid return and the provisions of the Income-tax Act shall apply, as if the assessee has failed to furnish the return.

Also, students may note that section 140A(3) says that if an assessee fails to pay tax or interest on self assessment he shall be deemed to be an assessee in default in respect of the tax or interest or both remaining un paid and all the provisions of the Act shall apply accordingly.

Question 23

Write short note on : Representative assessee. *(6 Marks) (Nov.2000)*

Answer

Section 160 gives the definition of representative assessees as follows :

(i) in respect of the income of a non-resident, specified in section 9(1) the agent of the non-resident including a person who is treated as an agent under section 163.

(ii) in respect of the income of a minor, lunatic or idiot, the guardian or manager who is entitled to receive or is in receipt of such income on behalf of the minor, lunatic or idiot.

(iii) in respect of income which the Court of Wards, the Administrator- General, the Official Trustee or any receiver or manager (including any person, whatever his designation, who in fact manages property on behalf of another) appointed by or under any order of the Court, receives or is entitled to receive, on behalf or for the benefit of any person, such Court of Wards, Administrator-General, Official Trustee, receiver or manager.

(iv) in respect of income which a trustee appointed under a trust declared by a duly executed instrument in writing (including a Wakf deed) receives or is entitled to receive on behalf of or for the benefit of the person, such trustee or trustees.

(v) in respect of income which a trustee appointed under an oral trust receives or is entitled to receive on behalf or for the benefit of the person, such trustee or trustees.

Question 24

(i) Discuss briefly about returns to be filed under section 139(1) proviso i.e. under economic criteria. (6 Marks) (Nov.2003)

(ii) Persons residing in notified cities and towns are required to file the return of income based on economic criteria. Discuss. List the persons who are exempted.

(8 Marks) (May 2000)

(iii) Returns under economic criteria (generally known as one by six criteria)

(6 Marks) (May 1999)

Answer

The Finance Act, 2006 has amended proviso to section 139(1) whereby filing of returns under economic criteria (known as one by six scheme) will apply only for previous year ending before 01.04.2005. In other words, for the previous years ending 31.03.2006 and thereafter, no such returns need to be filed.

Question 25

To whom the appeal lies against the Block assessment order? What is the limitation period for filing such appeal ? (4 Marks) (Nov.97)

Answer

Block assessment procedure contained in chapter XIV-B do not apply where the search is initiated on or after 31.05.2003. Hence, the question of block assessment will not arise in respect of previous year relevant to the assessment year 2007-08.
However, in respect of search cases provisions of sections 153A, 153B and 153C are applicable for the previous year relevant to the assessment year 2007-08. Such assessment orders are appealable similar to any other assessment order under section 246A and hence the appeal would lie before Commissioner (Appeals). The time limit making for appeal is 35 days from date of receipt of order from the Assessing Officer.

Question 26

In computing income under certain heads of income, method of accounting is irrelevant, while in some it is relevant. Comment.

(4 Marks) (Nov.2005)

Answer

Section 145(1) of the Income-tax Act, 1961 states that income chargeable under the head "Profit and gains of business or profession" or "Income from other sources" shall be computed in accordance with either cash or mercantile system of accounting regularly employed by the assessee.

This implies that the income under the remaining heads of income, namely Salaries. Income from house property and Capital gains, should be computed as per the relevant provisions contained in the Income-tax Act. In such cases, the income has to be computed as laid down by the provisions of the Act, irrespective of the method of accounting employed by the assessee.

The Central Government, under section 145(2), is empowered to notify accounting standards to be followed by any class of assesses or in respect of any class of income. So far, the CBDT has notified two accounting standards which are required to be followed by all assesses following the mercantile system of accounting.

Hence, it could be said that the method of accounting is irrelevant while computing income under certain heads of income, whereas in some others it is relevant.

CHAPTER 16

APPEALS AND REVISION

Question 1

Choose the correct answer with reference to the provisions of the Income-tax Act, 1961.

The time limit for passing an order of revision under section 263 by the Commissioner of income-tax, where the same is to give effect to a direction by the High Court is

(a) Two years from the date of direction

(b) Three years from the date of direction

(c) Two years from the end of the financial year in which the direction is given

(d) There is no time limit *(1 Mark) (May 2005)*

Answer

(d) i.e. there is no time limit.

Question 2

(i) Write short notes on: Revision by Commissioner of Income Tax u/s 263 of the Act.

(6 Marks) (May 2004) (6 Marks) (May 2000)

(ii) Write short note on: Revision of orders prejudicial to the revenue.

(6 Marks) (Nov.2001) (6 Marks) (Nov.99) (6 Marks)(May 1996)

Answer

Under section 263, the Commissioner can revise an order passed by the Assessing Officer if he considers it erroneous in so far as it is prejudicial to the interests of revenue. For this purpose, he may call for and examine the record of any proceeding under the Act. "Record" shall include all records relating to any proceedings under this Act available at the time of examination by the Commissioner of Income-tax.

If the Commissioner considers that any order passed by the Assessing Officer is erroneous and prejudicial to the interests of

revenue, then he can pass an order enhancing or modifying the assessment or canceling the assessment and directing a fresh assessment. For this purpose, the Commissioner may make or cause to be made such inquiry as he deems necessary. However, such order can be passed only after giving the assessee an opportunity of being heard.

The order cannot be revised after the expiry of 2 years from the end of the financial year in which the order sought to be revised was passed. In computing the period of 2 years, the time taken in giving an opportunity to the assessee to be reheard under the proviso to section 129 and any period during which the revision proceeding is stayed by an order or injunction of any court shall be excluded.

The time limit would not apply where an order in revision is passed in consequence of or to give effect to any finding or direction contained in an order of the Appellate Tribunal, the High Court or the Supreme Court.

Where any order passed by the Assessing Officer had been a subject matter of any appeal, the powers of the Commissioner shall extend to such other matters as had not been considered and decided in such appeal.

Students may note the following pointwise answer to the question.

(i) The Commissioner of Income Tax (CIT) has power on his own motion to call for and examine the record of any proceedings under the Act and make such enquiry as the deems necessary provided he considers that any order passed by the Assessing Officer is erroneous in so far as it is prejudicial to the interest of revenue.

(ii) He has to give the assessee an opportunity of being heard before any order is passed under this section.

(iii) He can enhance, modify or cancel an assessment. He can direct that a fresh assessment should be made.

(iv) The term `record' for the purpose of this section shall include all records relating to proceedings available at the time of his examination.

(v) If the order passed by Assessing Officer has been a subject matter of appeal, the power of the CIT shall extend to such matters as had not been considered and decided in such appeal. However, he will not have revisionary powers on matters which have been decided in the appeal.

(vi) Order passed under section 147 can also be revised under section 263.

(vii) There is a time limit of two years for revision which is to be reckoned from the end of the financial year in which the order sought to be revised was passed by the Assessing Officer.

Question 3

An order of assessment was made by a Deputy Commissioner of Income-tax on 20th March, 1996, disallowing among others, the following claims of an assessee :

		Rs.
(i)	***Technical fees paid to a non-resident company***	***8,40,000***
(ii)	***Salary paid to a technician***	***1,60,000***
(iii)	***Travelling expenses incurred on the travel of the wife of the Manager***	***2,00,000***
(iv)	***Salary paid to an employee – found to be in excess under Section 40A(2) of the Act***	***1,80,000***

The assessee filed an appeal to the Commissioner of Income-tax (Appeals) against disallowance mentioned against items (i), (ii), and (iii) above.

In the course of the appeal proceedings, it was ascertained that the assessee had paid totally Rs.16,80,000 in the year as technical fees under a collaboration agreement, but the Assessing Officer after examining the evidence produced, decided that 50% of the payment was capital expenditure. The assessee, in appeal, claimed that the interpretation placed by the Assessing Officer on the agreement was wrong and that the entire payment must be allowed as a deduction. Commissioner (Appeals) accepted this argument and deleted the addition of Rs.8,40,000 made by the Assessing Officer. He also allowed in full the claim against item no. (ii) and upheld the disallowance of the claim against item no. (iii) above.

By notice dated 20th April, 1998, Commissioner of Income-tax issued a notice under section 263 of the Income-tax Act proposing to review the order of assessment, made on 20th March, 1996, in regard to the claim of technical fees. He felt that the Assessing Officer must have concluded that the entire payment of technical fees was capital expenditure and to that extent, therefore, the order of assessment was prejudicial to the interests of revenue.

Was the Commissioner of Income-tax justified in this action ? Give reasons for your answer.

(6 Marks) (May 1998)

Answer

Let us assume the order was passed by the Assessing Officer in March 2004 and the Commissioner wants to invoke section 263 in April, 2006.

The proposal suffers from two fundamental infirmities :

(i) any action under section 263 should be taken and the order under that section should be passed within the period of two years from the end of the financial year in which the order sought to be revised was made. In this case, the order of assessment was made on 20th March, 2004 and the limitation period for making an order under section 263 expired on 31st March, 2006. In this case, the notice itself was issued in April, 2006 and thus it is time-barred.

(ii) The second infirmity is that the Commissioner cannot interfere under Section 263 on a matter which had been subject to appeal. In the present case the allowance of technical fees was the subject matter of appeal before CIT (Appeals) and hence Section 263 cannot be applied. Hence the proposed action is invalid and illegal.

Question 4

Ram received an assessment order under Section 143(3) along with a notice of demand for Rs.56,000 on 3rd March, 1996.

Ram wishes to dispute the demand since Ram does not agree with the disallowances made by the assessing officer. But till 30th April, 1996 Ram has not filed an appeal to Commissioner of Income Tax (Appeals). What are the remedies now open to Ram to contest the disallowances? (3 Marks) (May 1996)

Answer

Let us assume that the notice of demand was received on 3rd March, 2006 and till 30th April, 2006, assessee Ram has not preferred appeal before CIT (Appeals).

As per section 249, the appeal to Commissioner (Appeals) is to be presented within 30 days of the date of service of the notice of demand where the appeal relates to any assessment or penalty. Ram received the notice of demand on 3rd March. Hence, Ram should have filed the appeal to the CIT (Appeals) within 2nd April.

However, the CIT (Appeals) may admit an appeal after the expiry of the said period of 30 days, if he is satisfied that the Appellant had sufficient cause for presenting it within that period. Hence, Ram can apply to the CIT (Appeals) for condonation of delay giving sufficient reason for the delay.

If the delay is not condoned by the CIT (Appeals) under section 249 Ram can seek the remedy under section 264. As per section 264, the assessee can make application to the Commissioner for revision of the order passed by Assessing Officer within one year from the date on which the said order was communicated to him or the date on which he otherwise came to know of it, whichever is earlier.

Since the period of one year from 3rd March has not yet expired Ram can definitely seek the remedy under section 264 to contest the disallowances.

Question 5

In respect of assessment year 1995-96 an assessee disclosed, inter alia, the value of a property sold by him for an apparent consideration of Rs.5 lakhs and the resultant capital gains at Rs.1 lakh. This was accepted by the Assessing Officer under Section 143(3) without *making any enquiry with the parties to the transaction. The Commissioner of Income Tax acting under Section 263, set aside the assessment with a direction to enquire into the correct sale value in order to arrive at the capital gains chargeable to tax. Discuss the principle under which jurisdiction under Section 263 can be assumed by the C.I.T. in the circumstances of the case.* *(5 Marks) (May 97)*

Answer

It is the duty of the Assessing Officer to ascertain the actual facts stated in the return when the circumstances of the case are such as to provoke an enquiry. It is incumbent on the Assessing Officer to further investigate the facts stated in the return when circumstances would make such an enquiry prudent. The expression "erroneous" in section 263 would include a failure to make an enquiry. The order becomes wrong because such an enquiry has not been made. Even if information regarding the incorrectness of the sale consideration comes to light subsequent to the assessment, the matter falls within the scope of section 263. The definition of "record" in Explanation to Section 263 has removed any possible doubts in the matter.

Question 6

Discuss revision of orders under section 264 of the Income-tax Act *(6 Marks) (Nov.2002)*

Answer

(i) In the case of any order other than an order referred to in section 263 passed by a subordinate authority, the Commissioner may, either on his motion or on an application by the assessee for revision, call for the record of any proceedings under the Income-tax Act in which any such order has been passed and may pass such order thereon as he deems fit.

(ii) Any order prejudicial to the interest of assessee cannot be passed under this provision. However, the Commissioner declining to interfere will not amount to passing of an order prejudicial to the assessee.

(iii) The Commissioner shall not on his motion revise any order if the order has been made more than one year previously.

(iv) Every application for revision shall be accompanied by a fee of Rs.500/-.

(v) Application for revision by the assessee must be made within one year from the date on which the order was communicated to him or the date on which he otherwise came to know of it whichever is earlier.

(vi) On every application by an assessee for revision, an order shall be passed within one year from the end of the financial year in which such application was made by the assessee for revision. In computing this time limit, the time lost under section 129 or due to stay order by Court shall be excluded. Besides, there is no time limit for the Commissioner to pass an order of revision in consequence of or to give effect to any finding or direction contained in an order of the Appellate Tribunal, High Court or Supreme Court.

(vii) The Commissioner has the power to condone the delay, if he is satisfied that the assessee was prevented by sufficient cause from making the application within the specified time.

(viii) If the order is an appealable order, the application can be made only if the appeal is not filed or where the time limit for filing the appeal has not lapsed, only if the right of appeal is waived.

Question 7

Which of the orders are not subject to revision under section 264? *(4 Marks) (Nov.97)*

Answer

Section 264 says that any order other than an order to which section 263 applies passed by an authority subordinate to him, the Commissioner may either of his own motion or an application by the assessee for revision, call for the record of any proceeding under the Act and make an order. The order so passed may be after making such enquiry and not being prejudicial to the interests of the assessee.

The Commissioner shall not of his own motion revise an order under section 264 after the expiry of one year after it was made.

Where an appeal lies to the Commissioner (Appeals) or to the appellate tribunal shall not be eligible for revision under section 264.

Where the time limit for making appeal before Commissioner (Appeals) or Appellate Tribunal has not expired and where the assessee has not waived his right of appeal, an order under section 264 is not possible.

Question 8

Write short note on: *Appealable orders before Commissioner of Appeals.*

(6 Marks) (Nov.2002)

Answer

Under section 246A, the following orders shall be appealable.

(i) An order against the assessee where the assessee denies his liability to be assessed under this Act or intimation under section 143(1)/ 143(3) or 144. An order of assessment relating to fringe benefit tax passed under section 115 WE or a best judgment assessment under section 115 WF.

(ii) An order of assessment, re-assessment or re-computation under section 147/150. An order of assessment for fringe benefits escaping assessment passed under section 115 WG. Also, an order of assessment in search cases under section 153A.

(iii) An order made under section 154/155, enhancing the assessment/reducing the refund.

(iv) An order made under section 163, treating the assessee as the agent of a non-resident.

(v) An order made under section 170(2) or section 170(3).

(vi) An order made under section 171.

(vii) An order made under section 201.

(viii) An order made under section 237.

(ix) An order imposing a penalty under sections 221/271/271A/271F/ 271FB/ 272AA/272BB.

(x) An order imposing penalty under sections 271B/271 BB/271C /271CA /271D /271E /272A

Question 9

Write short notes on: Powers of the Commissioner (Appeals) *(6 Marks) (Nov.2001)*

Answer

As per section 251 of the Income-tax Act, 1961, the Commissioner (Appeals) while disposing of the appeal is vested with the following powers:-

(a) In an appeal against the orders of assessment, he may confirm, reduce, enhance or annul the assessment. He cannot set aside the assessment as that power has been removed w.e.f. 1.6.2001.

(b) In an appeal against an order imposing a penalty, he may confirm or cancel such order or vary it so as either to enhance or reduce the amount of penalty.

(c) In any other case, he may pass such orders in the appeal as he thinks fit.

(d) The Commissioner (Appeals) should not enhance an assessment or a penalty or reduce the amount of refund unless the appellant had a reasonable opportunity of showing cause against such enhancement or reduction.

(e) The Commissioner (Appeals) can also decide any matter arising out of the proceedings in which the order appealed against was passed, even if such matter was not raised before the Commissioner (Appeals) by the appellant.

CHAPTER 17

THE CENTRAL SALES TAX ACT, 1956

Question 1

Choose the correct answer with regard to the provisions of the Central Sales-tax Act :

(a) The collection of Central Sales-tax is effected by

(i) the State where the goods are produced ;

(ii) the State where the movement of goods begins ;

(iii) the State where the goods are delivered ;

(iv) the Central Government directly from the dealer. (1 Mark) (Nov. 2005)

(b) The levy of Central Sales-tax is on

(i) purchase of goods ;

(ii) sale of goods ;

(iii) purchase or sale of goods ;

(iv) None of the above.
(1 Mark) (Nov. 2005)

(c) G effected inter-state sale of declared goods to H, charging correct CST of 3%. G should obtain from H

(i) Form `D' ;

(ii) Form`C' ;

(iii) Form `G' ;

(iv) No form.
(1 Mark) (Nov. 2005)

(d) R of Coimbatore, Tamil Nadu sold to a Malaysian ship at Kochi port in Kerala, some goods for consumption on board the ship. Such sale will be

(i) inter-state sale ;

(ii) export sale as it is a foreign ship.

(iii) intra-state sale;

(iv) sale in the course of import.
(1 Mark) (Nov. 2005)

(e) A dealer engaged in effecting inter-state sale is required to get himself registered where his turnover exceeds

(i) Any amount

(ii) Rs.1,00,000

(iii) Rs.2,50,000

(iv) Rs.3,00,000
(1 Mark) (Nov. 2005)

(f) The collection of central sales tax is done by

(a) the State in which the movement of goods has first taken place ;

(b) the State in which the movement of goods ends ;

(c) the Central Government directly

(d) none of the agencies above.
(1 Mark) (May 2005)

(g) R Oils Ltd., New Delhi sent via its pipeline special purified oil to B Ltd. in Noida, Uttar Pradesh, through its branch at Noida. This transaction has to be regarded as :

(a) Branch transfer by HO to branch

(b) Branch transfer by HO to branch and then sale with State by the branch of R Oils Ltd., to B Ltd.

(c) Inter-State sale

(d) Intra-State sale
(1 Mark) (May 2005)

(h) X effected his first inter-state sale on 12.3.2005 and applied for registration on 10.4.2005. The effective date of registration will be :

(a) 10.4.2005

(b) 12.3.2005

(c) 12.4.2005

(d) Date on which the registering authority issues the registration certificate.

(1 Mark) (May 2005)

(i) In case of inter-State sale to the Government, the applicable rate of tax is

(a) Nil

(b) Always 4%

(c) *4% or the sales tax rate for the concerned goods in the appropriate State, whichever is higher*

(d) *4% or the sales tax rate for the concerned goods in the appropriate State, whichever is lower.*
(1 Mark) (May 2005)

Answer

(a) (ii) the State where the movement of goods begins

(b) (ii) sale of goods

(c) (ii) Form 'C' [assuming that H is a registered dealer and the declared goods are covered in the registration certificate of such dealer]

(d) (i) inter-state sale
(e) (i) Any amount
(f) (a) the State in which the movement of goods has first taken place
(g) (c) Inter-State sale
(h) (b) 12.3.2005
(i) (d) 4% or the sales tax rate for the concerned goods in the appropriate State, whichever is lower.

Question 2

Fill up the blanks, having regard to the provisions of the Central Sales-tax Act.

(1) *D, a dealer in Maharashtra has sold goods to G in Gujarat for which the sales tax rate in Maharashtra is 2% and the rate in Gujarat is 3%. The CST leviable is…….. ..*

(1 Mark) (Nov.2005)

(2) *The application for compulsory registration should be submitted by a dealer within……….days of making an inter-state sale. (1 Mark) (Nov.2005)*

(3) *C of Karnataka sends goods to T of Tamil Nadu for doing some job work. T adds some materials of his own, completes the job and returns the same to C. The above transaction……..(attracts/does not attract) liability to CST. (1 Mark) (Nov.2005)*

(4) *The dealer aggrieved by an appealable order should normally file appeal within……….days from the date of ……….. (1 + 1 Mark) (Nov.2005)*

Answer

(i) 2% [assuming that G is a registered dealer and the goods are covered in the registration certificate of such dealer and Form C is furnished]

(ii) 30

(iii) Attracts (See Note below)

(iv) 45 ; service of such order upon him.

Note – If the job worker does not use his own material, there is no transfer of property in goods involved in works contract, and consequently, CST is not payable. However, in this case, since T adds some materials of his own, tax may be leviable on material used by T in execution of job work, as it will be goods involved in execution of works contract.

Question 3

State with reasons whether the statements are true or false as per the provisions of the CST Act :

(i) If a dealer applies for amendments to his certificate of CST registration, the amendment will be effective from the date on which the dealer makes an application for amendment.

(ii) The certificate of CST registration is non-transferable.

(iii) One Form `C' issued by the buyer to seller can cover all transactions in one financial year.

(iv) In case of penultimate seller making sales to the actual exporters, the actual exporters shall issue a certificate to the penultimate seller in Form H.

(v) The directors of a private company in liquidation are jointly and severally liable personally for any sales tax liability of the company in liquidation. (5 x 1 = 5 Marks) (Nov.2005)

Answer

(i) True. If a dealer applies for amendment of his certificate of CST registration and the amendment is allowed by the CST authority, it becomes effective from the date on which the application for this purpose was made by the dealer.

(ii) True. Certificate of registration is not transferable. If the dealer sells his business, the new buyer has to apply for fresh registration. However, in case of retirement or death or addition of a partner, only amendment to the certificate of registration is necessary.

(iii) True. One Form `C' can cover all transactions in one financial year irrespective of the total value of transactions during the year. If, however, a transaction covers more than one financial year, separate Form `C' is required for each financial year.

(iv) True. The actual exporter has to issue a certificate to the penultimate seller in Form H. Form H can be obtained from sales tax authority by the exporter.

(v) **True.** As per section 18, if a private company is wound up and any tax assessed on the company cannot be recovered, then every person who was a director of the private company at any time during the period for which tax is due shall be jointly and severally liable for the payment of such tax, unless he proves that the non-recovery cannot be attributed to any gross neglect, misfeasance or breach of duty on his part in relation to the affairs of the company.

Question 4

Discuss whether the following statements are true or false, under the CST Act.

(i) *An Adatiya who brings together the buyer and seller of goods for commission and does not effect sale on his own account but brokers between the buyers and sellers for settling the price is not liable to be registered under the CST Act.*

(ii) *An Insurance Company, which has taken possession of damaged goods of the insured is a dealer if such goods are sold by the insurance company later on.*

(iii) *Profit motive is essential to call an activity a "Business" under the CST Act.*

(iv) *CST is leviable on transactions of leasing/hiring of assets for a defined period.*

(4 x 2 = 8 marks) (May 2005)

Answer

(i) **True**. A kachha Adatia does not sell goods on his own account. He merely does the job of broking between the buyer and seller for settling the price for which service he gets commission. Therefore, he is not liable to be registered under the Central Sales Tax Act as a dealer.

(ii) **True**. An insurance company which has taken possession of the damaged goods of the insured is a dealer, if such goods are sold later on.

(iii) **False**. Profit motive is not essential to call an activity a 'business' under the Central Sales Tax act. The definition of "business" clearly mentions that for an activity to be called "business" under section 2(aa), profits motive is not necessary.

(iv) **True**. CST is leviable on transactions of leasing/hiring of assets for a defined period. According to section 2(g) of the Central Sales Tax Act, transaction of leasing and hiring of assets for a defined period is deemed to be a sale.

Question 5

Discuss the following, with brief reasons, whether they are True/False under CST Act::

(a) *Appeal against an order passed by the registration authority must be filed within 90 days of the service of order to the Central Sales Tax Appellate Authority.*

(b) *Excise duty would form part of sale price and turnover.*

(c) *Where the dealer being a proprietor dies – the certificate of registration will be cancelled*

(d) *`Place of business' does not include place of business of the agent.*

(e) *A dealer who does not get himself registered is liable for penalty.*

(5 x 2 = 10 marks) (May 2004)

Answer

(a) **False :** As per section 20(2) appeal should be filed within 45 days from the date on which the order passed by the Assessing Authority is served on the dealer. However, the Authority may entertain any appeal after the expiry of 45 days but not later then 60 days from the date of service of the order, if it is satisfied that the appellant was prevented by sufficient cause from filing the appeal on time.

(b) **True :** Excise duty forms part of sale price and turnover. Therefore, it is not to be excluded or deducted from sale price or turnover.

(c) **True :** As per section 7(4)(b), where the dealer ceases to exist, his certification of registration will be cancelled by the Assessing Authority.

(d) **False** : As per section 2(dd), place of business includes the place of business of an agent where a dealer carries on business through such agent.

(e) **True** : Failure to get registered as required under section 7(1) is a punishable offence, if the dealer has made an inter-state sale. According to section 7(1), every dealer, who is liable to pay tax under the Central Sales Tax Act, is under an obligation to get himself registered under the Central Sales Tax Act. The liability to pay central sales tax arises only when the dealer makes an inter-state sale.

Note **– It is also possible to answer that this statement is false giving the explanation that only a dealer who makes an inter-state sale is liable to pay central sales tax and hence is required to get himself registered under section 7(1). Since the question does not mention that the dealer has made an inter-state sale or that the dealer is liable to pay central sales tax, students may assume that the dealer has not made an inter-state sale and is hence not liable to pay central sales tax. Therefore, he need not get himself registered, and consequently penal provisions are not attracted.**

Question 6

Answer any five from the following with brief reasons whether they are True/False under CST Act:

(a) *Both registered and unregistered dealers can collect tax under CST.*

(b) *Cost of freight separately charged in the invoice shall be deducted from sale price.*

(c) *Subsidy given by Government to manufacturers to compensate cost of production will form part of sale price*

(d) *All Directors of private company (present and past) are personally liable for any tax due under the CST Act*

(e) *Indian Railways which sells unclaimed/uncollected goods is a dealer.*

(f) *"Goods" include shares and securities.*

(g) *When goods are sent by VPP, the sale is said to take place in the State from where the parcel is sent.* *(5 x 2 = 10 marks) (Nov.2003)*

Answer

(a) **False :** Only a registered dealer can collect tax under the Central Sales Tax Act as per section 9A. Further, the registered dealer should collect the tax in accordance with the Central Sales Tax Act, 1956 and rules made thereunder.

(b) **True :** Section 2(h) provides that if freight is charged separately in the invoice, it shall be deducted from sale price.

(c) **False:** Where a product is \`controlled' and has to be sold at \`controlled price', subsidies are granted by the Government to manufacturers to compensate the cost of production, which is usually higher than the \`controlled price'. Such subsidy will not form part of sale price.

(d) **False :** Section 18 provides that the Directors of a private company which is wound up are jointly and severally liable for any tax arrears during their tenure unless they prove that the non-recovery cannot be attributed to their gross neglect, misfeasance or breach of duty. Since the statement in the question does not mention that the private company is would up, it is false.

Alternative Answer

True : The statement is true assuming that the liability has arisen consequent to winding up of the company and is attributable to the director's gross neglect, misfeasance or breach of duty.

(e) **True :** As per Explanation 2 to section 2(b), Indian Railways which sells unclaimed/uncollected goods is deemed to be a dealer. The Supreme Court has held in the Member, Board of Revenue, West Bengal vs. Controller of Stores, Eastern Railway, Calcutta (1989) 74 STC 5, that the sale of unclaimed goods was an activity for which the South Eastern Railway was a "dealer" and was liable to sales tax.

(f) **False :** The definition of goods under section 2(d) excludes shares and securities.

(g) **False :** The sale transaction is complete only when the buyer/consignee accepts the VPP. Hence, sale is said to take place where the goods are accepted and delivered.

Question 7

State with reasons whether the following are True/False under CST Act:

(a) *Charity or dharmada collected by dealer will not form part of sale price.*

(2 Marks) (Nov.2002)

(b) Packing charges realized by the dealer was an integral part of sale price.

(2 Marks) (Nov.2002)

(c) (i) Sale of bundles of old newspaper as waste papers, are exempt.

(2 Marks) (Nov.2002)

(ii) A publisher of newspaper sells the unsold copies of the paper as waste.

Is such a sale liable to sales tax. *(2 Marks) (Nov.2000)*

(d) `Goods' include shares and securities. *(2 Marks) (Nov.2002)*

(e) There is no benefit for a person to purchase the goods from a registered dealer.

(2 Marks) (Nov.2002)

Answer

(a) The statement is false. Any amount received by a dealer as consideration for the sale of any goods will form part of the sale price under section 2(h). Hence Charity/Dharmada collected will form part of sale price.

(b) The statement is true. Packing charges are charged for the services rendered in packing the goods and as such, they are an integral part of the sale price.

(c) The statement is false. Sale of bundles of old newspaper as waste paper is not sale of newspaper and is therefore, not exempt.

(d) The statement is false. As per section 2(d) the definition of `goods' does not include shares and securities.

(e) The statement is true, where the purchaser is not a registered dealer. However, the statement is false if the purchaser is a registered dealer because a registered dealer can purchase goods from another State against "C" form at a concessional rate.

Question 8

State with reasons, whether the following are True or False under the Central Sales-tax Act :

(a) Electricity supplied will not come within the meaning of `Goods' under Central Sales-tax Act.

(b) The supply of Aviation Spirit by a petroleum dealer from his depots at an Airport in India to an Aircraft proceeding abroad is an export out of India eligible for exemption under CST.

(c) In respect of Declared Goods, Central Sales Tax can exceed 4% for Sales to Government.

(d) Weighment charges charged separately from buyers will not form part of sale price.

(e) To avail concession in CST, in respect of sales to Registered dealers, `Form D' is to be furnished by the dealer. *(5 x 2 = 10 marks) (May 2003)*

Answer

(a) **False.** The definition of goods in section 2(d) is inclusive and hence electricity is not specifically excluded from goods. However, section 6(1) exempts electricity from liability to tax on inter state sale.

(b) **False.** As there is no destination to which the spirit is said to have been exported. Hence no exemption is available.

(c) **False.** It cannot exceed 4%. The applicable rate of tax would be 4% or State sales-tax rate, whichever is lower.

(d) **True.** Weighment charges, when separately charged, would not form part of the turnover of dealer.

(e) **False.** "Form D" will be produced only for sale to Government.

Question 9

(i) State the objects of the Central Sales Tax Act. *(5 Marks) (May 2000)*

(ii) State the objects of Central Sales Tax Act. *(5 marks) (Nov.98)*

(iii) State all the objectives for which Central Sales Tax Act, 1956 has been designed.

(7 marks) (May 1996)

Answer

The objects of the Central Sales Tax Act are :

- To formulate principles for determining when a sale or purchase of goods takes place in the course of interstate trade or commerce or when a sale or purchase takes place outside a State or when a sale or purchase takes place in the course of import into or export from India.
- To provide for the levy, collection and distribution of taxes on sale of goods in the course of interstate trade or commerce.
- To declare certain goods to be of special importance in interstate trade or commerce.
- To subject the State laws to restrictions and conditions in the matter of imposing taxes on the sale or purchase of goods declared by the Central Government to be of special importance.

Question 10

To what extent the Constitution (46th Amendment) Act, 1982 has widened the scope of making levy both in the case of Government of India as well as State Governments.

(5 Marks) (May 1996)

Answer

The Constitution (46th Amendment) Act, 1982 has widened the scope of making levy both in the case of Government of India as well as State Government. Both the Governments may after enacting suitable legislations, levy tax on the transactions of the following nature :

(a) Transfer of property in goods involved in the execution of a works contract ;

(b) Delivery of goods on hire purchase or any system of payment by instalments ;

(c) Transfer of the right to use any goods for any purpose for cash, deferred payment or other valuable consideration ;

(d) Supply of goods by an unincorporated association or body of persons to a member thereof for cash, deferred payment or other valuable consideration ; and

(e) Supply by way of particular service of good or any drink for cash, deferred payment or other valuable consideration.

The definition of term "sale" has been accordingly amended and it has wider coverage now.

Question 11

Write short note on Appropriate State. *(5 Marks) (Nov.2001)(May 1999)*

Answer

Section 2(a) defines the term "Appropriate state".

If a dealer has one or more places of business situated in the same State, that State would be the appropriate State.

If the dealer has places of business situated in different States, then the appropriate state in relation to the dealer would be every such State in which he has got a place of business.

The term is extremely important and material as it has been referred to in several sections, viz. Section 9, Section 8(2) and Explanation to Section 7(2) and Section 9(3).

Question 12

Write short note on business and place of business *(5 Marks) (May 98)*

Answer

The term 'business' is defined in section 2(aa) as 'includes any trade, commerce or manufacture or any adventure or concern in the nature of trade, commerce or manufacture, whether or not such trade, commerce, manufacture, adventure or concern is carried on with a motive to make gain or profit and whether or not any gain or profit

accrues from such trade, commerce, manufacture, adventure or concern'.

It also includes any transaction in connection with, or incidental or ancillary to such trade, commerce, manufacture, adventure or concern.

Place of business is defined in section 2(dd) and it includes (i) in any case where a dealer carries on business through an agent, (by whatever name called) the place of business of such agent ; (ii) a warehouse, godown or other place where a dealer stores his goods and (iii) a place where a dealer keeps his books of account.

Question 13

'Business' – how is it defined under the Central Sales-tax Act ? (5 Marks) (May 1998)

Answer

Section 2(aa) defines the term 'business'. It includes –

(i) Any trade, commerce or manufacture or an adventure in the nature of trade, commerce or manufacture, whether or not such trade, commerce and manufacture, adventure or concern is carried on with a motive to make gain, or profit and whether or not any gain or profit accrues from such trade, commerce, manufacture, adventure or concern; and

(ii) Any transaction in connection with or incidental to or ancillary to such trade, commerce, manufacture, adventure or concern.

Ordinarily, a business means any activity which occupies the time and labour of a person and is generally done with the object of making profit. The activity should be of sufficient volume, frequency, continuity and regularity. An activity presented without the profit motive may fall under business but every such activity cannot be treated as business.

Question 14

Write short note on:

(i) Crossing the Customs Frontier of India. (3 Marks) (Nov.2001)

(ii) 'Crossing the customs frontiers of India' and 'year'. (5 Marks) (Nov.97)

Answer

Section 2(ab) defines the expression "crossing the customs frontiers of India". It means 'crossing the limits of the area of a Customs Station in which imported goods or export goods are ordinarily kept before clearance by the Customs Authorities'.

'Customs station' means any Customs Port, Customs Airport or land Customs Station.

As per section 2(k) 'Year' in relation to a dealer means the year applicable in relation to him under the General Sales Tax law of the appropriate state, and where there is no such year applicable, the financial year.

Question 15

Discuss the correctness of the following proposition -

A branch outside the State cannot be considered as a dealer *(5 Marks) (May 2002)*

Answer

The given proposition is not correct. As per section 2(b) "dealer" means any person who carries on (whether regularly or otherwise) the business of buying, selling, supplying or distributing goods, directly or indirectly, for cash or for deferred payment or for commission, remuneration or other valuable consideration. Explanation 1 to the definition clarifies certain categories of agents who shall be deemed to be dealer for the purpose of the Act. As per the said Explanation a mercantile agent, agent handling goods or documents of title, agent for collection of payment and every branch or office in a State of a firm or company which is outside the State is also a dealer. Hence a branch outside the State is a dealer as per the said Explanation and accordingly the Explanation covers local branches and offices of firms and companies outside the State.

Question 16

Discuss the term `dealer' under the Central Sales Tax Act. *(5 Marks) (May 2000)*

Answer

As per section 2(b) the term "dealer" means any person who carries on (whether regularly or otherwise) the business of buying, selling, supplying or distributing goods, directly or indirectly, for cash or for deferred payment and includes –

(i) a local authority, a body corporate, a company, any co-operative society or other society, club, firm, HUF or other association of persons which carries on such business ;

(ii) a factor, broker, commission agent, del credere agent or any other mercantile agent, by whatever name called, who carries on the business of buying, selling or distribution of goods belonging to any principal, whether disclosed or not.

(iii) an auctioneer who carries on the business of selling or auctioning goods belonging to any principal, whether disclosed or not, whether the offer of the intending purchaser is accepted by him or by the principal or his nominee.

Question 17

Write short notes on : Deemed dealer *(5 Marks) (Nov.2001)*

Answer

The two explanations to section 2(b) of Central Sales-tax Act, 1956 deals with the expression 'deemed dealer'.

(a) Every person who acts as an agent, in any State of a dealer residing outside that State and buys, sells, supplies or distributes goods in the State or acts on behalf of such dealer as (i) mercantile agent as defined in the Sale of Goods Act, 1930 or (ii) an agent for handling of goods or documents of title relating to goods, or (iii) an agent for the collection or the payment of the sale price of goods or as a guarantor for such collection or payment, and every local branch or office in a State of a firm registered outside that State or a Company or other Body Corporate, the Principal office or Headquarters whereof is outside that State – Explanation 1.

(b) A Government which, whether or not in the course of business, buys, sells, supplies or distributes, goods, directly or otherwise, for cash or for deferred payment or for commission, remuneration or other valuable consideration shall, except in relation to any sale, supply or distribution of surplus, unserviceable or old stores or materials or waste products or obsolete or discarded machinery or parts or accessories thereof, be deemed to be a dealer for the purpose of the Act – Explanation II.

Question 18

(i) When can a Government be treated as a dealer ? *(3 Marks) (May 2004)*

(ii) When is a Government deemed to be a dealer for the purposes of the Central Sales Tax Act? *(3 Marks) (Nov.96)*

Answer

Explanation II to section 2(b) says that a Government which, whether or not in the course of business, buys, sells, supplies or distributes, goods, directly or otherwise, for cash or for deferred payment or for commission, remuneration or other valuable consideration shall be deemed to be a dealer.

However, such Government will not be deemed to be a dealer for the purposes of the Central Sales Tax Act, in relation to any sale, supply or distribution of surplus, unserviceable or old stores or materials or waste products or obsolete or discarded machinery or parts or accessories thereof.

Question 19

"The Central Government can become a dealer, but the State Government cannot." Is the statement correct? Give reasons. *(5 Marks) (Nov.99)*

Answer

This statement is incorrect. A Government, be it Central or State which, whether or not in the course of business, buys, sells, supplies or distributes goods directly or otherwise, for cash or for deferred payment or for commission, remuneration or other valuable consideration will be deemed to be a dealer.

However, a Government will not be deemed to be a dealer for the purposes of the Act, in relation to any sale, supply of distribution of surplus, unserviceable or old stores or materials or waste products or obsolete or discarded machinery or parts or accessories thereof.

Question 20

Explain the term "declared goods". Furnish any eight items of such declared goods under the CST Act. *(5 Marks) (May 2005)*

Answer

Declared goods means goods declared under section 14 of Central Sales Tax Act, 1956 to be of special importance in inter-State trade or commerce [Section 2(c)].

Examples of declared goods are :-

(i) Cereals

(ii) Coal, including coke in all its forms, but excluding charcoal

(iii) Cotton (indigenous or imported) in its un-manufactured state, whether ginned or unginned, baled, pressed or otherwise, but not including cotton waste

(iv) Cotton fabrics

(v) Cotton yarn, but not including cotton yarn waste

(vi) Crude oil

(vii) hides and skins, whether in a raw or dressed state

(viii) Iron and steel

(ix) Jute

(x) Oil seeds

(xi) Pulses

(xii) Man made fabrics

(xiii) Sugar

(xiv) Un-manufactured tobacco and tobacco refuse, cigars and cheroots of tobacco, cigarettes and cigarillos of tobacco and other manufactured tobacco

(xv) Woven fabrics of wool

(xvi) Aviation Turbine Fuel sold to a Turbo-Prop Aircraft

Note – Students are required to mention any 8 of the above declared goods.

Question 21

Short note on goods and declared goods *(5 Marks) (Nov.98)*

Answer

Section 2(d) defines the term 'Goods' and it includes all materials, articles or commodities and all kinds of moveable property, but does not include newspaper, actionable claims, stocks, shares and securities.

Declared goods is defined in section 2(c) and it means goods declared under section 14 of the Act, to be of special importance in inter-State trade or commerce.

Question 22

X sells his land along with the standing crops and trees for Rs.20 lakhs. The Sales-tax officer wants to assess for sale tax, the value of standing crops and trees. Comment.

(2 Marks) (Nov.2002)

Answer

Under section 2(7) of the Sale of Goods Act, growing crops, grass and things attached to and forming part of the land which are agreed to be severed before sale or under the contract of sale are "goods". So if separately sold they are liable to sales tax but if sold along with land they are not liable to sales tax since in that case, they are not "movable property".

Question 23

Explain briefly with reasons, if C.S.T. can be charged in the following situations :

(i) Sale of land and building

(ii) Sale of shares and securities

(iii) Value of goods transferred in works contract

(iv) Transfer of property in goods without consideration

(v) Transfer by way of mortgage *(2 x 5 marks) (May 2001)*

Answer

(i) No; Central Sales Tax can be charged on sale of land and building in view of definition of `goods' as per section 2(d) of Central Sales Tax Act, 1956. The definition of goods clearly excludes any immovable property and thus, no CST can be charged.

(ii) No; Central sales tax can be charged on sale of shares and securities in view of definition of `goods' as per section 2(d) of the Act. Shares and securities do not fall within the purview of the term `goods' and hence, no Central sales tax can be charged on sale of shares and securities.

(iii) Yes; Central sales tax can be charged on value of goods actually transferred in works contract in view of insertion of clause (29A) in Article 366 of the Constitution of India. The value of materials and labour charges have to be bifurcated in a works contract and only on the value of goods actually transferred in a works contract, CST can be charged.

(iv) No; Central sales tax can be charged on transfer of property in goods without consideration in view of the definition of `sale' as per section 2(g) of Central Sales Tax Act, 1956. One of the essential elements of sale is transfer for consideration in any form i.e. for cash or for deferred payment or for any other valuable consideration. A transfer of property without consideration does not amount to sale and thus, no Central Sales Tax can be charged.

(v) No; Central Sales Tax can be charged in case of transfer by way of mortgage. Mortgage implies transfer of immovable property for securing payment. The possession of goods may or may not be handed over to the mortgagee. The definition of sale does not include mortgage or hypothecation or a charge or pledge on goods, and thus, no Central Sales Tax can be charged in case of transfer by way of mortgage.

Question 24

Write short notes on the following in the context of Central Sales Tax Act: Place of business

(5 Marks) (May 2002)

Answer

Section 2(dd) defines the term "place of business". Central Sales tax is collected by the Government of that State only where the place of business is situated. The term "place of business" has been defined to include the following:

(a) In any case where a dealer carries on business through an agent, the place of business of such agent;

(b) Warehouse, godown or other place where a dealer stores goods;

(c) Place where a dealer keeps books of account.

A dealer can have one or more places of business in more than one State or city. In such a case he will have to get himself registered in that State.

Question 25

State with reason, whether the following sales are liable for CST :

Sale of bundles of Old Newspapers. *(2 Marks) (Nov.2004)*

Answer

The sale of bundles of old newspapers as waste paper is not sale of newspapers. They are goods and hence assessable to CST as held in the case of *The Hindu v. State of Tamil Nadu (1987) 67 STC 477 (SC).*

Question 26

State with reason, whether the following sales are liable for CST:

Sale of Electricity. *(2 Marks) (Nov.2004)*

Answer

Although electricity is goods as envisaged by section 2(d), sale of electricity has been specifically excluded by the charging section 6(1). As per section 6(1), CST is leviable on sale of goods other than electrical energy. Therefore, sale of electricity is not subject to CST.

Question 27

State with reason, whether the following sales are liable for CST :

Sale of standing trees to be severed under the terms of Contract. *(2 Marks) (Nov.2004)*

Answer

As per section 2(7) of Sale of Goods Act, 1930, "Goods", inter alia, include growing crops, grass and things attached to and forming part of the land, which is agreed to be severed before sale or under contract of sale. The standing trees to be severed under the terms of contract have become movable property and have not also been excluded from the definition of "goods under section 2(d) of CST Act. Therefore, the sale of standing trees agreed to be severed

under the term of contract could be regarded as sale of goods and is chargeable to CST.

Question 28

(i) Discuss the term `sale' under CST Act. *(3 Marks) (May 2004)*

(ii) Explain the term 'sale' under the Central Sales tax Act, 1956. *(3 Marks) (Nov.2001)*

(iii) What is a sale under the Central Sales-tax Act? What are the transactions that do not constitute a sale under the Act? Explain. *(9 Marks) (May 1998)*

Answer

Section 2(g) defines the term 'sale'.
"Sale" with its grammatical variations and cognate expressions, means any transfer of property in goods by one person to another for cash or deferred payment or for any other valuable consideration, and includes :-

(1) a transfer, otherwise than in pursuance of a contract, of a property in any goods for cash, deferred payment or other valuable consideration ;

(2) a transfer of property in goods (whether as goods or in some other form) involved in the execution of a works contract ;

(3) a delivery of goods on hire-purchase or any system of payment by instalments.

(4) a transfer of the right to use any goods for any purpose (whether or not for a specified period) for cash, deferred payment or other valuable consideration ;

(5) a supply of goods by any unincorporated association or body of persons to a member thereof for cash, deferred payment or other valuable consideration.

(6) a supply, by way of or as part of any service or in any other manner whatsoever, of goods, being food or any other article for human consumption or any drink (whether or not intoxicating), where such supply or service is for cash, deferred payment or other valuable consideration,

but does not include a mortgage or hypothecation of or a charge or pledge on goods.

Question 29

Discuss the correctness of the following proposition -

A works contract is not subjected to Central Sales Tax *(5 Marks) (May 2002)*

Answer

The given proposition is not correct. With effect from 11.05.2002 sale of goods involved in the execution of works contract is also covered by the enlarged definition of the term 'sale'. Even though the goods are not sold by the contractor to his customer in the same

form in which he bought them, still it is covered by term 'sale' defined in section 2(g). Hence, a contractor in one State selling goods to his customer in another State as a part and parcel of the works executed by him, is liable to tax under this Act with effect from 11.5.2002.

Question 30

(i) Write short note on: Sale Price. (5 Marks) (May 2000)

(ii) Define "Sale price" under the CST Act. (5 Marks) (Nov. 1999)

(iii) Write short note on: Sale Price (5 Marks) (May 1999)

(iv) Explain the term `Sale price' under the provisions of Central Sales Tax Act, 1956.

(3 Marks) (May 1996)

Answer

Under section 2(h) of the Central Sales Tax Act, `sale price' means the amount payable to a dealer as consideration for the sale of any goods. Thus it is equal to the valuable consideration payable to the seller in terms of the agreement of sale. It also includes any sum charged for anything done in respect of the goods before delivery to the buyer. E.g. if special packing charges are included in the price, it would be included in `sale price'. The following sums are however not to be included in the sale price:

(a) Cash discounts allowed in accordance with prevailing trade practice.

(b) Cost of freight or delivery or cost of installation if separately charged.

Question 31

Write short note on: Exclusion of freight and trade discount from sale price

(5 Marks) (May 1997)

Answer

Section 2(h) defining the term "sale price" says that the amount payable to a dealer, for the sale of any goods shall be the sale price. The amount of cash discount allowed according to the normal trade practice shall be reduced from the sale price.

The cost of freight and delivery charges if charged separately then it will not form part of sale price. If the freight or delivery or cost of installation is included and not charged separately, then it cannot excluded from the invoice value.

There is only one price payable by the buyer to the seller and that is calculated by deducting the trade discount from the catalogue price. Therefore, trade discount cannot be included in the taxable turnover.

Question 32

Discuss whether the following items will constitute and form part of "Sale Price" as defined under Section 2(2) of the C.S.T. Act :

(i) Excise Duty

(ii) Packing Materials

(iii) Returnable Containers *(3 x 2 = 6 Marks) (May 2001)*

Answer

(i) Excise Duty **: Sale price means the amount payable to a dealer as consideration for the sale of any goods. In finding out the consideration payable by the purchaser to the seller, it is immaterial to enquire as to how the amount of consideration is made up. The only relevant requisition is what is the amount payable by the purchaser and not what is the net consideration retained by the dealer. When goods manufactured are sold, the excise duty is passed on the purchaser and it forms a component of the consideration payable. Hence excise duty will form part of sale price.**

(ii) Packing Materials **: Sale price includes any sum charged for anything done by the dealer in respect of the goods at the time of or before delivery thereof. Packing is an act done by the dealer in respect of goods before delivery and the cost thereof is includible in the sale price.**

(iii) Returnable Containers **: The question whether the value of returnable containers will form part of the sale price will depend on whether there is a sale of these containers when they are filled, and thereafter re-sale when they are returned by the buyer after emptying them. When there is no binding obligation to return the containers, the transaction is one of sale. On the other hand, when there is an obligation to return as in the case of gas cylinder, there is no sale of the container.**

Question 33

Is trade discount includible in "Sale price" ? *(2 Marks) (Nov.2000)*

Answer

Trade discount is a deduction from catalogue price of goods allowed by a wholesaler to a retailer. It does not enter into the composition

of a sale price but exists apart from and outside it. It is not therefore includible in sale price.

Question 34

Write short note on Sales tax laws. *(5 Marks) (Nov.98)*

Answer

Section 2(i) defines the expression 'sales tax law' and it means any law for the time being in force in any State or part thereof, which provides for the levy of taxes on the sale or purchase of goods generally or on any specified goods expressly mentioned in that behalf.

The expression "General Sales Tax Law" means the law for the time being in force in any State or part thereof, which provides for the levy of tax on the sale or purchase of goods generally.

Thus, the former expression is much wider than the latter, because the former means all that is meant by the latter plus that which does not fall in it.

Question 35

Distinguish between the terms 'Sales tax law' and 'General sales tax law' as understood under the provisions of Central Sales tax Act, 1956. *(3 Marks) (Nov.97)*

Answer

As per section 2(i) 'sales tax law' means any law for the time being in force in any State or part thereof which provides for the levy of taxes on the sale or purchase of goods generally or on any specified goods expressly mentioned in that behalf.

'General Sales tax law' means the law for the time being in force in any State or part thereof which provides for the levy of tax on the sale or purchase of goods generally.

Thus the former expression is much wider than the latter because the former means all what is meant by the latter plus that which falls in to it.

Question 36

Define "turnover" and explain how it is to be determined under the Central Sales-tax Act.

(5 Marks) (Nov 2000)

Answer

The dealer's turnover is the aggregate of the sale prices received and receivable by him in respect of sale of any goods in the course of Inter-State trade or commerce made during any prescribed period and determined in the prescribed manner. Turnover is therefore, the sum-total of the sales made by a dealer during a period in the course of inter-State trade or commerce and determined in accordance with the provisions of the Act and the Rules made under the Act.

Determination of turnover

Section 8A provides for certain deductions from the aggregate of sale prices for determining the taxable turnover of the dealer. Two deductions are specifically provided for, namely, the amount corresponding to the collection of sales tax by the dealer either expressly or impliedly and in cases in which sales tax has not been separately charged, the amount to be deducted in respect of the same will be calculated according to the formula.

$$\frac{\text{Rate of tax} \times \text{aggregate of the sale price}}{100 + \text{rate of tax}}$$

If the turnover of the dealer is taxable at different rates, this formula shall be applied separately in respect of each part of the turnover liable to different rate of tax. This deduction shall not, however, be allowed according to this rule when sales tax has been separately charged.

The second deduction relates to the sale price of goods returned to the dealer by the purchaser within a period of 6 months from the date of delivery of goods.

The Central Government has power to prescribe by rules for other deductions.

Question 37

What is meant by "document of title" in the context of inter-State sale under the CST Act?

(3 Marks) (Nov.2005)

Answer

The term "documents of title to goods" is defined under section 2(4) of the Sale of Goods Act, 1930, as : "Document of title to goods" includes a bill of lading, dock warrant, warehouse-keeper's certificate, railway receipt, warrant or order for the delivery of goods and any other document used in the ordinary course of business as proof of possession or control of goods, or authorizing or purporting to authorize, either by endorsement or by delivery, the possessor of the document to transfer or receive goods thereby represented.

Some examples of documents of title are Lorry Receipt, Railway Receipt, Air Way Bill and Bill of Lading.

As per section 3(b), a sale or purchase of goods shall be deemed to take place in the course of inter-State trade or commerce if the sale or purchase is effected by a transfer of documents of title to goods during their movement from one State to another. Endorsement can be made on the "document of title" any time after the goods are handed over to the carrier but before physical delivery is taken from the carrier by the buying dealer.

Question 38

What constitutes a completed sale in the course of Inter-State Trade. *(5 Marks) (May 2002)*

Answer

As per section 3, a sale or purchase of goods shall be deemed to take place in the course of interstate trade when the sale or purchase occasions the movement of goods from one State to another and/or is effected by transfer of documents of title to the goods during their movement from one State to another. In this context, what constitutes a completed sale is explained by the Supreme Court in the case of *Bharat Sugar Industries Ltd v. D.P.Dube 14 STC 406.* The court said a transaction becomes a completed sale in the presence of the following four elements.

(a) There must be parties competent to contract;

(b) There must be mutual consent.;

(c) There must exist a thing, the absolute or generic property which is transferred from the seller to the buyer; and

(d) The consideration is in money paid or payable.

The sale gets completed when the goods are delivered to the buyer outside the State. To constitute a completed sale, delivery of goods to the buyer in the other state should have been completed. *Khosla & Co 43 STC 457(SC)*.

Question 39

Explain 'Stock transfer' and its treatment as an Interstate sale. *(5 Marks) (May 2002)*

Answer

The transfer of goods to a branch or dispatch of goods to a consignment agent does not amount to sale. Consequently there is no interstate sale and central sales tax liability though the goods move from one State to another State. In such cases the person dispatching the goods retains the ownership of goods and hence such transactions are known as stock transfer. There is no element of sale though the goods move from one State to another. However, if the movement of goods is occasioned on account of sale, such movement shall be treated as interstate sale and will give rise to taxability. Such a situation will arise when the movement of goods is occasioned by an order form another State by a purchaser. The goods though transferred from depot to depot or to branch would constitute a sale as there was an order and supply is made consequent o the order. (*Indian Oil Corporation Ltd v. Union of India 47 STC 1)*.

Question 40

What are the essential elements of an Inter-State sale? *(6 Marks) (Nov.99)*

Answer

Section 3 of the Central Sales tax Act, 1956 lays down the principles for determining when a sale or purchase of goods takes place in the course of inter-state trade or commerce. There are two conditions for a sale or purchase to be considered as inter State sale or purchase. They are explained below:

1. Section 3(a) provides that when a sale or purchase occasions the movement of goods from one State to another, it would be deemed to be a sale or purchase in the course of inter-State trade or commerce. There must be contract for sale or purchase. When goods move in the absence of such a contract, it is not deemed to be a movement in the course of inter-State trade or commerce. As such, these do not constitute sales. However, it would so amount if the goods have been sent in pursuance of contract of sale entered into with the branch, shop or agent or salesman.

2. In addition, section 3(b) provides that a sale or purchase that is effected by a transfer of documents of title of goods during their movement from one State to another is a sale in the course of inter-State trade or commerce.

3. As per *Explanation 1* movement of goods shall be deemed to have commence at the time the goods are delivered to a carrier or other bailee for transmission and terminate at the time when the delivery is taken from such carrier or bailee.

4. According to *Explanation 2* to section 3, where the movement of goods commences and terminates in the same State, it shall not be deemed to be movement of goods

from one State to another by reason merely of the fact that in the course of such movement the goods had passed through the territory of any other State. Therefore, sale or purchase of such goods shall not be deemed to be a sale or purchase in the course of inter-State trade or Commerce.

Question 41

State giving reasons whether the following sales are inter-state or intra-state

(a) A manufacturer in Andhra Pradesh supplies goods to his appointed agents outside the State against their orders.

(b) A manufacturer in Mumbai delivers goods to his dealers at the factory who move the goods for resale outside the State. *(4 Marks) (Nov.99)*

Answer

(a) In this case, the sales are inter-State sales since the movement of the goods from within the State of Andhra Pradesh to outside takes place in pursuance of the orders placed by the dealers outside that State.

(b) The sale will be an intra-state sale since the transaction is completed in Mumbai and the goods are subsequently transported outside the State.

Question 42

Mr.`A' of Madras sends his consignment of goods to his branch at Bangalore, without any prior contract of sale when the goods are in transit, Mr.`B' of Bangalore bought the railway receipt from A's branch office. Does this amount to sale? *(3 Marks) (May 99)*

Answer

The transaction is an inter-State sale. It is a sale by transfer of documents. As per Section 3(b) of the Act, a contract comes into existence after commencement and before termination of the inter-State movement of goods. In the instant case, the Railway receipt is a document of title according to Section 2(4) of Sale of Goods Act. The endorsement of the same and by delivery enables the possessor of document to transfer or receive goods thereby represented.

Question 43

Write short notes on: Liability to Central Sales Tax of sale by V.P.P. *(5 Marks) (Nov.96)*

Answer

In order to be an inter-state sale, it must answer the definition of the same in section 3 i.e. there must be movement of goods in

connection with the sale. In a sale by V.P.P. both the requirements of section 3 are satisfied. In a sale by V.P.P. there is an order by the buyer on the seller. The seller dispatches the goods by post, parcel and the goods are to be delivered by the postal authorities to the buyer on payment of the price. Where the buyer does not accept the goods and returns them, there is no sale and no sales tax can be levied on such sale.

When goods are sent by V.P.P. from one State to another, actual sale in terms of the definition of sale in section 2(g) of the Central Act takes place in that State where the parcel is received and its value is paid to the post office.

Question 44

Distinguish between inter-State sale and intra-State sale. *(4 Marks) (May 1997)*

Answer

An inter-State sale can take place only where it occasions the movement of goods from one State to another or it is effected by a transfer of documents of title to the goods during their movement from one State to another.

A sale can be said to be in the course of inter-State trade only if there is sale of goods and transport of goods from one State to another under a contract of sale. Unless both conditions are satisfied, there can be no inter-State sale.

In the case of intra-State sale, the movement of goods may take place without a contract of sale. For instance, a dealer in State 'A' may purchase goods in State 'B' and transport them to his place in State 'A'. The sale in this case is concluded and complete in State 'B' and the movement to the State 'A' does not take place by virtue of a contract of sale. In other words, where before the movement of goods there is a completed sale in favour of the purchaser and thereafter the goods are dispatched by the purchaser, the goods move as the property of the purchaser.

Question 45

D of Delhi comes to Hyderabad and purchased certain chemicals and transported them in his own name to Delhi. Is the sale chargeable to Central Sales Tax? *(2 Marks) (Nov.2002)*

Answer

The sale is completed at Hyderabad itself. Therefore, the sale does not occasion the movement of goods from one State to another under section 3(a) of Central Sales Tax Act. Hence, there is no liability to central sales tax.

Question 46

A enters into a single contract with B for sale of goods which are located in different States. Some of the goods are ascertained while the remaining are unascertained. Discuss where the sales take place in the context of the C.S.T. Act. *(4 Marks) (May 1997)*

Answer

As per section 4(2) a sale or purchase shall be deemed to take place inside a State if the goods are within the State, in the case of ascertained goods in the State in which the contract of sale is made. In the case of unascertained goods, the sale is deemed to take place in the State in which the appropriation is made to the contract of sale by the seller or the purchaser. Therefore, when the goods are located in different States, the sales are deemed to take place:

(i) In the case of ascertained goods, in the State or States in which the contract is made.

(ii) In the case of unascertained goods, in the State or States in which the appropriation to the contract of sale is made.

(iii) Thus even though there is only a single contract of sale by A to B, it will be deemed as if there were separate contracts with regard to each State separately for the ascertained and unascertained goods.

Question 47

The location of goods does not, by itself determine the place, where the sale takes place. Discuss. *(2 Marks) (May 2001)*

Answer

This is a correct proposition. Section 4 of the Sales Tax Act, 1956 determines where the sales are deemed to have taken place, which renders the location of goods as not constituting the over-riding factor. The test of sale is where the contract is made in the case of specific and ascertained goods.

In the case of unascertained goods it is the place where the appropriation to a contract of sale is made, that decides where the sales are deemed to have taken place.

To illustrate, goods may be located in Mumbai but if the contract of sale for specific goods is signed at Ahmedabad, the sale is deemed to have taken place in Ahmedabad.

Similarly in respect of unascertained goods, even if the contract is made in Mumbai, if it specifies that the goods would be selected, tested, weighed and delivered at Ahmedabad, the sale will be deemed to have taken place at Ahmedabad, because the appropriation to the contract is made there.

Question 48

Explain the concept of sale or purchase taking place outside a State. 6 Marks) (Nov.2000)

Answer

Section 4(1) does not actually define what is an outside-state sale but instead describes what is inside-State sale and then states that such a sale shall be outside all the other States.

For the purpose of determining inside-State sale or purchase, goods have been divided into two groups (i) specific or ascertained goods, and (ii) unascertained or future goods.

In the case of specific goods, sale or purchase shall be deemed to have taken place inside a State if the goods were within the State at the time the contract of sale was made.

In case of future goods, their sales or purchase shall be deemed to take place inside a State if the goods are within the State at the time of their appropriation to the contract of sale either by the seller or by the buyer. It is immaterial whether the other party to the contract gives his assent to the appropriation prior or subsequent to such appropriation.

In case of both the above groups of goods, it may so happen that there is a single contract of sale or purchase of goods situated at more than one. In such a case it shall be deemed that there are separate contracts in respect of the goods at each of such places.

Once the place of sale is fixed in a particular State as explained above, then the sale shall be deemed to be outside all other States. Consequently, only the State in which the sale has been localized can tax such a sale.

Question 49

X of Mumbai books his goods by air to his branch office at London. Subsequently he transfers the documents of title to the buyer at Scotland after the goods have crossed the customs frontiers of India. Is this a sale in the course of export? (3 Marks) (Nov.2003)

Answer

This is covered under section 5(1) of the Central Sales Tax Act, 1956. The sale is effected by transfer of documents of title to the goods after the goods have crossed the customs frontiers of India. Hence it is a sale in the course of export.

Question 50

X, an Export House of Delhi, first enters into a contract of sale with Y of New York, USA and subsequently purchases these goods from Z of Chennai for the purpose of export to Y of New York. Can the sale by Z to X (last sale before export) be termed as sale in the course of export ? (3 Marks) (Nov.2003)

Answer

As per section 5(3) of the Central Sales Tax Act, 1956, the last sale or purchase of any goods, preceding the sale or purchase occasioning the export of those goods out of the territory of India, shall be deemed to be in the course of such export if it took place after and was for the purpose of complying with, the agreement or order for or in relation to such export. Hence, in the given problem, sale by Z to X will be deemed as sale in the course of export as it was the last sale before export and it was for the purpose of export to Y of New York.

Question 51

When shall a sale or purchase of goods be deemed to take place in the course of export of goods out of the territory of India? Give two examples. (5 Marks) (May 2000)

Answer

Section 5(1) of the Act provides that a sale or purchase of goods shall be deemed to take place in the course of export of goods out of the territory of India only if the sale or purchase either:

(a) Occasions such export. For example, Mr.A of Mumbai enters into a contract with Mr.B of USA accordingly he moves the goods out of the territory of India ; or

(b) Is effected by a transfer of documents of title to the goods after the goods have crossed the customs frontier of India. Example: Mr.A of Mumbai transfers goods to his branch at Singapore and in the process sells the goods to Mr.X of Singapore by transfer of documents of title thereto.

Question 52

Difference between a sale for export and sale in the course of export. (5 Marks) (May 1998)

Answer

If a sale is effected by the seller and he is not connected with the export of the goods which actually takes place later, it will be a *sale for export*. The seller in this case may or may not have the knowledge that the buyer intends to export the goods purchased. The fact is that the seller does not know the ultimate destination of the goods he has sold.

A sale *in the course of export*, on the other hand, has an express connection between the sale and the export. The activities of sale of goods and their export are so integrated that the connection between the two contracts cannot be interrupted voluntarily, without a breach of contract or obligation or compulsion arising out of the transaction. In the case of sale in the course of export, the seller and the buyer have an intention to export, and obligation to export followed by an actual export of goods. The obligation may arise from any law or contract between the parties or mutual understanding or from the nature of the transaction itself.

Question 53

Article 286(1)(b) of the Constitution of India prohibits a state from imposing or authorizing the imposition of a tax on sale or purchase of goods where it takes place in the course of import or export of the goods into or out of the territory of India. State the conditions as well as the principles laid down for availing the aforesaid exemption. (8 Marks) (Nov.97)

Answer

The stated exemption is available subject to the following conditions:

(1) A sale or purchase shall be deemed to take place in the course of export of the goods out of the territory of India only if the sale or purchase occasions such export or is effected by a transfer of documents of title to the goods after the goods have crossed the customs frontiers of India.

(2) A sale or purchase of goods shall be deemed to take place in the course of import of the goods into the territory of India only if the sale or purchase either occasions such import or is effected by transfer of documents of title to the goods before the goods have crossed the customs frontiers of India.

(3) The last sale or purchase of any goods preceding the export shall also be deemed to be in the course of export if such last sale or purchase took place after and was for the purpose of complying with, the agreement or order for or in relation to such export.

In this connection, the following principles have been laid down:

(i) Sales and purchases which themselves occasion the export of the goods out of and import of the goods into the territory of India come within the exemption.

(ii) Sale in the State by the exporter or importer by transfer of shipping document while the goods are beyond the custom frontiers are within the exemption, assuming that the State's power of taxation extends to such transactions.

(iii) The course of import of goods starts at a point when the goods cross the customs barrier of the foreign country and ends at a point when the goods cross the customs barrier in the country.

(iv) Every sale beyond the customs barrier is not exempt. While all exports involve taking to goods out of the country, all goods taken out of the country cannot be said to be exported. The test is that the goods must have a foreign destination where they can be said to be imported. A mere movement out of India following the sale would not render the sale as one in the course of export. If the goods are exported and there is a sale or purchase in the course of that export occasioning the export to the foreign destination, the exemption is earned.

(v) The course of export out of or import into the territory does not commence or terminate until the goods cross the customs frontier.

Question 54

A sale of goods shall be deemed to take place in the course of export of goods out of the territory of India only if the sale occasions such export. What is the exception to this rule? Explain its significance. *(4 Marks) (May 1997)*

Answer

As per section 5(1), a sale or purchase shall be deemed to be an export sale if the goods go beyond the territory of India or the sale or purchase occasioning such export is effected by a transfer of documents of title to the goods after the goods have crossed the Customs Frontiers of India.

Section 5(3) provides the exception whereby even the last sale preceding the export shall also be deemed to be in the course of export. The following conditions are to be satisfied for complying with section 5(3).

(i) The transaction of such last sale takes place after the agreement or order is received by the exporter from the foreign buyer.

(ii) The last purchase must have taken place after the agreement with the foreign buyer has been entered into.

(iii) The transaction of such last sale or purchase is entered into for the purpose of complying with agreement or order received by the exporter from the foreign buyer.

Question 55

Explain the concept of the expression "Sale in the course of import". (3 Marks) (Nov.2000)

Answer

Section 5(2) says sale or purchase of goods shall be deemed to take place in the course of import of the goods into the territory of India only if the sale or purchase occasions import or is effected by a transfer of documents of titled to the goods before the goods have crossed the Customs Frontiers of India.

The course of import of goods starts at the point when the goods cross the customs barrier of the foreign country and ends at the point in the importing country after the goods cross the customs barrier. The sale which occasions the import is a sale in the course of import. A sale effected by a transfer of document or file to the governments before the goods have crossed the customs frontiers of India is also a sale in the course of import.

Question 56

(i) Write short note on penultimate sale of export. (5 marks) (Nov.2004)

(ii) Penultimate sale in the course of export trade. (3 Marks) (Nov.2001)

Answer

According to section 5(1), a sale or purchase of goods can qualify as a sale in the course of export of the goods out of the territory of India only if the sale or purchase has occasioned such export or is by a transfer of documents of title to the goods after goods have crossed the customs frontiers of India. Sale by an Indian exporter from India to a foreign importer alone qualifies as a sale which has occasioned the export of the goods. According to the Export Control Order, exports of certain goods can be made only by specified agencies such as the State Trading Corporation. In other cases also, manufacturers of goods, particularly in the small scale and medium sectors, have to depend on some experienced export house for exporting the goods because special expertise is needed for carrying on export trade. A sale of goods made to an export canalizing agency such as the State Trading Corporation or to an export house to enable such agency or export house to export those goods in compliance with an existing contract or order is inextricably connected with the export of the goods. Further, if such sales do not qualify as sales in the course of export, they would be liable to State sales tax and there would be a corresponding increase in the price of

the goods. This would make Indian exports incompetitive in the fiercely competitive international markets.

With aforesaid objective in mind, sub-section (3) was inserted in section 5 to provide that the last sale or purchase of any goods preceding the sale or purchase occasioning the export of those goods out of the territory of India shall also be deemed to be in the course of such export, if the following conditions are satisfied :

(a) there must have been pre-existing agreement or order to sell the specific goods to a foreign buyer ;

(b) the last purchase referred to in section 5(3) must have taken place after than agreement with the foreign buyer was entered into ;

(c) the last purchase must have been made for the purpose of complying with the pre-existing agreement or order.

(d) the goods purchased and sold by way of export should be the same.

Only if these conditions are satisfied, the transaction falls under section 5(3) and gets the status of "export sale" which is not subject to central sales tax – George Maigo & Co. v. State of Andhra Pradesh (1980) 46 STC 41 (AP).

Question 57

When does the liability to pay tax on Inter-State sales arise? *(5 Marks) (Nov.99)*

Answer

Section 6 is the charging section of the Central Sales tax Act, 1956. It stipulates that every dealer shall be liable to pay sales tax under the Act on all sales of goods other than electrical energy effected by him in the course of inter-state trade or commerce during any year. However, sales of goods which qualify as sales in the course of export out of territory of India, are exempt.

A dealer shall be liable pay tax under the Central Sales tax act on the sale of any goods effected in the course of inter-state trade or commerce notwithstanding that no tax would have been leviable under the local sales tax Act of the appropriate State if such sale had taken place inside that State. Therefore exemption in the local sales tax law is irrelevant for the purpose of Central Sales Tax Act.

Exemption however is available to the second and subsequent sale effected in the course of inter-state trade or commerce provided the sale is effected by transfer of documents of title to such goods during the movement from one State to another.

Question 58

Is a subsequent sale to government department exempt from Central Sales Tax ?

(2 Marks) (Nov.98)

Answer

As per section 6(2) where a sale of any goods in the course of interstate trade or commerce is occasioned movement of such goods from one state to another or has been effected by transfer of documents of titled to the goods, during the movement of goods from one state to another, it is called subsequent sale.

It is exempt if such subsequent sale is effected by transfer of documents of title to such goods during movement of those goods.

Question 59

Write short notes on : Exemption from C.S.T. of second and subsequent sales

(5 Marks) (May 1997)

Answer

Since every sale in the course of inter-state trade is liable to tax, the levy can become a multiple levy if the goods change hands several times during movement of one State to another. To mitigate the hardship, section 6(2) provides that all sales subsequent to the first one made to a registered dealer or government shall not be liable to tax. For availing this exemption, the following conditions should be fulfilled.

(a) It should be by one registered dealer to another registered dealer or govt.

(b) The sale should be a subsequent sale.

(c) It should be during the same movement of goods.

(d) It should be effected by a transfer of documents of title to such goods.

(e) It should be supported by necessary proof like certificates in Form E-I or E II or declaration in Form C or D.

(f) In the case of subsequent sale to a registered dealer, the sale should relate to goods referred to in section 8(3).

Question 60

X of Kolkata sells goods to Y of Chennai and delivers the same at Kolkata to MKS Transport. The lorry receipt was sent to Y by post. While goods were in transit, Y sells the goods to Z of Vijayawada by making an endorsement of LR and goods were diverted to Vijayawada. Is the second sale between Y and Z chargeable to tax? (2 Marks) (Nov.2002)

Answer

The first sale by X to Y is chargeable to central sales tax. However, sale of goods by Y to Z is exempt under Section 6(2) i.e. subsequent sale by transfer of documents to avoid multiple tax incidence. However, subsequent sale must be to the Government/Registered dealer and Form D/Form C is required to be furnished.

Question 61

How can a dealer establish his claim that he is not liable to pay Central Sales tax in respect of goods moved from one state to another by way of consignment sales. (4 Marks) (Nov.96)

Answer

Section 6A casts a burden of proof on the dealer where he claims that transfer of goods from one state to another is otherwise than by way of sale.

The movement of goods from one state to another may be by the reason of transfer of goods to any other place of his business or to his agent or principal. The burden of proving that the movement of goods is otherwise than by way of sale, is on the dealer.

For this purpose, he may furnish to the assessing authority a declaration in Form F signed by the principal officer of the consignee along with the evidence for dispatch of such goods. It has been held that this is only a permissive or optional way of proving that the movement of goods has been occasioned otherwise than as a result of sale.

Question 62

Ansari and Co. transferred its goods from its factory at Cochin to its branch at Mysore. Comment on the procedure to be adopted for branch transfer. (4 Marks) (Nov.2003)

Answer

Section 6A of the Central Sales Tax Act, 1956 provides that where any dealer claims that the movement of goods from one State to another was occasioned by transfer of such goods otherwise than by way of sale, then he must furnish to the assessing authority a declaration in Form F along with the evidence of dispatch of the goods. If the dealer fails to furnish such declaration then the movement of goods shall be deemed as a movement occasioned as a result of sale and would be chargeable to tax. The onus of proof, therefore, lies with the dealer.

After making such enquiry as considered necessary and on being satisfied that the particulars contained in the declaration furnished are true, the assessing authority shall treat the transaction as otherwise than by way of sale. Consequently, the assessee escapes tax burden.

Therefore, Ansari & Co., should obtain declaration in Form F and submit the same to the assessing authority along with evidence of despatch of the goods.

Question 63

How does a dealer prima facie discharge the burden of proof that he is not liable to tax in the course of Inter-state Sale ? *(3 Marks) (Nov.2000)*

Answer

Section 6A, says that the dealer may furnish to the assessing authority within the prescribed time a declaration duly filled in and signed by the principal officer containing the prescribed particulars in the prescribed form obtained from the prescribed authority along with evidence of dispatch of goods. Form `F' is the normal declaration satisfying the conditions, but is not the only method of discharging the burden of proof.

Question 64

Briefly discuss about transactions involving inter-State transfer of goods otherwise than by way of sale. What is the proof to be submitted in this regard under the CST Act?

(4 Marks) (May 2005)

Answer

As per section 6A, a transaction in the nature of transfer of goods from the head office of the principal in one State to a branch or agent in another State or vice-versa does not attract CST. This is because the movement of such goods from one State to another was occasioned by reason of transfer of such goods by the dealer to any other place of his business or to his agent or principal, as the case may be, and not by reason of sale.

The burden of proving that the movement of such goods was so occasioned is on the dealer. For this purpose, the dealer has to furnish a declaration to the assessing authority within the prescribed time in the prescribed form i.e. Form F, duly filledin and signed by the principal officer of the other place of business or his agent or

principal, as the case may be, along with evidence of dispatch of such goods.

Question 65

Is the registration as a dealer, compulsory, under the CST Act ? (4 Marks) (Nov.2004)

Answer

Section 7(1) of CST Act provides that every dealer liable to pay tax shall apply for registration. Under section 6, a dealer is liable to pay tax where he effects an interstate state sale. Therefore, it is obligatory for a dealer making an interstate sale to get himself registered so as to avoid penalty. The activity of an interstate sale renders a person exigible to central sales tax. Hence, every dealer selling goods even worth a rupee must apply for being registered.

In case of a dealer not effecting an inter-State sale, registration is not compulsory. However, such a dealer may apply voluntarily for registration under section 7(2) if he is liable to pay tax in his State or has a place of business in that State. This would enable him to avail the benefit of lower rate of tax when he buys goods from another State.

Question 66

Discuss the correctness of the following proposition -

A Certificate of Registration once granted cannot be amended (3 Marks) (Nov.2001)

Answer

The given proposition is not correct. A registered dealer can apply for amendment of his registration certificate under section 7(4)(a) of the Central Sales tax Act in the following circumstances:

(a) If the registered dealer has changed the name, place or nature of his business; or

(b) If he has changed the class or classes of goods in which he is carrying on his business; or

(c) For any other reason.

The amendment can be made by the authority who had granted the registration either on the application of the dealer or suo motu as per the information received by the authority from other sources.

Question 67

What are the benefits of registration under the Central Sales-tax Act, 1956?

(5 Marks) (Nov.99)

Answer

The benefit of registration under Central Sales Tax Act, 1956 is that when the purchaser of goods is a registered dealer, he can buy the goods against C-Form. In that case, the vendor will charge only 4%. CST on the value of goods sold. If the dealer is not a registered dealer then the rate of tax would be 10% which is the minimum rate of tax in respect of ordinary goods. Also, an unregistered dealer cannot issue C form, hence has to suffer higher rate of tax on inter-state purchase.

However, it is necessary to exercise a great deal of care in describing in the application for registration, the goods or classes of goods which have either been purchased for resale or for use in manufacture since without such items being specified in the certificate of registration, a dealer cannot issue C-form. Failure to do so would result in tax being charged at a higher rate of at least 10%.

Question 68

When can a registering authority impose a condition that a dealer should furnish a security for the issue of a certificate of registration? *(4 Marks) (Nov.96)*

Answer

A security may be required to be furnished before a certificate of registration is issued where it appears to the registering authority that

(i) For the proper realization of tax payable.

(ii) For the proper custody of forms referred to in section 6(2)(a) or section 6A(1) or section 8(4)(a)

that it is necessary to do so.

The registration authority shall make an order in writing and record therein the reasons for imposing such a condition [Section 7(2A)]

Question 69

What are the salient particulars required to be furnished in an application for registration under section 7 of the Central Sales Tax Act? *(4 Marks) (Nov.96)*

Answer

The salient particulars to be furnished in Form A prescribed under the Central Sales Tax Registration and Turnover Rules are -

(i) Name of the person deemed to be the manager of the business;

(ii) His status;

(iii) Principal place of business within the State;

(iv) Addresses of other places of business within the State;

(v) List of warehouses where the goods are stored

(vi) List of places of business in other states;

(vii) Nature of business – i.e. whether it is wholly agricultural, horticultural, mining, manufacture, wholesale or retail, contracting, catering etc,

(viii) Name and address of proprietor.

Question 70

What are the types of orders which are appealable under sub-section (3H) of section 7 of the C.S.T. Act? *(3 Marks) (May 1997)*

Answer

Section 7(3H) says that any person aggrieved by an order passed under the following provisions may within 30 days of the service of the order on him prefer an appeal against such order to the appellate authority.

(i) An order passed under section 7(2A) demanding security as a pre–condition for registration of a dealer;

(ii) An order passed under section 7(3A), demanding security or additional security from a registered dealer as a condition for continuance of the certificate of registration;

(iii) An order passed under section 7(3D) forfeiting the whole or any part of the security furnished by the dealer for realizing any amount of tax or penalty payable by the dealer;

(iv) An order passed under section 7(3G) refusing an application for refund of any amount or part thereof deposited by the dealer by way of security if it is not required for the purposes of this Act.

Question 71

Write short notes on: Compulsory and voluntary registration *(5 Marks) (May 1997)*

Answer

Section 7 of the CST Act provides for voluntary and compulsory registration. Under Section 7(1) a dealer is liable to pay tax when he effects an inter–state sale. It is compulsory for such a dealer to have himself registered.

The activity of the inter-state sale renders the person exigible to tax. Every dealer selling goods irrespective of value must apply for

registration. In the case of default, he will be guilty of an offence under section 10(aa).

As per section 7(2) a person may apply for registration voluntarily if he is liable to pay tax in his State in spite of the fact that he is not chargeable under the Central Sales Tax. But if he fails to do so, he incurs no penalty.

To a person purchasing goods in the course of inter-state trade or commerce registration is a boon because he can buy goods against C form and at the rate of 4%.

Question 72

When is a duplicate certificate of registration issued and how? *(2 Marks) (Nov.2002)*

Answer

When the original certificate is lost, defaced, destroyed or mutilated, a duplicate certificate will be issued under Rule 8(b) of the Central Sales Tax Rules, upon an application being made by the dealer on payment of requisite fee by way of court fee stamps.

Question 73

(i) Write short note on cancellation of the Certificate under the CST Act. *(5 Marks) (Nov.2004)*

(ii) When can a certificate of registration be cancelled? *(3 Marks) (May 2004)*

(iii) State the circumstances under which registration can be cancelled by the authority granting it. *(4 Marks) (Nov.2000)*

(iv) Explain suo moto cancellation of Registration *(5 Marks) (Nov.1997)*

Answer

The certificate of registration may be cancelled either

(a) on the request of the dealer; or

(b) by the assessing authority on its own motion.

<u>Cancellation on the request of dealer [section 7(5)]</u> : A dealer may himself apply for cancellation of certificate of registration by making an application alongwith the certificate and copies thereof to the assessing authority. Such application should be made at least six months before the expiry of the relevant financial year. The authority shall, unless the dealer is liable to pay tax under the Act, cancel the registration accordingly and such cancellation shall take effect from the end of the year.

<u>Cancellation by the Assessing Authority by its own motion [section 7(4)(b)] :</u>

The certificate of registration can be cancelled by the assessing authority under the following circumstances:

(a) If the dealer has ceased to carry on business.

(b) If the dealer has ceased to exist.

(c) If the dealer fails to furnish security or additional security when asked to do so.

(d) If the dealer fails to furnish fresh surety bond within 90 days of the death of the surety or his becoming insolvent.

(e) If the dealer fails to make up the deficiency of the security within time allowed, when due to its forfeiture, the security becomes insufficient.

(f) If the dealer fails to pay any tax or penalty payable under this Act.

(g) If the dealer ceases to pay tax under the Sales Tax law of the appropriate State.

(h) Any other sufficient reason.

However, before canceling the certificate of registration under any of the abovementioned circumstances, the assessing authority shall provide a reasonable opportunity to the dealer of being heard. The concerned dealer is required to surrender his certificate alongwith its copies to the assessing authorities, if the registration is cancelled in the aforesaid cases.

The authority concerned, however, has to give an opportunity to the dealer concerned to plead his case against the proposed cancellation. Any order passed canceling the registration without giving an opportunity of being heard to the dealer, is invalid.

Question 74

ABC Ltd. is located in Special Economic Zone. It wants to know the concessional benefits under the CST Act. Advise. *(4 Marks) (Nov.2003)*

Answer

Section 8(6) provides that no tax under this Act shall be payable by any dealer in respect of sale of any goods made by such dealer, in the course of inter-State trade or commerce, to a registered dealer in an unit located in any Special Economic Zone.

The goods so sold in the course of inter-State trade must be used for the purpose of manufacture, production, processing, assembling, repairing, re-conditioning, re-engineering, packaging or for use as trading or packing material or packing accessories by the unit located in special economic zone.

The registered dealer must have been authorized to establish such unit in the Special Economic Zone by the authority specified by the

Central Government in this behalf. Thus, ABC Ltd. which is located in a special economic zone, is eligible for the concessions mentioned above subject to fulfillment of conditions mentioned above.

Question 75

What is the tax incidence on sale to the Government *(5 Marks) (May 2002)*

Answer

As per section 8(1)(a) every dealer who, in the course of inter-state trade or commerce sells any goods to the Government, i.e., Central Government or State Government, shall be liable to pay tax @ 4% of his turnover. The selling dealer must obtain Form D from the purchaser i.e. the Government.

If the dealer, in the course of inter-state trade or commerce, makes a subsequent sale to the Government, it shall be exempt from tax if certain conditions are satisfied as per the provisions of section 6(2) of the Act, namely;

(a) the sale or purchase of goods under the local sales tax law of the State is generally exempt from tax or subject to tax generally at a rate which is lower than 4% and

(b) the selling dealer effecting such subsequent sale shall prove to the satisfaction of the prescribed authority that the sale is a subsequent sale.

Question 76

Write short notes on: Rates of tax in case of sale to Government. *(5 Marks) (May 2000)*

Answer

In terms of section 8(1)(a), every dealer who sells to the Government in the course of inter-state trade or commerce shall charge sales tax at 4% of the turnover. The above rate of 4% is for sales of any or all types of goods or for any purpose e.g. a sale of stationery made to the Government will also be chargeable at 4% (though not if it is sold to any other person). For availing of the concessional rate of 4%, the Government will have to issue certificate in Form D while buying the goods.

Question 77

State the relevance of the expression "exempt from tax" under Sales Tax Law of appropriate State. *(6 Marks) (May 99)*

Answer

The expression "exempt from tax" generally under the Sales Tax Law of the Appropriate State needs explanation. A sale or purchase shall not be deemed to be exempt from tax if it is exempt (a) only in specified circumstances or (b) under specified conditions or (c) in relation to which the tax is levied at specified stage or otherwise than with reference to the turnover of the goods.

Thus the exemption must have reference to a sale or purchase, but not to a dealer or to certain goods. Therefore an exemption granted with reference to a dealer or with reference to goods will not be operative in every case.

For instance, a dealer is exempt from tax under the Appropriate State enactment if his turnover does not exceed the prescribed quantum of turnover. However, inter-State sale made by such dealer will not be exempt under section 8(2A). A dealer, for being entitled to the concession in the rate of tax on inter-state sales, will have to secure from the purchaser a declaration in Form `C', if the sale is to a registered dealer or a certificate in form `D', if the sale is to a Government (not being a registered dealer).

He should furnish the same to the prescribed authority in the prescribed manner, within the prescribed time or within such further time as that authority, may permit, for sufficient cause as laid down in Section 8(4).

Question 78

Write short notes on : Sale of Declared Goods *(5 Marks) (May 1999)*

Answer

Section 8 (2) deals with sale of declared goods. The tax on the sale of declared goods to Government and Registered Dealers shall be calculated at the rate applicable to the sale or purchase of such goods inside the appropriate State.

Under section 15 of the Act, the State Legislature cannot make a law levying tax of more than 4% on the sale or purchase of declared goods. In the case of Inter-State sale of declared goods to unregistered dealers, the sales will be taxable at a rate which is twice that applicable to Inter-State sale of these goods in the appropriate State. In such cases the rate in respect of Inter-State sale can as well exceed four per cent.

Question 79

State the conditions for availing exemption on account of subsequent sale. (4 Marks) (Nov.97)

Answer

Conditions for availing exemption on account of subsequent sale.

(i) It should be by one registered dealer to another registered dealer or to the Govt.

(ii) It should be during the movement of goods from one state to another and the transfer of documents of title to the goods is during such movement of goods.

(iii) It should be supported by necessary proof like certificate in Form No.E-I or E-II and declaration in Form C if the sale is to a registered dealer or a certificate in Form D if the sale is to the Govt. not being a registered dealer.

(iv) In the case of subsequent sale to a registered dealer other than the Govt. the sale should relate to the goods referred to section 8(3).

Question 80

Write short notes on the following: 'Exempt from Tax'. (5 Marks) (May 1996)

Answer

Under section 8(5) the State Government may on the fulfillment of the requirements laid down in section 8(4) by the dealer may provide exemption from tax or lower rate of tax. However, before that it will consider issue of public interest. The exemption or lower rate will be notified in the official gazette. It could also be conditional exemption or concessional rate, which means a dealer, may have to satisfy the condition for enjoying exemption or concessional rate of tax.

Transfer of goods otherwise than by way of sale is exempt from tax from CST, section 6A.

Subsequent sale effected in the course of inter-state trade or commerce provided such sale is effected by transfer of documents of title to such goods during their movement from one state to another is also exempt from CST [Section 6(2)].

Question 81

Write short notes on: Rates of tax leviable in the course of Inter-State trade or Commerce. (5 Marks) (Nov.96)

Answer

The scheme for levy of sales tax relating to inter State sales falls within the following categories -

(a) Inter-State sale by a dealer to government or a registered dealer of the goods, referred to in section 8(3) shall be at 4 per cent provided the conditions prescribed in section 8(4) are satisfied – Section 8(1).

(b) Tax payable by a dealer on his turnover of inter-state sale not falling under sub-section (1) of Section 8 shall be twice the rate applicable to the sale or purchase of such goods inside the appropriate State – Section 8(2)(a)

(c) The tax payable relating to inter-State sales of other goods (other than declared goods) and not falling under section 8(1) shall be 10 per cent or at the rate applicable for sales inside the appropriate State, whichever is higher - Section 8(2)(b).

(d) In the case of goods, the sale or the purchase of which under the sales tax law of the appropriate State, is exempt from tax generally, it shall be 'nil' - Section 8(2)(c).

Question 82

Prosecution shall not lie in respect of an offence under certain circumstances.

(3 Marks) (Nov.2001)

Answer

Where any offence is compounded by imposition of penalty under section 10A of the Act, no prosecution shall lie in respect of such offence. Section 10A provides for imposition of penalty on a dealer instead of prosecuting him in respect of offences punishable under clause (b), (c) and (d) of section 10. The said offences are:

(a) False representation by a registered dealer that goods purchased by him are covered by certificate of registration.

(b) False representation by a dealer that he is a registered dealer when factually he is not a registered dealer.

(c) Failure on the part of the dealer without reasonable cause to make use of the goods purchased for such purposes specified in clauses (b), (c) or (d) of sub-section (3) or sub-section (6) of section 8 of the Act.

Question 83

Write short note on: Acts or omissions for which penalties can be levied under the Central Sales Tax Act. *(5 Marks) (May 2000)*

Answer

Penalties can be levied under the Act for the following acts/omissions :

(a) Furnishing a false certificate of declaration under section 6(2).

(b) Failure by a person to get himself registered under section 7.

(c) False representation by a registered dealer that goods purchased by him are covered by his certificate of registration.

(d) False representation by a dealer that he is a registered dealer.

(e) Failure without reasonable cause, by a dealer who has purchased any goods for any of the purposes specified in clauses (b), (c) or (d) of sub-section (3) of section 8.

(f) Possession of declaration form or certificate not obtained in accordance with the provisions of the Act.

(g) Collection of taxes by an unregistered dealer.

Question 84

Sales-tax law of every State shall be subjected to restrictions and conditions – Discuss.

(6 Marks) (May 99)

Answer

Section 15 of the Central Sales Tax Act deals with the restrictions and conditions in regard to tax on sale or purchase of declared goods within the State. Every Sales Tax law of a State shall be subject to the following restrictions and conditions in so far as it imposes or authorizes the imposition of tax on the sale or purchase of the declared goods being goods of special importance in inter-State trade or commerce.

(a) The rate of tax shall not exceed 4%.

(b) The tax shall not be levied in more than one state.

(c) Where tax is levied under the State Law for sale or purchase of any declared goods inside that State and such goods are sold in the course of Inter-State trade for which tax under this Act has been paid, the tax levied under State Law shall be returned to the person making such Inter-State sale. The refund shall not be granted unless inter-State Sales Tax has been actually paid.

(d) Where tax has been levied under State Law in respect of the sale or purchase of paddy inside that State, the tax leviable on rice procured out of such paddy shall be reduced by the amount of tax levied on such paddy.

(e) Each of the purchases referred to Section 14 whether whole or separated and whether with or without husk shall be treated as a single commodity for levy of tax under the State Law.

Question 85

Write short note on: Levy and Collection of Taxes. *(5 Marks) (May 1996)*

Answer

The State from which the movement of goods commences shall be the appropriate state empowered to assess, collect and enforce payment of any tax on behalf of the Government of India. For these purposes the appropriate State authorities are empowered to exercise all or any of the powers that they have under the general sales tax law of the State. Provisions made in the general sales tax of the appropriate State with regard to submission of returns, appeals, review, references, refunds, rebates and penalties and compounding of offences shall be applicable.

There is an exception to this general rule as aforesaid. The proviso to section 9(1) provides that in the case of second or subsequent sale by a registered dealer to an unregistered dealer in the same course of movement of goods from one State to another, tax will be levied and collected in the appropriate State of the registered dealer making the sale to the unregistered dealer.

Question 86

Write short note on: Powers of assessment including reassessment.

(5 Marks) (May 1996)

Answer

Sub-section (2) of section 9 empowers the State Sales tax authorities to assess, reassess, collect and enforce payment of Central Sales Tax. It authorizes the authorities under the State Sales Tax Laws to exercise all the powers which they have under those laws (including inter alia the power to impose penalties) for the purpose of Central Sales Tax also. The provisions relating to charging or payment of interest in the general sales tax law of the State are applicable for the purpose of Central Sales Tax Act also. The sub-section also provides that the provisions relating to offences and penalties (including provisions relating to penalties in lieu of prosecution for an offence or in addition to the penalties or punishment for an offence but excluding the provisions relating to matters provided for in section 10 and 10A) of the general sales tax law of each State shall with necessary modifications apply in relation to the assessment, collection and enforcement of payment of tax required to be collected under the Act.

Question 87

Write short notes on: Refund of sales tax-conditions to be fulfilled. *(5 Marks) (Nov.96)*

Answer

Under section 15 (b) of the CST Act, 1956 where a tax has been levied under the sales tax law of a State in respect of the sale or purchase inside the State of any declared goods and such goods are sold in the course of inter-state trade or commerce, and tax has been paid under the CST Act in respect of the sale of such goods in the course of inter-state trade or commerce, the tax levied under such law shall be reimbursed to the person making such sale in the course of inter-state trade or commerce in such manner and subject to such conditions as may be provided in any law in force in that State.

The scheme of the Act is that two sets of taxes should not be levied under two Acts in respect of the same goods. Where the same declared goods have been taxed under the State Act as inside sales and have also been subjected to tax on inter-state sales, the tax under Central Act is to prevail and the tax under the State Act is to be refunded. The refund can be claimed only by the person who effected the inter-state sale and by no other person.

Question 88

What is the extent of liability of a director of a private company in liquidation?

(4 Marks) (May 2005)

Answer

The liability of a director of a private company arises when the private company is wound up and any tax assessed on the company under the Central Sales Tax Act, 1956 for any period, whether before or in the course of or after its liquidation, cannot be recovered. In such a situation, section 18 of the Act imposes liability on every person who was a director of the private company at any time during the period for which the tax is due. Every director would be jointly and severally liable for the payment of such tax unless he proves that the non-recovery cannot be attributed to any gross neglect, misfeasance or breach of duty on his part in relation to the affairs of the company.

Question 89

(i) Write short notes on: Duties and liabilities of a liquidator. *(5 Marks) (Nov.2001)*

(ii) Liability of a liquidator of a company under Central Sales-tax Act. *(5 Marks) (May 1998)*

Answer

Section 17 deals with the duties and liabilities of liquidator of a company in liquidation.

(a) The liquidator or the receiver will have to give notice of his having assumed such charge within thirty days of his doing so, to the appropriate authority, which means the authority competent to assess tax on the company.

(b) It shall be obligatory on the part of the liquidator to make provision for the payment of such amount.

(c) Such payment shall be subject only to (i) payments to secured creditors having priority of payment over government dues; or (ii) meeting such costs and expenses of the winding up of the company as are, in the opinion of the appropriate authority reasonable.

(d) The liquidator is prohibited from parting with the assets or the properties of the company, unless due provision has been made for the payment of the amount specified by the appropriate authority.

(e) If the liquidator fails to give notice to the appropriate authority or to set aside the amount for discharging tax liability as explained above, the liquidator would be personally liable for the same. Where there are more liquidators than one, the above obligations and liabilities will attach to all the liquidators jointly and severally.

Question 90

Discuss briefly about the liability of a company in liquidation under Central Sales Tax Act.

(4 Marks) (May 2003)

Answer

Under section 17, the liquidator or the receiver will have to give notice of his having assumed such charge, within 30 days of assuming office to the Appropriate Authority. The aforesaid authority shall within 3 months of the receipt of such notice, intimate to the liquidator of an amount, which in his opinion will be sufficient to meet the tax liability of the company. It shall be obligatory on the part of the liquidator to make a provision for the payment of such amount subject only to

(i) payments to such creditors having priority of payment over Government dues ; and

(ii) meeting such costs and expenses of winding up of the company as are, in the opinion of the appropriate authority, reasonable.

Question 91

Discuss briefly about Central Sales Tax Appellate Authority u/s 19 of the Central Sales-tax Act. *(7 Marks) (May 2003)*

Answer

1. The Central Government shall constitute by notification in the Official Gazette, an authority called the Central Sales-tax Appellate Authority to settle inter-State disputes falling under section 6A and section 9 of the Central Sales Tax Act.
2. The authority shall consist of
   (a) a Chairman who is a retired judge of the Supreme Court, or a retired Chief Justice of a High Court ;
   (b) an officer of the Indian Legal Service who is, or is qualified to be an Additional Secretary to the Government of India ; and
   (c) an officer of a State Government not below the rank of Secretary or an officer of Central Government not below the rank of Additional Secretary, who is an expert in sales-tax matters.
3. The salaries and allowances payable to and the terms and conditions of service of, the Chairman and Members shall be as prescribed.
4. The Central Government shall provide the authority to such officers and staff as may be necessary for efficient exercise of the powers of the Authority under the Central Sales-tax Act.

Question 92

What are the different declaration forms used in Central Sales Tax ? State, when and for what purpose they are to be used ? (briefly in two/three sentences for each form).

(7 Marks) (Nov.2002)

Answer

The different declaration forms used under the C.S.T. Act are as under :

(i) Form C – This is a form of Declaration to be furnished by the registered dealer to the selling dealer from whom he purchases the goods to indicate that the goods are covered by his certificate of registration. In an inter-state sale, Form C entitles concessional rate of tax.

(ii) Form – D is a certificate to be issued by the Government which makes the purchases to the selling dealer to be eligible for concessional rate of tax.

(iii) Form E-I & E-II – Form E-I is given for first sale and E-II for second or subsequent sale (by the first purchaser to the second purchaser).

(iv) Form F- This is a Form of Declaration to be issued by the transferee in cases of branch transfer of goods to avoid levy of sales tax as there is no inter-State sale.

(v) Form G is given when Form C, D, E-I, E-II or F are lost, as an indemnity bond. The dealers who lost any of the said forms should give Form G to the Tax Officer to indemnify the Government against any loss.

(vi) Form H – While in the case of export, the actual exporter has customs documents, bills of lading etc., to prove that the goods are exempt from sales tax, the penultimate seller however has no such documents. Therefore, Form H, is a Certificate of export, issued by the exporter to the dealer from whom the goods have been purchased for enabling the latter to get the benefit of section 5(3).

Question 93

In respect of goods, which are exempt from tax can the cost of packing materials be charged to tax? *(1 mark) (May 2001)*

Answer

Yes. Where the commodity is exempt from tax, the sale price is inclusive of the containers or packing materials. Therefore the splitting up of the turnover can be carried out and the turnover in respect of the container or packing material can be subjected to tax – for example paddy in gunny bags.

Question 94

Examine the incidence of Sales-tax in the following cases :

(i) A company carrying on business sells tea and snacks to its employees from its factory canteen.

(ii) A coffee plantation with a view to facilitate new plantation clears the forest growth and sells trees, which are cut and sold as firewood.

(iii) A contractor obtains ballast from quarries belonging to the railways and supplies them at work sites. *(3 x 2 = 6 marks) (May 2001)*

Answer

(i) The incidence of sales tax is to be judged with reference to the definition of the expression "business". There is no doubt a sale in this case, but does it take place in the course of business ? Business as defined in clause (aa) of section 2 includes, inter alia, any transaction in connection with or incidental or ancillary to trade, commerce, manufacture, adventure or concern. The activity in which the company is engaged is ancillary or incidental to business. Therefore, the canteen sales are liable to sales tax.

(ii) Shade trees and forest growth constitute the fixed assets of the plantation company. Receipts from sale of such trees will constitute capital assets and not stock-in-trade. Therefore, there is no business in such goods and the proceeds of the trees are not taxable.

(iii) This is purely a contract for the supply of labour and does not involve any sale of goods. The property in the goods remain with the Railways. Hence, there is no sales tax leviable on the contract.

Question 95

Mr. D, a first stage dealer in packing machinery in the State of Gujarat furnishes the following data :

		Rs.
(i)	***Total inter state sales during F.Y. 2004-05***	***92,50,000***
	CST not shown separately	
(ii)	***Above sales include:***	
	Excise duty	***9,00,000***
	Freight	***1,50,000***
	(of this Rs.50,000 is not shown separately in invoices)	
	Insurance charges incurred prior to deliver of goods	***32,000***
	Installation and commissioning charges shown separately	***15,000***
	Incentive on sales received from manufacturer	***30,000***

Determine the turnover and CST payable, assuming that all transactions were covered by valid `C' Forms. *(7 Marks) (Nov.2005)*

Answer

Computation of Mr.D's turnover and central sales tax payable

	Rs.	***Rs.***
Total inter-state sales		**92,50,000**
Less:Freight shown separately in the invoices	**1,00,000**	
Installation and commissioning charges shown separately	**15,000**	
		1,15,000
Turnover including CST (A)		**91,35,000**
CST payable (91,35,000 X 4/104) (B)		**3,51,346**
Turnover excluding CST (A- B)		**87,83,654**

Central Sales tax payable		**3,51,346**

Note –

1. Excise duty forms part of the sale price and is not deductible.
2. Freight not shown separately in the invoices and insurance charges incurred prior to delivery of goods are not deductible in calculating the turnover.
3. Sale price includes incentive on sales received from manufacturer.
4. The CST on transactions covered by valid `C' forms is 4% or the State sales-tax rate, whichever is lower. It has been assumed that in this case, the State sales-tax rate is higher than 4%. Therefore, the rate of CST is taken as 4%.

Question 96

Total interstate sale for the Financial Year 2003-2004 of X Ltd. is Rs.1,50,70,000, which consists of the following :

	Rs.
4 % CST sales	**91,50,000**
2% CST sales	**59,20,000**

Out of the goods sold for Rs.1,50,000, on 16.7.2003 that were liable to CST @ 4% goods worth Rs.50,000 were returned on 12.12.2003 and goods worth Rs.1,20,000 were returned on 01.2.2004. A buyer to whom goods worth Rs.55,000 carrying 2% CST was dispatched on 16.4.2003, rejected the goods and the same were received back on 15.11.2004.

Compute the taxable turnover and tax liability of X Ltd., since all the relevant Forms have been received. *(5 Marks) (Nov.2004)*

Answer

Let us assume that the facts relate to the financial year 2006-07 and accordingly compute the taxable turnover and tax liability of X Ltd. Also, it is assumed that sales tax is not separately charged in the sale price and hence the sale includes CST.

Computation of taxable turnover of X Ltd

Particulars	***4% CST Rs.***	***2% CST Rs.***
Total sales	**91,50,000**	**59,20,000**
***Less*: Goods returned within 6 months**	**50,000**	
Goods rejected (the condition of		

6 months does not apply in the case)		**55,000**
	91,00,000	**58,65,000**
Less **: Central sales tax** **91,00,000 x 4/104** **58,65,000 x 2/102**	 **3,50,000** 	 **1,15,000**
	87,50,000	**57,50,000**

Computation of tax liability of X Ltd

Particulars	***Rs.***
On goods returned after 6 months (rate of 10% is applicable since buyer will not give 'C' form for the same)	
= Rs.1,20,000 x 100 / 104 = 1,15,385 @ 10%	**11,538**
On Sales of Rs.86,34,615 @ 4% (87,50,000 – 1,15,385)	**3,45,385**
On Sales of Rs.57,50,000 @ 2%	**1,15,000**
Total tax liability	**4,71,923**

Question 97

Mr. X reported sales turnover of Rs.36,20,000. This includes the following :

(i) Excise duty Rs.3,00,000 ; and

(ii) Deposit for returnable containers and packages Rs.5,00,000.

Sales Tax was not included separately in the sales invoice.

Compute tax liability under the CST Act, assuming the rate of tax @ 4%. (3 Marks) (May 2004)

Answer

Computation of Central Sales Tax liability of Mr. X

Turnover (including Central sales tax and deposit received towards returnable containers and packages)	**36,20,000**
***Less*: Deposit received towards returnable containers and packages not to be considered in turnover**	**5,00,000**
Turnover (including central sales tax)	**31,20,000**
***Less* : Central sales tax thereon = 31,20,000 x 4 /104**	**1,20,000**
Turnover (excluding central sales tax)	**30,00,000**

The Central Sales Tax liability is Rs.1,20,000 (being 4% of Rs.30,00,000)

Note – Excise duty is part of turnover and hence should not be excluded from turnover.

Question 98

Mr. Y of Mumbai purchased declared goods from Nagpur by paying sales tax at 3%. Subsequently, the commodity is sold to a dealer at Chennai. The dealer Y while collecting and remitting tax on the Interstate sale, wants refund of tax paid on sale within State (i.e. purchase from Nagpur).

Is he correct? (3 Marks) (May 2004)

Answer

Section 15(b) provides that if a tax has been levied on sale or purchase of any declared goods inside a State and the same goods are subsequently sold in the course of inter-state trade or commerce and is subjected to tax under the Central Sales Tax Act, the local sales tax realized previously has to be reimbursed to the dealer. However, the local sales tax can be reimbursed only when the central sales tax has been paid and not otherwise.

Hence, in this case, Mr. Y can claim refund of tax paid within the State after payment of central sales tax in respect of such declared goods.

Question 99

Mr. A reports his turnover at Rs.52,00,000 for the year ended 31-03-03. Also he reported that goods sold in March, 2003 have been returned by the customers to the value of Rs.5,20,000 in May 2003. He had not charged tax separately in the sale invoices. Assuming the tax rate is 4, compute his tax liability under the Sales Tax Act. (4 Marks) (Nov.2003)

Answer

	Rs.
Total turnover	**52,00,000**
Less **: Sale price of goods returned to the dealer by the purchaser of such goods (within 6 months from the date of delivery of the goods)**	**5,20,000**
Turnover in terms of the Central sales tax Act	**46,80,000**

Mr.A has not charged the amount of sales tax separately in the sales invoices. Therefore, according to section 8A, the sales tax has to be worked out applying the following formula

$$\frac{\text{Rate of tax X Aggregate of sale price}}{100 + \text{Rate of tax}}$$

$$\text{Central sales tax liability} = \frac{4 \text{ x } 46{,}80{,}000}{100 \text{ plus } 4}$$

$$= \frac{1{,}87{,}20{,}000}{104}$$

= Rs.1,80,000

Question 100

Mr. Vishal is a dealer. His sales during the first quarter of 1997-98 (April to June) are as under :

	Date	*Invoice No.*	*Amount Rs.*
(i)	**05.04.97**	**103/FCA/01/97**	**10,000 plus tax @ 4%**
(ii)	**12.04.97**	**103/FCA/02/97**	**80,000 plus tax @ 4%**
(iii)	**05.05.97**	**103/FCA/03/97**	**62,400 (inclusive of tax)**
(iv)	**06.06.97**	**103/FCA/04/97**	**14,000 plus C.S.T. @ 4%**
(v)	**27.06.97**	**103/FCA/05/97**	**18,000 plus C.S.T. @ 4%**

(vi) **Goods worth Rs.7,000 (exclusive of tax) against Invoice No.103/FCA/04/97 were returned on 29.06.97.**

(vii) **Goods worth Rs.13,000 (inclusive of tax) sold on 26.12.96 were returned on 30.06.97.**

(viii) **Goods worth Rs.6,500 (inclusive of tax) sold on 27.12.96 were returned on 30.06.97.**

All the above sales were made in the course of interstate trade. Calculate the turnover and sales tax payable if the rate of tax is 4%. *(8 Marks) (Nov.98)*

Answer

Aggregate sale value (inclusive of Sales Tax)

Invoice No.103/F.C.A/01/97/ (10,000 + 4%)	**10,400**
Invoice No.103/F.C.A/02/97/ (80,000 + 4%)	**83,200**
Invoice No.103/F.C.A./03/97	**62,400**
Invoice No.103/F.C.A/04/97/ (14,000 + 4%)	**14,560**
Invoice No.103/F.C.A/05/97/ (18,000 + 4%)	**18,720**
	1,89,280
***Less* : Sales return within 6 months**	**7,280**
	1,82,000

Turnover = 100 ? 1,82,000 / 100+4 = 1,75,000
Sales tax payable = 1,75,000 ? 4/100 = Rs.7,000
Note : Goods returned beyond six months are not deductible. Hence amount of Rs.13,000 and Rs.6,500 vide item No. (vii) & (viii) are not deductible.

Question 101

From the following details, compute the central sales-tax payable by a dealer carrying on business in New Delhi :

	Rs.
Total turnover for the year which included	***16,00,000***
(i) Trade commission for which credit notes have to be issued separately	***48,000***
(ii) Installation charges	***25,000***
(iii) Excise duty	***80,000***
(iv) Freight, insurance and transport charges recovered separately in the invoice	***60,000***
(v) Goods returned by dealers within six months of sale, but after the end of the financial year	***40,000***
(vi) Central Sales tax Buyers have issued 'C' forms for all purchases	

(6 Marks) (May 1998)

Answer

		Rs.
Gross turnover		**16,00,000**
Less **:Trade commission**	**48,000**	
Installation charges	**25,000**	
Freight, transport charges	**60,000**	
Goods returned within 6 months	**40,000**	
		1,73,000
Turnover including CST		**14,27,000**
Central sales tax @ 4%		
14,27,000 ? 4 / 104		**54,885**
Turnover		**13,72,115**
CST at 4% thereof		**54,885**

Question 102

(i) M/s. Snow White Ltd., Mumbai sells iron rods to M/s. Hyderabad Ltd. in Vijayawada for a value of Rs.10,00,000 inclusive of Central Sales Tax @ 4%. The local sales tax on iron rods in Mumbai is 3%. Both the dealers are registered dealers.

Ascertain the Central Sales-tax payable. *(2 Marks) (May 2003)*

(ii) If Hyderabad Ltd. were unable to submit Form `C', being an unregistered dealer, what will be the Central Sales Tax liability, if the local sales tax rate is 12% ?

Note : Iron rods are not declared goods. *(2 Marks) (May 2003)*

Answer

(i) Value of goods including CST @ 4% 10,00,000

Value of goods = 10,00,000 x 100 /104 = 9,61,538

If the sale is to a registered dealer, and the local State sales-tax is lower than 4%, then the lower of the two is to be charged. Hence, in this case, the local State sales-tax being 3%. CST is to be charged at 3%.

CST liability = 9,61,538 x 3 /100 = Rs.28,846

(ii) In this case, Hyderabad Ltd. is an unregistered dealer. Therefore, the local State sales-tax i.e.12% or 10% whichever is higher is to be adopted.

Therefore, CST liability = 9,61,538 x 12 /100 = Rs.1,15,385.