

PAPER – 7 : DIRECT TAXES

Answer all questions.

Question 1

Laxmi Tea Limited is engaged in growing and manufacturing tea in Assam and West Bengal. The company's profit and loss account for the year ended 31st March, 2009 shows a net profit of Rs.550 lacs after debiting or crediting the following amounts:

- (a) Depreciation Rs.40 lacs.
- (b) Interest amounting to Rs.2 lacs on term loan from a bank for purchase of machinery for one of its tea factories.
- (c) Repairs to factory building amounting to Rs.15 lacs for which a sum of Rs.10 lacs was withdrawn from Tea Deposit account maintained with National Bank for Agricultural and Rural Development (NABARD) as per section 33AB of the Income-tax Act.
- (d) Profit from sale of green tea leaves plucked in own gardens Rs.20 lacs.
- (e) Rs.5 lacs on account of stamp duty and registration fees for the issue of bonus shares.
- (f) Rs.10 lacs, being sales tax dues of earlier years determined during the year on disposal of appeals by the appellate authority, for which the company has furnished a bank guarantee to the Commercial Tax Authority.
- (g) Rs.5 lacs written off as bad in respect of a trade debt transferred from Saraswati Tea Limited in previous year 2005-06 pursuant to a scheme of amalgamation approved by the jurisdictional High Court.
- (h) Rs.2 lacs contributed to Employees' Welfare Trust.
- (i) Interest on inter-corporate deposit Rs.1 lac and Rs.1.50 lacs for February, 2009 and March, 2009, respectively, for which tax deducted at source was paid to the Central Government in June, 2009.

Following additional information are furnished by the management:

- (i) Depreciation as per Tax Audit Report under section 44AB Rs.55 lacs.
- (ii) One financial institution converted arrear interest of Rs.10 lacs into a new loan in financial year 2006-07, which is repayable in five annual instalments. The company has paid Rs.2 lacs towards the instalment due for the financial year 2008-09 in February, 2009.

The Suggested Answers for Paper 7: - Direct Taxes are based on the provisions applicable for A.Y. 2009-10, which is the assessment year relevant for November, 2009 examination.

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- (iii) A sum of Rs.250 lacs deposited in NABARD on 15th June, 2009 as per the provision of Section 33AB.

Compute total income of the company for the Assessment Year 2009-10 stating the reasons for each item. Ignore provision relating to Minimum Alternate Tax. (16 Marks)

Answer

Computation of total income of Laxmi Tea Ltd. for the A.Y.2009-10

Particulars	Amount in Rs.
A. <u>Profit and Gain from Business and Profession</u>	
Net profit as per Profit & Loss Account	5,50,00,000
Add: Items debited but to be considered separately or to be disallowed	
Depreciation as per accounts	40,00,000
Repairs to factory building to the extent of amount spent by withdrawal from Tea Deposit Account (Note 2)	10,00,000
Sales tax not paid (Note 4)	10,00,000
Contribution to Employees' Welfare Trust disallowed under section 40A(9) (Note 6)	2,00,000
Interest on inter-corporate deposit for February, 2009 for which tax deducted at source was deposited in June 2009 disallowed under section 40(a)(ia) (Note 7)	<u>1,00,000</u>
	<u>63,00,000</u>
	6,13,00,000
Less: Amount credited to profit & loss account but not chargeable to tax	
Profit on sale of green tea leaves plucked in own gardens is agricultural income and the same is exempt under section 10(1)	<u>20,00,000</u>
	5,93,00,000
Less: Deductions allowable while computing business income	
Depreciation as per Income-tax Rules	55,00,000
Payment of new loan converted from arrear interest (Note 8)	<u>2,00,000</u>
	<u>57,00,000</u>
	5,36,00,000
Deduction under section 33AB for making deposit in an account with NABARD as per scheme approved by the Tea Board, being lower of the following two amounts:	
Amount deposited	2,50,00,000

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40% of the profit from business of growing and manufacturing tea computed under the head "profits and gains from business and profession" before making this deduction (Rs.5,36,00,000 x 40%)	<u>2,14,40,000</u>	<u>2,14,40,000</u>
		3,21,60,000
Less : 60% of above, being agricultural income as per Rule 8		<u>1,92,96,000</u>
Business income		<u>1,28,64,000</u>
Gross Total Income		1,28,64,000
Less : Deduction under Chapter VIA		<u>Nil</u>
Total Income		<u>1,28,64,000</u>

Notes:

1. As per section 36(1)(iii), interest paid in respect of capital borrowed for the purpose of business or profession is allowed as deduction. The term loan was taken for purchasing machinery for use in a tea factory. Thus, the term loan was used for the purpose of business. Hence, interest on term loan is allowable as deduction. As interest has already been debited to the profit and loss account, no adjustment is required. It is assumed that–
 - (i) the new machinery was not acquired for extension of the business of the company; and
 - (ii) the interest has been actually paid.
2. As per section 33AB(6), where any amount standing to the credit of the assessee in the account maintained with NABARD is utilized by the assessee for the purpose of any expenditure in connection with eligible business in accordance with the scheme approved by the Tea Board, such expenditure shall not be allowed as deduction. Therefore, the amount of Rs.10 lacs withdrawn and utilized for incurring expenditure on repair to factory building is to be disallowed.
3. The Supreme Court, in the case of CIT vs. General Insurance Corporation (2006) 286 ITR 232, observed that there is no inflow of fresh funds or increase in capital employed on account of issue of bonus shares. There is only reallocation of company's fund on account of issue of bonus shares by capitalization of reserves. The company has not acquired any benefit of enduring nature. There is no increase in capital base of the company. Therefore, stamp duty and registration fee in connection with issue of bonus shares is allowable as revenue expenditure under section 37(1).
4. According to section 43B, any tax, duty, cess or fee (by whatever name called) is allowed as deduction if they are actually paid on or before the due date of filing return of income under section 139(1) irrespective of the method of accounting followed by the assessee. In the case of CIT vs. Udaipur Distillery Company Limited (2004) 268 ITR 305 (Raj), it was held that actual payment requires that amount must flow from the assessee to the

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public exchequer as such as specified in section 43B. Mere furnishing of bank guarantee by the assessee towards sales tax dues does not mean actual payment of sales tax dues. Therefore, sales tax liability determined on appeal shall be disallowed under section 43B for non-payment.

5. Under section 36(1)(vii) read with section 36(2), an assessee can claim deduction in respect of bad debt, provided the amount of such debt has been taken into account in computing total income of the assessee and it is written off in the books of account of the assessee. In the case of CIT vs. T.Veerabhadra Rao, K.Koteswara Rao & Co. (1985) 155 ITR 152 (SC), the Apex Court held that the successor of a business is entitled to write off the predecessor's debt as a bad debt and claim deduction if the other conditions are fulfilled. This is so because the benefit of deduction in respect of bad debt is not accrued to the assessee by way of personal relief but relates to the business. Therefore, the assessee company is entitled to deduction under section 36(1)(vii) read with section 36(2) in respect of debt transferred from the amalgamating company, Saraswati Tea Limited.
6. As per section 40A(9), any contribution made by the assessee as an employer to any fund, trust, company, association of persons, body of individuals, society registered under the Societies Registration Act or other institution for any purpose shall be disallowed, except where such contribution is paid to a recognised provident fund or approved superannuation fund or approved gratuity fund. Therefore, contribution to the Employees' Welfare Trust is to be disallowed.
7. Section 40(a)(ia) seeks to disallow interest paid to any resident, if tax is not deducted at source or, after deduction, tax is not deposited to the Central Government on or before the last date of the previous year i.e., on or before 31st March.

It may be noted that if tax has been deducted during the last month of the previous year, i.e., in March, and paid on or before the due date for filing return of income under section 139(1), then, interest shall not be disallowed. However, if tax has been deducted during any other month of the previous year (i.e., from April to February) but paid after the end of the previous year i.e., after 31st March, interest shall be allowed as deduction in the previous year in which such tax is paid.

In view of the above provision, interest of Rs.1 lac pertaining to February, 2009 shall be allowed as deduction only in the assessment year 2010-11, as the tax has been paid in the previous year 2009-10.

Interest of Rs.1.50 lacs pertaining to March, 2009 shall be allowed in the assessment year 2009-10 itself, as tax has been paid on or before due date for filing return of income for assessment year 2009 -10.

8. As per Explanation 3C to section 43B, a deduction of any sum, being interest payable on any loan or borrowing from a public financial institution shall be allowed, if such interest

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has been actually paid and such interest which has been converted into a loan or borrowing shall not be deemed to have been actually paid.

The manner in which the converted interest will be allowed as deduction has been clarified vide Circular No.7/2006 dated 17.7.2006. The unpaid interest, whenever actually paid to the financial institution, will be in the nature of revenue expenditure deserving deduction in the computation of income. Therefore, irrespective of the nomenclature, the deduction will be allowed in the previous year in which the converted interest is actually paid. Accordingly, the sum of Rs.2 lacs, being installment paid in February, 2009 shall be allowed as deduction while computing business income of P.Y.2008-09.

Question 2

- (A) ABC Ltd., incorporated as a public limited company for construction of ships, is to file its first return for the year ended 31.3.2009. The management is confused as to the admissibility of the following expenses incurred and therefore, asks you to explain how the same would be dealt with while preparing the return to be filed for A.Y. 2009-10:
- (a) Payments made for preparing feasibility report is Rs.25 lacs, for conducting market surveys is Rs.15 lacs and for underwriting commission on shares is Rs.85 lacs, besides fees and expenses of Rs.70 lacs for incorporation of company. The capital employed in the business is Rs.3,500 lacs.
 - (b) Amount of Rs.15 lacs paid to a local mafia (DON) for the excavation of inhabitants who were occupying the land to be used as a yard.
 - (c) Interest of Rs.150 lacs paid on loans taken for purchase of plant and machinery out of which Rs.130 lacs is for the period till such machines were commissioned.
 - (d) The amount of discount @ 2% on 5 year debentures of face value of Rs.1,000 lacs issued at par and were subscribed in full.
 - (e) Interest of Rs.400 lacs on the term loan taken from financial institution was accounted upto 31.3.2009 on accrual basis. The payment terms allowed a moratorium on interest for the period upto 30.6.2009. The interest of Rs.200 lacs outstanding on 31.3.2009 was paid by the company on 3.10.2009. (8 Marks)
- (B) Aerochem, a partnership firm, transfers a piece of land situated in Thane district on 17.8.2008 for Rs.50 lacs. The land, purchased on 6.3.1980 for Rs.1 lac, was registered on 3.4.1983 on payment of stamp duty of Rs.20,000. Expenses on land development and construction of boundary wall incurred in August, 1983 were of Rs.1,50,000. The charges for the transfer of land paid to the broker were 2½% of the sale consideration. Fair market value of the land as on 1.4.81 was Rs.1,50,000. The firm invested Rs.30 lacs on 1.12.2008 in the bonds issued by National Highways Authority of India redeemable after a period of 48 months. Compute the amount of capital gain chargeable to tax for Assessment Year 2009-10 with the help of cost inflation index for F.Y. 1983-84 and

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2008-09 of 116 and 582, respectively. Also, give in brief, the reasons and the provisions of the Act for each of the items dealt with. (7 Marks)

Answer

- (A) (a) The expenditure incurred is in the nature of preliminary expenses and the total of such expenses is Rs.195 lacs. These expenses are to be amortized under section 35D over a period of 5 years in equal installments. The proviso to section 35D(3) restricts the total allowable expenses to 5% of the capital employed and therefore, the company is entitled to amortise under section 35D, out of the total expenses of Rs.195 lacs, an amount of only Rs.175 lacs, being @ 5% of Rs.3,500 lacs, over a period of 5 years equally. Therefore, Rs.35 lacs is allowable in the A.Y.2009-10 under section 35D.
- (b) The amount paid to a local mafia for the excavation of inhabitants who were occupying the land to be used as a yard is a payment in the nature of an offence and is prohibited by law. Therefore, it is not allowable as business expenditure under section 37.
- (c) The interest of Rs.130 lakh paid on a loan taken for the acquisition of plant and machinery, relating to the period before commissioning of such plant and machinery, should be capitalized. Interest of Rs.20 lakh, attributable to the period after the machinery is put to use, is eligible for deduction under section 36 subject to the provisions of section 43B.
- (d) The Apex Court, in the case of Madras Industrial Investment Corporation vs. CIT (1997) 225 ITR 802, has held that discount on issue of debentures is of revenue nature and it will be allowed on proportionate basis over the life of the debentures. In this case, the discount on debentures amounts to Rs.20 lacs, being 2% of Rs.1,000 lacs. The company can, therefore, claim an amount of Rs.4 lacs (i.e., one-fifth of Rs.20 lacs) as an expenditure in the return for A.Y. 2009-10.
- (e) As per section 43B, interest due to a financial institution is allowable, if such interest is paid on or before the due date of filing of return under section 139(1). Interest of Rs.200 lacs not paid up to 30.9.2009, being the due date of filing of return under section 139(1), is, therefore, not allowable as deduction for the P.Y.2008-09.
- (B) Computation of Capital Gains chargeable to tax for A.Y.2009-10

Particulars	Rs.	Rs.
Gross sale consideration of the land		50,00,000
Less: Expenses on transfer of land paid to a broker @ 2.5% of the sale value [See Note 1]		<u>1,25,000</u>
Net Sale Consideration		48,75,000

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Less: Indexed cost of acquisition and improvement.

A) 1,50,000 x 582/100 [See Notes 2 & 4]	8,73,000	
B) 1,70,000 x 582/116 [See Notes 3 & 4]	<u>8,52,931</u>	<u>17,25,931</u>
		31,49,069

Less: Investment in bonds of NHAI eligible for exemption under section 54EC [See Note 5]

30,00,000

Capital Gains

1,49,069

Notes:

- (1) Brokerage paid is allowable as deduction under section 48(i) as held by Rajasthan High Court in the case of Sah Roop Narain vs. CIT (1987) 32 Taxman 453.
- (2) Cost of acquisition of the capital asset can be claimed as deduction under section 48 while computing capital gains. As per section 55(2)(b)(i), the cost of acquisition in case of a capital asset acquired before 1.4.81 shall be the actual cost of acquisition or the fair market value as on 1.4.81, at the option of assessee. Accordingly, in this case, the cost of acquisition would be the fair market value of the land on 1.04.81, as the same is beneficial to the assessee.
- (3) Cost of improvement of the capital asset can also be claimed as deduction under section 48. The cost of improvement, in this case, would include the expenditure of Rs.1,50,000 on land development and construction of boundary wall and expenditure of Rs.20,000 on payment of stamp duty. Therefore, the total cost of improvement would be Rs.1,70,000.
- (4) Since the asset transferred is a long-term capital asset, indexation benefit would be available and the indexed cost of acquisition and indexed cost of improvement are allowable as deduction while computing capital gains.
- (5) Under section 54EC, exemption is available for investment, made within a period of 6 months from the date of transfer, in bonds of NHAI or RECL, redeemable after 3 years. In this case, the transfer took place on 17.8.2008 and the investment was made in bonds of NHAI, redeemable after 4 years, on 1.12.2008, which is within the 6 month period. Therefore, the investment of Rs.30 lacs qualifies for exemption under section 54EC.

Question 3

- (a) Explain the core reasons for difference between the e-commerce transactions and the traditional business transactions causing difficulty to tax the income of e-commerce transactions. (3 Marks)
- (b) Mr. Korani transferred 2,000 debentures of Rs.100 each of Wild Fox Ltd. to Mrs. Rekha Korani on 3.10.07 without consideration. The company paid interest of Rs.30,000 in

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September, 2008 which was deposited by Mrs. Korani with Kartar Finance Co. in October, 2008. Kartar Finance Co. paid interest of Rs.3,000 upto March, 2009. How would both the interest income be charged to tax in A.Y. 2009-10? (3 Marks)

- (c) Sea Port Shipping Line, a non-resident foreign company operating its ships on the Indian Ports during the previous year ended on 31.3.2009, had collected freight of Rs.100 lacs, demurrages of Rs.20 lacs and handling charges of Rs.10 lacs inclusive of an amount of Rs.40 lacs collected in US dollars for the cargo booked for JNPT (Mumbai) from Antwerp. The expenses of operating its fleet during the year for the Indian Ports were Rs.110 lacs. The company denies its liability to tax in India. Examine. (3 Marks)
- (d) A search was conducted under section 132 in the business premises of Harish on 15th December, 2008. At that time, assessments under section 143(3) for assessment years 2006-07 and 2007-08 and reassessment proceeding under section 147 for assessment year 2005-06 were pending before the Assessing Officer.
- (i) What are the assessment years for which notice can be issued for making post-search assessment?
- (ii) What would be the fate of pending assessments and reassessment?
- (iii) What would be the effect, if the post-search assessment orders are annulled by the Income-tax Appellate Tribunal? (3 Marks)

Answer

- (a) The core reasons for difference between e-commerce transactions and traditional business transactions causing difficulty to tax the income from e-commerce transactions under the Income-tax Act, 1961 are absence of national boundaries, non-requirement of physical presence of goods and non-requirement of physical delivery in e-commerce transactions. Since e-commerce transactions are completed in cyberspace, it is often not clear as to the place where the transaction is effected, thereby causing difficulty in implementing source rule taxation.
- (b) As per section 64(1)(iv), income arising from assets transferred without adequate consideration by an individual to his spouse is liable to be clubbed in the hands of the individual. It may be noted that income on the asset transferred has to be clubbed but if there is accretion to the asset, any income on such accretion should not be clubbed.

Therefore, applying the provisions of section 64(1)(iv), Rs.30,000, being the interest on debentures received by Mrs. Korani in September, 2008 will be clubbed with the income of Mr. Korani, since he had transferred the debentures of the company without consideration to her in October, 2007.

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However, the interest of Rs.3,000 upto March 2009 earned by Mrs. Korani on the interest on the debentures deposited by her with Kartar Finance Company shall be taxable in her individual capacity and will not be clubbed with the income of Mr. Korani.

- (c) The provisions of section 44B would apply in this case. This section provides that in the case of an assessee, being a non-resident, engaged in the business of operation of ships, a sum equal to 7½% of the aggregate of the following amounts would be deemed to be the profits and gains of such business chargeable to tax under the head “Profits and gains of business or profession”
- (i) The amount paid or payable, whether within India or outside, to the assessee or to any person on his behalf on account of the carriage of passengers, livestock, mail or goods shipped at any port in India.
 - (ii) The amount received or deemed to be received in India by the assessee himself or by any other person on behalf of or on account of the carriage of passengers, livestock, mail or goods shipped at any port outside India.

The above amounts will include demurrage charges and handling charges.

These provisions for computation of the income from the shipping business in case of non-residents would apply notwithstanding anything to the contrary contained in the provisions of sections 28 to 43A of the Income-tax Act.

Therefore, in this case, M/s. Sea Port Shipping Line is required to pay tax in India on the basis of presumptive tax scheme as per the provisions of section 44B. The assessee shall not be entitled to set off any of the expenses incurred for earning of such income. Therefore, the Shipping Line is required to pay tax @ 7½% on the total receipts of Rs.130 lacs i.e., Rs.9.75 lacs.

- (d) (i) The notice under section 153A can be issued for six assessment years preceding the assessment year relevant to the previous year in which the search is conducted. In this case, the search is conducted in the previous year 2008-09, the relevant assessment year for which is A.Y.2009-10. Therefore, notice can be issued for the six preceding assessment years i.e. for assessment years 2003-04 to 2008-09.
- (ii) As per section 153A, the assessment or reassessment relating to any assessment year, falling within the above period of six assessment years, pending on the date of initiation of the search under section 132, shall abate. In other words, they will cease to be applicable. Therefore, the assessments under section 143(3) for assessment years 2006-07 and 2007-08 and the reassessment proceeding under section 147 for assessment year 2005-06 shall abate.
- (iii) Section 153A provides that where the post-search assessment order is annulled in any appeal or any other legal proceeding, the abated assessment and reassessment proceedings shall stand revived. Therefore, the assessments under

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section 143(3) relating to assessment years 2006-07 and 2007-08 and the reassessment proceeding relating to assessment year 2005-06, which abated on initiation of search, shall stand revived.

Question 4

- (a) Can prosecution be launched for each of the following actions or defaults committed? If yes, then explain the relevant provisions of the Act and the quantum of prescribed punishment.
- (i) The assessee had restrained and not allowed the officer authorized as per section 132(1)(iib) of the Act to inspect the documents maintained in the form of electronic record and the books of accounts.
 - (ii) The assessee deliberately has failed to comply with the requirement of section 142(1) and/or 142(2A).
 - (iii) The assessee deliberately has failed to make the payment of the tax collected under section 206C. (5 Marks)
- (b) Ankur, the owner of a land situated in Kerala used for growing thereon different types of fruits, paddy, vegetables and flowers, received from Yahoo Movies Ltd., Chennai, an amount of Rs.5 lacs as rent towards the use of this land for shooting of a film. The amount so received was accounted by him in the books as revenue derived from land and claimed to be exempt under section 10(1). He now wants to confirm from you whether the amount has been correctly treated by him as agricultural income. (4 Marks)
- (c) Fun India Limited has a carried forward credit of Rs.2 lacs under section 115JAA(3A) of the Income-tax Act from assessment year 2008-09. In the previous year 2008-09, the company's total income and book profit under section 115JB are Rs.5 lacs and Rs.8 lacs, respectively. Compute the tax payable by the company for assessment year 2009-10 and the amount to be carried forward under section 115JAA. (4 Marks)

Answer

- (a) (i) Failure to afford facility to the officer authorized as per section 132(1)(iib) is a case for which prosecution can be launched under section 275B and such person shall be punishable with rigorous imprisonment for a term which may extend to two years and shall also be liable to fine.
- (ii) Willful failure to produce books of account and documents as required under section 142(1) or willful failure to comply with a direction to get the accounts audited under section 142(2A) is a case for which prosecution can be launched under section 276D and such person shall be punishable with rigorous imprisonment for a term which may extend to one year or with a fine of Rs.4 to Rs.10 for every day during which the default continues or with both.

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- (iii) Deliberate failure to deposit the tax collected under section 206C to the credit of the Central Government is a case for which prosecution can be launched under section 276BB and such person shall be punishable with rigorous imprisonment for a term which shall not be less than three months but which may extend to seven years and with fine.
- (b) The income received by Mr. Ankur from a filmmaker for allowing them to shoot a film in the agricultural land owned by him is not in the nature of agricultural income because it was neither received by him against the sale of agricultural produce obtained nor for carrying out the normal agricultural operations on the land. The amount paid was only for the purpose of shooting of a film on such land.

To claim exemption for agricultural income under section 10(1), the conditions contained in section 2(1A) (a) to (c) have to be first complied with/fulfilled by the assessee. The Madras High Court in the case of B. Nagi Reddi v. CIT (2002) 258 ITR 719, following the judgment of Apex Court in the case of Raja Benoy Kumar Sahas Roy (1957) 32 ITR 466, has held, on identical facts, that the income derived for allowing a shooting of film in the agricultural land cannot be treated as agricultural income, as it has no nexus with the land, except that it was carried out on agricultural land.

- (c) According to section 115JAA, the tax credit to be allowed under the section is the difference between the minimum alternate tax paid under section 115JB and the tax payable by the assessee on his total income computed as per the other provisions of the Income-tax Act.

The amount of tax credit determined as aforesaid can be carried forward for seven assessment years. The brought forward tax credit shall be allowed to be set off in any assessment year to the extent of the difference between the tax on total income and minimum alternate tax which would have been payable under section 115JB for that assessment year.

Computation of tax payable by Fun India Limited for A.Y. 2009-10 and MAT credit to be carried forward to A.Y.2010-11

	Particulars	Rs.
A.	Total income	5,00,000
B.	Book profit	8,00,000
C.	Tax on A (30.9% of Rs.5,00,000)	1,54,500
D.	Tax on B (10.3% of Rs.8,00,000)	82,400
E.	Difference between C and D	72,100
F.	Tax credit brought forward from assessment year 2008-09	2,00,000
G.	MAT credit set-off (Being lower of E and F)	72,100
H.	Tax payable for A.Y.2009-10 (C - G)	82,400
I.	MAT credit to be carried forward to A.Y.2010-11 (F - G)	1,27,900

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Question 5

- (a) A trust, unless created for "charitable purpose", does not qualify to claim exemption under Chapter-III of the Act. In this context, explain the meaning of "charitable purpose" and examine whether the following objects constitute part of it:
- (i) Rural reconstruction and upliftment of the masses through Cottage Industry.
 - (ii) Welfare of industrial workers with a stipulation that the workers of settlor of trust have got preference over others. (5 Marks)
- (b) An assessee who had been served with an order of assessment passed under section 143(3) read with section 147 on 1.1.2009 had filed an application against this order before the CIT as per section 264 on 11.1.2009. However, the CIT refused to entertain the application on the pretext of premature application. Assessee seeks your opinion. (3 Marks)
- (c) "X", while making payment to a non-resident for providing technical services on a world bank aided project "Net of Tax", had deducted tax as per rates prescribed but says that the payee is not entitled for the TDS certificate since the tax was not to be borne by the payee as per agreement. Examine. (3 Marks)

Answer

- (a) As per section 2(15), "Charitable purpose" includes relief of the poor, education, medical relief and the advancement of any other object of general public utility. However, the advancement of any other object of general public utility shall not be a charitable purpose, if it involves the carrying on of any activity in the nature of trade, commerce or business, or any activity of rendering any service in relation to any trade, commerce or business, for a cess or fee or any other consideration, irrespective of the nature of use or application, or retention, of the income from such activity.
- (i) The Supreme Court has, in *Thiagarajar Charities vs. Addl. CIT* (1997) 225 ITR 1010, observed that "cottage industry" is associated with the idea of a small, simple enterprise or industry in which employees work in their own houses or in a small place, gathered together for the purpose, using their own equipments and is usually found in rural areas or so carried on, by the poorer section of the society. In substance, the activity of rural reconstruction and upliftment of masses through cottage industry is to afford relief to the poor and consequently, it is for charitable purpose.
 - (ii) The welfare of industrial workers with a stipulation that the workers of settlor of trust have preference over others would also constitute "charitable purpose" within the meaning of section 2(15). The Patna High Court has, in *CIT v. Tata Steel Charitable Trust* (1993) 203 ITR 764, observed that exemption under section 11(1) can be availed only if the following conditions are satisfied –

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

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

- (b) An assessee, who is aggrieved by the order of the Assessing Officer under section 143(3) read with section 147 passed on 1.1.2009, had moved an application for revision of order under section 264 on 11.1.2009. The order passed by the Assessing Officer under section 143(3) read with section 147 is an order appellable before the Commissioner (Appeals). The time limit for filing an appeal is 30 days from the date of order i.e. upto 31.1.2009. This time limit had not expired on 11.1.2009 and the assessee had also not waived his right of appeal while filing the application for revision on 11.1.2009 before the Commissioner of Income-tax. The application filed before the Commissioner of Income-tax for revision under section 264 by the assessee will only be considered when the conditions specified under section 264(4) have been complied with. One of the conditions is that the Commissioner shall not revise any order where an appeal against the order lies to the Commissioner (Appeals) or Appellate Tribunal and the time within which such appeal may be made has not expired, unless the assessee has waived his right of appeal. In the present case, the time limit had not expired on 11.1.2009 and the assessee had also not waived the right of appeal while filing the application for revision before the Commissioner of Income-tax on 11.1.2009 under section 264. Therefore, the Commissioner’s refusal to entertain such application is correct.
- (c) Section 195A provides that where under an agreement, the tax chargeable on any income is to be borne by the person by whom the income is payable, then, for the purpose of deduction of tax at source, such income shall be increased to such amount as would, after deduction of tax thereon, be equal to the net amount payable under the agreement. The CBDT has, vide Circular No.785 dated 24.11.99, clarified that even in those cases where the tax has been borne by the payer of income under an agreement, the payer is under a legal obligation to furnish a TDS Certificate as per the provisions of section 203 of the Income-tax Act, 1961. Therefore, the contention of Mr. X that the payee is not entitled for the TDS certificate is incorrect.

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Question 6

- (a) Raj & Family is a HUF in which Mrs. Raj has impressed upon a house property owned by her for the common hotchpot of the family. Examine whether the personal property of Mrs. Raj so blended by her can be treated as a property of HUF. (4 Marks)
- (b) Examine the correctness of the statement that "there exists no difference in the treatment of income claimed under section 10 with those claimed under Chapter VI-A of the Income-tax Act". (2 Marks)
- (c) A petition for stay of demand was filed before ITAT by XYZ Ltd. in respect of a disputed demand for which appeal was pending before it, on which stay was granted by the ITAT vide order dated 1.1.08. The bench could not function thereafter till 1.2.09 and therefore, the disputed matter could not be disposed off. The Assessing Officer attached the bank account on 16.1.09 and recovered the amount of Rs.15 lacs against the arrear demand of Rs.25 lacs. The assessee requested the Assessing Officer to refund back the amount as it holds stay over it. The Assessing Officer rejected the contention of the assessee. Now the assessee seeks your opinion. (3 Marks)
- (d) X Ltd., operating in India, is the dealer for the goods manufactured by Yen Ltd. of Japan. Yen Ltd. owns 55% shares of X Ltd. and out of 7 directors of the company, 4 were appointed by them. The Assessing Officer, after verification of transactions of Rs.300 lacs of X Ltd. for the relevant year and by noticing that the company had failed to maintain the requisite records and had also not obtained the accountants report, adjusted its income by making an addition of Rs.30,00,000 to the declared income and also issued a show cause notice to levy various penalties. X Ltd seeks your expert opinion. (5 Marks)

Answer

- (a) The Apex Court has, in the case of Pushpa Devi v. CIT (1977) 109 ITR 730, held that "to blend" means to share along with others and not to surrender one's interest in favour of others to the exclusion of oneself. If a Hindu female, who is a member of an undivided family, impresses her absolute, exclusive property with the character of joint family property, she creates new claimants to her property to the exclusion of herself because, not being coparcener, she has no right to demand a share in the joint family property by asking for a partition. The expression "blending" is inapposite in the case of a Hindu female who puts her separate property, be it the absolute property or limited estate, in the joint family stock.

Therefore, applying the decision of the above case to the case on hand, Mrs. Raj cannot blend her personal property with the character of joint family property because the right to blend is limited to coparceners as per principle laid down by the Apex Court.

Note – With effect from 9.9.2005, due to the amendment of the Hindu Succession Act, the daughter of a coparcener shall, by birth, become a coparcener in her own right in the

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same manner as a son. However, this amendment would not affect the answer, since in this case, Mrs. Raj is not the daughter of a coparcener of the HUF, Raj & Family, but is the wife of one of the coparceners.

- (b) The statement is incorrect. Section 10 lists out the items of income which do not form part of total income. Thus, such income are fully or partly exempt from tax. Items of income which are exempt under section 10 shall not form part of any head of income. Therefore, the income which are claimed as exempt under section 10 are excluded from gross total income, in the sense, they are not included in the computation of gross total income. However, for claiming deduction under Chapter VIA, the income must be included under the respective head of income for computation of gross total income and thereafter, deduction can be claimed under the respective section as specified in Chapter VI-A to arrive at the total income. In short, section 10 provides for exemption of income whereas Chapter VI-A provides for deductions from gross total income.
- (c) The Appellate Tribunal may, on merit, pass an order of stay in any proceedings relating to an appeal. However, such period of stay cannot exceed 180 days from the date of such order. The Appellate Tribunal has to dispose off the appeal within this period of stay. Where the appeal has not been disposed off within this period and the delay in disposing the appeal is not attributable to the assessee, the Appellate Tribunal can further extend the period of stay originally allowed. Section 254(2A) provides that the aggregate of the period originally allowed and the period or periods so extended or allowed shall not, in any case, exceed 365 days, even if the delay in disposing of the appeal is not attributable to the assessee. If the appeal is not disposed of within such period or periods, the order of stay shall stand vacated after the expiry of such period or periods.

Accordingly, even if an appeal is not heard by the bench, say, due to the bench not functioning or due to the department seeking adjournment, the stay granted by the Appellate Tribunal shall stand vacated after the period of 365 days, inspite of the assessee having taken all steps to ensure speedy disposal of the appeal and having a good prima facie case.

In the present case, the period of 365 days has expired on 31.12.2008, after which date the order of stay stands vacated. Accordingly, the recovery of Rs.15 lacs against the arrear demand of Rs.25 lacs made by the Assessing Officer is in order.

- (d) The facts of the case indicate that X Ltd. and Yen Ltd. of Japan are associated enterprises since Yen Ltd. holds shares carrying more than 26% of the voting power in X Ltd. and has appointed more than half of the board of directors of X Ltd. Since Yen Ltd. is a non-resident, any transaction between X Ltd. and Yen Ltd. would fall within the meaning of “international transaction” under section 92B. Therefore, the income arising from such transactions have to be computed having regard to the arm’s length price. The action of the Assessing Officer in making addition to the declared income and

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issuing show cause notice for levy of various penalties is correct since X Ltd. had committed defaults, as listed hereunder, in respect of which penalty, as briefed hereunder, is imposable -

- (i) Since X Ltd. has entered into an international transaction as defined in section 92B, any amount added or disallowed in computing the total income under section 92C(4), shall be deemed to represent income in respect of which particulars have been concealed or inaccurate particulars have been furnished which makes it liable for penalty under section 271(1)(c) read with Explanation 7. The penalty would be 100% to 300% of the amount of tax sought to be evaded.
- (ii) Failure to maintain the requisite records as required under section 92D in relation to international transaction makes it liable for penalty under section 271AA which will be 2% of the value of each international transaction.
- (iii) Failure to furnish report from an accountant as required under section 92E makes it liable for penalty under section 271BA i.e., a fixed penalty of Rs.1 lakh.

Question 7

- (a) The assessee had failed to deposit the amount of tax under section 140A amounting to Rs.10,000 but filed his return of income in time. The Assessing Officer, besides charging of interest as per section 234B and section 234C, also issued show cause notice to levy a penalty of Rs.2,000. The assessee claimed that there is no provision in the Act to impose penalty for non-payment of tax under section 140A. (3 Marks)
- (b) The income-tax authority did not file an appeal to the Income-tax Appellate Tribunal against an order of the Commissioner (Appeals) decided against the Income tax department on a particular issue in case of one assessee, Alpi for assessment year 2006-07 on the ground that the tax effect of such dispute was less than the monetary limit prescribed by CBDT. In assessment year 2007-08, similar issue arose in the assessments of Alpi and her sister Palki, which was decided by the Commissioner (Appeals) against the Department. Can the Income-tax department move an appeal to the Tribunal in respect of A.Y.2007-08 against the orders of the Commissioner (Appeals) for Alpi and her sister Palki? (3 Marks)
- (c) Cash of Rs.25 lacs was seized on 12.9.2008 in a search conducted as per section 132 of the Act. The assessee moved an application on 27.10.08 to release such cash after explaining the sources thereof, which was turned down by the department. The assessee seeks your opinion on, the following issues:
 - (i) Can the department withhold the explained money?
 - (ii) If yes, then to what extent and upto what period? (3 Marks)

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Answer

- (a) The failure on the part of the assessee to pay the whole or any part of the self-assessment tax under section 140A of the Income-tax Act makes him an assessee-in-default within the meaning of section 140A(3). The Assessing Officer can levy a penalty on the assessee-in-default by virtue of provisions of section 221(1) of the Income-tax Act and the maximum penalty which can be levied upon the assessee is to the extent of amount of tax remaining unpaid. Therefore, the issue of show cause notice levying a penalty of Rs.2,000 on the assessee, for non-payment of self-assessment tax of Rs.10,000 under section 140A, is in order.
- (b) The Finance Act, 2008 has inserted a new section 268A with retrospective effect from 1st April, 1999. Under section 268A(1), the CBDT is empowered to issue orders, instructions or directions to the other income-tax authorities, fixing such monetary limits, as it may deem fit, to regulate filing of appeal or application for reference by any income-tax authority.

Under section 286A(2), where an income-tax authority has not filed any appeal or application for reference on any issue in the case of an assessee for any assessment year, due to above-mentioned order/instruction/direction of the CBDT, such authority shall not be precluded from filing an appeal or application for reference on the same issue in the case of the same assessee for any other assessment year or any other assessee for the same or any other assessment year. Further, in such a case, it shall not be lawful for an assessee to contend that the income-tax authority has acquiesced in the decision on the disputed issue by not filing an appeal or application for reference in any case.

In view of above provision, it would be in order for the Income-tax Department to move an appeal to the Tribunal against the orders of the CIT(A) in respect of A.Y.2007-08 both for Alpi and Palki.

- (c) The proviso to section 132B(1)(i) provides that where the person concerned makes an application to the Assessing Officer, within 30 days from the end of the month in which the asset was seized, for release of the asset and the nature and source of acquisition of the asset is explained to the satisfaction of the Assessing Officer, then, the Assessing Officer may, with the prior approval of the Chief Commissioner or Commissioner, release the asset after recovering the existing liability under the Income-tax Act, Wealth-tax Act etc. out of such asset. Such asset or portion thereof has to be released within 120 days from the date on which the last of the authorizations for search under section 132 was executed.

In this case, since the application was made to the Assessing Officer within the 30 day period (i.e., before 31st October, 2008), the amount of existing liability may be recovered out of the asset and the balance may be released within 120 days from the date on which the last of the authorizations for search under section 132 was executed.

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Note - It may be noted that one of the conditions mentioned above for release of an asset is that the nature and source of acquisition of the asset should be explained to the satisfaction of the Assessing Officer. However, in this case, it has been given that the assessee's application for release of the asset, explaining the sources thereof, was turned down by the Department. It is possible to take a view that the application was turned down by the Department due to the reason that it was not satisfied with the explanation given by the assessee as to the nature and source of acquisition of the asset. In such a case, the above condition is not satisfied, and the asset (namely, cash) cannot be released.

Question 8

- (a) The owner of a house property, located at New Delhi, given on rent asks you to determine the value thereof on valuation date 31.3.2009 from the following information:
- (i) The annual value of property assessed by Delhi Development Authority is Rs.10 lacs.
 - (ii) The rent fixed is Rs.80,000 p.m., out of which Rs.5,000 is for the furniture.
 - (iii) DDA has levied taxes @ 5% of rent of property which are being paid by the tenant.
 - (iv) The cost of repairing the house is also borne by the tenant.
 - (v) The tenant has given a refundable deposit of Rs.5 lacs on which he is entitled to receive a simple interest @10% p.a.
 - (vi) The tenant is also required to make payment of yearly lease rent of Rs.10,000 to the society.
 - (vii) The unexpired period of lease on the valuation date is 35 years. (6 Marks)
- (b) Examine the correctness of the following taking into consideration the provisions of Wealth-tax Act :
- (i) The Commissioner of Wealth-tax is not empowered to reduce or waive penalty unless it is approved by the Chief Commissioner or Director General.
 - (ii) Penalty for concealment of wealth can be imposed where the value of assets disclosed by the assessee is Rs.4,00,000 but determined by the W.T.O. at Rs.6,00,000. (4 Marks)

Answer

- (a) Computation of value of the house property on valuation date 31.3.2009

Particulars	Rs.
Actual Rent received is Rs.75,000 p.m. because the rent of furniture does not constitute rent for the building (Rs.75,000 x 12)	9,00,000
Add: (i) Taxes borne by the tenant, being 5% of rent received	45,000

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(ii) Repairs since borne by the tenant, hence 1/9 th of actual rent received	1,00,000
(iii) 15% of amount of deposit of Rs.5 lacs less interest paid @ 10% (75,000 – 50,000)	25,000
(iv) Obligation of landlord for payment of lease rent met by tenant. Actual amount paid is to be added.	10,000
Annual Rent	10,80,000

The annual rent so worked out has to be compared with the assessed annual value of DDA and the higher value of the two has to be adopted as Gross Maintainable Rent (GMR). The assessed annual value is Rs.10,00,000 whereas the annual rent works out to Rs.10,80,000. Therefore, the annual rent is higher and shall be adopted for calculating the Net Maintainable Rent.

Particulars	Rs.
Computation of Net Maintainable Rent	
Gross Maintainable Rent (GMR), being the annual rent	10,80,000
Less: (i) Municipal Taxes levied by DDA	45,000
(ii) 15% of GMR	<u>1,62,000</u>
Net Maintainable Rent	<u>8,73,000</u>
Capitalised value of NMR	

Where the unexpired period of lease is less than 50 years but more than 15 years, the value is equal to NMR × 8 i.e., Rs.8,73,000 × 8. 69,84,000

Therefore, the value of house property on valuation date 31.3.2010 is Rs.69,84,000.

- (b) (i) Under section 18B of the Wealth-tax Act, the Commissioner is vested with the power to reduce or waive the penalty suo moto or on an application made by the assessee, if he is satisfied that the assessee has –
- (1) voluntarily and in good faith made full and true disclosure of the particulars of his wealth, prior to detection of the same by the Assessing Officer;
 - (2) co-operated in any enquiry relating to the assessment of his net wealth; and
 - (3) has also made satisfactory arrangements for the payment of tax or interest payable in consequence of an order passed by the Assessing Officer for the relevant assessment year.

However, no order reducing or waiving the penalty, in the above case, shall be made by the Commissioner without the prior approval of the Chief Commissioner or Director General, if the concealed net wealth in respect of which the penalty was imposed or imposable for any relevant assessment year exceeds Rs.5 lakh.

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- (ii) The levy of penalty under section 18(1)(c) of the Wealth-tax Act is in respect of concealment of wealth or furnishing inaccurate particulars of wealth. Explanation 4 to section 18 clarifies that an assessee would be deemed to have furnished inaccurate particulars of his wealth if the value of assets disclosed by him is less than 70% of the value as determined in an assessment under section 16 or 17, unless he proves that the value of assets as disclosed by him is the correct value. In the case of this assessee, the value of the assets determined by the Wealth-tax Officer is Rs.6 lakh whereas the value disclosed by the assessee is only Rs.4 lakh. Since the value disclosed by the assessee i.e., Rs.4 lakh is less than Rs.4.2 lakh, being 70% of the value determined by the Wealth-tax Officer, penalty under section 18(1)(c) is attracted in this case, unless the assessee proves that the value of assets disclosed by him is the correct value.