CONTENTS

1
BASIC CONCEPTS

Question 1

Mr. Bhargava, a leading advocate on corporate law, decided to reduce his practice and to accept briefs only for paying his taxes and making charities with the fees received on such briefs. In a particular case, he agreed to appear to defend one company in the Supreme Court on the condition that he would be provided with Rs.5 lacs for a public charitable trust that he would create. He defended the company and was paid the sum by the company. He created a trust of that sum by executing a trust deed. Decide whether the amount received by Mr. Bhargava is assessable in his hands as income from profession. (3 Marks) (June 2009)

Answer

In the instant case, the trust was created by Mr. Bhargava himself out of his professional income. The client did not create the trust. The client did not impose any obligation in the nature of a trust binding on Mr. Bhargava. Thus, there is no diversion of the money to the trust before it became professional income in the hands of Mr. Bhargava. This case is one of application of professional income and not of diversion of income by overriding title. Therefore, the amount received by Mr. Bhargava is chargeable to tax under the head "Profits and gains of business or profession".

Question 2

What is a zero coupon bond? State briefly the treatment of zero coupon bonds in the hands of the issuer and the investor under the Income-tax Act, 1961 (8 Marks) (Nov 2006)

Answer

Section 2(48) of the Income-tax Act, 1961 defines a zero coupon bond to mean a bond issued by any infrastructure capital company or infrastructure capital fund or a public sector company or scheduled bank on or after 1.6.2005, in respect of which no payment and benefit is received or receivable before maturity or redemption from such issuing entity.

Discount, which is the difference between the amount received or receivable by the issuer on issue of the zero coupon bond and the amount payable by the issuer on maturity or redemption thereof, would be allowed as deduction in the hands of the issuer on a pro rata basis having regard to the period of life of the bond as provided in section 36(1)(iiia). No tax is required to be deducted at source under section 194A in respect of income paid or payable in relation to such bond.

Maturity or redemption of a zero coupon bond will be treated as a transfer for purposes of capital gains in the hands of the investor as provided in section 2(47)(iva). Zero coupon bond held for not more than 12 months will be treated as a short-term capital asset. Thus, a zero coupon bond held for more than 12 months will be treated as a long-term capital asset. The proviso to section 112(1) will be applicable to long-term capital gain arising from the transfer of zero coupon bonds. Consequently, where the tax payable in respect of long-term capital gain arising from the transfer of zero coupon bonds exceeds 10% of the amount of capital gains before indexation, then, such excess shall be ignored while computing the tax payable by the investor.

Question 3

Explain the incidence of taxation on mutual concerns. *(4 marks) (Nov.2004)*

Answer

The concept of "mutuality" means that the contributors and beneficiaries are identical. Since one cannot make profit by dealing with oneself, there is no taxable profit involved wherever such concept applies. A mutual concern or association stands on the same principle. All the contributors to the common fund are entitled to participate in the surplus and all the participants to the surplus are contributors in the case of a mutual concern. The excess of income over expenditure in a year shall supplement the common fund for future utilization to the benefit of the contributors and the excess of expenditure over income shall be absorbed by the common fund.

Generally the surplus derived by a mutual concern is not chargeable to tax. Therefore, a trade, professional or similar association which functions on the principle of mutuality concept is not chargeable to tax, if there is any surplus on account of subscriptions, membership fees, entrance fees etc., exceeding the expenditure.

However, the following additional points need to be taken into consideration-

(i) Where a mutual concern carries on the business of insurance, the profits therefrom are chargeable to tax. Section 44 provides that the profits for this purpose have to be computed in accordance with the method prescribed in the Rules contained in the First Schedule.

(ii) In the case of trade, professional or similar associations, the income derived from specific services performed for its members is chargeable to tax u/s 28(iii). However, if there is a loss on account of expenditure exceeding the subscription etc. from members, such shortfall shall be absorbed by the income chargeable to tax u/s 28(iii). This set off as per section 44A cannot exceed 50% of the total income of such associations as computed before allowing the set off.

(iii) In the case of a mutual concern, if income is derived both from mutual activity as well as from non-mutual activity, the exemption applies only to the income from the mutual activity. The income attributable to the non-mutual activity will be liable to tax as was held by the Gujarat High Court in *Sports Club of Gujarat Ltd. vs CIT (1987) 171 ITR 504.*

Note : Students may refer to decision such as *Canara Bank Golden Jubilee Staff Welfare Fund v. Dy.CIT (2009) 308 ITR 203 (Karn)*

Question 4

Explain with reasons about the taxability of the following transactions for the Assessment year 2003-04:

(i) Raja was declared winner in a lucky dip on 15th August, 2002. He was paid cash of Rs.1,00,000 as prize money. *(2 Marks) (Nov.2003)*

(ii) Mr. Ravi, citizen of India and a non-resident purchased the Savings Certificates issued by Central Government from out of Dollars remitted from USA on 11-07-02 on which the interest for the year ended on 31-03-03 was Rs.3 lakhs. *(2 Marks) (Nov.2003)*

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

(i) The prize money of Rs.1 lakh received by Mr. Raja is fully chargeable to tax under the head 'Income from other sources'. The amount will be subject to tax at a flat rate of 30% (plus education cess) as per section 115BB.

(ii) Interest on investment made by a non-resident Indian out of money transferred in foreign currency for purchase of saving certificates issued before 1.6.2002 is exempt from tax. However, where the certificates are issued after 01.06.2002, the tax exemption would not apply. Therefore, assuming that the saving certificates were issued after 1.6.2002, the interest of Rs.3 lakhs so derived by the non-resident assessee on the saving certificates purchased on 11.7.2002 is liable to tax and exemption under section 10(4B) will not be available

Question 5

X Ltd., a domestic company, holds 50% of share capital of Y Ltd. which is another domestic company. Y Ltd. paid total dividend during the year ended on 31-03-03 of Rs.50 lakhs. Out of the dividend received from Y Ltd., X Ltd. distributed dividend of Rs.15 lakhs. Explain with reasons the amount of dividend chargeable to tax in the hands of X Ltd. *(3 Marks) (Nov.2003)*

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

The dividend received by X Ltd from Y Ltd is exempt from tax under section 10(34) if such dividend is covered by section 115-O. It is pertinent to note that the dividend covered by section 115-O is also not liable for ' book profit tax ' under section 115JB in the assessment of recipient company i.e. X Ltd in this case.

It may be of interest to a note that X Ltd while paying dividend distribution tax under section 115-O is eligible to reduce the dividend received from the dividend paid / declared by it. Since the dividend paid by X Ltd is less than the dividend received from its subsidiary, the tax liability under section 115-O would be 'nil'.

Assuming X Ltd distributed dividend of Rs.60 lakhs the dividend distribution tax at 16.995% is payable on the net payout of Rs.35 lakhs only i.e. dividend declared Rs.60 lakhs less Rs.25 lakhs being the dividend received from subsidiary domestic company which has paid DDT on the dividend declared by it.

Question 6

Does the tax borne by employer on behalf of employee in respect of provision of non-monetary perquisites constitute an income in the hands of employee? What are the tax implications of such payment in the hands of employer? *(5 Marks) (May 2003)*

Answer

Section 10(10CC) provides that in the case of an employee deriving income in the nature of non-monetary perquisites, the amount of tax on such income paid by his employer, is exempt from tax in the hands of employee. In view of this, in the instant case, by virtue of exemption provided in section 10(10CC), the tax borne by the employer on behalf of employees in respect of provision of non-monetary perquisites is exempt in the hands of the employees.

As regards tax implications of such payment in the hands of employer section 40(a)(v) provides for disallowance of the tax actually paid by employer under section 10(10CC) while computing the income chargeable under the head "Profit and gains of business or profession".

Question 7

An Indian company is engaged in the manufacture and sale of coffee grown by it in its own estates. Will it liable to tax under the IT Act. If so, how will its income be determined?

(3 Marks) (May 2002)

Answer

As per Rule 7B, income derived from the sale of coffee grown and cured by the seller in India, shall be computed as if it were income derived from business and 25% of such income shall be deemed to be income liable to tax. Income derived from the sale of coffee grown, cured, roasted and grounded by the seller in India with or without mixing chicory or other flavouring ingredients, shall be computed as if it were income from business and 40% of such income shall be deemed to be income liable to tax.

In computing such income, an allowance shall be made in respect of the cost of planting coffee plants in replacement of plants which have died or have become permanently useless in an area already planted, if such area has not previously been abandoned and for the purpose of determining the cost, no deduction shall be made in respect of the amount of any subsidy which under the provisions of section 10(31), is not includible in the total income.

Question 8

How do you deal with the following situations? Give reasons for your answer (The assessment year is 2001-2002):

Basu, Managing Director of a company is entitled to commission on sales as per the service agreement entered into. A part of the commission is converted into purchasing a single premium deferred annuity policy from Life Insurance Corporation of India. Basu claims that the commission diverted to secure the deferred annuity cannot be taxed in his personal assessment . (3 Marks) (May 2001)

Answer

The claim is inadmissible regardless of the assessment year to which the issue relates. The commission had accrued to the managing director and then it was applied to secure an annuity contract from LIC. The commission is recognized perquisite under section 17(2) of the Act. It forms part of the salary structure as per contract of service. It will be includible in the total income. (*CIT v. Navnitlal Shakarlal (2000) 113 Taxman 692 (SC)].*

Question 9

How do you deal with the following situation? Give reasons for your answer:

Nija Traders engaged in manufacturing was in receipt of sales-tax subsidy from State Government as the unit was in backward area. The subsidy is related to the sale of its products and payable once the production is commenced. Nija Traders claims that the subsidy is a capital receipt and hence cannot be included as income. (3 Marks) (May 2001)

Answer

The Supreme Court in its judgment in the case of *Sahney Steel And Press Works Ltd v. CIT (1997) 228 ITR 253 (SC)* has held that the payments from public funds to assist the assessee in carrying on trade or business must be treated as revenue receipts. The subsidy granted to the assessee such as sales tax refund, power concession or refund of bills paid and exemption from payment of water charges are to be treated as revenue receipts chargeable to tax. It was held that the character of the subsidy in the hands of the recipient will have to be determined having regard to the purpose for which the subsidy is given. If the monies are given for assisting the assessee in carrying out the business operations and the money is given only after and conditional upon commencement of production, the assistance must be treated assistance for the purpose of the trade. Therefore on the facts of the case, the sales tax subsidy was nothing but supplementary trade receipts and therefore is taxable. Also refer *CIT v. Rajaram Maize Products (2001) 251 ITR 427 (SC)*.

Students may note that the Madras High Court in *CIT v. Kanyakumari District Co-operative Spinning Mills Ltd (2003) 264 ITR 684 (Mad)* has held that subsidy received for providing employment to weaker sections of the society as capital receipt and not chargeable to tax.

Question 10

Income computed on the accrual basis is no longer relevant for taxation of income. Critically analyse the validity or otherwise of the same. *(3 Marks) (May 2001)*

Answer

As per the provisions of section 145, the normal rule is that either cash or mercantile system of accounting is to be followed. However, even in cases where mercantile system is followed, certain adjustments have been prescribed in the Act which provide for circumstances in which the claim for deduction is subject to actual payment. Such provisions are briefly outlined below:

Section 40 A(7) – Provision for gratuity allowable on payment basis only.

Section 43B – This is one of the most important provisions, which leads to distortion in the concepts of accrual of income. The items covered by this section are deductible only on payment basis:

1. Tax, duty, cess or fee.
2. Contribution to any provident fund, superannuation fund, gratuity fund or welfare fund.
3. Payment of bonus or commission.
4. Interest payable to certain financial institutions.
5. Interest payable to scheduled banks.

Section 145A also contributes indirectly to this distortion because adjustments are statutorily permitted in valuation of inventory for rates, taxes, duties etc.,

Question 11

Anand was the Karta of HUF. He died leaving behind his major son Prem, his widow, his grandmother and brother's wife. Can the HUF retain its status as such or the surviving persons become co-owners. *(3Marks) (Nov.2000)*

Answer

In the case of *Gowli Buddanna v. CIT (1966) 60 ITR 293 (SC)* the Supreme court has made it clear that there need not be more than one male member to form a HUF as a taxable entity under the Income-tax Act. The expression "Hindu Undivided family" in the Act is used in the sense in which it is understood under the personal law of the Hindus. Under the Hindu system of law, a joint family may consist of a single male member and the widows of the deceased male members and the Income-tax Act does not indicate that it should consist of at least two male members. Therefore, property of a joint Hindu family does not cease to belong to the family merely because the family is represented by a single co-parcener who possesses the right which an owner of property may posses.

It may be noted that the Hindu Succession (Amendment) Act, 2005 w.e.f. 06-09-2005 confers the same rights in the co-parcenary property on females as that is available to male members of the family. A daughter is coparcener of Hindu family property having right to seek partition of the coparcenary property similar to that of a son.

Question 12

You are consulted on the justifiability of the following claim. Your advice is to be framed based on the provisions of the Income-tax Act, 1961.

A liability towards expenditure as per agreement was provided in the books. However disputed for payment before a Court of law on interpretation of clauses of the agreement. Can it be claimed in the year of provision? *(3 Marks) (May 2000)*

Answer

The Supreme Court in *Kedernath Jute Mills Ltd v. CIT 82 ITR 363 (SC),* had held that where liability exists in *presenti,* the claim for the same cannot be denied merely because it has been disputed, where the assessee maintains his book of account on the mercantile system of accounting.

For the purposes of allowability of a claim or expenditure under the provisions of Income-tax Act, it is the document that has to be taken into account, based on which the provision has been made. According to the agreement, there was a liability in presenti. The liability in presenti is not a contingent liability unlike a future liability. A liability in presenti has to be provided so that the same cannot be denied at a later date on the premise that it has not been provided in the year in which the liability really accrued. In the circumstances though the liability provided in the books was disputed, since it is a liability in presenti as per the agreement, the same can be claimed in the year of provision.

2
RESIDENCE AND SCOPE OF TOTAL INCOME

Question 1

R Ltd. paid Rs.5 lakhs as sales commission to Mr. Francis (non-resident), who acted as its agent for booking orders from various customers who are outside India. The assessee has not deducted tax at source on the commission payment for the year ended 31.3.2008. On these facts:

(i) Decide whether the commission is chargeable to tax in the hands of Mr. Francis in India.

(ii) Decide about the deductibility of the commission payment in the assessment of R Ltd.

(4 Marks) (Nov 2008)

Answer

(i) A foreign agent of an Indian exporter operates in his own country and no part of his income arises in India. His commission is usually remitted directly to him and is, therefore, not received by him or on his behalf in India. Such an agent is not liable to income-tax in India on the commission. The commission paid to the non-resident agent of the Indian exporter for services rendered outside India is not chargeable to tax in India. Though the Circular No.23, dated 23.7.1969 has been withdrawn clause (b) of the Explanation 1 to section 9(1) says that in the case of non-resident no income shall be deemed to accrue or arise in India in respect of activities which are confined to purchase of goods in India for the purpose of export. In the case of foreign non resident agent, there would be no activity within India and hence such commission income for booking orders outside India could not be subjected to tax in India.

(ii) Section 40(a)(i) requires deduction of tax at source in respect of any interest, royalty, fees for technical services *or other sum chargeable under this Act,* which is payable outside India or in India to a non-resident. Since the non-resident agent has acted outside India his income would not be subjected to tax in India in view of clause (b) of the Explanation 1 to section 9(1). As the income is not chargeable to tax the question of deducting tax at source would not arise. Hence, disallowance under section 40(a)(i) would not be attracted, and the commission payment would be deductible in the assessment of R Ltd.

Question 2

"Income-tax Act, 1961 extends to whole of India". What meaning has been assigned to "India" under this Act? *(3 Marks) (May 2008)*

Answer

Section 2(25A) defines the term "India" to mean the territory of India as referred to in Article 1 of the Constitution, its territorial waters, seabed and sub-soil underlying such waters, continental shelf, exclusive economic zone or any other maritime zone as referred to in the Territorial Waters, Continental Shelf, Exclusive Economic Zone and other Maritime Zones Act, 1976 and the air space above its territory and territorial waters.

Question 3

J, a citizen of India, is employed in the Indian Embassy at Tokyo, Japan. He received salary and allowances at Tokyo from the Government of India during the year ending 31.3.2006 for services rendered by him in Tokyo. Besides, he was allowed perquisites by the Government. He is a non-resident for the assessment year 2006-07. Examine the taxability of salary, allowances and perquisites in the hands of J for the assessment year 2006-07.

(3 Marks) (Nov 2006)

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

Section 9(1)(iii) of the Income-tax Act, 1961 provides that salaries payable by the Government to a citizen of India for service outside India shall be deemed to accrue or arise in India. As such, salary received by J is chargeable to tax, even though he was a non-resident for A.Y.2010-11.

Section 10(7) exempts any allowances or perquisites paid or allowed as such outside India by the Government to a citizen of India for rendering service outside India. Therefore, the allowances and perquisites received by J are exempt as per section 10(7).

Question 4

A non-resident Indian has the following sources of income in India. You are required to compute his total income and determine his tax liability. Details of your workings, with reasons, should form part of your answer:

(1)	*Dividend from Indian company Rs.50,000*		
(2)	*Interest on debentures of an Indian company invested out of remittances in convertible foreign exchange*		*Rs.75,000*
	Less: Interest paid on money borrowed in India for investment in the debentures		*Rs.25,000*
		Net	*Rs.50,000*

(3)	*Long-term capital gains on sale of shares subscribed in convertible foreign exchange:*			
	Cost in 2000-01	*Rs.2,00,000*		
	Sale in 2003-04	*Rs.3,00,000*		
		Rs.1,00,000		
	Less: Brokerage	*Rs. 10,000*	*Net*	*Rs.90,000*
	Inflation index 2000-01	*406*		
	2003-04	*463*		
(4)	*Property income in India (Net)*			*Rs.2,00,000*
	T.D.S			*Rs.30,000*

The property was acquired partly out of a loan from HDFC. The repayment of loan made during the year amounted to Rs.20,000. The assessee also claims deduction of Rs.10,000 by way of donation to the Prime Minister's Relief Fund and of Rs.50,000 towards repayment of loan taken for higher education in India in 1998 before his migration. (12 Marks)(May 2004)

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

Chapter XII–A, comprising of sections 115C to 115-I, contains special provisions providing for a concessional tax treatment in relation to certain incomes of non-residents (i.e. investment income and long term capital gains). Therefore, in this case, the income of the non-resident has to be computed applying the provisions of Chapter XII-A.

According to section 115-C –

(a) The income derived by a non-resident Indian from any foreign exchange asset other than dividend referred to in section 115-O is called "Investment income"

(b) Foreign exchange asset includes debentures issued by an Indian public company acquired or purchased with or subscribed to in, convertible foreign exchange.

Section 115-D provides that in computing such "Investment income" or "Long-term capital gains" of a non-resident Indian –

(i) No deduction in respect of any expenditure or allowance under any provision of the Income-tax Act is allowable in computing such investment income;

(ii) No deduction under Chapter VI-A shall be allowed in respect of both investment income and long term capital gains and

(iii) No indexation will be applicable in respect of long term capital gains.

Section 115-E provides that the investment income and/or long-term capital gains in respect of foreign exchange asset will constitute a separate block of income and investment income will be charged to income-tax at a flat rate of 20% and long term capital gains at a flat rate of 10%. If the non-resident Indian has any other income in India, such other income will constitute an altogether separate block of income and charged to tax as if such other income had been the total income. The aggregate of the income-tax so calculated in respect of the said two blocks of income will be the tax payable.

Computation of total income for A.Y. 2010-11

			Rs.
1.	Dividend income – Exempt under section 10(34)		Nil
2.	Debenture Interest (interest on loans borrowed for investment not allowable as deduction as per section 115D(1))		75,000
3.	Long-term capital gains : Assuming it was subjected to Securities Transaction Tax, the entire long term capital gain from sale of shares is exempt under section 10(38)		NIL
4.	Property Income (Net) [See Note below]		2,00,000
Gross Total Income			**2,75,000**
Less:			
Deduction under section 80C in respect of housing loan repaid		20,000	
Deduction under section 80E allowable only in respect of interest paid on loan taken for higher education and no deduction for the principal repaid during the year.		NIL	
Deduction under section 80G in respect of donation to Prime Minister's Relief fund		10,000	30,000
Total income			**2,45,000**

Note: It has been assumed that Property Income (Net) implies the Income from house property net of all deductions.

Computation of tax payable

Tax at 20% on debenture interest of Rs.75,000		15,000
Total Income (as reduced by investment income) i.e. Rs.2,45,000 minus Rs.75,000	1,70,000	
Tax thereon		1,000
		16,000
Add: Education cess @ 3%		480
		16,480
Less: Tax Deducted at Source		30,000
Balance tax refundable		**13,520**

Note - It may be noted that section 115-I enables the non-resident to opt out of the applicability of Chapter XII-A for any assessment year by furnishing his return of income for that assessment year under section 139 declaring therein that the provisions of the Chapter XII-A shall not apply to him for that assessment year and his total income shall be computed as per regular provisions of the Act and tax on such total income shall be charged accordingly.

Since the debenture interest is taxed at 20% as against the regular slab rate of 10% applicable for total income upto Rs.3 lakhs, the assessee by opting for normal provisions of the Act could minimize his tax liability as given below:

Debenture interest		75,000
Rental income		2,00,000
Gross total income		2,75,000
Less :Deduction U/s.80C	20,000	
Deduction U/s.80E	Nil	
Deduction U/s.80G	10,000	
		30,000
Total income		2,45,000
Tax thereon		8,500
Add : Cess @ 3%		255
Total tax		8,755
TDS		30,000
Balance refundable		21,245

In this case, the assessee will gain by opting for regular provisions of the Income-tax Act, 1961 as the income liable for 20% rate of tax would be taxed at 10% as the total income is below Rs.3 lakh.

3

INCOME WHICH DO NOT FORM PART OF TOTAL INCOME

Question 1

Ms. J, a Sikkimese woman, married Mr. K, a non-Sikkimese, on 1st January, 2008. During the previous year 2008-09, she received rent of Rs.12 lacs from letting out of house properties situated in the State of Sikkim. Is she liable to income-tax for assessment year 2009-10? Will your answer be different, if she married Mr. K on 16th April, 2008? (3 Marks) (June 2009)

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

Section 10(26AAA) provides that the following income, which accrues or arises to a Sikkemese individual, shall be exempt from income-tax:

(1) Income from any source in the State of Sikkim; and

(2) Income by way of dividend or interest on securities.

However, the aforesaid exemption will not be available to a Sikkimese woman who marries a non-Sikkemese individual on or after 1st April, 2008.

Since Ms. J, the assessee, married Mr. K on 1st January, 2008, income derived by her by way of rent from properties situated in the State of Sikkim shall be exempt under section 10(26AAA).

However, if she had married Mr. K on 16th April, 2009, the exemption would not be available.

Question 2

State with reasons, based on the provisions of the Act, as to chargeability of the following receipts to tax in the assessment year 2008-09:

(1) Rent of Rs.60,000 charged from tenants occupying houses constructed on the land situated in India and used for agricultural purposes.

(2) Rameshwar Das Birla National award of Rs.51,000 was given to Mr. X, a Chartered Accountant by "Rameshwar Dasji Birla Smarak Kosh" for his contributions and work.

(3) Hundi superscribing "contributions in this hundi form part of corpus of trust fund" kept at Lord Venkteshwara Temple, Tirumala, was opened on 30.3.2008. Cash of Rs.100 lacs and valuable articles worth Rs.250 lacs were found to have been contributed by the devotees.

(4) Minister of Surface Transport was in receipt besides salary an amount of Rs.2,000 p.m. as entertainment allowance.

(5) Rent of Rs.30,000 for the period 1.4.2005 to 30.6.2005 due till the property sold out by the owner on 16.5.2007 was received on 12.2.2009 because of an order of court.

(2 × 5 = 10 Marks) (May 2008)

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

(1) Section 10(1) exempts agricultural income. The meaning and scope of agricultural income is defined in section 2(1A). According to *Explanation 2* to section 2(1A), any income derived from any building from the use of such building for any purpose (including letting for residential purposes or for the purpose of any business or profession) other than agriculture shall not be agricultural income. It appears that in this case, the house was occupied for residential purposes. Therefore, the rent of Rs.60,000 from letting out of houses constructed on agricultural land shall not be treated as agricultural income by virtue of *Explanation 2* to section 2(1A). Hence, such income would be chargeable to tax.

(2) Section 10(17A)(i) exempts any payment made in pursuance of any award instituted in public interest by the Central Government or any State Government or instituted by any other body and approved by the Central Government in this behalf. As per Notification No.199/19/98-IT(A-II) dated 15.11.2000, the Rameshwar Das Birla National Award instituted by Rameshwar Dasji Birla Smarak Kosh was approved by the Central Government only for three assessment years 1999-2000 to 2001-02. Hence, for A.Y.2010-11, no exemption would be available under section 10(17A).

(3) As per section 11(1)(d), income in the form of voluntary contributions made with a specific direction that they shall form part of the corpus of the trust or institution shall not be included in the total income of the recipient. Therefore, in order to get the benefit under this section, it is necessary that the donor gives a specific direction that the voluntary contribution made by him should form part of the corpus of the trust. However, in this case, the donors have not given any specific directions that the contribution should form part of the corpus of the trust. Therefore, the benefit of exemption under section

11(1)(d) would not be available to the collections made through the hundi and such collections would be treated as income from the property held under trust.

It may be noted that the provision relating to taxability of anonymous donations @ 30% under section 115BBC does not apply to voluntary contributions received by a trust or institution created or established wholly for religious purposes.

Note - As per section 11(1)(d), income in the form of voluntary contributions made with a specific direction that they shall form part of the corpus of the trust or institution shall not be included in the total income of the recipient. In the given case, there is a specific declaration by the temple authorities that the contributions being put in the hundi would form part of the corpus of the trust fund. Therefore, it is possible to presume that those who put the contributions in the hundi give a tacit declaration that the contributions would form part of the corpus. Hence, a view can be taken that such contributions shall not be included in the total income of the recipient.

(4) The entertainment allowance received by the Minister of Surface Transport is taxable under the head "Salaries". However, deduction under section 16(ii) is allowable to the extent of least of the following –

   (i) 1/5th of the salary

   (ii) Rs.5,000

   (iii) Actual entertainment allowance received, i.e., Rs.24,000 in this case.

(5) As per section 25AA, unrealised rent would be deemed to be the income chargeable under the head "Income from house property". Accordingly, it would be chargeable to income-tax as income of that previous year in which such rent is realised whether or not the assessee is the owner of that property in that previous year. Therefore, in this case, unrealised rent of Rs.30,000 would be charged to tax in the P.Y.2009-10 under the head "Income from house property" even though he is no longer the owner of the house property.

Question 3

An amount of Rs.5 lacs was paid on 17.3.07 to the parents of Amit by the Government of Maharashtra as a compensation to the aggrieved family whose only son Amit lost his life in Mumbai local train serial bomb blasts.

Explain with reasons, is the amount of compensation received chargeable to tax in A.Y. 2007-08? (3 Marks) (Nov 2007)

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

Section 10(10BC) defines disaster to mean a catastrophe, mishap, calamity or grave occurrence in any area, arising from natural or man made causes, or by accident or negligence. It should have the effect of causing substantial loss of life or human suffering or damage to, and destruction of, property, or damage to, or degradation of, environment. It should be of such a nature or magnitude as to be beyond the coping capacity of the community of the affected area. If, for this reason, any compensation is paid by the Central Government or by a State Government or by a local authority, then the same will be exempt from tax. Accordingly, the amount of Rs.5 lakh received by the parents of deceased Amit from the Government of Maharashtra for the disaster because of Mumbai local train serial bomb blasts, is exempt under section 10(10BC).

Question 4

Can an employee of a State Government claim exemption under section 10(10C) in respect of compensation received on voluntary retirement to the extent of Rs.5 lakhs and relief under section 89(1) in respect of the amount of compensation in excess of Rs.5 lakhs?

(4 Marks) (May 2006)

Answer

The Finance (No.2) Act, 2009 has inserted a proviso to section 10(10C) applicable from the assessment year 2010-11 onwards. Where any relief was allowed under section 89 for any assessment year in respect of any amount received or receivable on voluntary retirement or termination of service or voluntary separation, no exemption under section 10(10C) shall be allowed in respect of the said sum in that assessment year or any other assessment year.

The employee of the State Government can, therefore, opt to claim exemption of Rs.5 lakh under section 10(10C) or relief under section 89(1) in respect of compensation received on voluntary retirement, but not both.

Question 5

R purchased equity shares in P Ltd., a constituent of BSE-500 index on Mumbai Stock Exchange on 1st March, 2003. He sold the shares on 4th March, 2004 at a loss of Rs.10,000. He wants to set off the loss against other long-term capital gain during the year. Examine whether such set off is permissible. Both purchase and sale transactions were entered into on a recognized stock exchange. *(4 Marks) (Nov.2004)*

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

Section 10(38) exempts long term capital gain arising from transfer of equity shares in a company or a unit of an equity oriented fund, if such transfer has been subjected to Securities Transaction Tax. Hence, the capital gain / capital loss will have no tax implication.

In this case the assessee has suffered a loss of Rs.10,000 by selling eligible equity shares. It is settled principle that where income from a particular source is exempted under any provision of the Act, the loss arising from such source is not eligible for set off against income from a taxable source. In the case of *JCIT Vs. Thyagarajan.S.S (1981) 129 ITR 115 (Mad),* the Madras High Court held that loss incurred by an assessee from an exempted source, cannot go to set off income from a taxable source. In view of the same, the set off in the instant case is not permissible.

Question 6

A Public Sector Company has engaged you to frame a scheme of voluntary separation for its employees in order that the amount received by the employees under the scheme would qualify for tax exemption under section 10(10C). What points would you bear in mind while drawing up the scheme? What will be the tax treatment of the payments under the scheme in the hands of the company? (6 Marks) (May 2004)

Answer

Section 10(10C) provides that any amount received or receivable by an employee of a public sector company at the time of his voluntary retirement or termination of service under a scheme of voluntary separation is exempt to the extent such amount does not exceed Rs.5,00,000. The scheme, however, should be framed in accordance with the guidelines prescribed under Rule 2BA.

The guidelines in Rule 2BA provide that the scheme of voluntary separation framed by a public sector company should be in accordance with the following requirements in order to qualify for exemption –

(i) The scheme should apply to all employees (by whatever name called) including workers and executives of the company excepting directors.

(ii) The scheme should result in overall reduction in the existing strength of the employees of the company.

(iii) The vacancies caused by voluntary separation should not be filled up.

(iv) The retiring employee should not be employed in another company or concern belonging to the same management.

(v) The amount receivable on voluntary separation should not exceed the amount equivalent to three months salary for each completed year of service or salary at the time of retirement multiplied by the balance of months of service left before the date of retirement on superannuation.

Section 35DDA provides that, in the case of the company, where any expenditure has been incurred by way of payment to an employee under the scheme of voluntary retirement, one-fifth of the amount so paid shall be deducted in computing the profits and gains of the business for that previous year and the balance shall be deductible in equal installments in each of the four immediately succeeding previous years.

Note: It may be noted that VRS compensation eligible for exemption under section 10(10C) is however not eligible for relief under section 89 of the Act. [Finance (No.2) Act, 2009].

Question 7

XY & Co., a partnership concern had established an undertaking for manufacturing of computer software in Free Trade Zone. It furnishes the following particulars of its 2nd year of operations ended on 31-03-03:

- *Total sales of business* — *Rs.100 lakhs*
- *Export sales* — *Rs. 80 lakhs*
- *Profits of business* — *Rs. 10 lakhs*
- *Out of the total export sales, realisation of a sale of Rs. 5 lakhs is difficult because of insolvency of buyer. Realisation of rest of the sales is received in time.*
- *The plant and machinery used in the business had been depreciated @ 15% on SLM basis and depreciation of Rs.3 lakhs was charged in Profit & Loss account.*

Compute the taxable income of XY & Co. for the Assessment Year 2003-04.

(6 Marks) (Nov.2003)

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10. The second year of operation would be financial year 2009-10.

Answer

XY & Co. is carrying on the business of manufacture of computer software in a free trade zone as declared by the Government and therefore the income derived by the partnership firm is to be computed in accordance with the provisions of section 10A of the Act.

(1) **Export turnover –** under the definition given in clause (iv) of explanation 2 to Section 10A, export turnover means the consideration received in, or brought into, India by the assessee in convertible foreign exchange within a period of 6 months from the end of the previous year or, within such further period as the competent authority my allow in this behalf.

	Rs. in lakhs
Gross export sales	80.00
Less: Amount difficult to realise due to insolvency of buyer – does not fall within the definition of export turnover, since remittance to India is not possible without realisation.	5.00
	75.00

(2) The company had charged depreciation on plant and machinery @ 15% amounting to Rs.3 lakhs on SLM basis. Therefore, the cost of plant and machinery is Rs.20 lakhs. The amount of depreciation is, therefore, to be recomputed on WDV basis as per the prescribed rate of 15 % for the assessment year 2009-10:-

	Rs. in lakhs
Total cost of Plant & Machinery	20.00
Less: Depreciation @ 15% for the first year (AY 2009-10)	3.00
WDV at the end of the first year	17.00
Depreciation for second year (15% of Rs.17 lakhs) (AY. 2010-11)	2.55

(3) Profits of the business

	Rs. in lakhs
Net profits as given	10.00
Add: Depreciation on SLM basis	3.00
	13.00
Less: Admissible depreciation on WDV basis	2.55
Profits for the year	10.45

(4) Deduction under section 10A for the assessment year 2010-11 is:

Deduction under section 10A for assessment year 2010-11 =

$$100\% \times \frac{\text{Export Turnover}}{\text{Total Turnover}} \times \text{Profits of the business} =$$

$$100\% \times \frac{75}{100} \times 10{,}45{,}000 = 7{,}83{,}750$$

(5) **Taxable income of the firm for A.Y. 2010-11**

	Rs.
Net profits of the business	10,45,000
Less: Deduction under section 10A	7,83,750
Taxable income	**2,61,250**

Question 8

Amit, a captain in Indian army was killed at Kargil border during a war. The widow of Amit was paid an ex-gratia payment of Rs.50,000 in March, 2003, besides the family pension during the year of Rs.90,000. She wants to know about the taxability of both the receipts.

(4 Marks) (May 2003)

Answer

Section 10(19) provides for tax exemption of family pension if a member of the armed forces dies in the course of operational duties. Hence, if captain Amit had died in the course of operational duties, the family pension received by widow of captain Amit is fully exempt from tax.

According to CBDT Circular No.776 of June 8, 1999, any lumpsum ex-gratia payment made by the Central Government/State Government/Local Authority or Government public sector undertaking, to the widow or other legal heirs of an employee, who dies while in active service, will not be taxable as income under the Income-tax Act, 1961. Therefore, Rs.50,000 is not taxable.

Question 9

(a) *A company is engaged in the development and sale of computer software applications. It has started a new undertaking for which approval as hundred per cent export-oriented undertaking has been obtained from the Central Board of Direct Taxes. It furnishes the following data and request you (a) to compute the deduction allowable to it under section 10B in respect of assessment year 2002-03:*

	Rs. In lacs
Total profit of the company for the previous year	*50*
Total turnover, i.e. Export, Sales and Domestic Sales for the previous year	*500*
Consideration received in respect of export of software received in convertible foreign exchange within 6 months of the end of the previous year	*250*
Sale proceeds credited to a separate account in a bank outside India with the approval of RBI	*50*
Telecom and insurance charges attributable to export of software	*10*
Staff costs and travel expenses incurred in foreign exchange to provide technical assistance outside India to a client	*40*

(b) *State the conditions to be fulfilled for the undertaking to qualify for the deduction*

(c) *How long will the deduction be admissible?* *(12 Marks) (May 2002)*

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

(a) The deduction allowable under section 10B is 100% of the profits derived from export by the new undertaking. Such profit is calculated as a proportion of the export turnover to the total turnover which is applied to the total profit.

Export turnover is computed as under:

Sale proceeds of software received in convertible foreign exchange		250
Add : Deemed sale proceeds:		
Amount credited to a separate account maintained in a bank outside India with the approval of RBI (Explanation 2 to sub-section 3)		50
		300
Less : Telecom and insurance charges attributable to export	10	
Expenses incurred in foreign exchange outside India for providing technical service	40	
		50
Export turnover		250
Profit of the undertaking = $\text{Total profits} \times \dfrac{\text{Export turnover}}{\text{Total turnover}} = 50 \times \dfrac{250}{500}$		25
Deduction admissible U/s.10B		25

(b) Section 10B applies to a 100% Export Oriented Undertaking (EOU) which fulfills the following conditions –

(i) It manufactures or produces any article or thing or computer software.

(ii) It is not formed by the splitting up, or reconstruction of, a business already in existence.

(iii) It is not formed by the transfer of machinery or plant previously used for any purpose.

(iv) The sale proceeds of articles, things or computer software exported out of India are received in India or brought into India by the assessee in convertible foreign exchange within a period of six months from the end of the previous year, or within such further period as the competent authority may allow in this behalf.

(v) Further, where the sale proceeds are credited to a separate account maintained by the assessee with any bank outside India with the approval of the RBI, such sale proceeds shall be deemed to have been received in India.

(vi) The deduction shall not be admissible unless the assessee furnishes an audit report from a Chartered Accountant in the prescribed form along with the return of income, certifying that the deduction has been correctly claimed.

(vii) From the assessment year 2006-07 no deduction under the section shall be allowed to an assessee who does not furnish a return of income on or before the due date specified in section 139(1).

(c) The deduction under section 10B will be available for ten consecutive assessment years beginning with the assessment year relevant to the previous year in which the undertaking begins to manufacture or produce any article or thing or computer software.

No deduction shall however be allowed for the assessment year beginning on 1st April, 2011 and subsequent years.

Question 10

Happy Home is a public charitable trust created under a trust deed for providing relief to physically challenged persons and registered under section 12A of the Income-tax Act. The following are the particulars of receipts of the trust during the year ended 31st March, 2009:

		Rs. in lacs
(i)	*Income from properties held by trust (net)*	*15*
(ii)	*Income (net) from business (incidental to main objects)*	*14*
(iii)	*Voluntary contributions from public (including the corpus donation of Rs.7 lacs)*	*18*

The trust applied Rs.18 lacs towards various activities and programmes undertaken for the benefit of physically challenged persons during the year. The trust has also paid Rs.8 lacs towards repayment of a loan taken two years back for the purpose of construction of its centre for training the handicapped persons in various handicraft works and sports.

Determine the tax liability, if any, of the trust for the assessment year 2009-10 and also state how the trust can mitigate such liability. *(6 Marks) (June 2009)*

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

Computation of taxable income of Happy Home for the A.Y. 2010-11

Particulars	**Rs.**	**Rs.**
Income from properties held by trust	15,00,000	
Income from business incidental to the main objects of the trust	14,00,000	

Voluntary Contribution other than corpus donation **(Note 1)**	11,00,000	40,00,000
Less: 15% of income accumulated or set apart under section 11(1)(a)		6,00,000
		34,00,000
***Less:* Amount applied for charitable purposes**		
Activities and programmes for the benefit of physically challenged persons	18,00,000	
Repayment of loan taken for construction of training centre **(Note 2)**	8,00,000	26,00,000
Taxable Income		8,00,000

Tax Payable:		
Upto Rs.1,60,000	Nil	
Rs.1,60,000 - Rs.3,00,000	14,000	
Rs.3,00,000 **-** Rs.5,00,000	40,000	
Balance Rs.3,00,000	90,000	1,44,000
Add: Education cess @ 2%		2,880
Add: Secondary and higher education cess @ 1%		1,440
		1,48,320

In order to mitigate the tax liability, the trust, by notice in writing to the Assessing Officer can opt to accumulate or set apart the income for the purpose of investment in the next 5 succeeding years the Trust must apply in Form No.10 indicating the purpose of accumulation. The notice of accumulation must be given before the expiry of the time allowed under section 139(1). The amount set apart must be kept in investments/deposits specified in section 11(5). If the above trust has opted for such accumulation, then the tax burden would be reduced to the extent of such accumulation.

Notes:

(1) Section 11(1)(d) excludes from the total income of the person, any income in the form of voluntary contributions made with a specific direction that they shall form part of the corpus of the trust or institution.

(2) In *CIT vs. Janmabhumi Press Trust (2000) 242 ITR 457,* the Karnataka High Court held that where a debt is incurred for the purpose of the trust, the repayment of the debt would amount to an application of the income for the purpose of the trust. Therefore, repayment of loan taken for construction of training centre for physically challenged persons can also be considered as application for charitable purpose.

Question 11

Bharat Charitable Trust created on 1.1.2003 applied for registration of trust under section 12A of the Income-tax Act before the Commissioner of Income-tax on 1.7.2007 and requested for condonation of delay.

(i) Explain with reasons the period for which the trust is eligible to get exemption under section 11 and 12 of the Income-tax Act.

(ii) Can the exemption under sections 11 and 12 for A.Y. 2008-09 be denied if the trust is holding investments in equity shares of a public sector company since 1.4.2005.

(iii) The Trust has also applied for granting exemption under section 80G of the Income-tax Act. But the approval for the same has been rejected by the Commissioner of Income-tax under section 80G(5)(vi) of the Income-tax Act on 30.9.2007. The Trust seeks your advice on whether it can file an appeal against the said rejection before the higher authorities. (6 Marks) (Nov 2008)

Answer

(i) As per section 12A(2) in respect of applications filed on or after 1st June, 2007, the provisions of section 11 and 12 shall apply in relation to the income of the trust from the assessment year relevant to the financial year in which the application is made i.e. the exemption would be available only with effect from the assessment year relevant to the previous year in which the application is filed. It would not be available in respect of any earlier assessment year. Further, the power of the Commissioner to grant registration for past years, by condoning the delay in filing such application, has also been removed. Hence, Bharat Charitable Trust shall be eligible to get exemption under section 11 and 12 with effect from the financial year in which the application is made.

(ii) A trust registered under section 12A cannot be denied exemption for holding shares in a public sector company in view of section 13(1)(d)(iii). Hence, the exemption under section 11 and 12 cannot be denied to the trust for holding investments in equity shares of a public sector company.

(iii) Section 253 provides that an appeal can be filed before the Appellate Tribunal against an order passed by the Commissioner under section 80G(5)(vi) rejecting the application of such trusts for the purpose of recognition under section 80G.

Question 12

The following trusts claim that anonymous donations received by them during the financial year 2006-07 are not liable to tax under section 115BBC:

(i) A charitable trust referred to in section 11 which applied the entire amount of anonymous donations for purposes of the trust during the relevant financial year.

(ii) A trust established wholly for religious purposes which applied 75% of the amount of anonymous donations for the purposes of the objects of the trust during the relevant financial year.

Examine the validity of the claim made by the trusts. (4 Marks) (May 2007)

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

(i) Section 115BBC(1) provides for levy of tax @ 30% on anonymous donation received by, *inter alia*, charitable trusts or institutions referred to in section 11. Further, section 13(7) provides that the exemption provisions contained in sections 11 and 12 shall not be applicable in respect of any anonymous donation liable to tax under section 115BBC. As such, application of the anonymous donations received by the charitable trust for charitable purposes does not confer any exemption from tax. Therefore, the claim for non-taxability under section 115BBC of anonymous donations received by the charitable trust is not valid in law.

The Finance (No.2) Act, 2009 provides an exemption limit for taxability of anonymous donation under section 115BBC. The exemption would be the higher of –

(1) Rs. 1 lakh

(2) 5% of total donations received by the assessee

(ii) Section 115BBC(2) provides that the provisions contained in section 115BBC(1) relating to the taxability of anonymous donations are not applicable to any trust or institution created or established wholly for religious purposes. As such, the trust established wholly for religious purposes is not liable to be taxed in respect of the anonymous donations received by it. The application or non-application of such anonymous donation for the purposes of trust during the relevant financial year is not germane to the issue of taxability under section 115BBC.

Question 13

A charitable trust registered under section 12AA of the Income-tax Act, 1961 has, out of its income of Rs.3,90,000 for the year ending 31.3.2006 and sale proceeds of a capital asset, held by it for less than 36 months, amounting of Rs.9,60,000, purchased a building during the year ending 31.3.2006 for Rs.13,50,000. The capital asset was sold during the year ending 31.3.2006. The building is held only for charitable purposes. The trust claims that the purchase of the building amounts to application of its income for charitable purposes and that the capital gain arising on the sale of the capital asset is deemed to have been applied to charitable purposes. Are the claims made by the charitable trust valid in law?

(5 Marks) (May 2006)

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

Section 11(1)(a) stipulates that in order to avail exemption of income derived from property held under trust wholly for charitable or religious purposes, the trust is required to apply for charitable or religious purposes, 85% of its income from such property. In this case, the trust has earned income of Rs.3,90,000 for the year ended 31.3.2010. It has also earned short term capital gain from sale of capital asset for Rs.9,60,000. The trust had utilized the entire amount of Rs.13,50,000 for the purchase of a building meant for charitable purposes.

The Supreme Court in *S.RM. M. CT. M. Tiruppani Trust v. CIT (1998) 230 ITR 636* ruled that the assessee-trust, which applied its income for charitable purposes by purchasing a building for use as a hospital, was entitled to exemption under section 11(1) in respect of such income. The ratio of the decision squarely applies to the case of the charitable trust in question. Therefore, the charitable trust is justified in claiming that the purchase of the building amounted to application of its income for charitable purposes.

Under section 11(1A), where the whole of the sale proceeds of a capital asset held by a charitable trust is utilised by it for acquiring another capital asset, the capital gain arising therefrom is deemed to have been applied to charitable purposes and would be exempt. *Section 11(1A) does not make any distinction between a long-term capital asset and a short-term capital asset. The claim of the charitable trust to the effect that the capital gain is deemed to have been applied to charitable purposes is, therefore, in accordance with law.*

Question 14

A charitable trust, whose income can be exempt under section 11 of the Income-tax Act, was formed on 1st March, 2004. For the accounting year ended 31st March, 2005, it earned an income of Rs.60,000.

It filed with the Commissioner of Income-tax its application for registration on 30th March, 2005 explaining that for good and sufficient reasons, it was prevented from filing the application by the due date.

State:

(i) by which date the application for registration should have been filed;

(ii) whether such an application could have been filed before the formation of the trust;

(iii) in the absence of an order of registration from the Commissioner, can the trust be deemed to be registered;

(iv) the steps to be taken by the trust to secure exemption from income-tax;

(v) whether a certificate of registration once granted can be cancelled and if so, the conditions therefor *(5 Marks) (Nov.2005)*

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

(i) The person in receipt of income of the trust should make an application for registration in the prescribed form and in the prescribed manner to the Commissioner of Income-tax before the expiry of a period of 1 year from the date of creation of the trust.

(ii) No. The application for registration u/s 12A cannot be filed before the formation of the trust.

(iii) As per section 12AA(2), every order granting or refusing registration should be passed before the expiry of 6 months from the end of the month in which the application was received under section 12A. The Act does not provide for deeming registration of a trust in the absence of an order of registration from the Commissioner. However, in *Karnataka Golf Association v. Director of Income-tax (91 ITD 1)* it was held that if the communication granting or rejecting registration is not received before the expiry of 6 months from the end of the month in which the application is received by the income-tax authority, it would be deemed that the trust is registered on deemed basis.

(iv) The following are the steps to be taken by the trust to secure exemption from income-tax-

(1) The trust should be registered with the Commissioner of Income-tax under section 12A.

(2) The accounts of the trust for the previous year must be audited by a Chartered Accountant if its total income exceeds Rs.50,000, without giving effect to the provisions of section 11 and section 12. The audit report in the prescribed form, duly signed and verified by the Chartered Accountant, should be furnished along with the return of income of the trust for the relevant assessment year.

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

(4) The unapplied income and the money accumulated or set apart should be invested or deposited in the specified forms or modes.

(v) Yes, the certificate of registration can be cancelled by the Commissioner. According to section 12AA, if the Commissioner is satisfied that the activities of the trust are not genuine or are not being carried out in accordance with the objects of the trust, he shall, after giving the trust a reasonable opportunity of being heard, pass an order in writing canceling the registration of the trust.

Question 15

Gangaram Public Charitable Trust runs a hospital, which derived income of Rs.250 lakhs, from its operational activities. Expenses incurred to earn such income are Rs.55 lakhs. Depreciation on various assets used in the hospital is Rs.15 lakhs. Out of income of Rs.250 lakhs, the amount *accrued but not received as on 31-03-2005 is Rs.20 lakhs. The institution earmarked and set apart Rs.30 lakhs in March, 2005 to give as advance for a building intended to be taken on lease for expansion of the hospital, but the amount was paid on 7th April, 2005, as the lease agreement could not be signed by 31st March, 2005. The trust has got an ERP package developed and installed by an IT company during the year. The total cost to the trust on account of the ERP package was Rs.85 lakhs. Advice the trust on its total income, if the trust has incurred Rs.12 lakhs for purchase of a number of desktop and laptop computers for use in the hospital. (8 Marks) (May 2005)*

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

The total income of the trust for the A.Y. 2010-11 is computed hereunder:

	Particulars	**Rs. in lakhs**	
Income derived from property held under trust			250
Less:	Expenses incurred thereto	55	
	Depreciation on assets	15	70
			180
Less:	15% eligible for blanket exemption without any conditions (15% of Rs.180 lakhs)		27
			153
Less:	Income not received during the year, which can be spent in the year of receipt or in the immediately following year		20
			133
Less:	Non-application of income due to delay in signing lease agreement [The amount was applied on 7th April in the immediately following year – Option to be exercised in writing before the expiry of the time allowed under section 139(1) for furnishing the return of income]		30
Amount to be applied for the objects of the trust by 31.3.2010			**103**
Less:	Amount applied for the objects of the trust		
	(i) For development and installation of ERP package for the purpose of the trust	85	
	(ii) For purchase of desktop and laptop computers for the purposes of the trust	12	97
Taxable Income			**6**

Note -

(i) Depreciation should be allowed while computing income of a trust under section 11(1)(a). A trust can claim depreciation on assets even if the cost of assets has been fully allowed as application of income under section 11 in the past years. Even when the whole of capital expenditure has been treated as an application of income for charitable purpose u/s 11, the trust can still claim depreciation on assets used for its purposes on the basis of normal commercial principles.

(ii) If the income applied to charitable purposes in India falls short of 85% of the income derived during the year from property held under trust for the reason that the whole or any part of its income has not been received during that year, then such income, at the option of the person in receipt of income, can be applied during the previous year in which the income is received or in the immediately following previous year. The option is to be exercised in writing before expiry of the time allowed u/s 139(1) for filing return of income.

(iii) The word "applied" used in section 11 means that the income is actually applied for the charitable purposes of the trust. The word "applied" does not necessarily imply "spent". Even if a certain amount is irretrievably earmarked and allocated for charitable purposes, the said amount can be deemed to have been applied for charitable purposes. *[CIT vs. Trustees of H.E.H. Nizams Charitable Trust, (1981) 131 ITR 497 (AP).]*

(iv) The cost of getting an ERP package developed and installed is a capital expenditure. A charitable trust can apply its income either for revenue expenditure or for capital expenditure provided the expenditure is incurred for promoting the objects of the trust. Purchase of a fixed asset to be utilised for the purpose of the trust amounts to application of income for charitable purposes as held by the Supreme Court in *S.RM.M.CT.M.Tiruppani Trust vs. CIT (1998) 230 ITR 636.*

Question 16

(a) The books of account maintained by a National Political Party registered with Election Commission for the year ended on 31.3.2003 disclose the following receipts:

(a)	*Rent of property let out to a departmental store at Chennai*	*Rs.6,00,000*
(b)	*Interest on deposits other than banks*	*Rs.5,00,000*
(c)	*Contributions from 100 persons (who have secreted their names) of Rs.11,000 each*	*Rs.11,00,000*
(d)	*Contribution @ Rs.11 each from 1,00,000 members in cash*	*Rs.11,00,000*
(e)	*Net profit of cafeteria run in the premises at Delhi*	*Rs.3,00,000*

Compute the total income of the political party for the year 2003-04, with reasons for inclusion or otherwise. *(5 Marks) (May 2003)*

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

The total income of a political party registered with the Election Commission is to be computed as per section 13A under which the income derived from house property, income from other sources and income by way of voluntary contributions received from any person on fulfilling of the conditions as mentioned thereunder are exempt from tax.

Computation of income of National Party

	Particulars	*Amount*
(a)	The rent of the property of Rs.6 lakhs located at Chennai	Nil
(b)	The interest received on deposits of Rs.5 lakhs	Nil
(c)	The contributions given by 100 persons of Rs.11,000 each by secreting their identities (see note below)	Nil
(d)	The contribution of Rs.11 each given by its members being recorded in the books	Nil
(e)	Net profit of cafeteria at Delhi	3,00,000
	Total Income	3,00,000

Note:

In respect of each voluntary contribution in excess of Rs.20,000, exemption would be available only if the political party keeps and maintains a record of such contribution and the name and address of the person who has made such contribution. However, in this case, this provision is not attracted since the contribution given by each person is less than Rs.20,000.

Question 17

A public charitable trust registered under Section 12A of the I.T. Act, for the previous year ending 31.3.2003, derived gross income of Rs.16 lakhs, which consists of the following:

		(Rs. in Lakhs)
(a	*Income from properties held by trust (net)*	*5*
(b)	*Income (net) from business (incidental to main objects)*	*4*
(c)	*Voluntary contributions from public*	*7*

The trust applied a sum of Rs.11.60 lakhs towards charitable purposes during the year which includes repayment of loan taken for construction of orphan home Rs.3.60 lakhs.

Determine the taxable income of the trust for the assessment year 2003-2004.

(4 Marks) (May 2003)

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

(i) Statement of computation of income of public charitable trust

(i)	Income from property held under trust (net)		5,00,000
(ii)	Income (net) from business (incidental to main objects)		4,00,000
(iii)	Voluntary contributions from public		7,00,000
	Voluntary contribution made with a specific direction towards corpus are alone to be excluded under section 11(1)(d). In this case, there is no such direction and hence, included.		-------
			16,00,000
	Less: 15% of the income eligible for retention / accumulation without any conditions		2,40,000
			13,60,000
	Deduct: Amount applied for the objects of the trust		
	(i) Amount spent for charitable purposes (Rs.11,60,000 - 3,60,000)	8,00,000	
	(ii) Repayment of loan for construction of orphan home	3,60,000	11,60,000
	Taxable Income		**2,00,000**

Note : The trust may opt for accumulation of income by giving a notice in writing to the Assessing Officer in Form No.10 along with the return of income or before the completion of assessment and such accumulation to the extent of Rs.2 lakhs would save the trust from tax burden.

Question 18

How do you deal with the following situations? Give reasons for your answer. (Assessment Year 2002-03):

Ramji Charitable Trust has filed return of income for the Assessment Year 2001-02 within the stipulated time under section 139(1) and applied only 50% of its income to specified purposes. It intends to accumulate the balance 25% of income to be spent in future years. While completing the assessment, the Assessing Officer disallowed the accumulated income of 25% and taxed the same on the ground that the trust has not made any application under Section 11(2) along with return of income or even before the completion of assessment. Discuss the validity of the action of the Assessing Officer in this case. (3 Marks)(Nov.2002)

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

Section 11(2) provides that a charitable trust has to apply 85% of its income to charitable or religious purposes and where 85% of its income is not applied in the aforesaid manner, the trust may accumulate or set apart either the whole or part of its income for future application for such purposes in India. The requirement of the Act is that the trust has to make an application/intimation in Form No.10 for accumulation of income which should be filed or furnished before the assessing authority along with the return of income under section 139(1).

This requirement of filing application is mandatory and without those particulars, the assessing authority cannot entertain the claim of the assessee under section 11. Further, any claim for giving benefit of section 11 on the basis of information supplied subsequent to the completion of assessment would mean that the assessment order will have to be reopened. The Act does not contemplate such reopening of the assessment. Hence, furnishing of application for accumulation after completion of assessment cannot be accepted. This principle is settled in *CIT vs. Nagpur Hotel Owners Association 247 ITR 201 (SC).* Therefore, the action of the Assessing Officer is correct.

Question 19

Discuss the provisions relating to the taxation of Educational Institutions and the conditions in general required to be fulfilled by them for securing exemption from Income-tax.

(5 Marks) (May 2002)

Answer

(a) The provisions relating to taxation of educational institutions are enacted in section 10(23C). The educational institutions now fall into different categories as under:

 (i) Educational institutions which exist solely for educational purposes and not for purposes of profit and which are wholly or substantially financed by Government.

 (ii) Educational institutions which exist solely for educational purposes and not for purposes of profit, whose aggregate annual receipts do not exceed Rs.1 crore.

 (iii) Educational institutions existing solely for educational purposes and not for purposes of profit (excluding the (ii) above) which are approved by the prescribed authority.

 The first two are completely exempt from tax, without pre-conditions. One common feature of all institutions is that they ought to be non-profit making and must exist solely for educational purposes.

 Under Rule 2C, the authority prescribed for granting approval (given in (iii) above) is the Director General (Income-tax Exemptions) and the application has to be made to him in the prescribed form. The prescribed authority, before approving the educational institutions may call for such documents or information as it thinks fit in order to satisfy itself about the genuineness of the activities of the institution and may make such enquiries as it deems necessary. The following conditions have to be fulfilled by such an institution:

(b) It should apply its income or accumulate it for application wholly and exclusively to its objects and in a case where more than 15 % of its income is accumulated on or after 1st April, 2002, the period of accumulation of the amount exceeding 15% of the income shall not exceed five years. In other words, such accumulated sum must be applied for the purposes of education within the next five financial years.

(c) It does not invest its funds at any time during the previous year otherwise than in any one or more of the forms or modes specified in sub-section (5) of section 11. The exception to this requirement is in respect of equity shares of a public company forming part of the corpus as on 1.6.1998 or bonus shares received as accretion to those shares.

(d) The exemption will not apply to any income by way of profits and gains of a business, unless the business is incidental to the attainment of its objectives and separate books of account are maintained in respect of such business.

Question 20

A trust set up wholly for charitable purposes furnishes its return of income in respect of assessment year 1998-99 on 15.11.99, declaring an income of Rs.1 lakh. The Assessing officer on scrutiny of the return finds that the income of the trust is exempt from tax. Are there any penal consequences for the trust's failure to furnish the return of income within the prescribed time? *(3 Marks) (Nov.2001)*

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

As per section 139(4A) every person in receipt of income derived from property held under trust or other obligation wholly for charitable or religious purposes or in part only for such purposes or of income being voluntary contributions referred to in section 2(24)(iia) shall if the total income (without giving effect to the provisions of section 11 and 12) exceeds the maximum amount which is not chargeable to tax must furnish return of income in the prescribed form and in the prescribed manner.

Since the income of the trust has been found to be exempt under section 11 and 12, no interest under section 234A for delay can be charged. However, under clause (e) of sub-section (2) of section 272A, the person who is required to file a return in his representative capacity will be liable to pay by way of penalty a sum which shall not be less than one hundred rupees for every day during which the failure continues. Such a penalty can be levied by the

Joint Commissioner and a reasonable opportunity of hearing has to be given (sub-section 3 of section 272A). Further, under section 273B, no penalty is leviable under section 272A, if the person proves that there was reasonable cause for the said failure.

Question 21

Indicate the circumstances under which the income of a public charitable and religious trust will be subjected to income-tax at maximum marginal rate. *(4 Marks) (May 2001)*

Answer

The relevant provision which authorizes the levy of tax at maximum marginal rate is the proviso to sub-section (2) of section 164. Tax at the maximum marginal rate can be charged where the whole or part of the relevant income is not exempt under section 11 or section 12 by virtue of the provisions contained in clause (c) or clause (d) of section 13.

In other words, if the institution or trust has been created or established after the commencement of the Act and under the terms of the trust or rules governing the institution any part of the income enures directly or indirectly for the benefit of any person referred to in sub-section (3) or if any part of the income or any property of the trust or institution (whenever created or established) is used or applied for the benefit of such person. The persons referred to in sub-section (3) are the author or founder of the trust, a person who has made substantial contribution to the trust (i.e. his total contribution upto the end of the previous year exceeds Rs.50,000), where the author or founder is a HUF, a member of the family, a trustee or manager of the trust, any relative of the such author, founder, person, member, trustee or manager or any concern in which any of the persons referred to earlier have a substantial interest.

Section 164(2) applies where the income is derived from property held under trust wholly for charitable purposes. Section 164(3) is a similar provision for levy of tax at maximum marginal rate in cases where the income is derived from property held in trust is partly for charitable or religious purposes.

Question 22

Ramamurty Public Charitable Trust (Registered under section 12A of the Income-tax Act) furnishes the following data for the financial year ending 31.3.2000.

		(Rs. in lakhs)
(i)	*Income from Engineering College* *(Gross receipts Rs.100 lakhs)*	*10*
(ii)	*Income from properties held in trust (out of his Rs.2 lakhs was not received during the year and Rs.2 lakhs was received only on the last day of the year)*	*26*
(iii)	*Net income from business held under trust (As incidental to the main objects) as per books*	*2*
(iv)	*Amount spent on free scholarship, free meals and fee medical relief*	*9*
(v)	*Repayment of loan taken for construction of Health Care Centre*	*3*

You are required to:

(a) Compute the taxable income of the Trust for the assessment year, 2000-2001. Assume that option is exercised under explanation to section 11(1) of the Act. (9 Marks)

(b) Advise how the taxability on the computed income could be minimized or reduced.

(3 Marks) (Nov.2000)

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

(a) Computation of total income of Shri Ramamurthy Public Charitable Trust for A.Y. 2010-11

		(Rs.in lakhs)
(i)	Income from Engineering College – exempt under section 10(23C)(iiiad) as gross receipts do not exceed Rs.1 crore.	Nil
(ii)	Income from properties held under trust	26.00
(iii)	Income from business undertaking held under trust (assumed that the business is incidental to the attainment of objectives of the trust and separate books are maintained satisfying section 11(4A))	2.00
		28.00
	85% of the income required to be spent (85% of Rs.28 lakh)	23.80
	Less : Amount spent on free scholarship, free meals and free medical centre	(-)9.00
	Repayment of loans for construction of health centre (this is utilized for the fulfillment of the objects of the trust) See *CIT v.Janmbhoomi Press Trust 242 ITR 703)*	(-)3.00
		11.80
	Less: Option exercised under explanation 2 to section 11 of the Act	
	(i) Amount not received during the previous year	2.00
	(ii) income received on the last day to be spent in the next year	2.00
	Income of the trust liable to tax	7.80

(b) In order to minimize and /or reduce the tax liability, the trustees may give a notice in writing to the Assessing Officer in the prescribed manner about their intention to accumulate the unspent amount of Rs.7.80 lakhs specifying the period and the purpose for which, the accumulation is proposed to be made and invest the sum of Rs.7.80 lakhs in specified assets as per section 11(5). This accumulation would be in compliance with section 11(2) and in such case no tax will be payable on the sum of Rs.7.80 lakhs.

4

INCOMES FROM SALARIES

Question 1

Ayush, an employee of a management consultancy firm, was sent to UK in connection with a project of the firm's client for two months in a previous year. In addition to his salary, the firm paid per diem allowance for the period when he worked in UK to meet expenses on boarding and lodging. Tax was not deducted at source from such allowance by the employer. Ayush did not include such allowance in computation of his taxable salary for the relevant assessment year. In course of assessment of Ayush under section 143(3), the Assessing Officer sent a notice to him asking him to explain why the per diem allowance received by him should not be charged to tax? Ayush sought your advice. *(4 Marks) (June 2009)*

Answer

Per-diem allowance is exempt from tax under section 10(14)(i) read with Rule 2BB, as it is an allowance granted and spent to meet the ordinary daily charges incurred by an employee on account of absence from his normal place of duty. Rule 2BB exempts the allowance granted to meet the ordinary daily charges incurred by an employee on account of his absence from his normal place of duty. In the given case, Mr. Ayush was posted for a period of 2 months outside his normal place of duty and the allowance was paid to meet the boarding and lodging. Therefore, the allowance would fall under section 10(14)(i) read with Rule 2BB and would hence be exempt.

Question 2

IT Limited, under its Employment Stock Option Plan, allotted 500 equity shares to its finance manager, Ms. Cynthia on 15th May, 2008, when she exercised her option. The option was granted on 15th January, 2007 and the shares vested with Cynthia on 15th January, 2008. The company's shares are quoted in Bombay Stock Exchange, where the opening price and closing price on the date of vesting were Rs.250 and 256, respectively. The company recovered Rs.50 per share from Cynthia. Compute the value of fringe benefit for the assessment year 2009-10. If fringe benefit tax thereon is recovered by the company from Cynthia, can she claim such tax as a part of cost when she sells the shares?

(4 Marks) (June 2009)

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

The Finance (No.2) Act, 2009 has abolished FBT from the assessment year 2010-11 onwards. The shares allotted under the Employees' Stock Option Plan is liable to tax as perquisite in the hands of employees. The fair market value of shares on the date on which the option vests with the employee as reduced by the amount actually paid by, or recovered from, the employee in respect of such shares would be the value of perquisite.

As per Rule 40C, in case of shares listed in one recognized stock exchange, fair market value means the average of opening price and closing price of the share on the said stock exchange as on the date of vesting.

Therefore, in this case, the fair market value would be $\frac{250+256}{2}$ = Rs.253

Thus, the value of perquisite would be = (253 x 500) - (50 x 500) = Rs.1,01,500.

Under section 49(2AB), for the purpose of computing capital gain from the transfer of shares received under ESOP, cost of acquisition of such shares shall be the fair market value which has been taken into account while computing the value of perquisite. Thus such fair market value (in this case, Rs.253) shall be considered as cost of acquisition.

Question 3

Simran Pharma Ltd., a manufacturer of drugs and pharma products, provides the following information relating to payments made to its marketing manager in the year 2006-07:

- *Salary @ Rs. 20,000 p.m.*
- *Motor-cycle purchased for Rs.45,000 in June, 2006 was given free of cost.*
- *Conveyance allowance of Rs.5,000 p.m. which was allowed to him as exempt under section 10(14).*
- *Tickets worth Rs.4,000 for a cricket match between India and England.*
- *Reimbursement of medical expenses actually incurred by him of Rs.17,500.*

The company asks you to compute the amount of:

(a) *income chargeable to tax in the hands of marketing manager; and*

(b) *payments covered under fringe benefits, amount chargeable to FBT and the amount of such tax thereon.* *(6 Marks) (Nov 2007)*

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

Since FBT is not payable in respect of the expenditures incurred during the previous year 2009-10, the fringe benefits have to be considered as perquisites chargeable to tax in the hands of employees as per rule 3 of the Income-tax Rules, 1962.

	Particulars	Income of Marketing Manager (Rs.)
-	Salary	2,40,000
-	Free Motor cycle	45,000
-	Conveyance allowance exempt under section 10(14) for employee and totally tax free perquisite	Nil
-	Free ticket of a cricket match	4,000
-	Reimbursement of medical expenses (Reimbursement up to Rs.15,000 is exempt in the hands of the employee and the excess is taxable) .	2,500
	Total	**2,91,500**

(a) Income chargeable to tax in the hands of Marketing Manager is Rs.2,91,500

Note

The value of gift, voucher or token below Rs.5,000 in aggregate in a year received by the employee from the employer shall not be taxable as a perquisite. The free ticket of a cricket match could not be treated as gift and accordingly taxed in the above computation.

Question 4

Calculate the value of perquisite, if any, chargeable to tax in respect of free accommodation provided by the employer in a hotel to an employee, for the previous year ended 31.3.2003 :

(i) For 10 days when he was transferred from Delhi to Mumbai.

(i) Throughout the year as per contract of employment. *(4 Marks) (May 2003)*

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

(i) As per Rule 3, if the hotel accommodation is provided to the employee by the employer for a period not exceeding 15 days and such accommodation is provided on employee's transfer from one place to another, it is not a chargeable perquisite. In this case, the employer has provided accommodation in a hotel for a period of only 10 days. Hence, it is not a chargeable perquisite.

(ii) The employee was provided under a contract, accommodation in a hotel free of charge for throughout the year and accordingly the value of perquisite will be 24% of salary of the employee or the actual charges paid or payable to the hotel, whichever is less. The calculation shall be for the period during which such accommodation is provided and the value shall be reduced by the rent, if any, actually paid or payable by the employee.

Question 5

Find out the taxable value of perquisite from the following particulars in case of an employee to whom the following assets held by the company were sold on 13.6.2002:

Amount of Rs.

	Car	***Laptop***	***Furniture***
Cost of Purchase (May 2000)	*8,72,000*	*1,22,500*	*35,000*
Sale Price	*5,15,000*	*25,000*	*10,000*

The assets were put to use by the company from the day these were purchased.

(6 Marks) (Nov.2002)

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10. It may be assumed that the month of acquisition is May 2007 and date of sale to employee is 13.06.2009.

Answer

The assets transferred by the company shall be considered for the purpose of valuation of perquisites under section 17(2) of the Act read with Rules. The value of perquisite in respect of assets transferred is determined after allowing normal wear & tear for the period of use of such assets by employer.

	Car	*Laptop*	*Furniture*
Basis of Depreciation	WDV	WDV	SLM
Cost of asset to company (assumed as May 2007)	8,72,000	1,22,500	35,000
Less: Normal wear & tear upto May, 2008 @ 20% - 50% - 10% respectively	1,74,400	61,250	3,500
	6,97,600	61,250	31,500
Less: Normal wear and tear upto May, 2009	1,39,520	30,625	3,500
Balance, in May, 2009	5,58,080	30,625	28,000
Less: Sale value on 13.06.09	5,15,000	25,000	10,000
Value of Perquisite	**43,080**	**5,625**	**18,000**

Note: As per Rule 3(7) of Income-tax Rules, normal wear and tear has to be calculated at the aforementioned prescribed rates applying Straight Line Method (SLM) to Furniture and Written Down Value (WDV) method to all other assets.

Question 6

Babu joined a company on 01.06.01 and was paid the following emoluments and allowed perquisites as under:

Emoluments :	*Basic pay Rs.25,000 per month* *D.A. Rs.10,000 per month* *Bonus Rs.50,000 per month*

Perquisites:

(i) *Furnished accommodation owned by the employer and provided free of cost*

(ii) *Value of furniture there in Rs.3,00,000*

(iii) *Motor-car owned by the company (with engine c.c. less than 1.6 litres) along with chauffeur for official and personal use.*

(iv) *Sweeper salary paid by company Rs.1,500 per month*

(v) *Watchman salary paid by company Rs.1,500 per month*

(vi) *Educational facility for 2 children provided free of cost. The school is owned and maintained by the company.*

(vii) *Interest free loan of Rs.5,00,000 given on 1.10.2001 for purchase of a house. No repayment was made during the year.*

(viii) *Interest free loan for purchase of computer Rs.50,000 given on 1.1.02. No repayment was made during the year.*

(ix) *Corporate membership of a club. The initial fee of Rs.1,00,000 was paid by the company. Babu paid the bills for his use of Club facilities.*

You are required to compute the income of Babu under the head "Salaries" in respect of assessment year 2002-03. Suitable assumptions may be made, wherever necessary.

(12 Marks) (May 2002)

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

Computation of income from salaries of Mr. Babu for A.Y.2010-11

Basic pay	Rs.25,000 x 10	2,50,000
D.A.	Rs.10,000 x 10	1,00,000
Bonus	Rs.50,000 (See Note 1)	50,000

		4,00,000
Perquisites-		
(a)	Rent free accommodation – assumed that D.A is not included for superannuation benefits. 15% of (2,50,000+50,000) (See Note 2)	45,000
(b)	Value of furniture 10% of Rs.3,00,000 for 10 months	25,000
(c)	Motor car Rs.2700 x 10 (As per new perquisite rules – applicable for Nov, 2010 exam)	27,000
(d)	Sweeper – Actual cost to company 1500 x 10	15,000
(e)	Watchman – Actual cost to company 1500 x 10	15,000
(f)	Educational facility for 2 children Assumed that the cost of education per child does not exceed Rs.1,000 p.m.	NIL
(g)	Interest free loan for purchase of house 10% p.a. (assumed that it is for term of 5 to 15 years) on Rs.5 lakhs for 6 months	25,000
(h)	Interest free loan for purchase of computer 16.50% p.a. of Rs.50,000 for 3 months (treated as personal loan)	2,062
(i)	Club membership – (not a chargeable perquisite in respect of initial fee for corporate membership)	Nil
	Income from salary	**5,54,062**

Note :-

1. In the data relating to emoluments, basic pay has been given at Rs.25,000 p.m. and D.A. at Rs.10,000 p.m. The bonus figure of Rs.50,000 p.m. does not fit in well with the basic and D.A. at the given levels. Hence, Rs.50,000 has been taken as the annual bonus.
2. It is assumed that Mr. Babu is residing in a city having a population exceeding 25 lakhs as per 2001 census.
3. Where the employer has obtained corporate membership of a club and the facility is enjoyed by the employee or any member of his household, it is liable to fringe benefit tax in the hands of the employee and it is not a perquisite chargeable to tax under the head "salary".
4. Motor car owned by employer used partly for official purpose and partly for personal purpose by the employee is taxable as perquisite. The cubic capacity of the engine is less than 1.6 litres. The perquisite value including driver salary is Rs.1800 + Rs.900 per month. The perquisite value is therefore Rs.27,000 (Rs.2,700 x 10).

   Note – This calculation is based on new perquisite rules which are relevant only for November 2010 exam.

Question 7

Write short notes on the following:

Employee's stock option scheme *(4 Marks) (May 2002)*

Answer

The Finance (No.2) Act, 2009 has substituted sub-clause (vi) of clause (2) of section 17 w.e.f. 01.04.2010. Accordingly, the value of any specified security or sweat equity share allotted or transferred directly or indirectly, by the employer, or former employer, free of cost or at concessional rate is chargeable to tax as perquisite.

According to the Explanation to the section,

(a) 'specified security' means the securities as defined in section 2(h) of the Securities Contracts (Regulation) Act, 1956 and, where employees' stock option has been granted under any plan or scheme therefor, includes the securities offered under such plan or scheme.

(b) 'sweat equity shares' means equity shares issued by a company to its employees or directors at a discount or for consideration other than cash for providing know-how or making available rights in the nature of intellectual property rights or value additions, by whatever name called.

(c) the value of any specified security or sweat equity shares shall be the fair market value of the specified security or sweat equity shares, as the case may be, on the date on which the option is exercised by the assessee (employee) as reduced by the amount actually paid by, or recovered from the assessee in respect of such security or shares.

(d) 'fair market value' means the value determined in accordance with the method as may be prescribed.

(e) 'option' means a right but not an obligation granted to an employee to apply for the specified security or sweat equity shares at a predetermined price.

Question 8

A, an individual, has income taxable only under the head 'salaries'. In the course of the previous year ended 31st March, 2001, he pays Rs.10,000 to an institution recognized by the prescribed authority under section 35CCA of the Income-tax Act.

Will A be entitled to any deduction under the Act and if so, in what an amount?. Discuss.

(4 Marks) (May 2001)

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

The question is whether the deduction of the amount paid to an institution recognised by the prescribed authority under section 35CCA is available to a person, deriving income under the head "Salary". Section 80GGA permits the deduction to all assessees, other than an assessee whose gross total income includes income chargeable under the head "profits and gains of business or profession". Mr.A fulfils this condition. Therefore, he is eligible for 100% deduction of the amount paid by him to the institution, on fulfillment of the conditions prescribed in section 80GGA.

Question 9

Ajay is employed as senior executive of Manu Ltd. Manu Ltd offers rights to its existing shareholders in the ratio 1:1 on 15th February 2000 at Rs.150 per share. Ajay was offered 500 shares at Rs.150,which he exercised. On these facts you are consulted by Ajay as to.

(a) The tax consequences for the assessment year 2000-2001

(b) If Ajay is already as shareholder of 250 shares, allotted in public issue will it make any difference. *(4 Marks)(May 2000)*

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10. It may be assumed that the fair market value is Rs.300 per share.

Answer

(a) The Finance (No.2) Act, 2009 has substituted sub-clause (vi) of clause (2) of section 17 which is applicable from the assessment year 2010-11 onwards. The value of any specified security or sweat equity shares allotted or transferred, directly or indirectly, by the employer, or former employer, free of cost or at concessional rate to the assessee employee is taxable as perquisite. The meaning of the terms 'specified security', 'sweat equity shares', 'fair market value' are dealt with in the Explanation given therein.

The fair market value of the shares so determined in accordance with the method as may be prescribed less the amount actually recovered from the employee, shall be the value of perquisite chargeable to tax.

The value of perquisite would be:

Fair market value of shares determined as per the prescribed method in Income-tax Rules, 1962 = 500 shares @ Rs.300 each	1,50,000
Less: Amount recovered from the employee @ Rs.150 per share	75,000
Value of perquisite chargeable to tax	75,000

The Finance (No.2) Act, 2009 has inserted sub-section (2AA) to section 49 and the cost of acquisition of specified security or sweat equity shares referred to in section 17(2)(vi) shall be the fair market value which has been taken into account for the purpose of perquisite valuation.

(b) In case the employee is a shareholder and was allotted shares in the same manner as was allotted to other shareholders by the company without any concession / reduction in value then the question of valuation of perquisite would not arise.

5

INCOME FROM HOUSE PROPERTY

Question 1

P, an individual, borrowed Rs.20,00,000 for repair and reconstruction of his self-occupied house property and paid interest of Rs.1,60,000 thereon during the year ending 31.3.2007. What is the amount of interest allowable as a deduction under section 24 for the assessment year 2007-08? (3 Marks) (May 2007)

Answer

Section 24(b) provides that where the self-occupied house property has been acquired, constructed, repaired, renewed or reconstructed with borrowed capital, deduction towards interest payable thereon shall not exceed Rs.30,000. Therefore, only Rs.30,000 would be allowed as deduction on account of interest on loan borrowed for repair and reconstruction of self-occupied house property. The higher limit of Rs.1,50,000 in respect of interest on loan borrowed on or after 1.4.99 would be available only where such loan is borrowed for acquisition or construction of self-occupied property and not for repair or reconstruction of such property.

Question 2

A Hindu undivided family owns a property which has been let out to a firm carrying on business. The family is a partner in the firm through the Karta. No rent has been charged by the HUF from the firm for use of the premises by the firm. The Assessing Officer, however, has taxed the family on the notional income from property based on municipal valuation. Is this decision justified? (4 Marks) (May 2004)

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

Under section 22, the annual value of a property is chargeable to tax under the head "Income from house property" in the hands of the owner. However, this section specifically excludes property occupied for the purposes of own business or profession of the assessee, the profits of which are chargeable to income-tax. In *CIT v. Shri. Champalal Jeevraj (1995) 215 ITR 289 (Mad)* it was observed that where the Karta of the HUF is a partner in the firm in his representative capacity and the firm occupied a portion of the house belonging to the HUF, the benefit of exclusion under section 22 was available to the HUF. Accordingly, the annual value of the property shall be 'nil' while computing the total income of the HUF. Therefore, in this case, the action of the Assessing Officer is not correct in taxing the HUF on the notional income from property.

Question 3

'X', an American national, is a resident in India during the previous year ended on 31.3.2003. He was the owner of a building located in New York. The same was on rent @ US $ 12,500 p.m. The Municipal Corporation of New York was paid taxes on such building of US $ 10,000 on 12.2.2003. Besides the above property, he purchased a piece of land at Delhi for construction of a house. The said land was given on rent for running of a dairy @ Rs.3,000 p.m. w.e.f. 1.10.2002. The value of one US $ in Indian rupee throughout the year remained at Rs.46.50.

'X' wants to know his taxable income for assessment year 2003-04. (5 Marks) (May 2003)

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

For the previous year, Mr. X, an American National, was a resident in India. Accordingly the income received by him by way of rent of the house property located in USA is subject to tax in India. Municipal taxes so paid in the country where the property is situated are also to be allowed as held in the case of *CIT v. R. Venugopala Reddiar (1965) 58 ITR 439* by the Madras High Court.

The income chargeable to tax will be as under:-

Particulars	*Rs.*	*Rs.*
Income from House Property		
House property located in New York.		
Annual rental value being actual rent received of US $ 12,500 p.m. converted into Indian Rupees @ 46.50	69,75,000	
Less: Municipal taxes paid (US $ 10,000 X 46.5)	4,65,000	
Net Annual Value (NAV)	65,10,000	
Less: Deduction u/s 24 @ 30% of NAV	19,53,000	45,57,000
Income from other sources		
Rental income from the land located at Delhi given on rent for 6 months		18,000
Total income		**45,75,000**

Note:

Rent from vacant land is chargeable to tax under the head "Income from other sources".

Question 4

How do you deal with the following issue under the respective provisions of the Income-tax Act?

The assessee, who was deriving income from "house property", realised a sum of Rs.52,000 on account of display of advertisement hoardings of various concerns on the roof of the building. He claims that this amount should be considered under the head "House Property" and not under "other sources". *(3 Marks) (Nov.2000)*

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

This question came up for consideration before the Calcutta High Court in *Mukherjee Estate (P) Ltd v. CIT (2000) 244 ITR 1.* It was decided that the assessee let out the roof for advertisement for hoarding and that the income cannot be considered as income from house property as hoardings do not form part of the building. Such income is chargeable under the head "Income from other sources".

6

PROFITS AND GAINS OF BUSINESS OR PROFESSION

Question 1

Intelysis Limited charged depreciation on its fixed assets at the rates prescribed in the Income-tax rules in its accounts consistently. The Assessing Officer disallowed the same and considered depreciation computed at the rates prescribed in the Companies Act, 1956, for the purpose of computation of 'book profit' under section 115JB of the Income-tax Act for the assessment year 2008-09. Examine the correctness of the action of the Assessing Officer.

(3 Marks) (June 2009)

Answer

This issue was settled by the Supreme Court in *Malayala Manorama Co. Ltd. v. CIT (2008) 300 ITR 251.* The Apex Court observed that for the purpose of computation of book profit under section 115JB, the Assessing Officer's power is restricted to examining whether the books of account are certified by the authorities under the Companies Act as having been properly maintained in accordance with the Companies Act. Thereafter, he only has the limited power of making additions and deductions as provided for in Explanation 1 to section 115JB. The Assessing Officer does not have the jurisdiction to go behind the net profit shown in the profit and loss account except to the extent provided in Explanation 1 to section 115JB. Where an assessee is consistently charging depreciation in its books of account at the rates prescribed in Income-tax Rules and the accounts of the assessee have been prepared and certified as per the provisions of the Companies Act, the Assessing Officer does not have any jurisdiction under section 115JB to rework the net profit of the assessee by substituting the rates of depreciation prescribed under the Companies Act.

Applying the ratio of the Supreme Court decision to this case, it may be concluded that the action of the Assessing Officer is not correct.

Note - The rates of depreciation prescribed in Schedule XIV to the Companies Act are the minimum rates at which depreciation is to be charged in the profit & loss account. The rates prescribed in the Income-tax Rules are higher than those prescribed in the Companies Act. A company is, therefore, not precluded from adopting higher rates of depreciation, if the circumstances justify. Thus, even if a company adopts the higher rates of depreciation prescribed in the Income-tax Rules, it can be said that the company has prepared the accounts in the manner provided under the Companies Act.

Question 2

'X' Ltd., transferred its fertilizer business to a new company ' Y ' Ltd., by way of demerger with effect from appointed date of 1.4.2007 after satisfying the conditions of demerger. Further information given:

(a) WDV of the entire block of plant and machinery held by 'X' Ltd. as on 1.4.2007 is Rs. 100 crores;

(b) Out of the above, WDV of block of plant and machinery of fertilizer division is 70 crores;

(c) 'X' Ltd. has unabsorbed depreciation of Rs.50 lakhs as at 31.3.2007;

On the above facts:

(i) You are required to explain the provisions of the income-tax as to the allowability of depreciation, post-merger, in the hands of 'X' Ltd. and 'Y' Ltd. as at 31.3.2008 duly calculating the depreciation. (4 Marks) (Nov 2008)

(ii) State how the unabsorbed depreciation has to be dealt with for the assessment year 2008-09. (3 Marks) (Nov 2008)

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

(i) In the case of a demerger, satisfying the conditions as laid down in section 2(19AA), the depreciation claim is governed by the provisions as under:

(1) As per the *Explanation 7A* of section 43(1), where in a scheme of demerger, if the demerged company transfers any capital asset to the resulting company, being an Indian company, the actual cost of the capital asset transferred shall be taken to be the same as it would have been if the demerged company had continued to hold the capital asset for the purpose of its own business.

(2) The resulting company will be entitled to depreciation on the written down value of the block of assets transferred to it, which will be the written down value of the transferred assets of the demerged company immediately before the demerger [Explanation 2B to section 43(6)].

(3) *Explanation 2A* to section 43(6) provides that the written down value of the block of assets in the hands of the demerged company shall be the written down value of the block of assets of the demerged company for the immediately preceding previous year as reduced by the written down value of the assets transferred to the resulting company pursuant to the demerger.

(4) As per the above provisions, the calculation of depreciation on plant and machinery in the hands of 'X' Ltd. and 'Y' Ltd. is as under:

WDV of plant and machinery	'X' Ltd.	'Y' Ltd.
	Amt. in crores	
As at 1st April, 2009	30.00	70.00
Less: Depreciation @ 15%	4.50	10.50
WDV as at 31st March, 2010	25.50	59.50

Note – It is presumed that Y Ltd. is an Indian company

(ii) Set-off of unabsorbed depreciation:

(i) As per section 72A(4), on demerger, the unabsorbed depreciation directly relatable to the undertakings transferred to the resulting company is allowed to be carried forward and set off in the hands of the resulting company.

(ii) Where such unabsorbed depreciation is not directly relatable to the undertaking transferred to the resulting company, it has to be apportioned between the demerged company and the resulting company in the same proportion in which the assets of the undertakings have been retained by the demerged company and transferred to the resulting company.

(iii) The demerged company and the resulting company would be allowed to carry forward and set-off their respective portion of unabsorbed depreciation, as calculated above, for an unlimited period as per section 32(2).

Question 3

Specify all those public facilities which have been notified by CBDT as infrastructure facility for the purpose of section 36(1)(viii). (5 Marks) (May 2008)

Answer

The CBDT, vide Notification No. SO 1153(E) dated 20.07.2006, has notified the following public facilities as infrastructure facility for the purpose of section 36(1)(viii):

(1) Inland Container Depot and Container Freight Station notified under the Customs Act, 1962

(2) Mass Rapid Transit system

(3) Light Rail Transit system

(4) Expressways

(5) Intra-urban or semi-urban roads like ring roads or urban by-passes or flyovers

(6) Bus and truck terminals

(7) Subways

(8) Road dividers

(9) Bulk Handling Terminals which are developed or maintained or operated for development of rail system

(10) Multilevel Computerised Car Parking.

Question 4

M/s. Nagdiwala Enterprises, a partnership firm constituted by a doctor and a non-doctor engaged in running a multispeciality hospital, seeks your opinion in the context of provisions of the Act as to allowability/chargeability of the following transactions for preparing its return for A.Y. 2008-09:

(a) Depreciation on the instruments, imported from U.K. for Rs.2 lacs cleared by customs on 22.3.2008 on payment of duty of Rs.1 lakh, installed and ready for use on 26.3.2008. Only one operation with the help of such instruments was performed till 31.3.2008.

(b) The book profits calculated as per section 40(b) are Rs.3 lacs and payment of salary to working partners was Rs.1 lakh. Clause for payment of salary to working partners though appears in the deed, but the same is silent as to quantum and the manner of distribution.

(c) Salary of Rs.10,000 p.m. paid to the wife of a partner for working as an anesthesist. The normal salary of an anesthesist in the town is Rs.7,500 p.m. or less.

(d) Purchase of medicines in cash on 18.12.2007 for Rs.35.000.

(e) Revenue expenditure of Rs.10,000 incurred for promoting family planning amongst its employees.

(f) Interest of Rs.3,000 paid on an overdraft of Rs.1 lac taken for making payment of installment of advance tax of Rs.1.25 lacs. *(8 Marks) (May 2008)*

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

The allowability/chargeability of each of the transactions entered into by M/s Nagdiwala Enterprises for the purpose of computation of income for Assessment Year 2010-11 shall be as under:-

(a) The surgical instruments used by a firm engaged in the business of running a hospital are covered under the category of Plant & Machinery, on which the rate of depreciation is 15%. The depreciation on the instruments imported from U.K. is allowable to the firm since the same were put to use during the previous year ended on 31.3.10 because of performing of one operation. However, the same were used in the previous year for less than 180 days and accordingly the allowable depreciation will be one half of the normal depreciation. The cost of instruments is Rs.3 lakh and the amount of depreciation thereon works out to Rs.22,500 [3,00,000 × 15% × ½].

(b) As per section 40(b), payment of remuneration to a working partner is allowable as deduction only if it is authorised by and in accordance with the terms of the partnership deed. *CBDT Circular No.739 dated 25.3.96 clarifies that no deduction in respect of remuneration paid to partners is allowable unless the partnership deed either specifies the amount of remuneration payable to each individual working partner or lays down the manner of quantifying such remuneration.* If the partnership deed contains a clause for payment of salary to working partners without specifying the manner of quantification or manner of distribution of such salary, the payment of salary to the working partners cannot be construed to be authorised by and in accordance with the partnership deed.

(c) Section 40A(2) provides that if any expenditure in respect of which payment has been made to, *inter alia*, any relative of the partner of a firm and the Assessing Officer is of the opinion that such expenditure is excessive or unreasonable having regard to the fair market value of the services for which the payment is made, then disallowance under this section is attracted to the extent the same is excessive or unreasonable. In this case, salary of Rs.10,000 p.m. is paid to the partner's wife, who is working as an anesthetist. The fair market value of a similar service is Rs.7500 p.m. Therefore, disallowance under section 40A(2) is attracted to the extent of Rs.2500 p.m., since to that extent, the same is excessive.

(d) Section 40A(3) provides for 100% disallowance of an expenditure, in respect of which payment is made in a sum exceeding Rs.20,000 otherwise than by way of account payee cheque or account payee bank draft. Therefore, the entire amount of Rs.35,000 incurred for purchase of medicines in cash is disallowed under section 40A(3).

(e) Section 36(1)(ix) provides for deduction in respect of expenditure incurred by companies to promote family planning amongst its employees. However, since the assessee in this case is a partnership firm, such expenses are not allowable as deduction under section 36(1)(ix).

(f) Interest on the overdraft taken for making payment of installment of advance tax is not allowable under section 37(1) since it is not an expenditure wholly and exclusively incurred for the purpose of business as held by the Apex Court in the case of *East India Pharmaceutical Works Ltd. v. CIT (1997) 224 ITR 627.*

Question 5

Raja Ltd., made a provision on 31.3.02 of Rs.85,500 against a bill of supplier of raw material by charging the amount to profit and loss account and claimed deduction thereof while computing the income chargeable to tax for A.Y. 2002-03. The amount of Rs.40,000 not paid to the party till 31.3.06 was paid in cash on 11.6.06. The Assessing Officer issued show cause notice to the company to rectify the computation of income for the A.Y. 2002-03 on account of payment made in cash on 11.6.06.

Can the Assessing Officer do so? *(4 Marks) (Nov 2007)*

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

Section 40A(3A) provides that where an allowance has been made in the assessment for any year in respect of any liability for any expenditure incurred by the assessee and subsequently, during any previous year, the assessee makes any payment in respect of such liability in a sum exceeding Rs.20,000 otherwise than by an account payee cheque drawn on a bank or by an account payee bank draft, the payment so made shall be deemed to be profits and gains of business or profession of the subsequent year.

Section 40A(3A) is attracted in this case since the company has made a cash payment of Rs.40,000 in respect of a liability incurred and allowed earlier. Accordingly, Rs.40000/-, will be added in the computation of income for the A.Y.2010-11 (considering that the payment was made on 11.06.2009).

The action of the Assessing Officer to issue show cause notice to rectify the computation of income of earlier assessment year is not valid. The payment would go to increase the assessable income of the assessee for the previous year relevant to the assessment year in which such payment is made.

Question 6

"Easy Call Ltd.", to provide telecom services in Mumbai, obtained a licence on 11.4.2004 for a period of 10 years ending on 31.3.2014 against a fee of Rs.27 lacs to be paid in 3 installments of Rs.10 lacs, 9 lacs and 8 lacs by April, 2004, April, 2005 and April, 2006 respectively. Explain, how the payment made for licence fee shall be dealt with under the Income-tax Act, 1961 and work out the amount, if any, deductible in this respect out of income chargeable to tax for A.Y. 2007-08 and subsequent years. *(5 Marks) (Nov 2007)*

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10. It may be assumed that the payments were made in April 2007, 2008 and 2009 respectively to determine the amount of deduction allowable for the assessment year 2010-11.

Answer

The payment made for acquiring the licence to operate telecom services in Mumbai shall be subject to deduction as per the scheme in section 35ABB. As per section 35ABB, any amount actually paid for obtaining licence to operate telecommunication services shall be allowed as deduction in equal installments during the number of years for which the license is in force. If the payment is made before the commencement of business, the deduction shall be allowed beginning with the year of commencement of business. In any other case, it will be allowed commencing from the year of payment. Deduction shall be allowed up to the year in which the license shall cease to be in force.

The amount of deduction available for A.Y. 2010-11 is Rs.3 lakh as worked out below:-

(1)	*(2)*	*(3)*	*(4) = (3)/(2)*
Previous year of payment	*Unexpired period of license*	*Installment paid (Rs.)*	*Deduction in respect of each installment (Rs.)*
2007-08	10 years	10,00,000	1,00,000
2008-09	9 years	9,00,000	1,00,000
2009-10	8 years	8,00,000	1,00,000
		27,00,000	3,00,000

The deduction under section 35ABB for assessment year 2010-11 onwards till A.Y. 2017-18 will be Rs.3 lakh each year.

Note – It is assumed that the company has commenced business during the P.Y.2007-08.

Question 7

GP Ltd. was incorporated on 31.12.2005 for manufacture of tyres and tubes for motor vehicles. The manufacturing unit was set up on 30.4.2006. The company commenced its manufacturing operations on 1.5.2006. The total cost of the plant and machinery installed in the unit is Rs.100 crores. The said plant and machinery included second hand plant and machinery bought for Rs.10 crores and new plant and machinery for scientific research relating to the business of the assessee acquired at a cost of Rs.10 crores.

Compute the amount of depreciation allowable under section 32 of the Income-tax Act, 1961 in respect of the assessment year 2007-08. Furnish explanations in support of your computation. *(4 Marks) (May 2007)*

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

Computation of depreciation allowable for the A.Y. 2010-11 in the hands of GP Ltd.

Particulars	**Rs. in crores**	
Total cost of plant and machinery	100.00	
Less: Used for Scientific Research (Note 1)	10.00	
	90.00	
Normal Depreciation at 15% on Rs.90 crores		13.50
Additional Depreciation:		
Cost of plant and machinery	100.00	

Less:	Second hand plant and machinery (Note 2)	10.00		
	Plant and machinery used for scientific research, the whole of the actual cost of which is allowable as deduction under section 35(2)(ia) (Note 2)	10.00	20.00	
			80.00	
Additional Depreciation at 20%				16.00
Depreciation allowable for A.Y.2010-11				**29.50**

Notes:

1. As per section 35(2)(iv), no depreciation shall be allowed in respect of plant and machinery purchased for scientific research relating to assessee's business, since deduction is allowable under section 35 in respect of such capital expenditure.
2. As per section 32(1)(iia), additional depreciation is allowable in the case of any new machinery or plant acquired and installed after 31.3.2005 by an assessee engaged in the business of manufacture or production of any article or thing, at the rate of 20% of the actual cost of such machinery or plant.

   However, additional depreciation shall not be allowed in respect of, inter alia, –

   (i) any machinery or plant which, before its installation by the assessee, was used either within or outside India by any other person;

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

   In view of the above provisions, additional depreciation cannot be claimed in respect of -

   (i) Second hand plant and machinery; and

   (ii) New plant and machinery purchased for scientific research relating to assessee's business in respect of which the whole of the capital expenditure can be claimed as deduction under section 35(1)(iv) read with section 35(2)(ia).

Question 8

S, an individual, carried on the business of purchase and sale of agricultural commodities like paddy, wheat, etc. He borrowed loans from Punjab State Financial Corporation and State Bank of India and has not paid interest as detailed hereunder:

		Rs.
(i)	*Punjab State Financial Corporation (Previous years 2004-05, 2005-06 & 2006-07)*	*36,00,000*
(ii)	*State Bank of India (Previous years 2005-06 & 2006-07)*	*72,00,000*
		1,08,00,000

Both Punjab State Financial Corporation and State Bank of India, while restructuring the loan facilities of S during the year ended 31.3.2007, converted the above interest payable by S to them as loan repayable in 36 equal instalments. During the year ended 31.3.2007, S paid six instalments to Punjab State Financial Corporation and five instalments to State Bank of India. S claimed the entire interest of Rs.1,08,00,000 as an expenditure while computing the income from business of purchase and sale of agricultural commodities. Discuss whether his claim is valid and if not, what is the amount of interest, if any, allowable. (4 Marks) (May 2007)

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

Section 43B allows deduction only on "payment" basis in respect of certain expenditure specified therein, irrespective of the method of accounting followed by the assessee. Such expenditure would be allowed as deduction in the previous year in which the liability to pay such sum was incurred only if the payment is made on or before the due date for filing the return of income under section 139(1). If the payment is made after the stipulated due date, deduction can be claimed only in the year of actual payment. Such specified expenditure include, *inter alia*,

(1) interest on loan or borrowing from any public financial institution or a State financial corporation or a State industrial investment corporation; and

(2) interest on any loan or advances from a scheduled bank.

A clarification has been given by way of insertion of Explanations 3C and 3D in section 43B by the Finance Act, 2006. These *Explanations* clarify that if any sum payable by the assessee as interest on any such loan or borrowing or advance is converted into a loan or borrowing or advance, the interest so converted and not "actually paid" shall not be deemed as actual payment, and hence would not be allowed as deduction. The clarificatory explanations reiterate the rationale that conversion of interest into a loan or borrowing or advance does not amount to actual payment. Therefore, Rs.1,08,00,000, being the aggregate of interest on loan (from a State Financial Corporation and a scheduled bank) converted into loan will not be allowed as deduction. Consequently, the claim of S is not valid.

The manner in which the converted interest will be allowed as deduction has been clarified in Circular No.7/2006 dated 17th July, 2006. The unpaid interest, whenever actually paid to the bank or 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.

Hence, the repayment of Rs.16,00,000 during the A.Y. 2010-11, as detailed hereunder, will be allowed as deduction while computing the business income of S.

Particulars	Rs.
Paid to Punjab State Financial Corporation (36,00,000 x 6/36)	6,00,000
Paid to State Bank of India (72,00,000 x 5/36)	10,00,000
	16,00,000

Question 9

Mr. Q, a non-resident, operates an aircraft between Singapore and Chennai. He received the following amounts in the course of the business of operation of aircraft during the year ending 31.3.2007:

(i) Rs.2 crores in India on account of carriage of passengers from Chennai.

(ii) Rs.1 crore in India on account of carriage of goods from Chennai.

(iii) Rs.3 crores in India on account of carriage of passengers from Singapore.

(iv) Rs.1 crore in Singapore on account of carriage of passengers from Chennai.

The total expenditure incurred by Mr. Q for the purposes of the business during the year ending 31.3.2007 was Rs.6.75 crores.

Compute the income of Mr. Q chargeable to tax in India under the head "Profits and gains of business or profession" for the assessment year 2007-08. *(4 Marks) (May 2007)*

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

Section 44BBA incorporates special provisions for computing profits and gains of the business of operation of aircraft in the case of non-residents. Section 44BBA starts with a non-obstante clause. Therefore, section 44BBA overrides the provisions contained in sections 28 to 43A. As such, the business income of Mr. Q is required to be computed in accordance with the provisions of section 44BBA.

Under section 44BBA(1), a sum equal to 5% of the aggregate of the amounts specified in sub-section (2) is deemed to be the profits and gains chargeable to tax under the head "Profits and gains of business or profession". Sub-section (2) specifies the following amounts -

(a) the amount paid or payable, whether in or out of India, to the assessee or to any person on his behalf on account of the carriage of passengers, livestock, mail or goods from any place in India; and

(b) 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 from any place outside India.

Keeping in view the provisions of section 44BBA, the income of Mr. Q chargeable to tax in India under the head "Profits and gains of business or profession" is worked out hereunder -

	Rs.
Amount received in India on account of carriage of passengers from Chennai	2,00,00,000
Amount received in India on account of carriage of goods from Chennai	1,00,00,000
Amount received in India on account of carriage of passengers from Singapore	3,00,00,000
Amount received in Singapore on account of carriage of passengers from Chennai	1,00,00,000
	7,00,00,000

Income from business under section 44BBA at 5% of Rs.7,00,00,000 is Rs.35,00,000, which is the income of Mr.Q chargeable to tax in India under the head "Profits and gains of business or profession" for the A.Y.2010-11.

Question 10

XYZ Ltd. incurred expenditure amounting to Rs.3,00,000 in connection with the issue of rights shares and Rs.2,00,000 in connection with the issue of bonus shares during the year ending 31.3.2007. The company seeks your opinion in the matter of eligibility for deduction of the expenditure incurred from its business profits for the assessment year 2007-08.

(4 Marks) (May 2007)

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

The Supreme Court has, in *Brooke Bond India Ltd. v. CIT (1997) 225 ITR 798 (SC),* held that expenditure incurred by a company in connection with issue of shares with a view to increase its share capital is directly related to the expansion of its capital base and, therefore, constitutes a capital expenditure. The issue of rights shares results in expansion of the capital base of XYZ Ltd. Hence, expenditure of Rs. 3,00,000 incurred by the company in connection with the issue of rights shares is a capital expenditure and is not allowable as a business expenditure.

On the other hand, the issue of bonus shares does not result in inflow of fresh funds or increase in the capital employed. It is merely capitalization of reserves. The issue of bonus shares does not expand the capital base of the company. The total funds available with the company and its capital structure will remain the same on issue of bonus shares. The Supreme Court, in *CIT v. General Insurance Corporation (2006) 286 ITR 232*, considered this effect of issue of bonus shares and ruled that expenditure incurred in connection with the issue of bonus shares was allowable as a revenue expenditure. In view of the decision of the Supreme Court, XYZ Ltd. will be eligible for deduction of the expenditure amounting to

Rs.2,00,000 incurred in connection with the issue of bonus shares from its business profits for the assessment year 2010-11.

Question 11

What is an adventure in the nature of trade? State the factors which are relevant in deciding whether a transaction is an adventure in the nature of trade. *(7 Marks) (Nov 2006)*

Answer

The term "business" has been defined in section 2(13) of the Income-tax Act, 1961 to include any trade, commerce or manufacture or any adventure or concern in the nature of trade, commerce or manufacture. Adventure in the nature of trade implies that the adventure has the characteristics of trade but not all of them. That indeed is the distinguishing mark of an adventure since if it possessed all the characteristics, it would be a full blown trade straightaway.

The Supreme Court has, in *G. Venkataswami Naidu & Co. v. CIT (1959) 35 ITR 594 and CIT v. H. Holck Larsen (1986) 160 ITR 67,* identified certain factors which are relevant in deciding whether a transaction is an adventure in the nature of trade.

In deciding whether a transaction is an adventure in the nature of trade, several factors are relevant such as, the motive, intention or purpose with which the article sold was bought earlier, the character of articles purchased and sold, that is, whether the articles are fit for sale as merchandise, ordinary occupation of the assessee, that is, whether he is a trader or not, whether the purchase of the commodity and its resale were allied to his usual trade or incidental to it, quantity of the commodity purchased and sold, acts prior to purchase showing a design or purpose, manner of disposal, similarity of transactions to operations usually associated with trade or business, repetition of transactions, period of holding, circumstances that led to the sale, treatment in books of account etc. In each case, it is the total effect of all relevant factors and circumstances that determine the character of the transaction.

Question 12

A Hindu undivided family is carrying on the business of purchase and sale of food grains. The Karta of the family manages the business. Can the Hindu undivided family pay salary to the Karta and claim the payment made as a deduction from the profits of its business? If so, what are the conditions and limitations for such payment? *(4 Marks) (Nov 2006)*

Answer

The Supreme Court has, in *Jugal Kishore Baldeo Sahai v. CIT (1967) 63 ITR 238,* held that if remuneration is paid to the karta of a Hindu undivided family (HUF) under –

(i) a valid agreement which is bona fide and

(ii) is in the interest of, and expedient for, the business of the family and

(iii) the payment is genuine and not excessive,

such remuneration would be an expenditure laid out wholly and exclusively for the purpose of business of the family and would be allowable as a deduction while computing the income of the HUF. The test which should be applied for judging, what is a valid agreement is, whether the agreement for payment of salary to the karta was by or on behalf of all the members of the family and whether it was in the interests of the business of the family so that it could be justified on the grounds of commercial expediency. Thus, the HUF can pay salary to the karta for services rendered by him to the business of the family under a vaild agreement, which may be expressed or implied. Such payment will be eligible for deduction from the business profits of the HUF, if it is not excessive and is not unreasonable.

Question 13

X Ltd., is a company engaged in the business of growing, manufacturing and selling of tea.

For the accounting year ended 31st March, 2005, its composite business profits, before an adjustment under section 33AB of the Income-tax Act, were Rs.60 lakhs. In the year, it deposited Rs.25 lakhs with NABARD.

The company has a business loss of Rs.10 lakhs brought forward from the previous year.

The company withdrew in February, 2005 Rs.20 lakhs from the deposit account to buy a non-depreciable asset for Rs.18 lakhs and could not use the balance before the end of the accounting year. The withdrawal and the purchase were under a scheme approved by the Tea Board.

The non-depreciable asset was sold in November, 2005 for Rs.29 lakhs.

Indicate clearly the tax consequences of the above transactions and the total income for the relevant years. *(5 Marks) (Nov.2005)*

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

Computation of total income of X Ltd. for A.Y.2010-11

Particulars		**Rs.**
(i)	**Composite profits before allowing deduction under section 33AB**	60,00,000
	Less: Deduction u/s 33AB	
	[Lower of 40% of Rs.60 lakhs (i.e. Rs.24 lakhs) or the actual amount deposited with NABARD (i.e. Rs.25 lakhs)]	24,00,000
		36,00,000
	As per Rule 8 of Income-tax Rules, 40% of this sum is subject to income-tax and the balance 60% is treated as agricultural income.	
	Hence, the business income is 40% of Rs.36 lakhs	14,40,000
	Add: Non-utilisation of amount withdrawn:	
	[i.e.(Rs.20 lakhs – Rs.18 lakhs)] x 40% (See Note 1)	80,000

Business income	15,20,000
Less: Business loss brought forward from the previous year	10,00,000
Total income	**5,20,000**

(ii) Computation of total income of X Ltd. for A.Y.2011-12

Particulars	*Rs.*
Business income (See Note 3)	7,20,000
Capital gains (Short-term) (See Note 2)	11,00,000
Total Income	**18,20,000**

Note 1

As per section 33AB amount withdrawn from deposit account maintained under this section if not utilized either wholly or in part, within that previous year, the whole of such amount which is not so utilized shall be deemed to be profits and gains of business and accordingly chargeable to income-tax as the income of that previous year [Section 33AB(7)].

Note 2 - Computation of capital gains

Particulars	*Rs.*
Sale proceeds	29,00,000
Less: Cost of acquisition	18,00,000
Short term capital gains (since the period of holding is less than 36 months)	**11,00,000**

Note 3 - Computation of business income

Since the asset is sold within 8 years, the cost of the asset i.e. Rs. 18 lakhs should be treated as income since the same has been allowed as deduction in the assessment year 2010-11.

However, out of this Rs.18 lakhs, 60% would be agricultural income and the balance 40% i.e. Rs.7.2 lakhs would be business income of P.Y.2010-11. This is because deduction under section 33AB was allowed in P.Y.2009-10 before disintegration of income into agricultural income and non-agricultural income.

Where any asset is sold or transferred within 8 years from the end of the year in which it was acquired, such part of the cost as is relatable to the deduction allowed under section 33AB(1) shall be deemed to be the profits and gains of business or profession of the previous year in which the asset is sold or otherwise transferred [section 33AB(8)]. In the problem the part of the cost of the asset as is relatable to the deduction allowed is not given. Therefore, the entire cost is assumed as deduction allowed at the time of deposit. Accordingly, 40% of cost of the asset is taxed as business income.

Question 14

In the course of an assessment proceeding, the Assessing Officer enhanced the value of the closing stock and added the difference to the total income.

In the assessment year subsequent to this, the assessee wants the Assessing Officer to enhance, by the same amount, the value of the opening stock of that year.

Discuss the validity of the claim. *(5 Marks) (Nov.2005)*

Answer

The Supreme Court, in *Mahendra Mills Ltd.v PB Desai, AAC [1975] 99 ITR 135,* has held that since the closing stock of one assessment year furnishes the figure of the opening stock for the succeeding year, therefore, to the extent of ascertaining the closing stock and opening stock positions, the assessments for the two years telescope into each other. The record showing the closing stock of one assessment year formed a part of the evidence relevant to the assessment for the next assessment year. Therefore, the value of the closing stock of the preceding year must be the value of the opening stock of the succeeding year. Hence, if the value of closing stock at the end of a year is enhanced, the enhanced value should be taken as the value of the opening stock of the next year for the purpose of income tax.

The claim of the assessee in this case is, therefore, valid.

Question 15

State whether the provisions of section 41(1) of the Act can be applied to a case, where refund of excise duty has been obtained by the assessee on the basis of a decision of the CEGAT and where the matter has been taken up in further appeal to the Court by the Central Excise Department. *(4 Marks) (Nov.2005)*

Answer

This question has been answered by the Apex Court in *Polyflex (India) Pvt. Ltd. v. CIT [2002] 257 ITR 343.* The Apex court observed that in a case where a statutory levy in respect of goods dealt with by the assessee is discharged and subsequently the amount paid is refunded, it is the first part of section 41(1)(a) that more appropriately applies i.e. it will be a case where the assessee "has obtained any amount in respect of such expenditure". It will not be a case of "benefit by way of remission or cessation" of a trading liability. Where an expenditure is actually incurred by reason of payment of duty on goods and a deduction or allowance is given in the assessment of an earlier period, the assessee is liable to discharge that benefit as and when he obtains refund of the amount so paid. The possibility of the refund being set at naught on a future date will not be a relevant consideration. Once the assessee gets back the amount which was claimed and allowed as business expenditure during an earlier year, the deeming provision in section 41(1) comes into play and it is not necessary that the Revenue should await the verdict of a higher court. If the higher court upholds the levy at a later date, the assessee is not without remedy to get back the relief.

Therefore, the refund of excise duty pursuant to the decision of the CEGAT would be subject to tax by virtue of section 41(1) and it is not necessary that the Revenue should await the verdict of a higher court.

Question 16

The profit and loss account of East West Bank Ltd. operating in India for the financial year 2004-05 contains, interalia, the following particulars:

	(Rupees in crores)
Profit before taxation	*100*
Depreciation as per books	*25*
Depreciation admissible as per income tax rules	*40*
Corporation tax disputed by the bank and not paid	*10*
Bad debts written off	*45*
Provision for non-performing assets as per prudential norms of Reserve Bank of India	*250*
Provision for standard assets at 2% of such advance as per the above norms	*5*
Net depreciation on investments under "held-for-trading" and "available-for-sale" categories calculated on lower of cost price or market price basis as per guidelines of Reserve Bank of India.	*30*

Other Information:

(a) In assessment year 2003-04 provision for doubtful debts allowed in assessment amounted to Rs.35 crores only

(b) The assessment for assessment year 2004-05 resulted in a loss and unabsorbed depreciation amounting to Rs.30 crores and Rs.40 crores respectively and the bank was not allowed deduction on account of provision for doubtful debts

(c) Unrealised interest income not recognized in the accounts in financial year 2004-05 in respect of non-performing assets as per asset classification norms of RBI amounts to Rs. 65 crores.

(d) The aggregate average rural advances calculated as per section 36(1)(viia) read with rule 6ABA amounts to Rs.30 crores.

From the above information compute total income of the bank for the A.Y. 2005-06.

(10 Marks) (May 2005)

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

Computation of total income of East West Bank Limited for the A.Y. 2010-11

Particulars	Rs. in crores	
Profits & gains of business		
Net profit as per profit & loss account		100.00
Add: Depreciation as per books	25.00	
Disputed corporation tax disallowed as it is not paid - section 43B	10.00	
Bad debts [See Note 3 below]	45.00	
Provision for doubtful debts considered separately	255.00	335.00
		435.00
Less: Depreciation as per Income-tax Rules		40.00
		395.00
Less: Brought forward business loss	30.00	
Unabsorbed depreciation	40.00	70.00
Total income before Chapter VI-A deduction and deduction U/s.36(1)(viia)		325.00
Less: Provision for doubtful debts u/s 36(1)(viia)		
7.5% of total income before allowing deduction under Chapter VI-A (7.5% of Rs.325 crores)	24.38	
10% of aggregate average advances by rural branches (10% of Rs.30 crores)	3.00	27.38
Gross total income		**297.62**
Less: Deduction under Chapter VI-A		Nil
Total Income		**297.62**

Note:

1. Investments held under "held-for-trading" and "available-for-sale" categories are to be considered as stock in trade of bank even though they are shown under the head "investments" in the balance sheet under the Banking Regulations Act *[Refer United Commercial Bank Ltd. vs CIT (1999) 106 Taxman 601 (SC)]*. Hence, loss due to diminution in value of investments is allowed as deduction. As the effect has already been given in the accounts, no further adjustment is required.
2. Interest on bad or doubtful categories of debts as per Reserve Bank's guidelines is to be taxed in the previous year in which it is credited by the bank to its profit & loss account or the year in which it is actually received by the bank, whichever is earlier, as per the provisions of section 43D. Therefore, unrealised interest on non-performing assets amounting to Rs.65 crores is not taxable.

3. Section 36(1)(vii) provides that that where the actual amount of bad debts exceeds the credit balance in the provision for bad and doubtful debts, such excess bad debts written off can be claimed as deduction.

   The credit balance in the provision for doubtful debts includes both the opening balance and the credit during the year adding up to Rs.67.63 crores (i.e. 35 crores + 250 crores), whereas the bad debts written off during the year is only Rs.45 crores. Therefore, the bad debts written off during the year is not in excess of the credit balance in the provision for doubtful debts account. Hence, no deduction is allowable under section 36(1)(vii) in respect of bad debts written off during the year **(See Provision for doubtful debts account below given for better understanding of the students)**.

Provision for doubtful debts A/c (For A.Y.2010-11)

	Rs. in crores		**Rs. in crores**
To Debtors (bad debts written off)	45.00	By balance b/f (Opening balance)	35.00
To balance c/f (Closing balance)	245.00	By Profit and Loss A/c (Provision made during the year for advances)	255.00
	290.00		**290.00**

Question 17

A company engaged in the manufacturing of pharmaceutical products, commenced its business on 1.4.2003. During the financial years 2000-01 to 2002-03 it had incurred Rs.2.00 lacs annually as expenditure on salaries and purchase of raw materials for the purpose of research connected with its business. During the previous year 2003-04, it incurred on scientific research, revenue expenditure of Rs.2.00 lacs and a capital expenditure of Rs.3.50 lacs on purchase of plant and machinery. Since the result of the research was unsuccessful, the company sold it its plant and machinery on 31.12.2003 for Rs.8.00 lacs and closed its research activity. Compute the admissible deduction under Section 35 for the assessment year 2004-05. (4 Marks) (Nov.2004)

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10 i.e. the expenditure was incurred during financial year 2006-07 to 2008-09 and the plant and machinery was sold on 31.12.2009.

Answer

The company is eligible for deduction u/s.35 in respect of current year expenditure on scientific research and in-house research and development related to its business. Applying the provisions of section 35, the admissible deduction for A.Y.2010-11 is computed as under –

Particulars	*Rs. in lacs*
Expenditure incurred during the earlier three years on salaries and purchase of raw materials for the purpose of research connected with the business – fully allowed in the year of commencement of business by virtue of *Explanation* to section 35(1)(i) – [Rs.2 lacs × 3]	6.00
Revenue expenditure on scientific research incurred during the previous year	2.00
Capital expenditure on scientific research incurred during the previous year	3.50
Admissible deduction u/s 35 for the A.Y.2010-11	**11.50**

The plant and machinery used for scientific research when sold for Rs.8 lakhs the tax consequences are as follows:

(a) sale proceeds equal to the amount of deduction allowed is taxable under section 41(3). In this case, the deduction allowed is Rs.3.50 lakhs, hence it is taxable as deemed business income.

(b) The excess of sale consideration over the cost of the asset is taxable under the head "capital gains" and the amount chargeable to tax in this case would be Rs.4.50 lakhs.

Question 18

A company engaged in textile manufacturing, debited to its Profit & Loss Account a sum of Rs.60,000, being the interest on loan of Rs.6,00,000 taken for financing its expansion scheme. The plant and machinery purchased for the project with the loan were not received during the year and those were still in transit at the end of the year. A sum of Rs.6,000 was paid to a broker who arranged the loan. Discuss the admissibility or otherwise of the interest on borrowing. *(4 Marks) (Nov.2004)*

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

Interest paid in respect of capital borrowed for the purposes of business or profession is admissible u/s 36(1)(iii). However, the proviso to section 36(1)(iii) says that interest paid in respect of capital borrowed for acquiring an asset 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 will not be allowed as deduction.

In this case, the asset (plant & machinery) was not put to use till the end of the previous year. Therefore, interest of Rs.60,000 will not be allowed as a deduction. However, the cost of the asset shall be increased by the amount of interest and depreciation shall be admissible on the enhanced cost of Rs.6,60,000 once the asset is put to use.

As regards the brokerage of Rs.6,000 paid to a broker for arranging the loan there are two possible views –

The first view is that since the definition of the term "interest" u/s 2(28A) includes service fee or other charges in respect of moneys borrowed, "brokerage" can be considered to fall under the scope of the term "other charges" and is therefore covered by the definition "interest". Hence, brokerage of Rs.6,000 for arranging the loan will be treated in the same way as interest and capitalized with the cost of the asset.

The alternate view is based on the High Court decision in C.Moolchand v. CIT (1956) 29 ITR 449 (Hyd.), where it was held that brokerage or commission paid to an agent for arranging a loan for the purpose of business is not allowable as deduction u/s 36(1)(iii), but allowable under section 37(1). As per this view, Rs.6,000 paid to broker for arranging the loan is allowable under section 37(1).

Question 19

A partnership firm, consisting of three partners A, B and C was engaged in the business of Civil Construction and received the following amounts by way of contract receipts:

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

Each partner of the firm was entitled to draw Rs.2,500 by way of salary as authorized by the terms of the partnership deed. Interest of Rs.1,00,000 was also paid to partner C on the capital of Rs.5,00,000 contributed by him. The profit as per books of accounts, before deduction of salary to partners and interest to partner C amounted to Rs.2,50,000. Compute the total income of the firm, applying the provisions of section 44AD. (5 Marks) (May 2004)

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

As per section 44AD, in the case of an assessee, carrying on the business of civil construction, whose gross receipts from such business does not exceed Rs.40 lakhs, a sum equal to 8% of the gross receipts paid or payable to the assessee or such higher sum as declared by the assessee in his return of income shall be deemed to be the income from such business.

For the purpose of section 44AD, "Gross receipts" will not include the value of material supplied by Government. Therefore, in this case, the gross receipts would be only Rs.30,00,000.

8% of the gross receipts of Rs.30 lakhs will be Rs.2,40,000. The profit as per books of accounts, before deduction of salary and interest to partners, is Rs.2,50,000. Since profit as per books of account is Rs.2,50,000, which is higher than 8% of the gross receipt, it will be adopted and on this working partner salary and interest to partners as per section 40(b) would be allowed.

Computation of allowable deduction in respect of salary and interest paid to partners –

The allowance of salary and interest paid to partners is subject to the conditions and limits specified in section 40(b). The allowable salary and interest has been worked out below –

Salary to partners – Rs.30,000 × 3 =	90,000
This is within the ceiling limit provided in section 40(b)(v)	
First Rs.2,50,000 @ 90% 2,25,000	
Interest to partner C limited to 12% of Rs.5,00,000	60,000
Total deduction allowable in respect of salary and interest	1,50,000

Income of the firm as per books (before allowing deduction in respect of salary and interest to partners)	2,50,000
Less: Salary and interest allowable as deduction	1,50,000
Total income of the firm	**1,00,000**

Question 20

A company had an inventory of closing stock on 31.3.02, the cost of manufacture of which was Rs.10 lakhs. Since the goods were liable to excise duty, provision of Rs.10 lakhs towards the duty was also made in the accounts. Since the excise duty was eligible for deduction only on actual payment, the company valued the closing stock at cost viz. Rs.10 lakhs. Discuss the position from the taxation point of view. *(4 Marks) (May 2004)*

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

Under section 145A, the valuation of inventory has to be carried out by including the amount of duty actually paid or incurred by the assessee to bring the goods to the place of its location and condition on the date of valuation. Therefore, excise duty should be included in the valuation of closing stock and the deduction of such excise duty shall be available as per the provisions of section 43B.

Question 21

The WDV of Plant and Machinery on 01-04-02 of X Ltd. engaged in manufacturing of PVC granules is Rs.1,000 lakhs. Company purchased additional plant and machinery for Rs.800 lakhs on 18-04-02 inclusive of a second-hand machine imported from China of Rs.200 lakhs to increase its installed capacity of production from 1000 TPA to 1500 TPA. The production from new machine was taken w.e.f. 1-12-02. Workout, by giving reasons, the amount of allowable depreciation. *(5 Marks) (Nov.2003)*

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

Provisions of section 32(1)(iia) specify that the assessee engaged in the business of manufacture or production of any article or thing is entitled for an additional depreciation @ 20% of the actual cost of such plant & machinery acquired and installed after 31.3.05. It has been further stated in the said proviso that the additional depreciation shall not be available in respect of those plant & machinery which, before its installation by the assessee, were used either within India or outside India by any other person.

The depreciation allowable will be as under:-

	Particulars	*Amount of Depreciation Rs. in lakhs*
-	Depreciation on WDV of machinery as on 1st April Rs.1000 lakhs @ 15%	150
-	Depreciation on Plant & Machinery purchased on 18th April but actual production commenced w.e.f. 1st December. Depreciation will be restricted to 50% of the normal depreciation i.e. 50% of (800 x 15%)	60
-	Additional depreciation @ 20% of the actual cost of new Plant & Machinery (which increased the installed capacity from 1000 TPA to 1500 TPA*). This depreciation is also to be restricted to 50% since production has commenced only on 1st December. 50% of (20% of Rs.600 lakhs)	60
	Total Depreciation	**270**

*****Increase in capacity is not a condition or relevant factor for the purpose of getting additional / accelerated depreciation from the assessment year 2005-06 onwards.

Question 22

Alpha Ltd., a manufacturing company, which maintains accounts under mercantile system, has disclosed a net profit of Rs.12.50 lakhs for the year ending 31st March, 2003. You are required to compute the taxable income of the company for the Assessment year 2003-04, after considering the following information, duly explaining the reasons for each item of adjustment:

(i) Advertisement expenditure includes the sum of Rs.60,000 paid in cash to the sister concern of a director, the market value of which is Rs.52,000.

(ii) Legal charges include a sum of Rs.45,000 paid to consultant for framing a scheme of amalgamation duly approved by the Central Government.

(iii) Repairs of plant and machinery includes Rs.1.80 lakhs towards replacement of worn out parts of machineries.

(iv) A sum of Rs.6,000 on account of liability foregone by a creditor has been taken to general reserve. The same was charged to the Revenue Account in the Assessment Year 1998-99.

(v) Sale proceeds of import entitlements amounting to Rs.1 lakh has been credited to Profit & Loss Account, which the company claims as capital receipt not chargeable to income-tax.

(vi) Being also engaged in the biotechnology business, the company incurred the following expenditure on in-house research and development as approved by the prescribed authority:

(a) Research equipments purchased Rs.1,50,000.

(b) Remuneration paid to scientists Rs.50,000.

The total amount of Rs.2,00,000 is debited to the Profit & Loss account.

(12 Marks) (Nov.2003)

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

Computation of taxable income of Alpha Ltd. for the A.Y. 2010-11

	Particulars	*Rs.*
	Net profit as per Profit & Loss account	12,50,000
	Add: (a) Items debited to profit and loss A/c but not deductible	
1.	**Payment of advertisement expenditure of Rs.60,000**	
	(i) Rs.8,000, being the excess payment to a relative disallowed under section 40A(2)	(+) 8,000

	(ii) As the payment is made in cash and since the remaining amount of Rs.52,000 exceeds Rs.20,000, 100% shall be disallowed under section 40A(3)	(+) 52,000
2.	Legal charges for framing amalgamation scheme (deductible under section 35DD in five years). 1/5th of Rs.45,000 i.e. Rs.9,000 to be allowed in the current year. Balance Rs.36,000 (Rs.45,000 - Rs.9,000) is to be added back. **(See Note below)**	(+) 36,000
3	Under section 31, expenditure relatable to current repairs regarding plant, machinery or furniture is allowed as deduction. The test to determine whether replacement of parts of machinery amounts to repair or renewal is whether the replacement is one which is in substance replacement of defective parts or replacement of the entire machinery or substantial part of the entire machinery - *CIT v. Darbhanga Sugar Co. Ltd. [1956] 29 ITR 21 (Pat).* Here expenditure on repairs does not bring in any new asset into existence. Such replacement can only be considered as current repairs. Hence no adjustment	
	Add: Items chargeable as business income but not credited to profit and loss A/c	
4.	Liability foregone by creditor [taxable under section 41(1)]	(+) 6,000
5.	Sale proceeds of import entitlements. The sale of the rights gives rise to profits or gains taxable under section 28(iiia). As the amount has already been credited to Profit and Loss Account, no further adjustment is necessary.	
	Less: Amount not debited to profit and loss account but allowable as deduction	
6.	Expenditure on in-house research and development is entitled to a weighted deduction of 150% of the expenditure (both capital and revenue) so incurred under section 35(2AB)(1) = 1.5 x 2 lakhs = 3 lakhs Expenditure Rs.2,00,000 already debited to Profit & Loss Account	
	Additional deduction of Rs.1 lakh is further allowed	(-) 1,00,000
	Taxable Income	**12,52,000**

Note: As per the provisions of section 35DD, any expenditure incurred wholly and exclusively for the purpose of amalgamation, would be allowed as a deduction in 5 successive years (1/5th each year) commencing from the year in which the amalgamation takes place. The problem has been worked out on the assumption that the amalgamation has taken place during the previous year itself.

Question 23

By virtue of an agreement entered into on 1.9.2002 between X Ltd. and Y Ltd., X Ltd. agrees not to carry on any business relating to computer software in India for the next 3 years, for which Y Ltd. agrees to pay a sum of Rs.12,00,000 to X Ltd. The said amount was paid on 1st December, 2002. Indicate treatment of such receipt in the hands of X Ltd. for the assessment year 2003-04 ? (4 Marks) (May 2003)

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

As per section 28(va) the following sums received or receivable, in cash or kind under an agreement shall be taxable as income from business: (a) any sum for not carrying out any activity in relation to any business; or (b) any sum for 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.

The instant case clearly falls within the ambit of section 28(va)(a). As such, the receipt of Rs.12,00,000 is chargeable to tax as business income in the hands of X Ltd

Question 24

The balance sheet of 'X' Ltd. a shipping company shows the following details as at 31.3.2002 :

-	*Balance in reserve created u/s 33AC of I.T. Act*	*Rs.1,000 lakhs*
-	*Paid up capital*	*Rs.500 lakhs*
-	*Balance in general reserve*	*Rs.100 lakhs*
-	*Share premium account*	*Rs.50 lakhs*
-	*W.D.V. of ships*	*Rs.3,000 lakhs*

Net profit for the year ended on 31.03.03 is Rs.400 lakhs. Following information is further collected from records:

(a) *Amount of Rs.60 lakhs being the deficit of W.D.V. of a ship retired from the business and sold on 13.6.02 for Rs.150 lakhs, was charged in P & L account.*

(b) *Payments charged in miscellaneous expenses include an amount of Rs.10 lakhs paid to a don who abducted one of its ships while it was in red sea.*

(c) *Depreciation for the year, Rs.800 lakhs was charged on straight line method basis.*

(d) *A ship added in its fleet during the year costed Rs. 920 lakhs sailed for her first journey from JNPT on 10.10.2002.*

(e) *A ship was added in 1999-2000 with the financial assistance of a foreign bank. The last instalment of loan of US $ 50,000 was paid on 18.9.2002. The value of one US $ at the time when loan was taken was Rs.44 but at the time of repayment it was Rs.48. The exchange difference was charged in miscellaneous expenses in profit and loss account.*

Compute the taxable income of X Ltd. for A.Y. 2003-04, with reasons for adjustments made.

(12 Marks) (May 2003)

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

Chapter XII-G of the Income-tax Act containing sections 115V to 115VZC was inserted by the Finance (No.2) Act, 2004 applicable from the assessment year 2005-06. It is an optional scheme for companies engaged in the business of operating qualifying ships. The presumptive income determination under this chapter is optional and one of the vital information for computation of income required is "net tonnage capacity" of the ships. Since that information is not available in the question given, the solution is prepared without taking into account the chapter XII-G.

Third proviso to section 33AC(1) says that no deduction would be allowed in respect of the profits earned by the assessees engaged in shipping business from the assessment year 2005-06 onwards.

Taking note of the above changes in law the solution is prepared hereunder:

The computation of the income of 'X Ltd' for the A.Y. 2010-11

Particulars	*Rs. In lakhs*
Net profit as per profit & loss account	400.00
Add: Items charged in profit & loss account to be considered separately or to be added as disallowable	
Loss on sale of ship to be adjusted against the WDV of the block of ships u/s 32	60.00
Payment to a don for release of ship abducted not allowable u/s 37(1) being payment for illegal activity [Explanation to the section 37(1)]	10.00
Depreciation on SLM basis	800.00
Difference in the value of loan taken in foreign currency for purchase of capital asset viz. ship ; wrongly charged as expense	2.00
	1272.00
Less: Admissible depreciation u/s 32 of the Act on the Block (As per Note - 1)	662.40
Taxable income	609.60

Note 1: Calculation of Depreciation

The admissible amount of depreciation will be as under:-

Particulars	*Rs. in lakhs*
WDV of the ships at the beginning of the year	3000
Less: Sale value of ship retired from business	150
	2850
Add: Difference in the exchange rate of the foreign currency loan repaid during the year to be capitalized u/s 43A	2
	2852
Add: Value of new ship added during the year (used for less than 180 days)	920
WDV of the ships at the end of the previous year	3772
Depreciation @ 20% on Rs.2852 lakhs	570.40
Depreciation @ 20% on Rs.920 lakhs restricted to 50% since the ship was put to use for less than 180 days during the previous year	92.00
Total depreciation for the year	**662.40**

Note 2: Disallowance of expenditure for any purpose which is an offence

According to Explanation to section 37(1), any expenditure incurred by an assessee for any purpose which is an offence or which is prohibited by law shall not be deemed to have been incurred for the purpose of business. Thus, the payment made to the don is disallowed.

Question 25

You are engaged to carry out the tax audit of a firm under section 44 AB and in carrying out this assignment, you are required to tackle the following issues. Indicate how you will deal with them.

(i) Duty of the auditor to report on a penalty or fine imposed on the firm.

(ii) Expenditure incurred in respect of which payment has been made in a sum exceeding Rs.20,000, otherwise than by a crossed cheque or crossed bank draft.

(iii) Sum payable as an employer by way of contribution to a provident fund.

(iv) Particulars of loans or deposits exceeding the limit specified in section 269 SS taken during the year.

(v) Accounting ratios in a trading concern. *(3 X 5 = 15 Marks) (Nov.2001)*

Answer

(i) In Form No.3CD the tax auditor has to specify the penalty or fine for violation of law and any other penalty or fine as well as expenditure incurred for any purpose which is an offence or which is prohibited by law.

The tax auditor should obtain in writing the details of all payments by way of penalty or fine for violation of law or otherwise and how such amount has been dealt with in the books of account. The tax auditor is not required to express any opinion as to the allowability or otherwise of the amount. He is only to give details of such items as have been charged in the profit and loss account.

(ii) The tax auditor should obtain a list of all cash payments in respect of expenditure exceeding Rs.20,000 made during the year. Which should also include the list of payments exempt as per Rule 6DD. The list should be verified with the books of account to ascertain whether the conditions are satisfied. Expenditure items in respect of which specific exemption has been granted are not required to be stated. Where there are practical difficulties in verifying whether payments have actually been made through account payee crossed cheques or account payee crossed bank drafts, suitable qualification should be made as under "It is not possible to verify whether the payment in excess of Rs.20,000 has been made otherwise than by account payee crossed cheques or account payee crossed bank drafts as necessary evidence is not in possession of the assessee". Also, a certificate from the assessee must be obtained as regards whether all payments covered by section 40A(3) read with rule 6DD have been complied with or not by issuing account payee crossed cheques or bank draft. The receipt of certificate must be stated in the Form No.3CD in clause 17(h).

(iii) In respect of P.F.contributions, detailed information is to be furnished with regard to amount received during the previous year, due date for payment, amount paid during the previous year, liability incurred during the previous year and discharge of such liability.

In view of the voluminous nature of the information the tax auditor can apply test checks and compliance tests to obtain satisfaction in this regard. In the case of big assessees, where the information to be stated is voluminous, the tax auditor may exercise his professional judgment and state only those cases where the actual date of payment is beyond the due date of payment. Students may note that employees contribution to provident fund recovered out of salary is chargeable to tax as income (section 2(24)(x)) and the payment within the 'due date' is eligible for deduction under section 36(1)(va). The 'due date' for this purpose is the date by which the employer is required to credit the employees contribution as per the relevant Act.

In respect of employer's own contribution which is eligible for deduction under section 43B, the 'due date' for such payment is available upto the date prescribed for filing the return in section 139(1).

(iv) The particulars to be given in the case of loan or deposit accepted during the previous year exceeding the limit specified in section 269 SS:

(a) Name and address and P.A.No (if available) of the lender or depositor.

(b) Amount of loans or deposit taken or accepted.

(c) Whether the loan was squared up during the previous year.

(d) Maximum amount outstanding in the account at any point during the previous year.

(e) Whether the loan or deposit was taken or accepted otherwise than by an account payee cheque or bank draft.

The tax auditor should verify all loans or deposits where the balance has reached Rs.20,000 or more during the previous year, because the total of the deposits of Rs.20,000 and above are covered even though each individual item may be less than Rs.20,000. There are practical difficulties in verifying whether the loan or deposit is taken by crossed cheque or crossed draft. He should obtain a certificate from the assessee and accordingly report in clause 24 of Form 3CD.

(vi) The accounting ratios to be given in the case of a trading concern are

Gross profit to turnover

Net profit to turnover

Stock in trade to turnover

Material consumed to finished products produced.

While calculating these ratios, the tax auditor should assign meanings to the above terms as understood by generally accepted accounting principles.

Question 26

An assessee incurs expenditure of a capital nature on scientific research related to the business carried on by him. Such expenditure, which is allowable under section 35 remains unabsorbed in the business in which it was incurred. How will the unabsorbed portion be dealt with? (4 Marks) (Nov.2001)

Answer

As per section 35(4) read with section 32(2), the unabsorbed portion shall be set off against the profits and gains, if any, of any other business or profession carried on by the assessee in the same assessment year.

If the unabsorbed capital expenditure on scientific research cannot be wholly set off under the clause above, the amount not so set off shall be set off from the income under any other head in the same assessment year. If it is still unabsorbed, it shall be carried forward to the following assessment year and set off against income under the head "profits and gains from business or profession" regardless of the continuance or discontinuance of business to which it relates.

However, such unabsorbed capital expenditure on scientific research can be carried forward only for a maximum of 8 assessment years immediately succeeding the assessment year in which such capital expenditure was incurred.

Question 27

(i) *A corporation was set up by the State Government transferring all the buses owned by it for a consideration of Rs.75 lakhs, which was discharged by the Corporation by issue of equity shares. The Corporation in its assessment claimed depreciation. Can the depreciation be denied in the Corporations hands on the ground that there was no registration of the buses in favour of the Corporation?* *(3 Marks) (May 2001)*

(ii) *Ravi succeeded to his father's business in the year 1998. In the previous year ending 31.3.2001, Ravi has written off the balance in the name of 'Y' which relates to supply made by his father, when he carried on business. Ravi desires to know whether the write off could be eligible for deduction.* *(3 Marks) (May 2001)*

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

(i) The decision of the Supreme Court in *Mysore Minerals Ltd v. CIT (1999), 239 ITR 775* is relevant in the context of the facts stated. The term "asset used" in section 32 must be assigned a wider meaning and anyone in possession of property in his own title, exercising dominion over the property, to the exclusion of others and having the right to use and enjoy it, must be taken to be the owner.

Registration of the buses is only a formality to perfect the title and does not bar enjoyment. The Corporation cannot therefore be denied depreciation on the buses. A similar decision was also taken in *CIT v. J & K Tourism Development Corporation 114 Taxman 734 (J&K).*

(ii) The deduction of bad debt is allowed if it is written off in the books of account of the assessee. In this case Ravi has succeeded to the business carried on by his father. Under clause (vii) of section 36(1) the amount has been written off in the books of account as irrecoverable is eligible for deduction provided the debt has been taken into account in computing the income of the business in an earlier previous year [vide section 36(2)]. Therefore Ravi is eligible for deduction in respect of the amount due in the name of Y which is written off in the books of account as bad debt, even though the debt represents the amount due for the supplies made by previous owner viz. deceased father of Ravi. [*CIT v. T.Veerabhadra Rao K.Koteswara Rao and Co (1985) 155 ITR 152 (SC)]*.

Question 28

A is an association governed by the provisions of Section 44A of the Income-tax Act. The subscription receipts for the year ended 31st March, 2001 were Rs.60,000. The expenditure in the normal course of its activities was Rs.85,000. Its other income taxable under the Act works out to Rs.75,000. On these facts, you are consulted as to.

(i) How A's taxable income will be determined for assessment year 2001-2002.

(ii) In case the association did not have the other income taxable will there be any difference in the computation of its income? Please advise (5 Marks) (May 2001)

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10. Further, subscription receipts have been taken as Rs.3,60,000, expenditure in the course of normal activities as Rs.3,85,000 and other taxable income (worked out) as Rs.1,75,000.

Answer

(i) Under section 44A, the income from subscriptions shall be set off against expenditure incurred solely for the protection or advancement of the interest of its members and if there is a deficiency it shall be first be set off against the association's income under the head "Profits and gains of Business or Profession" and if there is still a deficiency it shall be set off against income under any other head. This section supersedes the other provisions of the Act.

	Rs.
Income from subscription	3,60,000
Less: Expenses incurred in the course of its activities	3,85,000
Balance deficiency	(-)25,000
Less: Other income	1,75,000
Taxable income	1,50,000

There is a ceiling on the deduction admissible by way of deficiency being that it shall not exceed one-half of the income of the association. This ceiling has not been exceeded above (vide section 44A(3)).

(ii) If the association has no other taxable income, the computation would be as under:

		Rs.
Income from subscription		3,60,000
Less: Expenses	3,85,000	
But restricted to 50 % of the income		1,80,000
Total income		1,80,000

Question 29

A public limited company engaged in the generation and distribution of power had its business acquired by the Government in June, 1999. Certain items of plant and machinery used by the company in its business were taken over by the Government at a price which resulted in the company realizing a surplus of Rs.26,60,000 over its written down value. The compensation *was received by the company in April, 2000 which was accepted by it under protest. The company proceeded to initiate arbitration proceedings under law and was granted an additional compensation of Rs.16 lakhs. This was decided by the arbitrators in December, 2000 and received by the company in March, 2001. The company claims that the assessment of the company to tax should not be made since the business was completely taken over by the Government in June, 1999 and at the time of final determination of compensation in March,2001, the company did not exist.*

Do you agree to the company's claim?. Discuss with reference to the assessment year(s) to which the claim to tax, if any, can be related. (6 Marks) (May 2001)

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

The provisions of section 41(2) are clearly attracted in this case as the company is a power generation and distribution company. Where any building, machinery, plant or furniture owned by an assessee in respect of which depreciation has been claimed under section 32(1)(i) and which was used for the purpose of business is sold and the money payable in respect of such plant and machinery exceeds the written down value, so much of the excess as does not exceed the difference between the actual cost and written down value shall be chargeable to tax as income of the previous year in which the moneys payable become due.

The Explanation to this section also provides that, where the moneys payable become due in a previous year in which the business is no longer in existence, the provisions will continue to apply as if the business is in existence. This provision was inserted w.e.f. 1.4.1998 and applies to assessees engaged in the business of generation and distribution of power.

Applying these provisions to the question, the excess of Rs.26,60,000/- over its written down value (assuming such excess does not exceed the original cost of acquisition of the asset) is taxable as business income. The additional compensation of Rs.16 lakhs which became due is taxable as income of the previous in which it is received.

The company's claim is not tenable as the Explanation to section 41(2) clearly lays down that the business is deemed to be in existence in the years in which the moneys payable become due. Acquisition by Government results in a sale for the purpose of section 41(2). CIT v. *United Provinces Electricity Supply Co (2000) 110 Taxman 134 (SC).*

Question 30

Praveen was a partner in a firm in his capacity as the Karta of his HUF. On the amounts deposited by the partners, the firm paid interest. Praveen, in his individual capacity had made deposits in the same firm in which he was a partner. The assessee claimed that the interest paid in his individual capacity should not be disallowed. The Assessing Officer did not agree and disallowed the interest paid to Praveen in his individual capacity. Discuss.

(3 Marks)(Nov.2000)

Answer

Explanation 2 to section 40(b) clearly states that where an individual is a partner in a firm on behalf of or for the benefit of any other person, any interest paid by the firm to such individual otherwise than as a partner in representative capacity shall not be taken into account for the purposes of clause (b) of section 40.

Since Praveen is a partner in his capacity as the karta of his HUF and the interest is paid by the firm in his individual capacity, such interest is not hit by the provisions of section 40(b). This position was brought out by the Supreme Court in Brij Mohan Das Laxman Das v. CIT (1997) 223 ITR 825 and followed by the Madras High Court in a recent case R.M.Appavu Chettiar Sons v. CIT (2002) 256 ITR 289 (Mad). Therefore, the Assessing Officer's action in disallowing the interest paid to Praveen in his individual capacity is not correct.

Question 31

Write short notes on :

Successor in business for the purpose of profits chargeable to tax under section 41 of the Income-tax Act. (4 Marks) (Nov.2000)

Answer

For purposes of section 41(1) of the Income-tax Act "successor in business" means –

(i) In the case of amalgamation of companies, the amalgamated company.

(ii) In the case a person is succeeded by another person in that business or profession of the first mentioned person, the other person.

(iii) Where a firm carrying on a business is succeeded by another firm, the other firm.

(iv) Where there has been a demerger, the resulting company.

Question 32

Capsule Ltd, during the financial year ending 31.3.2000 paid production bonus of an amount of Rs.3 lakhs pursuant to a settlement arrived with the workers in addition to the statutory payment of Rs.1 lakh as per Bonus Act. On these facts, your advise is sought.

(a) whether the sum of Rs.3 lakhs is deductible as per the provisions of section 36(i)(ii) of the Act?.

(b) If the claim is not so deductible, can it be claimed under any other provision?.

(4 Marks) (Nov.2000)

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

Section 36(1)(ii) refers to amounts payable as bonus or commission for services rendered where such sums would not have been payable to him as profits or dividend, if it had not been paid as bonus or commission. Rs 3 lakhs paid as production bonus is deductible as per the provisions of section 36(1)(ii) subject to section 43B. In case production bonus is not deductible under section 36(1)(ii), it can be claimed as deduction under section 37(1), as the expenditure is laid out wholly and exclusively for business purposes.

Question 33

You are consulted on the justifiability of the following claims. Your advice is to be framed based on the provisions of the Income-tax Act, 1961.

(i) A company paid the full consideration for building for its Administrative office and occupied the same as the possession was taken. The Registration could not take place before the end of the previous year for some reason or other. Can the depreciation claim be made?. (3 Marks) (May 2000)

(ii) Secret commission was paid and debited under Commission Account. Is it allowable expenditure. (3 Marks) (May 2000)

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

(i) One of the conditions for the claim of depreciation under the provisions of section 32 of the Income-tax Act, 1961 is that the assessee should be the owner of the asset. In the facts of the given case, the asset is an immovable property, namely, buildings acquired for the administrative office. Full consideration has been paid. However, the registration could not take place before the end of the previous year.

The Supreme court had an occasion to consider this issue in the case of *Mysore Minerals Ltd v. CIT (239 ITR775).* The Supreme court stated that the very concept of depreciation suggests that tax benefit on account of depreciation legitimately belongs to one who has invested in the capital asset and is utilizing the capital asset.

In the facts of the given case, though the document of title was not executed, the full consideration has been paid and the dominion over the property by taking possession excluded the owner who had to transfer the asset and therefore the right to use and occupy the property and enjoy it was exercised by taking possession and the execution of the formal deed of title may take place at any given point of time.

Following the decision of the Supreme Court, depreciation can be claimed in respect o the building that is acquired for the administrative office, though registration has not yet taken place.

(ii) Secret commission is one of the forms of commission payment generally made by business organizations. Secret commission is a payment for obtaining business orders or contracts from parties and /or customers and paid to employees and / or officials of those parties and / or customers or companies from whom business orders are obtained by the assessee.

The Explanation to section 37(1) of Income-tax Act, 1961 provides that any expenditure incurred by an assessee for any purpose which is an offence or which is prohibited by law, shall not be deemed to have been incurred for the purpose of business and no deduction or allowance shall be made in respect of such expenditure. In view of the Explanation, any expenditure incurred for a purpose which is an offence and prohibited by law cannot be allowed as expenditure. Therefore, secret commission payment, if it could be established as a payment for an offence prohibited by law, the same cannot be allowed deduction.

Question 34

An assessee purchases know-how for manufacture of fuel injection pipes on 10-04-1998. He wants proportional reduction for six assessment years under section 35AB of the Act commencing from assessment year 1999-2000. Is this allowable? (4 Marks) (May 2000)

Answer

Section 32 has been amended to allow depreciation on intangible assets like know-how, patents, copyrights, trademarks, licences, franchises or any other business or commercial rights of similar nature, if they are acquired on or after 1st April, 1998.

Since in this case the assessee had acquired the know-how after 1st April 1998, it is to be treated as capital expenditure and eligible for depreciation.

On the other hand, if the expenditure is incurred for use of know-how (not ownership of 'know-how'), such amount will be allowable as revenue expenditure.

Question 35

(a) *Ravi Traders, a partnership firm consisting of three partners. 'A', 'B' and 'C' is assessed to Income-tax as partnership firm assessed as such. 'B' and 'C' retired from the partnership with effect from 31st December 1998 'A' took over the business and continued as a proprietor. The stock in trade as at 31st December, 1998 was valued at average purchase price for settlement of accounts, which was the system consistently followed. On these facts, you are consulted on the following issues:*

Under which provisions of the Income-tax Act, 1961 M/s. Ravi Traders for the period 1.4.1998 to 31.3.1999 shall be assessed for the assessment year 1999-2000? Can the Assessing Officer dispute the stock valuation in the assessment of the firm? (4 Marks) (May 2000)

(b) *'A' desires to admit three partners from 1st April, 2000. Amongst the partners, it is agreed that two partners, shall be the working partners and be paid remuneration, your advice is* *sought as to the requirements to see that the remuneration to the working partners is allowable in the hands of the firm under the Income-tax Act.* *(4 Marks) (May 2000)*

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

(a) M/s. Ravi Traders was a partnership firm and it became a proprietary concern thereafter. Therefore there was a discontinuance of the firm. Section 189 of Income-tax Act provides for the assessment in the case of a discontinuance or dissolution of the firm to safeguard the interests of the Revenue for the assessment of the firm and levy of tax. The section proceeds on the premise that the firm is deemed to be a continuing firm for purposes of assessment in that assessment year. The section provides that (a) the assessment shall be made as if no discontinuation has taken place (b) every person who was a partner at the time of discontinuance of the firm and the legal representative of any such partner who is deceased, shall be jointly and severally liable for the tax and penalty and or other sums payable and (c) all the other provisions of the Act so far as may be, shall apply to any such assessment or imposition of penalty or other sum. Penalty proceedings can be initiated and penalty may be imposed on such firm even after the discontinuance and/or dissolution. Therefore the firm M/s. Ravi Traders shall be assessed as partnership firm assessed as such as per the provisions of section 189.

On the issue whether the Assessing Officer can dispute the stock valuation at the time of conversion of firm into proprietary concern, the answer is "no". The settled principle is that when the partnership firm is converted into a proprietary concern of one of the partners and the closing stock is taken over by him at the cost and there is no revaluation of stock, it cannot be said that any profit accrued to the firm. This is the principle laid down by Gujarat High Court in *Chunilal Khushaldas Patel v. CIT (66 ITR 522 (Guj))*. Dissolution is different from discontinuance and in the present facts of the case the firm has become a proprietary concern because one of the partners took over the firm's business and continued the business. Therefore the principle laid down by Supreme Court in the case of *ALA Firm v. CIT 189 ITR 285* will not apply to the facts of the case. Hence the Assessing Officer cannot dispute the stock valuation.

(b) Any payment of remuneration by whatever name called to a working partner shall be allowed as deduction under section 40(b)(v), provided the following conditions are satisfied.

(i) The payment is to be authorized by the deed of partnership in writing.

(ii) It should be in accordance with the terms of the partnership.

(iii) The remuneration per month should be quantified. It cannot be left open to be determined by the partners as at the end of accounting period (vide Board Circular 739 dated 25th March, 1996)

(iv) The maximum amount of remuneration of all working partners put together should not exceed the limits prescribed in clause (v) of section 40(b) of the Act.

(v) On the first Rs. 3 lakh of book profit or in case of loss, the limit would be the higher of Rs. 1,50,000 or 90% of book profit and on the balance of book profit, the limit would be 60%.

Question 36

M/s. PR and M/s. ST are firms with common partners carrying on different businesses. M/s. PR had taken a loan from M/s. ST for the purpose of its business. Interest on the loan for the year ending 31.3.2006 worked out to Rs.20,000. M/s. PR deducted tax of Rs.2,244 on interest and paid the balance sum of Rs.17,756 in cash to M/s. ST on 31.3.2006. Tax deducted was remitted to the credit of the Central Government on 30.4.2006. How will you treat the interest paid while computing the total income of M/s. PR for the assessment year 2006-07?

(3 Marks) (May 2006)

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

Section 40(a)(ia) provides that interest paid shall not be allowed as deduction in computing business income, if tax deductible at source has not been deducted thereon or if deducted, has not been paid within the prescribed time. If the amount was credited during the last month of the previous year (i.e. March 2010), the time limit for remitting the TDS amount is available upto the 'due date' for filing the return prescribed under section 139(1). Thus the remittance on 30.04.2010 is in accordance with the provisions of law warranting no disallowance of expenditure.

However, if the amount was credited / paid prior to 01.03.2010, the time limit for remittance would expire by 31.03.2010 and since the TDS amount was remitted on 30.04.2010, interest amount is not eligible for deduction as expenditure.

7

CAPITAL GAINS

Question 1

Sridhar purchased a residential flat from Devraj in 2005. However, the deed of conveyance has not been registered in the name of Sridhar till date. Sridhar has let out the flat at a monthly rent of Rs.15,000 to Mohan. Sridhar claims that rent received is not chargeable under the head "Income from house property", but the same is chargeable under the head "Income from other sources" and he can claim deduction for expenses on repair and insurance premium on actual basis and also depreciation. Examine the correctness of Sridhar's claim.

(3 Marks) (June 2009)

Answer

In order to assess income under the head "Income from house property" the assessee must be the owner of the house property. The need for registration of document in favour of a person to enable him to be treated as the owner of the house property for the purpose of section 22, was considered by the Supreme Court in the case of CIT vs. Poddar Cement Pvt. Ltd. (1997) 226 ITR 625. It was held that so long as a person is entitled to receive income from the house property in his own right and not on behalf of some one else, it is not necessary that the sale deed must be registered in favour of the person to treat him as the owner of the property for the purpose of section 22. In such a case, the income derived from the property is chargeable to tax under the head "Income from house property". The fact that registration is not yet complete does not affect the chargeability of such income under the head "Income from house property". Therefore, the claim of Sridhar that rent should be assessed under the head "Income from other sources" and deduction of various expenses and depreciation should be allowed therefrom is not tenable.

Question 2

Betki Limited is a company in which 70% shares are held by Ruhu Limited. Betki Limited, in its annual general meeting held on 18th May, 2008, declared a dividend amounting to Rs.40 lacs to its shareholders for the year ended 31st March, 2008 and it paid dividend distribution tax on 28th May, 2008. Ruhu Limited did not declare any dividend for the year ended 31st March, 2008. It, however, declared an interim dividend amounting to Rs.60 lacs on 1st December, 2008 for the year ended 31st March, 2009. What is the amount of tax on dividend payable by Ruhu Limited? What would be your answer, if 60% of shares in Ruhu Limited are held by

Hilsha Limited, a domestic company? Does the position further change, if Hilsha Limited is a foreign company? (6 Marks) (June 2009)

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

As per section 115-O, dividend distribution tax at the rate of 15% (plus surcharge @ 10%, education cess @ 2% and secondary and higher education cess @ 1%) is levied on dividend, declared, distributed or paid by a domestic company. As per sub-section (1A), inserted to section 115-O a holding company receiving dividend from its subsidiary company can reduce the same from dividends declared, distributed or paid by it. For this purpose, the matching principle does not apply. This means that even if the dividend received and dividend distributed relate to different periods, the same can be adjusted for the purpose of computing dividend distribution tax of the holding company. However, the dividend shall not be considered for reduction more than once.

The conditions to be fulfilled for this purpose are as follows:

(1) The subsidiary company should have actually paid the dividend distribution tax;

(2) The holding company should be a domestic company;

(3) The holding company should not be a subsidiary company of any other company.

For this purpose, a holding company is a company which holds more than 50% of the nominal value of equity shares of another company.

On the basis of the aforesaid provision, dividend distribution tax payable by Ruhu Limited shall be 16.995% of [(Rs.60,00,000 - (Rs.40,00,000 x 70%)] i.e. Rs.5,43,840.

If 60% of shares of Ruhu Limited are held by Hilsha Limited, then Ruhu Limited is a subsidiary company of Hilsha Limited. In that case, the condition (See condition no.3 above) laid down in section 115-O(1A) is not satisfied and Ruhu Limited cannot reduce the amount of dividend received from Betki Limited for computation of dividend distribution tax. Hence, dividend distribution tax payable by Ruhu Limited shall be 16.995% of Rs.60,00,000 i.e. Rs.10,19,700.

The above situation remains the same where Hilsha Limited is a foreign company.

Question 3

A shareholder of a demerged Indian company received shares from the resulting company in the scheme of demerger. The shareholder wants to transfer the said shares received subsequent to the demerger for consideration. Your advice is sought on the tax consequences as to the shares received on demerger and sought to be transferred. (4 Marks) (June 2009)

Answer

As per the provisions of section 47(vid), any transfer or issue of shares by the resulting company to the shareholders of the demerged company in a scheme of demerger is not regarded as a transfer for the purposes of capital gains under section 45, if the transfer or issue is made in consideration of the demerger of the undertaking.

As a consequence of the demerger, the existing shareholders of the demerged company will receive shares in a resulting company. When the shareholder subsequently intends to transfer the said shares, the cost of such shares will have to be arrived at as per the provisions of section 49(2C). According to the said provision, the cost of acquisition of shares in the resulting company will be the amount which bears to the cost of acquisition of shares held by the assessee in the demerged company, the same proportion as the net book value of the assets transferred in a demerger bears to the net worth of the demerged company immediately before such demerger.

As per the provisions of section 2(42A)(g), for determining the period of holding of such shares, the period for which the shares of the demerged company were held by the assessee would also be considered.

If the shares are held for more than one year, and transferred through a recognized stock exchange and securities transaction tax has been paid on such sale, the long-term capital gain arising therefrom would be exempt under section 10(38). If the total holding period does not exceed one year, then the short-term capital gains arising on sale of such shares would be taxable @15% under section 111A.

Question 4

Sri Sajjan converted the capital asset, acquired by him in the year 1988, into stock-in- trade at the fair market value on 1st March, 2008. Sri Sajjan sold the entire stock-in-trade so converted, on 25th November, 2008. Sri Sajjan seeks your advice as to the tax implications of the transaction with reference to the provisions of Indian Income-tax Act for the assessment year 2009-10. *(5 Marks) (June 2009)*

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10 i.e. the capital asset was converted into stock in trade on 01.03.2009 and was sold on 25.11.2009.

Answer

Conversion of a capital asset into stock-in-trade falls within the definition of transfer under section 2(47). Therefore, in this case, transfer has taken place during the previous year 2008-09. However, as per section 45(2), the capital gains liability arises only in the year in which the stock-in-trade is sold i.e. previous year 2009-10 in this case. It is a long-term capital gain since the asset was acquired in 1988. The fair market value (FMV) on the date of conversion i.e. on 1.3.2009 is deemed to be the full value of consideration accruing as a result of transfer of the capital asset.

Therefore, in the year of sale of stock-in-trade (i.e. P.Y. 2009-10), both business income and capital gains would arise.

Business income =	Sale consideration of stock-in-trade	–	FMV on the date of conversion
Capital gains =	FMV on the date of conversion	–	Indexed cost of acquisition / improvement

Question 5

A piece of land owned by Mr. Mishra located on Jaipur-Delhi highway was acquired by NHAI in the F.Y.2003-04, but the award ordered in F.Y. 2004-05 was paid in the F.Y. 2006-07. This land was purchased by him on 2.4.1977 for Rs.1,000. The fair market value of the land as on 1.4.1981 was Rs.900. Compensation paid was Rs.5 lacs.

The other piece of land located in Chennai purchased in April, 2003 for Rs.25 lacs was also sold by him in February, 2007 for Rs.35 lacs, but sale deed thereof could not be executed by 31.3.2007. The value for the purpose of stamp duty applied by the stamp valuation authority was Rs.38 lacs.

Compute the income chargeable to tax arising as a result of these transactions in the A.Y.2007-08. The CIIs for the F.Y.2003-04, 2004-05 and 2006-07 are 463, 480 and 519 respectively. *(6 Marks) (Nov 2007)*

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10 i.e. the compensation was received for the land in Jaipur – Delhi highway in the previous year 2009-10 and the land in Chennai was sold in February 2010 for Rs.35 lacs. The CII for F.Y.2009-10 is 632.

Answer

Computation of taxable income of Mr. Mishra for A.Y.2010-11

Particulars	Rs.
Capital Gains	
(A) Long-term capital gain derived from transfer of land on Jaipur-Delhi highway acquired by NHAI in F.Y. 2003-04 for which award was paid in F.Y. 2009-10 is chargeable to tax in A.Y.2010-11 [See Note (i) below]	
Sale consideration i.e. compensation paid	5,00,000
Less: Indexed cost of acquisition [See Note (ii) below]	
$\frac{(1000 \times 463)}{100}$	4,630
	4,95,370

(B)	Sale of land at Chennai in February 2010 [See Note (iii) below]	
	Full value of consideration as per section 50C [See Note (iv) below]	38,00,000
	Less: Indexed cost of acquisition	
	$\frac{(25{,}00{,}000 \times 632)}{463}$	34,12,527
		3,87,473

Total income chargeable to tax arising as a result of these transactions in the A.Y.2010-11 is = Rs.8,82,843(i.e. Rs.4,95,370 +Rs.3,87,473).

Notes:

(i) The capital gains arising on compulsory acquisition shall be charged to tax in the year in which the compensation is first received as per section 45(5)(a).

(ii) The option of fair market value as on 1.4.81 is not exercised by the assessee since the fair market value is lower than the cost.

463 is the cost inflation index of F.Y.2003-04 i.e. the year in which the property was compulsorily acquired.

632 is the cost inflation index of FY 2009-10 i.e. the year in which the property at Chennai was sold.

(iii) The execution of sale deed is not compulsory for the purpose of charge of capital gain because the transfer of right enabling enjoyment of immovable property gives rise to charge of capital gains as held by the Kerala High Court in the case of *CIT v. C.F. Thomas (2006) 284 ITR 557.*

(iv) As per section 50C, the value applied by the stamp valuation authority is deemed to be the full value of consideration received or accruing as a result of such transfer, since such value is higher than the sale consideration of Rs.35 lakh.

Question 6

V, an individual, owned three residential houses which were let out. Besides, he and his four brothers co-owned a residential house in equal shares. He sold one residential house owned by him during the previous year relevant to the assessment year 2007-08. Within a month from the date of such sale, the four brothers executed a release deed in respect of their shares in the co-owned residential house in favour of V for a monetary consideration. V utilised the entire long-term capital gain arising out of the sale of the residential house for payment of the said consideration to his four brothers. V is not using the house, in respect of which his brothers executed a release deed, for his own residential purposes, but has let it out to another person, who is using it for his residential purposes. Is V eligible for exemption under section 54 of the Income-tax Act, 1961 for the assessment year 2007-08 in respect of the long-term capital gain arising from the sale of his residential house, which he utilised for *acquiring the shares of his brothers in the co-owned residential house? Will the ownership of two more houses by him on the date of sale of the residential house and non-use of the new house for his own residential purposes disentitle him to exemption? (6 Marks) (May 2007)*

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

The long-term capital gain arising on sale of residential house would be exempt under section 54 if it is utilized, *inter alia*, for purchase of a new residential house within one year before or two years after the date of transfer. Release by the other co-owners of their share in co-owned property in favour of V would amount to "purchase" by V for the purpose of claiming exemption under section 54 *[CIT v. T.N. Aravinda Reddy (1979) 120 ITR 46 (SC)].* Since such purchase is within the stipulated time of two years, V is eligible for exemption under section 54. As V has utilised the entire long-term capital gain arising out of the sale of the residential house for payment of consideration to the other co-owners who have released their share in his favour, he can claim full exemption under section 54.

The ownership of two more houses on the date of sale of the residential house by V will not disentitle him from claiming the exemption under section 54. Such restriction is contained only in section 54F and not in section 54. Further, there is no requirement in section 54 that the new house should be used by the assessee for his own residence. The condition stipulated is that the new house should be utilised for residential purposes. This requirement would be satisfied even when the new house is let out for residential purposes.

Question 7

S, an individual purchased a site on 21.4.2000 for Rs.2,00,000. He completed construction of a building thereon on 14.2.2003 at a cost of Rs.10,00,000. He sold the property consisting of site and building on 7.12.2005 for Rs.20,00,000. S seeks your opinion on the nature of capital gain arising to him from the sale of the property for the assessment year 2006-07. Computation of capital gain is not necessary. (5 Marks) (Nov 2006)

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10. It has been assumed that the site was acquired on 21.04.2004, the building construction was completed on 14.02.2007 and the property consisting of site and building was sold on 07.12.2009.

Answer

Site and building are separate capital assets for the purpose of capital gains. This distinction is clear from the scheme of the Income-tax Act, 1961. For the purpose of section 32, a building which is entitled to depreciation means only the superstructure and does not include the site on which it is built. This was held by the Apex Court in *CIT v. Alps Theatre (1967) 65 ITR 377*.

In this case, the site is a long-term capital asset since it is held by S for more than 36 months and the building is a short-term capital asset since it is held by S for less than 36 months. The site is an independent capital asset and continues to be so even after the construction of the building thereon. Even though the property consisting of site and building was sold as a single asset for a consolidated price of Rs.20,00,000, such price can be attributed to the site and building separately. Therefore, in the case of S, the capital gain attributable to the site is assessable as long-term capital gain and the capital gain attributable to the building is assessable as short-term capital gain for the assessment year 2010-11. On identical facts, the Rajasthan High Court in *CIT v. Vimal Chand Golecha (1993) 201 ITR 442,* the Madras High Court in *CIT v. Dr. D. L. Ramachandra Rao (1999) 236 ITR 51* and the Karnataka High Court in *CIT v. C.R. Subramanian (2000) 242 ITR 342* have taken this view.

Question 8

(i) J inherits a house property from his father, who had mortgaged it. J discharges the mortgage debt. J later sells the property. Can he claim the amount paid to the mortgagee as cost of improvement in computing the capital gain?

(ii) L mortgaged his house property and utilized the mortgage amount to perform the marriage of his son. He paid the amount to the mortgagee later. Upon sale of the said property thereafter, he claims the mortgage debt discharged as forming part of the cost of acquisition. Can capital gain be computed accepting his claim? (4 Marks) (May 2006)

Answer

(i) J inherited the house property with the liability to discharge the mortgage debt. He can, therefore, claim the amount paid to the mortgagee as cost of improvement while computing the capital gain on sale of the said property. The decision of the Supreme Court in *RM. Arunchalam v. CIT (1997) 227 ITR 222* supports this view.

(ii) L has himself created the mortgage in respect of his house property. It is a self-created mortgage. Therefore, the debt discharged by L on the property under mortgage created by him does not form part of cost of acquisition. The decision of the Supreme Court in *V.S.M.R. Jagadish Chandran v. CIT (1997) 227 ITR 240* supports this view. Therefore, capital gain on sale of the property cannot be computed on the basis of the claim made by him.

Note – This question can also be answered with reference to the recent Bombay High Court ruling in *CIT v. Roshanbabu Mohammed Hussein Merchant (2005) 144 Taxman 720 / 275 ITR 0231*. This case highlights the difference in tax treatment in respect of allowability of the expenditure incurred on removing an encumbrance in two different cases, namely –

(i) In a case where the mortgage is created by the previous owner and

(ii) In a case where the mortgage is created by the assessee himself.

The Bombay High Court pointed out that there is a distinction between the obligation to discharge the mortgage debt created by the previous owner and the obligation to discharge the mortgage debt created by the assessee himself. Where the property acquired by the assessee is subject to the mortgage created by the previous owner, the assessee acquires absolute interest in that property only after the discharge of mortgage debt. In such a case, the expenditure incurred by the assessee to discharge the mortgage debt created by the previous owner to acquire absolute interest in the property is treated as 'cost of acquisition' and is deductible from the full value of consideration received by the assessee on transfer of that property. However, where the assessee acquires property which is unencumbered, the assessee gets absolute interest in that property on acquisition. When the assessee transfers that property, he is liable for capital gains tax on the full value realized, even if he has himself created an encumbrance on that property. The assessee is under an obligation to remove that encumbrance for effectively transferring the property. In other words, the expenditure incurred by the assessee to remove the encumbrance created by the assessee himself on the property (which was acquired by him without any encumbrance) is not an allowable deduction under section 48.

Question 9

State the cases where the benefit of indexation of costs is not available for determination of capital gains. *(5 Marks) (Nov.2005)*

Answer

In the following cases, the benefit of indexation is not available for determination of capital gains on transfer of long-term capital assets –

1. Transfer of bonds/debentures other than capital indexed bonds issued by the Government (*Proviso 3* to section 48).
2. Transfer of shares or debentures acquired by a non-resident in foreign currency in an Indian company (*Proviso 1 and 2* to section 48).
3. Transfer of undertaking or division in a slump sale (Section 50B)
4. Transfer of units of Unit Trust of India or a Mutual Fund specified under section 10(23D) purchased in foreign currency by an overseas financial organisation referred to as offshore funds (Section 115AB)
5. Transfer of Global Depository Receipt purchased in foreign currency by an individual resident in India and employee of an Indian company or its subsidiary engaged in specified knowledge based industry or service (Section 115ACA).
6. Transfer of securities by Foreign Institutional Investors (Section 115AD).
7. Transfer of a foreign exchange asset by a non-resident Indian (Section 115D)

Further, indexation benefit is not available on capital gains arising on transfer of a depreciable asset since such capital gains would always be short-term capital gains.

Question 10

Mr. X bought 10,000 equity shares of TT Ltd., listed in stock exchanges in India and abroad and a constituent of BSE 500 on 15th March, 2003 @Rs.2,250 per share. He sold the shares at Rs.5,000 per share on 31st December, 2004. The brokerage and securities transactions tax deducted were at 0.5% and 0.075% respectively. Examine the liability of Mr. X to income tax for the assessment year 2005-06. Will your answer be different, if instead of selling the shares in the market Mr. X privately transferred the shares to his son at the same price? (Cost Inflation Factors: 2002-03-447; 2004-05-480) (6 Marks) (May 2005)

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

As per section 10(38), any income arising from the transfer of a long-term capital asset, being equity shares of a company is exempt from income tax on fulfillment of the following conditions:

(i) The sale of equity shares is effected on or after 1st October, 2004, being the date on which Chapter VII of the Finance (No.2) Act, 2004 (i.e. Securities Transactions Tax) came into force and

(ij) Such transaction is chargeable to securities transactions tax.

For a listed equity share, sold on or after 1st October, 2004 the provisions of section 10(38) shall apply. As the shares of TT Ltd. are held by Mr.X for more than 12 months before transfer, they are long-term capital assets. Since the sale took place after 1-10-2004 and the transaction was subject to securities transactions tax, the long term capital gain arising from transfer of such shares shall be exempt from income tax u/s 10(38).

In the second case, Mr. X privately transferred the shares to his son at Rs.5000 per share. Since the sale was not entered in any stock exchange, securities transactions tax was not payable on such sale. Hence, the provisions of section 10(38) will not apply. The provisions of section 112 relating to calculation of tax on long term capital gains would apply.

The tax liability on capital gains will be governed by the proviso to section 112(1) under which long term capital gains on listed securities will be taxed at 20% of capital gains computed taking indexation benefit or at 10% of the capital gains computed without indexation benefit , whichever is lower. Since the shares were sold on 31st December 2009, the capital gains have to be computed as follows -

Particulars	Rs.
Computation of capital gains taking into consideration indexation benefit	
Gross sale consideration	5,00,00,000
Less: Brokerage @ 0.5%	2,50,000
Net sale consideration	4,97,50,000

Less: Indexed cost of acquisition (2,25,00,000 x 632/447)	3,18,12,080
Long-term capital gain	1,79,37,920
Tax on above @ 20% [after exhausting basic exemption limit of Rs.1,60,000]]	35,55,584
Education cess @ 3%	1,06,668
Total tax payable	**36,62,252**
Computation of capital gains without taking into consideration indexation benefit	
Gross sale consideration	5,00,00,000
Less: Brokerage @ 0.5%	2,50,000
Net sale consideration	4,97,50,000
Cost of acquisition	2,25,00,000
Long-term capital gain	2,72,50,000
Tax @ 10% (after reducing basic exemption limit of Rs.1,60,000)	27,09,000
Education cess @ 3%	81,270
Total tax payable	**27,90,270**

So, the tax payable will be Rs.27,90,270 (being lower of the two)

Note:

1. In arriving at the net consideration, only brokerage can be deducted. The securities transaction tax paid is not deductible as per the last proviso to section 48.
2. According to the proviso to section 112(1)(a), if the assessee does not have any income other than long-term capital gains, the basic exemption limit should be exhausted against long-term capital gains. Therefore, tax on long-term capital gains has been calculated @ 20% after exhausting basic exemption limit, assuming that Mr. X is a resident.
3. The basic exemption limit is not relevant for computing @ 10% tax on long-term capital gains without indexation benefit.

Question 11

Redemption of preference shares amounts to "transfer" within the meaning of Section 2(47) of the Income Tax Act, 1961 in the hands of the shareholder. Discuss. (4 marks) (Nov.2004)

Answer

The definition of the term "transfer" u/s 2(47) is not an exhaustive definition but an inclusive one. "Transfer" in relation to capital asset includes, *inter alia*, sale, exchange or relinquishment of capital asset.

When shares are redeemed by a company, it only means that the concerned shareholder is giving up his or her ownership or claim with reference to the shares in favour of the company. The consideration received by the shareholder from the company is certainly for sale/relinquishment of the interest in the shares and therefore, the redemption of preference shares amounts to "transfer" and the gain arising therefrom, being the excess realization over the cost of acquisition, shall be charged to tax under the head "Capital Gains". This was upheld by the Supreme Court in *Anarkali Sarabhai vs CIT (1997) 224 ITR 422*. If the redemption is after a period of 12 months from the date of acquisition of shares by the shareholder, the long term capital gain shall be computed by deducting the indexed cost of acquisition. The resultant long term capital gain shall be charged to tax in accordance with the provisions of section 112.

Question 12

What is meant by the term "Demerger"? What are the exemptions and benefits available as a result of a demerger transaction? (4 Marks) (May 2004)

Answer

According to section 2(19AA), demerger in relation to companies, means the transfer pursuant to a scheme of arrangement under section 391 to 394 of the Companies Act, by a demerged company of one or more of its undertakings to any resulting company in such a manner that:

(1) All the property of the undertaking, being transferred by the demerged company, immediately before the demerger, must become the property of the resulting company by virtue of the demerger;

(2) 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;

(3) The property and liabilities are transferred by the demerged company to the resulting company at their value appearing in the books of account immediately before the demerger;

(4) In consideration of the demerger, the resulting company issues shares to the shareholders of the demerged company on a proportionate basis;

(5) Shareholders holding not less than three-fourth in value of the shares of the demerged company become shareholders of the resulting company by virtue of the demerger;

(6) The transfer of the undertaking is on a going concern basis;

(7) The demerger is in accordance with the conditions, if any, notified under section 72A(5) by the Central Government in this behalf.

Some of the exemptions and benefits available as a result of the demerger transaction are enumerated hereunder -

(i) There will be no capital gains tax liability in respect of transfer of capital assets by the demerged company to the resulting Indian company [section 47(vib)];

(ii) Shareholders of the demerged company are not chargeable to capital gains tax with reference to shares transferred to the resulting company in return for allotment of shares. [section 47(vid)];

(iii) Any distribution of shares pursuant to a demerger by the resulting company to the shareholders of the demerged company shall not be treated as deemed dividend as per section 2(22)(v), and hence there will be no tax liability on this account;

(iv) As per section 72A(4), in the case of a demerger, the accumulated loss and unabsorbed depreciation of the demerged company, as attributable to the demerged undertaking, shall be allowed to be carried forward and set-off in the hands of the resulting company.

Question 13

Aries Tubes Private Ltd. went into liquidation on 01.06.2003. The company was seized and possessed of the following funds prior to the distribution of assets to the shareholders:

Share Capital	*5,00,000*
Reserves prior to 1.6.2003	*3,00,000*
Excess realization in the course of liquidation	*5,00,000*
Total	*13,00,000*

There are 5 shareholders, each of whom received Rs.2,60,000 from the liquidator in full settlement. The shareholders desire to invest the resultant element of capital gains in long-term specified assets as defined in section 54EC. You are required to examine the various issues and advice the shareholders about their liability to I.T. *(7 marks) (May 2004)*

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

Under section 46(1), where the assets of a company are distributed to its shareholders on its liquidation, such distribution shall not be regarded as transfer in the hands of the company for the purpose of section 45.

However, under section 46(2), where the shareholder, on liquidation of a company, receives any money or other assets from the company, he shall be chargeable to income-tax under the head "capital gains", in respect of the money so received or the market value of the other assets on the date of distribution as reduced by the amount of dividend deemed under section 2(22)(c) and the sum so arrived at shall be deemed to be the full value of the consideration for the purposes of section 48.

As per section 2(22)(c), dividend includes any distribution made to the shareholders of a company on its liquidation, to the extent to which the distribution is attributable to the accumulated profits of the company immediately before its liquidation, whether capitalized or not.

In this case, the accumulated profits immediately before liquidation is Rs.3,00,000. The share of each shareholder is Rs.60,000 (being one-fifth of Rs.3,00,000). An amount of Rs.60,000, is therefore, taxable under section 2(22)(c) in the hands of each shareholder.

Therefore, Rs.2,00,000 [i.e. 2,60,000 minus 60,000 taxed as deemed dividend u/s2(22)(c)] is the full value of consideration in the hands of each shareholder as per section 46(2). Against this, the investment of Rs.1,00,000 by each shareholder is to be deducted to arrive at the capital gains of Rs.1,00,000 of each shareholder. The benefit of indexation is available to the shareholders, but could not be computed in the absence of required information. Since the equity shares are not listed, it would not be liable for Securities Transaction Tax and hence the capital gain (long term) is not exempt under section 10(38). Also, the rate of tax on such long term capital gain would be 20% and subject to the provisions of section 112.

Exemption under section 54EC is available only where there is an actual transfer of capital assets and not in the case of deemed capital gain as per the decision rendered in the case of *CIT v. Ruby Trading Co (P) Ltd (2003) 259 ITR 54 (Raj).*

Note - It is assumed that the above capital gain is a long-term capital gain.

Question 14

X had taken a loan under registered mortgage deed dated 16-07-00 against the house, which was purchased by him on 26-03-81 for Rs.5 lakhs. The said property was inherited by his son 'A' under will who for obtaining a clear title thereof had paid the outstanding amount of loan on 12-02-03 of Rs.15 lakhs. The said house property was sold by 'A' on 16-03-03 for Rs.50 lakhs. State with reasons the amount chargeable to capital gains for A.Y. 2003-04 (Cost Inflation Index 447).

Note – Cost Inflation Index 447 had been erroneously printed as Cost of Index Rs.447 in the question paper. *(5 marks) (Nov.2003)*

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

The cost of inherited property to Mr. 'A' shall be the cost to the previous owner as per provisions of section 49(1)(iiia) and therefore, Rs.5 lakhs, being the cost to his father (amount paid by his father on 26.3.81 for acquiring the property) shall be the cost to Mr. A, who is the new owner. Payment of outstanding loan of the predecessor by the successor for obtaining a clear title of the property by release of Mortgage Deed shall be the cost of acquisition of the successor under section 48 read with section 55(2) of the Act as held by the Apex Court in case of *RM. Arunachalam v. CIT [1997] 227 ITR 222.*

Taxable Capital Gain for the A.Y. 2010-11

			Rs.
Sale consideration of house property			50,00,000
Less:			
Indexed cost of acquisition (see Note below)			
(i)	Cost to previous owner – no indexation is given on the assumption that the asset was sold in the same year in which it was inherited as per Will.	5,00,000	
(ii)	Loan amount paid by Mr. A (Benefit of CII not available on the assumption that the loan amount was paid in the year of sale)	15,00,000	20,00,000
	Capital gains		**30,00,000**

Note: Since the property was acquired by Mr. A through inheritance, the cost of acquisition to A will be cost to the previous owner. However, indexation will be from the year in which the assessee i.e. 'A' in this case, first held the asset. It has been assumed that the property was inherited by 'A' and loan was paid off in the same year and was sold during the previous year 2009-10.

Question 15

'X', purchased on 18.6.1982, house property for Rs.2,25,000 which was sold to A on 18.10.2002 for Rs.8,75,000. The sub-registrar, at the time of registration of sale deed, charged stamp duty on Rs.12,50,000 which was paid by the buyer. The Assessing Officer while assessing for capital gain referred the matter to the valuation officer who determined the value of property at Rs.15,00,000 on the date of transfer. X seeks your advice on the following:

(i) Is the Assessing Officer correct to charge capital gain on the value of Rs.15,00,000 as determined by valuation officer?

(ii) The amount of capital gain on which 'X' is required to pay capital gains tax. (The CII for F.Y. 82-83 is 109 and of F.Y. 2002-03 is 447). (5 Marks) (May 2003)

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

(i) According to section 50C, the Assessing Officer can refer the property to the valuation officer, only when the following two conditions are satisfied:

   (a) The value fixed by the stamp valuation authority is not disputed in appeal or revision etc.

(b) The assessee claims before the Assessing Officer that the value adopted or assessed by the stamp valuation authority exceeds the fair market value (FMV) of the property as on the date of transfer.

In the instant case the assessee paid the stamp duty as fixed by the stamp valuation authorities. The assessee did not request the Assessing Officer to refer the property to the valuation officer for valuation. Hence, the Assessing Officer's action, in referring the property to the valuation officer, is not correct.

(ii) The amount on which the assessee is required to pay capital gains tax will be as under:-

Sale consideration of the house property to be adopted u/s 50C(1)		Rs.12,50,000
Less: Indexed cost of acquisition	$2,25,000 \times 632/109$	Rs.13,04,587
Long term capital loss		**Rs. 54,587**

Question 16

Specify the items of capital assets in respect of which the cost of acquisition shall be taken as 'nil' under the provisions of the Income-tax Act, 1961 while computing Capital gains.

(4 Marks) (Nov.2002)

Answer

According to section 55 of the Income-tax Act, 1961, the cost of acquisition shall be taken to be 'nil' in the case of the following capital assets:

1. Self generated goodwill of a business
2. Bonus shares
3. Right to subscribe to rights issues
4. Tenancy rights
5. Stage carriage permits
6. Loom hours
7. Any right to manufacture, produce or process any article or thing; and
8. A trademark or brand name associated with the business.

Question 17

Dalal entered into an agreement with Shroff for the sale of his property and received earnest money of Rs.1,00,000 on 1.4.2000. The balance of Rs.4,00,000 was to be paid within 3 months, failing which Dalal was entitled to a compensation of Rs.50,000. The earnest money was also liable to forfeited. Shroff defaulted in the payment of the balance within the time specified and therefoe the earnest money was forfeited. A suit was also filed for breach of contract and Rs.50,000 was awarded, which was received on 28.3.2001. Discuss the nature of the two receipts from the point of view of liability to tax. *(4 Marks) (Nov.2001)*

Answer

The matter relating to the liability to tax of earnest money and compensation has arisen for consideration by the Apex Court in *Travancore Rubber and Tea Co Ltd v. CIT 243 ITR 159.* The quality and nature of receipt for income-tax purposes are fixed once and for all when the subject of the receipt is received and subsequent operations do not change that nature. Section 51 preserves this rule enunciated in *Morley (Inspector of Taxes) v. Tattersall 7 ITR 316.* There is a distinction between earnest money and compensation, but it loses its significance in the context of section 51 which includes "other moneys" in addition to earnest money.

Accordingly, the amount received by way of earnest money is not taxable but would go to reduce the cost of acquisition of asset at the time of its ultimate sale. The compensation received for breach of contract is also not chargeable to tax at the time of receipt but would go to reduce the cost of acquisition of the asset while reckoning capital gain at the time of its ultimate sale.

Question 18

(i) Chand Ltd decided to effect buy back of shares capital by purchase of shares in open market. During the previous year ending 31.3.2001. Chand Ltd purchases 10,000 shares. Discuss the tax implications in the hands of Chand Ltd and shareholders.

(3 Marks) (May 2001)

(ii) Discuss the tax treatment of surplus arising out of deep discount bonds:

(a) On sale of such bonds

(b) On realization of such bonds on maturity. *(4 Marks) (May 2001)*

Answer

(i) Section 46A of the Act provides for the taxability of capital gains in the hands of shareholders, when the shares are purchased by the company in the open market in order to effect buy back of its shares. In the hands of Chand Ltd, there shall be no liability to tax as the payment is on capital account.

In the case of shareholders, the difference between the consideration received by the shareholders and the cost of acquisition will be chargeable to tax as capital gains. Any payment made by a company on purchase of its own shares in accordance with section 77A of the Companies Act, 1956 will not constitute dividend [Clause (iv) of section 2(22)].

(ii) The CBDT in Letter No.F.No.225/45/96 dated 03-12-1996, have clarified that the difference between purchase price and redemption price is taxable as interest income. If the bonds are transferred before maturity, the sale consideration less cost of acquisition is taxable as capital gain.

Again the CBDT have clarified in Circular No.2 of 2002 dated 15-02-2002, that the difference between the cost of acquisition and market value as on 31st March immediately succeeding shall be taxable as interest income. In respect of subsequent assessment years, the difference in market values as on the closing dates of the respective previous years shall be taken as interest income.

Where the bonds are sold before maturity, the sale price less the market value as on the closing date of the immediately preceding financial year shall be taken as the capital gain/loss. If the bonds are transferred within 12 months from the date of acquisition, the resultant will be short term capital gain/loss. Where it is transferred after 12 months, it will be a long term capital gain/loss.

In the year of redemption, the redemption price and the market value as on 31st March immediately preceding will be compared and will be treated as interest income.

If the bonds are kept as trading asset instead of interest income, the income will obtain the character of business income. The Circular No.2 of 2002 has stated that small non-corporate investors having deep discount bonds upto an aggregate face value of Rs.1 lakh can continue to offer income for tax in accordance with the earlier circular viz. F.No.225/45/96 dated 03-12-1996.

Question 19

Mukherjee furnishes the following information:

Purchase of shares No. of shares	*Month & Year of purchase*	*Shares dematted month and year*
1,000	*March, 1992*	*July, 1999*
500	*March, 1995*	*---*
1,000	*December, 1996*	*October, 1998*

He sold 1,500 shares in January, 2001 out of the dematted shares. He seeks your advise as to the taxability towards capital gains for the assessment year 2001-2002.(3 Marks) (May 2001)

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

If the shares dematted represent equity shares of a company, any transfer made and in respect of which Securities Transaction Tax is chargeable, the resultant long term capital gain is exempt under section 10(38).

Assuming that the long term capital gain arising from the transfer of shares is not exempt under section 10(38) for the reasons such as (a) not being an equity share (b) not liable for Securities Transaction Tax due to transfer made otherwise, the following could be taken as the guidance for deciding the tax implication.

Section 45(2A) is to be applied and it says that any profits and gains arising from the transfer made by the depository shall be chargeable as the income of the beneficial owner in the previous year in which the transfer takes place. The Central Board of Direct Taxes, by its Circular No.768 dated 24.6.1998 has directed that the cost of acquisition of shares and the period of holding shall be determined on the basis of first-first-out method (FIFO). The FIFO method will apply only to the dematted shares and not to those held in physical form. The dematted shares were acquired in the years 1992 and 1996 and therefore as per the provisions read with the circular, the shares dematted first will be construed as sold first.

As per the given facts of the case, the shares sold were 1500. For arriving at the liability to capital gains tax:-

(a) The purchase cost of 1000 shares acquired in December,1996 (first dematted) and the proportionate purchase cost of 500 shares out of the shares acquired in March 1992 will be taken as cost of shares. The transfer has to be construed in the same manner and not the year of their acquisition.

The indexation of the cost is permissible as per section 48 of the Income-tax Act. The loss or gain shall be arrived at after deducting the indexed cost.

Question 20

A Manufacturing company was transporting two of its machines from unit 'A' to unit 'B' (which is at a distance of 100 miles) on 1st September,1999 by a truck. On account of a civil disturbance, both the machines were damaged. The insurance company paid Rs.5 lakhs for the damaged machines. On these facts, for submitting the return of income for the previous year ending 31st March, 2000, your advice is sought as to:

(i) Whether the damage of machines result in any transfer?

(ii) How the amounts received from the insurance company are to be treated for taxability?

(iii) Would there be any impact on the written down value of the block of plant and machinery as at 31st March 2000? (5 Marks) (Nov.2000)

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

As per section 45(1A) receipt of insurance compensation in the form of money or any asset is to be treated as consideration and capital gain is accordingly to be charged to tax. The two qualifying conditions prescribed are (a) the compensation should have been received because of damage or destruction of capital asset and (b) the damage or destruction is as a result of circumstances mentioned therein.

In the facts of the case, both the conditions are satisfied and therefore, the compensation is to be treated as consideration. Applying section 45(1A) the answers to the issues are:

(i) in the case of damage or destruction, there is no actual transfer;

(ii) the receipt of insurance compensation of Rs.5 lakhs has to be treated as consideration in accordance with the provisions of section 45(1A).

(iii) in the instant case, as per the provisions of section 43(6)(c) the receipt of compensation of Rs.5 lakhs calls for adjustment in the written down value of the block of assets. If the written down value is more than Rs.5 lakhs, then Rs.5 lakhs should be deducted from written down value. On the other hand, if the written down value is less than Rs. 5,00,000, the difference would be treated as short term capital gain.

Question 21

Gama Ltd, located within the corporation limits decided in December, 1999 to shift its industrial undertaking to non-urban area. The company sold some of the assts and acquired new assets in the process of shifting. The relevant details are as follows:

(Rs.in lakhs)

	Particulars	*Land*	*Building*	Plant & Machinery	*Furniture*
(i)	*Sale proceeds (sale effected in March, 2000)*	*8*	*18*	*16*	*3*
(ii)	*Indexed cost of acquisition*	*4*	*10*	*12*	*2*
(iii)	*Cost of acquisition in terms of section 50*	*--*	*4*	*5*	*2*
(iv)	*Cost of new assets purchased in July,1999 for the purpose of business in the new place*	*4*	*7*	*17*	*2*

Compute the capital gains of Gama Ltd. for the assessment year, 2000-2001.

(7 Marks) (Nov.2000)

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

Section 54G deals with deduction in respect of any capital gain that may arise from the transfer of an industrial undertaking situated in an urban area in the course of or in consequence of shifting to a non-urban area.

If the assessee purchases new machinery or plant or acquires a building or land or constructs a new building or shifts the original asset and transfers the establishment to the new area, within 1 year before or 3 years after the date on which the transfer takes place, then, instead of the capital gain being charged to tax, it shall be dealt with as under:

1. If the capital gain is greater than the cost of the new asset, the difference between the capital gain and the cost of the new asset shall be chargeable as income 'under section 45'.
2. If the total gain is equal to or less than the cost of the new asset, section 45 is not to be applied.

The capital assets referred to in section 54G are machinery or plant or land or building or any rights in building or land. Consequent on this concession , if the new assets are sold within a period of 3 years, the cost thereof will be 'nil' for the purpose of computation of capital gain on such sale in the first case and in the second case, the cost will be reduced by the capital gain.

Under section 50, where the capital asset forms part of a block of assets, in respect of which depreciation has been allowed, the provisions of section 48 and 49 will be treated as modified as under:

Where the full value of the consideration received as a result of transfer exceeds the written down value of the block of assets at the beginning of the year, the excess shall be deemed to be capital gains arising from the transfer of short term capital assets.

1. The first step therefore is to determine the capital gain arising out of the transfer and thereafter apply the provisions of section 54G.

(a)	**Land** – Sale proceeds (Non depreciable)		8,00,000
	Less: Indexed cost		4,00,000
	Long term capital gain		4,00,000
	Less: Cost of new assets purchased within one year before the transfer (under section 54G) (See note 1 below)		3,00,000
	Balance		1,00,000
(b)	**Building** – sale proceeds (depreciable assets)		18,00,000
	*Less :*W.D.V. is deemed as cost of acquisition u/s.50		4,00,000
	Short term capital gain		14,00,000
(c)	**Plant & machinery** sale proceeds (depreciable asset)		16,00,000
	Less: WDV is deemed cost under section 50		5,00,000
	Short term capital gain		11,00,000
(d)	**Furniture** sale proceeds (depreciable asset)		3,00,000
	Less: WDV is deemed cost under section 50		2,00,000
	Short term capital gain(see note 2 below)	**(A)**	1,00,000

Summary

Short term capital gain : Building	14,00,000
Short term capital gain : Plant & machinery	11,00,000
	25,00,000

Less: New assets purchased U/s.54G (See Note below)			25,00,000
Net short term capital gain		**(B)**	Nil

Total short term capital gain (A)+(B) = 1 lakh

Note – Total exemption available under section 54G is Rs. 28 lakh (Rs. 4 lakh + Rs.7 lakh + Rs.17 lakh). The exemption should first be exhausted against short tem capital gain as the incidence of tax in case of short-term capital gain is more than in case of long term capital gain. Therefore, Rs.25 lakh is exhausted against short term capital gain and the balance of Rs. 3 lakh against long term capital gain.

Question 22

Anand entered into an agreement for sale of certain properties in which there were tenants subject to vacant possession. He had accordingly to pay certain consideration to the tenants for their agreeing to vacate the properties and claimed such payments to secure vacant possession as incurred in connection with the transfer of the property within the meaning of section 48(1) of the Act. Would 'A' succeed in his claim? (3 Marks) (May 2000)

Answer

Anand's claim is valid in law. Under the agreement, the assessee had to give vacant possession. Payments made to tenants to obtain vacant possession was incurred wholly and exclusively in connection with the agreement of sale which preceded the transfer and in fulfillment of a condition of sale. The amount paid to the tenants is, therefore, deductible as expenditure under section 48(1) of the Act.

Question 23

Balance sheet of JB Opticals Limited as on 31-03-1999 reads as under:

Paid up capital Rs .2,52,00,000

	Unit A (Rs.)	*Unit B (Rs.)*
Fixed assets	*1,00,00,000*	*1,50,00,000*
Debtors	*1,00,00,000*	*75,00,000*
Liabilities	*28,00,000*	*50,00,000*
Stock in trade	*50,00,000*	*25,00,000*
Reserves		*1,48,00,000*
Share premium		*22,00,000*
(Revaluation reserve)		*(70,00,000)*

The company acquired Unit B on 1.04.1997. They made certain capital additions in the form of Generator set and additional building etc., for Rs.25 lacs during the year 1997-98. The members of the company have authorized the Board in their meeting held on 28.01.2000 to dispose of the unit 'B'. The company decides to sell the Unit 'B' by way of slump sale for Rs.225.00 lacs as consideration. The buyer has agreed with the vendor-company to give time *for putting thought the sale but not later than 30.06.2000 subject to a discount of 1% on agreed sale consideration. However, this discount is not applicable if the sale is completed after 31.03.2000. The company now approaches you to advise them as a measure of tax planning to determine the date of sale keeping in view of the capital gains tax.*

(5 Marks)(May 2000)

The provisions of the Income-tax Act, 1961 relevant for A.Y. 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10 i.e. date of acquisition of unit B as 01.04.2007 and option for sale whether to be made before 31.03.2010 or after 31.03.2010.

Answer

Determination of net worth of Unit B of M/s. J.B.Opticals Ltd.

	Rs.in lakhs
Book value of fixed assets	150
Debtors	75
Stock in trade	25
	250
Less :Liabilities	50
Net worth	200

Comparative calculation of chargeable capital gains

	Sale before 31.3.2010	*Sale after 31.03.2010*
Sale consideration	225,00,000	225,00,000
Less: Discount	2,25,000	Nil
Net sale consideration	222,75,000	225,00,000
Less: Net worth	200,00,000	200,00,000
Short term capital gain	22,75,000	N.A.
Long term capital gain	N.A.	25,00,000
Tax rate	30.9%	20.6%
Tax thereon	7,02,975	5,15,000

***Note**: The assessee is advised to effect slump sale after 31.03.2010 as the tax liability arising out of long term capital gains is less than the tax liability arising on short term capital gain if transferred before 31.03.2010.*

Question 24

The assessee was a company carrying on business of manufacture and sale of art-silk cloth. It purchased machinery worth Rs.4 lakhs on 1-5-1995 and insured it with United India Assurance Ltd against fire, flood, earthquake etc., Depreciation was granted at 15% for each assessment year. The insurance policy contained a reinstatement clause requiring the insurance company to pay the value of the machinery, as on the date of fire etc., in case of destruction of loss. A fire broke out in August, 1999 causing extensive damage to the machinery of the assessee rendering them totally useless. The assessee company received a sum of Rs.6 lakhs from the *insurance company on 15th March, 2000. Discuss the issues arising on account on the transactions and their tax treatment.*

(Cost inflation index for financial year 1995-96 and 1999-2000 are 281 and 389 respectively)

(8 Marks) (May 2000)

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

Section 45(1A) inserted with effect from 1-4-2000 supersedes the decision of the Supreme Court in *Vania Silk Mills P Ltd (191 ITR 647)*. Under this provision, where any person receives any money or other assets under an insurance from an insurer on account of damage to or destruction of capital asset, then, any profits and gains arising form the receipt of such money or other assets, shall be chargeable to income tax under the head "Capital Gains" and shall be deemed to be the income of such person of the previous year in which such money or asset was received.

For the purpose of section 48, the money received or the market value of the asset shall be deemed to be the full value of the consideration accruing as a result of the transfer of such capital asset. Since the asset was destroyed and the money from the insurance company was received in the previous year, there will be a liability to capital gains in respect of the insurance moneys received by the assessee.

Assuming the written down value of the asset as Rs.2 lakhs as on 01.04.2009 the computation of capital gain and tax implication is given below:

Under section 45(1A) any profits and gains arising from receipt of insurance moneys is chargeable under the head "Capital gains". For the purpose of section 48, the moneys received shall be deemed to be the full value of the consideration accruing or arising. Under section 50 the capital gains in respect of depreciable assets had to be computed in the following manner:

Full value of the consideration	Rs.6,00,000
Less: Written down value of the beginning of previous year	Rs.2,00,000
Short term capital gains	Rs.4,00,000

8

INCOME FROM OTHER SOURCES

Question 1

MNO Ltd. is a company in which the public are not substantially interested. K is a shareholder of the company holding 15% of the equity shares. The accumulated profits of the company as on 31.3.2006 amounted to Rs.10,00,000. The company lent Rs.1,00,000 to K by an account payee bank draft on 1.10.2006. The loan was not connected with the business of the company. K repaid the loan to the company by an account payee bank draft on 30.3.2007. Examine the effect of the borrowal and repayment of the loan by K on the computation of his total income for the assessment year 2007-08. *(3 Marks) (May 2007)*

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

As per section 2(22)(e), any payment by a company, in which the public are not substantially interested, by way of advance or loan to a shareholder, being a person who is the beneficial owner of shares holding not less than 10% of the voting power, shall be treated as dividend to the extent to which the company possesses accumulated profits.

In the instant case, MNO Ltd. is a company in which the public are not substantially interested. The company has accumulated profits of Rs.10,00,000 on 31.3.2009. The loan given by the company to K was not in the course of its business. K holds more than 10% of the equity shares in the company. Therefore, assuming that K has voting power equivalent to his shareholding, section 2(22)(e) comes into play and the sum of Rs.1,00,000, representing the amount lent by the company to K, is includible as dividend in the total income of K for the assessment year 2010-11.

Under section 2(22)(e), the liability arises the moment the loan is borrowed by the shareholder and it is immaterial whether the loan is repaid before the end of the accounting year or not. Therefore, the repayment of loan by K to the company on 30.3.2010 will not affect the taxability of the sum of Rs.1,00,000 as dividend in his hands.

Question 2

Discuss the taxability or otherwise of the following gifts received by M, an individual, during the financial year 2006-07:

(i) Rs.24,000 each from his four friends on the occasion of his birthday.

(ii) Wrist watch valued at Rs.60,000 from his friend. *(3 Marks) (May 2007)*

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

(i) Section 56(2)(vi) and (vii) provides that where any sum of money is received without consideration by an individual or a Hindu undivided family from any person or persons exceeding Rs.50,000 in aggregate in any previous year, the whole of the aggregate value of such sum will be liable to tax. In the instant case, M has received Rs.24,000 from each of his four friends. The aggregate amount of gifts received works out to Rs.96,000. As such, the entire amount of Rs.96,000 is taxable under the head "Income from other sources".

(ii) New Clause (vii) has been inserted in section 56(2) w.e.f.1.10.2009 to bring within its scope, in addition to any sum of money, the value of property received without consideration or for inadequate consideration. For this purpose, "property" means immovable property being land and building or both, shares and securities, jewellery, archaeological collections, drawings, paintings, sculptures or any work of art. Therefore, the gift of wrist watch valued at Rs.60,000 received by M from his friend is not covered by the term 'property'. Accordingly, it is not chargeable to tax.

Question 3

The Assessing Officer found, during the course of assessment of a firm, that it had paid rent in respect of its business premises amounting to Rs.60,000, which was not debited in the books of account for the year ending 31.3.2005. The firm did not explain the source for payment of rent. The Assessing Officer proposes to make an addition of Rs.60,000 in the hands of the firm for the assessment year 2005-06. The firm claims that even if the addition is made, the sum of Rs.60,000 should be allowed as deduction while computing its business income since it has been expended for purposes of its business. Examine the claim of the firm.

(2 Marks) (May 2006)

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

The claim of the firm for deduction of the sum of Rs.60,000 in computing its business income is not tenable. The action of the Assessing Officer in making the addition of Rs.60,000, being the payment of rent not debited in the books of account (for which the firm failed to explain the source of payment) is correct in law since the same is an unexplained expenditure under section 69C. The proviso to section 69C states that such unexplained expenditure, which is deemed to be the income of the assessee, shall not be allowed as a deduction under any head of income. Therefore, the claim of the firm is not tenable.

Question 4

D, a lady, received *the following gifts during the year ending 31.3.2006:*

(i) Rs.30,000 from her elder sister.

(ii) Rs.50,000 from the daughter of her elder sister.

(iii) Rs.1,25,000 from various friends on the occasion of her marriage.

Discuss the taxability or otherwise of these gifts in the hands of D (4 Marks) (May 2006)

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

(i) Section 56(2)(vi)and(vii) provides for taxation of gifts exceeding Rs.50,000, received by an individual from any person other than those specified, under the head "Income from other sources". The proviso states that gifts received from any relative would not be so taxed. *Explanation* to section 56(2)(vi) defines the term "relative". Sister of the individual is included in the said definition. Therefore, gift of Rs.30,000 received by D from her elder sister is not taxable.

(ii) Daughter of the elder sister of an individual is not a "relative" within the definition of the term as contained in Explanation to section 56(2)(vi). Since the amount received from the daughter of her elder sister is exactly Rs.50,000, the whole of the amount gifted shall not be included in D's total income. Therefore, the entire sum of Rs.50,000 is not taxable in the hands of D.

(iii) The proviso to section 56(2)(vi) stipulates that gifts received by an individual on the occasion of the marriage of the individual, is not taxable. Therefore, gifts amounting to Rs.1,25,000 received by D from her friends on the occasion of her marriage are not taxable.

Question 5

M, an individual, is 70 years of age. He is a sitting member of the State Assembly of Karnataka and for the financial year 2004-05 received the following amounts from the Assembly Secretariat :

(i)	*Basic pay*	*Rs.3,000 p.m.*
(ii)	*Constituency allowance*	*Rs.8,000 p.m.*

(iii) Telephone allowance *Rs.4,000 p.m.*

(iv) Electricity allowance *Rs.3,000 p.m. [from June, 2004 onwards]*

He owns a house in Delhi which has been let out at Rs.5,000 p.m. He received rent for 10 months only, the house having remained vacant for two months. Municipal taxes of Rs.1,200 were paid by the tenant. Interest of Rs.14,000 was paid by M on the amount borrowed by him to buy the house.

M has an agricultural income of Rs.55,000.

Compute his tax liability for the relevant assessment year. *(7 Marks) (Nov.2005)*

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

Computation of total income of Mr. M for A.Y.2010-11

Particulars			*Rs.*	*Rs.*
Income from house property				
Gross Annual Value (GAV) **[See Note 1 below]**			50,000	
Municipal taxes (not allowed since it is borne by tenant)			-	
Net annual value (NAV)			50,000	
Less: Deduction u/s 24				
(a) 30% of NAV	15,000			
(b) Interest on borrowed capital	14,000		29,000	21,000
Income from Other Sources [See Note 2 below]				
Basic Pay			36,000	
Constituency allowance (Rs.8,000 x 12)		96,000		
Electricity allowance (Rs.3,000 x 10)		30,000		
Telephone allowance (Rs.4,000 x 12)		48,000		
		1,74,000		
Less: Exempt u/s 10(17)[Rs.8000 p.m.]		96,000	78,000	1,14,000
Total Income				**1,35,000**

Note – 1. In the absence of other information, rent received has been taken as the Gross Annual Value.

2. The pay and allowances of a member of the State Assembly would be taxable under the head "Income from other sources", since there is no employer-employee relationship in this case.

3. Agricultural income is exempt under section 10(1). As the income is below taxable limit, there would be no impact due to aggregation of agricultural income for rate purposes.

Question 6

V.G. had placed to deposit of Rs.10 lakhs in a bank on which he received interest of Rs.80,000. He had also borrowed Rs.5 lakhs from the same bank on the security of the deposit and was liable to pay Rs.50,000 by way of interest to the bank. He therefore offered the difference between two amounts of Rs.30,000 as income from other sources. Is this correct? (May 2004)

Answer

The interest income from deposit in the bank is assessable under the head "Income from Other Sources". The deduction admissible against this income is any expenditure (not being in the nature of capital expenditure) laid out or expended wholly and exclusively for the purpose of making or earning such income. However, the interest paid on the borrowing of Rs.5 lakhs does not fall in this category. This has been held by the Supreme Court in *CIT v. Dr. V. Gopinathan (2001) 248 ITR 449.* In that case, the Supreme Court observed that the interest received by the assessee from the bank on a fixed deposit is income in his hands and there could be no deduction there from unless there is a law permitting such deduction. The interest on a loan taken by the assessee on the security of the fixed deposit would not go to reduce the income by way of interest on the fixed deposit as there is no provision for deduction of such interest on the loan.

Therefore, in this case, the full sum of Rs.80,000 will be liable to tax under the head "Income from Other Sources".

Question 7

Parimal, Managing Director of Heavens Engg. Pvt. Ltd. holds 70% of its paid up capital of Rs.20 lakhs. The balance as at 31-03-02 in General Reserve was Rs.6 lakhs. The company on 1-04-02 gave an interest-free loan of Rs.5 lakhs to its Supervisor having salary of Rs.4,000 p.m., who in turn on 15-6-02 advanced the said amount of loan so taken from the company to Shri Parimal. The Assessing Officer had taxed the amount of advance in the hands of Parimal. Is the action of Assessing Officer correct? (3 Marks) (Nov.2003)

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

The company had advanced a loan to an employee who in turn had advanced the same to the Managing Director of the company holding 70% of its capital. By virtue of the provisions of section 2(22)(e), the same shall be treated as the payment by a company in which public are not substantially interested, on behalf of, or for individual benefit of any such share holder (who holds not less than 10% of the voting power), to the extent to which the company possesses accumulated profits.

In this case, the company has reserves of Rs.6 lakhs on 31st March of the preceding year and the amount of loan advanced on 1st April is Rs.5 lakhs. Therefore, the payment is to be treated as deemed dividend. The amount of interest-free loan of Rs.5 lakhs given by the company to the supervisor who in turn had given the same to Mr.Parimal, shall be construed as the amount given for the benefit of Mr. Parimal and is treated as deemed dividend chargeable to tax in the hands of Mr. Parimal. This has been held by the Supreme Court in the case of *L.Alagusundaram Chettiar v. CIT (2001) 252 ITR 813/(2002) 121 Taxman 587.*

Question 8

An enterprise engaged in manufacturing of steel balls discontinued its activities and decided to lease out its factory building, plant and machinery and furniture from 1.4.2001 on a consolidated lease rent of Rs.50,000 per month. Compute the income for Assessment Year 2002-03 of the assessee from following information:

		Rs.
(i)	*Interest received on deposits*	*1,00,000*
(ii)	*Brokerage paid on hundi loan taken*	*2,000*
(iii)	*Interest paid on hundi and other loans which were given as deposits on interest to others*	*75,000*
(iv)	*Expenses incurred on repairs of building, plant and machinery.*	*15,000*
(v)	*Fire insurance premium of plant and machinery and furniture.*	*12,000*
(vi)	*Depreciation for the year*	*1,47,500*
(vii)	*Legal fees paid to an advocate for drafting and registering the lease agreement*	*1,500*
(viii)	*Factory licence fees paid for the year*	*1,000*

(ix) There is unabsorbed depreciation of Rs.2,75,000 for the Assessment Years 2000-01and 2001-02.

(x) Interest paid includes an amount of Rs.25,000 remitted outside India on which TDS was not deducted since the party had furnished Form H. *(8 Marks) (Nov.2002)*

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

The income derived from leased assets shall be chargeable to tax as 'Income from other sources' under section 56(2)(iii) of the Act but the computation thereof shall be made after allowing deductions specified under sections 30, 31 and 32 subject to section 38 of the Act. This is as per the provisions of section 57(ii) and 57(iii) of the Act.

Income from other sources

		Amount (Rs.)	*Amount (Rs.)*
(A)	Lease Rent for 12 months @ Rs.50,000 p.m.		6,00,000
Less:	*Expenses and deductions allowable under section 57(ii) & 57(iii) of the Act:*		
	Repairs	15,000	
	Fire Insurance Business	12,000	
	Legal expenses for drafting of lease agreement	1,500	
	Factory Licence fee	1,000	
	Depreciation for the year	1,47,500	
	Unabsorbed depreciation of earlier assessment years – eligible for deduction	2,75,000	4,52,000
			1,48,000
(B)	Interest on Deposits	1,00,000	
Less:	*Expenses allowable under section 57(i):*		
	Brokerage 2,000		
	Interest on Hundi Loans 50,000	52,000	48,000
	Total Income		**1,96,000**

Note:

1. Depreciation of Rs.2,75,000 pertains to earlier assessment years. The unabsorbed depreciation shall form part of the current year depreciation and can be set off against any other head of income. Accordingly, the amount of Rs 2,75,000 is adjustable / allowed to be set off against 'Income from other sources'.
2. Interest paid to non-resident is not eligible for deduction as the tax has not been deducted at source. Furnishing of Form H is not applicable for non-resident.

Question 9

Shyam was contributing amount to unrecognized provident fund. On 15th March, 2001, he had finally drawn the deposited amount along with interest. He seeks your advice as to how it has to be dealt, in his computation for assessment year 2001-02. *(3 Marks) (May 2001)*

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

Shyam's own contribution to the unrecognized provident fund will not attract any tax liability on its return to him. However, any payment received from an employer or former employer from an unrecognized provident fund to the extent to which it does not consist of contribution by him or interest on such contribution will constitute profits in lieu of salary under section 17(3)(ii) and will thus be chargeable to tax on receipt.

Hence, Shyam will be advised to include in his return of income the amounts withdrawn by him from the unrecognized provident fund to the extent it constitutes the contribution by the employer and interest thereon.

Interest on own contribution to unrecognized provident fund however is taxable under the head "other sources".

9

INCOME OF OTHER PERSONS INCLUDED IN ASSESSEE'S TOTAL INCOME

Question 1

Antaryami settled 1/4th share of his property under a trust for the education and maintenance of his minor daughter, Poulomi. Under the terms of the trust deed, the income accruing to the trust, after meeting the expenses of maintenance and education of Poulomi, was to be accumulated and paid over to her on her attaining majority. The Assessing Officer assessed the income arising from 1/4th share of the property, settled for the benefit of Poulomi, in the hands of Antaryami. Examine the correctness of the assessment. (4 Marks) (June 2009)

Answer

As per section 64(1A), the income of a minor child should be included in the total income of that parent, whose total income before such inclusion is higher.

The Supreme Court, in *CIT v. M.R. Doshi (1995) 211 ITR 1*, held that where the income from the trust was to be accumulated until the child attained majority, the clubbing provisions would not get attracted, since no benefit accrues to the minor child during the period when such child is a minor.

However, in this case, the minor daughter Paulomi is eligible for the benefits during the period when she is a minor, since income from the trust is being used for meeting her education and maintenance expenses. Only the remaining income is to be accumulated and paid over to her on her attaining majority. Therefore, since benefit under the terms of the trust deed is accruing, even though to a limited extent, to the minor daughter Paulomi during the period when she is a minor, the ratio applicable in the Supreme Court decision cited above cannot be applied in this case. Accordingly, the clubbing provisions under section 64(1A) will get attracted.

Therefore, the stand taken by the Assessing Officer to tax the income in the hands of Antaryami is correct. However, only so much of income as is used for meeting the education and maintenance expenses of Paulomi during the current year should be clubbed in the hands of Antaryami after providing for an exemption of Rs.1,500 under section 10(32).

Question 2

Mr. Siddharth was a partner in a firm, representing his HUF, holding 25% of the share in the firm. His wife Vineeta, a house lady, was admitted in her individual capacity in the firm for 25%

share. She was paid remuneration which has been proposed by the Assessing Officer to be clubbed in the hands of Siddharth-HUF by invoking section 64 of the Act. (4 Marks) (Nov 2007)

Answer

As per section 64(1)(ii) of the Income-tax Act, in computing the total income of any "individual", the remuneration paid to spouse by a firm in which the individual has substantial interest shall be liable for clubbing. In the present case, Mr. Siddharth is not a partner in his individual capacity, but a partner in representative capacity.

The Supreme Court has, in the case of *CIT vs. Om Prakash (1996) 217 ITR 785,* held that an individual can be a partner in a partnership firm in his individual capacity or in the capacity of the karta of a Hindu undivided family or, for that matter, in any other capacity, e.g., as a trustee. Where a person is a partner as the karta of a Hindu undivided family, the capacity in which he is a partner in the partnership firm is relevant as between him and the other members of the Hindu undivided family. The income the karta receives as a partner is not his individual income; it is the income of the Hindu undivided family and he receives it on behalf of the Hindu undivided family. It is for this reason that the income of the wife arising from her membership of the partnership firm, is held not includible in the income of the Hindu undivided family since the total income of the Hindu undivided family is not the total income of the individual (husband). For section 64(1) to get attracted, it is necessary that the spouse should be a partner in a partnership firm in his individual capacity. It is not attracted where he is a partner as the karta of the Hindu undivided family to which his wife belongs.

The action of the Assessing Officer in this case is, therefore, not correct.

Question 3

H, a mentally retarded minor, has a total income of Rs.1,20,000 for the assessment year 2006-07. The total income of his father L and of his mother R for the relevant assessment year is Rs.2,40,000 and Rs.1,80,000 respectively. Discuss the treatment to be accorded to the total income of H for the relevant assessment year. (3 Marks) (May 2006)

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

Section 64(1A) provides that all income accruing or arising to a minor child has to be included in the income of that parent, whose total income is greater. However, the income of a minor child suffering from any disability of the nature specified in section 80U shall not be included in the income of the parents but shall be assessed in the hands of the child. Thus, the total income of H has to be assessed in his hands and cannot be included in the total income of either his father or his mother.

Question 4

Dinesh, an individual engaged in the business of finance, advances Rs.5 lacs to his HUF on interest at 12% p.a., which is the prevailing market rate. The HUF invests the amount in its business and earns profit of Rs.2 lacs from this money. Can the assessing officer add a sum of Rs.1,40,000 (i.e. Rs.2,00,000-Rs.60,000) as income of Dinesh under section 64(2) of the Income-tax Act? Will the position remain the same, if Dinesh does not charge any interest?

(4 Marks) (Nov.2004)

Answer

Section 64(2) shall be applicable only where an individual member of HUF converts his property into the property of HUF or throws it into the common stock of the HUF without adequate consideration. In this case, Dinesh does not transfer money to his HUF but only lends an amount of Rs.5 lakhs to his HUF at an interest of 12%, which is the prevailing market rate. This is a transaction of loan, which pre-supposes, repayment. Dinesh continues to be the owner of the amount lent. Thus, there is no transfer of property from Dinesh to the HUF. Therefore, the Assessing Officer cannot add the profit arising to HUF in the total income of Dinesh by invoking section 64(2).

Even if no interest is charged by Dinesh, the nature of transaction will not change. It still remains as a loan transaction.

Question 5

Mr. Rose, out of his own funds, had taken an FDR for Rs.10,00,000 bearing interest @ 10% p.a. payable half-yearly in the name of his wife Lilly. The interest earned for the year 2000-01 of Rs.1,00,000 was invested by Mrs. Lilly in the business of packed spices which resulted in a net profit of Rs.55,000 for the year ended 31.3.2002. How shall the interest on FDR and income from business be taxed for the Assessment Year 2002-03? (4 Marks) (Nov.2002)

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

Section 64(1)(iv) of the Act specifies that the income derived by the spouse of an assessee from the assets transferred directly or indirectly without adequate consideration or intention to live apart shall be clubbed with the income of the transferor. Therefore, the interest income of Rs.1 lakh of Mrs. Lilly on the FDR of Rs.10 lakhs shall be clubbed with the income of her husband.

When Mrs. Lilly invested the interest income in a business and earned profits therefrom, such profits shall not be clubbed with the income of her husband but shall be taxable in her individual capacity. This is so because the income from the accretion of the transferred assets is not to be clubbed with the income of the transferor. *CIT v. M.S.S.Rajan (2001) 252 ITR 126 (Mad)*.

Question 6

In the following cases discuss whether the loss could be set off:

(i) Smt. Shanti carried on business with gifted funds of her husband Mahesh. For the previous year ending 31.3.2001. Shanti incurred loss of Rs.2 lakhs which loss Mahesh wants to set-off from his taxable income. (3 Marks) (May 2001)

(ii) Smt. Bhanu succeeded to the business of her husband Sri.Bhavesh who died on 10th September 2000. She carried on the business as proprietrix. The business of Bhavesh upto the date of his death resulted in a loss. Smt. Bhanu earned profit in business for the period ending 31.03.2001. Bhanu wants to set off the loss of her husband for the period ending 10th September,2000 against her income. (3 Marks) (May 2001)

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

(i) Under section 64(1)(iv), where any asset is transferred directly or indirectly to the spouse by an individual, otherwise than for adequate consideration or in connection with an agreement to live apart, the income arising therefrom is included in the hands of the transferor. The term "income" in this context includes "loss" as well. Therefore, the loss sustained by Shanti in the business carried on by her with funds gifted by her husband can be set off by her husband.

(ii) Section 78(2) says that where any person carrying on any business or profession is succeeded in such capacity by another person otherwise than by inheritance, no person other than the person incurring the loss is entitled to carry forward the loss and set it off against his income.

The facts of the case seem to indicate that Smt.Bhanu has succeeded to the business by inheritance and is not affected by the provisions of section 78(2). Therefore she is eligible to carry forward and set off the loss of her husband against her own income. Succession by inheritance is an exception to the general bar against carry forward and set off contained in section 78(2).

Question 7

Naresh is a fashion designer having lucrative business. His wife is a model. Naresh pays her monthly salary of Rs.10,000. The Assessing Officer while admitting that the salary is an admissible deduction, in computing the total income of Naresh had applied the provisions of section 64(1), and had clubbed the income (salary) of his wife in Naresh hands.

Discuss the correctness of the action of the Assessing Officer (4Marks) (Nov.2000)

Answer

This question is based on the principles laid down by Madras High Court in the case of *CIT v. Smt. R.Bharati (240 ITR 697) (240 ITR 772)* where the interpretation of the terms "professional qualifications" and "knowledge" came up for consideration as per proviso to section 64(1).

These words do not necessarily connote a qualification conferred by a recognized university after examining the candidate who has undergone a course of study in a technical subject or course of study preparing him for a profession of law, accountancy etc. Accordingly, the term "qualification" must be given a wide meaning as referring to the qualities which are required to be possessed by a person performing the work that he does, so long as that work is capable of being regarded as technical or professional.

The word "professional" is a term capable of very broad meaning and would encompass a variety of occupations. A large number of occupations are being practiced which form a source of livelihood and are capable of being regarded, as professions as long as they require certain degree of skill. A person having skill, experience and competence in a line of work can be regarded as professionally qualified for the purpose of section 64(1)(ii).

A model in the light of above is having skill, competence and experience in her line and is thus professionally qualified. Hence, the action of the Assessing Officer is not correct.

10

SET OFF AND CARRY FORWARD OF LOSSES

Question 1

Explain those conditions which are required to be fulfilled by the predecessor and successor co-operative banks in order to claim benefit of Section 72AB of the Act? (5 Marks) (May 2008)

Answer

The benefit of carry forward and set-off of accumulated loss and unabsorbed depreciation allowance in case of business re-organisation of co-operative banks would be available under section 72AB only on fulfillment of the following conditions -

(a) Conditions to be fulfilled by the predecessor bank

(1) it should have been engaged in the business of banking for three or more years; and

(2) it should have held at least three-fourths of the book value of fixed assets as on the date of the business re-organisation, continuously for two years prior to the date of business re-organisation.

(b) Conditions to be fulfilled by the successor bank

(1) should hold at least three-fourths of the book value of fixed assets of the predecessor co-operative bank acquired through business re-organisation, continuously for a minimum period of five years immediately succeeding the date of business re-organisation;

(2) continues the business of the predecessor co-operative bank for a minimum period of five years from the date of business re-organisation; and

(3) fulfils such other conditions as may be prescribed to ensure the revival of the business of the predecessor cooperative bank or to ensure that the business re-organisation is for genuine business purpose.

Question 2

JKL Ltd. filed its return of loss for the assessment year 2006-07 on 10.1.2007 beyond the time prescribed under section 139(3) declaring a total loss of Rs.15,00,000. It approaches you for advice regarding the course of action to be taken to secure the benefit of carry forward of the business loss for set off against future profits. Advise the company suitably in the matter.

(2 Marks) (May 2007)

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

JKL Ltd. is advised to file an application under section 119(2)(b) with the Central Board of Direct Taxes(CBDT) seeking a direction to the concerned Assessing Officer to allow its claim for carry forward of business loss. The Karnataka High Court has, in *Associated Electro Ceramics v. Chairman, CBDT (1993) 201 ITR 501*, held that the Board has the power to condone the delay, in cases having claim of carry forward of losses, in exercise of its power under section 119(2)(b). Further, Circular No.8 of 16.5.2001 clarifies that the CBDT has the power under section 119(2)(b) to condone the delay in filing a return of loss having a claim of carry forward of losses.

Question 3

M/s. JKLM, a firm, consists of four partners namely, J, K, L and M. They shared profits and losses equally during the year ending 31.3.2005. The assessed business loss of the firm for the assessment year 2005-06 which it is entitled to carry forward amounts to Rs.3,60,000. A new deed of partnership was executed among J, K, L and M on 1.4.2005 in terms of which they agreed to share profits and losses in the ratio of 15:15:20:50 respectively.

Compute the amount of business loss relating to the assessment year 2005-06, which the firm is entitled to set off against its business income for the assessment year 2006-07. The business income of the firm for the assessment year 2006-07 is Rs.3,30,000. Your answer should be supported by reasons. (3 Marks) (May 2006)

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10. It has been assumed that the loss pertains to assessment year 2008-09 and it is sought to be set off against business income of assessment year 2010-11.

Answer

The firm is entitled to set off its brought forward business loss amounting to Rs.3,60,000 relating to the assessment year 2008-09 to the extent of Rs.3,30,000 against its business income of Rs.3,30,000 for the assessment year 2010-11 as per the provisions of section 72(1). Section 78(1), which deals with carry forward and set-off of losses in case of change of constitution of firm, is applicable to cases where a partner has retired or died. The section is not applicable to a case where there is a change in the ratio of sharing profits and losses amongst the existing partners. Therefore, section 78(1) is not applicable to the case of M/s. JKLM. The unabsorbed business loss of Rs.30,000 relating to the assessment year 2008-09 will be carried forward further after its set-off against the business income of the assessment year 2010-11.

Question 4

R, an individual resident in India, bought 1,000 equity shares of Rs.10 each of A Ltd. at Rs.50 per share on 30.5.2005. He sold 700 equity shares at Rs.35 per share on 30.9.2005 and the remaining 300 shares at Rs.25 per share on 20.12.2005. A Ltd. declared a dividend of 50%, the record date being 10.8.2005. R sold on 1.2.2006, a house from which he derived a long-term capital gain of Rs.75,000.

Compute the amount of capital gain arising to R for the assessment year 2006-07.

(5 Marks) (May 2006)

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

The amount of capital gains arising to R has to be computed applying the provisions of sub-section (7) of section 94, which provides that "where:

(a) any person buys or acquires any securities or unit within a period of three months prior to the record date; and

(b) such person sells or transfers -

  (i) such securities within a period of three months after such date; or

  (ii) such unit within a period of nine months after such date; and

(c) the dividend or income on such securities or unit received or receivable by such person is exempted,

then the loss, if any, arising to him on account of such purchase and sale of securities or unit, to the extent such loss does not exceed the amount of dividend or income received or receivable on such securities or unit, shall be ignored for the purpose of computing his income chargeable to tax".

For this purpose, "record date" means such date as may be fixed by a company for the purpose of entitlement of the holder of the securities to receive dividend and "securities" includes stocks and shares.

Computation of capital gains of Mr. R for the assessment year 2010-11

Particulars	Rs.	Rs.
Long-term capital gain on sale of building		75,000
Less: Short-term capital loss on sale of shares		
700 shares	7,000	
300 shares	7,500	14,500
Taxable long-term capital gains		**60,500**

Computation of capital gain on sale of shares of A Ltd. by Mr.R

Date of purchase of shares		30.5.2009
Record date		10.8.2009
Date of sale of shares	30.9.2009	20.12.2009
Number of shares sold	700	300
Sale price per share	Rs.35	Rs.25

Particulars	**Rs.**	**Rs.**
Sale consideration	24,500	7,500
Less: Cost of acquisition	35,000	15,000
	10,500	7,500
Less: Dividend income as per section 94(7) [700×10×50%] [See Note below]	3,500	Not deductible
Short-term capital loss on sale of shares	**7,000**	**7,500**

Note:

1. 700 shares are sold within 3 months of record date, hence related dividend income should be deducted from the loss as per section 94(7).
2. 300 shares having been sold after 3 months of record date, section 94(7) is not applicable. So, the dividend income of Rs.1,500/- should not be deducted. Such dividend is exempt under section 10(34).
3. Short-term capital loss can be set-off against long-term capital gains as per the provisions of section 74(1)(a). Therefore, short-term capital loss on sale of shares can be set-off against long-term capital gains on sale of building.

Question 5

An assessee sustained a loss under the head "Income from house property" in the previous year relevant to the assessment year 2005-06, which could not be set off against income from any other head in that assessment year. The assessee did not furnish the return of loss within the time allowed under section 139(1) in respect of the relevant assessment year. However, the assessee filed the return within the time allowed under section 139(4). Can the assessee carry forward such loss for set off against income from house property of the assessment year 2006-07? (3 Marks) (May 2006)

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

Section 139(3) stipulates that an assessee claiming carry forward of loss under the heads "Profits and gains of business or profession" or "Capital gains" should furnish the return of loss within the time stipulated under section 139(1). There is no reference to loss under the head "Income from house property" in section 139(3). The assessee, in the instant case, has filed the return showing loss from property within the time prescribed under section 139(4). The assessee is, therefore, entitled to carry forward such loss for set off against the income from house property of the subsequent assessment year.

Question 6

M, an individual, was carrying on a business as sole proprietor. On his death, his legal heirs decide to continue the same business by forming a firm.

At the time of death, M had a determined business loss of Rs.2 lakhs, under the provisions of the Income-tax Act, to be carried forward.

Does the firm, consisting of all the legal heirs of M, get a right to have this loss adjusted against its current income? Discuss. *(4 Marks) (Nov.2005)*

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

Section 78(2) provides that where a person carrying on any business or profession has been succeeded in such capacity by another person, otherwise than by inheritance, then the successor is not entitled to carry forward and set-off the loss of the predecessor against his income. This implies that the only exception is when the business passes on to another by inheritance.

The Apex Court, in *CIT v. Madhukant M. Mehta (2001) 247 ITR 805*, has held that where the business is succeeded by inheritance, the legal heirs are entitled to the benefit of carry forward of the loss of the predecessor. Even if the legal heirs constitute themselves as a partnership firm, the benefit of carry forward and set off of the loss of the predecessor should be made available to the firm.

In this case, the business of M was continued by his legal heirs after his death by constituting a firm. Hence, the exception given in section 78(2) along with the decision of the Apex Court discussed above apply in this case. Therefore, the firm is entitled to carry forward the business loss of Rs.2 lakhs of M.

Question 7

A private limited company has share capital in the form of equity share capital. The shares were held uptil 31st March, 2002 by four members A, B, C and D equally. The company made losses/profits for the past three assessment years as follows:

Assessment Year	*Business Loss*	*Unabsorbed Depreciation*	*Total*
	Rs.	*Rs.*	*Rs.*
2000-2001	*Nil*	*15,00,000*	*15,00,000*
2001-2002	*Nil*	*12,00,000*	*12,00,000*
2002-2003	*9,00,000*	*9,00,000*	*18,00,000*
Total	*9,00,000*	*36,00,000*	*45,00,000*

The above figures have been accepted by the tax department.

During the previous year ended 31.3.2003, A sold his shares to Y and during the previous year ended 31.3.2004, B sold his shares to Z. The profits for the past two previous years are as follows:

31.3.2003 Rs.18,00,000 (before charging depreciation of Rs.9,00,000)

31.3.2004 Rs.45,00,000 (before charging depreciation of Rs.7,50,000)

Compute taxable income for A.Y.2004-05. Workings must form part of your answer.

(9 Marks) (Nov.2004)

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10 i.e. the figures for the year ended 31.3.2003 relate to A.Y. 2009-10 and for the year ended 31.3.2004 relate to A.Y. 2010-11. Further, it is assumed that the figures of brought forward losses and unabsorbed depreciation relate to A.Y. 2006-07, A.Y. 2007-08 and A.Y. 2008-09.

Answer

(a) A, B, C and D are the four shareholders of a private limited company. The shareholding pattern of the company in the last three financial years are given below:

As on 31st day of March	*A*	*B*	*C*	*D*	*Y*	*Z*
	%	*%*	*%*	*%*	*%*	*%*
I year	25	25	25	25	-	-
II Year	-	25	25	25	25	-
III Year	-	-	25	25	25	25

Section 79 provides that, in case of a closely held company, no loss incurred in the previous year shall be carried forward and set off against the income of the subsequent previous year unless the shares carrying at least 51% of the voting power of the company are beneficially held on the last day of the previous year in which the loss is sought to be set off, by the same shareholders, who beneficially held the shares carrying at least 51% of the voting power on the last day of the previous year in which the loss was incurred.

Since shareholders holding at least 51% of the voting power are the same in the first and second year, the restriction imposed by section 79 is not applicable for the second year. Thus, the taxable income for the assessment year 2009-2010 would be:

Particulars	*Rs.*
Business profit	18,00,000
Less: Current year's depreciation	9,00,000
	9,00,000
Less: Brought forward business loss (as per section 72(2))	9,00,000
Taxable income	Nil

Unabsorbed depreciation relating to the earlier assessment years can be carried forward to the next assessment year i.e. 2010-11. There is no brought forward business loss and section 79 is not applicable in case of carry forward of unabsorbed depreciation. Section 32 governs the carry forward and set off of depreciation for which the shareholding pattern is not relevant at all. Consequently, the income for A.Y.2010-11 will be determined as under -

Particulars	*Rs.*	*Rs.*
Business income		45,00,000
Less: Current year's depreciation		7,50,000
		37,50,000
Less: Unabsorbed depreciation:-		
Assessment year I	15,00,000	
Assessment year II	12,00,000	
Assessment year III	9,00,000	36,00,000
Taxable Income for A.Y.2010-11		**1,50,000**

Question 8

Rajesh & Co., the sole proprietary concern of Mr. Rajesh got converted into partnership after his death on 02-04-02 by his two sons and the business of Rajesh & Co., was continued to be carried in the same manner. There were business losses of Rs.4.25 lakhs till 31-03-02. The net results of the business for the year ended 31-03-03 were profits of Rs.5 lakhs. The partners want to set off the losses of Rs.4.25 lakhs from the profits of the firm. Can they do so? *(3 Marks) (Nov.2003)*

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

The business of sole proprietary concern was converted into a partnership because of the death of the proprietor. His two sons, who are the legal heirs, continued the business. Section 78(2) provides that in the case of succession by inheritance, the successor can carry forward and set-off the loss of predecessor against his income. The Supreme Court, in the case of *CIT v. Madhukant M. Mehta [2001] 247 ITR* 805, has held that where the legal heirs of a deceased-proprietor enter into partnership and carry on the same business in the same premises under the same trade name, there is succession by inheritance as contemplated in section 78(2) and the assessee-firm is entitled to carry forward and set off the deceased's business loss against its income for subsequent years.

Therefore, the partnership firm formed by the two sons who inherited the business of Mr. Rajesh can set-off the loss of the predecessor i.e. sole-proprietary concern.

Question 9

X Ltd., a pharmaceutical company having accumulated losses and unabsorbed depreciation to be set off in future for Rs.130 lakhs and Rs.250 lakhs as on 31.3.2001 was demerged on 16.5.2001 and 30% of its total assets were transferred to the resulting company, XY Ltd. How shall the accumulated losses and unabsorbed depreciation of the demerged company be dealt with in the return for Assessment Year 2002-03 of the resulting company:

(i) When the same are not directly relatable to the undertakings transferred and

(ii) When the same are directly relatable to the undertakings transferred.

(4 Marks) (Nov.2002)

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

The accumulated business loss and unabsorbed depreciation of the demerged company shall be carried forward and set off by the resulting company under section 72A(4) of the Act in the following manner:

(i) Where such loss or unabsorbed depreciation is not directly relatable to the undertaking transferred to the resulting company, such loss shall be apportioned between the demerged company and the resulting company in the same proportion in which assets of the undertaking have been retained by the demerged company and transferred to the resulting company and shall be allowed to be carried forward and set off in the hands of the demerged company or the resulting company, as the case may be. In this case, therefore, 30% of Rs.130 lakhs and Rs.250 lakhs, shall be allowed to be carried forward and set off by the resulting company and the balance by the demerged company.

(ii) Where such loss or unabsorbed depreciation is directly relatable to the undertaking transferred to the resulting company, the entire loss or unabsorbed depreciation shall be allowed to be carried forward and set off in the hands of the resulting company. Accordingly, in such a case, the entire amount of Rs.130 lakhs and Rs.250 lakhs shall be allowed to be set off in the hands of the resulting company.

Question 10

Write short notes on:

Carry forward and set off of losses in the event of change in shareholdings of companies in which public are not substantially interested. *(4 Marks) (Nov.2000)*

Answer

Section 79 prescribes the condition for carry forward and set off of losses in the case of companies, not being companies in which the public are substantially interested. No loss incurred in any year prior to the previous year shall be carry forward and set off if the persons who beneficially held shares of the company carrying not less than 51% of the voting power on the last day of the year or years in which loss was incurred continue to be the shareholders on the last day of the previous year concerned.

There are 2 exceptions to this rule.

(i) Where a change in the voting power takes place consequent upon the death of a shareholder or on account of transfer of share by way of gift to any relative of such shareholder.

(ii) Where a change in the voting power takes place in an Indian 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 company continue to be shareholders of the amalgamated or the resulting foreign company.

Question 11

Amalgamation of companies 'A' and 'B' has been approved by the BIFR in order to rehabilitate the sick company 'B'. During the course of assessment of 'B' company, the Assessing Officer refuses to allow carry forward of losses under section 72A of the Income-tax Act for the reason that the activities of the sick company had been closed consequent to labour unrest and that the loss suffered by the said company was "Capital loss". Is the Assessing Officer justified? *(3 Marks) (May 2000)*

Answer

The Assessing Officer is not justified in treating the loss as capital loss for the following reasons:

The order of BIFR is a speaking order and binding on the transferee-company under amalgamation. In order to rehabilitate the sick company, the BIFR constituted by the Central Government passed an order to enable the transferee-company to enjoy the benefits of carry forward of losses under section 72A of the Income-tax Act. The order has been passed in the interest of public, shareholders and institutions, who have funded the cost of the project and the workmen. The Assessing Officer has no jurisdiction to deny the benefits granted under section 72A of the Act.

11

DEDUCTIONS FROM GROSS TOTAL INCOME

Question 1

The Finance Act, 2008 brought in a new provision effective from 1st April, 2009 for granting deduction of 100% of profit derived by an undertaking from the business of operating and maintaining a hospital located anywhere in India, other than excluded area, subject to certain conditions. State briefly those conditions. *(2 Marks) (June 2009)*

Answer

As per section 80-IB(11C) for granting deduction of 100% of profit derived by an undertaking from the business of operating and maintaining a hospital located anywhere in India, other than the excluded area, subject to the following conditions:

(i) The hospital should be constructed and should start functioning between 1st April, 2008 to 31st March, 2013.

(ii) The hospital should have at least 100 beds for patients.

(iii) The construction of the hospital should be in accordance with the regulations or bye-laws of the local authority.

(iv) Audit report in the prescribed form signed and verified by a chartered accountant certifying that the deduction has been correctly claimed should be filed along with the return of income.

Question 2

Ayush, an employee with M/s Isomer Solutions Ltd., provides the following information relating to his income for financial year 2007-08:

(i) He received salary Rs.25,000 per month including conveyance allowance @ Rs. 2,500 per month for official purposes.

(ii) He deposited Rs.2,500 per month in his account under a pension scheme notified by the Central Government.

(iii) He paid a sum of Rs.60,000 during the year as interest on loan taken in April, 2006 from bank for higher studies of his daughter.

(iv) He paid health insurance premium for himself and for his family members Rs.8,500 in cash and Rs.9,000 by credit card.

(v) He invested Rs.40,000 in notified bonds under section 80C issued by NABARD in July, 2007.

(vi) *Equity shares having fair market price of Rs.1,00,000 were allotted to him by the company at a concessional price of Rs. 20,000 on 30.5.2007, which were sold by him for Rs.1,80,000 on 28.2.2008.*

Compute the total income of Ayush for assessment year 2008-09 and give reasons for treatment to each of the items. *(6 Marks) (Nov 2008)*

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

Computation of total income of Mr. Ayush for the Assessment Year 2010-11

Particulars	Rs.	Rs.
Salaries		
Gross salary received	3,00,000	
Add: Shares allotted at concessional price – fair market value less the amount recovered from the employee [Section 17(2)(vi)] (i.e. Rs.1,00,000 minus Rs.20,000)	80,000	
	3,80,000	
Less: Conveyance allowance exempt under section 10(14)	30,000	
		3,50,000
Capital gains		
Sale consideration of equity shares sold on 28.02.2010	1,80,000	
Less: Fair Market Price of shares on the date of allotment (i.e. 30.5.2009)	1,00,000	
Short-term Capital Gains		80,000
Gross Total Income		**4,30,000**
***Less:* Deduction under Chapter VIA**		
Under section 80C		
For investment in notified bonds issued by NABARD	40,000	
Under section 80CCD		
For deposit in pension scheme notified by Central Government [Rs.30,000 but restricted to 10% of salary i.e. 10% of Rs.2,70,000]	27,000	
Under section 80D		
For payment of health insurance premium by credit card	9,000	
Under section 80E		
For payment of interest on loan taken from bank for higher studies of daughter	60,000	1,36,000
Total Income		**2,94,000**

Notes:

(i) Conveyance allowance received for official duties is fully exempt under section 10(14).

(ii) Section 80CCD provides for deduction of employee's and employer's contribution to pension scheme notified by the Central Government. The Finance Act, 2007 has extended this deduction also to individuals employed by any other employer on or after 1.1.2004. However, if the amount contributed exceeds 10% of salary, then the deduction would be restricted to 10% of salary.

(iii) The deduction under section 80E available to an individual in respect of interest on loan taken for his higher education has now been extended by the Finance Act, 2007, to also include interest on such loan taken for higher education of his relative i.e. his or her spouse and children. Hence, interest on loan taken by Mr. Ayush from bank for the higher studies of his daughter is eligible for deduction under section 80E.

(iv) The maximum permissible deduction under section 80D in respect of medical insurance premium has been increased from Rs.10,000 to Rs.15,000 by the Finance Act, 2007, and such payment can be made by any mode other than cash. Hence, payment of Rs.8,500 made in cash will not qualify for deduction under section 80D.

(v) Subscription to notified bonds of NABARD will qualify for deduction under section 80C with effect from A.Y.2008-09.

(vi) The Finance (No.2) Act, 2009 has abolished FBT from the assessment year 2010-11 onwards. The fringe benefit would be taxable as perquisite in the hands of employee who received such shares at concessional rate from the employer. The value would be the fair market value of the specified security or sweat equity shares on the date on which the option vests with employee as reduced by the amount actually paid by, or recovered from the employee in respect of such security or shares.

Consequently as per section 49(2AA) inserted by the Finance (No.2) Act, 2009 it has been provided that for the purpose of computing capital gains in the hands of the employee at the time of sale of such securities/shares by the employee, the cost of acquisition shall be the fair market value which has been taken into account for the purpose of computing the perquisite value in the hands of employee.

Question 3

Explain the meaning of "eligible business" referred to in section 80-IE granting tax holiday in respect of profits and gains of certain undertakings in North-Eastern States. (4 Marks) (May 2008)

Answer

Eligible business as referred to in section 80-IE of the Act means the business of :

(a) hotel (not below two star category),

(b) adventure and leisure sports including ropeways;

(c) providing medical and health services in the nature of nursing home with a minimum capacity of 25 beds;

(d) running an old-age home;

(e) operating vocational training institute for hotel management, catering and food craft, entrepreneurship development, nursing and para-medical, civil aviation related training, fashion designing and industrial training;

(f) running information technology related training center;

(g) manufacturing of information technology hardware; and

(h) bio-technology.

Question 4

PQR Co-operative Bank, a co-operative society, having its area of operation confined to Gubbi Taluk and the principal object of which is to provide for long-term credit for agricultural and rural development activities, has received the following amounts during the year ending 31.3.2007:

(i) Interest amounting to Rs.1,00,000 from its members on loans advanced to them.

(ii) Interest amounting to Rs.1,50,000 on deposits with other co-operative societies.

(iii) Rent amounting to Rs.2,00,000 from letting out its godowns for storage of commodities.

PQR Co-operative Bank seeks your advice in the matter of taxability of the above amounts and the eligibility for deduction, if any, in respect thereof for the assessment year 2007-08.

(5 marks) (May 2007)

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

Sub-clause (viia) to section 2(24) includes within the scope of definition of income, the profits and gains of any business of banking (including providing credit facilities) carried on by a co-operative society with its members. Hence, the interest of Rs.1,00,000 received by PQR Co-operative Bank on loans advanced to its members constitutes its income.

Further, interest received amounting to Rs.1,50,000 on deposits with other co-operative societies and rent amounting to Rs.2,00,000 received from letting out its godowns for storage of commodities also constitute the income of the co-operative bank.

Sub-section (4) of section 80P provides that section 80P shall not apply to any co-operative bank other than a primary agricultural credit society or a primary co-operative agricultural and rural development bank. Explanation to section 80P(4) defines a primary co-operative agricultural and rural development bank to mean a society having its area of operation confined to a taluk and the principal object of which is to provide for long-term credit for agricultural and rural development activities. PQR Co-operative Bank is a primary co-operative agricultural and rural development bank as defined in the said *Explanation* since it is a co-operative society having its area of operation confined to Gubbi Taluk and its principal object is to provide long-term credit for agricultural and rural development activities. Therefore, it is eligible for deduction under section 80P.

Interest of Rs.1,00,000 received by the bank on loans advanced to its members is eligible for deduction in full under section 80P(2)(a)(i).

Interest of Rs.1,50,000 received by the bank from deposits with other co-operative societies qualifies for deduction in full under section 80P(2)(d).

Rent of Rs.2,00,000 received by the bank from letting out its godowns for storage of commodities is eligible for deduction in full under section 80P(2)(e).

Question 5

C, an individual, resident in India, paid medical insurance premium amounting to Rs.20,000 by cash during the year ending 31.3.2006 out of his income chargeable to tax in respect of the policy taken on the health of his dependent father in accordance with the scheme framed by the General Insurance Corporation of India and approved by the Central Government. Besides, he paid Rs.90,000 during the year ending 31.3.2006 for the medical treatment of his dependent mother, aged 69 years, in respect of a disease specified in Rule 11DD(1) of the Income-tax Rules, 1962. He received Rs.20,000 from the insurance company for the said medical treatment of his mother. C seeks your advice on the deductions, if any, available in respect of these two payments. (6 marks) (Nov 2006)

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

Section 80D provides for deduction in respect of medical insurance premium paid by an individual or a Hindu undivided family subject to certain conditions and limitations. One of the conditions for allowance of the deduction is that the premium should be paid by any mode other than cash. C has paid the premium by cash and is therefore, not eligible for deduction under section 80D.

However, C is eligible for deduction under section 80DDB in respect of the payment made by him during the relevant previous year for the medical treatment of his dependent mother in respect of the specified disease. The ceiling limit of deduction is Rs.60,000 since the payment made is in respect of his dependent mother who is above 65 years of age. Section 80DDB provides that the assessee shall be allowed a deduction of the amount actually paid for medical treatment of the specified disease or Rs.60,000 (since the payment is in respect of a senior citizen), whichever is less, in respect of that previous year in which such amount was actually paid. The second proviso to that section provides that *deduction under that section* shall be reduced by the amount received under an insurance. From a combined reading of the section and the proviso, it can be inferred that in this case, Rs.20,000, being the amount received from the insurer, should be deducted from Rs.60,000, which is the *deduction allowable as per section 80DDB* (since it is lower than the amount of Rs.90,000 actually paid).

Therefore, Rs.40,000 [i.e. Rs.60,000 minus Rs.20,000] is the deduction available under section 80DDB.

Question 6

A co-operative society engaged in the business of banking seeks your opinion in the matter of eligibility of deduction u/s 80P on the following items of income earned by it during the year ending 31.3.2006:

(i) Interest on investment in Government securities made out of statutory reserves

(ii) Hire charges of safe deposit lockers. *(3 Marks) (May 2006)*

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

(i) As per section 80P(4) the benefit of deduction is limited to primary agricultural credit society or primary co-operative agricultural and rural development bank. If the assessee does not fall within the eligible category, the benefit of deduction under section 80P could not be availed.

(ii) If the assessee is an eligible entity then interest earned on investment in Government securities made out of statutory reserves is eligible for deduction [as per the decision of the Supreme Court in *CIT v. Karnataka State Co-operative Apex Bank (2001) 251 ITR 194*]. Similarly provision of safe deposit lockers is part of the ordinary banking business. Income from hiring of such lockers is also income from banking business, eligible for deduction under section 80P.

Question 7

(a) An institution has been established wholly for charitable and religious purposes within the meaning of sections 11 and 12 of the Income-tax Act. Donations made to such an institution do not automatically qualify for deduction under section 80G. Discuss the validity of this proposition. *(May 2004)*

(b) Expenditure on medical treatment of an assessee and members of his family constitute a major element of a household budget, particularly if he or a member of his family suffers from physical disability. Discuss the relevant provisions which provide relief or deductions available to a non-salaried person, in this respect.(2× 6=12 Marks) (May 2004)

Answer

(a) An institution which has been established wholly for charitable and religious purposes within the meaning of sections 11 and 12 has to satisfy certain other conditions to qualify for deduction under section 80G (vide sub-section 5). The additional conditions required to be satisfied are:

1. The instrument under which the institution is established should not contain any provision for the transfer or application at any time of the whole or any part of the income or assets for any purpose other than a charitable purpose.
2. The institution should not be for the benefit of any particular religious community or caste.
3. The institution should maintain regular accounts of its receipts and expenditure.
4. The institution should be constituted either as a public charitable trust or registered under the Societies Registration Act or section 25 of the Companies Act or be a university established by law or an institution financed wholly or in part by the Government or a local authority.
5. In relation to donations made after 31.5.1992, the institution should for the time being, be approved by the Commissioner of Income-tax in accordance with rules made in this behalf.

Charitable purpose does not include any purpose of a religious nature with two exceptions:

(a) An institution established for the benefit of Scheduled Caste, Backward classes, Scheduled Tribes or of women and children, shall not be deemed to be an institution expressed to be for the benefit of a religious community or caste.

(b) Incurring of expenditure not exceeding 5% of its total income of that previous year for religious purpose will not disqualify an institution for the purpose of section 80G.

Students may note that Finance (No.2) Act, 2009 has omitted proviso to clause (vi) of sub-section 5 of section 80G to provide that once an approval is granted it shall continue to be valid in perpetuity. However, the Commissioner has the power to withdraw the approval if he is satisfied that the activities of the institution or fund are not genuine or are not being carried out in accordance with the objects of the institution or fund. Approvals expiring on or after 01.10.2009 shall be deemed to have been extended in perpetuity unless specifically withdrawn. Where the approvals expire before 01.10.2009, these have to be renewed and once renewed these shall continue to be valid in perpetuity unless specifically withdrawn.

(b) Sections 80D, 80DD, 80DDB and 80U of Chapter VI-A of the Income-tax Act provide deduction in respect of medical insurance premium paid/ medical expenditure incurred/ amount deposited with LIC or any other insurer approved by the IRDA.

Sections 80DD and 80U, which particularly provide for deduction in respect of a person with disability, are discussed hereunder -

(i) Under section 80DD, deduction is allowable to an individual or HUF, resident in India, in respect of any expenditure incurred for the medical treatment (including nursing), training, rehabilitation of a dependent with disability or a payment made to L.I.C. or any other insurer approved by the IRDA for the maintenance of a dependent with disability. The deduction under this section is Rs.50,000, irrespective of the quantum of expenditure incurred or deposit made. The deduction is Rs.1,00,000, where the dependent is a person with severe disability.

(ii) Under section 80U, an individual who is a resident and who is certified by a medical authority to be a person with disability at any time during the previous year, shall be entitled to a deduction of Rs.50,000. If it is a case of severe disability, deduction shall be Rs.1,00,000. A copy of the certificate issued by the Medical authority is required to be furnished in respect of the assessment year for which the deduction is claimed along with the return of income.

Question 8

What is the deduction allowable in respect of donations for political purposes? How will expenditure on advertisements in souvenirs of political parties be dealt with, in computing income from business? (5 Marks) (May 2004)

Answer

Sections 80GGB and 80GGC have been inserted in the Income-tax Act, 1961 by the Election and Other Related Laws (Amendment) Act, 2003 w.e.f. 11.9.2003.

As per section 80GGB, any sum contributed by an Indian company in the previous year to any political party shall be allowed as deduction while computing its total income. For the purpose of this section, the word "contribute" has the meaning assigned to it under section 293A of the Companies Act, 1956, which provides that -

(a) a donation or subscription or payment given by a company to a person for carrying on any activity which is likely to effect public support for a political party shall also be deemed to be contribution for a political purpose;

(b) the 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 to be a contribution to such political party or a contribution for a political purpose to the person publishing it.

As per section 80GGC, any amount of contribution made by an assessee being any person, except local authority and every artificial juridical person wholly or partly funded by the Government shall be allowed as deduction while computing the total income of such person.

For the purposes of sections 80GGB and 80GGC, "political party" means a political party registered under section 29A of the Representation of the People Act, 1951.

As regards expenditure on advertisements in souvenirs of political parties, the meaning of the word "contribute" as discussed above as per section 80GGB makes it clear that such expenditure is deemed to be a contribution to a political party or for a political purpose. However, section 37(2B) provides that no allowance shall be made in respect of expenditure incurred by an assessee on advertisement in any souvenir, brochure, tract, pamphlet or the like published by a political party. Therefore, the provisions of section 37(2B) have to be given effect to in computing gross total income. Thereafter, while allowing Chapter- VIA deductions, such expenditure would be allowed under section 80GGB.

The Finance (No.2) Act, 2009 has extended the scope for deduction under sections 80GGB and 80GGC in respect of any sum contributed to "electoral trust". The meaning of "electoral trust" is defined in section 2(22AAA), which means a trust approved by the Board in accordance with the scheme made in this regard by the Central Government. Hence, contribution made to electoral trust is also eligible for deduction under section 80GGB or section 80GGC.

Question 9

Roxy Cine Arts of Mumbai is engaged in distribution of cinematography films. It started construction of a multiplex theatre and convention hall in Navi Mumbai in April, 2002 and completed in December, 2002. The profits for the year ended 31-03-03 of all the activities are:

(i)	*Distribution of Cinematography Films*	*Rs. 5 lakhs*
(ii)	*Convention Centre*	*Rs. 2 lakhs*
(iii)	*Multiplex Theatre*	*Rs. 1 lakh.*

Compute the taxable income for the Assessment year 2003-04 with reasons.

(4 marks) (Nov.2003)

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

Income from multiplex theatre is eligible for deduction under section 80-IB(7A) @ 50% for five assessment years provided the multiplex theatre was constructed before 31.03.2005. No deduction could be claimed under this section beyond fifth year. Therefore, for the assessment year 2010-11, benefit of section 80-IB(7A) will not be available.

Similarly, the construction of convention centre ought to have completed before 31.03.2005 for availing deduction under section 80-IB(7B) for five years @ 50% of the profits and gains derived therefrom.

Therefore, no deduction under section 80-IB(7A) and under section 80-IB(7B) could be availed by Roxy Cine Arts for the assessment year 2010-11.

Question 10

How do you deal with the following situations? Give reasons for your answer. (Assessment Year 2002-03):

The Assessee, a Co-operative Society, earned interest income out of the reserve funds, which had been invested with SBI/RBI in compliance with statutory provisions in order to carry on banking business and claimed deduction under Section 80P(2)(a) of Income-tax Act. The Assessing Officer declined to allow the claim, but restricted its claim to that part of interest income derived from working or circulating capital. Examine the validity of the action of Assessing Officer. *(3 marks) (Nov.2002)*

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

No deduction under section 80-P would be allowed from the assessment year 2007-08 unless the assessee is a primary agricultural credit society or a primary co-operative agricultural and rural development bank.

Assuming the society is eligible for deduction by being a primary agricultural credit society or a primary co-operative agricultural and rural development bank the eligibility for deduction under section 80-P vis a vis the validity of the action of the Assessing Officer is to be decided. In order to carry on the business of banking, the society had to make investments out of the reserve funds with SBI/ RBI in compliance with statutory provisions and the same was necessary and consequently such investments are part of the business activities falling within the scope of section 80P(2)(a) of the Income-tax Act. There is nothing in the phraseology in section 80P(2)(a)(i) which makes it applicable only to income derived from working or circulating capital. Thus, the action of the Assessing Officer is not correct in law and he should allow the total interest income derived from investments made out of reserve funds under section 80P(2)(a). [*CIT vs. Karnataka State Co-operative Apex Bank 251 ITR 194 (SC)]*.

Question 11

Write short notes on the following:

Deduction in respect of loan taken for higher education *(4 Marks) (May 2002)*

Answer

Section 80-E governs the deduction in respect of repayment of loan taken for higher education. It applies to individuals and the deduction is limited to payment of *interest on loan* taken from any financial institution or any approved charitable institution for the purpose of pursuing his higher education or for the purpose of higher education of his or her relative i.e. spouse or children of the individual or the student for whom the individual is a legal guardian. There is no monetary limit in respect of the interest on educational loan paid by the assessee. The deduction is admissible for the initial assessment year and seven assessment years succeeding that year or until the interest is paid by the assessee in full, whichever is earlier.

13

ASSESSMENT OF VARIOUS ENTITIES

Question 1

X, Y and HUF of Z (represented by Z) are partners with equal shares in profits and losses of a firm, M/s Popular Cine Vision, which is engaged in the production of TV serials and telefilms. In the previous year 2007-08, one partner 'A' retired, but his dues have been settled in the previous year 2008-09.

The earlier partnership deed did not authorise payment of remuneration or interest to partners. The partnership deed was revised by the partners on 1st June, 2008 to authorise payment of remuneration of Rs.1 lac per month to each working partner and simple interest at 15% per annum to X and Y on their capital. X, Y and Z are actively associated with the affairs of the firm.

The Profit & Loss Account of the firm for the year ended 31st March, 2009 shows a net profit of Rs.10 lacs after debiting/crediting the following:

(a) *Interest amounting to Rs.15 lacs paid to X and Y on the balances standing to their capital accounts from 1st April, 2008 to 31st March, 2009.*

(b) *Remuneration to the partners including partner in representative capacity Rs.30 lacs.*

(c) *Interest amounting to Rs.2 lacs paid to Z on loan provided by him in his individual capacity at 16% interest.*

(d) *Royalty of Rs.5 lacs paid to partner X, who is litterateur and a professional script writer, for use of his scripts as per an agreement between the firm and X.*

(e) *Two separate payments of Rs.18,000 and Rs.15,000 made in cash on 1st February, 2009 to Altaf, a hairdresser, against his bill for services rendered in January, 2009 and two payments of Rs.19,000 and Rs.10,000 made in cash on 1st February and 2nd February, 2009, respectively, to Priyam, an assistant cameraman, against her bill for services provided in January, 2009.*

(f) *Amount of Rs.5 lacs provided in the books on 31st March 2009 as liability for remuneration to Shreyashi, a film artist and a non-resident. Tax deducted at source under section 195 from the amount so credited was paid on 3rd June, 2009.*

(g) Amount of Rs.6 lacs provided as gratuity for the year on the basis of actuarial valuation. Gratuity paid to retired employees is Rs.1.50 lacs.

(h) Interest of Rs.1.20 lacs received on income-tax refund under section 244(1A) in respect of assessment year 2007-08.

The firm has also provided the following additional information:

The amount due to A, the former partner, was Rs.15 lacs. The dues were settled on 30th September, 2008 by transferring a plot of land purchased two years back having a book value of Rs.10 lacs. The difference of Rs.5 lacs was credited to partners' capital accounts in their profit sharing ratio. The fair market value of the plot on the date of transfer was Rs.16 lacs.

Compute the total income of the firm for the assessment year 2009-10 stating the reasons for treatment of each item. (16 Marks) (June 2009)

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

Computation of Total Income of M/s. Popular Cine Vision for the A.Y.2010-11

	Rs.	*Rs.*
Profits and Gains from Business or Profession		
Net Profit as per Profit & Loss A/c		10,00,000
Add: Expenses disallowed or considered separately		
Interest to partners in excess of 12% (Note 1)	5,00,000	
Disallowance under section 40A(3) for aggregate cash payment exceeding Rs.20,000 in a single day (Note 5)	33,000	
Remuneration to non-resident film artist to be disallowed under section 40(a)(i) as the TDS payment was made in June 2010 (Note 6)	5,00,000	
Provision for gratuity (Note 7)	4,50,000	
Partners' Remuneration	30,00,000	
Royalty paid to Partner X (Note 4)	5,00,000	49,83,000
		59,83,000
Less: Interest on income-tax refund (Note 8)		1,20,000
Book Profit		58,63,000
Less: Partners' remuneration allowable under section 40(b)(v)		
(i) As per limit prescribed in section 40(b)		

On first Rs.3,00,000	90%	2,70,000	
On the balance Rs.55,63,000	60%	33,37,800	
		36,07,800	
(ii) Remuneration actually paid or payable (Rs.1,00,000 × 10 months × 3 partners) + (Royalty Rs.5 lakh)		35,00,000	
(i) or (ii) whichever is less, is deductible			35,00,000
			23,63,000
Capital Gain			
Short-term capital gain on transfer of land (Note 9)			6,00,000
Income from other sources			
Interest on income-tax refund			1,20,000
Gross Total Income			**30,83,000**
Deductions under Chapter VI-A			Nil
Total Income			**30,83,000**

Notes:

1. As per section 40(b) simple interest at 12% p.a. to partners relating to the period after the date of partnership deed is allowable. Therefore, interest to partners from 1st April to 31st May, 2009 should be disallowed. Further, the excess interest @ 3% paid from 1st June, 2009 to 31st March, 2010 should also be disallowed.

		Rs.
Interest for April and May, 2009	15,00,000 x 2/12	2,50,000
Excess interest from June'09 to March'10	(15,00,000 x 3/15) x 10/12	2,50,000
		5,00,000

Note – It is assumed that Rs.15 lacs is the cumulative interest paid to X and Y during the year, since the question does not mention Rs.15 lacs "each" paid to X and Y.

2. Even though Z is a partner in a representative capacity, he is still a partner. Therefore, remuneration to Z should also be subject to the limits prescribed in section 40(b). This view finds support from the decision of the Supreme Court in the case of *Rashik Lal & Co. vs CIT (1998) 229 ITR 458 (SC).*

3. As per Explanation 1 to section 40(b) where an individual is a partner in a firm in a representative capacity, the provisions of section 40(b) shall not apply to any interest payable by the firm to such individual in his personal capacity. Z represents his HUF in

the firm. However, Z gave the loan in his individual capacity. Hence, assuming that the provisions of section 40A(2) do not get attracted in this case, such interest shall be allowed as deduction in full even though the interest rate is more than 12% p.a.

4. It may be noted that the limits specified under section 40(b)(v) are applicable in case of payment of salary, bonus, commission, or remuneration, by whatever name called, to a working partner. From a plain reading of the section, it is clear that any remuneration, **by whatever name called**, paid to a working partner, is subject to the limits laid down in section 40(b)(v). Therefore, the royalty of Rs.5 lakh paid to partner X would also be subject to the limits laid down in section 40(b)(v). Hence, the same has to be added back for computing book profits.

5. Section 40A(3) provides for disallowance of any expenditure in respect of which aggregate of payments made otherwise than by an account payee cheque or account payee bank draft in a single day to a person exceeds a sum of Rs.20,000. Hence, the payments of Rs.18,000 and Rs.15,000 in cash on 1.2.2010 to Altaf, a hairdresser, shall be disallowed, since the aggregate payment of Rs.33,000 exceeds the limit of Rs.20,000.

   In case of payment of bill of the assistant cameraman, since the aggregate payment in cash on a single day does not exceed Rs.20,000, disallowance under section 40A(3) is not attracted.

6. As per section 40(a)(i), any sum payable to a non-resident shall not be allowed as deduction, if tax has not been deducted at source or after deduction, has not been paid within the time limit prescribed in section 200(1). Tax deducted from the amount of remuneration credited to payee's account on 31st March 2010 has to be deposited latest by 31st May, 2010. The firm has paid the tax on 3rd June, 2010 and hence, the remuneration shall not be allowed.

7. As per section 40A(7), any provision made for payment of gratuity to employees on their retirement or on termination of employment for any reason is disallowed. However, any provision made for the purpose of payment of a sum by way of any contribution to an approved gratuity fund or for the purpose of payment of gratuity which has become payable during the previous year shall be allowed as deduction. The question does not mention any approved gratuity fund. However, gratuity of Rs.1.50 lacs paid to retired employees is allowable as deduction. Hence, the balance provision of Rs.4.50 lacs (i.e., Rs.6 lacs – Rs.1.50 lacs) is to be disallowed.

8. Interest on income-tax refund is assessable under the head "Income from other sources".

9. Distribution of a capital asset by a firm to its partner on dissolution or otherwise attracts capital gains tax liability as per the provisions of section 45(4) and the fair market value of the asset on the date of transfer is deemed to be the full value of consideration received or accruing as a result of the transfer. The words "or otherwise" includes within its scope, cases of distribution of capital assets on retirement of a partner also. [*CIT vs.*

A. N .Naik Associates 265 ITR 346 (Bom.)]. Therefore, distribution of a plot of land on retirement of a partner would attract section 45(4).

Rs.16 lacs, being the fair market value of the plot on the date of transfer, is deemed to be the full value of consideration. Therefore, the capital gain would be Rs.6 lacs (i.e., Rs.16 lacs – Rs.10 lacs).

Question 2

Hyper Ltd., engaged in diversified activities, earned a net profit of Rs.14,25,000 after debit/credit of the following items to its profit and loss account for the year ended on 31.3.2008:

(a)	***Items debited to Profit and Loss Account***	***Rs.***
	Expenses on Industrial Unit exempt under section 10A	*2,10,000*
	Provision for Loss of Subsidiary	*70,000*
	Provision for Sales Tax Demand (paid before due date)	*75,000*
	Provision for Wealth Tax Demand	*90,000*
	Provision for Income Tax Demand	*1,05,000*
	Expenses on purchase/sale of equity shares	*15,000*
	Depreciation	*3,60,000*
	Interest on deposit credited to buyers on 31.3.2008 for advance received from them, on which TDS was deposited on 31.7.2008	*90,000*
(b)	***Items credited to Profit and Loss Account***	
	Income on Industrial Unit exempt under section 10A	*2,70,000*
	Profit from 100% EOU under section 10B	*60,000*
	Long term capital gain on sale of equity shares on which securities transaction tax was paid	*3,60,000*
	Income from units of UTI	*75,000*

The company provides the following additional information:

(i) *Depreciation includes Rs.1,50,000 on account of revaluation of fixed assets.*

(ii) *Depreciation allowable as per Income-tax Rules is Rs.2,80,000.*

(iii) *Brought forward Business Loss/Unabsorbed Depreciation:*

F.Y.	***Amount as per books***		***Amount as per Income-tax***	
	Loss	***Depreciation***	***Loss***	***Depreciation***
1999-2000	*2,50,000*	*3,00,000*	*2,00,000*	*2,50,000*
2004-2005	*Nil*	*2,70,000*	*1,00,000*	*1,80,000*
2005-2006	*3,50,000*	*3,15,000*	*1,20,000*	*2,10,000*

You are required to:

(i) compute the total income of the company for the assessment year 2008-09 giving the reasons for treatment of items and

(ii) examine the applicability of section 115JB of the Income-tax Act, and compute book profit and the tax credit to be carried forward. *(16 Marks) (Nov 2008)*

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

Computation of total income of M/s Hyper Ltd. for the A.Y. 2010-11

Particulars	Rs.	Rs.
Net profit as per Profit & Loss Account		14,25,000
Add: **Items disallowed /considered separately**		
Expenses on industrial unit exempt under section 10A [expenses in relation to exempt income are not be allowed]	2,10,000	
Provision for loss of subsidiary [since it is not wholly and exclusively for the purpose of business of the assessee]	70,000	
Provision for wealth-tax [disallowed under section 40(a)(iia)]	90,000	
Provision for sales tax [is fully allowable since the sales tax has been paid before the due date]	-	
Provision for income-tax [disallowed under section 40(a)(ii)]	1,05,000	
Expenses on transfer of shares [not deductible from business income. It is to be deducted from gross sale consideration while computing capital gains]	15,000	
Interest on deposit credited on 31.3.2010 and tax deposited on 31.7.2010 [allowed under section 40(a)(ia)]	Nil	
Depreciation debited to profit and loss account [only depreciation calculated as per Income-tax Rules is allowable as deduction]	3,60,000	8,50,000
		22,75,000
Less: **Items credited but not includible under business income or are exempt under the provisions of the Act**		
Income of industrial unit under section 10A, since it is an exempt income	2,70,000	
Profit from 100% EOU under section 10B, being an exempt income	60,000	
Long-term capital gain on sale of equity shares on which securities transaction tax was paid, since it is not a business income.	3,60,000	

Income from UTI, since it is not a business income.	75,000	
		7,65,000
		15,10,000
Less: Depreciation (allowable as per Income-tax rules)		2,80,000
		12,30,000
***Less*: Set-off of brought forward business loss and unabsorbed depreciation**		
Brought forward business loss under section 72	4,20,000	
Brought forward depreciation under section 32	6,40,000	10,60,000
Income from business		**1,70,000**
Capital Gains		
Long term capital gain on sale of equity shares on which securities transaction tax was paid	3,60,000	
Less: Exempt under section 10(38)	3,60,000	Nil
Income from Other Sources		
Income from units of UTI	75,000	
Less: Exempt under section 10(35)	75,000	Nil
Total Income		**1,70,000**
Tax payable @ 30%		51,000
Add: Education cess @ 2%	1,020	
Secondary and higher education cess @ 1%	510	1,530
Tax Payable as per the Income-tax Act		52,530

Computation of Book Profit under section 115JB

Particulars	**Rs.**	**Rs.**
Net Profit as per Profit & Loss Account		14,25,000
***Add:* Net Profit to be increased by the following amounts as per Explanation 1 to section 115JB**		
Provision for loss of subsidiary	70,000	
Provision for income-tax	1,05,000	

Depreciation	3,60,000	5,35,000
		19,60,000
***Less:* Net Profit to be reduced by the following amounts as per Explanation 1 to section 115JB**		
Depreciation debited to profit and loss account (excluding depreciation on account of revaluation of fixed assets) (i.e. Rs.3,60,000 – Rs.1,50,000)	2,10,000	
Income from UTI [since it is an income exempt under section 10(35)]	75,000	
Brought forward business loss or unabsorbed deprecation as per books of account, whichever is less, taken on cumulative basis	6,00,000	8,85,000
Book Profit		**10,75,000**
15% of book profit		1,61,250
Add: Education cess @ 2%	3,225	
Secondary and higher education cess @ 1%	1,613	4,838
		1,66,088

In case of a company, it has been provided that where income-tax payable on total income computed as per the provisions of the Act is less than 15% of book profit, the book profit shall be deemed as the total income and the tax payable on such total income shall be 15% thereof plus education cess @ 2% and secondary and higher education cess @ 1%. Accordingly, in this case, since income-tax payable on total income computed as per the provisions of the Act is less than 15% of book profit, the book profit of Rs.10,75,000 is deemed to be the total income and income-tax is payable @ 15% thereof plus education cess @ 2% and secondary and higher education cess @ 1%. The tax liability, therefore, works out to be Rs.1,66,088.

Section 115JAA provides that where tax is paid in any assessment year in relation to the deemed income under section 115JB(1), the excess of tax so paid, over and above the tax payable under the other provisions of the Income-tax Act, will be allowed as tax credit in the subsequent years. The tax credit is, therefore, the difference between the tax paid under section 115JB(1) and the tax payable on the total income computed in accordance with the other provisions of the Act. This tax credit is allowed to be carried forward for ten assessment years succeeding the assessment year in which the credit became allowable. Such credit is allowed to be set off against the tax payable on the total income in an assessment year in which the tax is computed in accordance with the provisions of the Act, other than section 115JB, to the extent of excess of such tax payable over the tax payable on book profits in that year.

Particulars	**Rs.**
Tax on book profit under section 115JB	1,66,088
Less: Tax on total income computed as per the other provisions of the Act	52,530
Tax credit to be carried forward	**1,13,558**

Notes:

1. Income from industrial unit under section 10A and profit from 100% E.O.U. under section 10B are exempt from income-tax. However, MAT is leviable on income eligible for exemption under section 10A and 10B. Hence, such income should not be reduced while computing book profits and consequently, expenses relating to such units should not be added back while computing book profits.
2. Long-term capital gains on sale of equity shares through a recognized stock exchange on which securities transaction tax (STT) is paid is exempt under section 10(38). One of the adjustments to the book profit is that exempt income under section 10, which is credited to profit and loss account, would be deducted in arriving at the book profit. However, deduction of such long-term capital gains is not allowed for computing book profit. Consequently, expenditure to earn such income should not be added back to arrive at the book profit. Section 10(38) also provides that such long term capital gain of a company shall be taken into account in computing the book profit and income-tax payable under section 115JB.

Question 3

The net profit for the year ended on 31.3.2008 of India Biotech Ltd. engaged in the business of bio-technology works out to Rs.45 lacs after debit/credit of the following items:

(i) Profit of Rs.2,50,000 from a hedging contract entered into for meeting out the loss in foreign currency payments towards an imported machinery of Rs.80 lacs installed on 1.2.2008.

(ii) Incidental charges of Rs.20 lacs paid to a financial institution for taking short-term loan of Rs.25 crores repayable in 18 months.

(iii) Commission of Rs.25,000 paid to a recovery agent for getting realisation of an old outstanding.

(iv) Registration fees of Rs.20,000 and listing fees of Rs.30,000 paid to the Registrar of Companies and the Stock Exchange respectively on the issue of bonus shares.

(v) Amount of Rs.1,00,000 towards carry forward losses for Asst. year 1998-99 of X Ltd., which got merged with the company during the financial year 2003-04.

(vi) Interest received from banks of Rs.90,000 net of TDS of Rs.10,000.

(vii) Amount of Rs.1,50,000 incurred towards reconditioning of generator.

(viii) Employees share to the EPF for the month of March, 2008 of Rs.40,000. The amount was deposited with the PF Commissioner on 22.4.2008.

Compute the total income of the company for Asst. year 2008-09 and give brief reasons for the treatment given to each of the items. *(13 Marks) (May 2008)*

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

Computation of Total Income of India Biotech Ltd. for A.Y. 2010-11

Particulars	Amount Rs.	Amount Rs.
Income from business		
Net Profit as per profit and loss account		45,00,000
Less: Items credited but to be considered separately		
Profit from hedging contract	2,50,000	
Interest from banks	90,000	3,40,000
		41,60,000
Add: Employee's share already charged in Profit & Loss Account but not deposited within the 'due date' specified under the PF Act as per section 36(1)(va)		40,000
		42,00,000
Add: Depreciation on plant and machinery on account of hedging profit (7.5% on Rs.2,50,000)	18,750	
Additional depreciation (10% on Rs.2,50,000)	25,000	43,750
		42,43,750
Income from other sources		
Interest received from banks (gross)		1,00,000
Total Income		**43,43,750**

Notes -

1. Hedging contract is entered into for safeguarding against any loss that may arise due to currency fluctuation. The profit from such contract entered into for meeting loss in foreign currency payments towards imported machinery has to be adjusted against the cost of plant and machinery. Consequently, the same will have an impact on depreciation and additional depreciation on imported plant and machinery. It is presumed that the conditions for claim of additional depreciation are satisfied and accordingly, the additional depreciation has been charged to profit and loss account. Since there is a reduction in the cost of plant and machinery on account of the hedging profit of Rs.2,50,000, the excess depreciation and additional depreciation debited to the profit and loss account have to be added back to the profits.

2. Incidental charges incurred for raising short term loan from financial institutions is allowable as deduction, since, as per CBDT letter F.No.32/6/62-IT(A-1) dated 16.1.1963,–

   (i) it is in respect of a short term loan of a duration of not more than 2 years; and

   (ii) it does not exceed 1% of Rs.25 crores, being the amount of loan raised.

3. Commission of Rs.25,000 paid to a recovery agent for realisation of old outstanding is an allowable expense under section 37 as per *DCIT v. Super Tannery (India) Ltd. (2005) 274 ITR 338 (All).* It is assumed that the company has deducted tax at source and remitted the same in accordance with the provisions of section 194H.
4. The Supreme Court has, in *CIT v. General Insurance Corporation (2006) 286 ITR 232,* observed that the issue of bonus shares does not result in expansion of the capital base of the company. Therefore, the expenditure incurred by the company on account of registration fees and listing fees for the issue of bonus shares is allowable as revenue expenditure.
5. As per section 72A, the unabsorbed business loss of the amalgamating company shall be deemed to be the loss of the amalgamated company for the previous year in which the amalgamation took place. Therefore, such loss can be set-off against the income of the amalgamated company in the year of amalgamation and the balance, if any, can be carried forward and set-off against the business income of the amalgamated company in the subsequent years. Such loss can be carried forward by the amalgamated company for a maximum period of 8 years from the year of amalgamation. In this case, the amalgamation took place in the financial year 2003-04 and therefore, the 8 year period has not expired in the financial year 2009-10. Therefore, the set-off of losses of Rs.1 lakh relating to X Ltd. is in order. It is assumed that the conditions specified in section 72A are satisfied.
6. Interest received from banks is chargeable to tax under the head "Income from other sources", assuming that there is no nexus between the interest income and the business of the assessee. For this purpose, the net amount of interest has to be grossed up by adding the amount of TDS of Rs.10,000. Since the net interest of Rs.90,000 is credited to profit and loss account, the same has to be reduced to compute the business income.
7. Expenditure on reconditioning of the generator is in the nature of normal repairs and is eligible for deduction under section 31.
8. As per section 2(24)(x), "income" includes any sum received by an employer from his employees as contributions to any provident fund. Section 36(1)(va) permits the employer to claim deduction in respect of such employee contributions to PF provided they are remitted within the due date specified under the PF Act, which is the 15th day of the succeeding month with a grace period of 5 days. Therefore, the due date in this case would be 20th April, 2010. However, since the amount of Rs.40,000 was deposited with the PF commissioner only on 22nd April, 2010, the same will not be allowed as deduction while computing the business income.

Question 4

Prakash, a member in two AOPs, namely, "AOP & Co." and "Prakash & Akash", provides the following details of his income for the year ended on 31.3.2007:

(a) "AOP & Co.", assessed at normal rates of tax, had credited in his account, amount of Rs.96,000 as interest on capital, Rs.96,000 as salary and Rs.20,000 as share of profit.

(b) A house property located at Jaipur was purchased on 1.7.2001 with the borrowed capital in "Prakash & Akash" jointly shared equally and occupied by both of them for self residential purposes. Total interest paid for the year 2006-07 on the borrowed capital was Rs.1,60,000.

Compute the income and the tax liability thereon for the A.Y. 2007-08 and support your answer with brief reasons and the provisions of the Act. (6 Marks) (Nov 2007)

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

Mr. Prakash is a member in two AOPs, namely, AOP & Co. and Prakash & Akash. Though Prakash & Akash is an AOP, the income from the house property will not be assessed as income of the AOP, but will be included in the hands of the individual members as per section 26, since the share of each member is definite and ascertainable. Hence, Prakash's share of income from house property would be assessed in his individual hands.

Since AOP & Co., has been taxed at normal rates of tax, Mr.Prakash's share income from the AOP (i.e. salary, interest on capital and his share of profit) would be included in his total income. Mr. Prakash, however, would be entitled to a relief under section 86 in respect of this income which has been included in his total income but on which tax has already been paid by the AOP. As per section 110, the relief shall be allowed at the average rate of tax calculated on the total income inclusive of such income.

Hence, the tax liability in the hands of Mr. Prakash would be as under:-

Particulars	**Rs.**	**Rs.**
Annual Value (½ share in house property used for own residence)	Nil	
Less: Interest on loan [½ share in Rs.1,60,000] – Since the loan is borrowed on or after 1.4.1999 and is used for acquiring property within 3 years, deduction would be available upto a maximum of Rs.1,50,000. This limit of Rs.1,50,000 applies for each member separately.	80,000	
Loss from house property		(-) 80,000
Share income from AOP & Co.		
- Interest on capital	96,000	
- Salary	96,000	
- Share of profit	20,000	2,12,000
Total Income		**1,32,000**
Tax on total income		NIL

Question 5

HSP, a partnership firm engaged in the business of running a heritage hotel approved by the competent authority provides the following information relating to the year ended on 31.3.2007:

(a) Net profit as per P & L account of Rs.200 lacs was arrived at after charge of the following:

(i) Depreciation on hotel building having W.D.V. on 1.4.2006 of Rs.500 lacs was charged by treating the same as plant and machinery.

(ii) Expenses of Rs.1,00,000 incurred for the purpose of promoting family planning among its employees.

(iii) Payment of Rs.50,000 for an advertisement published in the souvenir released on 15th August by Bhartiya Janta Party.

(iv) Compensation of Rs.1,00,000 paid to the suppliers of automatic kitchen appliances because of termination of the contract after receipt of 50% of appliances.

(v) Wines and liquor imported in F.Y. 2005-06 for Rs.20 lacs and were available in the stock on 1.4.2006 for Rs.5 lacs were confiscated by the Govt. authority and therefore were written off.

(vi) Expenses of Rs.20 lacs incurred on replacement of carpets in the foyer, lounge and bar.

(b) Out of amount credited to the reserve created under section 80HHD(1) in the F.Y. 2001-02, an amount of Rs.15 lacs could not be utilised for the purposes as per section 80HHD(4) till 31.3.2007.

(c) Amount of Rs.4 lacs equal to U.K. £5000 was remitted and paid to a travel agent resident of U.K. as commission for the booking of international tourists in the hotel. Tax at source was not deducted out of such payment.

(d) Amount of Rs.40,000 each was paid in cash to the suppliers of vegetables, milk products and eggs on 11.2.07 because of suspension of banking operations due to strike of bank employees.

(e) Amount of Rs.5 lacs written off in the F.Y. 2004-05 as irrecoverable from a travel agent; an amount of Rs.2 lacs out of it was recovered on 13.3.07 and credited to a reserve account.

Compute the income chargeable to tax for A.Y. 2007-08 and give reasons in brief for treatment given to each of the items. *(14 Marks) (Nov 2007)*

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

Computation of taxable income of M/s. HSP for the A.Y.2010-11

Particulars		Amount in Rs.
Income from business and profession		
Net profit as per profit and loss account		2,00,00,000
Add : *Items charged in profit and loss account which are not allowable*		
Excess depreciation on building @ 5%(i.e. 15% - 10%) on Rs.500 lakh	25,00,000	
Expenses on promoting family planning amongst the employees	1,00,000	
Advertisement in souvenir of a political party	50,000	
Compensation to a supplier of kitchen appliances	1,00,000	27,50,000
Add: Amount credited to reserve under section 80HHD		15,00,000
Add : Recovery of bad debts credited in reserve but chargeable under section 41 (4)		2,00,000
Total Income		**2,44,50,000**

Reasons for treatment given to each of the items specified:-

(1) Hotel building does not constitute plant and machinery and therefore, depreciation chargeable thereon is 10%. However, depreciation has been charged in the profit and loss account at the rate applicable to plant and machinery i.e. @ 15%. Accordingly, the excess depreciation charged in the profit and loss account @ 5% (15%-10%) has to be added to income.

(2) Expenses on promoting family planning amongst employees is allowable under section 36(1)(ix) *only to a company assessee*. In this case, since the assessee is a firm, such expenses are not allowable and therefore, the same has to be added back.

(3) Advertisement of any nature given in a magazine / souvenir published by a political party is not allowable as per section 37(2B).

(4) Compensation paid for breach of a contract for supply of a capital asset is in the nature of capital expenditure as held by the Supreme Court in case of *Swadeshi Cotton Mills Co. Ltd. vs. CIT (1967) 63 ITR 65.* Accordingly, the same will be disallowed and added back to income.

(5) The Apex Court in case of *Dr. T.A. Quereshi vs CIT (2006) 287 ITR 0547* observed that loss of stock-in-trade has to be considered as a trading loss. Explanation to section 37(1) is not relevant here since it is not a case of business expenditure but one of business loss. Business loss is allowable on ordinary commercial principles.

Therefore, since wine and liquor formed part of stock-in-trade of the firm, confiscation of the same has to be allowed as a business loss.

(6) The expenditure incurred on replacement of carpets by a hotel are in the nature of expenses incurred for the purposes of business and are allowable as revenue expenses under section 37(1).

(7) Deduction under section 80HHD was allowable only upto assessment year 2004-05. It is assumed that the amount was credited to reserves during the financial year 2003-04. The five year period would therefore expire on 31.3.2009. Since the amount of Rs. 15 lacs was not utilized for the specified purposes till 31.3.2009, the same is deemed to be the profit of the year immediately following the period of 5 years i.e. A.Y. 2010-11 (i.e. P.Y.2009-10).

(8) The payment to a non-resident outside India without deduction of tax at source is an allowable expense notwithstanding the withdrawal of CBDT Circular No.786 dated 7.2.2000 by means of Circular No.7 of 2009 dated 22.10.2009 as there is no income accruing or arising to the non-resident in India.

(9) The cash payments made totaling Rs.1,20,000 on the day when bank employees were on strike is an exception as per rule 6DD(k) and clarification of CBDT as per letter No.142(14)/70 dated 28/9/1970. Therefore, disallowance under section 40A(3) is not attracted.

(10) The recovery of a debt which was earlier written off under section 36(1)(vii) and was allowed as deduction is chargeable to tax under section 41(4) in the year of such recovery. Accordingly, such amount has to be added to income despite the fact that the same was credited by the firm in a reserve account.

Question 6

M/s. HIG, a firm, consisting of three partners namely, H, I and G, carried on the business of purchase and sale of television sets in wholesale and manufacture and sale of pens under a deed of partnership executed on 1.4.2002. H, I and G were partners in their individual capacity. The deed of partnership provided for payment of salary amounting to Rs.1,25,000 each to H and G, who were the working partners. A new deed of partnership was executed on 1.10.2006 which, apart from providing for payment of salary to the two working partners as mentioned in the deed of partnership executed on 1.4.2002, for the first time provided for payment of simple interest @ 12% per annum on the balances standing to the credit of the Capital accounts of partners from 1.4.2006. The firm was dissolved on 31.3.2007 and the Capital assets of the firm were distributed among the partners on 20.4.2007. The net profit of the firm for the year ending 31.3.2007 after payment of salary to the working partners and debit/credit of the following items to the Profit and Loss Account was Rs.1,50,000:

(i) Interest amounting to Rs.1,00,000 paid to the partners on the balances standing to the credit of their capital accounts from 1.4.2006 to 31.3.2007.

(ii) Interest amounting to Rs.50,000 paid to the partners on the balances standing to the credit of their Current accounts from 1.4.2006 to 31.3.2007.

(iii) Interest amounting to Rs.20,000 paid to the Hindu undivided family of partner H @ 18% per annum.

(iv) Payment of Rs.25,000 towards purchase of television sets made by crossed cheque on 1.11.2006.

(v) Rs.30,000 being the value of gold jewellery received as gift from a manufacturer for achieving sales target.

(vi) Depreciation amounting to Rs.15,000 on motor car bought and used exclusively for business purposes, but not registered in the name of the firm.

(vii) Depreciation under section 32(1)(ii) amounting to Rs.37,500 of new machinery bought and installed for manufacture of pens on 1.11.2006 at a cost of Rs.5,00,000. There was no increase in the installed capacity as a result of the installation of the new machinery.

(viii) Interest amounting to Rs.25,000 received from bank on fixed deposits made out of surplus funds.

The firm furnishes the following information relating to it:

(a) Closing stock-in-trade was valued at Rs.60,000 as per the method of lower of cost or market rate consistently followed by it. The market value of the closing stock-in-trade was Rs.65,000.

(b) Brought forward business loss relating to the assessment year 2006-07 was Rs.50,000.

(c) The fair market value of the capital assets as on 31.3.2007 was Rs.20,00,000 and the cost of their acquisition was Rs.15,00,000.

Compute the total income of M/s. HIG for the assessment year 2007-08.

You are required to furnish explanations for the treatment of the various items given above.

(16 Marks) (May 2007)

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

Computation of total income of M/s.HIG for the A.Y. 2010-11

Particulars	**Rs.**	**Rs.**
Net profit as per profit & loss account		1,50,000
Add: Interest to partners on capital accounts for the period from 1.4.2009 to 30.9.2009	50,000	
Interest to partners on current accounts from 1.4.2009 to 31.3.2010	50,000	
100% of Rs.25,000 paid towards purchase of television sets	25,000	
Difference on account of valuation of closing stock-in-trade at market value	5,000	

Salary paid to working partners considered separately	2,50,000	
		3,80,000
		5,30,000
Less: Additional depreciation on new machinery		50,000
		4,80,000
Less: Interest received from bank on fixed deposits considered separately		25,000
		4,55,000
Less: Salary to working partners -		
(i) As per limit in section 40(b)		
On first Rs.3,00,000 @ 90%	2,70,000	
On the balance of Rs.1,55,000 @ 60%	93,000	
	3,63,000	
(ii) Salary actually paid Rs.	2,50,000	
Deduction allowed being (i) or (ii) whichever is less		2,50,000
		2,05,000
Less: Business loss relating to assessment year 2006-07 set off		50,000
Income from business		**1,55,000**
Income from other sources		
Interest received from bank on fixed deposits		25,000
Total Income		**1,80,000**

Explanation for the treatment of various items

(i) Interest to partners authorised by the partnership deed will be allowed as deduction only for the period beginning with the date of the partnership deed and not for any earlier period as per section 40(b)(iv). Therefore, interest paid to the partners on the balances standing to the credit of their capital accounts from 1.10.2009 alone is eligible for deduction, since the partnership deed was executed only on 1.10.2009. Interest for the period prior to 1.10.2009 is not allowed.

(ii) The partnership deed of 1.10.2009 provides for payment of interest on balances in capital accounts of partners only. As such, the interest paid on the balances standing to the credit of the current accounts of partners is not allowable under section 40(b). The Kerala High Court has, in *Novel Distributing Enterprises v. DCIT & Anr. (2001) 251 ITR 704 (Ker)*, on identical facts, held that interest paid to the partners on their current account balances is not allowable.

(iii) Since H is a partner in his individual capacity, interest paid to the Hindu Undivided Family of partner H does not attract disallowance under section 40(b)(iv).

(iv) Section 40A(3) provides for disallowances @ 100% of the expenditure incurred otherwise than by an account payee cheque / account payee bank draft. Since the firm has made payment of Rs.25,000 towards purchase of television sets after 13.7.2009 by a crossed cheque and not by an account payee cheque, 100% of such expenditure would be disallowed.

(v) Gold jewellery valued at Rs.30,000 received as gift from a manufacturer for achieving sales target is taxable under section 28(iv), being a benefit arising from business.

(vi) Depreciation on motor car bought and used exclusively for the purposes of business is allowable though not registered in the name of the firm in view of the ratio of the decision of the Supreme Court in *Mysore Minerals Ltd. v. CIT (1999) 239 ITR 775*.

(vii) The firm is entitled to additional depreciation @ 20% under section 32(1)(iia) in respect of the new machinery installed for manufacture of pens. Since the new machinery is put to use for less than 180 days during the relevant previous year, the additional depreciation is restricted to 50% of the prescribed rate of 20% i.e. it is restricted to 10%.

(viii) Interest received from bank on fixed deposits made out of surplus funds is assessable under the head 'Income from other sources'. Hence, it is not taken into account for the purpose of computing book-profit.

(ix) The Supreme Court has, in *A.L.A Firm v. CIT (1991) 189 ITR 285*, held that the closing stock has to be valued at market rate in the case of a dissolved firm. As such, the closing stock-in-trade of the firm has to be valued at the market rate.

(x) Net profit shown in the profit and loss account 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 constitutes book profit as per *Explanation 3* to section 40(b). Carry forward and set off of business loss is covered under Chapter VI. Hence, brought forward business loss relating to the assessment year 2006-07 is not considered for calculation of book-profit.

(xi) Section 45(4) is not applicable to the firm for the assessment year 2010-11, since though the dissolution of the firm took place on 31.3.2010, there was no transfer by way of distribution of capital assets during the relevant previous year. The distribution of the capital assets took place on 20.4.2010. The capital gains will be assessable in the assessment year 2011-12.

Question 7

RST Ltd. is engaged in the manufacture and sale of drugs and pharmaceuticals. Its net profit for the year ending 31-3-2006 after debit/credit of the following items to the Profit and Loss Account was Rs.28,00,000.

(i) Income-tax paid on non-monetary perquisites provided to the employees Rs.1,00,000.

(ii) Legal fees incurred in defending title to factory premises Rs.2,00,000.

(iii) Expenditure on scientific research (not in respect of cost of land or building) on in-house research and development facility approved by the prescribed authority Rs.10,00,000.

(iv) Interest paid on arrears of sales tax Rs.1,00,000.

(v) Cash payment of Rs.20,000 made on 10.10.2005 to a supplier towards purchase of raw material.

(vi) Rent received from letting out vacant land Rs.1,00,000.

(vii) Arrears of rent received in respect of a house property, which was let out in the earlier years and which was not charged to tax in any earlier year Rs.2,00,000. The said property was sold during the year ending 31.3.2004.

The company had paid royalty in India to a foreign company amounting to Rs.3,00,000 on 1.5.2004, which was disallowed by the Assessing Officer for the assessment year 2005-06 since tax was not deducted thereon. The company deducted and paid tax at source on the said amount of royalty on 1.1.2006.

The company has brought forward loss from property relating to the assessment year 2004-05 amounting to Rs.40,000.

Compute the total income of RST Ltd. for the assessment year 2006-07.

Furnish explanations for the treatment of the various items given above. (16 Marks) (Nov 2006)

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

Computation of total income of RST Ltd for the assessment year 2010-11

	Particulars	**Rs.**	**Rs.**
Profits and gains of business or profession			
Net profit as per profit and loss account			28,00,000
Add: Income-tax paid on non-monetary perquisites provided to employees not allowable [See Note (i)]			1,00,000
			29,00,000
Less:	Deduction / Additional deduction allowable		
	Additional sum allowable towards scientific research expenditure [See Note (iii)]	5,00,000	
	Royalty paid during the year ending 31.3.2009, without deduction of tax, disallowed in A.Y. 2009-10, now allowable as tax thereon is deducted and paid [See Note (viii)]	3,00,000	8,00,000
			21,00,000
Less:	Income credited in the profit and loss account to be considered under other heads of income		

Rent received from letting out vacant land [See Note (vi)]	1,00,000	
Arrears of rent received in respect of property let out in the earlier years [See Note (vii)]	2,00,000	3,00,000
		18,00,000
Income from house property		
Arrears of rent received in respect of property let out in earlier years	2,00,000	
Less: 30% of Rs.2,00,000	60,000	
	1,40,000	
Less: Brought forward loss from property relating to A.Y.2007-08 (assumed) set off [See Note (ix)]	40,000	1,00,000
Income from other sources		
Rent received from letting out vacant land [See Note (vi)]		1,00,000
Total Income		**20,00,000**

Explanations for the treatment of the various items are furnished herein below -

(i) Income-tax paid by an employer on non-monetary perquisites provided to the employees is not deductible as per section 40(a)(v).

(ii) Legal fees incurred in defending title to factory premises is an expenditure incurred wholly and exclusively for the purpose of business and is, therefore, allowable under section 37(1). This was held by the Supreme Court in *Dalmia Jain & Co. Ltd. v. CIT (1971) 81 ITR 754.*

(iii) Expenditure on scientific research incurred by the company is entitled to deduction at 1-$^1/_2$ times as per section 35(2AB)(1). Since the company has debited Rs.10,00,000 in the profit and loss account, the additional deduction of Rs.5,00,000 is claimed while computing its total income.

(iv) Interest paid on arrears of sales tax is not penal in nature but is compensatory in character and is an allowable deduction under section 37(1) as held by the Supreme Court in *Lachmandas Mathurdas v. CIT (2002) 254 ITR 799.*

(v) Disallowance under section 40A(3) is attracted where cash payment in excess of Rs.20,000 is made in respect of any expenditure. In such a case, 100% of the expenditure is disallowed. Since the cash payment made by the company is Rs.20,000, that is, not exceeding Rs.20,000, the expenditure does not attract disallowance under section 40A(3).

(vi) Rent received from letting out vacant land is assessable under the head "Income from other sources".

(vii) Arrears of rent received in respect of the house property let out in earlier years is deemed to be income from house property in the year of receipt. Such arrears of rent, after deduction of 30% thereof, is assessable as income from house property even though the assessee is not the owner of the property in the year of its receipt as provided in section 25B.

(viii) Royalty paid during the year ending 31.3.2009 in respect of which tax was deducted and paid during the previous year ending 31.3.2010 is allowable as deduction for the assessment year 2010-11 as per the proviso to section 40(a)(i).

(ix) Brought forward loss from house property relating to the assessment year 2007-08 is set off against the deemed income from house property for the assessment year 2010-11 in accordance with the provisions of section 71B.

Question 8

ABC Ltd. is engaged in the manufacture and sale of textiles. Its net profit for the year ending 31.3.2006 after debit/credit of the following items to the Profit and Loss Account was Rs.75,00,000:

(i) Payment to two employees of Rs.2,50,000 each in connection with their voluntary retirement.

(ii) Fringe benefit tax paid Rs.1,00,000.

(iii) Charges of Rs.2,00,000 paid for the advertisement in souvenir published by a Political Party registered with the Election Commission of India.

(iv) Retrenchment compensation paid to employees of one of the units closed down during the year Rs.10,00,000.

(v) Capital expenditure incurred for the purpose of promoting family planning amongst its employees Rs.3,00,000.

(vi) Banking cash transaction tax paid Rs.10,000.

(vii) Interest paid under section 234B for short payment of advance tax pertaining to the assessment year 2005-06 Rs.1,10,000.

(viii) Loss incurred in transactions of purchase and sale of shares of various companies Rs.3,00,000.

(ix) Compensation received from supplier for delay in supply of raw materials Rs.1,00,000.

(x) Dividend received from a foreign company Rs.2,00,000.

The total sales of ABC Ltd. for the year was Rs.30 crores out of which export sales amounted to Rs.10 crores.

Compute the total income of ABC Ltd. for the assessment year 2006-07.

Furnish explanations for the treatment of the various items given above.(16 Marks) (May 2006)

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

Computation of total income of ABC Ltd. for the Assessment Year 2010-11

Particulars	**Rs.**
Net profit as per Profit and Loss Account	75,00,000
Add: Inadmissible expenditure	
4/5th of Rs.5,00,000 paid to employees on voluntary retirement [1/5th is allowable as deduction u/s 35DDA]	4,00,000
Fringe benefit tax u/s 40(a)(ic) [Assumed as paid for the A.Y. 2009-10]	1,00,000
Advertisement charges of souvenir of political party u/s 37(2B)	2,00,000
4/5th of Rs.3,00,000, being capital expenditure incurred for promoting family planning amongst employees [1/5th is allowable as deduction u/s 36(1)(ix)]	2,40,000
Interest paid u/s 234B	1,10,000
Loss incurred in transactions of purchase and sale of shares [assumed as speculation loss]	3,00,000
	88,50,000
Less: Dividend received from a foreign company considered under the head 'Income from other sources'	2,00,000
Business income	86,50,000
Income from other sources	
Dividend received from a foreign company	2,00,000
Gross total income	**88,50,000**
Less: Deduction u/s 80GGB	2,00,000
Total income	**86,50,000**

Explanations for the treatment of the various items in computing the total income of the company are furnished below -

(i) Section 35DDA provides for amortisation of expenditure incurred under voluntary retirement scheme over a period of five years in equal instalments. The company is, therefore, entitled to deduction of Rs.1,00,000, being one-fifth of the total sum of

Rs.5,00,000 paid to the two employees in connection with their voluntary retirement for the relevant assessment year.

(ii) Fringe benefit tax paid is not allowable as deduction from business profits as per section 40(a)(ic). Hence, fringe benefit tax paid is disallowed.

(iii) Section 37(2B) prohibits allowance of any expenditure incurred by an assessee on advertisement in any souvenir, brochure, pamphlet or the like published by a political party. As such, advertisement charges paid in respect of souvenir published by a political party is not allowable as deduction from business profits of the company.

However, under section 80GGB, expenditure incurred by an Indian company on advertisement in any publication, including a souvenir, by a political party is deemed to be a contribution of such amount to the political party and is, therefore, allowable as deduction in the hands of the company. It is logical to presume that ABC Ltd. is an Indian company.

(iv) Retrenchment compensation paid to employees at the time of closure of one of the units of the business is allowable as per the decision of the Allahabad High Court in *CIT V. JK Cotton Spinning & Weaving Co. Ltd. (2005) 145 Taxman 591.*

(v) Capital expenditure incurred for the purpose of promoting family planning amongst employees is deductible over a period of 5 years as per the first proviso to section 36(1)(ix). Hence, only Rs.60,000 is deductible in the current year in respect of such expenditure incurred by the company.

(vi) Banking cash transaction tax paid by the company is eligible for deduction in view of section 36(1)(xiii).

(vii) Interest paid for delayed payment of tax by the assessee is part and parcel of the liability to pay income-tax. When income-tax paid is itself not allowable as a deduction under section 40(a)(ii), the interest paid under section 234B cannot qualify for deduction. Thus, interest paid under section 234B is not deductible.

(viii) Loss of Rs.3 lakhs incurred by the company in dealing of shares constitutes speculation loss in view of the Explanation to section 73. In the absence of any speculative profit for the year, speculation loss is to be carried forward under section 73(2) for set off against speculation profits of subsequent assessment years. It can be carried forward for a maximum of 4 assessment years

(ix) Compensation received from supplier for delay in supplying the raw materials is a trading receipt.

(x) Dividend received from a foreign company in assessable under the head “Income from other sources”.

(xi) There is no tax incentive for export sales on the assumption that the assessee is not eligible for any deduction under sections 10A, 10AA or 10B.

Question 9

(a) *T and Q are individuals, who constitute an Association of persons, sharing profit and losses in the ratio of 2:1. For the accounting year ended 31st March, 2005, the Profit and Loss account of the business was as under:*

Figures are in Rs. '000s

Cost of goods sold	*4,250*	*Sales*	*4,900*
Remuneration to:		*Dividend from companies*	*25*
T	*130*	*Capital gains-Long term*	*640*
Q	*170*		
Employees	*256*		
Interest to:			
T	*48.3*		
Q	*35.7*		
Other expenses	*111.7*		
Sales-tax penalty due	*39*		
Net profit	*524.3*		
	5,565		***5,565***

Additional information furnished:

(i) *Other expenses included:*

   (a) *entertainment expenses of Rs.35,000;*

   (b) *wristwatches costing Rs.2,500 each were given to 12 dealers, who had exceeded the sales quota prescribed under a sales promotion scheme;*

   (c) *employer's contribution of Rs.6,000 to the Provident Fund was paid on 14th January, 2005.*

   (d) *Rs.30,000 was paid in cash to an advertising agency for publicity.*

(ii) *Outstanding sales tax penalty was paid on 15th October, 2005. The penalty was imposed by the Sales-tax Officer for non-filing of returns and statements by the due dates.*

T and Q had, for this year, income from other sources of Rs.94,000 and Rs.32,000 respectively.

Required to :

(i) *Compute the total income of the AOP for the assessment year 2005-06;*

(ii) *Ascertain the tax liability of the Association for that year; and*

(iii) *Ascertain the tax liability for that year of the individual members.(8 Marks) (Nov.2005)*

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10. It has been assumed that the members have total income above Rs.1,60,000 for the previous year ended 31.03.2010 before inclusion of income from the AOP.

Answer

(i) Computation of total income of the AOP for A.Y.2010-11

Particulars	*Rs.*	*Rs.*
Profit & gains of business (**See Working Note below**)		3,12,300
Long term capital gain		6,40,000
Income from other sources[Dividend is exempt u/s 10(34), assuming that it was received from domestic companies]		-
Total income		**9,52,300**

Working Note -

Computation of profits and gains of business

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

(ii) Computation of tax liability of the AOP for A.Y.2010-11

Particulars	*Rs.*	*Rs.*
Long-term capital gain (Rs.6,40,000 @ 20%)		1,28,000
Other income (Rs.3,12,300 @ 30%)		93,690
Tax on total income		**2,21,690**
Add: Education cess @3%		6,650
Total tax due		**2,28,340**

Notes –

1. Since one of the members has individual income more than the basic exemption limit, the AOP will be assessed at the maximum marginal rate. The maximum marginal rate includes the surcharge applicable in relation to the highest slab of income in case of an individual. As such surcharge shall not be chargeable as the total income does not exceed the prescribed limit.

   Since the AOP is taxed at maximum marginal rate, the share income of members is not taxable in their hands individually.

2. Since the employer's contribution to PF has been paid during the previous year itself, it is allowable as deduction.

3. Penalty imposed for delay in filing sales tax return is not deductible since it is on account of infraction of the law requiring filing of the return within the specified period. – *CIT v. Ratanchand Bholanath (S.S) (1986) 160 ITR 500 (M.P.)*

(iii) Computation of tax liability of members T & Q for the A.Y.2010-11

Members of the AOP have to pay tax on their total income taking in to account savings/ investments etc. The share income from AOP is taxable in their personal assessment.

Question 10

MKG Agency is a partnership firm consisting of father and three major sons. The partnership deed provided that after the death of father, the business shall be continued by the sons, subject to the condition that the firm shall pay 20% of the profits to the mother. Father died in March, 2003. In the previous year 2003-04, the reconstituted firm paid Rs.1 lakh (equivalent to 20% of the profits) to the mother and claimed the amount as deduction from its income. Examine the correctness of the claim of the firm. (3 Marks) (May 2005)

Answer

The issue raised in the problem is based on the concept of diversion of income by overriding title, which is well recognised in the income tax law. In the instant case, the amount of Rs.1 lakh, being 20% of profits of the firm, paid to the mother gets diverted at source by the charge created in her favour as per the terms of the partnership deed. Such income does not reach the assessee-firm.

Rather, such income stands diverted to the other person as such other person has a better title on such income than the title of the assessee. The firm might have received the said amount but it so received for and on behalf of the mother, who possesses the overriding title. Therefore, the amount paid to the mother should be excluded from income of the firm. This view has been confirmed in *CIT vs. Nariman B. Bharucha & Sons (1981) 130 ITR 863 (Bom).*

Question 11

A domestic company is liable to pay minimum alternate tax under section 115JB for the Assessment Year 2003-04. While computing book profit under section 115JB the company *claims provision for deferred tax charged to Profit & Loss account in accordance with Accounting Standard-22 of the Institute of Chartered Accountants of India, which is sought to be disallowed by the Assessing Officer. On what grounds you can contest such disallowance?*

(4 Marks) (Nov.2004)

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

Clause (h) to the Explanation to section 115JB provides that the amount of deferred tax and any provision therefor, is to be added to the net profit of the company. Similarly, any amount credited to profit and loss account being the amount of deferred tax is to be reduced / deducted for computing the book profit under section 115JB. Therefore, the action of the AO is valid in law.

Question 12

R & Co. is a partnership firm consisting of two partners R and S. The partners decide to dissolve the firm on 31.3.2004. The firm owns a land which was purchased 15 years back. One of the decisions taken in the scheme of dissolution was that the land, whose present market value was ascertained at Rs.15,00,000, would be given to S. A suggestion was made to the firm that instead of making an allotment at the time of dissolution, the firm can gift the land to S by making book entries. Discuss the pros and cons of the decision and advise the firm suitably in this context. *(6 Marks) (Nov.2004)*

It is assumed that the firm was dissolved on 31.3.2010.

Answer

The question involves consideration of the following two issues:

(i) Can immovable property be transferred from the firm to a partner without any registration?

(ii) Is it better to transfer the land on dissolution to a partner or to make a gift of the land to the partner?

If any immovable property is transferred by a firm to its partner, registration of the transfer of document is required in order to effect such a transfer and enable the partner to get a perfect title. This view was upheld by the Mumbai High Court in *C.I.T vs J.M.Mehta & Bros (1992) 214 ITR 716*. According to this decision, transfer of an immovable property by mere book entries will not be valid. However, in the event of dissolution of a firm and distribution of assets, there is no need for registration as was decided by the Supreme Court in *S. V. Chandra Pandian & Others* vs *S. V. Sivalinga Nadar & Others (1993) 212 ITR 592*. The decision is based on the principle that a firm is not a distinct legal entity, apart from the partners constituting it. Each and every partner has an undefined interest in each and every property of the firm. Therefore, it can be concluded that if the land is gifted, registration will be required and if the land is distributed on dissolution, registration will not be required.

Section 47 lists out certain transactions which are not regarded as transfer and one such transaction is gift. Therefore, gift of immovable property does not attract capital gains tax upto 30.9.2009. However, the transaction of gift would result in taxability of such asset value as income under the head 'other sources' if it is made after 1.10.2009.

On the other hand, if the land is allotted to the partner at the time of dissolution instead of making a gift, the firm would be subjected to capital gains tax liability. The fair market value as on the date of distribution shall be deemed to be the full value of consideration for computation of capital gains. The indexed cost of acquisition should be reduced from the sale consideration to arrive at the capital gains. The capital gains so computed shall be charged to tax in accordance with the provisions of section 112.

Thus, taking into account the above aspects, it is advised as under:

(i) The firm may gift the land to partner S instead of allotting the same to him at the time of dissolution which will attract capital gains tax. Also, the gift deed has to be executed and registered for recognition under the law. However, gift is chargeable to tax in the assessment of the partner as income from 'other sources' if the transaction is effected on or after 1.10.2009.

(ii) The firm may opt for dissolution and allotment of land to the partner in which case the property need not be registered and the deed of dissolution is sufficient for transfer of ownership. In such a case, the firm however will have to pay capital gain by taking fair market value of the land, as deemed consideration for computing capital gains.

Question 13

Netherlands Oil Corporation is a Foreign Company engaged in the exploration of oil and gas in all countries including India. In respect of its Indian business, the company has prepared the Profit and Loss Account in accordance with Part II and III of Schedule VI to the Companies Act, 1956 and such Profit and Loss Account for the previous year ended 31.03.2002 shows a Net Profit of Rs.65 lakhs. The Net Profit from activities in all other countries stands at Rs.550 lakhs. The company informs that while arriving at the Net Profit as indicated above in respect of Indian business, the following debits/credits have been made in its Profit and Loss Account.

	Credits to the Profit and Loss Account	***Rs.(in Lakhs)***
(i)	*Net agricultural income in India*	*16*
(ii)	*Share of profits from a firm engaged in business in India*	*15*
(iii)	*Amount withdrawn from Reserve created during 2000-01 (Book Profit was not increased by the amount transferred to such reserve in the year 2000-01)*	3
(iv)	*Profits from an Industrial Undertaking covered and qualified for*	

	deduction under Section 10B of Income-tax Act, 1961.	*30*
(v)	*Profits from an Industrial Undertaking covered and qualified for deduction under Section 10C of Income-tax Act, 1961.*	*6*

	Debits to the Profit and Loss Account	***Rs.(in Lakhs)***
(i)	*Expenditure relating to 10B undertaking*	*12*
(ii)	*Depreciation for current year under Companies Act, 1956*	*24*
(iii)	*Interest to Financial Institutions not paid upto the date of filing the return*	*6*
(iv)	*Penalty for infraction of law*	*1*
(v)	*Proposed Dividend*	*3*
(vi)	*Provision for Taxation (Income-tax)*	*2*
(vii)	*Transfer to General Reserve*	*5*
(viii)	*Provision for Unascertained Liabilities*	*2*
(ix)	*Expenditure relating to 10C undertaking*	*5*

The following additional information is also provided:

	Rs.(in lakhs)
Brought forward book loss	*12*
Depreciation allowable under Income-tax rules.	*30*
Brought forward business loss and unabsorbed depreciation as per Income-tax law.	*18*

(Loss Rs.8 lakhs and Depreciation Rs. 10 lakhs)

You are requested to compute the total tax liability of the company for the Assessment Year 2002-03. *(15 Marks) (Nov.2002)*

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10. Instead of Section 10C undertaking, consider an section 80-IC undertaking for solving this problem.

Answer

Computation of Book Profit in accordance with section 115JB of the Income-tax Act, 1961.

	Rs. in lakhs	*Rs. in lakhs*
Net Profit as per Profit & Loss Account		65

Add:	Transfer to General Reserve	5	
	Proposed Dividend	3	
	Provision for taxation	2	
	Provision for unascertained liabilities	2	12
			77
Less:	Net Agricultural Income (section 10 (1) of the Act)	16	
	Share of Profit from a firm (Section 10(2A) of the Act)	15	31
Profits from undertaking qualifying for deduction under section 10B of the Act is not eligible for exclusion from the assessment year 2008-09 onwards. Similarly, expenditure of the eligible undertaking covered by section 80-IC is not to be adjusted for the purpose of computing Book Profit under section 115JB			
Book Profit	(A)		46

Computation of Total Income as per Income Tax Act

		Rs. in lakhs	*Rs. in lakhs*
Net Profit as per Profit & Loss Account			65
Add:	Transfer to General Reserve	5	
	Proposed Dividend	3	
	Provision for taxation	2	
	Provision for unascertained liabilities	2	
	Expenditure relating to an Undertaking eligible for deduction under section 10B of the Act	12	
	Expenditure relating to an undertaking eligible for deduction under section 80-IC of the Act.	5	
	Depreciation as per books of account	24	
	Interest to financial institutions disallowed Under section 43B of the Act	6	
	Penalty for infraction of law	1	60
			125
Less:	Income exempt from tax		
	Net agricultural Income under section 10(1) of the Act	16	
	Amount withdrawn from General Reserve	3	

	Share of profit from a firm under section 10(2A) of the Act	15	
	Profits from Industrial Undertaking eligible for deduction under section 10B of the Act	30	
	Profits from Undertaking eligible for deduction under section 80-IC of the Act	6	
	Depreciation as per Income-tax Rules	30	100
	Profits from business for the year		**25**
Less:	Unabsorbed Depreciation under section 32(2) of the Act	10	
	Brought forward loss under section 72 of the Act	8	18
	Total Income (B)		**7**

Computation of tax liability for the assessment year 2010-11

		Rs.	Rs.
1.	Book profit as per (A)	46,00,000	
	Tax thereon @ 15%		6,90,000
2.	Total income as per (B)	7,00,000	
	Tax on total income @ 40%		2,80,000
3.	The assessee must pay tax as per deemed income computed under section115JB with education cess @ 3%. (effective rate 15.45%).		

Note:

1. No adjustment is required in respect of amount withdrawn from reserves for computing "Book Profit" as the said amount had not been taken into consideration for increase of book profit of the earlier assessment year. However, such amount would be excluded for computing total income as net profit of Rs.65 lakhs stands increased by the said credit of Rs.3 lakhs to the profit & loss account.

2. As per section 115JB of the Act, amount of loss brought forward or unabsorbed depreciation as per books, whichever is less, has to be reduced from net profit. As only brought forward loss is indicated at Rs.12 lakhs in the question, it has been assumed that there is no unabsorbed depreciation as per books of account. Therefore, no adjustment has been made in this respect for computing the "Book Profit".

3. Since the company is a foreign company it is not liable to be taxed in respect of its profits attributable to its activities outside India.

4. Section 115JB of the Act does not provide for the increase of net profit by the amount of expenditure relatable to any income to which section 80-IC of the Act applies. It also does not provide for the exclusion of income relatable to industrial undertaking covered under section 10B of the Act. Accordingly, no adjustment in respect of both expenditure and income pertaining to an undertaking covered under sections 10B and 80-IC of the Act was made while computing book profit.

Note: It is possible to assume that the company, though a foreign company, has made prescribed arrangements for the declaration, distribution or payment of dividends in India, and accordingly calculate the tax at 30% plus education cess at 3% thereon treating it as a domestic company.

Question 14

A firm consisting of four partners was dissolved consequent to the death of one of the partners. The remaining partners reconstituted the firm immediately, without discontinuance of the business, and carried on the business as before. The inventory of stocks on the date of dissolution was valued at cost, which was lower than the market value and all other assets were valued at book value, for the purpose of transfer to the reconstituted firm. The Assessing Officer, while arriving at the total income of the firm was constituted prior to dissolution, valued the stocks as well as the other assets at market value. You are required to comment on the correctness of the Assessing Officer's action. *(4 Marks) (May 2002)*

Answer

The position regarding the valuation of stocks and other assets on dissolution of a firm has been the subject matter of litigation for a long time. In *ALA Firm v. CIT 189 ITR 295,* the Supreme Court held that in taking accounts for the purposes of dissolution, the firm and partners would value the assets only on a realistic basis and not at cost or any other value appearing in the books of account.

In *Sakthi Trading Company v. CIT 250 ITR 871* the Supreme Court reviewed all the cases relating to valuation and held that in ALA Firm's case, there was not only a dissolution but also a discontinuance thereof and the stocks had therefore to be valued at market value for settling the accounts of the partners. Where there is no discontinuance of the business, the stocks have to be valued at cost or market value, whichever is lower. This is the established rule of commercial practice and accountancy.

In respect of other assets, section 45(4) will apply and hence other assets have to be valued at market price for the purpose of computing capital gains upon dissolution of firm due to death of a partner.

Question 15

"NEPTUNE" is a shipliner, used in carrying passengers and cargo, owned by M/s Thomas & Thomas of U.K. The ship carried the passengers and cargo in June, 2006 from Singapore to Mumbai and vice versa and collected charges thereof amounting to Rs.200 lacs. It left Mumbai port on 15.6.06 for its journey to Korea. No other journey to India was undertaken by any of

the vessels of the company during the year ended on 31.3.07. The non-resident company had authorized its Indian agent to comply with the income tax provisions.

You are consulted by the company to explain about the procedure as to return of income to be filed and the period within which the assessment thereof will be completed by the Assessing Officer. *(4 Marks) (Nov 2007)*

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

M/s. Thomas & Thomas of U.K shall be required to file the return of income in India for the journey of its ship before it leaves for onward journey to Korea.

However, as per the proviso to section 172(3), where the Assessing Officer is satisfied that it is not possible for the master of the ship to furnish the return before the departure of the ship from the port, and if satisfactory arrangements have been made for filing of return and payment of tax by the authorised agent in India, he may permit filing of return within 30 days of departure of the ship.

Section 172(4A) provides a time limit of 9 months for completion of assessment in such cases. The period of 9 months is reckoned from the end of the financial year in which the return under section 172(3) is furnished.

Question 16

The directors of a private company are personally liable to pay the income tax due from the company. Discuss. *(4 Marks) (May 2007)*

Answer

Section 179 contains the provisions relating to the liability of directors of a private company in liquidation in respect of tax due from the company. Where any tax due from a private company in respect of income of any previous year or from any other company in respect of any income of any previous year during which such other company was a private company cannot be recovered, then, every person who was a director of such company at any time during the relevant previous year shall be jointly and severally liable for the payment of such tax. However, the director shall not be so liable if 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.

Where a private company is converted into a public company and the tax assessed in respect of income of any previous year during which such company was a private company cannot be recovered from the company, then such tax dues shall be recovered from every person who was a director during the relevant previous year.

Question 17

In respect of the taxes due from a Private Limited company, which could not be recovered from it, the Tax Recovery Officer attached the properties of an erstwhile director for recovery thereof. It was contended by the director that a notice under section 156 had not been served on him and therefore, the proceedings for recovery were not valid. What is the correct legal position? *(3 Marks) (Nov.2001)*

Answer

The liability of a director of a private limited company for arrears due from the company is provided in section 179. There is no necessity to issue a notice to a director, because the position of a person on whom liability is fastened is equated to that of an 'assessee' in default. For the purpose of section 220(4) of the Income-tax Act, the person held liable under section 179 would be deemed to be an assessee in default. *This may be contrasted with the arrears of a partnership firm which may be recovered from the erstwhile partners only after issue of a notice under section 156 and a default is committed by them.*

Under section 179 every person who was a director of a private limited company at any time during the relevant previous year shall be jointly and severally liable for the payment of taxes which cannot be recovered from the company, unless he proves that the non-recovery cannot be attributed to any gross negligence, misfeasance or breach of duty on his part in relation to the affairs of the company. [*S.Bansal Singh v. T.R.O. Punj 236 ITR 508]*

Question 18

The net profits of XYZ Ltd. for the year ended 31st March, 2005, after debiting/crediting the following items, were Rs.9 lakhs:

(a) The company had taken on lease an old building for the purposes of locating its business. Due to old age of the building, it was demolished and a new building put up, which was used for purposes of XYZ's business from September, 2004. The cost of the new building Rs.10 lakhs was written off as revenue expenditure. The lessor permitted the company to have an extension of the lease by another twenty years.

(b) Rs.1 lakh was paid as an annual fee for technical services to a foreign collaborator under an agreement approved by the Government.

(c) The company collected Rs.3 lakhs from its customers by way of sales tax in the year 1986-87 and had remitted it to the State Government in due time. On the levy being challenged in the High Court, the Court held the collection as illegal and the State Government in February, 2005 refunded the amount to the company.

(d) Land development charges of Rs.1.5 lakhs were paid to the State Industrial Development Corporation on allotment of a commercial plot.

(e) A criminal case was filed against a Director of the company, in his official capacity. The company spent legal expenses of Rs.50,000 defending him in the proceedings. The Director was acquitted of the charges at the end.

(f) The company issued in the year bonus shares to its shareholders and for that purpose had to enhance the authorised capital. Fees of Rs.1.5 lakhs were paid to the Registrar of Companies in this regard. These have been written off in the accounts as revenue expenses.

(g) The company paid Rs.70,000 as interest on deposits to some of the non-resident buyers on advances received from them. No tax at source was deducted on the payment.

(h) Overdraft interest of Rs.40,000 was paid to the company's bank to enable the company to pay its income tax dues.

(i) The opening and closing stocks of the year were Rs.90,000 and Rs.1,17,000 respectively and were undervalued by 10% on cost.

(j) Some investments were held by the company (not as stock in trade), which had to be depreciated by Rs.4.8 lakhs due to a directive from the Government.

The balance on 1st April, 2004 to the Profit and Loss Account, shown separately in the Balance Sheet, was a debit of Rs.2 lakhs.

The company had the following claims brought forward from the prior years:

Business losses relating to	
Assessment year 1994-95	*Rs.8 lakhs*
Assessment year 2002-03	*Rs.4 lakhs*
Losses under the head capital gains -	
Long-term	
Assessment year 2003-04	*Rs.3 lakhs*
Unabsorbed depreciation	
(as per IT records as well as the books of the company)	*Rs.12.50 lakhs*

Required to :

(a) Calculate the total income of XYZ Ltd. for the assessment year 2005-06 [Your answer should clearly indicate the reasons for the treatment of the individual items given above.]

(b) Examine the applicability of section 115JB of the Income-tax Act to the company for the same assessment year. (16 Marks) (Nov.2005)

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

(a)	**Computation of total income of XYZ Ltd. for the A.Y.2010-11**		
	Particulars	*Rs.*	*Rs.*
Net profit as per profit and loss account			9,00,000
Add :	Cost of the new building – written off is a capital expenditure – disallowed.	10,00,000	
	Land development charges paid to State Industrial Development Corporation is a capital expenditure – hence disallowed	1,50,000	
	Fees paid to ROC for issuing bonus shares by increasing authorized capital is a revenue expenditure – hence allowed. [*CIT v. General Insurance Corpn (2006) 156 Taxman 96 (SC)*]	Nil	
	Interest on deposit to non-resident buyers without deduction of tax at source – disallowed under section 40(a)(i)	70,000	
	Interest to bank on overdraft for payment of income-tax dues – disallowed as per Supreme Court's decision in *East India Pharmaceutical Works Ltd. v. CIT (1997) 224 ITR 627*	40,000	
	Depreciation on investments not held as stock-in-trade	4,80,000	
	Under valuation of stock (1,17,000-90,000) x 10/90	3,000	17,43,000
			26,43,000
Less:	Depreciation on building @10% on Rs.10 lakhs **(See Notes 1 & 2)**		1,00,000
	Business Income		25,43,000
Less:	Set-off of business loss and unabsorbed depreciation		
	Business loss of A.Y.1994-95 cannot be set-off against business income of the current year, since business loss can be carried forward for a maximum period of 8 years only.	-	
	Business loss of A.Y.2002-03	4,00,000	
	Long-term capital loss of A.Y.2003-04 cannot be set-off against business income since as per section 74, long-term capital loss can be set-off only against long-term capital gains.		
	Unabsorbed depreciation	12,50,000	16,50,000
	Total Income		**8,93,000**
(b)	**Tax on total income as computed under the Income-tax Act**	**Rs.**	
	Tax on total income of Rs.8.93 lakhs	2,67,900	
	Add: Surcharge – Not applicable	………	

		2,67,900	
	Add: Education cess @ 3%	8,040	
	Tax on total income	**2,75,940**	
	Computation of tax as per section 115JB		
	Net profit as per profit and loss account	9,00,000	
	Add: Decrease in value of investment not eligible for deduction if the amount is set aside by way of provision for diminution in value of asset	4,80,000	
		13,80,000	
	Less: Business loss of Rs.2 lakhs, since it is lower than the unabsorbed depreciation of Rs.12.50 lakhs	2,00,000	
	Book Profit	**11,80,000**	
	15% of book profit	1,77,000	
	Add: Surcharge – Not applicable	……	
		1,77,000	
	Add: Education cess @ 3%	5,310	
		1,82,310	

Since the income-tax payable on the total income of the company computed under the Income-tax Act is not less than 15% of its book profit, section 115JB will not apply for A.Y.2010-11.

Notes:

1. As per *Explanation 1* to section 32(1), where an assessee carries on business or profession in a building which is not owned by him but in respect of which he holds a lease or other right of occupancy, depreciation is to be allowed on account of any capital expenditure incurred by the assessee on construction of any structure for improvement/ renovation of the building as if the structure is a building owned by the assessee. Therefore, depreciation is allowable on the capital expenditure of Rs.10 lakhs incurred by XYZ Ltd. towards the cost of the new building put up after demolition of the old building.
2. The rate of depreciation on buildings is 10%. Since it is put to use for more than 182 days during the previous year 2009-10, full depreciation is allowable.
3. Payment of annual fees for technical services to a foreign collaborator is an allowable business expense and has been correctly charged to profit and loss account. Therefore, no adjustment is required.
4. Sales tax refund from the Government has to be treated as a revenue receipt. Since it has been correctly credited to profit and loss account, no adjustment is required.

5. Land development charges paid to SIDC on allotment of a commercial plot is a capital expenditure [*Jaswant Trading Co. v. CIT (1995) 212 ITR 293 (Raj)]*

6. Section 37(1) does not make any distinction between expenditure incurred in civil litigation and that incurred in criminal litigation. If the expenditure is *bona fide* incurred wholly and exclusively for the purpose of the business, it is allowable as deduction *[CIT v. Birla Cotton Spinning & Weaving Mills Ltd. (1971) 82 ITR 166 (SC)]*. Therefore, in this case, since legal expenses were incurred by the company for defending the Director in a criminal case filed against him in his official capacity, it is allowable as deduction.

7. Fees paid to Registrar of Companies for enhancement of authorised capital to issue bonus shares is deductible since it is related to issue of bonus shares. Alternatively, if ti is a mere increase in authorized capital then such expenditure is a capital expenditure and not deductible under section 37(1*)[Punjab State Industrial Development Corporation Ltd. v. CIT 225 ITR 792 (SC)].*

8. Since no tax has been deducted at source on payment of interest to non-residents, interest paid will not be allowed as a deduction as per section 40(a)(i).

9. Interest paid to bank on overdraft for payment of income-tax dues is not an expenditure incurred wholly and exclusively for the purpose of business and is hence, not deductible under section 37(1) as per the Supreme Court's decision in *East India Pharmaceutical Works Ltd. v. CIT (1997) 224 ITR 627.*

10. The under valuation of both opening and closing stocks will have an impact on the profits for the year and accordingly, the difference in valuation of stock has to be credited to profit and loss account to the extent of 10% of cost.

11. Value of investment written down is on capital account and hence not allowed, even if such write down was on a directive from the Government. Clause (i) of Explanation to section 115JB provides for increasing the net profit if any amount is set side as provision for diminution in the value of any asset. Though it is stated as written off in the question, it is assumed that the charge to profit and loss account is by way of provision to meet possible loss in future and accordingly adjusted in the solution while computing book profit.

Question 19

Tarun Shipping Co. Ltd., having its registered office in Mumbai, plies two ocean-going vessels which it owns. The registered tonnage of the two vessels are 47,549 tonnes and 800 kgs and 25,759 tonnes and 400 kgs respectively. In the accounting year 2004-05, the first vessel was operated for 360 days and the second for 199 days.

The accounts of the company reveal the following results :

(i)	*Profit from core shipping activity*	*Rs.60.50 lakhs*
(ii)	*Profit from incidental activity*	*Rs.15,000*

Compute the tax payable by the company for the assessment year 2005-06, taking note of the new provisions of the law relating to taxation of income of shipping companies. Also indicate the specified conditions for the applicability of the new procedure. (6 Marks) (Nov.2005)

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

(a) Computation of tax payable by Tarun Shipping Company Ltd. for the A.Y.2010-11

Particulars	*Rs.*
Taxable income **(See Working Note below)**	59,35,040
Tax @ 30%	17,80,512
Add: Surcharge (Not applicable as the income is below Rs.100 Lakhs)	Nil
	17,80,512
Add: Education cess @ 3%	53,415
Total tax payable	**18,33,927**

Working Note

Computation of Tonnage Income [Section 115VG]

Particulars	*Ship I*	*Ship 2*
	Rs.	*Rs.*
First 1,000 tons (1000 x 46/100)	460	460
Next 9,000 tons (9,000 x 35/100)	3,150	3,150
Next 15,000 tons (15,000 x 28/100)	4,200	4,200
Balance [(22,500/800) x 19/100]	4,275	152
	12,085	**7,962**

Tonnage income -	
Ship 1 (12,085 × 360)	43,50,600
Ship 2 (7,962 × 199)	15,84,438
	59,35,038
Taxable income (rounded off)	59,35,040

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

As per section 115VF, the tonnage income computed under section 115VG would be deemed to be the profits chargeable under the head "Profits and gains of business or profession". This is, however, subject to fulfillment of the conditions mentioned below in the next paragraph. Then, the relevant shipping income referred to in section 115-VI(1), which includes the profit from core shipping activity (i.e. Rs.60.50 lakhs) and the profit from incidental activity (Rs.15,000), shall not be chargeable to tax.

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

(i) An option to get assessed under Chapter XII-G has to be filed by the company.

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

Question 20

SK Private Limited is engaged in the business of civil construction. The Profit and Loss account of the company for the year ended 31st March, 2005 is as under:

	Rs.		*Rs.*
Opening stock of building materials	*40,000*	*Receipts from the business of Civil construction contracts*	*37,60,000*
Salary to workers and		*Rent of godown*	*80,000*
Employees	*4,10, 000*	*Surplus from insurance*	
Purchase of building materials	*24,00,000*	*compensation received for loss of plant and machinery by fire*	*2,00,000*
Interest on loan	*3,20,000*	*Interest on company deposits*	*25,000*
Office administration		*Dividend from companies*	*50,000*
Expenses	*2,60,000*	*Closing stock of building*	
Travelling expenses	*1,40,000*	*Materials*	*25,000*
Municipal taxes on godown	*12,000*		
Insurance premium for godown	*8,000*		
Directors' remuneration	*2,53,000*		
Depreciation on plant and machinery	*65,000*		

Provision for tax:				
Current tax	*1,00,000*			
Deferred tax	*43,000*	*1,43,000*		
Net profit		*89,000*		
		41,40,000		***41,40,000***

The following additional information is also available :

(i) Municipal tax of godown includes Rs.3,000 not paid by the company.

(ii) The book value of the plant and machinery, which was insured against fire, was Rs.4,20,000. The written down value of plant and machinery block under section 43(6) as on 31st March, 2004 was Rs.1,85,000.

(iii) The entire building materials were purchased from a firm in which the managing director of this company is a partner. The fair market value of the materials purchased is Rs.20,00,000.

(iv) Interest on loan includes Rs.15,000 being interest on loan taken for investment in shares of various companies.

(v) Office administration expenses include Rs.90,000 paid as a donation to a charitable organization recognized under Section 80G.

(vi) The prescribed rate of depreciation under the Income Tax rules for plant and machinery is 25%.

(vii) The company has decided to follow the presumptive tax provision in respect of its business income.

Compute the total income of SK Private Ltd. for the assessment year 2005-06. Your answer should include explanations of your treatment of various items. Ignore the provision of minimum alternate tax under Section 115JB. (16 Marks) (May 2005)

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

Computation of total income of S.K. Private Limited for the A.Y. 2010-11

	Particulars	Rs.	Rs.
A.	**Profits & gains of business**		
	Presumptive profit from the business of civil construction as per section 44AD (8% of Rs.37,60,000)		3,00,800
B.	**Capital Gains**		
	As per section 45(1A), where any money is received under an insurance from an insurer on account of damage to or		

	destruction of any capital asset due to fire, any profit arising on receipt of such money is to be taxed as capital gains. For the purpose of section 48, the value of money received shall be deemed to be the full value of consideration received or accruing as a result of transfer of such capital asset.		
	Amount received from insurance company (4,20,000 + 2,00,000)	6,20,000	
	It is assumed that the surplus of Rs.2 lakhs credited to profit and loss account represents the surplus over the book value of plant and machinery.		
	Less: WDV of the block as at 1st April	1,85,000	
	Short term capital gains		4,35,000
	(Capital gains from transfer of a depreciable capital asset is deemed to be a short-term capital gain u/s 50)		
C.	**Income from house property**		
	Gross Annual Value	80,000	
	(Rent from godown is taken to be the gross annual value in the absence of other information relating to municipal value, fair rent etc.)		
	Less: Municipal tax actually paid (12,000-3,000)	9,000	
	Net annual value	71,000	
	Less: Deduction under section 24		
	30% of net annual value u/s 24 (1)	21,300	
			49,700
D.	**Income from other sources**		
	Interest on company deposits	25,000	
	Dividend from companies [Exempt under section 10(34), assuming that dividend is from domestic companies]	-	25,000
	Gross Total Income		**8,10,500**
	Less: Deduction under Chapter VI-A		
	Section 80G		
	Donation to recognised charitable organisation		
	Amount donated	90,000	
	Qualifying Amount (restricted to 10% of Gross Total Income)	81,050	
	Deduction under this section (50% of qualifying amount)		40,525
	Total Income		**7,69,975**

Notes:

1. As per section 44AD, in the case of an assessee engaged in the business of civil construction or supply of labour for civil construction, an amount equal to 8% of gross receipts paid or payable to the assessee shall be deemed to be profits and gains from such business at the option of the assessee. The option is available if the gross receipts does not exceed Rs.40 lakhs in the relevant previous year. In this case, the company's gross receipts in the previous year on account of such business does not exceed Rs.40 lakhs. Thus, the company is entitled to exercise the option of paying tax under presumptive tax system.
2. Where the assessee opts for paying income tax under presumptive tax provisions of section 44AD, the deductions allowable under sections 30 to 38, including depreciation, shall be deemed to have been allowed. Therefore, separate deductions are not allowable for salary, purchase of materials, interest on loan, office administration expenses, travel expenses and directors' remuneration, since they are deemed to have been already allowed.
3. As deductions under sections 30 to 38 are deemed to have been allowed, the question of disallowance under section 40A(2) or any other provision does not arise. Therefore, even if the assessee company makes payment for purchase of materials to a firm, where the managing director is a partner, disallowance u/s 40A(2) is not attracted.
4. Similarly, WDV of assets used for such business shall be deemed to have been computed as if depreciation has been actually allowed.
5. Since dividend income is fully exempt under section 10(34), no deduction can be claimed in respect of any expenditure incurred to earn such income as per the provisions of section 14A. Therefore, interest on loan taken for investment in shares, dividend from which is exempt under section 10(34), is not allowable as deduction.

Question 21

A & Co. Limited, engaged in the business of manufacturing, shows a net profit of Rs.65.00 lacs for the financial year ended 31-3-2004. A scrutiny of the Profit & Loss Account revealed the following:

(i) *Rent of Rs.2.40 lakhs from a commercial property owned by the company and let to a bank was included in the profit.*

(ii) *Loss of Rs.5 lakhs due to non-realisation of advances given to a wholly owned subsidiary Company engaged in the business of hire-purchase financing charged to Profit & Loss Account.*

(iii) *The Company used to include interest cost in valuation of its finished stock upto the financial year 2002-03. During the financial year 2003-04 the Company changed its accounting policy to adopt AS-2 (Valuation of Inventories) issued by the ICAI and excluded interest cost in valuation of finished stock. This has resulted in a decrease in the year's profit by Rs.15.40 lacs.*

(iv) *Municipal taxes on commercial property debited Rs.0.22 lacs, which were ultimately paid on 1-12-2004.*

(v) *The Company has received equity shares of AB Ltd. valued at Rs.1.25 lacs in exchange of equity shares of CD Ltd. in a scheme of amalgamation during the year. The shares in CD Ltd. were acquired in 1998-99 at a cost of Rs.0.40 lacs. The surplus has been credited to Profit & Loss account. Both AB and CD are Indian companies.*

(vi) *An executive, while on business trip abroad, died and gratuity paid voluntarily amounted to Rs.6.00 lacs.*

(vii) *As restructuring of its debt, the company has converted arrears of interest of Rs.5.00 lakhs on term loan into a new term loan with a revised repayment schedule. The company has paid Rs.0.50 lac towards such funded interest during the year.*

(viii) *Legal charges in connection with alteration of the Articles of Association Rs.1.50 lacs and for issue of bonus shares Rs.5.00 lacs.*

(ix) *The company has purchased scrap materials amounting to Rs.0.60 lacs, the payment for which was made in cash on 15th August, 2003.*

(x) *The profit, as shown above, includes Rs.5.00 lacs received from a Foreign Government for use of company's product. This was, however, not brought into India.*

Compute the net income of the company for the assessment year 2004-05 clearly indicating the basis of treatment of each item. *(16 Marks) (Nov.2004)*

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

Computation of net income of A & Co. Ltd. for the A.Y. 2010-2011

	Particulars	*Rs. in lacs*
I.	Income from House Property (Working Note 1)	1.68
II.	Profits and gains of business or profession (Working Note 2)	71.47
	Gross Total Income	**73.15**
	Less: Deduction under Chapter VI-A	-
	Total Income	**73.15**

Working Note 1

Computation of income from house property	
Gross annual value (See Note 3 below)	2.40
Less: Municipal taxes are not allowable as deduction since they were not paid in the previous year.	-
Net Annual Value (NAV)	**2.40**
Less: 30% of NAV	0.72
Income from house property	**1.68**

Working Note 2

Computation of income under the head "Profits and gains of business or profession".			
Net profit as per profit and loss account			65.00
***Add*: Inadmissible expenditure**			
(i)	Loss on non-realization of advance to wholly owned subsidiary company does not arise in the normal course of business, since the assessee is engaged in the business of manufacturing and not financing. Hence, loss is to be disallowed.	5.00	
(ii)	Municipal tax on commercial property is not allowable as a deduction under this head of income.	0.22	
(iii)	Arrears of interest converted into funded interest term loan not allowed. However, amount of funded interest term loan paid allowed as deduction.	4.50	
(iv)	Legal expenses of Rs 1.50 lacs for amendment of Articles of Association is deductible. [Allahabad High Court in *CIT vs Modi Spinning & Weaving Mills Co Ltd. (1973) 89 ITR 304].*	--	
(v)	Legal expenses in connection with the issue of bonus shares is a revenue expenditure and hence allowable. [*Warner Hindustan Ltd v. CIT 171 ITR 224 (AP)* and *CIT v. General Insurance Corpn.(2006) 156 Taxman 96 (SC)*]	--	9.72
			74.72
***Less:* Admissible deductions and income not taxable/considered separately**			
(i)	Rent of commercial property let out on rent to a bank. This is taxable under the head "Income from House Property" and has been considered separately.	2.40	
(ii)	Surplus on exchange of shares on amalgamation of companies – (See note 2 below)	0.85	3.25
Income under the head "Profits and gains from business or profession"			**71.47**

Note:-

1. Rs.5 lacs received from a foreign Government for use of company's product though not brought to India, it is taxable as the assessee is assumed as domestic company and resident in India.
2. Under section 47(vii) any transfer by a shareholder, in a scheme of amalgamation, of a capital asset, being shares held by him in the amalgamating company does not attract capital gains tax, if the transfer is made in consideration of the allotment of any shares in

the amalgamated company and the amalgamated company is an Indian company. Since the surplus is credited to profit and loss account, it is excluded by way of deduction.

3. Rent of commercial property has been taken as its gross annual value in the absence of other information.

4. A company can change its method of valuation of stock provided the change is made for *bona fide* reason and is followed consistently in future. The assessee changed its method of valuation of stock in line with the pronouncement of a professional body. Therefore, the genuineness of the change in method of valuation of stock cannot be questioned. Hence, even though the profit is lower by Rs.15.40 lacs, it would not have any impact on the computation of income.

5. Payment of gratuity Rs.6.00 lacs on account of death of an executive while on business trip is allowable as deduction. *[CIT vs. Laxmi Cement Distributors (P) Ltd. (1976) 104 ITR 711 (Gujarat)].* Since it has already been debited to the profit and loss account, no further adjustment is required.

6. Payment for scrap materials was made on 15th August being the "Independence Day" on which banks are closed. Such payment is covered by Rule 6DD(j) of the Income-tax Rules. Therefore, the expenditure cannot be disallowed under section 40A(3).

Question 22

A domestic company, ABC Ltd., has an undertaking newly established for export of Computer Software in a free trade zone, the profits of which have been merged in the net profit of the company as per Profit and Loss Account prepared in accordance with the provisions of Parts II and III of Schedule VI to the Companies Act. It furnishes the following particulars in respect of Assessment Year 2004-05 and seeks your opinion on the application of section 115JB. You are also required to compute the total income and tax payable.

(1)	*Net profits as per P and L A/c as per schedule VI*			*Rs.200 lakhs*
(2)	*Profit and Loss A/c includes:*			
	(a)	*Credits*	*Dividend income*	*Rs. 20 lakhs*
			Excess realized on sale of land held as investment	*Rs. 30 lakhs*
			Net profit of the undertaking for export of computer software	*Rs.100 lakhs*
	(b)	*Debits:*	*Depreciation on straight line method basis*	*Rs.100 lakhs*
			Provision for loss of subsidiary company	*Rs. 60 lakhs*
(3)	*Depreciation allowable as per I.T. Act and Rules*			*Rs.150 lakhs*
(4)	*Capital gains as computed under I.T. Act*			*Rs. 40 lakhs*
(5)	*Losses brought forward as per books of account :*			
	Business loss			*Rs. 50 lakhs*
	Unabsorbed depreciation			*Rs. 60 lakhs*

The company has represented to you that the excess realized on sale of land cannot form part of the book profit for purposes of section 115JB. You will have to deal with this issue.

(16 Marks) (May 2004)

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

In the case of a company, it has been provided that where tax on 15% of book profit exceeds tax on total income computed as per normal provisions , the book profit shall be 'deemed to be the total income' for tax purposes.

It is therefore necessary to compute total income as per Income-tax Act as well as book profits.

I.	**Computation of Total income as per Income-tax Act**	*(Rs. in lakhs)*	
	Net profit as per P & L A/c		200
	Add: Depreciation on straight line basis	100	
	Provision for losses of subsidiary company	60	160
			360
	Less: Dividend income – exempt under section 10(34)	20	
	Excess realized on sale of land (considered separately)	30	
	Net profit of the undertaking in Free Trade Zone exempted under section 10A.	100	
	Depreciation as per Income-tax Rules	150	300
	Business Income (as per Income-tax Act)		60
	Less: Set-off of brought forward business loss (See Note 1 below)		50
			10
	Capital gains as per Income-tax Act		40
			50
	Less: Set-off of unabsorbed depreciation (See Note 1 below)		50
	Total Income as per Income-tax Act		**Nil**

Note:

1. It has been assumed that the figures of unabsorbed depreciation and business loss as per Income-tax Act and as per the books of account are same in the given problem.

2. Total unabsorbed depreciation b/f from P.Y. is Rs.60 lakhs against which Rs.50 lakhs is set-off in the current year. The balance of Rs.10 lakhs is to be carried forward to the next assessment year.

II. Computation of book profit under section 115JB *(Rs. in lakhs)*

Net profit as per P & L A/c		200
Add: Provision for loss of subsidiary		60
		260
Less: Dividend income exempt under section 10(34)	20	
Business loss which is less than unabsorbed depreciation	50	70
" Book Profit"		**190**

I. Since total income is 'nil' as per the Income-tax Act, the tax payable is also 'nil'.

II. 15% of book profit of Rs.190 lakhs is Rs.28.50 lakhs.

Since 15% of book profit exceeds the total income, the book profit of Rs.190 lakhs shall be 'deemed to be the total income' and the tax payable on such total income shall be 15% thereof i.e. Rs.28,50,000 plus surcharge @ 10% of Rs.2,85,000 plus education cess @ 3% [of tax and surcharge] being Rs.94,050. Total tax liability Rs.32,29,050.

With regard to the company's representation, in respect of long term capital gain whether liable for book profit tax under section 115 JB, it may be noted that under item (xii)(b) of para 3 of Part II of Schedule VI, profits or losses in respect of transactions of an exceptional or non-recurring nature, if material in amount, are to be disclosed. Since the excess realized on sale of land has been included in net profit computed under Schedule VI, it will form part of book profit [*Bombay High Court judgment in CIT v. Veekay Lal Investment Co. Pvt. Ltd. 249 ITR 597*].

Question 23

The accounts of a public company have been prepared in accordance with provisions of Parts II and III of Schedule VI to the Companies Act and its Profit and Loss Account laid before the Annual General Meeting for the previous year ending 31st March, 2001 shows a net profit of Rs.15 lakhs. The following information relevant for the purpose of computing its assessable income has been extracted from a scrutiny of the profit and loss account:

Credits in Profit and Loss A/c

(1)	*Profit from a new industrial undertaking qualifying for deduction under section 80-IA (Net)*	*17,00,000*
(2)	*Profits from a new industrial undertaking qualifying for deduction under section 10A (Gross)*	*10,00,000*
(3)	*Long-Term capital gains*	*3,00,000*

Debits in Profit and Loss A/c

(1)	*Expenditure relating to industrial undertaking qualifying for deduction under section 10 A*	*7,00,000*
(2)	*Depreciation relating to 1999-2000 brought forward*	*10,00,000*
(3)	*Business loss relating to 1999-2000 brought forward*	*12,00,000*
(4)	*Current year depreciation*	*10,00,000*
(5)	*Penalty for infraction of law*	*1,00,000*
(6)	*Provision for sales-tax*	*3,00,000*
(7)	*Dividend proposed*	*2,00,000*

Depreciation admissible under the Income-tax Act and Rules for the previous year is Rs.19,50,000. The capital gain has been invested in specified assets under section 54EC. Sales tax provided in the accounts has been remitted before the due date. There is no loss or unabsorbed depreciation to be carried forward and adjusted as per IT assessment.

You are required to compute the total tax liability of the company for the assessment year 2001-2002. *(12 Marks) (Nov.2001)*

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

1. The impact of the provisions of section 115JB has to be ascertained and for this purpose the income-tax on the total income as computed under the Income-tax Act has to be compared with 15% of the book profits ascertained under section 115JB.

Computation of total income under the Income-tax Act.

Net Profit as Profit and Loss account		15,00,000
Add : Expenses not allowable:		
Depreciation (1999-2000)	10,00,000	
Business Loss (1999-2000)	12,00,000	
Penalty – not an admissible deduction	1,00,000	
Proposed dividend	2,00,000	
		25,00,000
		40,00,000
Less : Expenses deductible :		
Depreciation for the year additionally allowable (Rs.19,50,000 – 10,00,000)		9,50,000
		30,50,000

Less : LTCG to be considered under the respective head		3,00,000
		27,50,000
Less : Exemption under section 10 A profits (10,00,000 – 7,00,000)		3,00,000
Profit and Gains from business		24,50,000
Capital Gains	3,00,000	
*Less :*Exemption under section 54EC (Note 5)	3,00,000	Nil
		24,50,000
Less : Deduction under section 80-IA		17,00,000
Total Income		7,50,000

Tax payable @ 30.9% = Rs. 2,31,750

Computation of Book Profit under section 115JB

Net Profit (see note 7)	37,00,000
Proposed dividend	2,00,000
	39,00,000
Less: Brought forward depreciation (see Note 4)	10,00,000
Book profit under section 115JB	29,00,000

Tax at 15% of 29,00,000 = Rs.4,35,000 plus education cess @ 3%.
The tax liability is Rs.4,48,050.

Since tax payable on income computed as per the provisions of the Income-tax Act, 1961 is less than 15% of the book profit, the book profit of Rs. 29 lakh would be deemed to be the total income and tax is payable @15% thereon plus 2% education cess and 1% secondary and higher education. The total tax liability would be Rs. 4,48,050.

Note:

1. Income from new industrial undertaking qualifying for deduction under section 80-IA will not be reduced in computing book profit under section 115 JB.
2. Provision for sales-tax is an ascertained liability. Hence it is not to be added [See clause (c) of Explanation].
3. Book profit includes capital gains (See CIT v. Veekely Investment Co Ltd 249 ITR 597)
4. Brought forward depreciation or business loss, whichever is less is deductible while computing book profit under section 115JB.
5. Capital gains are not chargeable to tax as the assessee has invested the gain in specified assets mentioned in section 54EC.

6. Income from the units eligible for deduction under sections 10A / 10B is not to be to excluded while computing book profit.

7. Students may note that the debit entries pertaining to unabsorbed depreciation and brought forward business loss are not in consonance with Parts II and III of Schedule VI to the Companies Act, 1956. These items are part of the balance sheet under "Reserves and Surplus" on the liabilities side of "Profit & Loss Account" (as the case may be) on the assets side. In order to rectify the treatment in the books of account, the following adjustments should be made:

Net Profit	15,00,000
*Add :*Debits incorrectly made:	
Unabsorbed depreciation	10,00,000
B/f business loss	12,00,000
Net Profit as per Schedule VI	37,00,000

Question 24

Xtra Ltd. gives the following information for the year ended 31.3.2008:

- *Net Profit as per Profit and Loss Account for the financial year 2006-07 Rs.33,00,000 was included in General Reserve.*
- *On 1.8.2007, the company redeemed its redeemable bonus shares for Rs.9,09,000.*
- *A shareholder holding 10% equity shares of the company borrowed Rs.3,00,000 from the company @ 18% per annum on 31.8.2008.*
- *The company declared dividend of Rs.14,00,000 at its annual general meeting held on 30.9.2007. But the dividend remained unpaid up to 31.3.2008.*

Compute the tax liability of the company under section 115-O (tax on distributed profits) for the A.Y. 2008-09.
Also give reasons for treatment of each item. *(4 Marks) (Nov 2008)*

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

Computation of tax liability of Xtra Ltd. under section 115-O [for the A.Y. 2010-11]

Particulars	**Rs.**
Redemption of Bonus Shares [See Note 1 below]	9,09,000
Dividend declared at AGM [See Note 3 below]	14,00,000
Taxable Dividend	**23,09,000**

Tax payable on distributed profits under section 115-O [Rs.23,09,000×16.995%] [See Note 4 below]	**3,92,415**

Notes –

(1) It is assumed that the bonus shares are in the form of redeemable preference shares, since only then such redemption is possible. If such bonus shares are issued to equity shareholders, it does not amount to distribution of dividend at the time of issue of bonus shares, as there is no release of assets. However, when bonus shares are redeemed, there will be release of assets and in that event it would constitute dividend under section 2(22)(a).

(2) Borrowing by a shareholder holding 10% equity shares of the company is deemed dividend under section 2(22)(e), taxable in the hands of shareholder. Therefore, the company is not liable to pay any tax on it.

(3) The tax on distributed profits shall be paid within 14 days from the date of declaration or distribution or payment of any dividend, whichever is earliest. Therefore, in this case, the dividend distribution tax is payable within 14 days of the declaration though dividend is not actually paid up to end of the previous year.

(4) The rate of tax on distributed profits to 15% in respect of any amount declared, distributed or paid by a domestic company by way of dividends [Section 115-O]. The effective rate of tax (including surcharge@10%, education cess@2% and secondary and higher education cess@1%) is 16.995%.

14

TAX PLANNING

Question 1

Mr. Gavaskar sought voluntary retirement from a Government of India Undertaking and received compensation of Rs.40 lakhs on 31st January, 2005. He is planning to use the money as capital for a business dealership in electronic goods. The manufacturer of the product requires a security deposit of Rs.15 lakh, which would carry interest at 8% p.a. Gavaskar's wife is a graduate and has worked as marketing manager in a multinational company for 15 years. She now looks for a change in employment. She is willing to join her husband in running the business. She expects an annual income of Rs.3 lakhs. Mr. Gavaskar would like to draw a monthly remuneration of Rs.40,000 and also interest @10% p.a. on his capital in the business. Mr. Gavaskar has approached you for a tax efficient structure of the business.

Discuss the various issues, which are required to be considered for formulating your advice. Computation of income or tax liability is not required. (8 Marks) (May 2005)

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

The selection of the form of organisation to carry on any business activity is essential in view of the differential tax rates prescribed under the Income-tax Act, 1961 and specific concessions and deductions available under the Act in respect of different entities. For the purpose of formulating advice as to the tax efficient structure of the business, it is necessary for the tax consultant to consider the following issues:

1. In the case of sole proprietary concern, interest on capital and remuneration paid to the proprietor is not allowable as deduction under section 37(1) as the expenditure is of personal nature. On the other hand, in the case of partnership firm, both interest on capital and remuneration payable to partners are allowable under section 37(1) subject to the conditions and limits laid down in section 40(b). Remuneration and interest however should be authorised by the instrument of partnership and paid in accordance with such instrument. Interest to partners can be allowed up to 12% on simple interest basis, while the limit for allowability for partners' remuneration is based on book profit under section

40(b). The Finance (No.2) Act, 2009 has increased the basic limit for working partner salary and it merits consideration in formulating the strategy.

2. Partner's share in the profits of firm is not taxed in the hands of the partners by virtue of section 10(2A).
3. If a proprietary concern is formed, the salary of Mrs. Gavaskar shall be allowed as deduction under section 37(1).
4. The possibility of invoking section 40A(2) cannot be ruled out as salary is payable to a relative, who is an interested person within the meaning of section 40A(2). However, it can be argued successfully that salary of Rs.3 lakh is justified in view of her long experience as marketing manager of a multinational company and the fair market value of services to be rendered by her to the concern.
5. An issue arises as to whether remuneration of Mrs. Gavaskar would be includible in the total income of Mr. Gavaskar. Under section 64(1)(ii), remuneration of the spouse of an individual working in a concern in which the individual is having a substantial interest shall be included in the total income of the individual. However, the clubbing provision does not apply if the spouse possesses technical or professional qualification and the income is solely attributable to the application of his or her technical or professional knowledge and experience. Further, technical or professional qualification would not necessarily mean the qualifications obtained by degree or diploma of any recognized body *[Batta Kalyani vs. CIT (1985) 154 ITR 0059 (AP)]* The experience of Mrs. Gavaskar as a marketing manager in a multinational company for 15 years may reasonably be considered as a professional qualification for this purpose.
6. If Mrs. Gavaskar joins the proprietary concern of her husband as employee, remuneration of Rs.3 lakhs shall be taxed in her hands under the head "salary".
7. If she joins as partner in the business, remuneration shall be taxed in her hand as business income under section 28 to the extent such remuneration is allowed in the hands of the firm under section 40(b).
8. The tax rate applicable to an individual depends on the level of his/her income, whereas for partnership firms it is flat rate at 30%. For individuals, the rate of tax is at 10% upto Rs.3 lakh and @ 20% for income exceeding Rs.3 lakhs but not exceeding Rs.5 lakhs and @ 30% in respect of income exceeding Rs.5 lakhs for the assessment year 2010-11. Cess @ 3% is attracted in both the cases.

Note : Considering the comparatives given above, Mr.Gavaskar is advised to commence a proprietary concern and pay salary to Mrs.Gavaskar. In the event of the business expanding and necessitating inclusion of Mrs. Gavasakar, it can always be resorted to with zero tax consequence by converting into a partnership firm or limited liability partnership, as the case may be, to avail all the advantages.

Question 2

Explain the doctrine of form and substance in the context of tax planning.(4 Marks) (May 2004)

Answer

The following are certain principles enunciated by the Courts on the question as to whether it is the form or substance of a transaction, which will prevail in income-tax matters:

(i) **Form of transaction is to be considered in case of genuine transactions-** It is well settled that when a transaction is arranged in one form known to law, it will attract tax liability whereas, if it is entered into in another form which is equally lawful, it may not. Therefore, in considering whether a transaction attracts tax or not, the form of the transaction put through is to be considered and not the substance. However, this rule applies only to genuine transactions. [*Motor and General Stores (P) Ltd. v. CIT (1967) 66 ITR 701(AP)*

(ii) **True legal relation is the crucial element for taxability** -It is open for the authorities to pierce the corporate veil and look behind the legal facade at the reality of the transaction. The taxing authority is entitled as well as bound to determine the true legal relation resulting from a transaction. The true legal relation arising from a transaction alone determines the taxability of a receipt arising from the transaction *[CIT v. B.M. Kharwar (1969) 72 ITR 603 (SC)]*

(iii) Substance (i.e. actual nature of expense) is relevant and not the form –

(a) In the case of an expenditure, the mere fact that the payment is made under an agreement does not preclude the department from enquiring into the actual nature of the payment [*Swadeshi Cotton Mills Co. Ltd. v. CIT (1967) 63 ITR 57(SC)*].

(b) In order to determine whether a particular item of expenditure is of revenue or capital nature, the substance and not merely the form should be looked into. [*Assam Bengal Cement Co. Ltd. v. CIT (1955) 27 ITR 37 (SC)*].

Question 3

Distinguish between Tax planning and Tax Evasion (4 Marks) (May 2001)

Answer

Tax planning is carried out within the framework of law by availing the deductions and exemptions permitted by law and thereby minimizing tax liability. Tax planning is an arrangement by which full advantage is taken of the concessions and benefits conferred by the statute, without violation of legal provisions. Tax evasion on the other hand is an attempt to reduce tax liability by dubious or artificial methods or down right fraud. It is illegal and denies the State its legitimate share of tax.

15

DOUBLE TAXATION RELIEF

Question 1

Mr. Bansal, a resident Indian and aged 67 years, has derived the following income during the previous year 2008-09:

		Rs.
(i)	*Income from business in India*	*2,50,000*
(ii)	*Commission (Gross) from a company in Hong Kong (Tax paid in Hong Kong Rs.60,000)*	*3,00,000*
(iii)	*Dividend (Gross) from a company in Hong Kong (Tax paid in Hong Kong Rs.18,000)*	*90,000*
(iv)	*Interest on fixed deposit and savings account with banks in India*	*2,00,000*

India has no double tax avoidance agreement with Hong Kong. Compute the income and tax payable by Mr. Bansal for assessment year 2009-10. *(5 Marks) (June 2009)*

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

Mr. Bansal is entitled to relief under section 91, since :-

(i) He is a resident in India during the relevant previous year.

(ii) Income, by way of commission and dividend, accrues or arises to him outside India (in Hong Kong) during the previous year.

(iii) Such income is not deemed to accrue or arise in India during the previous year.

(iv) The income in question, namely, commission and dividend, has been subjected to income-tax in Hong Kong in the hands of Mr. Bansal and he has paid tax on such income in Hong Kong.

(v) There is no agreement under section 90 for the relief or avoidance of double taxation between India and Hong Kong.

Therefore, he is entitled to the deduction under section 91, from the Indian income-tax payable by him, of a sum, calculated on such doubly taxed income at the Indian rate of tax or at the Hong Kong rate of tax, whichever is lower.

Computation of total income and tax liability of Mr. Bansal for A.Y.2010-11

Particulars		Rs.
Income from business in India		2,50,000
Commission received from a company in Hong Kong		3,00,000
Dividend received from a company in Hong Kong		90,000
Interest on fixed deposits and savings account with banks in India		2,00,000
Total Income		**8,40,000**
Tax on the above:		
Upto Rs.2,40,000	Nil	
Over Rs.2,40,000 & upto Rs.3,00,000	6,000	
Over Rs.3,00,000 & upto Rs. 5,00,000	40,000	
Over Rs.5,00,000	1,02,000	
		1,48,000
Education cess @ 2% and secondary and higher education cess @ 1%		4,440
Total tax liability		1,52,440
Average rate of income-tax in India: **(**1,52,440/8,40,000 x 100**)**	18.15%	
Average rate of income-tax in Hong Kong (78,000/3,90,000 x 100)	20%	
Double tax relief under section 91 shall be @18.15% or 20% of foreign income, whichever is less [i.e., 3,90,000 x 18.15%]		70,785
Net tax liability (Rs.1,52,440 – Rs.70,785)		**81,655**

Question 2

An individual resident in India, having income earned outside India in a country with which no agreement under section 90 exists, asks you to explain whether the credit of the tax paid on the income in that country will be allowed to him in India. *(4 Marks) (Nov 2007)*

Answer

The assessee is a resident in India and accordingly, the income accruing or arising to him globally is chargeable to tax in India. However, section 91 specifies that if a person resident in

India has paid tax in any country with which no agreement under section 90 exists, then, for the purpose of relief or avoidance of double taxation, a deduction is allowed from the Indian income-tax payable by him, of a sum calculated on such doubly taxed income at Indian rate of tax or the rate of tax of such country, whichever is lower, or at the Indian rate of tax if both rates are equal. Accordingly, the assessee shall not be given any credit of the tax paid on the income in other country, but shall be allowed a deduction from the Indian income-tax payable by him as per the scheme of section 91.

Question 3

The Income-tax Act, 1961 provides for taxation of a certain income earned by X. The Double Taxation Avoidance Agreement, which applies to X, excludes the income earned by X from the purview of tax. Is X liable to pay tax on the income earned by him? Discuss. (4 Marks) (May 2006)

Answer

Section 90(2) makes it clear that where the Central Government has entered into a Double Taxation Avoidance Agreement, then in respect of an assessee to whom such agreement applies, the provisions of the Act shall apply to the extent they are more beneficial to the assessee. This means that where tax liability is imposed by the Act, the Double Taxation Avoidance Agreement may be resorted to for reducing or avoiding the tax liability.

The Supreme Court has held, in *CIT v. P.V.A.L. Kulandagan Chettiar (2004) 267 ITR 654,* that in case of any conflict between the provisions of the Double Taxation Avoidance Agreement and the Income-tax Act, 1961, the provisions of the Double Taxation Avoidance Agreement would prevail over those of the Income-tax Act. X is, therefore, not liable to pay tax on the income earned by him.

Question 4

What is the circumstance in which it is not necessary for a non-resident Indian, whose total income is above the taxable limit, to file his return of income under section 139(1)?

(2 Marks) (May 2006)

Answer

Section 115G of the Income-tax Act, 1961 provides that it is not necessary for a non-resident Indian to furnish a return of income under section 139(1) if his total income only consisted of investment income or long-term capital gain or both and the tax deductible at source under Chapter XVII-B has been deducted from such income.

Question 5

Arif, a resident both in India and Malaysia in previous year 2004-05, owns immovable properties (including residential house) at Malaysia and India. He has earned income of Rs. 50 lakhs from rubber estates in Malaysia during the financial year 2004-05. He also sold some property in Malaysia resulting in short-term capital gain of Rs. 10 lakhs during the year. Arif has no permanent establishment of business in India. However, he has derived rental income of Rs. 6 lakhs from property let out in India and he has a house in Lucknow where he stays *during his visit to India. The Article 4 of the double taxation avoidance agreement between India and Malaysia provides that where an individual is a resident of both the Contracting States, then he shall be deemed to be resident of the Contracting State in which he has permanent home available to him. If he has permanent home in both the Contracting States, he shall be deemed to be a resident of the Contracting State with which his personal and economic relations are closer (centre of vital interests).*

You are required to state with reasons whether the business income of Arif arising in Malaysia and the capital gains in respect of sale of the property situated in Malaysia can be taxed in India. *(6 Marks) (May 2005)*

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

Section 90(1) of the Income-tax Act empowers the Central Government to enter into an agreement with the Government of any country outside India for avoidance of double taxation of income under the Indian law and the corresponding law of that country. Section 90(2) provides that where the Central Government has entered into an agreement with the Government of any other country for granting relief of tax or for avoidance of double taxation, then, in relation to the assessee to whom such agreement applies, the provisions of the Income-tax Act, 1961 shall apply to the extent they are more beneficial to that assessee.

Arif has a residential house both in Malaysia and India. Thus, he has a permanent home in both the countries. However, he has no permanent establishment of business in India. The Double Taxation Avoidance Agreement (DTAA) with Malaysia provides that where an individual is a resident of both the countries, he shall be deemed to be resident of that country in which he has a permanent home and if he has a permanent home in both the countries, he is deemed to be resident of that country, which is the centre of his vital interests i.e. the country with which he has closer personal and economic relations. Arif owns rubber estates in Malaysia from which he derives business income. However, Arif has no permanent establishment of his business in India. Therefore his personal and economic relations with Malaysia are closer, since Malaysia is the place where –

(a) the property is located and

(b) the permanent establishment (PE) has been set-up

Therefore, he shall be deemed to be resident of Malaysia for A.Y. 2010-11.

The fact of the case and issues arising therefrom are similar to that of *CIT vs. P.V.A.L. Kulandagan Chettiar (2004) 137 Taxman 460*, where the Supreme Court held that –

(1) If an assessee is deemed to be a resident of a contracting State where his personal and economic relations are closer, then in such a case, the fact that he is a resident in India

to be taxed in terms of sections 4 and 5 would become irrelevant, since the DTAA prevails over sections 4 and 5.

(2) The treaty has application as well to capital gains derived from immovable property situated at Malaysia vide Article 6 of the tax treaty.

Therefore, in this case, Arif is not liable to income tax in India for assessment year 2010-11 in respect of business income and capital gains arising in Malaysia.

16

TRANSFER PRICING

Question 1

EF Limited, an Indian company, is engaged in manufacturing electronic components. 74% of shares of the company are held by EF Inc., incorporated in USA. EF Limited has borrowed funds from EF Inc. at LIBOR plus 150 points. The LIBOR prevalent at the time of borrowing is 4% for US $. The borrowings allowed under the External Commercial Borrowings guidelines issued under Foreign Exchange Management Act are LIBOR plus 200 basis points. Discuss whether the borrowing made by EF Limited is at arm's length ('LIBOR' means London Inter-Bank Offer Rate). *(5 Marks) (June 2009)*

Answer

One of the methods for determination of arm's length price in an international transaction is Comparable Uncontrolled Price method (CUP). Under the CUP method, the price charged or paid for property transferred or services rendered in a comparable uncontrolled transaction, or a number of such transactions, is identified. Such price is adjusted to account for differences, if any, between the international transaction and the comparable uncontrolled transaction or between the enterprises entering into such transactions, which could materially affect the price in the open market. The adjusted price so arrived at is taken to be an arm's length price in respect of the property transferred or services provided in the international transaction.

EF Inc., USA and EF Limited, the Indian company shall be deemed to be associated enterprises since the former holds more than 26% voting power in the latter.

The arm's length rate of interest can be determined by using CUP method having regard to the rate of interest on external commercial borrowing permissible as per guidelines issued under Foreign Exchange Management Act. The interest rate permissible is LIBOR plus 200 basis points i.e., 4% + 2% = 6%, which can be taken as the arm's length rate. The interest rate applicable on the borrowing by EF Limited, India from EF Inc., USA, is LIBOR plus 150 basis points i.e., 4% + 1.5% = 5.5%. Since the rate of interest, i.e. 5.5% is less than the arm's length rate of 6%, the borrowing made by the EF Ltd. is not at arm's length. However, in this case, the taxable income of EF Ltd., India, would be lower if the arm's length rate is applied. *Hence, no adjustment is required since the law of transfer pricing will not apply if there is a negative impact on the existing profits.*

Question 2

In the context of transfer pricing provisions, read with rules, what are the factors to be considered while selecting the most appropriate method? *(6 Marks) (Nov 2008)*

Answer

Rule 10C deals with the determination of the most appropriate method. Under this Rule, the method which is best suited to the facts and circumstances of each particular international transaction, and which provides the most reliable measure of an arm's length price in relation to the international transaction will be considered as the most appropriate method.

For the purpose of selecting the most appropriate method, the following factors should be taken into account -

(i) the nature and class of the international transaction;

(ii) the class or classes of associated enterprises entering into the transaction and the functions performed by them taking into account assets employed or to be employed and risks assumed by such enterprises;

(iii) the availability, coverage and reliability of data necessary for application of the method;

(iv) the degree of comparability existing between the international transaction and the uncontrolled transaction and between the enterprises entering into such transactions;

(v) the extent to which reliable and accurate adjustments can be made to account for differences, if any, between the international transaction and the comparable uncontrolled transaction or between the enterprises entering into such transactions;

(vi) the nature, extent and reliability of assumptions required to be made in application of a method.

Question 3

Anush Motors Ltd., an Indian company declared income of Rs.300 crores computed in accordance with Chapter IV-D but before making any adjustments in respect of the following transactions for the year ended on 31.3.2007:

(i) 10,000 cars sold to Rida Ltd. which holds 30% shares in Anush Motors Ltd. at a price which is less by $ 200 each car than the price charged from Shingto Ltd.

(ii) Royalty of $ 1,20,00,000 was paid to Kyoto Ltd. for use of technical know-how in the manufacturing of car. However, Kyoto Ltd. had provided the same know-how to another Indian company for $ 90,00,000.

(iii) Loan of Euro 1000 crores carrying interest @ 10% p.a. advanced by Dorf Ltd., a German company, was outstanding on 31.3.2007. The total book value of assets of Anush Motors Ltd. on the date was Rs.90,000 crores. The said German company had also advanced a

loan of similar amount to another Indian company @ 9% p.a. Total interest paid for the year was EURO 100 crores.

Explain in brief the provisions of the Act affecting all these transactions and compute the income of the company chargeable to tax for A.Y.2007-08 keeping in mind that the value of 1$ and of 1 EURO was Rs.50 and Rs.55, respectively, throughout the year. (7 Marks) (Nov 2007)

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

Any income arising from an international transaction, where two or more "associated enterprises" enter into a mutual agreement or arrangement, shall be computed having regard to arm's length price as per the provisions of Chapter X of the Act.

Section 92A defines an "associated enterprise" and sub-section (2) of this section speaks of the situations when the two enterprises shall be deemed to associated enterprises. Applying the provisions of section 92A(2)(a) to (m) to the given facts, it is clear that "Anush Motors Ltd." is associated with :-

(i) Rida Ltd. as per section 92A(2)(a), because this company holds shares carrying more than 26% of the voting power in Anush Motors Ltd.;

(ii) Kyoto Ltd. as per section 92A(2)(g), since this company is the sole owner of the technology used by Anush Motors Ltd. in its manufacturing process;

(iii) Dorf Ltd. as per section 92A(2)(c), since this company has financed an amount which is more than 51% of the book value of total assets of Anush Motors Ltd.

The transactions entered into by Anush Motors Ltd. with different companies are, therefore, to be adjusted accordingly to work out the income chargeable to tax for the A.Y. 2010-11.

	Income of Anush Motors Ltd. as computed under Chapter IV-D, prior to adjustments as per Chapter – X	Rs.300 crore
Add:	Difference on account of adjustment in the value of international transactions:	
(i)	Difference in price of car @ $ 200 each for 10,000 cars ($ 200 x 10,000 x 50)	Rs.10 crore
(ii)	Difference for excess payment of royalty of $ 30,00,000 ($ 30,00,000 x 50) [See Note below]	Rs.15 crore
(iii)	Difference for excess interest paid on loan of EURO 1000 crores (55*1000*1/100)	Rs.550 crore
	Total Income	Rs.875 crore

Note – The difference for excess payment of royalty has been added back presuming that the manufacture of cars by Anush Motors Ltd. is wholly dependent on the use of know-how owned by Kyoto Ltd.

Question 4

What is the legislative objective of bringing into existence the provisions relating to transfer pricing ? (3 Marks) (May 2005)

Answer

The presence of multinational enterprises in India and their ability to allocate profits in different jurisdictions by controlling prices in intra-group transactions prompted the Government to set up an Expert Group to examine the issues relating to transfer pricing.

There is a possibility that two or more entities belonging to the same multinational group can fix up their prices for goods and services and allocate profits among the enterprises within the group in such a way that there may be either no profit or negligible profit in the jurisdiction which taxes such profits and substantial profit in the jurisdiction which is tax haven or where the tax liability is minimum. This may adversely affect a country's share of due revenue. The increasing participation of multinational groups in economic activities in India has given rise to new and complex issues emerging from transactions entered into between two or more enterprises belonging to the same multinational group. The profits derived by such enterprises carrying on business in India can be controlled by the multinational group, by manipulating the prices charged and paid in such intra-group transactions, which may lead to erosion of tax revenue. Therefore, transfer pricing provisions have been brought in by the Finance Act, 2001 with a view to provide a statutory framework which can lead to computation of reasonable, fair and equitable profits and tax in India, in the case of such multinational enterprises.

Question 5

US Ltd., a US company has a subsidiary, IND Ltd. in India. US Ltd. sells computer monitors to IND Ltd. for resale in India. US Ltd. also sells computer monitors to CMI Ltd., another computer reseller. It sells 50,000 computer monitors to IND. Ltd. at Rs.11,000 per unit. The price fixed for CMI Ltd. is Rs.10,000 per unit. The warranty in case of sale of monitors by IND Ltd. is handled by IND Ltd. However, for sale of monitors by CMI Ltd., US Ltd. is responsible for the warranty for 3 months. Both US Ltd. and IND Ltd. offer extended warranty at a standard rate of Rs.1,000 per annum. On these facts, how is the assessment of IND Ltd. going to be affected? (8 Marks) (Nov.2004)

Answer

US Ltd., the foreign company and IND Ltd., the Indian company are associated enterprises since US Ltd holds not less than 26% voting rights in IND Ltd. (being a subsidiary of US Ltd., more than 50% of its voting rights would be held by US Ltd.). US Ltd. sells computer monitors to IND Ltd. for resale in India. US Ltd also sells identical computer monitors to CMI Ltd, which is not an associated enterprise. The price charged by US Ltd. for a similar product transferred in comparable uncontrolled transaction is, therefore, identifiable. Therefore, Comparable Uncontrolled Price (CUP) method for determining arm's length price can be applied.

While applying CUP method, the price in comparable uncontrolled transaction needs to be adjusted to account for difference, if any, between the international transaction (i.e. transaction between US Ltd. and IND Ltd.) and uncontrolled transaction (i.e. transaction between US Ltd. and CMI Ltd.) and the price so adjusted shall be the arm's length price for the international transaction.

For sale of monitors by CMI Ltd., US Ltd. is responsible for warranty for 3 months. The price charged by US Ltd. to CMI Ltd. includes the charge for warranty for 3 months. Hence arm's length price for computer monitors being sold by US Ltd. to IND Ltd. would be:

Particulars	*No.*	*Rs.*
Sale price charged by US Ltd. to CMI Ltd.		10,000
Less: Cost of warranty included in the price charged to CMI Ltd. (Rs.1,000 x 3 /12)		250
Arm's length price		**9,750**
Actual price paid by IND Ltd. to US Ltd.		11,000
Difference per unit		**1,250**
No. of units supplied by US Ltd. to IND Ltd.	50,000	
Addition required to be made in the computation of total income of IND Ltd. (1,250 × 50,000)		6,25,00,000

No exemption or deduction under section 10A/10B or under chapter VI-A would be allowable in respect of the enhanced income of Rs.6.25 crores.

Question 6

Discuss the concept of Arm's length price as envisaged in Section 92C of the Income-tax Act.

(6 Marks) (Nov.2003)

Answer

"Arm's length price" is defined in section 92F(ii) to mean price which is applied or proposed to be applied in a transaction between persons other than associated enterprises, in uncontrolled conditions. Section 92 C deals with the method to be adopted for determining the arm's length price and the factors to be considered for applying a particular method.

Section 92C provides that the arm's length price in relation to an international transaction shall be determined by any of the following methods, being the most appropriate method, having regard to the nature of the transaction or class of transaction or class of associated persons or functions performed by such persons or such other relevant factors as the Board may prescribe, namely:-

(a) comparable uncontrolled price method;

(b) resale price method;

(c) cost plus method;

(d) profit split method;

(e) transactional net margin method;

(f) such other method as may be prescribed by the Board.

Out of the above, the most appropriate method shall be selected in the manner as may be prescribed by the Rules. However, if more than one price is determined by the most appropriate method, then the arithmetical mean of such price shall be taken as arm's length price.

The Finance (No.2) Act, 2009 has inserted a further proviso to section 92C(2) whereby if the variation between the arm's length price determined and the price at which the transaction was actually undertaken does not exceed 5% of the latter (i.e. the actual transaction price) then the price at which the international transaction was undertaken shall be deemed to be the arm's length price.

Question 7

(a) When shall a transaction be considered as an international transaction?

(2 Marks) (May 2003)

(b) In what circumstances shall a transaction entered into with a person other than an associated enterprise be deemed to be a transaction between two associated enterprises? (4 Marks) (May 2003)

Answer

(a) An international transaction is one which satisfies the following criteria -

(i) A transaction between two or more associated enterprises, either or both of whom are non-residents;

(ii) It is in the nature of purchase, sale or lease of tangible or intangible property, or provision of services, lending/borrowing money or any other transaction having a bearing on the profits, income, losses or assets of such enterprises;

(iii) It includes a transaction in the nature of a mutual agreement, or arrangement between two or more associated enterprises for the allocation or apportionment of any contribution, cost or expense incurred (or to be incurred) in connection with a benefit, service or facility provided (or to be provided) to any one or more of such enterprises.

(b) As per the provisions of section 92B(2), a transaction entered into by an enterprise with a person other than the associated enterprise, shall for the purposes of sub-section (1), be deemed to be a transaction entered into between two associated enterprises if

(i) there exists a prior agreement in relation to the relevant transaction between such other person and the associated enterprise; or

(ii) the terms of the relevant transaction are determined in substance between such other person and the associated enterprise.

Question 8

(a) What are the methods under which the arm's length price, relating to an international transaction, is determined under section 92-C? (4 Marks) (May 2002)

(b) (i) A Ltd is an Indian Company which is a 100 per cent subsidiary of B Ltd a Foreign Company. B Ltd sells its products to A Ltd at 15 dollars per unit. At the same time, it sells its products to an unrelated party at $ 20 per unit. How will the arm's length price be determined in this transaction? (2 Marks) (May 2002)

(ii) In the above example, if A Ltd is the sole selling agent of the products of B Ltd and if A Ltd resold the goods at 20 dollars, how will the arm's length price be determined?. (4 Marks) (May 2002)

Answer

(a) Under section 92C, the arm's length price in relation to an international transaction is determined by applying any of the following methods:

(a) Comparable uncontrolled price method.

(b) Resale price method

(c) Cost plus method

(d) Profit split method

(e) Transactional net margin method

(f) Such other method as may be prescribed by the Board.

The most appropriate method shall be applied in the manner prescribed. Where more than one price is determined by the most appropriate method, the arm's length price shall be taken to be the arithmetical mean of such prices.

The Finance (No.2) Act, 2009 has inserted a further proviso to section 92C(2) whereby if the variation between the arm's length price determined and the price at which the transaction was actually undertaken does not exceed 5% of the latter (the actual transaction price) then the price at which the international transaction was undertaken shall be deemed to be the arm's length price.

(b) (i) This is covered by the Comparable uncontrolled price method. The price charged for a comparable uncontrolled transaction i.e $ 20 per unit is adjusted to account for the differences between the first transaction and the second one, which could materially affect the price in the open market. Such adjusted price is taken to be an arm's length price in respect of the first transaction.

(ii) This example is covered by the resale price method. It is assumed that the goods have been resold by A Ltd at 20 dollars to an unrelated enterprise. Such resale price is reduced by the normal gross profit margin accruing to an unrelated enterprise from the purchase and sale of the same goods. This price so arrived at is further reduced by the expenses incurred by the enterprise in connection with the purchase. The price so arrived at is adjusted to take into account the functional and other differences including differences in accounting practices which could materially affect the gross profit margin in the open market. The adjusted price arrived at in this manner will be the arm's length price.

17

FOREIGN COLLABORATION

Question 1

A foreign company, ST, has entered into an agreement with an Indian Company KN for supply of know-how and the agreement is within the Industrial Policy conditions laid down by the Central Government. In the year 2004-05, Rs.50 lakhs is paid, under the agreement, to ST by KN.

ST claims to have spent Rs.14 lakhs as expenses in India to be recognized as a deduction.

In the following situations, what will be your decision on the tax liability of the parties:

(i) The agreement having been entered into before 1st June, 2002 and approved by the Government, KN pays to the Indian income-tax authorities the tax payable by ST;

(ii) There is no agreement as to KN bearing the tax liability; the royalty payable is decided to be Rs.59 lakhs net of taxes. (5 Marks) (Nov.2005)

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

(i) As per section 10(6A), in the case of a foreign company deriving income by way of royalty or fees for technical services from the Government or an Indian concern under the terms of an agreement entered into before 1.6.2002 relating to a matter included in the industrial policy of the Central Government, the tax paid by the Government or an Indian concern on such income would not be included in the total income of the foreign company. Hence, such tax paid would be exempt in the hands of the foreign company.

Therefore, in the present case, the tax paid by KN will be exempt from tax in the hands of ST. In this case, section 195A is not applicable and consequently, the royalty of Rs.50 lakhs should not be grossed up. As per section 44D, where a foreign company receives income by way of royalty from an Indian concern in pursuance of an agreement made on or after 1st April, 1976 but before 1st April, 2003, no deduction is allowable in respect of any expense or allowance under sections 28 to 44C in computing such income.

The rate of tax is 20% as per section 115A(1)(b)(A), if the royalty is received in pursuance of an agreement made after 31.5.1997 but before 1.6.2005.

(ii) Since there is no agreement as to KN bearing the tax liability, the benefit under section 10(6A) is not available. However, KN has to deduct tax at source on royalty payment to ST, a foreign company, as per section 195. Since in this case, KN has to pay the royalty of Rs.59 lakhs 'net of taxes' to ST, therefore, the royalty has to be grossed up.

The tax liability of ST has to be computed as under:

Net royalty income	59,00,000
Gross royalty income (59,00,000 x 100/79.40)	74,30,730
Tax on royalty of 74,30,730 @ 20.60 %	15,30,730

KN has to deduct this tax of Rs.15,30,730 at source under section 195.

Question 2

XY Pvt. Ltd., a company having registered head office in Singapore, for the first time had carried out operations during 2002-03 of purchase of goods in India on four occasions. Immediately after purchase, the company exported the same to China. The total value of such exports was Rs.100 lakhs, on which it earned profits of Rs.20 lakhs, before the expenses of Rs.12 lakhs, which were directly paid by H.O. The company seeks your advice to its liability to tax in India:

(i) How much income for A.Y. 2003-04 shall be subject to tax?

(ii) To what extent deduction under section 80HHC shall be available? (4 Marks) (Nov.2003)

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

(i) Section 2(26) defines an "Indian Company". The proviso to section 2(26) states that for a company to be an Indian company, the registered or principal office should be in India. In this case, since the registered office is in Singapore, XY Pvt. Ltd. is not an Indian company.

A company, other than an Indian company, would be considered as resident in India only if the control and management is wholly in India. In this case, the control and management is not wholly in India and therefore, XY Pvt. Ltd. is a non-resident / not a domestic company.

XY Pvt. Ltd. is a non-resident assessee during the previous year relevant to assessment year 2010-11. As per Explanation (b) of section 9(1)(i), no income shall be deemed to accrue or arise in India to a non-resident through or from operations which are confined to purchase of goods in India for the purpose of export. XY Pvt. Ltd. had purchased the goods in India and thereafter exported the same in total to China and accordingly no income of the non-resident company shall be subject to tax for assessment year 2010-11.

(ii) No deduction under section 80HHC would be allowable from the assessment year 2005-06 hence the issue does not arise.

Question 3

M/s. Kangaru Australia, a non-resident foreign company, had entered into a collaboration agreement on 21.02.2002 with an Indian company and was in receipt of the following payments during the previous year ended on 31.03.03. How do you deal with them for computation, in the case of M/s. Kangaru Australia?

(i) Interest on 8% debentures for Rs.50 lakhs issued by Indian company on 01.07.2002 in consideration of providing of technical know-how, manufacturing process and designs.

(ii) Service charges @ 2$^1/_2$% of the value of Plant & Machinery for Rs.500 lakhs leased out to Indian company payable each year before 31st March. (4 Marks) (Nov.2003)

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

The foreign non-resident company had entered into a collaboration agreement with the Indian company and was in receipt of interest on debentures and service charges during the year. These incomes shall be subject to tax as under:-

(i) The interest on debentures of Rs.3 lakhs, being 8% of Rs.50 lakhs, for the period from 1st July to 31st March (9 months) shall be chargeable as "Income from other sources".

(ii) The service charges of Rs.12.50 lakhs for the year, being 2½% of the value of the plant & machinery of Rs.500 lakhs, will be a payment by the collaborator in the nature of royalty as per Explanation 2(iva) to section 9(1)(vi) and accordingly, will be subject to tax under section 115A(1)(b).

Question 4

Human Life Insurance Co. of U.K. conducted business in India during 2001-02. It seeks your advice for the computation of its income from Life Insurance business in India, in accordance with the provisions of Income-tax Act, 1961. (3 Marks) (Nov.2002)

Answer

The income of Human Life Insurance Corporation of U.K. in respect of the business conducted in India shall be worked out in accordance with Rule-6 of First Schedule read with section 44 of the Act. The income chargeable to tax will be computed as under:

(a) That proportion of the global income which corresponds to the proportion which its premium income derived from India bears to its total premium income.

(b) The global income shall be computed in the manner as laid down in the Act for computing the profits and gains of life insurance business carried on in India.

Question 5

M/s. Global Airlines incorporated as a company in USA operated its flights to India and vice versa during the year 2001-02 (April, 2001 to March, 2002) and collected charges of Rs.125 lakhs for carriage of passengers and cargo out of which Rs.65 lakhs were received in U.S Dollars for the passenger fare booked from New York to Mumbai. The total expenses for the year on operation of such flights were Rs.195 lakhs. Income chargeable to tax of the foreign airlines may please be computed. *(4 Marks) (Nov.2002)*

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

The income of Global Airlines is to be calculated and computed with reference to the provisions contained in section 44BBA on presumptive basis at the rate of 5 per cent of the total amount of passenger fares received and charges for handling of cargo, whether received in India or outside India. Therefore, the airlines is to be assessed on Rs.6.25 lakhs for the relevant assessment year, which is 5% of total collection of Rs.125 lakhs from flights to India and vice versa. The expenses incurred on operation of such flights are to be ignored.

Question 6

A foreign company has entered into an agreement with an Indian company on 1st June 2001 under which industrial equipment belonging to the firms has been leased to the latter on an annual lumpsum payment of $ 50,000. How will the lease rent be taxed in the hands of the foreign company in respect of assessment year 2002-03? *(3 Marks) (May 2002)*

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

Under clause (iva) of Explanation 2 to section 9(1) inserted w.e.f 01.4.2002, the expression "royalty" would include any lump sum consideration for the use of or the right to use of any industrial, commercial or scientific equipment. Under section 44D, no deduction will be allowed in respect of any expenditure or allowance in computing the income by way of royalty. Under section 115A, income-tax payable on such royalty under an agreement entered into after 31st May, 1997 but before 1st day of June, 2005 will be 20%. This will be subject to the provisions of the Double Taxation Avoidance Agreement between India and the country in which the foreign company is assessed.

Question 7

Write short notes on the following:

Global depository receipts and their impact on non-residents (4 Marks) (May 2002)

Answer

Under section 115AC, in the case of non-resident, the income by way of dividends, other than dividends referred to in section 115-O, on GDR's is subjected to concessional rate of tax.

Global Depository Receipts means any instrument in the form of depository receipt or certificate (by whatever name called) created by the Overseas Depository Bank outside India and issued to non-resident investors against the issue of ordinary shares or foreign currency convertible bonds of issuing company.

The tax payable on both the dividend income and long-term capital gains, arising out of the transfer of GDR's will be 10%. No deduction under section 28 to 44C or section 57 will be allowed against such income. The deduction under chapter VI-A will be allowed only after reducing such income from the gross total income of the assessee. The benefits of indexation will also not be available in computing capital gains arising on transfer of GDR's.

Question 8

Becker, a tennis professional and a non-Indian citizen participated in India in a Tennis Tournament and won the prize money of Rs.1.50 lacs. He contributed articles on the tournament in a local newspaper for which he was paid Rs.10,000. He was also paid Rs.50,000 by a Soft Drink company for appearance in a T.V. advertisement. Although his expenses in India were met by the sponsors, he had to incur Rs.30,000 towards his travel costs to India. He was a non-resident for tax purposes in India. What would be his tax liability in India for assessment year 2001-2002? Is he required to file his return of income under section 139(1)? (6 Marks) (Nov 2001)

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

Under section 115BBA, all the three items of receipts in India are chargeable to tax. No expenditure is allowable against such receipts. The rate of tax chargeable is 10 per cent, plus education cess @2% and secondary and higher education cess @1%. The total tax liability works out to Rs. 21,630 being 10.3% of Rs. 2,10,000.

Thus, Becker will be liable to tax on the income earned in India. He is not required to file his return of income if (a) his total income during the previous year consists only of income arising under section 115BBA and (b) the tax deductible at source under the provisions of Chapter XVIII-B has been deducted from such income.

Question 9

A foreign company has the following two options before it for negotiation with an Indian company. It seeks your advice as to the incidence to tax, under the provisions of Income-tax Act, 1961, to exercise the better option.

(i) Receiving royalty for the use of rights of manufacturing process

(ii) Outright sale of manufacturing process. *(6 Marks) (May 2000)*

Answer

The question is a narrow one, on the incidence of tax, on the use of a manufacturing process or its outright sale. The use of a manufacturing process yields a return by way of royalty and the tax thereon is leviable at 20% under section 115A (1) clause (b) if the agreement made before 1st June 2005. Where the agreement is made after 1st June 2005, the rate of tax shall be 10%.

The agreement governing the payment of royalty should be approved by the Central Government or where it relates to a matter included in the industrial policy, it should be in accordance with that policy.

The sale of manufacturing process would yield capital gain which is also chargeable to tax at 20% under section 112(1) clause (c). Therefore, under either option, the incidence of tax is the same if the agreement is made before 01-06-2005. If the agreement is made after 01-06-2005 then it would be beneficial to offer the income as per section 115 A instead of section 112 (1)(c) as the tax rate applicable would be @ 10%.

Where, the entire operations relating to the outright sale is carried out, outside India, then it is possible to say that no capital gains would accrue or arise in India –*Shriram Bearings Ltd 224 ITR 724 (SC).*

18

BUSINESS RESTRUCTURING

Question 1

Your client, Ashavari Ltd. has two industrial undertakings-one engaged in production of audio music CDs and cassettes and the other engaged in production of video CDs. As a restructuring drive, the company has decided to sell its undertaking producing video CDs as a going concern by way of slump sale for Rs. 450 lakhs to a new company called Tori Ltd., in which it holds 75% equity shares. The balance sheet of Ashavari Ltd. as on 31st March, 2005 reads as follows:

		Rs. in lakhs
	Audio Unit	*Video Unit*
Fixed Assets	*150*	*225*
Debtors	*150*	*112.5*
Inventories	*75*	*37.5*
Liabilities	*42*	*75*
Paid up share capital		*Rs. 378 lakhs*
General Reserve		*Rs. 222 lakhs*
Share premium		*Rs. 33 lakhs*
Revaluation Reserve		*Rs. 140 lakhs*

The company set up the video unit on 1st April, 2001. The written down value of the block of assets for tax purpose as on 31st March, 2005 is Rs.200 lakhs of which Rs.85 lakhs are attributable to video unit.

(i) Determine the tax liability which would arise to Ashavari Ltd. from slump sale; (5 Marks)

(ii) Suggest modification of the restructuring plan of Ashavari Ltd. without changing the amount of consideration so as to make it more tax efficient. (3 Marks) (May 2005)

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

(i) As per section 50B, any profits or gains arising from the slump sale effected in the previous year is chargeable to income tax as capital gains arising from the transfer of capital assets and shall be deemed to be the income of the previous year in which the transfer takes place.

If the assessee owned and held the undertaking transferred under slump sale for more than 36 months before such slump sale, the capital gain shall be deemed to be long-term capital gain.

Particulars	Rs.
Calculation of capital gains	
Slump sale consideration	4,50,00,000
Less: Cost of acquisition (net worth) [See Working Note below]	1,60,00,000
Long-term capital gain	**2,90,00,000**
Calculation of tax liability	
Income tax @ 20%	58,00,000
Surcharge @ 10%	5,80,000
	63,80,000
Education cess @ 3%	1,91,400
Total tax liability	**65,71,400**
Working Note:	
Net worth of Video unit	Rs
WDV of block of assets	85,00,000
Debtors	1,12,50,000
Inventories	37,50,000
	2,35,00,000
Less: Liabilities	75,00,000
Net worth	**1,60,00,000**

Note - Indexation benefit is not available in the case of slump sale as per section 50B(2)

(ii) Transfer of any capital asset from a holding company to its 100% Indian subsidiary company is exempt from tax under section 47(iv). Therefore, if it is possible for Ashavari Ltd to acquire the entire shareholding of Tori Ltd and then make slump sale, in which case, the resultant capital gain shall not attract capital gains tax.

However, Ashavari Ltd should not transfer any shares in Tori Ltd for a period of 8 years from the date of such (slump) sale.

19

TAXATION OF E-COMMERCE TRANSACTIONS

Question 1

E-commerce transactions have replaced concepts generally associated with international transactions traditionally. Discuss briefly the issues involving such transactions.

(7 Marks) (May 2004)

Answer

E-commerce transactions, in its widest sense, means business transactions conducted over a network, using computers and telecommunication. E-commerce is a method of transacting business and is not a transaction by itself. Such a method will involve electronic advertising, electronic sales and electronic delivery.

The issues involving e-commerce transactions are as follows:

(i) Traditional business rests squarely on the physical presence and delivery of goods, but e-commerce transcends geographical barriers.

(ii) Income out of an international transaction is subject to tax both in the Home State by virtue of "personal attachment" to the transfer and in the host State by virtue of "economic attachment" to the income itself. Thus, this gives rise to double taxation of the same income.

(iii) Tax treaties seek to tax profits on the basis of what is popularly known as "Permanent Establishment". However, in the case of e-commerce transactions, no establishment is required across the border to carry on business.

(iv) Taxable jurisdiction of any country covers its national boundaries. E-commerce takes place through satellite and the server can be in any part of the globe and in all probability, in a tax haven country.

(v) For adopting the existing principles to e-commerce situations, there are two key areas:

   (a) the extent to which a web-site can constitute a permanent establishment and how income may be attributed to it;

   (b) the manner in which payments for digitized products are to be characterized.

The source rule of taxation embodied in section 9 will become increasingly difficult to apply and increasing emphasis would be given on the Residence Rule. Such a situation could spell diminishing revenues for developing countries, particularly in situations of technology transfers, where host States are generally developing countries.

20

INCOME TAX AUTHORITIES

Question 1

Examine the correctness of the statement "that the jurisdiction of an Assessing Officer cannot be objected by the assessee". (4 Marks) (May 2008)

Answer

According to section 124(3), the assessee can raise a question as to the jurisdiction of an Assessing Officer within the prescribed time limit as under:

(i) where a return has been filed under section 139(1) then, within one month from the date of service of notice under section 142(1) or section 143(2) or before the completion of assessment, whichever is earlier.

(ii) where no return has been filed, then, within the expiry of time allowed by the notice under section 142(1) or section 148 for filing the return or within the time allowed in show cause notice issued seeking as to why a best judgment assessment under section 144 should not be made, whichever is earlier.

Where the assessee calls in question the jurisdiction of an Assessing Officer and the Assessing Officer is not satisfied with such claim, he shall refer the matter for determination by the Director General or Chief Commissioner or Commissioner before the assessment is made.

Therefore, in view of the above provisions, the statement that "the jurisdiction of an Assessing Officer cannot be objected by the assessee" is not correct.

Question 2

The Assessing Officer issued notices under section 133 to four banks requiring particulars relating to a customer in a specific format duly verified in a prescribed manner. One of the banks refused to part with the information on the ground that the letter did not specify about any proceeding pending against the said customer under the Income-tax Act.

(3 Marks) (Nov 2007)

Answer

It is not necessary that any proceeding should be pending against the customer for the purpose of invoking section 133(6) of the Income-tax Act. It is with a view to collecting information that power is given to an Assessing Officer under section 133(6) to issue notice requiring a banking company to furnish information in respect of such points or matters as may be useful or relevant to any *enquiry or proceeding* under the Act. The second proviso to section 133(6) makes it clear that such information can be sought for even when no proceeding under the Act is pending; such power can be exercised even in case of an enquiry, the only safeguard being that before this power can be invoked by the Assessing Officer, the approval of the Director or the Commissioner, as the case may be, has to be obtained [*Karnataka Bank Ltd. vs. Secretary, Government of India (2002) 255 ITR 508(SC)].*

The action of the Assessing Officer in this case is, therefore, correct assuming that he has obtained the prior approval of the Director or the Commissioner, as the case may be.

Question 3

An Assessing Officer entered a hotel run by a person, in respect of whom he exercises jurisdiction, at 8 p.m. for the purpose of collecting information, which may be useful for the purposes of the Act. The hotel is kept open for business every day between 9 a.m. and 9 p.m. The hotelier claims that the Assessing Officer could not enter the hotel after sunset. The Assessing Officer wants to take away with him the books of account kept at the hotel. Examine the validity of the claim made by the hotelier and the proposed action of the Assessing Officer with reference to the provisions of section 133B of the Income-tax Act, 1961. *(4 Marks) (Nov 2006)*

Answer

Section 133B(2) of the Income-tax Act, 1961 empowers an income-tax authority to enter any place of business during the hours at which such place is open for the conduct of business. The hotel is open from 9.00 a.m. to 9.00 p.m. for the conduct of business. The Assessing Officer entered the hotel at 8.00 p.m. which falls within the working hours. The claim made by the hotelier to the effect that the Assessing Officer could not enter the hotel after sunset is not in accordance with law.

Section 133B(3) provides that an income tax authority acting under this section shall, on no account, remove or cause to be removed from the place wherein he has entered, any books of account. In view of this clear prohibition in section 133B(3), the proposed action of the Assessing Officer to take away with him the books of account kept at the hotel is not valid in law.

Question 4

In the course of search operations under section 132, a tax payer makes a declaration under section 132(4) on the earning of income not disclosed. Can that statement save the tax payer from a levy of penalty under section 271(1)(c)? *(4 Marks) (Nov.2005)*

Answer

As per *Explanation 5* to section 271(1)(c), the assessee shall not be deemed to have concealed income where, in the course of search under section 132, he makes a statement under section 132(4) that any money, bullion, jewellery or other valuable article or thing found in his possession or under his control, has been acquired out of his income which has not been disclosed so far in his return of income to be furnished before the expiry of the time specified in section 139(1), and also specifies in the statement the manner in which such income has been derived and pays the tax, together with interest, if any, in respect of such income. In such a case, the statement can save the tax payer from levy of penalty under section 271(1)(c).

Students may note that Explanation 5 to section 271(1)(c) will not apply in respect of search initiated under section132 on or after 01.06.2007.

Further, section 271AAA which provides for levy of penalty @ 10% of the undisclosed income computed in search assessment would apply. This penal provision would not be applicable where a statement is made under section 132(4) of the Act.

Question 5

State whether the information regarding possession of unexplained assets and income received from the Central Bureau of Investigation, a Government agency, can constitute "information" for action under section 132 of the Act. Discuss (5 Marks) (Nov.2005)

Answer

As per section 132(1)(c), authorization for search and seizure can take place if the authority, in consequence of *information in his possession*, has *reason to believe* that any person is in possession of money, bullion, jewellery or other valuable article or thing and these assets represent, either wholly or partly, income or property which has not been, or would not be disclosed by such person for the purposes of this Act. In the absence of such information, a search cannot be validly authorized.

The Apex Court in *UOI v Ajit Jain [2003] 260 ITR 80* has held that mere intimation by the CBI that money was found in the possession of the assessee, which according to the CBI was undisclosed, without something more, does not constitute "information" within the meaning of section 132, on the basis of which a search warrant could be issued. Consequently, the Supreme Court held that the search conducted on this basis and the (block) assessment made pursuant to such search was not valid.

Question 6

(a) In the course of search on 25.03.2003, assets were seized. State the procedure laid down to deal with such seized assets under the Act. (3 marks) (Nov.2003)

(b) The Director of Income Tax received information that Mr. X has unaccounted cash exceeding Rs.50 lakhs. Can the Director pass orders for seizure of the cash invoking his powers under section 131(1A)? Does the Director have any other course open to him for the seizure of cash? (4 marks) (Nov.2003)

Answer

(a) Section 132B of the Income-tax Act deals with the application of assets seized under section 132. Such assets will be first applied towards the existing liability under the Income-tax Act, Wealth-tax Act, Expenditure-tax Act, Gift-tax Act and the Interest-tax Act. Further, the amount of liability determined on completion of search assessment and in respect of which the assessee is in default or deemed to be in default, may be recovered out of such assets.

Where the nature and source of acquisition of such seized assets is explained to the satisfaction of the Assessing Officer, the amount of any existing liability mentioned in para 1 above may be recovered out of such asset and the remaining portion, if any, of the asset may be released, with the prior approval of the Chief Commissioner or Commissioner as the case may be. The release must be made within 120 days from the date on which the last of the authorisations for search was executed. The assets would be released to the person from whose custody they were seized.

When the assets consist of solely of money, or partly of money and partly of other assets, the Assessing Officer may apply such money in the discharge of the liabilities referred to in para 1 above and the assessee shall be discharged of such liability to the extent of the money so applied. However, the assets other than money may also be applied for the discharge of such liabilities if the complete recovery could not be made from the money seized or the money seized was not sufficient.

(b) The powers under section 131(1A) deals with power of discovery and production of evidence. They do not confer the power of seizure of cash or any asset. The Director, for purposes of making an enquiry or investigation relating to any income concealed or likely to be concealed by any person or class of persons within his jurisdiction shall be competent to exercise powers conferred under section 131(1), which confine to discovery and inspection, enforcing attendance, compelling the production of books of account and other documents and issuing commissions. Thus, the power of seizure of unaccounted cash is not one of the powers conferred on the Director under section 131(1A).

However, under section 132(1), the Director has the power to initiate search proceeding by issuing search warrant and effect seizure through an authorized officer, if he has reason to believe that any person is in possession of any money which represents wholly or partly income which has not been disclosed. Therefore, the proper course open to the Director is to exercise his power under section 132(1) and authorise the officers concerned to enter the premises in which the cash is kept and seize the unaccounted cash.

Question 7

During the course of survey operations under Section 133A, carried on 5th March, 2003, the Income-tax authority, impounded the books of account and other documents inspected by him, relating to the assessee and retained the same in his custody. Is the action of the officer justified under law? (4 Marks) (May 2003)

Answer

Section 133A(3)(ia) empowers the Income-tax Authority to impound and retain in his custody, books of account or other documents inspected by him during survey subject to recording of reasons for so doing. However, such impounded books of account or other documents shall not be retained for more than 10 days (exclusive of holidays) without obtaining the approval of the Chief Commissioner or Director General as the case may be.

Hence, assuming that the above conditions are fulfilled, the action of the Income-tax authority is justified.

Question 8

An Income-tax authority in the course of exercising powers of survey under section 133A serves a summon on the assessee and impounds the books of account and other documents found in the premises visited. Discuss the legality of its action. *(4 Marks) (May 2002)*

Answer

Section 133A(3)(ia) empowers the income-tax authority to impound books of account or other documents after recording his reasons for so doing. The books impounded could be retained in his custody for a period of 10 days (excluding holidays). However, for retention of books impounded beyond 10 days (excluding holidays), approval of the Chief Commissioner or Director General as the case may be, must be obtained.

The action of the income-tax authority to impound books in the course of survey is legal.

Question 9

The business premises of Ram Bharose Ltd. and the residence of two of its directors at Delhi were searched under section 132 of the Act by the DDI, Delhi. The search was concluded on 9.8.2007 and following were also seized besides other papers and records:

(i) Papers found in the drawer of an accountant relating to Shri Krishna Ltd., Mumbai indicating details of various business transactions. However, Ram Bharose Ltd. is not having any direct or indirect connection of any nature with these transactions and Shri Krishna Ltd., Mumbai and its directors.

(ii) Jewellery worth Rs. 5 lacs from the bed room of one of the director, which was claimed by him to be of his married daughter.

(iii) Papers recording certain transactions of income and expenses having direct nexus with the business of the company for the period from 16.4.04 to date of search. It was admitted by the director that the transactions recorded in such papers have not been incorporated in the books.

You are required to answer on the basis of aforesaid and the provisions of Act, following questions:

(a) What action the DDI shall be taking in respect of the seized papers relating to Shri Krishna Ltd., Mumbai?

(b) Whether the contention raised by the director as to jewellery found from his bed-room will be acceptable?

(c) What presumption shall be drawn in respect of the papers which indicate transactions not recorded in the books?

(d) Proceedings for how many years shall now be taken up and within which time limit the assessment thereof be completed by the Assessing Officer?

(e) Can the company move an application for settlement of case as per Chapter XIX-A of the Act? *(11 Marks) (Nov 2007)*

Answer

(a) The authorised officer being DDI, Delhi is not having any jurisdiction over Shri Krishna Ltd., Mumbai, and therefore as per section 132(9A), the papers seized relating to this company shall be handed over by him to the Assessing Officer having jurisdiction over Shri Krishna Ltd., Mumbai within a period of 60 days from the date on which the last of the authorisations for search was executed for taking further necessary action thereon.

(b) The contention raised by the Director will not be acceptable because as per the provisions of sub-section (4A)(i) of section 132, where any books of account, other documents, money, bullion, jewellery or other valuables are found in the possession or control of any person in the course of search, then, in respect thereof, it may be presumed that the same belongs to that person.

(c) As per section 132(4A), the presumptions in respect of the papers, indicating transactions not recorded in the books but having direct nexus with the business of the company, are that the same belong to the company, contents of such papers are true and the handwriting in which the same are written is/are of the persons(s) whose premises have been searched.

(d) The search was conducted after 31.05.2003 and therefore, as per provisions of section 153A, the Assessing Officer will issue notices to the company to furnish the return of income in respect of each assessment year falling within six assessment years immediately preceding the assessment year relevant to the previous year in which the search is conducted. Assuming the date of search as 09.08.2009, notices for A.Y. 2004-05 to 2009-10 shall be issued by the Assessing Officer.

The assessment for six assessment years shall be completed (as per provisions of section 153B(1)(a) read with proviso) within a period of 21 months from the end of the financial year in which the last of the authorisation for search was executed. Therefore, the assessment for the six assessment years shall be required to be completed by the Assessing Officer by 31.12.2011 as the search was concluded on 9.08.2009.

(e) With effect from 1.6.2007, the definition of a case as per section 245A(b) has been amended to restrict the cases eligible to appear before the Settlement Commission. Accordingly, no proceedings, except the original assessment proceedings should be pending at the time of making an application to Settlement Commission. Therefore, an application cannot be made to the Settlement Commission where search has been initiated under section 132 followed by assessment under section 153A.

21

ASSESSMENT PROCEDURE

Question 1

Tai Ltd. filed its return of income for assessment year 2008-09 on 6th June, 2008. The return is selected for regular assessment under section 143(3) for which notice under section 143(2) is served on the company on 3rd October, 2009. The company responded to the notice under section 143(2). State whether the service of the notice is within time and if not, whether the assessment order can be challenged by the assessee. *(4 Marks) (June 2009)*

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

The time limit for service of notice under section 143(2) is six months from the end of the financial year in which the return of income was furnished by the assessee. The return of income for assessment year 2010-11 was filed by the assessee on 6th June, 2010. Therefore, the notice under section 143(2) has to be served by 30th September, 2011. However, the notice was served on the assessee only on 3rd October, 2011. Hence the notice issued under section 143(2) is time-barred.

However, as per section 292BB, where an assessee had appeared in any proceedings or co-operated in any enquiry relating to an assessment or reassessment, it shall be deemed that any notice required to be served upon him, has been duly served upon him in time in accordance with the provisions of the Act and such assessee shall be precluded from raising any objection in any proceeding or enquiry that the notice was (a) not served upon him or (b) not served upon him in time or (c) served upon him in an improper manner. However, the above provision shall not be applicable where the assessee has raised such objection before the completion of such assessment or reassessment. Therefore, in the instant case if the assessee, Tai Limited, had raised an objection to the proceeding, on the ground of non-service of the notice under section 143(2) upon it on time, then the validity of the assessment order can be challenged. In absence of such objection, the assessment order cannot be challenged.

Question 2

(a) *The assessment was made under section 143(1) for assessment year 2005-06. The assessee has received a notice under section 148 on 6th April, 2008 for reopening of* *assessment. Can the assessee challenge the legality of the notice on the ground of change of opinion?* *(3 Marks) (June 2009)*

(b) Is it possible for the Assessing Officer to initiate proceeding under section 147 in respect of income involving matters which are the subject matter of an appeal?

(2 Marks) (June 2009)

(c) The Assessing Officer has no power to make any adjustment to the income returned by the assessee while processing the return of income under section 143(1). Examine the correctness of the statement. *(5 Marks) (June 2009)*

Answer

(a) Under the scheme of section 143(1), only the adjustments relating to any arithmetical error in the return and incorrect claim which is apparent from any information in the return are permitted. In short, what is permissible is only correction of errors apparent on the basis of the return filed. Thus, while making the adjustments under section 143(1), the Assessing Officer has no power to go beyond the information given in the return and make any allowance or disallowance. Therefore, the intimation given under section 143(1) cannot be treated as an order of assessment. Hence, there being no assessment under section 143(1), the question of change of opinion does not arise.

Therefore, the assessee cannot challenge the legality of the notice issued under section 148 reopening the assessment on the grounds of change of opinion in a case where no assessment is made under section 143(3), but only an intimation is issued under section 143(1). This inference is supported by the Supreme Court ruling in *ACIT vs. Rajesh Jhaveri Stock Brokers P. Ltd. (2007) 291 ITR 500.*

(b) As per second proviso in section 147 the Assessing Officer may assess or reassess an income which is chargeable to tax and which has escaped assessment, other than the income involving matters which are the subject matter of any appeal, reference or revision. Therefore, in respect of income involving the matters which are the subject matter of an appeal, it is not possible for the Assessing Officer to initiate proceeding under section 147.

(c) As per section 143(1) in computation of total income of an assessee the following adjustments could be made to the returned income:

(i) any arithmetical error in the return; or

(ii) an incorrect claim, if such incorrect claim is apparent from any information in the return.

Thus, section 143(1) now seeks to allow the Assessing Officer to make adjustments for correcting arithmetical mistakes and incorrect claims apparent from the return filed.

For the purpose of section 143(1), "an incorrect claim apparent from any information in the return" shall mean such claim on the basis of an entry, in the return of income,-

(i) of an item, which is inconsistent with another entry of the same or some other item in such return;

(ii) in respect of which, information required to be furnished to substantiate such entry, has not been furnished;

(iii) in respect of a deduction, where such deduction exceeds specified statutory limit which may have been expressed as monetary amount or percentage or ratio or fraction.

Therefore, the statement is not correct.

Question 3

Discuss the correctness or otherwise of the following proposition in the context of the Income-tax Act, 1961:

A fresh claim before the Assessing Officer can be made only by filing a revised return and not otherwise. *(4 Marks) (Nov 2008)*

Answer

This proposition is correct. A return of income filed within the due date may be revised by filing a revised return under section 139(5) where the assessee finds any omission or wrong statement in the original return subject to satisfying other conditions. There is no provision in the Income-tax Act to make changes or modification in the return of income by filing a letter. In a case where a return of income has been filed within the due date, the only option available to the assessee to make an amendment to such return is by way of filing a revised return under section 139(5). Therefore, a fresh claim can be made before the Assessing Officer only by filing a revised return and not otherwise. The Supreme Court in *Goetze (India) Ltd. vs. CIT (2006) 284 ITR 323* has held that there was no provision in the Income-tax Act to allow an amendment in the return of income filed except by way of filing a revised return.

Question 4

Answer the following in the context of provisions contained in Income-tax Act, 1961:

The Assessing Officer within the powers vested in him under section 142(2A), while examining the accounts of PNF Ltd., had ordered to get the same audited. The company challenges this order on the ground "that the opportunity was not provided to them by the Assessing Officer prior to passing of such an order". *(4 Marks) (May 2008)*

Answer

The Assessing Officer had passed an order to get the accounts audited under section 142(2A) without providing the assessee an opportunity of being heard before issuing such order. The Apex Court, in the case of *Rajesh Kumar v. DCIT (2006) 287 ITR 91,* has observed that the order under section 142(2A) is a quasi judicial order. Therefore, the principles of natural justice have to be applied and the assessee has to be given an opportunity of being heard before directing the special audit. The principles of natural justice are based on two principles, namely, (i) nobody shall be condemned unheard; (ii) nobody shall be a judge of his own cause. Once it is held that the assessee suffers civil consequences and any order passed would be prejudicial to him, the principles of natural justice must be held to be implicit.

Accordingly, to give effect to this observation of the Supreme Court, the Finance Act, 2007 has inserted a proviso to section 142(2A) to provide that the Assessing Officer shall not direct the assessee to get the accounts so audited unless the assessee has been given a reasonable opportunity of being heard.

Therefore, in this case, the order of the Assessing Officer is not valid since the assessee was not given an opportunity of being heard prior to passing of such order.

Question 5

Smt. Kanti engaged in the business of growing, curing, roasting and grounding of coffee after mixing chicory had a total income of Rs.3,25,000 from this business which was her only source of income during the year ended on 31.3.07. She consults you to have an opinion whether she is required to file return of income for the Asst. Year 2007-08 as per provisions of section 139(1) of the Act. *(3 Marks) (Nov 2007)*

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

The clarification regarding filing of return of income by the coffee growers being individuals covered by Rule 7B of the Income tax Rules, 1962 is given in Circular No.10/2006 dated 16.10.06. According to this Circular, an individual deriving income from growing, curing, roasting and grounding of coffee with or without mixing chicory, would not be required to file the return of income if the aggregate of 40% of his or her income from growing, curing, roasting and grounding of coffee with or without mixing chicory and income under all other sources liable to tax in accordance with the provisions of this Act, is equal to or less than the basic exemption limit prescribed in the First Schedule of the Finance Act of the relevant year.

In this case, Smt. Kanti has a total income of Rs.3,25,000 from this business, which was her only source of income for P.Y.2009-10. 40% of her total income works out to Rs.1,30,000, which is less than the basic exemption limit of Rs.1,90,000 in respect of resident women assessees. Therefore, Smt. Kanti is not required to file a return of income for the A.Y.2010-11 as per the provisions of section 139(1).

Question 6

R, an individual, filed his return of income for the assessment year 2006-07 on 15.6.2006. He later discovered that he had not claimed deduction under section 80-C in the said return. He claimed the said deduction through a letter addressed to the Assessing Officer. The Assessing Officer completed the assessment without allowing the deduction claimed by R. Is the Assessing Officer justified in doing so? *(2 Marks) (May 2007)*

Answer

The Supreme Court has, in *Goetze (India) Ltd. v. CIT (2006) 284 ITR 323,* ruled that the assessing authority has no power to entertain a claim for deduction made after filing of the return of income otherwise than by way of a revised return. In the instant case, R has claimed the deduction under section 80C, which he omitted to claim in the original return of income, through a letter addressed to the Assessing Officer and not by filing a revised return under section 139(5). In view of the decision of the Supreme Court cited above, the Assessing Officer was justified in completing the assessment without allowing the deduction under section 80C.

Question 7

X, an individual, has got his books of account for the year ending 31.3.2007 audited under section 44AB. His total income for the assessment year 2007-08 is Rs.1,90,000. He desires to know if he can furnish his return of income for the assessment year 2007-08 through a Tax Return Preparer. *(3 Mark) (May 2007)*

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

Section 139B provides for submission of return of income through Tax Return Preparers. It empowers the Central Board of Direct Taxes (CBDT) to frame a scheme for the purpose of enabling any specified class or classes of persons to prepare and furnish their returns of income through Tax Return Preparers. Specified class or classes of persons have been defined to mean any person, other than a company or a person whose accounts are required to be audited under section 44AB or under any other existing law, who is required to furnish a return of income under the Act. Thus, companies and persons whose accounts are liable for tax audit under section 44AB do not fall within the definition of 'specified class or classes of persons' and consequently, cannot furnish their returns of income through Tax Return Preparers. In the instant case, the books of account of X for the year ending 31.3.2010 have been audited under section 44AB. As such, he cannot furnish his return of income for the assessment year 2010-11 through a Tax Return Preparer.

Question 8

T, an individual, filed his return of income for the assessment year 2006-07 on 15.6.2006 declaring a total income of Rs.1,20,000. He later discovered that he had not claimed a particular deduction amounting to Rs.2,10,000 while computing his business income in the said return. He filed a revised return on 3.1.2007 declaring a total loss of Rs.90,000. The Assessing Officer proposes to disallow the claim of T for carry forward of the business loss amounting to Rs.90,000 for the reason that the revised return declaring loss for the first time was filed beyond the time prescribed under section 139(3). Examine the validity of the proposed action of the Assessing Officer. *(3 Marks) (May 2007)*

Answer

T has filed his original return of income for the assessment year 2010-11 within the due date specified in section 139(1). Section 139(5) empowers an assessee, who discovers any omission or wrong statement in the return filed by him under section 139(1), to file a revised return before the expiry of one year from the end of the relevant assessment year or before the completion of the assessment, whichever is earlier. T, having discovered an omission to claim a particular deduction in the return filed by him under section 139(1), has filed a revised return within the time prescribed under section 139(5). A revised return has the effect of replacing the original return and relates back to the date of the original return. Thus, where a return was filed under section 139(1) declaring income and later it was revised declaring a loss, the loss shall be allowed to be carried forward as the revised return shall substitute the original return which was filed within time. There is no bar on filing a revised return showing loss for the first time. Therefore, the proposed action of the Assessing Officer to deny the benefit of carry forward of business loss to T is not valid in law. [Refer *CIT v. Periyar District Co-operative Milk Producers Union Ltd (2004) 266 ITR 705 (Mad)*].

Question 9

Can an order of assessment, which was in accordance with the law as it stood on the date when it was passed, be rectified by the Assessing Officer under section 154 of the Income-tax Act, 1961, on account of a subsequent amendment of the law with retrospective effect?

(4 Marks) (Nov 2006)

Answer

An order of assessment, which was in accordance with the law as it stood on the date when it was passed, becomes erroneous on account of a retrospective amendment of the law made subsequently. Such an order falls within the scope of section 154. The Supreme Court has, in *IAC of Agricultural I.T. v. V.K. Ravi Namboodiripad (1974) 96 ITR 73,* held that an assessment based on the law as it stood on the date of assessment could be rectified after an amendment of the law with retrospective effect within the period of limitation. In *CIT v. E. Sefton & Co. (P.) Ltd. (1989) 179 ITR 435*, the Calcutta High Court observed that if the assessment order is plainly and obviously inconsistent with the specific and clear provision as amended retrospectively, indisputably there is a mistake apparent from record. In the light of the retrospective amendment, the assessment order had to be revised. In view of this, it can be said that the Assessing Officer can, under section 154 of the Income-tax Act, 1961, rectify the order of assessment in the light of the later amendment of the law with retrospective effect, subject to limitation provided under sub-section (7) of section 154.

Question 10

State whether the following persons have to mandatorily furnish their return of income for the assessment year 2006-07.

(i) Mr. A, an individual, aged 50 years, whose gross total income before deduction under section 80C is Rs.1,90,000 and total income after deduction under section 80C is Rs.95,000.

(ii) M/s. XYZ, a firm, which has incurred a loss. *(4 Marks) (Nov 2006)*

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

(i) The fourth proviso to section 139(1) requires every person, whose total income without giving effect to the provisions of section 10A, 10B, 10BA and Chapter VIA exceeds the maximum amount not chargeable to tax, to compulsorily furnish the return of income for the relevant assessment year on or before the due date. The gross total income of Mr.A before deduction under section 80C exceeds the basic exemption limit of Rs.1,60,000 and therefore, Mr. A has to furnish his return of income for the assessment year 2010-11.

(ii) It is compulsory for firms to furnish their returns of income and loss on or before the due date. Therefore, M/s XYZ has to furnish its return of loss for the assessment year 2010-11 on or before the due date.

Question 11

EIH Private Ltd's assessment for assessment year 1996-97 was completed under Section 143(3) on 31st December, 1998. The company went in appeal to the Commissioner (Appeals) and the appeal was decided on 16th August, 2003 and the appeal effect was duly given by the Assessing Officer on 25th August, 2003. Thereafter, on 1st September, 2004 the Assessing Officer noticed a mistake in calculation of depreciation on a particular block of assets, which reduced the income by Rs.1.10 lakh. The assessing officer issued notice under section 154 for the purpose of rectifying the mistake. Is such rectification permissible? (3 Marks) (May 2005)

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10. The question has been answered assuming that Commissioner (Appeals) decided the case on 16.08.2004 and the Assessing Officer gave effect to the appellate order on 25.08.2004. The Assessing Officer noticed the error on 01.09.2008.

Answer

Any rectification order under section 154 has to be passed within 4 years from the end of financial year in which the order sought to be amended was passed. Order sought to be amended does not necessarily mean the original order. It could be any order including the amended or rectified order. Where any matter has been considered and decided in any proceeding by way of appeal or revision, 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.

For subsequent rectification, the time limit of 4 years shall be from the end of the financial year in which the earlier rectification order was passed. *[Hind Wire Industries Ltd vs. CIT (1995) 212 ITR 639 (SC)].* In the given case, the time limit of 4 years has to be reckoned from the end of the financial year in which the order giving effect to the CIT(Appeal)'s decision was passed. Therefore, the rectification order can be passed by the Assessing Officer at any time before expiry of 4 years from the end of the financial year 2004-05 i.e. on or before 31st March, 2009. In this case, the mistake was noticed by the Assessing Officer on 1st September, 2008, for which he issued notice under section 154 for rectifying the mistake. Such rectification is permissible as the time limit of 4 years expires only after 31st March, 2009.

Question 12

A company submitted the return of income for assessment year 2002-03 on 10th October, 2002. The Assessing Officer served a notice u/s 143(2) on the company on 14th August, 2003 in order to make assessment under section 143(3). Thereafter, on 1st September, 2003, the Assessing Officer issued an intimation under section 143(1). Such intimation shows a demand for Rs.10,500 towards tax and interest. The company argues that the issue of intimation under section 143(1) is bad in law. Discuss. *(3 Marks) (May 2005)*

Answer

This issue came up before the Apex Court, in *CIT v. Gujarat Electricity Board (2003) 260 ITR 84.* The Supreme Court held that once regular assessment proceedings have commenced under section 143(2) of the Income-tax Act, 1961, it is a limitation on the jurisdiction of the Assessing Officer to commence proceedings under section 143(1)(a) of the Act. Section 143(1)(a) of the Act enacts a summary procedure for quick collection of tax and quick refunds. Under the scheme, if there is a serious objection to any of the orders made by the Assessing Officer determining the income, it is open to the assessee to ask for rectification under section 154. It is not open to the Revenue to issue intimation under section 143(1)(a) of the Income-tax Act, 1961, after notice for regular assessment is issued under section 143(2). The Legislature intended that where the summary procedure under section 143(1) has been adopted, there should be scope available for the Revenue, either *suo moto* or at the instance of the assessee, to make a regular assessment under section 143(2). However, the converse is not available. A regular assessment proceeding having been commenced under section 143(2), there is no need nor is it possible for a summary proceeding under section 143(1)(a).

Question 13

(a) *J filed a return of income for the Assessment Year 1999-2000, in due time disclosing a total income of Rs.4 lakhs. The taxes due on the income were covered by taxes deducted at source, advance tax and self-assessment tax.*

The return was taken for scrutiny by the Assessing Officer, who made large additions to the income disclosed by J. On appeal, the High Court set aside the order of assessment and directed a fresh assessment to be made after hearing the parties. The court order had become final since neither party had preferred an appeal against it.

The assessing officer did not make any fresh assessment with the result that the assessment became barred by time.

J has filed a petition that since no assessment of his income had been made by the assessing officer, the entire taxes paid, including the pre-assessment payments, must be refunded to him.

Is he justified in making this claim? Discuss. *(4 marks) (Nov.2004)* *(b) An assessment was completed by the Assessing Officer under section 143(3) on the basis of return submitted and other information furnished by the assessee. The Assessing Officer accepted the cost of the land after waiting for a reasonable period for report of the valuation officer to whom a reference was made. Subsequent to receiving the report from the valuer, it revealed that there was a variation by about Rs.3.00 lacs. On the basis of this valuation report, the Commissioner issued notice under section 263 to set aside the completed assessment.*

Justify the action of the Commissioner. (3 Marks) (Nov.2004)

(c) M filed return of income for Assessment Year 2003-04 claiming a refund of Rs.45,000. The said refund was granted and paid to the assessee on 1st March, 2004 after processing the return under section 143(1). Later on, the case was taken up for regular assessment by issue of notice under section 143(2) and the said assessment was completed on 16th August, 2004 resulting in demand of Rs.2500. Is the assessee liable to pay interest on the amount of refund already granted to him and if so, what is the amount of such interest? (3 Marks) (Nov.2004)

(d) A search was initiated in the premises of an assessee on 11th November, 2003 and it was concluded on 14th November, 2003. What is the period of limitation for issue of notice for making assessment of preceding six assessment years? In case assessment under Section 143(3) for assessment year 2001-02 and appeal before CIT(A) for assessment year 1999-2000 are pending on 11th November, 2003, what would be the fate of such pending assessment and appeal? (4 marks) (Nov.2004)

Answer

(a) The Gujarat High Court held, in *Saurashtra Cement and Chemical Industries Ltd. v. ITO (1992) 194 ITR 659,* that the liability to pay income-tax arose under section 4(1) of the Act and did not depend upon an assessment order being made by the Assessing Officer. It depends upon the enactment of the annual Finance Act laying down the rates of taxation for the relevant assessment year. Thus, as soon as the rates are prescribed, the liability to pay tax crystallizes.

On filing of return under section 139, the provisions of section 140A also get activated, since if any taxes over and above those paid by way of advance tax and tax deducted at source remain, payment has to be made under section 140A before a valid return of income could be filed by an assessee. Payment of pre-assessment taxes does not depend on an assessment being made by the Assessing Officer.

In the present case, J had paid taxes on the basis of his own declaration of income. J's primary liability under section 4 of the Act is not absolved merely due to absence of a formal assessment. As decided by the Supreme Court in *CIT v. Shelly Products (2003) 261 ITR 367*, pre-assessment taxes paid on the basis of admitted income do not become refundable in the absence of an assessment. Hence J's contention is incorrect.

(b) As per the facts of the case, the Assessing Officer completed the assessment before the valuation report was received. The valuation report was received subsequent to completion of the assessment. However, it may be noted that the said report forms part of the 'record', which the Commissioner may call for and examine under section 263(1). A perusal of the valuation report revealed a variation of Rs.3 lakhs and to that extent it can be said that the order of the Assessing Officer was prejudicial to the interests of Revenue and also erroneous. The Commissioner is absolutely justified in issuing notice u/s 263 since the term "record" used in the said section includes all the records available at the time of examination by the Commissioner even though such records may not have been available at the time of regular assessment. This view was upheld by the Supreme Court in *CIT v. Shree Manjunathesware Packing & Camphor Works (1998) 231 ITR 335*.

(c) As per section 234D, inserted from 1st June 2003 by the Finance Act 2003, where any refund is granted to the assessee after processing the return u/s 143(1) and later on, in the regular assessment there is no refund due or the amount refunded exceeds the amount refundable, the assessee shall be liable to pay simple interest at ½% for every month or part of a month from the date of grant of refund to the date of such regular assessment on the whole or the excess amount so refunded.

In this case, the assessee was granted refund after processing the return u/s 143(1) and upon regular assessment u/s 143(3) it was found that nothing is refundable and the assessee had to pay Rs.2,500 towards taxes. The assessee hence has to pay interest at 6% per annum on the refund granted of Rs.45,000 from the date of grant of refund to the date of regular assessment.

(d) Under section 153A, where a search is initiated u/s 132 or books of account, other documents or any assets are requisitioned u/s 132A after 31.5.2003, the Assessing Officer shall issue notice to such person requiring him to furnish within such period as may be specified in the notice, the return of income in respect of six assessment years immediately preceding the assessment year relevant to the previous year in which such search is conducted or requisition is made. No time limit has been prescribed for the Assessing Officer to issue such notice to the person in whose case search is initiated u/s 132 or requisition is made u/s 132A. However, the Assessing Officer has to complete the assessment within a period of 21 months from the end of the financial year in which the last of the authorizations for search was executed. For example, if the last of the authorizations for search was executed on 14th November 2007, the time limit for completion would be 31st December, 2009.

The second proviso to section 153A provides that assessment or reassessment, if any relating to any assessment year falling within the above period of six assessment years, pending on the date of initiation of search u/s 132 or making of requisition u/s 132A shall abate. Therefore, if the assessment for any assessment year was pending on the date of initiation of search u/s 132, the same shall abate.

Section 153A provides that the assessment or reassessment pending on the date of initiation of search shall abate. The section, however, does not deal with the appeals which are pending on the date of initiation of search. Hence, the appeal for the earlier year assessment years shall not abate. The appeal proceedings shall continue as such and would not be affected by the search assessment.

Question 14

On whom and when does section 139(4C) cast responsibility to file a return of income. What will be the effect of failure to comply with the provisions of this section? (5 Marks) (May 2003)

Answer

Section 139(4C) was introduced w.e.f. 1.4.2003 and this section applies to -

(i) Scientific Research Association referred to in section 10(21).

(ii) News agency referred to in section 10(22B)

(iii) Association or institution referred to in section 10(23A) or 10(23B).

(iv) Fund or institution or trust or university or educational institution or any hospital or medical institution referred to in clauses (iv) to (via) of section 10(23C) and

(v) Trade union referred to in section 10(24)

These entities shall furnish their return of income if their total income without giving effect to the provisions of section 10, exceeds the maximum amount which is not chargeable to tax.

Failure to comply with the provisions of section 139(4C) will attract penalty under section 272A(2)(e) equal to Rs.100 for each day during which the default continues.

Question 15

M/s Shiv Traders, a partnership firm sustained business loss of Rs.2 lakhs, inclusive of admissible depreciation of Rs.1.15 lakhs (u/s 32 of I.T. Act) for the year ended 31.3.2002. The firm did not file its return for that year. The Assessing Officer issued a notice u/s 142(1) on 1st March, 2003, in compliance to which the firm filed its return for the said year declaring the loss of Rs.2 lakhs, and sought carry forward for next year. Is the firm's claim justified?

(4 Marks)(May 2003)

Answer

M/s. Shiv Traders failed to file its return of loss within the time allowed under section 139(3) and the same was filed by it in response to notice u/s 142(1). The provisions of section 80 read with section 139(3) clearly specify that the return filed by the assessee in response to notice u/s 142(1) is a belated return and therefore, the benefit of carry forward of business loss shall not be available. However, the assessee shall be entitled to carry forward the unabsorbed depreciation of Rs.1.15 lakhs as per provisions of section 32(2) of the Act. The unabsorbed depreciation shall be added to the depreciation allowance of the following previous year and will be deemed to be part of that allowance of that previous year.

Question 16

(a) *In an order of assessment for the A.Y. 2002-03, the assessee noticed a mistake for which application u/s 154 was moved and the order was rectified. Subsequently, the assessee moved further application for rectification u/s 154 which was rejected by the Assessing Officer on the ground that the order once rectified cannot be rectified again. Is* *the contention of the Assessing Officer correct ?* *(3 Marks) (May 2003)*

(b) *The return for A.Y.2001-02 was filed on time as per Section 139(1). The assessee during the course of assessment proceedings u/s 143(2), noticed certain omissions and therefore filed a revised return on 18.4.2003. The Assessing Officer ignoring the revised return so filed framed the order on 27.4.2003. Is the action of Assessing Officer correct?*

(3 Marks) (May 2003)

Answer

(a) It has been held by the Hon'ble Apex Court in the case of *Hind Wire Industries Ltd. v. CIT (1995) 212 ITR 639* that the order once amended can also be rectified subsequently provided the mistake apparent from record is rectifiable u/s 154. The Apex Court enlarged the scope of the words used in that section by stating that it does not necessarily mean the original order. It could be any order including the amended or rectified order. The action of the Assessing Officer is therefore, incorrect.

(b) The original return was filed in time and the proceedings were already taken up for assessment u/s 143(2). The revised return filed by the assessee and it was not given cognizance and the action of the Assessing Officer in making the assessment in disregard of the revised return filed is correct because as per the provisions of section 139(5) the assessee can file the revised return only within a period of one year from the end of the relevant assessment year to which the return relates or before completion of the assessment, whichever is earlier.

In this case, the time limit of one year from the relevant assessment year had already expired and the assessee is not eligible to file a revised return. If at all a revised return is filed, the Assessing Officer may ignore that return and proceed further. Hence, the action of the Assessing Officer is correct.

Question 17

Briefly discuss the concept of accelerated assessment applicable to Association of persons/body of individuals for the assessment year 2003-04. *(3 Marks) (May 2003)*

The answer is based on the provisions applicable for A.Y.2010-11.

Answer

Section 174A provides for accelerated assessments in cases of certain Association of Persons (AOP), Body of Individuals (BOI) & Artificial Juridical Persons. If such AOP, BOI etc. is formed or established for a particular event or purpose and the Assessing Officer, apprehends that the AOP/BOI is likely to be dissolved in the same year or in the next year before completion of assessment in the normal course, the Assessing Officer may make an assessment of the income upto the date of dissolution as income of the relevant assessment year even without waiting for the end of the previous year or filing of return by the assessee. This provision is on the same basis as contained in section 174 which deals with accelerated assessment of persons leaving India. The provisions of sub-section (2) to (6) of section 174 shall, so far as may be, apply to any proceedings in the case of any such person (AOP, BOI etc.) as they apply in the case of persons leaving India.

Question 18

Can the Assessing Officer complete the assessment under Section 144 of the Income-tax Act, 1961 even though there is no failure on the part of the assessee under Section 139(1), (4), (5), 142(1), 142(2A) or 143(2) of the Act? If so, under what situation? (4 Marks) (Nov.2002)

Answer

Under section 144 of the Act, the Assessing Officer is empowered to make an assessment if the total income to the best of his judgment when there are failures on the part of the assessee under sections 139(1), 139(4) and 139(5) or sections 142(1), or 142(2A) or 143(2) of the Act.

The Assessing Officer can exercise this power legally in other situations contemplated under section 145 of the Act and he may make the assessment in the manner provided in section 144 of the Act. Such power is, however, optional and may be exercised in the following situations:

1. Where the Assessing Officer is not satisfied about the correctness or completeness of the accounts of the assessee;
2. Where the method of accounting has not been regularly followed by the assessee;
3. Where the Accounting Standards notified by the Central Government under section 145(2) of the Act have not been regularly followed by the assessee.

Question 19

What do you understand by the expression Protective Assessment? Illustrate your answer with an example. (4 Marks) (Nov.2001)

Answer

Under the Income-tax Act, clubbing provisions enable the Assessing officer to tax the income of a person in another person's hands under certain circumstances. However, same income cannot be taxed in the hands of two persons under the law. When the ownership of the income is in dispute or is a matter of doubt, it is open to the Assessing Officer to assess a particular income in the case of the person who is considered as liable to tax and include the same income in the case of another person also as a protective measure. Such an assessment is known as protective assessment.

For example, Mrs.A files her return of income showing a business income of Rs.2 lakhs, and if the Assessing Officer is of the view that the said income belongs to her husband, Mr.A. The Assessing Officer can assess the sum of Rs.2 lakhs in the hands of Mr.A and shall proceed to assess the same amount in the hands of Mrs. A also in a protective basis.

Protective assessment is made to ensure that when the issue is finally settled, the assessment of such income is not barred by time limitation. When the issue is finally settled in appeal or otherwise, only one assessment will stand and the other will be cancelled automatically. It requires to be mentioned that the Income-tax Department cannot recover the tax from both the assessees in respect of the same income.

Question 20

Discuss the correctness or otherwise of the following with reference to the provisions of the Income-tax Act.

As assessment reopened under section 147 cannot be dropped *(4 Marks) (May 2001)*

Answer

The proposition is not correct. Under section 152(2), where the assessment is reopened under section 147, an assessee may claim that the proceedings be dropped for the following reasons.

(a) He had been assessed on an amount or to a sum not lower than what he would be rightly liable for even if the income alleged to have escaped assessment had been taken into account ; or

(b) His assessment or computation had been properly made and he has not impugned any part of the original assessment order for that year either under sections 246 to 248 or under section 264.

It may be noted that in a reassessment proceeding, the assessee is not eligible to reopen matters concluded by an order under sections 154 or 155 or 260 or 262 or 263.

Question 21

A return of income was filed within the statutory time provided under the Act, without making the payment of self assessment tax due as per return. The same was paid before completion of assessment. The Assessing Officer wants to declare the return as invalid. Is the Assessing Officer justified? *(4 Marks) (Nov.2000)*

Answer

Section 140A directs the assessee to pay self assessment tax and interest due and enclose the proof of such payment along with the return. Still if a return is furnished without proof of payment of taxes, it has to be accepted and treated as a return. At the best it can be treated as a defective return.

Sub-section (3) of section 140A says that the assessee to be treated as an assessee in default for non payment of self assessment tax.

Hence, while the return is to be treated as defective the application of section 140A(3) may also be pressed into service. A defective return is considered invalid only when the assessee fails to rectify the return within the specified time in spite of the intimation from the Assessing Officer.

In this case, the assessee has not deposited the self-assessment tax and has also not claimed the credit for the same. Therefore, he cannot be expected to submit proof of payment along with the return. For these reasons, the proposal of the Assessing Officer to declare the return as invalid is not justified.

Question 22

The assessment of Shah Ltd for the assessment year 1997-98 was completed under section 143(3) on 30.6.99. There was an audit objection that interest on borrowals ought to have been disallowed partly as there was diversion of borrowed funds to sister concerns without charge of interest. Shah Ltd did not accept the audit objection. On these facts

(a) What are the options open to revenue to deal with audit objection.

(b) Can the assessment be re-opened. *(4 Marks)(May 2000)*

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

(a) One of the options available to Revenue to disallow a part of the interest is by invoking section 263. The Supreme Court in the case of *CIT v. Sree Manjunatheswara Packing Products and Camphor Works 231 ITR 35* has held that the power of the CIT under section 263 is of wide amplitude. Section 263 empowers CIT to make or cause to be made such inquiry as he deems fit in order to find out whether any order passed by the Assessing Officer is erroneous in so far as is prejudicial to the interests of Revenue. Once he comes to the conclusion on the basis of material that the order of the Assessing Officer is prejudicial to the interests of Revenue, he is empowered to pass an order to enhance, modify, cancel or set aside the assessment and direct a fresh assessment. On the facts of the present case, the CIT can call for the records of the case and decide whether there is any error in not disallowing a part of the interest under section 36(1)(iii). If he is satisfied that such an error has been committed, he can issue a notice to the assessee and pass appropriate orders.

(b) The assessment cannot be reopened under section 147 on the basis of an audit objection. Audit party cannot express an opinion on the admissibility of an item of expenditure, since this a matter to be decided by the Assessing Officer having regard to the facts of the case. The amended provisions of section 147 empower the Assessing Officer, to reopen an assessment, if he has “reason to believe” that income has escaped assessment. The Delhi High Court has examined the scope of this power and had held that the belief must be own, not based on change of opinion on the same facts. *Garden Silk Mills Pvt Ltd v. DCIT (1999) 237 ITR 671.*

Question 23

On 1.9.2002, Prem & Sons have been searched. During the search, papers belonging to his close friend Mr. Shyam indicating concealed income have been found. How should the Assessing Officer proceed in such a situation under the Act? *(4 Marks) (May 2003)*

Answer

Where the Assessing Officer is satisfied that any undisclosed income belongs to any person other than the person subjected to section 132 search proceedings or whose books or documents or assets were requisitioned under section 132A, then, the relevant books, records or assets seized or requisitioned shall be handed over to the Assessing Officer having jurisdiction over such other person and that Assessing Officer shall proceed against such other person. Section 153C provides for assessment of such other person subsequent to such transfer of books, records or assets seized or requisitioned.

Question 24

Examine whether the following actions initiated / taken by the Income-tax Authorities are proper and valid under the provisions of the Act.

(i) The Assessing Officer, within his jurisdiction, surveyed the residential house of an assessee who is engaged in money lending business therefrom on 10.5.2001 (Thursday) at 4.30 p.m. (Nov.2002)

(ii) The return of income for the Assessment Year 2000-01 filed on 01.2.2001 was selected for Scrutiny Assessment for which first notice under section 143(2) was issued on 27.02.2002. (Nov.2002)

(iii) The assessment completed under section 143(3) for Assessment Year 1995-96 was found to have been based on wrong information given by the assessee. Accordingly the income of Rs.1,32,500 earned on 03.05.94 had escaped assessment, for which, notice under section 148 to reopen the assessment was issued on 11.3.2002.

(3×2 =6 marks) (Nov.2002)

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

(i) The Assessing Officer, under section 133A, is empowered to conduct a survey on the business premises of an assessee within his jurisdiction *on any working day after sunrise but before sunset*. In the present case, the assessee was engaged in money lending business from his residence which shall be construed as business premises and therefore, the action of the Assessing Officer to conduct survey on residential premises on Thursday, which was a working day, at 4.30 p.m. is correct.

(ii) Assuming the return for the assessment year 2009-10 was filed on 01.02.2010 and the notice was served on 27.02.2011, the validity of notice under section 143(2) is discussed.

The time limit prescribed for issuance of a notice under section 143(2) for selecting a case for regular assessment under section 143(3) is 6 months from the end of the financial year in which the return of income was filed. In the present case, the return was filed in the month of February and *the notice was* ***served*** *after the expiry of 6 months from the end of the financial year*. The notice ought to have been served before 30.09.2010. Since the notice was not **served** on the assessee within 6 months from the end of the financial year in which the return was filed, the assessment under section 143(3) would be invalid.

(iii) Assuming that the assessment under section 143(3) was completed for the assessment year 2002-03 and the notice was issued on 11.03.2009, the validity of the notice is discussed hereunder.

An assessment completed under section 143(3) can be reopened under section 148 (where the income escaping assessment is more than Rs.1 lakh) within a period of 6 years from the end of the assessment year in which the income was first assessable. The income of Rs.1,32,500 which escaped assessment could be subjected to reassessment within a period of 6 years from the end of the assessment year to which it relates. The time limit of 6 years from the end of the relevant assessment year would expire on 31.03.2009 and since the notice was served on 11.03.2009, it is valid in law. However, after serving notice under section 148 the time limit for completion of assessment would be 9 months from the end of the financial year in which the notice was served. The time limit in this case would be available upto 31.12.2009.

22

SETTLEMENT OF CASES

Question 1

Does the Settlement Commission have the power to reduce or waive interest levied under sections 234A, 234B and 234C of the Income-tax Act? Discuss. (6 Marks) (Nov.2005)

The Settlement Commission does not have the power under section 245-D to reduce or waive the interest payable by an assessee under the provision of section 234A, 234B or 234 C. Discuss. (6 Marks) (May 2002)

Answer

The matter concerning the power of the Settlement Commission to reduce or waive interest chargeable under section 234A, 234B or 234C has been settled by the Supreme Court in *CIT v. Anjum M.H.Ghaswala reported in 252 ITR 1.* According to the judgment, sub-section (6) of section 245D is only procedural in nature providing for fixing the term by which the amounts settled under sub-section (4) will have to be paid. It does not empower the Commission either to reduce or waive the interest. Any settlement made by the Commission must be in accordance with the provisions of the Act.

The Settlement Commission does not have the power to reduce or waive the interest levied under sections 234A, 234B and 234C. It does not authorize the waiver or deduction of tax. The levy of interest under sections 234A, 234B or 234C is mandatory in nature and therefore any settlement made must include the interest under these sections.

Question 2

An assessee's case is pending in appeal before the Income Tax Appellate Tribunal for assessment year 2000-01. Since the appeal is pending, the assessee wishes to file an application to the Settlement Commission for disclosing additional income, the income tax on which is Rs.15 lakhs. Is it possible to make such application? Will your answer be different if the Tribunal sets aside the case and restores the matter to Commissioner (Appeals)?

(3 Marks) (May 2005)

Answer

As per section 245A(b) the word 'case' means any proceeding under the Act of any person in respect of any assessment year or assessment years which may be pending before the Assessing Officer on the date on which an application under section 245C(1) is made.

If an appeal is pending before the Income-tax Appellate Tribunal (ITAT), it cannot be treated as a case pending before the Assessing Officer and hence, it will not be possible for the assessee to make an application to the Settlement Commission.

Even if the Tribunal sets aside the case and restores the matter to Commissioner (Appeals), it cannot be treated as a case or proceeding pending before the Assessing Officer since Commissioner (Appeals) is an appellate authority and not Assessing Officer.

Question 3

(a) Does the Settlement Commission have jurisdiction to entertain an application made under section 245C(1) in respect of a case covered by Chapter XIV-B (Search and seizure case). (2 Marks) (Nov.2000)

(b) Power of the Settlement commission to grant immunity from prosecution and penalty is limitless. (4 Marks) (Nov.2000)

Answer

(a) Clause (b) of section 245A has restricted the cases eligible to appear before the Settlement Commission. The term 'case' would mean any proceeding for assessment under the Act of any person in respect of any assessment year or years which is pending before the AO and which alone shall be eligible for settlement by the settlement commission.

The following shall not be a proceeding for the purpose of filing an application under section 245C.

(i) a proceeding for assessment or reassessment or recomputation under section 147;

(ii) a proceeding for assessment or reassessment for any of the assessment years referred to in section 153A(b) in the case of a person referred to in section 153A or section 153C.

(iii) a proceeding for assessment or reassessment for the assessment year referred to in section 153B(1)(b) in the case of a person referred to in section 153A or section 153C.

(iv) a proceeding for making fresh assessment in pursuance of an order under section 254 or section 263 or section 264 setting aside or cancelling an assessment.

(b) As per section 245H, the Settlement Commission has the power to grant to immunity from prosecution for any offence under Income-tax Act or under Indian Penal code and under any other Central Act in force.

It also has the power to grant immunity in whole or in part from the imposition of any penalty under the Income-tax Act with respect to the case covered by the settlement, if any, only if the person who has made the application has co-operated with the Commission and has made a full and true disclosure of his income and the manner in which it was derived.

Further if the proceedings for the prosecution for any such offence has been instituted before the date of receipt of application for settlement under section 245C of Income-tax Act, the Settlement Commission cannot grant immunity.

The Settlement Commission, however, shall not grant immunity from prosecution for any offence under the Indian Penal Code or under any Central Act other than this Act (Income-tax Act, 1961) and Wealth-tax Act, 1957 to a person who makes an application under section 245C on or after 01.06.2007.

23

ADVANCE RULINGS

Question 1

Explain as to what the term 'Advance Ruling' means under the Income-tax Act 1961.

(4 Marks) (Nov 2008)

Designated Authority can determine any issue under the Income-tax Act, 1961 by giving `Advance Ruling'. Elaborate the meaning assigned to `Advance Ruling' under the aforesaid Act. *(3 Marks) (Nov.2002)*

Answer

The term 'advance ruling' has been defined in section 245N(a) to mean :-

(a) a determination by the Authority in relation to a transaction which has been undertaken or is proposed to be undertaken by a non-resident applicant; or

(b) a determination by the Authority in relation to the tax liability of a non-resident arising out of a transaction which has been undertaken or is proposed to be undertaken by a resident applicant with such non-resident,

and such determination shall include the determination of any question of law or of fact specified in the application;

(c) a determination or decision by the Authority in respect of an issue relating to computation of total income which is pending before any income-tax authority or the Appellate Tribunal and such determination or decision shall include the determination or decision on any question of law or of fact relating to such computation of total income specified in the application.

Question 2

An order for A.Y. 2006-07 was passed by the A.O. as per section 143(3), but the typist wrongly typed in the order assessment year as 2005-06 and the relevant previous year as ending on 31.3.2005. Assessee claimed in appeal that the same is an invalid order which was not accepted by the CIT(A) on the ground of error of clerical nature. What do you say about the correctness of the order of the CIT(A)? *(3 Marks) (May 2008)*

Answer

Section 292B provides that no return of income, assessment, notice or summons furnished or made or issued or taken in pursuance of any of the provisions of the Income-tax Act shall be invalid or deemed to be invalid merely by reason of any mistake, defect or omission in such return of income, assessment or notice etc., if such return of income, assessment, notice, summons etc. is in substance and effect in conformity with or according to the intent and purpose of the Act. *Therefore, a clerical mistake cannot invalidate an otherwise valid assessment*. Thus, the typographical error in the assessment order as to assessment year and previous year does not make the same invalid unless established otherwise. Accordingly, the action of the Commissioner of Income-tax (Appeals) in not accepting the claim of the assessee is valid.

Question 3

Q, a non-resident, made an application to the Authority for Advance Rulings on 2.1.2006 in relation to a transaction proposed to be undertaken by him. On 31.3.2006, he decides to withdraw the said application. Can he withdraw the application on 31.3.2006?

(2 Marks) (Nov 2006)

Answer

Section 245Q(3) of the Income-tax Act, 1961 provides that an applicant, who has sought for an advance ruling, may withdraw the application within 30 days from the date of the application. Since more than 30 days have elapsed since the date of application by Q to the Authority for Advance Rulings, he cannot withdraw the application.

Question 4

A foreign company entered into contracts with several Indian companies for installation of mobile telephone system and made an application to the Authority for Advance Rulings for advance ruling on the rate of withholding tax on receipts from Indian companies. One of the Indian companies made an application to its Assessing Officer for determination of the rate at which tax is deductible on payment to the said foreign company. The Authority for Advance Rulings rejected the application of the foreign company on the ground that the question raised in the application is already pending before an income tax authority. Is the rejection of the application of the foreign company justified in law? *(8 Marks) (May 2006)*

Answer

The matter relates to the admission or rejection of the application filed before the Advance Ruling Authority on the grounds specified in clause (i) of the first proviso to sub-section (2) of section 245R of the Income-tax Act, 1961.

Clause (i) of the first proviso of section 245R(2) provides that the Authority shall not allow the application where the question raised in the application is already pending before any income-tax authority or Appellate Tribunal or any court.

In the above case, no application had been filed or contention urged by the applicant (foreign company) before any income-tax authority/Appellate Tribunal/court, raising the question raised in the application filed with AAR. One of the Indian companies, however, had raised the question before the Assessing Officer, not on the applicant's behalf or with a view to benefit the applicant, but only to safeguard its own interest, as it had a statutory duty to deduct the proper amount of tax from payments made to a non-resident. Although the question raised pertains to one of the payments made or to be made to the non-resident applicant, it was not one pending determination before any income-tax authority in the applicant's case.

Therefore, as held by the AAR in *Ericsson Telephone Corporation of India AB v. CIT (1997) 224 ITR 203,* the application filed by the Indian company before the Assessing Officer cannot be treated to have been filed by the non-resident. Hence, it would not be proper to reject the application of the foreign company relying on clause (i) of the proviso to sub-section (2) of section 245R of the Income-tax Act. The application is, therefore, maintainable.

Question 5

Can a person resident in India seek advance ruling from the Authority for Advance Ruling?

(3 Marks) (May 2005)

Answer

Section 245N enables a resident falling within any such class or category of persons as may be notified by the Central Government to make an application for Advance Ruling. Such notified resident applicant can seek ruling in respect of issues relating to computation of total income which is pending before any income-tax authority or the Appellate Tribunal. Such a resident applicant can make an application to seek decision on a question of law or a question of fact. Public sector companies as defined in section 2(36A) of the Income-tax Act, 1961 have been notified as applicant for this purpose.

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

Question 6

Discuss the following proposition:

An advance ruling can become void *(3 Marks) (May 2001)*

Answer

As per section 245T, an advance ruling can be declared to be *void ab initio* by the Authority for Advance Ruling if, on a representation made to it by the Commissioner or otherwise, it finds that the ruling has been obtained by fraud or misrepresentation of facts. Thereafter, all the provisions of the Act will apply as if no such advance ruling has been made. A copy of such order shall be sent to the applicant and the Commissioner.

24

APPEALS, REFERENCES AND REVISION

Question 1

(a) The Commissioner of Income-tax issued notice to revise the order passed by an Assessing Officer under section 143. During the pendency of proceedings before the Commissioner, on the basis of material gathered during survey under section 133A, the Commissioner of Income-tax issued a second notice, the contents of which were different from the contents of the first notice. State with reasoning whether the action of the Commissioner is justified as to the second notice. (3 Marks) (Nov 2008)

(b) State the circumstances where the appellant shall be entitled to produce additional evidence, oral or documentary, before the Commissioner of Income-tax (Appeals) other than the evidence produced during the proceedings before the Assessing Officer.

(3 Marks) (Nov 2008)

Answer

(a) The action of the Commissioner in issuing the second notice is not justified. The term "record" has been defined in clause (b) of *Explanation* to section 263(1). According to this definition "record" shall include and shall be deemed always to have included all records relating to any proceeding under the Act available at the time of examination by the Commissioner. In other words, the information, material, report etc. which were not in existence at the time the assessment was made and came into existence afterwards can be taken into consideration by the Commissioner for the purpose of invoking his jurisdiction under section 263(1). However, at the same time, in view of the express provisions contained in clause (b) of the *Explanation* to section 263(1), such information, material, report etc. can be relied upon by the Commissioner only if the same forms part of record when the action under section 263 is taken by the Commissioner,

Issuance of a notice under section 263 succeeds the examination of record by Commissioner. In the present case, the Commissioner initially issued a notice under section 263, after the examination of the record available before him. The subsequent second notice was on the basis of material collected under section 133A, which was totally unrelated and irrelevant to the issues sought to be revised in the first notice. Accordingly, the material on the basis of which the second notice was issued could not be said to be "record" available at the time of examination as emphasised in *Explanation (b)* to section 263(1).

(b) As per Rule 46A(1) of the Income-tax Rules 1962, an appellant shall be entitled to produce before the Commissioner (Appeals), evidence, either oral or documentary, other than the evidence produced by him during the course of proceedings before the Assessing Officer, only in the following circumstances -

(a) where the Assessing Officer has refused to admit evidence which ought to have been admitted; or

(b) where the appellant was prevented by sufficient cause from producing the evidence which he was called upon to produce by the Assessing Officer; or

(c) where the appellant was prevented by sufficient cause from producing before the Assessing Officer any evidence which is relevant to any ground of appeal; or

(d) where the Assessing Officer has made the order appealed against without giving sufficient opportunity to the appellant to adduce evidence relevant to any ground of appeal.

Question 2

Discuss the correctness or otherwise of the following propositions in the context of the Income-tax Act, 1961:

(a) The powers of the Commissioner of Income-tax (Appeals) to enhance the assessment are plenary and quite wide.

(b) At the time of hearing of rectification application, the Income-tax Appellate Tribunal can re-appreciate the evidence produced during the proceedings of the appeal hearing.

(c) The High Court cannot interfere with the factual finding recorded by the lower authorities and the tribunal, without any valid reasons. *(4 × 3 = 12 Marks) (Nov 2008)*

Answer

(a) The proposition is correct in law. The Supreme Court has, in *CIT vs. McMilan & Co. (1958) 33 ITR 182 and CIT vs. Kanpur Industrial Syndicate (1964) 53 ITR 225*, held that in disposing of an appeal before him, the appellate authority can travel over a whole range of the assessment order. The scope of his powers is co-terminus with that of the Assessing Officer. He can do what the Assessing Officer can do and can also direct him to do what he has failed to do. He can assess income from sources which have been considered by the Assessing Officer but not brought to tax. He can consider every aspect of the assessment order and give appropriate reliefs.

The Allahabad High Court has, in *CIT v. Kashi Nath Chandiwala (2006) 280 ITR 318*, held that the appellate authority is empowered to consider and decide any matter arising out of the proceedings in which the order appealed against was passed notwithstanding the fact that such matter was not raised before him by the assessee. The Commissioner (Appeals) is entitled to direct additions in respect of items of income not considered by the Assessing Officer.

Further, the Apex Court has, in the case of *Jute Corporation of India Ltd. vs. CIT (1991)* 187 *ITR* 688, held that the appellate authority is vested with all the plenary powers which the subordinate authority may have in the matter. He also has the jurisdiction to permit the appellant to raise an additional ground, if the ground became available subsequently because of change in law or because of change in circumstances and such ground could not have been raised at the time of filing the return or at the time of making an assessment. He must be satisfied that the ground raised is *bona fide* and that the same could not have been raised earlier for good reasons.

Thus, the powers of the appellate authority in enhancing the assessment are very wide and plenary.

(b) The proposition is not correct as per law. This is because section 254(2) specifically empowers the Appellate Tribunal to amend any order passed by it, either *suo-moto* or on an application made by the assessee or Assessing Officer, with a view to rectifying any mistake apparent from record, at any time within 4 years from the date of the order sought to be amended.

The powers of the tribunal under section 254(2) relating to rectification of its order are very limited. Such powers are confined to rectifying any mistake apparent from the record. The mistake has to be such that for which no elaborate reasons or inquiry is necessary. Accordingly, the re-appreciation of evidence placed before the Tribunal during the course of the appeal hearing is not permitted. It cannot re-adjudicate the issue afresh under the garb of rectification. This issue came up for consideration before the Punjab & Haryana High Court in the case of *CIT vs. Vardhman Spinning (1997)* 226 *ITR 296.* The Court observed that the jurisdiction to review or modify orders passed by the authorities under the Act cannot be inferred on the basis of a supposed inherent right.

(c) The proposition is correct in law. A finding of fact cannot be disturbed by the High Court in exercise of its powers under section 260A. The Income-tax Appellate Tribunal is a fact finding authority and the findings of fact recorded by the Tribunal can be interfered with by the High Court under section 260A only on the ground that the same were without evidence or material, or if the finding is contrary to the evidence, or is perverse or there is no direct nexus between conclusion of fact and the primary fact upon which that conclusion is based.

In *CIT vs. P. Mohanakala (2007) 291 ITR 278* and *Commissioner of Agricultural income-tax vs. M.N.Moni (2007) 291 ITR 387*, the Apex Court observed that the High Court had set aside the factual findings of the lower authorities and the Tribunal without any valid reason. The Apex Court held that the findings of fact could not be interfered with by the High Court without carefully considering the facts on record, the surrounding circumstances and the material evidence. There is no scope for interference with the factual findings, unless the findings are *per se* without reason or basis, perverse and/or contrary to the material on record.

Question 3

Answer the following in the context of provision contained in Income-tax Act, 1961:

Assessment for A.Y. 2002-03 was completed as per section 143(3) considering the various claims so made by the assessee on 23.12.2003. Subsequently, this was reopened under section 147 on certain issues, but excluding the claim of the assessee as to "Lease Equalisation Fund". The order of reassessment was passed on 24.11.2006. The Commissioner within the powers vested under section 263 passed an order on 11.1.2008 rejecting the claim of assessee as to "Lease Equalisation Fund". The assessee challenges that the action of the CIT is not sustainable because the same was barred by limitation.

(4 Marks) (May 2008)

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10. The question has been answered assuming that the order under section 143(3) was passed on 23.12.2006, the order of reassessment was passed on 24.11.2009 and revision order under section 263 was passed on 11.01.2010.

Answer

This issue was settled by the Supreme Court in *CIT v. Alagendran Finance Ltd. (2007) 293 ITR 1.* The Supreme Court observed that though there was no doubt that once an order of assessment is reopened, the previous assessment will be held to be set aside and the whole proceedings would start afresh, however, it would not mean that even when the subject-matter of reassessment is distinct and different, the entire proceeding would be deemed to have been reopened. The doctrine of merger would apply only in a case where the subject-matter of reassessment and the subject-matter of assessment are the same. However, in this case, the revision proceedings related to Lease Equalisation Fund, which was not the subject matter of reassessment. Therefore, the doctrine of merger does not apply in this case and the revision proceedings are barred by limitation.

Section 263(2) provides no order shall be made under section 263(1) after the expiry of two years from the end of the financial year in which the order sought to be revised was passed**.** The period of limitation as referred to in section 263(2) relates to the assessment in which the claim of the assessee as to Lease Equalisation Fund was considered by the Assessing Officer. This issue was not the subject matter of reassessment proceedings. Accordingly, the period of limitation shall be reckoned with reference to the original assessment order and not from the date of the order of reassessment. Therefore, in this case, the revision proceedings are barred by limitation since the original assessment order was made on 23.12.2006 and the revision should have been made by 31.3.2009.

Question 4

An assessee, who is aggrieved by all or any of the following orders, is desirous to know the available remedial recourse and the time limit against each under the Income-tax Act, 1961:

(i) passed under section 143(3) by the A.O.

(ii) passed under section 263 by the CIT.

(iii) passed under section 272A by the Director General.

(iv) passed under section 254 by the ITAT. *(6 Marks) (May 2008)*

Answer

(i) An assessee, aggrieved by the order passed under section 143(3) by the Assessing Officer, can file an appeal before the Commissioner of Income-tax (Appeals) under section 246A(1) within 30 days of the date of service of the notice of demand relating to the assessment. However, where the assessee does not want to prefer an appeal, then he can move a revision petition before the Commissioner of Income-tax under section 264 within a period of one year from the date of on which the order was communicated to him or the date on which he otherwise came to know of it, whichever is earlier.

(ii) An assessee, aggrieved by the order passed under section 263 by the Commissioner of Income-tax, can file an appeal to Income-tax Appellate Tribunal under section 253(1)(c) within 60 days of the date on which the order sought to be appealed against is communicated to the assessee.

(iii) An assessee, aggrieved by the order passed under section 272A by the Director General, can file an appeal before the Income-tax Appellate Tribunal under section 253(1)(c) within 60 days of the date on which the order sought to be appealed against is communicated to the assessee.

(iv) An assessee, aggrieved by the order passed under section 254 by the Income-tax Appellate Tribunal, can file an appeal before the High Court under section 260A within 120 days from the date of receipt of order of Income-tax Appellate Tribunal, only where the order gives rise to a substantial question of law.

Question 5

Write a brief note on filing of memorandum of cross-objections before the Income-tax Appellate Tribunal. *(5 Marks) (Nov 2006)*

Answer

Section 253(4) of the Income-tax Act, 1961 gives the respondent, in every appeal filed before the Income-tax Appellate Tribunal, a right to file a memorandum of cross-objections against any part of the order of the Commissioner (Appeals). This right of filing a memorandum of cross-objections is an independent right given to the respondent in an appeal and is in addition to the right of appeal which may or may not be exercised by the assessee or the Assessing Officer under section 253(1) or section 253(2). The memorandum of cross-objections has to be in the prescribed form and verified in the prescribed manner and has to be filed within 30 days of the receipt of notice of the appeal. The Tribunal is empowered to permit filing of memorandum of cross-objections after the expiry of the prescribed period if sufficient cause is shown. Such memorandum of cross-objections will be disposed of by the Appellate Tribunal as if it were an appeal presented within the time specified in section 253(3). There is no fee for filing a memorandum of cross-objections.

Question 6

An appeal was preferred by the assessee to the Commissioner (Appeals) against the order of assessment made by the Assessing Officer. The appeal was allowed by the Commissioner (Appeals). The assessee later found that he was entitled to a certain deduction, which was neither claimed by him nor allowed by the Assessing Officer in the course of assessment. The issue of deduction was not raised by the assessee in the appeal before the Commissioner (Appeals) and was not considered by the Commissioner (Appeals). Examine the power of the Commissioner to revise under section 264 the order of assessment in order to allow such deduction on an application by the assessee. *(4 Marks) (Nov 2006)*

Answer

Section 264(4)(c) provides that the Commissioner shall not revise an order which has been made the subject of an appeal to the Commissioner (Appeals). This bar remains unaffected by the scope of the appeal to the Commissioner (Appeals). Therefore, the fact that the relief claimed in the application filed by the assessee under section 264(1) was not the subject matter of appeal to the Commissioner (Appeals) does not alter the position that the order of assessment was the subject of the appeal. The Supreme Court has, in *Hindustan Aeronautics Ltd. v. CIT (2000) 243 ITR 808*, held that the Commissioner has no power to revise any order under section 264, if the order has been made subject to an appeal to the Appellate Tribunal, even if the relief claimed in the revision is different from the relief claimed in the appeal.

The word 'order' in section 264(4)(c) refers to the order appealed against and not to the relief claimed in appeal. In view of this, the Commissioner cannot exercise his powers under section 264 to revise the order of assessment and allow the deduction claimed by the assessee in his application.

Question 7

S, an individual, filed his return of income for the assessment year 2005-06 erroneously offering for taxation, interest received from notified Relief Bonds exempt under section 10(15)(iic), in the said return. The Assessing Officer completed the assessment under section 143(3) on 20.4.2006 accepting the income returned by S. S had furnished complete particulars relating to the interest income in the return of income. S approaches you for advice regarding the steps to be taken to secure exemption of the income. Advise S about the various remedies available under the Income-tax Act, 1961 for the redressal of his grievance.

(6 Marks) (May 2006)

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

S can file an appeal under section 246A, against the order of assessment, to the Commissioner (Appeals). The law is well settled that an appeal can be filed by an assessee even against inclusion in assessment, of such income erroneously included by him in the return of income. Reliance is placed on the decision of the Delhi High Court in *CIT v. Bharat General Reinsurance Co. Ltd. (1971) 81 ITR 303.*

If an assessee makes a mistake in submitting a return of income and submits to be assessed on a particular income before the assessing authority, he is not estopped or precluded by law from preferring an appeal and showing to the appellate authority that the income is, in fact, either wholly or partly, not exigible to tax. If such a contention is taken, it is the duty of the appellate authority to examine the matter and determine the proper tax leviable. There is no question of invoking the doctrine of estoppel in such a case *[Narsepalli Oil Mills v. State of Mysore (1973) 32 STC 599 (Mys.)]*

In the alternative, S can file a revision petition under section 264 with the Commissioner of Income-tax seeking exemption of interest from Relief Bonds, not claimed in the return of income and not allowed in the order of assessment.

The other course of action S could take is to file an application under section 154 with the Assessing Officer, seeking rectification of the order of assessment made. The consistent judicial view is that exemption not claimed by the assessee and not allowed by the Assessing Officer, though the material relating thereto was in the return of income, constitutes a mistake apparent from the record within the meaning of section 154 of the Act.

Question 8

The assessment of Ashok for assessment year 2001-02 was completed under section 143(3) on 15th January, 2004. The Commissioner acting under section 263 directed the Assessing Officer to add certain amount appearing in the balance sheet in total income of Ashok. Ashok did not challenge the order of the Commissioner under section 263 by filing appeal to the Tribunal. The Assessing Officer passed a fresh assessment order on 1st October, 2004 including the said amount in total income of Ashok pursuant to the order of the Commissioner. Ashok disputed the fresh assessment order in appeal to Commissioner (Appeals) under Section 246A. The Commissioner (Appeals) dismissed the appeal on the ground that the Assessing Officer only complied with direction of the Commissioner under section 263, which was not disputed by Ashok in appeal to Tribunal. Examine the correctness of the stand taken by the Commissioner (Appeals). *(3 Marks) (May 2005)*

Answer

An assessee can file an appeal to the Tribunal against the order passed by the Commissioner u/s 263. However, in this case, the assessee did not file any appeal to the Tribunal against the order of the Commissioner u/s 263. He waited for the fresh assessment order to be passed by the Assessing Officer in pursuance of the direction of the Commissioner. The order of any fresh assessment made under section 150 pursuant to direction contained in an order of revision under section 263 is itself appealable under section 246A(1)(b). Therefore, the mere fact that the assessee did not dispute the order of the Commissioner by filing an appeal to the Tribunal does not take away the right of the assessee to dispute the fresh assessment order by filing appeal to Commissioner (Appeals) u/s 246A. Therefore, the stand taken by the Commissioner (Appeals) is not correct in law.

Question 9

Discuss the following propositions:

(i) The Income Tax Appellate Tribunal cannot admit additional evidence during the hearing of the appeal. (3 Marks) (Nov.2003)

(ii) The Commissioner of Income Tax can revise an order during the pendency of an appeal before the First Appellate Authority. (3 Marks) (Nov.2003)

(iii) The Commissioner of Appeals cannot admit an appeal filed beyond 30 days from the date of receipt of order by an Assessee. (2 Marks) (Nov.2003)

Answer

(i) Rule 29 of Appellate Tribunal Rules, 1963 deals with production of additional evidence before the Appellate Tribunal.

The parties to the appeal shall not be entitled to produce additional evidence, either oral or documentary, before the Tribunal. However, the following are the exceptions to this rule –

(a) where the Tribunal requires any document to be produced or any witness to be examined or any affidavit to be filed to enable it to pass orders or for any other substantial cause; or

(b) where the income-tax authorities have decided the case without giving sufficient opportunity to the assessee to adduce evidence either on points specified by them or not specified by the them.

In case (a) above, the Tribunal may allow such document to be produced or witness to be examined or affidavit to be filed.

In case (b) above, the Tribunal may allow such evidence to be adduced.

However, in both cases, the Tribunal should record its reasons in writing.

(ii) Revision of orders by the Commissioner can be carried out under section 263 or section 264.

Revision of orders prejudicial to the interest of revenue [Section 263]

Section 263(1)(c) provides that if an order passed by the Assessing Officer has been the subject matter of any appeal, the same cannot be revised. However, at the same time, the power of the Commissioner under sub-section (1) of section 263 shall extend to such matters as had not been considered and decided in such appeal.

Revision of other orders [Section 264]

The Commissioner shall not revise any order under section 264, where an appeal against the order lies to the Commissioner (Appeals) or to the Appellate Tribunal, but it has not been made and the time within which such appeal may be made has not expired. However, if the assessee has waived his right of appeal, the Commissioner can revise the order under this section.

(iii) As per section 249(3) of the Income-tax Act, the Commissioner (Appeals) may admit an appeal after the expiry of the period of 30 days specified in section 249(2) if he is satisfied that the appellant had sufficient cause for not presenting the appeal within the prescribed time.

Question 10

An assessee is aggrieved by the order of the Assessing Officer and requests you to contest the same by filing an appeal before the Commissioner of Income-tax (Appeals) as well as by filing a revision petition before the Commissioner under section 264 of the Act. Can the assessee invoke both the remedies against the order of the Assessing Officer simultaneously.

(4 Marks) (May 2002)

Answer

Section 264(4) provides that the Commissioner shall not revise any order under section 264 in the following cases –

(a) Where any appeal against the order lies to the Commissioner (Appeals) or to the Appellate Tribunal but has not been made and the time within which such appeal may be made has not expired or, in the case of an appeal to the Commissioner (Appeals) or the Appellate Tribunal the assessee has not waived his right of appeal ; or

(b) Where the order has been made the subject of an appeal to the Commissioner (Appeals) or to the Appellate Tribunal.

Even though the provisions of section 246A do not specifically bar an appeal being filed simultaneously along with a revision petition under section 264, it is clear from a reading of section 264 that the assessee is barred from seeking revision unless he has waived the right of appeal.

Therefore, it is clear that the assessee can either apply for revision before the Commissioner under section 264 or file an appeal before the Commissioner of Income-tax (Appeals), but cannot invoke both the remedies simultaneously.

Question 11

An appeal shall lie to the High Court from every order passed in appeal by the Appellate Tribunal if the High Court is satisfied that the case involves a substantial question of law. Under what circumstances does a question become a substantial question of law?

(3 Marks) (May 2002)

Answer

To be a substantial question of law, the issue must be debatable and not previously settled by the law of the land or a binding precedent. It must have a material bearing on the decision of the case, in so far as the rights of the parties before it are concerned. The word "substantial" qualifying on the question of law, means having substance, essential, real, important or considerable. It is to be understood as something in contradistinction with technical or academic. To be a substantial question there must be foundation for it laid in the pleadings and the question should emerge from the sustainable findings of fact arrived at by the Court of facts. If the appraisal of the evidence suffers from a material irregularity or is based on inadmissible evidence or from conjectures or surmises, it gives rise to a substantial question of law. *[Santosh Hazari v. Purushottam Tiwari 251 ITR 84 (SC].*

Question 12

In the assessment of a firm, the Assessing Officer made two additions (i) Unexplained cash credits Rs.1 lac. (ii) Disallowance under section 43B. The firm filed an appeal before the CIT and being unsuccessful before the Appellate Tribunal only on the addition of unexplained cash credits. It was not successful in either forum. With regard to the disallowance under section 43B, it did not file any appeal, but preferred a revision petition before the CIT under section 264, who dismissed it on the ground that the assessment was the subject matter of an appeal to the Appellate Tribunal. The assessee relies on the Board's circular under which the CIT is empowered to accept such a petition. Is the petition maintainable. *(4 Marks) (Nov.2001)*

Answer

The Supreme Court in *Hindustan Aeronatics Ltd v. CIT (248 ITR 898)* has laid at rest any controversy on this point. It has held that under section 264, the Commissioner has no power to revise any order which has been made the subject matter of an appeal to the Appellate Tribunal, even if the relief claimed in the petition is different from the relief claimed in appeal. With regard to the Board's circular, the instructions are, no doubt, binding on the authorities under the Act but where the Supreme Court or High court has declared the law on the question arising for consideration, it will not be open to a court to direct that a circular would be given effect to, over-riding the order of the High Court or Supreme Court.

Question 13

Discuss the correctness or otherwise of the following with reference to the provisions of the Income-tax Act.

(i) Commissioner (Appeals) has no power to decide a matter that was not raised before him.

(4 Marks) (May 2001)

(ii) The Income-tax Appellate Tribunal cannot amend its orders *(4 Marks) (May 2001)*

(iii) A case before the Appellate Tribunal cannot be dealt when there is a difference of opinion amongst the members of the Bench *(4 Marks) (May 2001)*

(iv) An appeal shall lie to the High court against the order of the Tribunal.

(3 Marks) (May 2001)

Answer

(i) This proposition is not correct. Under the Explanation to section 251(2) the Commissioner (Appeals) in disposing of an appeal, may consider and decide any matter arising out of the proceedings in which the order appealed against was passed, even if such matter was not raised before him by the appellant. The power of admission of any grounds of appeal is conferred on the CIT (Appeals) under section 250(5), if he is satisfied that the omission in the grounds of appeal was not wilful or unreasonable.

(ii) The proposition is not correct. Under section 254(2), the Tribunal may, within four years from the date of the order, rectify any mistake apparent from record if it is brought to its notice either by the Assessing Officer or by the assessee. However, an amendment which has the effect of enhancing an assessment or reducing a refund or otherwise increasing the liability of the assessee shall not be made unless a notice has been given to the assessee of the intention to do so and a reasonable opportunity of being heard has been given. The Tribunal, however, has no inherent power to review its own order.

(iii) This proposition has been negatively stated and is not correct. Under section 255(4), if the members of a Bench of the Tribunal differ in opinion on any point, the point shall be decided according to the opinion of the majority, if there is a majority. If the members are equally divided, they shall state the point or points on which they differ and the case shall be referred to the President for hearing on such point or points by one or more members of the Tribunal. Such point shall be decided according to the opinion of majority of the members of the Tribunal who heard the case, including those who first heard it.

(iv) Under section 260A(1), an appeal shall lie to the High Court from every order passed by the Appellate Tribunal upto the date of establishment of the National Tax Tribunal, if the High Court is satisfied that the case involves a substantial question of law.

To be "substantial", a question of law must be debatable, not previously settled by law of the land or a binding precedent and must have a material bearing on the decision of the case, if answered either way, in so far as the rights of the parties before it are concerned.

Question 14

Write short notes on:

The First Appellate Authority has the power to stay Demand. *(4 Marks) (Nov.2000)*

Answer

The appellate jurisdiction conferred on the first appellate authority under section 251 impliedly grants the power of doing all such acts as are essentially necessary to its effective exercise. The statutory conferment of the appellate power carries with it the duty and obligation as well in proper cases to make or grant such orders for stay of the order under challenge, pending disposal of the appeal. [*Paulsons Litho Works v. ITO (1994) 208 ITR 676]*.

Power of stay is independent of the provisions of section 220(6) and it is not necessary that before moving the first appellate authority, an assessee should approach the Assessing Officer [*Kesav Cashew Co v. Deputy CIT (1994) 201 ITR 1014]*. The first appellate authority is obliged to exercise the power judicially and judiciously having regard to the prima facie case made out, the need for imposing just measures to protect the interest of revenue in public interest. At the same time, the very object of the appeal should not be rendered nugatory, if interim orders of stay are not granted.

Question 15

An assessment made by the Assessing Officer, resulting in a demand of Rs.10 lacs, was upheld in appeal and the assessee filed a second appeal before the Appellate Tribunal on 10.6.2001. This appeal is pending. The application of the assessee for stay of the demand was accepted by the Appellate Tribunal by its order dated 30th June 2001. Ignoring the stay granted, the Assessing Officer attached the bank account of the assessee on 15.3.2002 and collected the demand outstanding. Discuss the correctness of the A.O's action.

(3 Marks) (May 2002)

Answer

In this case, the appeal was filed before the Appellate Tribunal and the application for stay was granted by the Tribunal. Under the proviso to sub-section (2A) of Section 254, where a stay order has been made in any proceeding relating to an appeal, the Appellate Tribunal shall dispose of the appeal within a period of 180 days from the date of such order. Further, if such appeal is not disposed of within the period specified, the stay order shall stand vacated after the expiry of the said period.

In this case, the stay order had expired after 180 days and therefore the bar on the recovery of tax stood vacated on that date. Assuming that the Appellate Tribunal does not extend the stay, the Assessing Officer was correct in attaching the bank account and recovering the taxes.

It may be noted that the maximum time the Appellate Tribunal can grant stay cannot exceed 365 days and the Appellate Tribunal shall dispose of the appeal within the period or periods of stay so extended or allowed.

Students may note that the Finance Act, 2008 has substituted proviso to section 254(2) whereby if Appellate tribunal does not dispose of the appeal within the stay period allowed or extended, the order of stay shall stand automatically vacated whether or not the delay in disposing of the appeal is attributable to the assessee.

25

PENALTIES

Question 1

A notice to levy penalty u/s 271(1)(c) was issued on 11.6.07. The assessee in response thereto filed on 13.7.07 a written submission requesting to decide the matter. The A.O. before whom this reply was filed retired on 31.7.07 and the officer, who succeeded him passed the penalty order without providing any further opportunity, but by taking into cognizance the reply filed by the assessee. Whether the order by the A.O. is valid? (3 Marks) (May 2008)

Answer

As per the provisions of section 129, whenever an Assessing Officer ceases to exercise jurisdiction and he is succeeded by another, then, the authority so succeeding may continue the proceedings from the stage at which the proceedings were left by the predecessor provided the assessee does not demand that before the proceeding is so continued he may be re-heard by the successor officer. In the present case, the assessee had only filed a written submission in respect of the notice for levy of penalty. However, he had not specifically requested to be reheard at the time of change in office. Accordingly, the penalty order passed by the successor officer without providing any further opportunity to be reheard is a valid order. This was also held by the Apex Court in the case of *Pradip Lamp Works v. CIT (2001) 249 ITR 797.*

Question 2

What is the quantum of penalty that could be levied in each of the following cases:

(i) Failure to get books of accounts audited as required under section 44AB of the Income-tax Act within the time prescribed under the Act.

(ii) Failure to get books of accounts audited in response to the notice issued under section 142(2A) of the Income-tax Act.

(iii) Failure to furnish audit report as required under section 92E of the Income-tax Act.

(3 Marks) (Nov 2007)

Answer

The penalty that could be levied in each case is:-

(i) Failure to get books of accounts audited as required under section 44AB of the Income-tax Act - a sum equal to ½% of the total sales, turnover or gross receipts, as the case may be, in business, or of the gross receipts in profession, in such previous year or years, or a sum of Rs.1,00,000, whichever is less [Section 271B].

(ii) Failure to get books of accounts audited in response to the notice issued under section 142(2A) – a sum of Rs.10,000 [Section 271(1)].

(iii) Failure to furnish audit report under section 92E of the Income-tax Act - a sum of Rs.1,00,000 [Section 271BA].

Question 3

The assessment of B, an individual, for the assessment year 2004-05 was made under section 143(3) of the Income-tax Act, 1961 on 18.3.2005. The assessment has become final and is not the subject-matter of an appeal or revision. The Assessing Officer issued a show cause notice for levy of penalty under section 271(1)(c) to B on 25.3.2005. B furnished a reply to the said notice on 30.3.2005. There was a change in incumbent and the Assessing Officer, who made the assessment and issued the show cause notice, was succeeded by another. The successor-Assessing Officer suo motu issued a notice under section 129 to B on 20.9.2005. B did not respond to the said notice. The successor-Assessing Officer passed an order on 4.10.2005 levying penalty under section 271(1)(c). Examine the validity of the order of penalty passed with reference to the aspect of limitation. *(8 Marks) (Nov 2006)*

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10. It has been assumed that the show cause notice was issued on 25.03.2009 and the assessee furnished reply on 30.03.2009 and the Assessing Officer passed order levying penalty on 04.10.2009.

Answer

Section 275(1) provides for the time limit for passing an order of penalty. Clause (c) thereof requires that the order of penalty should be passed before the expiry of the financial year in which the proceedings, in the course of which action for the imposition of penalty has been initiated, are completed, or six months from the end of the month in which action for imposition of penalty is initiated, whichever period expires later. The time limit in this case, as per section 275(1)(c), is 30.9.2009. *Explanation* to section 275(2) states that in computing the period of limitation, the time taken in giving an opportunity to the assessee to be re-heard under the proviso to section 129 shall be excluded. A plain reading of the proviso to section 129 indicates that it is the assessee who may demand to be re-heard before any order is passed against him. In the instant case, notice under section 129 was not issued by the successor- Assessing Officer at the instance of B. B did not request him to provide an opportunity of re-hearing. The Supreme Court has in *Pradip Lamps Works v. CIT (2001) 249 ITR 797* ruled that where the assessee replied to the show cause notice issued by the predecessor–Assessing Officer, the successor–Assessing Officer can levy penalty without giving a fresh notice of hearing to the assessee in the absence of a demand by the assessee for re-hearing. The Karnataka High Court, in *B. N. Amarnath v. CIT (2003) 259 ITR 590,* held that the Explanation to section 275(2) could not be invoked by the Department unilaterally to compute the period of limitation on its own, by issue of notice under section 129, without there being any request for re-hearing by B.

Therefore, in this case, the order of penalty should have, therefore, been passed by the successor–Assessing Officer on or before 30.9.2009 as per the provisions of section 275(1)(c). The order of penalty having been passed on 4.10.2009 is barred by limitation and therefore, invalid.

Question 4

X, an individual whose total sales in the business of food grains for the year ending 31.3.2005 was Rs.66 lakhs, did not maintain books of account. The Assessing Officer levied penalties under section 271A for non-maintenance of books of account and section 271B for not getting the books audited as required by section 44AB. Is the Assessing Officer justified in levying penalty under section 271B? *(3 Marks) (May 2006)*

Answer

X has not maintained books of account though he was required under the Income-tax Act to do so since his gross sales exceeded Rs.40 lakhs. He is liable to pay penalty under section 271A for such default. Accordingly, the action of the Assessing Officer in levying penalty under section 271A is correct. However, where books of account have not been maintained, there cannot be a question of getting them audited. Audit of books of account presupposes maintenance of books of account. When admittedly X has not maintained books, he cannot obviously get the audit done. In *Surajmal Parsuram Todi v. CIT (1996) 222 ITR 691*, the Gauhati High Court has held that when a person commits an offence by not maintaining books of accounts as contemplated by section 44AA, the offence is complete and after that there can be no possibility of any offence as contemplated by section 44AB and, therefore, the imposition of penalty under section 271B is erroneous.

Therefore, in this case, the Assessing Officer is not justified in levying penalty under section 271B.

Question 5

Can penalty under section 271(1)(c) of the Income-tax Act for concealment of income or particulars thereof be imposed on "intangible" additions to income made by the Assessing Officer. Can these additions be utilised by the assessees to explain investments made in the subsequent years?

Is there any time limit for initiation of penalty proceedings in such cases? Discuss.

(5 Marks) (Nov.2005)

Answer

In many cases, the Assessing Officer makes additions to the returned income purely on account of certain technical reasons. For example, he calculates the total income of the assessee by assuming a certain rate of gross profit or yield, or he disallows a portion of certain expenses on estimated basis. These are called intangible additions. The Supreme Court, in *Anantharam Veerasighaiah and Co. v. CIT (1980) 123 ITR 457 observed that the secret profits or undisclosed income of an assessee earned in an earlier assessment year, commonly described as intangible additions, are also the real income of the assessee. Therefore, the assessee can explain the unexplained investment etc. of the current year to have been met out of intangible additions made in the past*.

Explanation 2 to section 271(1) enables the Assessing Officer to initiate penalty proceedings in respect of intangible additions made in the past which are claimed by the assessee to be a source of any receipt, deposit or outgoing or investment in any subsequent year. The penalty proceedings shall be initiated for the assessment year in which such intangible additions were made and shall be leviable only on such intangible additions made in the past years which have been claimed to be a source of receipt, deposit, outgoing or investment of the subsequent year.

According to section 271(1A), where any penalty is imposable by virtue of *Explanation 2* to section 271(1), the proceedings for imposition of such penalty may be initiated at any time, even if assessment proceedings in the course of which such penalty could have been initiated have been completed.

Question 6

GK Ltd. filed its return of income for the assessment year 2002-03 on 1.4.2003. The assessing officer levied a penalty of Rs. 5,000 under Section 271F. The assessee makes a submission to the CIT (Appeals) that he has furnished the return of Income within the due date specified in Section 139(4) and hence no penalty should be levied under 271F. Discuss.

(3 Marks) (May 2005)

Answer

Penalty of Rs.5,000 under section 271F is imposable on a person who is required to furnish return of income under section 139(1) for failure to furnish such return before the end of the relevant assessment year. It is true that the assessee can file a belated return under section 139(4) within one year from the end of the relevant assessment year or before completion of assessment, whichever is earlier. However, right to file a belated return after the end of the assessment year does not mean that the liability to pay penalty ceases. The Supreme Court's decision in *Pradip Lamps Works vs. CIT (2001) 249 ITR 797* supports this view. Hence, the assessee is liable for penalty under section 271F for late filing of the return.

Question 7

State the conditions, if any, to be satisfied by an assessee in order to get relief under section 273A(4) of the Income-tax Act, 1961 regarding the waiver of penalty. Can the Commissioner of Income-tax refuse to grant relief when the conditions laid down in the section are complied with by the assessee? (5 Marks)(Nov.2002)

Answer

There are two conditions to be satisfied by an assessee in order to get relief in the form of a waiver or reduction of penalty by the Commissioner of Income-tax under section 273A(4) of the Act. These conditions are:

(i) The payment of penalty would cause "genuine hardship" to the assessee and the Commissioner is satisfied about the existence of genuine hardship having regard to the circumstances of the case. The existence of genuine hardship would entitle the assessee to relief. The CBDT in its circular No 784 dated 22-11-99 has clarified that genuine hardship should exist both at the time of making the application and at the time the Commissioner passes the order under section 273A(4) of the Act.

(ii) The assessee has co-operated in any enquiry relating to the assessment or any proceeding for the recovery of any amount due from him.

Therefore, if the above two conditions are satisfied, the Commissioner has no discretion to refuse to exercise his powers and is bound to grant relief under the above section. In case the quantum of penalty exceeds Rs.1 lakh the Commissioner cannot grant relief without the previous approval of the Chief Commissioner or the Director General, as the case may be.

Question 8

KP Madhusudan & Co., a partnership firm, had taken certain bank drafts for payments to suppliers of rice and it had made entries in the accounts a few days later, but not on the dates on which the bank drafts were obtained. The explanation of the assessee was that since sufficient cash balance was not available on those dates, it had obtained hand loans from friends and, as it had expected to repay such loans within a short time, no entries were made in its books of account in respect thereof. Due to inability to furnish evidence for such loans, the assessee offered the amount of Rs.93,000 as additional income towards unexplained investment. Penalty proceedings were initiated by Assessing Officer under Section 271(1)(c) read with Explanation 1B of Income-tax Act and levied a penalty of Rs.37,975. Is the levy of penalty justifiable? (3 Marks) (Nov.2002)

Answer

Clause (B) of Explanation 1 to section 271(1)(c) says that when an assessee offers an explanation which he is not able to substantiate and fails to prove such explanation is bona fide, then the amount added or disallowed in computing the total income of such person as a result thereof shall be deemed to represent the income in respect of which particulars have been concealed. However, nothing contained in the Explanation shall be applicable to a case referred to in clause (B) in respect of any amount added or disallowed as a result of the rejection of any explanation offered by such person, if such explanation is bona fide and all the facts relating to the same and material to the computation of his total income have been disclosed by him.

In this legal background, as the firm was unable to produce evidence for the loans, it had offered Rs 93,000 as additional income and paid the taxes. In the circumstances, the case clearly falls within the jurisdiction of Explanation 1(B) and hence the levy of penalty is justified. *[K.P. Madhusudanan vs. CIT 251 ITR 99 (SC)].*

Question 9

An appeal against an assessment order for Assessment Year 1992-93 is decided by the Income-tax Appellate Tribunal against the assessee and the order is served on the Commissioner on 27.12.2001. The Assessing Officer levies penalty under Section 271(1)(c) of the Income-tax Act, 1961 vide his order dated 27.6.2002 for the aforesaid Assessment Year for which the appeal has been decided against the assessee. The assessee seeks your advice on the following:

(i) Is the Assessing Officer empowered under the Act to impose penalty after a period of ten years?

(ii) What remedial action can be taken against the order and what is the prescribed time limit thereof? *(4 Marks) (Nov.2002)*

Answer

(i) The penalty imposed under section 271(1)(c) is to be examined with reference to the provisions of limitation in section 275(1)(a) which states that in calculating the period of limitation for imposition of penalty, the time taken in deciding the order by the Appellate Authorities shall be excluded. A penalty can be imposed within a period of 6 months from the end of the month in which the order was received by Commissioner of Income Tax. In the present case the order of penalty is within the time limit and therefore a correct order.

(ii) The remedy available to the assessee against the order of penalty is to present an appeal under section 246A before Commissioner of Income Tax (Appeals) within 30 days from the date of receipt of the penalty order as the same is an appellable order under section 246A(1)(j) of the Act.

Question 10

An assessee had credited a sum of Rs.50,000 in cash in the account of Madan, said to represent a loan obtained from him. The Assessing Officer, having gone into the genuinenesss of the transaction, disbelieved the story of loan and treated the sum of Rs.50,000 as the income of the assessee from undisclosed sources. He also started proceedings under section 271D and levied a penalty of Rs.60,000 on the assessee for having accepted the loan in contravention of section 269SS. Examine the correctness of the levy. *(4 Marks) (May 2002)*

Answer

There are several flaws in the penalty levied by the Assessing Officer. Firstly, the penalty leviable under section 271D cannot exceed the sum equal to the loan taken. Hence, the maximum penalty leviable would be Rs.50,000. Secondly, any penalty imposable under section 271D shall be imposed by the Joint Commissioner. Hence, unless the Assessing officer happens to be a Joint Commissioner the levy of penalty will be invalid. Thirdly, the Assessing Officer cannot, on the one hand, treat the loan as undisclosed income of the assessee and on the other, treat it as a loan for the purpose of section 269SS read with section 271D. Such a treatment will be self contradictory. The moment the amount of Rs.50,000 is treated as undisclosed income, it ceases to bear the character of loan and therefore the foundation for the levy of penalty under section 271D disappears. [*Diwan Enterprises v. CIT and Others 246 ITR 571]*.

Question 11

Anurag Traders, a partnership firm, for the assessment year 1998-99, filed its return of income disclosing an income of Rs.40,000. The assessment was completed on an income of Rs.1,20,000 in the month of June, 1999. The additions included (a) profit on suppressed sales of Rs.40,000, (b) disallowance of expenses Rs.40,000. The assessment became final as no appeal was preferred. Penalty proceedings were initiated on the charge of concealment of income of suppressed profits. After considering the explanation to the notice to the penalty, penalty was levied on the charge that inaccurate particulars were furnished. M/s. Anurag Traders contends that the order of penalty is bad in law. Is the contention justified.

(4 Marks) (Nov.2000)

Answer

In the given facts of the case, the Assessing Officer has issued notice towards concealment of income in terms of suppression of sales. The Income-tax Officer levied penalty on the charge of furnishing of inaccurate particulars of income. Therefore the penalty order is bad in law.

As per section 27(1)(c) of the Act, if the Assessing Officer in the course of any proceedings under the Act is satisfied that the person has concealed the particulars of his income or has furnished inaccurate particulars, then a penalty can be levied. The circumstances in which the penalty could be levied are:

(i) That there is no full and true disclosure of income and thus there is concealment of income.

(ii) That there is no disclosure under proper head of income.

(iii) That inaccurate particulars of income are furnished, meaning thereby, that there is falsity in the income returned and the constituent elements of income ultimately determined.

(iv) Accordingly the charge must be specific. In short, the issuing of notices and levying of penalty must be for the same reason.

The Gujarat High Court had the occasion to consider a similar issue in the case of *A.M.Shah & Co v. CIT 238 ITR 415*. The High court held that the charge and the levy of penalty should be for the same reason. In this case, penalty proceedings were initiated on the charge of concealment of income. However, the penalty was finally levied on the ground that the aseessee has furnished inaccurate particulars. Such change of stand for imposition of penalty is not valid in law.

Question 12

Examine the following cases and state whether the same are liable for penalty as per the provisions of the Income-tax Act:

(i) Raman & Associates had made payment in excess of the limits prescribed to the contractors for carrying out labour job work at various sites, but had not deducted tax at source as per section 194C.

(ii) Hotels and Hotels were asked by Income-tax Officer (CIB) to furnish details of all such tourists who stayed in their hotels and had paid bill amount in excess of Rs.10,000. They have not furnished the requisite information inspite of various reminders.

(iii) An assessee whose turnover in the previous year was Rs.20 lacs had neither opted to be taxed as per section 44AF of the Act nor had kept and maintained books of accounts.

(2 × 3 = 6 Marks) (May 2008)

Answer

(i) Penalty under section 271C is attracted for failure to deduct tax at source. The penalty would be a sum equal to the amount of tax which such person has failed to deduct. Such penalty can be imposed only by the Joint Commissioner. Therefore, Raman & Associates shall be liable for penalty under section 271C equal to the amount of tax which they have failed to deduct under section 194C from the payments made to the contractors.

(ii) Section 133(6) empowers an Income-tax Officer to require any person to furnish information in relation to such points or matters which will be useful for or relevant to any enquiry or proceeding under the Act. Failure on the part of an assessee to furnish the information in relation to such points or matters as required by the Income-tax Officer makes him liable for penalty under section 272A(2) of Rs.100 for every day during which the failure continues.

Note – In a case where no proceeding is pending, the Income-tax Officer can exercise this power only after obtaining the approval of the Director or Commissioner, as the case may be. In this case, it is presumed that the Income-tax Officer has obtained the approval of the Director or Commissioner before exercising this power.

(iii) In this case, since the assessee has not opted for presumptive taxation under section 44AF, he has to maintain books of accounts as prescribed under section 44AA. Since he has not maintained the books of accounts, he is liable to pay a penalty of Rs.25,000 under section 271A for default in complying with the provisions of section 44AA.

26
OFFENCES AND PROSECUTIONS

Question 1

The Assessing Officer lodged a complaint against M/s. KLM, a firm, under section 276CC of the Income-tax Act, 1961 for failure to furnish its return of income for the assessment year 2005-06 within the prescribed time. The tax payable on the assessed income, as reduced by the advance tax paid and tax deducted at source, was Rs.60,000. The appeal filed by the firm against the order of assessment was allowed by the Commissioner (Appeals). The Assessing Officer passed an order giving effect to the order of the Commissioner (Appeals). The tax payable by the firm as per the said order of the Assessing Officer was Rs.1,000. The Assessing Officer has accepted the order of the Commissioner (Appeals) and has not preferred an appeal against it to the Income Tax Appellate Tribunal. The firm desires to know of the maintainability of the prosecution proceedings in the facts and circumstances of the case. *(3 Marks) (May 2007)*

Answer

Section 276CC provides for prosecution for willful failure to furnish a return of income within the prescribed time. However, prosecution proceedings will not be attracted if the tax payable by the assessee on the total income determined on regular assessment, as reduced by the advance tax, if any, paid and any tax deducted at source, does not exceed Rs.3,000. Even though the tax liability of the firm as per the original order of assessment exceeded Rs.3,000, however, as a result of the order of the Commissioner (Appeals), it got reduced to Rs.1,000, which is, less than Rs.3,000. Therefore, since the tax liability of the firm on final assessment was determined at Rs.1,000, the prosecution proceedings are not maintainable. In *Guru Nanak Enterprises v. ITO (2005) 279 ITR 30*, where the facts were similar, the Supreme Court held that prosecution was unwarranted.

27

MISCELLANEOUS PROVISIONS

Question 1

"Proceedings cannot be initiated under the Act, unless a proper notice to this effect has been served upon." In this context answer:

(i) What are the prescribed modes of service of such notice?

(ii) On whom should the notice be addressed and served upon in the cases where the assessee is a company, a dissolved firm, a deceased person and a partitioned HUF.

(5 Marks) (May 2008)

Answer

(i) The service of notice or summon or requisition or order or any other communication under this Act may be made by delivering or transmitting a copy thereof to the person named therein -

(1) by post or such courier services as approved by the CBDT; or

(2) in such manner as provided in the Code of Civil Procedure, 1908 for the purposes of service of summons; or

(3) in the form of any electronic record as provided in Chapter IV of the Information Technology Act, 2000; or

(4) by any other means of transmission as may be provided by rules made by the CBDT in this behalf.

The CBDT is empowered to make rules providing for the addresses (including the address for electronic mail or electronic mail message) to which such communication may be delivered or transmitted to the person named therein.

(ii) The service of notice in the given cases should be on the persons mentioned hereunder:-

Person	Notice be addressed and served on
A company	Principal officer of the company
A dissolved firm	Any person (not being a minor) who was a partner immediately before dissolution.

A deceased person	The legal heirs of the deceased.
A partitioned HUF	Last Manager of the HUF, or, if he is dead, then, all adult members of the erstwhile HUF.

Question 2

State briefly the provisions relating to furnishing of annual information return under the Income-tax Act, 1961. What are the consequences of not furnishing the annual information return? (7 Marks) (May 2007)

Answer

Section 285BA provides that the following persons who are responsible for registering or maintaining books of account or other document containing a record of any specified financial transaction, under any law for the time being in force, shall furnish an annual information return in respect of such specified financial transaction registered or recorded by him during any financial year beginning on or after 01.04.2004.

The following persons are covered –

(a) an assessee; or

(b) the prescribed person in the case of an office of Government; or

(c) a local authority or other public body or association; or

(d) the Registrar or Sub-Registrar appointed under section 6 of the Registration Act, 1908; or

(e) the registering authority empowered to register motor vehicles under Chapter IV of the Motor Vehicles Act, 1988; or

(f) the Post Master General as referred to in clause (j) of section 2 of the Indian Post Office Act, 1898; or

(g) the Collector referred to in clause (c) of section 3 of the Land Acquisition Act, 1894; or

(h) the recognized stock exchange referred to in clause (f) of section 2 of the Securities Contracts (Regulation) Act, 1956; or

(i) an officer of the Reserve Bank of India, constituted under section 3 of the Reserve Bank of India Act, 1934; or

(j) a depository referred to in clause (e) of sub-section (1) of section 2 of the Depositories Act, 1996

Such annual information return should be furnished to the prescribed income-tax authority or such other authority or agency as may be prescribed in respect of –

(i) such transactions registered or recorded by him during any financial year beginning on or after 1st April, 2004, and

(ii) information relating to which is relevant and required for the purposes of this Act

The annual information return has to be furnished within the prescribed time after the end of such financial year in such form and manner (including on a floppy, diskette, magnetic cartridge tape, CD-ROM or any computer readable media) as may be prescribed.

"Specified financial transaction" as per section 285BA(3) covers the following transactions –

(i) transaction of purchase, sale or exchange of goods or property or right or interest in a property, or

(ii) transaction for rendering any service, or

(iii) transaction under a works contract, or

(iv) transaction by way of an investment made or an expenditure incurred, or

(v) transaction for taking or accepting any loan or deposit

The CBDT may prescribe different values for different transactions in respect of different persons, having regard to the nature of such transactions. The value or the aggregate value of such transactions during a financial year so prescribed referred to above should not be less than fifty thousand rupees.

Section 271FA provides a penalty for not furnishing a return as required under section 285BA(1). Penalty of Rs.100 is attracted for every day during which failure continues, if a person who is required to furnish an annual information return fails to furnish such return within the time prescribed.

Question 3

"Tax Recovery Officer, can recover the arrear demands from the assessee in default out of sale proceeds of the property attached after making a proclamation". How can such proclamation be made under the Act? (4 Marks) (Nov.2003)(May 2008)

Answer

Movable Property [Rules 38 & 39 of Schedule II to the Income-tax Act, 1961]

Where the Tax Recovery Officer orders sale of movable property, he should issue a proclamation in the language of the district, of the intended sale, specifying the time and place of sale and whether the sale is subject to confirmation or not.

The proclamation should be made by beat of drum or other customary mode, -

(a) in the case of property attached by actual seizure –

 (i) in the village in which the property was seized, or, if the property was seized in a town or city, then, in the locality in which it was seized; and

 (ii) at such other places as the Tax Recovery Officer may direct;

(b) in the case of property attached otherwise than by actual seizure, in such places, if any, as the Tax Recovery Officer may direct.

A copy of the proclamation should also be affixed in a conspicuous part of the office of the Tax Recovery Officer.

Immovable Property [Rule 54 of Schedule II to the Income-tax Act, 1961]

The Tax Recovery Officer shall make a proclamation for sale of immovable property at some place on or near such property by beat of drum or other customary mode. A copy of the proclamation shall be affixed on a conspicuous part of the property and also upon a conspicuous part of the office of the Tax Recovery Officer.

Where the Tax Recovery Officer directs, such proclamation shall also be published in the Official Gazette or in a local newspaper or both, and the cost of such publication shall be deemed to be cost of the sale.

Where the property to be sold is divided into lots, then it is not necessary to make a separate proclamation for each lot of property, unless in the opinion of the Tax Recovery Officer, proper notice of sale cannot otherwise be given.

Question 4

Vijay Agencies, a partnership firm constituted by three partners with equal shares was dissolved on 1-04-99 after a search. The liability to tax finally decided against the firm outstanding to be paid was Rs.15 lakhs. Out of three partners, one was declared insolvent on 18-03-01 by the Court. The Assessing Officer, for recovering the demand, attached the Bank Accounts of other two partners and could recover an amount of Rs.6 lakhs from the Account of one such partner. You are asked by the partners of dissolved firm:

(i) About the liability of each of them to pay outstanding demand.

(ii) Whether the action of Assessing Officer to attach the Bank Account of partners against demand of dissolved firm is justified? (4 Marks) (Nov.2003)

Answer

(i) As per section 189(3), every person who was at the time of dissolution, a partner of the firm, shall be jointly and severally liable for the amount of tax, penalty or other sum payable and all the provisions of the Act relating to assessment of such tax or imposition of such penalty or other sum, shall apply. Therefore, the three partners (till one was declared as insolvent by the Court) are jointly and severally liable for making the payment of outstanding dues of Rs.15 lakhs. After insolvency of one of the partners, the other two partners shall be jointly and severally liable to pay such demand.

(ii) Accordingly, the action of the Assessing Officer to attach the bank accounts of the partners for recovery of outstanding demand is correct and the amount of Rs.6 lakhs recovered by attachment of the bank account of one of the partners is also in order.

Question 5

Explain the circumstances under which the Assessing Officer can resort to provisional attachment of the property of the assessee. Also state the period of time for which such attachment can take place. *(4 marks)(Nov.2003)(Nov 2001)*

Answer

As per the provisions of section 281B of the Act, there can be provisional attachment to protect the interest of Revenue in certain cases i.e.-

(i) During the pendency of any proceeding for the assessment of any income or for the assessment or reassessment of any income which has escaped assessment, the Assessing Officer is of the view that for the purpose of protecting the interest of Revenue it is necessary so to do, he may, with the previous approval of the Chief Commissioner, Commissioner, Director General or Director, by an order in writing attach provisionally any property belonging to the assessee in the manner provided in the Second Schedule. [Section 281B(1)]

(ii) Such provisional attachment shall cease to have effect after the expiry of a period of six months from the date of order made under section 281B(1). However, the period can be extended by the Chief Commissioner, Commissioner or Director General or Director**,** as the case may be, for the reasons to be recorded in writing for a further period or periods as he thinks fit. The total period of extension in any case cannot exceed 2 years.

(iii) Where an application for settlement under section 245C is made, the period commencing from the date on which such application is made and ending on the date on which an order under section 245D(1) is passed, shall be excluded for reckoning the period of 2 years.

(iv) Further, the period during which the proceedings for assessment or reassessment are stayed by an order or injunction of any court shall be excluded while computing the total period of two years extended by Chief Commissioner, Commissioner, Director General or Director.

Question 6

Penalty is not leviable, if certain conditions are satisfied, in the case of block assessment. Discuss. *(4 marks) (Nov.2002)(May 2000)*

Answer

Block assessment contained in Chapter XIV-B would not apply in respect of search initiated after 31.05.2003. Where a search under section 132 is initiated after 31.05.2003, the assessment of income would be similar to regular assessment and not liable for block assessment as the provisions of Chapter XIV-B would not apply. In such cases, no immunity from penalty is available to the tax payer by means of specific statutory provision. However, admission under section 132(4) might provide some relief from penalty under section 271AAA.

Question 7

Mr. Biswas, a stock broker, has defaulted with regard to his income-tax payments and the Assessing Officer has attached his membership card of Stock Exchange under section 281B of the Income-tax Act, 1961. Mr. Biswas contends that the membership card is not transferable and is not his personal asset. Discuss the validity of attachment of the card by the Assessing Officer in the context of Section 281B of the Act. (4 marks) (Nov.2002)

Answer

The right of membership is not a private asset and it is merely a personal privilege granted to the member. It is non-transferable and incapable of alienation by the member or his legal representative except to the limited extent provided in the rules and regulations of the stock exchange and subject to the fulfillment of conditions prescribed by the stock exchange. The nomination, even if permitted, is subject to the rules and is not automatic. The right of nomination is vested in the stock exchange absolutely in the case of death of or default of a member. Thus the membership card is not the property of the assessee and therefore cannot be attached under section 281B of the Act. It has been so held by the Apex Court in the case of *Stock Exchange Ahmedabad vs.ACIT 248 ITR 209*.

28

COLLECTION AND RECOVERY OF TAX

Question 1

East Bengal Club, a renowned football club, has engaged Raghu, a resident in India, as its coach at a remuneration of Rs.6 lacs annually. The club wants to know from you whether it is liable to deduct tax at source from such remuneration. *(3 Marks) (June 2009)*

Answer

Section 194J requires deduction of tax at source @10% from the amount credited or paid by way of fees for professional services, where such amount or aggregate of such amounts credited or paid to a person exceeds Rs.20,000 in a financial year. As per Explanation (a) to section 194J, professional services includes, inter alia, services rendered by a person in the course of carrying on such other profession as is notified by the CBDT for the purpose of section 194J. Accordingly, the CBDT has, vide Notification No.88 dated 21.8.2008, in exercise of the powers conferred by clause (a) of the Explanation to section 194J notified the services rendered by, inter alia, coaches and trainers in relation to the sports activities as professional services for the purpose of section 194J. Therefore, the club is liable to deduct tax at source under section 194J from the remuneration payable to the Coach, Raghu.

Question 2

State the circumstances under which a certificate can be issued by the Assessing Officer to the Tax Recovery Officer. *(4 Marks) (Nov 2008)*

Answer

The assessee is required to pay the tax due as per the notice of demand issued under section 156 within 30 days of the service of notice. If the amount is not paid within 30 days, then it could be recovered as per the provisions of sections 222 to 227, 229 and 232 of the Income-tax Act. Where the assessee has not paid the tax due within the specified period, the Assessing Officer may issue a certificate to the Tax Recovery Officer for initiating recovery proceedings in the following circumstances –

(a) where the assessee has not filed an appeal before Commissioner (Appeals) or Appellate Tribunal; and

(b) has also not made any request for extension of time for payment of tax.

As per the provisions of section 222, when an assessee is in default or is deemed to be in default in making a payment of tax, the Tax Recovery Officer may draw up under his signature a statement in the prescribed form specifying the amount of arrears due from the assessee. Such statement is referred to as "certificate". He shall proceed to recover from such assessee the amount specified in the certificate by one or more of the modes mentioned below, in accordance with the rules laid down in the Second Schedule -

(a) attachment and sale of the assessee's movable property;

(b) attachment and sale of the assessee's immovable property;

(c) arrest of the assessee and his detention in person;

(d) appointing a receiver for the management of assessee's movable and immovable properties.

The Tax Recovery Officer may have recourse to any of the above measures notwithstanding that proceedings for recovery of the arrears by any other mode have already been taken.

Question 3

P Ltd. is engaged in manufacture of a product. It paid a lump-sum deposit and obtained 50 mobile phone services so that the employees of the assessee can be contacted immediately. The company paid Rs.45,000 every month towards the service and call charges to the mobile phone franchise. On these facts:

(i) Whether P Ltd. has to deduct tax at source on the payment?

(ii) If so, under which provisions of the Act? *(3 Marks) (Nov 2008)*

Answer

In this case, the assessee pays the service and call charges every month to a mobile phone franchise. *Explanation 2* to section 9(1)(vii) provides that "fees for technical services" means any consideration (including any lump sum consideration) for the rendering of any managerial, technical or consultancy services (including the provision of services of technical or other personnel). Therefore, mere collection of fee by the mobile phone franchise from the customers for use of mobile phone services will not amount to receipt of fees towards technical services. When a subscriber pays money to the mobile phone franchise, it is towards the benefit of availing the services to communicate with others and not for any technical services. The payment made is for the use of airtime. Installation of technical equipment to ensure connectivity to the subscriber cannot make it technical services. Therefore, P Ltd. does not have to deduct tax at source under section 194J on the payments made to the mobile phone franchisee towards the service and call charges. This view was upheld by the Madras High Court in *Skycell Communications Ltd. v. Dy. CIT (2001) 251 ITR 53.*

Question 4

ABC Ltd. took on sub-lease a building from J, an individual, with effect from 1.9.2006 on a rent of Rs.10,000 per month. It also took on hire machinery from J with effect from 1.10.2006 on hire charges of Rs.9,000 per month. ABC Ltd. entered into two separate agreements with J for sub-lease of building and hiring of machinery. The rent of building and hire charges of machinery for the financial year 2006-07 amounting to Rs.70,000 and Rs.54,000 respectively were credited by ABC Ltd. to the account of J in its books of account on 31.3.2007. Examine the obligation of ABC Ltd. to deduct tax at source in respect of the rent and hire charges.

(4 Marks) (May 2007)

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

Section 194-I dealing with deduction of tax at source from payment of rent has been amended by the Finance (No.2) Act, 2009 with effect from 01.10.2009 by reducing the rate of tax deduction. The rate of TDS applicable is 2% for machinery hire charges and 10% for building lease rent w.e.f. 1.10.2009. The scope of the section includes within its ambit, rent for machinery, plant and equipment. Tax is required to be deducted at source from payment of rent, by whatever name called, under any lease, sub-lease, tenancy or any other agreement or arrangement for the use of, *inter alia*, building and machinery, irrespective of whether such assets are owned or not by the payee. The limit of Rs.1,20,000 for tax deduction at source will apply to the aggregate rent of all the assets. Even if two separate agreements are entered into, one for sub-lease of building and the other for hiring of machinery, rent and hire charges under the two agreements have to be aggregated for the purpose of application of the threshold limit of Rs.1,20,000. Therefore, ABC Ltd. has to deduct tax at source under section 194-I in respect of the rent and hire charges aggregating to Rs.1,24,000 credited to the account of J, the payee.

Question 5

M, an individual, had let out his building on a monthly rent of Rs.12,000. The tenant deducted tax under section 194-I from the rent paid to M, but did not remit such tax to the credit of the Central Government. M filed his return of income for the assessment year 2006-07 including therein the rental income from the said building and paid the balance tax on his total income after taking credit for tax deducted at source by the tenant. The Assessing Officer has called upon M to pay the tax to the extent of tax deducted at source. Is the Assessing Officer justified in doing so? (4 Marks) (Nov 2006)

Answer

Section 205 of the Income-tax Act, 1961 provides that where tax is deductible at source under the provisions of Chapter XVII, the assessee shall not be called upon to pay the tax himself to the extent to which tax has been deducted from that income. Section 205, therefore, bars a direct demand being made on an assessee to the extent of tax deducted from the income. The Income-tax Department can recover the tax deducted at source from the tenant and not from M in view of the clear mandate in section 205. The Karnataka High Court has in *Smt. Anusuya Alva v. DCIT (2005) 278 ITR 206* ruled that tax deducted at source by the tenant from the rent paid but not remitted to the credit of the Central Government can be recovered only from the tenant and not from the landlord. Therefore, in view of the clear mandate in section 205, the Assessing Officer is not justified in law in calling upon M to pay the said tax.

Question 6

Examine the obligation of the person responsible for paying the income to deduct tax at source and indicate the due date for payment of such tax, wherever applicable, in respect of the following items:

(i) *MNO Ltd., the employer, credited salary due for the financial year 2005-06 amounting to Rs.2,40,000 to the account of Q, an employee, in its books of account on 31.3.2006. Q has not furnished any information about his income/loss from any other head or proof of investments/payments qualifying for deduction under section 80C.*

(ii) *T, an individual whose total sales in business during the year ending 31.3.2005 was Rs.1.20 crores, paid Rs.9 lakhs by cheque on 1.1.2006 to a contractor, for construction of his business premises, in full and final settlement. No amount was credited earlier to the account of the contractor in the books of T.*

(iii) *BCD Ltd. credited Rs.18,000 towards fees for professional services and Rs.12,000 towards fees for technical services to the account of HG in its books of account on 6.10.2005. The total sum of Rs.30,000 was paid by cheque to HG on 18.12.2005*

(6 Marks) (May 2006)

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

(i) Section 192 requires deduction of tax from salary at the time of payment. Thus, the employer is not required to deduct tax at source when salary has not been paid but is merely credited to the account of the employee in its books of account. MNO Ltd, therefore, is not required to deduct tax at source in respect of the salary merely credited to the account of employee Q which is not paid.

(ii) Turnover of the individual 'T' exceeded Rs.40 lakh in the financial year 2008-09. As the payment during financial year 2009-10 to the contractor had exceeded the limits prescribed in section 194C, tax deduction is to be made.

The rate of tax deduction is 2% if the recipient (i.e. contractor) is other than an individual / HUF. In the case of individual/ HUF being the contractor, the tax deduction is at 2% upto 30.09.2009 and at 1% w.e.f. 01.10.2009.

(iii) The limit of Rs.20,000 for non-deduction of tax under section 194J has been separately fixed for fees for professional services and fees for technical services. This means that if a person has rendered services falling under both the categories, tax need not be deducted if the fees for each category does not exceed Rs.20,000 even though the aggregate of the amounts credited to the account of such person or paid to him for both the categories of services exceed Rs.20,000. Therefore, BCD Ltd., is not required to deduct tax at source in respect of the fees either at the time of credit or at the time of payment.

Question 7

Alap Ltd. has made payments on various dates in financial year 2004-05 to Vilambit Ltd. towards work done under different contracts as follows :

Contract Number	*Date of payment*	*Amount (Rs.)*
1.	*5.5.2004*	*13,000*
2.	*6.6.2004*	*15,000*
3.	*8.8.2004*	*20,000*
4.	*10.9.2004*	*20,000*
5.	*10.10.2004*	*10,000*

Alap Ltd. claims that it is not liable to deduction of tax at source under section 194C. Examine the correctness of the claim made by the company. What would be the position if the value of the contract no. 5 is Rs. 1,000 only and there is no other contract during the year.

(4 Marks)(May 2005)

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

As per section 194C(5) tax has to be deducted at source where the amount credited or paid or likely to be credited or paid to a contractor or sub-contractor exceeds Rs.20,000 in a single payment or Rs.50,000 in aggregate during a financial year.

Therefore, in the given case, even though the value of each individual contract does not exceed Rs.20,000, the aggregate amount of the sums paid exceeds Rs.50,000. Therefore, Alap Ltd's contention is not correct and tax is required to be deducted at source from Rs.20,000, being the contract no.4 in which the aggregate payment exceeded Rs.50,000.

The answer is the same even if the value of the last contract is Rs.1,000 or more or less, as the aggregate payment had already exceeded Rs.50,000 upto contract No.4.

Question 8

Discuss the liability for tax deduction at source in the following cases for the assessment year 2003-2004 :

(i) Mr. Anand has been running a sole proprietary business whose accounts are audited under section 44AB of Income-tax Act, 1961. He pays a monthly rent of Rs.15,000 for the office premises to Mr. R, the owner of building and an individual. Besides, he also pays service charges of Rs.10,000 per month to Mr. R towards the use of furniture, fixtures and vacant land appurtenant thereto. (3 Marks) (May 2003)

(ii) By virtue of an agreement with a nationalised bank, a catering organisation receives a sum of Rs.50,000 per month towards supply of food, water, snacks etc. during office hours to the employees of the bank. (2 Marks) (May 2003)

(iii) An Indian company pays gross salary including allowances and monetary perquisites amounting to Rs.4,80,000 to its General Manager on which the tax liability works out to Rs.1,17,600 for the accounting year 2002-03. Besides, the company provides non-monetary perquisites to him in the same period whose value is estimated at Rs.1,20,000.

(3 Marks) (May 2003)

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

(i) Where the payer is an individual or HUF whose accounts are required to be audited as per the provisions of section 44AB of the Act for the immediately preceding financial year, he has to deduct tax at source. If the accounts of Mr. Anand are subject to tax audit for the assessment year 2009-10 under section 44 AB of the Income-tax Act, 1961, he is covered by the proviso to section 194-I for the assessment year 2010-11.

Accordingly, Mr. Anand is liable to deduct tax at source under section 194-I on the rental payments made. Section 194-I provides that rent includes any payment, by whatever name called, for the use of land or building together with furniture, fittings etc. Therefore, in the given case, apart from monthly rent of Rs.15,000 p.m., service charge of Rs.10,000 p.m. is also within the purview of TDS. Hence, both the payments aggregating to Rs.25,000 per month will fall under the provisions of section 194-I. Consequently, Mr. Anand should deduct tax @ 15% upto 30th September, 2009 and 10% thereafter.

(ii) Explanation to section 194-C provides that catering services are covered under the expression "work" for the purpose of tax deduction at source and the catering organisation will have to be treated as a contractor. As the payment exceeds

Rs.20,000/-, the nationalised bank is required to deduct tax at source at 2% on the payments made to catering organisation under 194-C. If the catering organization is an individual or HUF then the tax deduction shall be @ 1% for the period from 01.10.2009 to 31.03.2010.

(iii) Under section 192, the employer may pay tax on non-monetary perquisites without deduction of tax at source from salary payable to the employees. Such tax will have to be worked out at the average rate applicable to aggregate salary income of the employee and payment of tax will have to be made every month along with tax deducted at source on monetary payment of salary, allowances etc.

Therefore, in the given case, the amount of income-tax attributable to the value of non-monetary perquisites provided to the employee is not subject to tax deduction under section 192 in case the company has exercised such option. The balance amount of tax of Rs.1,17,600 needs to be deducted from the salary of the employee on an average basis

Question 9

The following issues arise in connection with the deduction of tax at source under Chapter XVII-B Discuss the liability for tax deduction in these cases:

(a) An employee of the Central Government receives arrears of salary for the earlier 3 years. He enquires whether he is liable for deduction of tax on the entire amount during the current year.

(b) A T.V.channel pays Rs.10 lakhs on 1.7.2001 as prize money to the winner of a quiz programme. Who will be a Millionarie?

(c) State Bank of India pays Rs.50,000 per month as rent to the Central Government for a building in which one of its branches is situated.

(d) A television company pays Rs.50,000 to a cameraman for shooting of a documentary film.

(e) A State Government pays Rs.20,000 as commission to one of its agent on sale of lottery tickets

(f) A Turf Club awards a jack-pot of Rs.5 lacs to the winner of one of its races.

(6 × 2 = 12 Marks)(Nov.2001)

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

(a) As per section 192, tax is deductible at source by any person who is responsible for paying any income chargeable under the head salaries. However, under sub-section (2A) of that section, the employee will be entitled to relief under section 89(1) and consequently he will be required to furnish to the person responsible for making the payment, such particulars in Form No.10E. The person, hence responsible for making the payment shall compute the relief and take it into account while making deduction of tax at source from salary.

(b) Under section 194B the person responsible for paying by way of winnings from any card game and other game in an amount exceeding Rs.5,000 shall at the time of payment deduct income-tax Act at 30%.

(c) Section 194-I, which governs the deductions of tax at source on payment of rent, exceeding Rs.1,20,000 per annum is applicable to all taxable entities excepting individuals and HUF's. However, under CBDT Circular No.699 dated 30.1.1995, exception is provided in respect of payments made to Government (State and Central) and institutions not liable to income-tax.

(d) If the cameraman is an employee of the T.V. Company, the provisions of section 192 will apply. However, if he is a professional, section 194-J will apply. Tax at 10% will have to be deducted at the time of credit of Rs.50,000 or on its payment, whichever is earlier. (See CBDT circular No.714 dated 3.8.1995)

(e) Under section 194G, the person responsible for paying to any person stocking, distributing, purchasing or selling lottery tickets shall at the time of credit of the commission or payment thereof, whichever is earlier, amounting to more than Rs.1,000, deduct income-tax at 10%.

(f) The payment by way of winnings from horse race is governed by section 194BB. Under this section, the person responsible for payment shall, at the time of payment if it exceeds Rs.2,500, deduct tax at source @ 30%.

Question 10

Discuss the following propositions :

Interest levied under section 220 of the Act can be waived *(3 Marks) (May 2001)*

Answer

Under section 220(2A), the Chief Commissioner or the Commissioner, may reduce or waive the amount of interest paid or payable by an assessee, if he is satisfied that.

(i) Payment of such interest has caused or would cause undue hardship to the assessee;

(ii) Default in the payment of the amount on which interest has been charged was due to circumstances beyond the control of the assessee and

(iii) The assessee has cooperated in any inquiry relating to the assessment or any proceeding for the recovery of any amount due from him.

Question 11

How do you deal with the following issues under the respective provisions of the Income-tax Act?

(a) A foreign company, who has a branch operating in India pays salary to its employees "net of tax". It declines to issue certificate under section 203 to its employees of the tax deducted at source on the ground that it had not deducted any tax at source. (3 Marks)

(b) A foreign company pays fee for professional and technical services rendered to it by an Indian law and accountancy firm. The foreign company does not have any branch, agent or establishment in India. Advice the foreign company as to, how it could comply with provisions of section 194J. (3 Marks) (Nov.2000)

Answer

(a) This position was considered by the Board and Circular NO.785 dated 24-11-1988, issued on this point.

"Payments net of tax" has been contemplated under section 195 A.

In cases where the amount is paid, "net of tax", then for the purpose of deduction of tax at source, such income should be increased by such an amount as would, after deduction of tax thereon, be equal to the net amount payable. In all such cases, where the amount is agreed to be paid "net of tax", *the payer is under legal obligation to furnish a certificate for the tax deducted at source in the prescribed form to the payee within the time prescribed under section 203.* The foreign company is under a legal obligation to pay the tax on behalf of its employees and also issue the certificate to its employees under section 203.

(b) In its Circular No.726 dated 18.10.1995, the Board considered such a situation and having regard to the practical difficulties involved, decided that any fees paid through regular banking channels to any chartered accountant, lawyer, advocate or solicitor who is resident in India by the non-residents who do not have any agent or business connection or permanent establishment in India may not be subject to the provisions of tax deduction at source under section 194J of the Income-tax Act.

Question 12

You are consulted on the justifiability of the following claims. Your advice is to be framed based on the provisions of the Income-tax Act, 1961.

(i) Mr. Govind won the first prize in a lottery ticket and the prize money was a Maruti car worth Rs.2 lakhs. According to section 194B, tax has to be deducted at source from the

winnings of lottery at the time of payment of the prize money. What is the procedure to be adopted before handing over the Maruti Car to Mr.Govind?. (3 Marks) (May 2000)

(ii) A private trust has two individuals and one HUF as beneficiaries and their shares were equal. The trust borrowed certain amounts on which interest payable to a single lender was Rs.15,000. Is the trust obliged to deduct tax at source at the time of payment/credit of such interest to the lender? (3 Marks) (May 2000)

Answer

(i) This position is covered by the second proviso to section 194B itself. It is provided therein that where the winnings are wholly in kind or partly in kind and partly in cash, but the cash part of it is not sufficient to meet the liability for tax deduction at source, the person responsible shall, before releasing the winnings, ensure that the tax has been paid in respect of the winnings. Therefore, in the case under consideration, the entire winnings being in kind, a sum equal to the tax to be deducted at source (@ 30% for the assessment year 2010-11) must be collected from Mr. Govind by the agent and remitted to the Government account before releasing the Maruti car to him.

(ii) Under section 194A, any person, not being an individual or a Hindu undivided family who is responsible for paying to a resident any income by way of interest other than income by way of interest on securities shall at the time of credit of such income to the account of the payee or at any; time of payment thereof deduct income-tax thereon at the rates in force. In this case, the beneficiaries as well as their shares are known. *The trust can be assessed in the same manner and to the same extent as the beneficiaries and therefore, the trust will have the same status as that of the beneficiaries i.e. individuals or HUF as the case may be*. Since interest paid or credited to an individual or HUF is not covered by section 194A, no tax needs to be deducted at source. However, in case the accounts of the trust are required to be audited as per the provisions of section 44AB, then it is liable to deduct tax at source @10%.

29

WEALTH TAX

Question 1

(a) Mr. Manocha has a house property in Delhi, which was lying vacant for last 3 years. He constructed the property in 1990 at a cost of Rs.40 lacs. He has let out the same at a monthly rent of Rs.30,000 for a period of three years with effect from 1st January, 2009. The quarterly corporation tax is Rs.30,000. He took a premium of Rs.1,20,000 from the tenant and also security deposit of Rs.1,00,000. The house was constructed on a land measuring 4,000 sft. It has three floors each measuring 960 sft. Compute the value of the house property for wealth tax purpose as at valuation date 31.3.2009.

(7 Marks) (June 2009)

(b) An association of persons (AOP), comprising of two members Akash and Vikash, owns an urban land valued at Rs.60 lakh on the valuation date 31.3.2009. Examine the tax implications under the Wealth Tax Act. (3 Marks) (June 2009)

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

(a) Computation of value of the house property for wealth tax purpose

Particulars	Rs.	Rs.
Computation of Actual Rent & Annual Rent		
Actual Rent (Rs.30,000 x 3)		90,000
Add: Adjustment for premium received from tenant (Rs.1,20,000/3) x 3/12		10,000
15% p.a. of Security Deposit i.e. 15% x Rs.1,00,000 x 3/12		3,750
Actual Rent for 3 months		**1,03,750**
Annual Rent (Rs.1,03,750 x 12/3)		**4,15,000**
Computation of Net Maintainable Rent (NMR)		
Gross Maintainable Rent, being the annual rent		4,15,000

Less: Corporation Tax (Rs.30,000 x 4)	1,20,000	
15% of Gross Maintainable Rent	62,250	1,82,250
Net Maintainable Rent (NMR)		**2,32,750**
Capitalised value of NMR		
Capitalised value (Rs.2,32,750 x 12.5)	29,09,375	
Cost of acquisition	40,00,000	
Capitalised value is the higher of the above		40,00,000
Add: Premium		
(i) Aggregate Area	4000 Sq.Ft.	
(ii) Specified Area (60%)	2400 Sq.Ft.	
(iii) Built up area	960 Sq.Ft.	
(iv) Unbuilt Area	3040 Sq.Ft.	
(v) Excess of unbuilt area over specified area	640 Sq.Ft.	
% of excess area on aggregate area		
(640/4000) × 100	16%	
(vi) Premium to be added when (v) is 16% (40% of capitalized value i.e., 40% of Rs.40 lakh)		16,00,000
Value of house property for wealth-tax purpose		**56,00,000**

(b) The tax implications of an asset owned by an association of persons under the Wealth-tax Act are as follows:

(i) As per section 3**,** only individuals, Hindu Undivided Families and Companies are liable to wealth tax. Therefore, an association of persons (AOP) is not chargeable to wealth-tax.

(ii) However, as per section 4(1)(b), the value of interest of a member of an AOP in the assets of the AOP is to be included in his net wealth. Schedule III lays down the manner of determination of the value of such interest.

(iii) Section 21AA deals with a situation where the shares of the members of an AOP are indeterminate or unknown. Where assets chargeable to wealth-tax are held by an AOP and the individual shares of the members are indeterminate or unknown on the date of formation or at any time thereafter, wealth tax is to be levied in the like manner and to the same extent as applicable to an individual.

Question 2

(a) Matisha Constructions Ltd. furnishes the following particulars of its wealth for the valuation date as on 31.3.2008:

		Rs.in lacs
(i)	*Land in urban area (held as stock in trade since 1996).*	*81*
(ii)	*Motor cars (including one imported car, worth Rs.18 lacs used for hiring)*	*38*
(iii)	*250 acres agricultural land acquired at Greater Noida Township on 27.8.2007 for construction of residential flats/commercial complex. However, Greater Noida Authority has reserved 25 acres land as green belt.*	*250*
(iv)	*Residential flats of 1500 sq feet each provided to 3 employees (salary of one employee exceeded Rs.5 lacs per annum)*	*36*
(v)	*Farm house of 5 acre at a remote village*	*9*
(vi)	*Cash in hand as per cash book*	*3*
	Liabilities:	
(i)	*Loan for purchase of land at Urban area*	*30*
(ii)	*Loan for purchase of land at Greater Noida*	*120*
(iii)	*Wealth-tax liability for Assessment year 2007-08*	*12*
(iv)	*Loan for construction of residential flats*	*9*

Compute the net wealth of the company for assessment year 2008-09.

(8 Marks) (Nov 2008)

(b) *Mr. X, a member of co-operative housing society, was allotted a plot as per the bylaws of the society. He constructed a house on plot and substituted the name of his wife in the records of the society in his place. The society executed the registered sale deed in respect of said plot in favour of his wife. The Assessing Officer included the value of the said property in the hands of Mr. X. Examine the validity of the action of the Assessing Officer.* *(2 Marks) (Nov 2008)*

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

(a) Computation of Net Wealth of M/s Matisha Constructions Ltd. for A.Y. 2010-11

	Particulars	Rs. in lacs
Assets [as per the definition of assets under section 2(ea)]		
(i)	Land in urban area (held as stock in trade since 1996) – taxable since it is held as stock-in-trade for more than 10 years	81
(ii)	Motor cars (excluding imported car not being an asset since it is used for hiring) [38 lac – 18 lac]	20

(iii)	Agricultural land acquired for construction of residential and commercial complex (is a stock-in-trade in the hands of a construction company – hence, not an asset)			Nil
(iv)	(a) Residential flats provided to 2 employees drawing salary less than Rs.5 lacs per annum – not an asset			Nil
	(b) Residential flat provided to one employee drawing salary exceeding Rs.5 lacs per annum is an asset [36 × 1/3]			12
(v)	Farm house at a remote village is not an asset (assuming that it is not situated within 25 km from the local limits of any municipality)			Nil
(vi)	Cash in hand as per cash book is not an asset since it represents cash recorded in the books			Nil
				113
Less:	**Liabilities**			
(i)	Loan for purchase of land in urban area – deductible, since it is incurred in relation to land in urban area, which is an asset chargeable to wealth-tax.	30		
(ii)	Loan for purchase of agricultural land - not deductible, since land is not an asset	Nil		
(iii)	Wealth Tax liability for Assessment year 2007-08 – wealth tax liability is not deductible	Nil		
(iv)	Loan for construction of residential flats - the portion relating to taxable asset (1/3) is deductible i.e. $\frac{1}{3} \times 9$ lacs	3		33
Net Wealth				**80**

(b) The Allahabad High Court has, in the case of *Ram Saran Das Tandon v. CWT (2007) 292 ITR 546,* held that when the assessee has ceased to be a member of the society, he could not be treated as the owner of the house property. Therefore, the value of the property is not assessable in his hands.

In this case, assuming that Mr.X has received adequate consideration from his wife Mrs.X for the transfer, the action of the Assessing Officer in including the value of said property in the hands of Mr. X is not valid.

Question 3

(a) State with reasons whether the following constitute assets chargeable to wealth-tax on the valuation date 31.3.2008:

(i) Agricultural farm house situated 26 kms outside the municipal limits of Jaipur, but within 22 kms of Niwai Muncipal Corporation.

(ii) Factory building and godowns leased out on rent.

(iii) Silver and gold in the jewellers shop

(iv) *Aircraft held by a shipping company having turnover of Rs.800 crores for exclusive use of its managing director.*

(v) *A cash balance of Rs.1,50,000.* *(5 Marks) (May 2008)*

(b) *Rakesh, a married coparcener having no son but two minor daughters, gets a commercial property on disruption of the HUF on 17.3.2008. He, therefore, seeks your advice to know in whose hands the value of this property would be subject to wealth-tax on the valuation date 31.3.2008.* *(3 Marks) (May 2008)*

(c) *How can the arrear demand of wealth-tax be recovered by the department where the assessee dies prior to making payment thereof?* *(2 Marks) (May 2008)*

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

(a) (i) According to the definition of the term 'asset' under section 2(ea), building includes a farm house situated within 25 kms from the local limits of a municipality. Therefore, the farm house situated within 25 kms from the local limits of Niwai Municipal Corporation is an asset as per section 2(ea) of the Wealth-tax Act.

(ii) There are some exceptions to the chargeability of building to wealth-tax. One of the exceptions is property in the nature of commercial establishments or complexes. Therefore, factory buildings and godowns leased out on rent are not assets within the meaning of section 2(ea) of the Wealth-tax Act.

(iii) The silver and gold lying in a jeweller's shop are not assets under section 2(ea) of the Wealth-tax Act as the same constitute stock-in-trade of the assessee.

(iv) The definition of asset under section 2(ea) includes yachts, boats and aircrafts, other than those used by the assessee for commercial purposes. Therefore, the aircraft held by a shipping company for the exclusive use of its managing director is not an asset chargeable to tax, assuming that it was used only for business purposes. Aircraft used for one's own business is construed as used for "commercial purposes".

(v) The cash in hand in excess of Rs.50,000 is an asset chargeable to wealth-tax in case of individuals and HUFs. In case of any other person, any cash not recorded in the books will only be treated as an asset.

(b) The facts given in the question are similar to the facts of the case decided by the Apex Court in the case of *Narendra Nath v. CWT (1969) 74 ITR 190* wherein it was held by the Court that if a co-parcener not having a son but having two minor daughters receives his share in the joint family property on disruption, then, such property would belong to the HUF comprising of himself, his wife and minor daughters and cannot be assessed as his individual property.

It may be noted that any property in the nature of commercial establishments are excluded from the definition of asset under section 2(ea). Therefore, commercial property received by Rakesh would not be chargeable to wealth-tax on the valuation date.

(c) Where the assessee dies prior to making of payment of demand of wealth tax, the same shall be recovered as per section 19(1) out of the estate of the deceased from his executor, administrator or other legal representative. The executor, administrator or other legal representative shall be liable to pay out of the estate of the deceased person, to the extent to which the estate is capable of meeting the charge, the wealth tax assessed as payable by such person, if he had not died.

Question 4

(a) Mr. Rajpal gives the particulars of various assets held by him on 31.3.2007 and requests you to compute his net wealth by explaining in brief that why the same was dealt with like that :

(i) Jewellery gifted to wife from time to time in total of Rs.1 lac and were available with her on the valuation date having market value of Rs.5 lacs.

(ii) A flat in Mumbai purchased under instalment scheme in 1986 for Rs.6 lacs and used for own residence since then. The market value of it was Rs.20 lacs on 31.3.2007 and installment of Rs.1 lac was also outstanding.

(iii) He is a qualified engineer and was in possession of instruments used for his professional activity. The value of all such instruments was Rs.1 lac.

(iv) Urban land purchased for Rs.2 lacs in August 2004 located at Jaipur, in the name of his son who is suffering from a disability specified under section 80U. The age of his son on 31.3.2007 was 10 years and value of land was Rs.5 lacs.

(v) House located in NOIDA shown in his wealth-tax return for A.Y.2006-07 at Rs.40 lacs was sold on 20.3.07 for Rs.45 lacs, but the sale deed thereof was executed on 3.4.07. (5 Marks) (Nov 2007)

(b) Examine the correctness of the statement that "All types of land held by an assessee on the valuation date are treated as 'Urban land' under the Wealth-tax Act."

(5 Marks) (Nov 2007)

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

(a) Computation of Net Wealth of Mr. Rajpal on 31.3.2010

	Particulars of asset with reason for chargeability	Amount (Rs.)
1.	Under section 4(1)(a)(i) read with Rule 18 of Schedule III, the fair market value of gifted jewellery on the valuation date will be included in the wealth of Mr. Rajpal.	5,00,000
2.	The flat at Mumbai used by the assessee for his own residence is exempt under section 5(vi) and accordingly, the liability of outstanding installment is not deductible.	Nil
3.	Professional instruments held on the valuation date used for the purpose of profession are not assets for the purpose of levy of wealth-tax.	Nil
4.	Urban land is an asset by virtue of section 2(ea)(v). However, since the same is in the name of his minor son who suffers from a disability specified under section 80U, the clubbing provisions are not applicable as per section 4(1)(a)(ii).	Nil
5.	The property at Noida was sold during the year and is, therefore, not an asset of the assessee but is an asset of the beneficial owner, since ownership of the property passes on sale of the property and execution of sale deed only confirms the act of the parties.	Nil
	Net Wealth	**5,00,000**

(b) Urban land is an "asset" as per section 2(ea)(v) of the Wealth Tax Act and it means (i) land situated in any area comprised within the jurisdiction of a municipality or cantonment board and which has a population of not less than 10,000 according to the last preceding census; (ii) land situated in any area not being more than 8 kms from the local limits of any municipality or cantonment board.

However, in spite of fulfilling the above conditions, the following are not treated as urban land:-

(i) land on which construction of a building is not permissible under any law for the time being in force in the area in which such land is situated;

(ii) land occupied by any building which has been constructed with the approval of the appropriate authority;

(iii) unused land held by the assessee for industrial purposes for a period of 2 years from the date of its acquisition by him; and

(iv) any land held by the assessee as stock-in-trade for a period of 10 years from the date of its acquisition by him.

Therefore, all types of land held by an assessee on the valuation date may not be treated as urban land under the Wealth-tax Act.

Hence, the statement is not correct.

Question 5

(a) *S gifted Rs.2,00,000 to his wife on 10.4.2006. His wife bought gold jewellery on 31.1.2007 out of the said sum of Rs.2,00,000. The fair market value of the gold jewellery as on 31.3.2007 was Rs.2,50,000. S claims that since his wife has not held on 31.3.2007 the sum of Rs.2,00,000 which he gifted to her, no amount is includible in his net wealth for the assessment year 2007-08. Examine the claim of S.* *(3 Marks) (May 2007)*

(b) *Wealth tax is not payable by an assessee in respect of any property held under trust or other legal obligation for any public purpose of a charitable or religious nature in India. Do you agree with the statement?* *(2 Marks) (May 2007)*

(c) *Compute the net wealth of UMV Ltd. (carrying on the business of running cars on hire and also dealing in jewellery) which furnishes the following particulars of its assets and liabilities as on 31.3.2007:*

		(Rs. In crores) Book value	(Rs. in crores) If valued as per Schedule III
Assets			
(i)	*Fixed Assets:*		
	Plant & Machinery	*10*	*15*
	Factory Building	*25*	*10*
	Urban land (450 sq. meters)	*40*	*100*
	Motor cars	*5*	*10*
(ii)	*Investments*		
	Jewellery	*15*	*30*
	Plot of land in Mumbai (480 sq. meters)	*10*	*50*
	Equity shares in subsidiary companies	*20*	*25*
(iii)	*Current assets :*		
	Inventories (Jewellery)	*150*	*150*
	Sundry Debtors	*10*	*10*
	Cash and bank balances (includes cash balance of Rs.1,00,000)	*5*	*5*

Liabilities			
(i)	*Current Liabilities*	*40*	*40*
(ii)	*Loans secured on Fixed Assets (Urban land)*	*30*	*30*

(5 Marks) (May 2007)

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

(a) Section 4(1)(a) of the Wealth-tax Act, 1957 provides that the value of assets which are transferred, directly or indirectly, otherwise than for adequate consideration or in connection with an agreement to live apart, by a husband to his wife or vice versa, are to be clubbed in the hands of the transferor, whether the assets are held in the form in which they were transferred or otherwise. The Supreme Court has, in *CWT v. Kishan Lal Bubna (1993) 204 ITR 600*, held that where the assessee transfers money and the transferee utilises that money to acquire an asset, it is the value of that asset on the valuation date which is relevant for the purposes of computing the net wealth of the assessee. Where, what is transferred by the assessee is an asset and the transferee disposes of the asset and acquires with the consideration received another asset, it is the value of that acquired asset on the valuation date which is relevant for the purposes of computing the net wealth of the assessee. In view of this legal position, the claim of S is not valid. The value of gold jewellery as per Schedule III on the valuation date 31.3.2010 is includible in the net wealth of S for A.Y.2010-11. Therefore, Rs.2,50,000, being the fair market value of gold jewellery as on 31.3.2010 is includible in the net-wealth of S under section 4(1)(a).

(b) The statement is valid. This exemption is provided in section 5(i). However, this exemption shall not apply to any property forming part of any business carried on by the above trust. In the following cases the assets, though held in business, shall continue to be exempt from wealth-tax:

(a) Any property held under any trust or other legal obligation forming part of any business, other than the business referred to in section 11(4A)(a) or section 11(4A)(b) of the Income-tax Act, 1961 in respect of which separate books of accounts are maintained; or

(b) Any property forming part of a business carried on by an institution, fund or trust referred to in section 10(23B) or 10(23C) of the Income-tax Act, 1961.

(c) Computation of Net Wealth of UMV Limited as on the valuation date 31.03.2010

	Particulars	Reasons	Value (Rs. in crores)
Assets:			
(i)	Fixed Assets:		
	Plant & Machinery	Not an asset u/s 2(ea)	Nil
	Factory building	Commercial property. Hence, not an asset u/s 2(ea)	Nil
	Urban land (450 sq. meters)	It is an asset u/s 2(ea) - Refer Note 2	100
	Motor cars	Used for running on hire. Hence, not an asset u/s 2(ea) – Refer Note 3	Nil
(ii)	Investments:		
	Jewellery	Not stock-in-trade. Hence, an asset u/s 2(ea)	30
	Plot of land in Mumbai	An asset u/s 2(ea). Refer Note 2	50
	Equity shares in subsidiary companies	Not an asset u/s 2(ea)	Nil
(iii)	Current assets:		
	Inventories (Jewellery)	Stock-in-trade. Hence, not an asset u/s 2(ea)	Nil
	Sundry Debtors	Not an asset u/s 2(ea)	Nil
	Cash and bank balances (includes cash balance of Rs.1,00,000)	Bank balance – not an asset under section 2(ea).	Nil
		Cash in hand – recorded in books – hence, not an asset under section 2(ea).	Nil
Value of assets as per Schedule III of the Wealth-tax Act, 1957(A)			**180**
Liabilities:			
(i)	Current Liabilities	Not incurred in relation to an asset under section 2(ea). Hence, not eligible for deduction.	Nil
(ii)	Loans secured on Fixed Assets (Urban land)	Assuming that the loan is taken for purchase of urban land, which is included in the net wealth, it is eligible for deduction.	30
Liabilities eligible for deduction (B)			**30**
Net wealth [(A) – (B)]			**150**

Notes:

1. The value of any asset other than cash shall be its value as on the valuation date determined in the manner laid down in Schedule III.
2. Plot of land not exceeding 500 sq. meters is exempt only in the case of an individual or HUF and not in the case of a company.
3. It is assumed that all the motor cars are used in the business of running on hire.

Question 6

D, an individual, has the following assets and liabilities as on 31.3.2006

Assets	*Rs. in lakhs*
Plot of land at Bhopal comprising an area of 1,200 square metres on which building has been constructed without the approval of the appropriate authority	*25*
Building constructed on land at Bhopal without the approval of the appropriate authority and used for his business purposes.	*10*
Motor cars held as stock-in-trade	*60*
Gold jewellery brought into India from Singapore, where he was residing, on his return to India on 1.11.2002 for permanently residing in India.	*6*
Jewellery made of Platinum.	*9*
Interest in the coparcenary property of the Hindu undivided family of which he is a member	*15*
Cash in hand recorded in the books of account	*5*
Fixed deposits in a co-operative bank	*10*
Liabilities	
Loan borrowed for marriage of daughter	*6*
Loan borrowed for construction of building at Bhopal	*5*

The minor married daughter of D holds a plot of land at Indore valued at Rs.20 lakhs.

The amounts stated against the assets, except cash in hand, are the values determined as per section 7 of the Wealth-tax Act, 1957 read with Schedule III thereto.

Compute the net wealth of D for the assessment year 2006-07.

State the reasons for inclusion or exclusion of the various items. *(10 Marks) (Nov 2006)*

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

Computation of net wealth of Mr. D for the A.Y.2010-11

Particulars	Note	Rs.
Plot of land of 1,200 sq. mts. at Bhopal	(a)	25,00,000
Building constructed on land at Bhopal – construction without the approval of appropriate authority – not an asset under section 2(ea) since used for business purposes	(b)	Nil
Motor cars held as stock-in-trade – not an asset under section 2(ea)	(c)	Nil
Gold jewellery brought from Singapore on 1.11.2005 (Assumed) on his return to India for permanently residing in India – Exempt under section 5(v)	(d)	Nil
Jewellery made of platinum	(e)	9,00,000
Interest in coparcenary property of the HUF– Exempt under section 5(ii)	(f)	Nil
Cash in hand in excess of Rs.50,000	(g)	4,50,000
Fixed deposits in a co-operative bank–not an asset under section 2(ea)	(h)	Nil
Gross wealth		**38,50,000**
Less: Liabilities		
Loan borrowed for marriage of daughter – not deductible	(i)	Nil
Loan borrowed for construction of building at Bhopal – not deductible	(j)	Nil
Net wealth		**38,50,000**

The reasons for the inclusion or exclusion of the various items are furnished below -

(a) Plot of land at Bhopal on which building has been constructed without the approval of the appropriate authority is an asset under section 2(ea) and is, therefore, includible in the net wealth. Since the plot of land comprises an area of more than 500 square meters, it is not eligible for exemption under section 5(vi).

(b) Building constructed on land at Bhopal without the approval of the appropriate authority is not a specified asset under section 2(ea) since it is used for business purposes by D. It is, therefore, not includible in the net wealth.

(c) Motor cars held as stock-in-trade do not fall under the purview of 'asset' under section 2(ea) and are, therefore, outside the net of wealth tax.

(d) Gold jewellery brought into India on 1.11.2005 (assumed) from Singapore is exempt for seven successive assessment years beginning with the assessment year 2006-07 under section 5(v).

(e) Jewellery made of platinum is an asset under section 2(ea) and is, therefore, included in the net wealth.

(f) Interest in the coparcenary property of the Hindu undivided family of which D is a member is exempt under section 5(ii).

(g) Cash in hand, in excess of Rs.50,000, is includible in the net wealth of an individual, whether such cash is recorded in the books of account or not.

(h) Fixed deposits in a co-operative bank do not constitute 'assets' within the meaning of section 2(ea) and, therefore, are excluded from net wealth.

(i) Only loans borrowed in relation to the 'assets' as per section 2(ea) are deductible. Hence, loan borrowed for marriage of daughter is not deductible.

(j) Since building at Bhopal is used for business purposes and is, therefore, not an asset and excluded while computing the net wealth, the loan borrowed for its construction is not a deductible debt.

(k) Assets held by a minor married daughter are not includible in the net wealth of any parent as per section 4(1)(a)(ii). Hence, the value of the plot of land at Indore, held by the minor married daughter, does not form part of the net wealth of D.

Question 7

G, an individual, furnishes the following particulars of his assets and liabilities as on 31.3.2006:

Assets:	***Rs. in lakhs***
Residential house at New Delhi	*25*
Residential house at Agra	*15*
Plot of land comprising an area of 450 square meters at Mumbai	*60*
House at New Delhi exclusively used for carrying on his business	*15*
Commercial complex at Agra	*20*
Residential house at Chennai let out for 335 days during the relevant previous year	*10*
Motor cars used in business of running them on hire	*20*
Shares in private limited companies	*25*
Cash in hand	*3*
Gold jewellery	*12*
Liabilities:	
Loan borrowed for purchase of land at Mumbai	*20*
Loan borrowed for purchase of shares in private limited companies	*10*
Loan borrowed for purchase of gold jewellery	*6*

Amounts stated against assets, except cash in hand, are the values determined as per section 7 of the Wealth-tax Act, 1957 read with Schedule III thereto.

Compute the net wealth of G for the assessment year 2006-07.

State the reasons for inclusion or exclusion of the various items. *(10 Marks) (May 2006)*

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

Computation of net wealth of G for the A.Y. 2010-11

	Particulars	Amount in Rs.
(a)	Residential house at New Delhi is an asset	25,00,000
(b)	Residential house at Agra is an asset	15,00,000
(c)	Plot of land comprising an area of 450 square meters at Mumbai is an asset but exempt under section 5(vi)	Nil
(d)	House at New Delhi exclusively used for carrying on his business is not an asset	Nil
(e)	Commercial complex at Agra is not an asset	Nil
(f)	Residential house at Chennai let out for 335 days during the relevant previous year is not an asset	Nil
(g)	Motor cars used in the business of running them on hire is not an asset	Nil
(h)	Shares in private limited companies is not an asset	Nil
(i)	Cash in hand in excess of Rs.50,000 is not includible in net wealth	2,50,000
(j)	Gold jewellery is an asset	12,00,000
		54,50,000
	Less: Debts incurred in relation to assets	
(k)	Loan borrowed for purchase of land at Mumbai (not deductible since exemption under section 5(vi) has been claimed in respect of the said land)	Nil
(l)	Loan borrowed for purchase of shares in private limited companies (not deductible since shares are not included in net wealth)	Nil
(m)	Loan borrowed for purchase of gold jewellery	6,00,000
	Net Wealth	**48,50,000**

Reasons for inclusion or exclusion of the various items are furnished below:

(a) Residential house at New Delhi is included, as residential house is an "asset" within the meaning of section 2(ea) of the Wealth Tax Act, 1957. Exemption under section 5(vi) is not claimed in respect of this house as it is more beneficial for the assessee to claim exemption in respect of plot of land at Mumbai whose value is higher.

(b) Residential house at Agra is an asset u/s 2(ea) and, therefore, included in the net wealth.

(c) Plot of land measuring 450 square metres at Mumbai is exempt under section 5(vi) and, therefore, does not form part of net wealth. One house or part thereof or a plot of land, not exceeding 500 square metres, belonging to an individual or a Hindu Undivided Family is exempt u/s 5(vi) without any monetary ceiling.

(d) House at New Delhi, occupied for own business purposes, is excluded from net wealth as it is not an asset.

(e) Commercial complex at Agra is excluded as it is not an asset.

(f) Any residential property let out for a minimum period of 300 days in the previous year is not considered as an asset. Residential house at Chennai let out for more than 300 days is, therefore, excluded from net wealth.

(g) Motor cars used in business of running them on hire are not assets as per section 2(ea)(ii) and, therefore, excluded from net wealth.

(h) Shares in private limited companies are not assets and, therefore, excluded from net wealth.

(i) Cash in hand, in excess of Rs.50,000, of individuals constitutes an asset. Therefore, Rs.2,50,000, being cash in hand in excess of Rs.50,000, is included in net wealth.

(j) Gold jewellery constitutes an asset as per section 2(ea) and is includible in net wealth.

(k) Debts incurred in relation to an exempted asset are not deductible in computing net wealth. Loan borrowed for purchase of land at Mumbai is not deductible as exemption under section 5(vi) has been claimed in respect of the said land.

(l) Loan borrowed for purchase of shares in private limited companies is not deductible while computing net wealth as shares are not included in net wealth.

(m) Gold jewellery, being an asset, has been included in the net wealth. Therefore, loan borrowed for purchase thereof is deductible in computing the net wealth.

Question 8

New Era Construction Ltd. furnishes the following particulars of its wealth for the valuation date of 31st March, 2005. Compute its net wealth and the wealth tax payable by it for the Assessment Year 2005-06:

	Rs.	***Rs.***
Land in rural area (within 5 kms of Aligarh – purchased in 1990, construction on which is permissible) (Rs.90 lakhs)		*90,00,000*
Land in urban area (for construction of Mall)		*20,00,000*
Land in urban area (held as stock-in-trade since 1990)		*50,00,000*
Motor car (including one imported car worth Rs.6 lakhs)		*11,00,000*
Jewellery (held as stock-in-trade)		*18,00,000*
Aircraft for use of directors and auditors		*1,58,00,000*

Bank balance			*5,00,000*
Cash in hand as per cash book			*2,70,000*
Guest house and land appurtenant thereto in rural area			*8,00,000*
Residential flats of identical size provided to six employees for their use near factory in rural areas (salaries of two such employees exceed Rs.5,00,000 p.a.)			*15,00,000*
Residence provided to managing director (salary exceeds Rs.5,00,000 p.a.)			*10,00,000*
Flats constructed remaining unsold (not held as stock)			*30,00,000*
Residence provided to whole time director (salary Rs.15,000 p.m.)			*17,00,000*
The company has taken the following loans :			
(a)	*for purchase of jewellery*	*6,00,000*	
(b)	*for purchase of aircraft*	*7,00,000*	
(c)	*for flats constructed remaining unsold*	*2,00,000*	
(d)	*for residence provided to whole time director*	*90,000*	

(10 Marks) (Nov.2005)

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

Computation of net wealth and wealth-tax payable by New Era Construction Ltd. for the A.Y.2010-11

	Particulars	*Rs.*	***Rs.***
1.	Land in rural area within 5 kms. of Aligarh (within the prescribed limit)		90,00,000
2.	Land in urban area (for construction of mall) [It has been assumed that the land has not been held as stock-in-trade]		20,00,000
3.	Land in urban area (held for more than 10 years as stock in trade – hence taxable)		50,00,000
4.	Motor car (including imported car)		11,00,000
5.	Jewellery (held as stock in trade – hence, not taxable)		Nil
6.	Aircraft for use of directors and auditors – Aircraft used for one's own business is construed as used for "commercial purposes".		Nil
7.	Bank balance - not an asset under section 2(ea)		Nil

8.	Cash in hand as per cash book - not an asset as per section 2(ea)		Nil
9.	Guest house in rural area		8,00,000
10.	(a) Four residential flats given to employees, whose salary does not exceed Rs.5,00,000 p.a. - exempt		Nil
	(b) Two residential flats given to employees, whose salary exceed Rs.5,00,000 p.a. – taxable		5,00,000
11.	Residential house given to Managing Director whose salary exceeds Rs.5,00,000 p.a.		10,00,000
12.	Unsold flats		30,00,000
13.	Residence given to whole time director (not taxable, since salary does not exceed Rs.5,00,000 p.a.)		Nil
Gross Wealth			2,24,00,000
Less: Debts			
1.	Loan for purchasing jewellery – Not deductible since jewellery held as stock in trade is exempt from wealth-tax	Nil	
2.	Loan for purchasing aircraft – Not deductible since aircraft is used for commercial purposes is not an asset under section 2(ea)	Nil	
3.	Loan for flats constructed remaining unsold	2,00,000	
4.	Loan for residential house provided to the whole time director – not deductible as the house is exempt from wealth-tax	Nil	2,00,000
Net Wealth			2,22,00,000

Computation of wealth tax payable for A.Y.2010-11

On Net Wealth up to Rs.30,00,000	-
On the balance wealth of Rs.1,92,00,000 @ 1%	1,92,000
Wealth Tax Liability	1,92,000

Question 9

Steel, Oil and Coal are partners in a firm engaged in the business of running a manufacturing unit in the municipal town of Siliguri having a population of more than 10,000 located in the State of West Bengal. Given below is the Balance Sheet of the firm as on 31st March, 2005:

		Rs. in lakhs		*Rs. in lakhs*
Partner's Capital			*Urban Land*	*300*
Steel	*300*		*Urban Land (Construction not allowed)*	*700*
Oil	*400*		*Factory Land*	*200*

Coal	*200*	*900*	*Residential House*	*300*
Cash credit from bank (Secured by hypothecation of stock and debtors)		*200*	*Plant (WDV)*	*120*
Term loan taken from bank (Secured by charge on gold and silver)		*1,200*	*Factory shed*	*400*
Creditors		*1,000*	*Lorry (WDV)*	*100*
Other liabilities		*600*	*Stocks*	*300*
			Gold and Silver	*800*
			Sundry Debtors	*180*
			Advance Tax	*200*
			Cash at Banks	*300*
Total		***3,900***		***3,900***

Two urban lands are valued by independent valuer at Rs.550 and Rs.50 lakhs respectively. The market value of gold and silver on the balance sheet date is Rs.1,100 lakhs. The value of residential house as per Rule 3 of schedule III is Rs.350 lakhs.

Term loan was taken for purchase of : (a) plant and machinery Rs.300 lakhs;(b) Lands, the plots are of which are of equal size Rs.700 lakhs.

The residential house is occupied by partner Steel, who looks after the production activity of the firm.

Partner Oil is a non-resident for Income-tax purposes.

The partners share the profits in the ratio of 2 : 2 : 1.

Details of personal assets of the partners as on 31st March, 2005 are as follows :

*(Rs. in lakhs)**

Particulars	*Steel*	*Oil*	*Coal*
Shares of Companies	*40*	*Nil*	*Nil*
Cash in hand (in India)	*Nil*	*0.75*	*Nil*
Fixed deposit and other deposits with banks	*35*	*32*	*40*
Loan taken for making investment in the firm	*30*	*Nil*	*Nil*
Residential House in Nairobi, Kenya	*Nil*	*400*	*Nil*

You are required to determine the assessable wealth of each partner as at 31st March, 2005 stating clearly the reason for inclusion or exclusion of each item. (10 marks) (May 2005)

** In the question paper, "rupees in lakhs" had been given as "rupees in thousands". This problem has been solved below taking the figures as "rupees in lakhs".*

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

A partnership firm is not liable to wealth tax u/s 3 of the Wealth Tax Act. However, in respect of assets belonging to the firm, the individual partners are deemed to be the owners of those assets as per section 4(1)(b). Therefore, the value of partner's interest in assets of the firm determined in the manner laid down in Schedule III is to be included in the net wealth of the partner.

The value of the interest of each partner in the assets of the firm has to be determined as per Rules 15 and 16 of Schedule III to the Wealth Tax Act.

Net wealth of the firm on the valuation date shall be first determined without considering the exemption u/s 5.

The net wealth as calculated to the extent of partners' capital is to be allocated among the partners in proportion to their capital contribution. The balance of the net wealth shall be allocated as per the agreement for distribution of assets in the event of dissolution and where there is no such agreement, in their profit sharing ratio. The sum total of amounts so allocated to a partner shall be treated as the value of interest of that partner in the firm.

The assets eligible for exemption u/s 5 are also to be included in the value of interest of each partner. The exemption u/s 5 shall be available to the individual partners while computing their net wealth.

Computation of net wealth of firm for the A.Y. 2010-11

	Particulars	**Rs. in lakhs**
1.	Urban land [See Note 1]	550
2.	Residential house [See Note 2]	300
3.	Gold & silver [See Note 3]	1100
		1950
	Less: Deductible debts u/s 2(m) in respect of urban land (Rs.700 lakhs × ½) [See Note 6]	350
	Net Wealth	**1600**

Note –

1. Since the value as per Rule 20 of Schedule III i.e. Rs.550 lakhs exceeds book value of Rs.300 lakhs by more than 20%, value as per Schedule III has to be taken to be the value of urban land.

2. Written down value of the residential house of the firm is required for the purpose of comparison with Schedule III value. Only if the value as per Schedule III exceeds the written down value by more than 20%, should Schedule III value be taken for computing net wealth of the firm. However, since the written down value is not given in the question, it has been assumed that the Balance Sheet value represents the written down value for the purpose of solving the problem. In such a case, for calculation of net wealth of firm, assuming the balance sheet value to be the written down value, the value of residential house should be Rs.300 lakhs, since this value does not exceed Schedule III value of Rs.350 lakhs by more than 20%.
3. Since the value of gold and silver as per Rule 18 of Schedule III i.e. the market value of Rs.1100 lakhs exceeds the book value of Rs.800 lakhs by more than 20%, the market value of Rs.1100 lakhs has been taken as the value of gold and silver.
4. As per sub-rule 2(d) of Rule 14, the value of the following assets which are disclosed in the Balance Sheet should not be taken into account namely -
   (i) Advance tax under the Income-tax Act
   (ii) The value of assets in respect of which wealth tax is not payable under this Act [In this case, the following are the assets in respect of which wealth tax is not payable – urban land on which construction is not allowed, factory land, factory shed, plant, stocks, sundry debtors and cash at bank].
5. As per the Madras High Court decision in *Southern Roadways Ltd. v. CWT (2001) 251 ITR 0213*, "motor car" covers all motor vehicles other than heavy vehicles, such as lorries and buses. Therefore, Lorry, being a heavy vehicle is not covered under "motor car" and hence is not an asset under section 2(ea).
6. It has been assumed that term loan of Rs.700 lakhs was taken for purchase of urban lands only. Since the plots are of equal size, Rs.350 lakhs is allowable as deduction, since it represents a debt in respect of a taxable asset, namely, urban land. The balance Rs.350 lakhs represents a debt in respect of urban land on which construction is not allowed which is not an asset under section 2(ea), and hence deduction is not allowable.

Allocation of firm's net wealth to partners

Particulars	Steel	Oil	Coal
Net wealth to the extent of aggregate capital of partners in 3:4:2	300	400	200
Balance of net wealth in profit sharing ratio of 2:2:1	280	280	140
	580	**680**	**340**

Computation of partners' net wealth

Particulars	Steel	Oil	Coal
Interest in assets of the firm	580	680	340

Cash in hand in excess of Rs.50,000 is an asset u/s 2(ea)	-	0.25	-
	580	**680.25**	**340**
Less: exemption u/s 5 in respect of house property *	108.75	127.50	63.75
Deductible debts u/s 2(m) for loan taken in making investment in firm	30	-	-
Net wealth	**441.25**	**552.75**	**276.25**

*Interest in residential property of the firm = Value of house x value of partner's interest/net wealth of firm

Steel's share = 300 x 580/1600 = Rs.108.75 lakh

Oil's share= 300 x 680/1600 = Rs.127.50 lakh

Coal's share = 300 x 340/1600 = Rs.63.75 lakh

Residential house property at Kenya is to-be excluded as Oil is a non-resident and the asset owned by a non-resident outside India is not taxable as per section 6(i).

Question 10

What are the various circumstances under which an assessee will be deemed to have concealed the particulars of his net wealth or furnished inaccurate particulars thereof?

(4 marks) (Nov.2004)

Answer

The circumstances under which an assessee will be deemed to have concealed the particulars of his net wealth or furnished inaccurate particulars thereof are as follows:

(i) Where a person fails to offer an explanation or offers an explanation which is found to be false in respect of any facts material to the computation of net wealth, he will be deemed to have concealed the particulars. Further, where such person offers an explanation which he is unable to substantiate and fails to prove that such explanation is bonafide and that all the facts relating to the same and material to the computation of his net wealth have been disclosed by him, he will be deemed to have concealed the particulars - *Explanation 2* to section 18.

(ii) Where a person not previously assessed to wealth tax, fails, without reasonable cause, to furnish within the due date, a return of his net wealth which he is required to furnish and the Assessing Officer is satisfied that the person has assessable wealth, he shall be deemed to have concealed the particulars of his assets - *Explanation* 3 to section 18.

(iii) Where the value of any asset returned by any person is less than 70% of the value of such asset as determined in an assessment u/s 16 or 17, such person shall be deemed to have furnished inaccurate particulars.

(iv) Where in the course of search u/s 37A, the assessee is found to be the owner of any money, bullion, jewellery or other valuable article or thing and such assets have been neither declared in the return of wealth nor recorded in the books of account, he shall be deemed to have concealed the particulars of such assets or furnished inaccurate particulars of such assets.

Question 11

X Limited is engaged in the construction of residential flats. For the valuation date 31.3.2004, it furnishes the following data and requests you to compute the taxable wealth:

(i) Land in urban area (Construction is not permitted as per Municipal Laws in force) Rs.35,00,000

(ii) Motor-cars (used on hire by the company) Rs.7,00,000

(iii) Jewellery (Investment) Rs.15,00,000. Loan taken for purchasing the same Rs.10,00,000

(iv) Cash Balance (as per books) Rs.1,75,000

(v) Bank Balances Rs.2,50,000

(vi) Guest House (situated in a place which is 30 kms away from the local limits of the municipality) Rs.6,00,000

(vii) Residential flats occupied by the Managing Director Rs.10,00,000. The managing director is on whole time appointment and is drawing remuneration of Rs.2,00,000 per month.

(viii) Residential house let out on hire for 200 days Rs.8,00,000

The computation should be supported with proper reasoning for inclusion or exclusion.

(6 marks) (Nov.2004)

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

Computation of taxable wealth of X Limited as on 31.3.2010

	Particulars	*Note No.*	*Rs. in lacs*
(i)	Land in urban area	(1)	Nil
(ii)	Motor-cars used on hire	(2)	Nil
(iii)	Jewellery	(3)	15
(iv)	Cash balance	(4)	Nil
(v)	Bank balance	(5)	Nil
(vi)	Guest house	(6)	6
(vii)	Residential flat occupied by the Managing Director	(7)	10
(viii)	Residential house let out for 200 days	(8)	8
	Total wealth		**39**

Less: Debts: Loan obtained for purchasing jewellery	(9)	10
Net wealth as on 31.3.2010		**29**

Notes:

(1) Land in urban area on which the construction is not permitted as per municipal laws in force is not an asset with in the meaning of "asset" as defined u/s 2(ea) and as such excluded from taxability.

(2) Motor car held as stock in trade or used on hire is not taxable. It is taxable only if it is used for business purposes or personal purposes.

(3) Jewellery is always taxable unless the same is held as stock in trade.

(4) Cash on hand in excess of Rs.50000 as on the valuation date is taxable in the case of an individual or HUF. In other cases it is not taxable to the extent reflected in the books of account. In this case, since cash balance of Rs.1,75,000 is as per books of X Ltd., it is not taxable.

(5) Bank balance is not an asset within the meaning of "asset" as defined in section 2(ea).

(6) Guest house situated 30 kms away from the local limits of the municipality is an asset and is therefore taxable. Only in the case of farm house situated beyond 25 kms from the local limits of any municipality, the taxability would not arise.

(7) Residential flat which is allotted by a company to an employee or an officer or a director who is in whole time employment, having gross annual salary of Rs.5 lacs or more is an asset within the meaning of "asset" as defined in section 2(ea) of the Act. Accordingly, the residential flat occupied by the managing director is taxable since his annual remuneration is Rs.24 lacs.

(8) Any residential property which is let out for a minimum period of 300 days in the previous year is not an asset. In the given case, the residential house is taxable since it has been let out for only 200 days (i.e. less than 300 days during the previous year).

(9) Debts incurred in relation to assets chargeable to wealth tax shall be allowed as deduction in the computation of net wealth. Accordingly loan obtained for purchase of jewellery shall be allowed as deduction since jewellery is assessable to wealth tax.

Question 12

A company incorporated outside India is not liable to wealth tax in India. Discuss.

(2 marks) (May 2004)

Answer

Under section 2(h) of the Wealth-tax Act, a company shall have the same meaning as assigned to it in clause (17) of section 2 of the Income-tax Act. As per section 2(17), a company means, *inter alia*, any body corporate incorporated by or under the laws of a country outside India. Therefore, such a company will be liable to wealth tax in respect of assets which are subject to wealth tax under section 2(ea) of the Wealth-tax Act.

Question 13

A Cooperative Society formed for the purpose of construction of residential flats for its members acquired a large area of urban land for Rs.3 crores. The society had a membership of 10 members, all having equal share. The Assessing Officer proposes to tax urban land in the hands of the society.

(i) What is meant by urban land?

(ii) Is the action of the Assessing Officer correct?

(iii) Can the members of the society be assessed on their share in the value of the urban land? (8 marks)(May 2004)

Answer

(i) Urban land is chargeable to wealth tax since it falls under the definition of asset in section 2(ea). Urban land means land situated –

(a) in any area comprised within the jurisdiction of a municipality (whether known as a municipality, municipal corporation, notified area committee, town area committee, town committee or by any other name) or a cantonment board and which has a population of not less than ten thousand, according to the last preceding census for which the relevant figures have been published before the valuation date; or

(b) in any area within eight kilometers from the local limits of any municipality or cantonment board as the Central Government may specify by notification in the Official Gazette, having regard to the extent of and scope for urbanization of that area.

It does not include land on which construction of a building is not permissible under any law for the time being in force in the area in which such land is situated or any land occupied by any building which has been constructed with the approval of the appropriate authority, or any unused land held by the assessee for industrial purposes for a period of 2 years from the date of its acquisition or any land held by the assessee as stock-in-trade for a period of 10 years from the date of its acquisition by him.

(ii) No wealth tax can be levied on a cooperative society as section 45 specifically excludes cooperative societies from the purview of wealth tax. Therefore, the action of the Assessing Officer proposing to tax urban land in the hands of the society is incorrect.

(iii) Under section 4(1)(b), in computing the wealth of an assessee who is a member of an association, there shall be included as belonging to that assessee, the value of his interest in the assets of the association as determined in the manner laid down in Schedule III. But an exception has been made in the case of a member of a cooperative housing society. Therefore a member of a cooperative housing society cannot be charged on the value of his interest in the urban land.

Further, the deeming provision under section 4(7) is applicable only in respect of "building or part thereof" allotted to members and not in respect of open plot of land belonging to a Co-operative society.

Question 14

(a) State with reasons whether the following constitute assets chargeable under Wealth Tax Act as the wealth of Raja, a former ruler? (Assume that there is taxable wealth as on valuation date 31-03-03):

(i) Jewellery transferred to a minor handicapped daughter on 31-12-02.

(2 marks) (Nov.2003)

(ii) 50% of the Palace (occupied by him and declared by Government as his official residence) was rented out throughout the previous year ending 31-03-03.

(2 marks) (Nov.2003)

(b) State the circumstances in which the Wealth Tax Officer can refer valuation of an asset to the Valuation Officer. (2 marks) (Nov.2003)

(c) Return of net wealth declaring wealth of Rs.55.50 lakhs for Assessment year 2000-01 was filed by Ravi on 30-09-01. The Assessing Officer issued notice under section 16(2), which was served upon the assessee on 28-02-02. The assessment was completed by the Assessing Officer on 13-03-03 on the wealth of Rs.85 lakhs. Ravi wants to know:

(i) Whether the order passed by the Assessing Officer is a valid order under the Act?

(ii) Will his case be fit for levy of penalty, if assessed wealth is not disputed?

(4 marks) (Nov.2003)

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

(a) (i) As per section 4(1)(a)(ii) of the Wealth Tax Act, 1957 the clubbing provisions are not applicable in the case of a minor child who is suffering from any disability of the nature specified in section 80U of the Income-tax Act, 1961.

In view of the aforesaid provisions, in case the minor child is suffering from a disability referred to in section 80U, the income and wealth of such a child shall not be clubbed in the hands of the parents. However, if the disability is not of the nature specified in section 80U, clubbing provisions will apply.

(ii) The palace of the former ruler, which was declared by the Government as his official residence is not an asset chargeable to Wealth Tax under section 5(iii). However, the building/buildings (comprised in the palace) which were rented out by the former ruler shall constitute an asset chargeable to Wealth Tax. The Supreme Court in the case of *Mohd. Ali Khan v. CWT [1997] 224 ITR 672* held that where a palace consisting of a number of buildings was declared to be the official residence of the ruler, and some of the buildings were occupied by the ruler and the others were let out to tenants, the exemption will be available only in respect of buildings occupied by the ruler.

(b) Section 16A provides that the Assessing Officer may refer valuation of any asset under the following circumstances:

(i) In a case where the value of the asset as returned is in accordance with the estimate by a registered valuer, if the Assessing Officer is of the opinion that the value so returned is less than the fair market value (FMV).

(ii) In any other case, if the Assessing Officer is of the opinion:

- that the fair market value of the asset exceeds by $33^1/_3$% or Rs.50,000/- over the value of such asset as adopted by the assessee; or
- that having regard to the nature of the asset and the other relevant circumstances, it is necessary to make a reference.

(c) (i) Let us assume that the facts relate to assessment year 2009-10 and the return was filed on 30.09.2009 and the notice under section 16(2) was served on 28.02.2010 and the assessment was completed on 13.03.2011.

From the assessment year 2004-05 onwards, the time limit for completion of assessment under section 17A of the Wealth Tax Act is 21 months from the end of the assessment year in which the net wealth was first assessable. Notice under section 16(2) has to be served within 12 months from the end of the month in which the return is furnished.

In this case, the notice under section 16(2) was served within 12 months from the end of the month in which the return was furnished. Also, the order was passed within 21 months from the end of the assessment year. Therefore, the order passed by the Assessing Officer is a valid order under the Act.

(ii) Explanation 4 to section 18 of the Wealth-tax Act, 1957, specifies that where the value of an asset returned by any person is less than 70% of the value of such asset as determined in an assessment under section 16 or section 17, then such person shall be deemed to have furnished inaccurate particulars of such asset and shall be liable for levy of penalty under section 18(1)(c). In the present case, the wealth assessed by the Assessing Officer is Rs.85 lakhs against the returned wealth of Rs.55.50 lakhs. The returned wealth is only 65.3% of assessed wealth. Since the returned wealth is less than 70% of the wealth assessed and determined by the Assessing Officer, therefore, the assessee is liable for levy of penalty under section 18(1)(c) of the Wealth Tax Act, unless he proves that the value of the asset as returned by him is the correct value.

Question 15

(i) Mr. Raj executed a 'will' during his life time. His uncle Mr. Amitabh was appointed as executor, under the 'will'. Mr. Raj died on 13.6.2002. The executor could complete the distribution of assets after the valuation date 31.3.2003. The wealth tax records of Raj

reveal that (a) the return of wealth for the valuation date 31.3.2002 has not been filed; (b) wealth tax demands for the assessment years 1999-2000 and 2000-2001 are payable. On these facts, Mr. Amitabh approached you to advise him on his obligations under Wealth Tax Act. *(5 marks) (May 2003)*

(ii) In respect of defaults committed under Wealth Tax Act, penalty proceedings are initiated against the deceased prior to his death. Can the wealth tax officer continue the proceedings and levy penalty on the legal representative? *(3 marks) (May 2003)*

(iii) *X enters into an agreement on 13.3.2003 to sell the house property for Rs.50 lakhs purchased by him for Rs.20 lakhs and received an advance of Rs.10 lakhs. Further, an amount of Rs.15 lakhs was received by him on 22.3.2003 but the sale deed could only be executed on 21.4.2003. Does the house constitute his asset on the valuation date 31.3.2003.* *(2 marks)(May 2003)*

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

(i) Let us assume that date of demise of Mr.Raj as 13.01.2010. The pending wealth tax demand relate to assessment years 2006-07 and 2007-08.

Mr. Amitabh was appointed as an executor of the 'will' by deceased Mr. Raj. As per the provisions of section 19 of the Wealth Tax Act, the tax liability of the deceased is payable by the legal representative in the following situations.

(i) Where the assessment had been completed on the deceased but tax is still payable [section 19(1)];

(ii) Where the deceased has not furnished a return or the return furnished by him is incorrect or incomplete [section 19(2)].

Therefore, Mr. Amitabh is responsible for filing of the pending wealth tax return of the deceased for the assessment year 2010-11 and making payment of the wealth-tax demands for A.Y. 2006-07 & 2007-08 out of the estate of the deceased.

Further, as per section 19A, the executor of a 'will' is responsible for the assessment in respect of the estate of the deceased for the period from the date of death of the deceased till the completion of the distribution of assets amongst the legatees. The executor holds the status as of the deceased during the period of distribution of assets amongst the beneficiaries in the 'will' and accordingly a separate assessment will be made under section 19A in the hands of the executor in respect of the net wealth of the deceased.

(ii) Section 19 of the Wealth-tax Act determines the liability of legal representative for the defaults committed by the deceased assessee. According to section 19(3), the provisions of section 14, 15 and 17 shall apply to legal representative as they apply to any person referred to in those sections, whereas section 18 dealing with penalty does not form part of section 19(3). In view of the legal position, penalty under section 18 of

Wealth Tax Act can neither be levied nor penalty proceedings already initiated be continued on the legal representative for the defaults committed by deceased against whom penalty proceedings have been initiated prior to his death.

(iii) Since the sale deed was executed only in April of the next financial year and the house property was transferred by 'X' only after the valuation date i.e. after 31st March, the assessee has to include the asset i.e. house property in his net wealth for wealth tax purpose.

Question 16

Explain the procedure for adoption of the value of Jewellery for the valuation date as at 31st March, 2002 and subsequent 3 years assuming the value of Jewellery has been determined by Valuation Officer as at 31st March, 2001. (2 Marks) (Nov.2002)

Answer

Rules 18 & 19 of Part G of Schedule III to the Wealth Tax Act provide that when the value of jewellery has been determined by Valuation Officer, such value shall be taken to be value of such jewellery for the subsequent 4 assessment years subject to the following two adjustments:

(a) Where the jewellery includes gold or silver or any alloy of these, then the value of such metal as on the valuation date relevant to that assessment year shall be substituted for the value as on the valuation date on which the Valuation Officer determined the value.

(b) Where jewellery is sold or otherwise disposed off or jewellery is acquired, the value of jewellery determined shall be reduced or increased to the extent of such deletions or additions to the jewellery.

Question 17

Mr. Kamat, a not ordinarily resident in India, seeks your advice with regard to the furnishing of his wealth-tax return. The value of assets held on 31.3.2002 is indicated below. You are requested to compute the taxable wealth of Mr. Kamat giving justification for the inclusion or exclusion of each item. The valuation date as indicated above is 31st March, 2002:

		Rs.
(i)	*Motor cars of foreign make held as Fixed Assets*	*9,50,000*
(ii)	*Gold bonds under Gold Deposit Scheme, 1999*	*15,00,000*
(iii)	*Residential house property at Pune let out with*	
	effect from 05th June, 2001	*11,00,000*
(iv)	*Jewellery held*	*9,00,000*
(v)	*Lands purchased for industrial purpose:*	
	on 1st January, 1998	*5,50,000*
	on 25th March, 2001	*7,50,000*
(vi)	*Loan against the purchase of lands:*	
	on 01st January, 1998	*2,75,000*

	on 25th March, 2001	*3,50,000*
(vii)	*Wealth-tax liability*	*9,000*
(viii)	*Cash in hand*	*75,000*
(ix)	*Cash at Bank*	*1,25,000*
(x)	*Fixed Assets located in USA*	*50,00,000*
(xi)	*Value of Assets held by Mrs. Kamat acquired out of the gifts received from her husband:*	
	Shares and Securities	*2,00,000*
	Residential House Property at Mumbai	*9,00,000*

(8 marks) (Nov.2002)

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

Computation of taxable wealth of Mr. Kamat on valuation date 31.3.2010

			Rs.
(a)	Motor cars of foreign make held as fixed assets [included as asset under section 2(ea)(ii)]		9,50,000
(b)	Gold Bonds under Gold Deposit Scheme, 1999 [Not an asset w.e.f. 2000-01 under section 2(ea)(iii)]		Nil
(c)	Residential House Property let out for 300 days: [not an asset under section 2(ea)]		Nil
(d)	Jewellery Held: [Asset under section 2(ea)(iii)]		9,00,000
(e)	(i)	Land purchased on 01.01.2008 (assumed) [included as asset under section 2(ea)(v) as 2 years have lapsed from the date of acquisition]	5,50,000
	(ii)	Land purchased – II (assumed as held for less than 2 years - exempt under section 2(ea)(v)]	Nil
(f)	Cash on hand in excess of Rs.50,000 taxable [Section 2(ea)(vi)]		25,000
(g)	Cash at bank [exempt under section 2(ea)(vi)]		Nil
(h)	Fixed assets located in USA (Not included as assets in the case of Not Ordinarily Resident in India)(Section 6)		Nil
(i)	Deemed assets includible under section 4(1)(a) Shares and Securities: [Not an asset under section 2(ea)]		Nil

	Residential House Property at Mumbai [Exempt under section 5(vi)]	Nil
Total		24,25,000
Less:(a)	Wealth Tax liability (Not a deductible debt)	Nil
(b)	Loan taken against purchase of land	
	Outstanding balance, being debt in relation to taxable wealth under the Wealth Tax Act	2,75,000
(c)	Loan against the purchase of land-II.	
	Since the asset is exempted from tax the debt is not deductible	Nil
	Net Wealth	21,50,000

Question 18

ABC Ltd is a company engaged in the construction and sale of buildings. It has the following assets as on 31.3.2002. You are required to compute the Net Wealth of the company, in respect of Assessment year 2002-03:

		Rs.in lacs
(i)	*Flats – residential ready for sale*	*200*
(ii)	*Commercial properties ready for sale*	*500*
(iii)	*Guest House situated 30 kms away from Delhi*	*25*
(iv)	*2 Residential Houses occupied by:*	
	(a) An officer having an annual salary of Rs.4 lakhs	*10*
	(b) An officer having an annual salary of Rs.5 lakhs	*15*
(iv)	*Cars used for company's business*	*20*
(vi)	*Aircraft used by the officers for business purposes*	*400*
(vii)	*Urban land held from 31.3.1990, on which no building could be built due to dispute of title*	*50*
(viii)	*Cash in hand*	*5*

(10 marks)(May 2002)

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

Net Wealth of ABC Ltd as on Valuation Date 31.3.2010

		Rs. in Lakh
(i)	Residential flats for sale – stock in trade – exempt u/s 2(a)(i)(2)	NIL
(ii)	Commercial properties being stock-in-trade – exempt u/s.2(ea)(i)(2)	NIL
(iii)	Guest House situated beyond 25 km from the municipal limits of Delhi – asset u/s 2 (ea)(i)	25
(iv)	Residential house allotted to employee with annual salary of Rs.4 lakhs – exempt U/s.2(ea)(i)(1)	NIL
(v)	Residential house allotted to employee with annual salary of Rs.5 lakhs – asset u/s.2(ea)(i)	15
(vi)	Cars (other than those used for running on hire or stock-in-trade) – asset u/s.2(ea)(ii)	20
(vii)	Aircraft used other than for commercial purposes – asset u/s.2(ea)(iv)	400
(viii)	Urban land held as stock-in-trade for over 10 years – asset u/s.2(ea)(v) [See Note)	50
(ix)	Cash on hand (assumed that is recorded in the books of account)	Nil
	Net Wealth	510

Note: The question clearly states that no construction could be carried out due to dispute of title. The exemption under the Explanation 1(b) to clause (ea) of section 2 is available only if the construction is prohibited in that place by law. This is not the case here. Hence the value of urban land will have to be included in the net wealth.

Question 19

(a) Under the Wealth Tax Act, what is the scope of taxation of an individual who is not residing in India? (1 Mark)(May 2002)

(b) How is the assessment made on such a person and what are the provisions for recovery of tax from him?. (4 Marks)(May 2002)

Answer

(a) In computing the net wealth of an individual who is not residing in India, the value of assets and debts located outside India shall not be taken into account. Value of assets and debts located within India will be considered for the purpose of net wealth computation. Assets for the purpose of wealth tax would mean assets defined in section 2 (ea) of the Wealth- tax Act, 1957.

(b) Under section 22 where a person liable to wealth tax is residing outside India, the tax may be levied upon and recovered from his agent, who will be deemed to be an assessee in respect of such tax.

A person employed by or on behalf of the non-resident or through whom such person is in receipt of income, profits or gains or who is in possession or has custody of any asset of such person (non-resident) and upon whom the Assessing Officer has caused a notice to be served of his intention of treating such a person as an agent shall be deemed to be the agent of such person. No person shall be deemed to be the agent of a non-resident unless he or she is given an opportunity of being heard by the Assessing officer as to his being treated as such. An agent who pays any sum under the Act shall be entitled to recover the sum so paid from the person on whose behalf it is paid or to retain out of any moneys that may be in his possession or may come to him in his capacity as agent an amount equal to the sum so paid. Notwithstanding anything contained in section 22, any arrears of tax due from a person residing outside India may be recovered from any assets of such person which are or may at any time come to India.

Question 20

(a) How is the value of the interest of a person in a firm of which he is a partner determined under the Wealth Tax Act? (3 Marks) (Nov.2001)

(b) The concept of a partial partition is alien to the W.T.Act. Discuss. (3 Marks) (Nov.2001)

Answer

(a) Under clause (b) of section 4, the value of the interest of a partner in a firm is to be determined in the manner laid down in schedule III. Under Schedule III part E, Rule 16 lays down the method of such determination. The net wealth of the firm shall first be determined as if it were the assessee. Thereafter, that portion of wealth of the firm as is equal to the amount of its capital shall be allocated among the partners in the proportion in which capital has been contributed by them. The residue of the net wealth of the firm shall be allocated among the partners in accordance with the agreement of partnership for distribution of assts in the event of dissolution and in the absence of such an agreement, in the proportion in which the partners are entitled to share the profits. The sum total so allocated to a partner shall be taken as the value of his interest. No account shall be taken of the exemption under section 5(1) in determining the net wealth of the firm.

(b) Under section 20 of the Wealth-tax Act, a partition of a HUF takes place only when the joint family property has been partitioned as a whole among the various members or groups of members in definite portions. Whereas under section 171 of the Income-tax Act a partial partition has been given legal recognition, such a concept is ruled out under the Wealth Tax Act by the usage of the term "as a whole" and in definite portions. There should be a severance in the status of jointness. Otherwise the provisions of section 20 are not attracted. Further, section 20A clearly lays down that where a partial partition has taken place after 31.12.1978, such family shall continue to be liable to be assessed as if no such partial partition has taken place. The effect of a partial partition will be that those assets divided or allowed to a member or some of them will continue to be treated as HUF property and assessed as such.

Question 21

(a) *Amar Co-operative Housing Society Ltd owns a building in Mumbai, which stands on freehold land. There is no unbuilt area. It has 10 members, each of whom has contributed Rs.10 lacs towards the shares in the Co-operative society. The building was completed and occupied exclusively for residential purposes by its members before 31.3.2001. It was financed partly by the shares contributed by members and partly by bank finance. The annual value fixed by the municipality for the building is Rs.20 lakhs, the taxes amount to Rs.1 lakh.*

'X' is a member of the society owning one of the flats. The cost of the flat to 'X' has been fixed by the society at Rs.20 lakhs and the amount outstanding by way of instalment loan payable to the society by 'X' is Rs.2 lakhs. You are required to determine the net wealth of 'X' as on 31.03.2001. *(6 Marks)(Nov.2001)*

(b) *Mr.Jogi is aged 45 years. His father settled a property in trust giving whole life interest therein to Jogi. The income from the property for the years 1997-98 to 2000-01 was Rs.60,000, Rs.64,000, Rs.70,000 and Rs.76,000 respectively. The expenses incurred each year were Rs.2,000, Rs.4,000, Rs.5,000 and Rs.6,000 respectively. Calculate the value of life interest of Mr.Jogi in the property to settled on the valuation dated 31.3.2001, with the help of the factor 9.267.* *(3 Marks) (Nov.2001)*

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

(a) **Valuation of building as per Rule 3 of Schedule III**

Gross maintainable rent		20,00,000
Deduct municipal tax	1,00,000	
Deduction @ 15%	3,00,000	4,00,000
		16,00,000
Net Maintainable Rent X 12.5 = 2 crores		
X's share in the property (1/10)	20,00,000	
Less : Outstanding instalment	2,00,000	
	18,00,000	

Under clause (vi) of section 5, the assessee can claim exemption of the net wealth of Rs.18 lakhs relating to residential flat.

Notes –

1. A Co-operative society is not an assessee under the Wealth Tax Act.

2. Under sub-section (7) of section 4, where an assessee is a member of a co-operative society and a building or part thereof is allotted to him, he is deemed to be the owner of the building or part thereof and the value thereof shall be included in computing the net wealth of such assessee. The value of any outstanding instalment towards the cost of the building is also deemed to be a debt owed by him in relation to such building.

   Under the second proviso to Rule 3, if the value arrived at on the basis of Schedule III is less than the cost of acquisition, the cost of acquisition shall be taken to be the value of the property. However, this proviso will not apply, if the house is exclusively used for residential purposes by the assessee himself throughout the period of 12 months preceding the valuation date and the cost of construction does not exceed Rs.50 lakhs in Mumbai. The period of 12 months would mean the period right from inception if it is less than 12months.

(b) The valuation of life interest of Mr.Jogi in the property settled by his father is governed by Rule 17 of Schedule III. The average annual income of the last three yeas is to be considered for the purpose of valuation. The expenses of the last three years are also to be taken on an average by restricting it to 5 per cent of the average annual income.

Computation of interest:

Average annual income of last 3 years (64,000 +70,000+76,000)	70,000
Less: Average of annual expenses restricted to 5% of the average annual income i.e. 1/3 x (4,000 + 5,000 + 6,000) = Rs.5,000 but restricted to 5% of Rs.70000	3,500
Net average annual income	66,500

Value of life interest = Rs.66,500 x 9.267 = Rs.6,16,255

Question 22

'X' is the legal heir of 'C'. 'C.' had delayed filing of the returns of wealth for the assessment year 1996-97 to 1998-99. Penalty proceedings under section 18(1)(a) were initiated by the assessing officer against 'C' when he was alive and were continued against 'X'. Penalty were levied against 'X' who contends that no penalty for delay in the filing of return of wealth could be levied. In the contention correct?. Discuss. *(5 Marks) (May 2001)*

Answer

The question is based on the judgment of the Delhi High Court in *CWT v. H.S.Chauhan 245 ITR 704*. In this case, the delay in filing the returns of wealth was attributable to "C" during his lifetime. The question is whether a legal representative can be penalized for default committed by the person of which he is the representative. Section 19(3) of the Wealth Tax Act provides only for the application of sections 14,15 and 17 to the representative, as they would have applied to the deceased. Section 18, which deals with penalties, is not applicable to legal representative. Therefore, "X" cannot be subjected to penalty.

Question 23

Bhaskar, a person of Indian origin was working in Kenya from 1987. He returned to India for permanent settlement in May, 1999, when he remitted money into India. For the valuation date 31st March 2001, the following particulars were furnished. You are required to compute the taxable wealth. The reason for inclusion or exclusion should be stated.

(i)	*Building owned and let out for 270 days for residence* *Net maintainable rent (40,000) and the market value Rs.10,00,000* *(Excess of unbuilt area over specified area is 20% of the aggregate area)*	
(ii)	*Jewellery:*	
	(a) Purchased in April '99 out of money remitted to India from Kenya	*5,00,000*
	(b) Purchased in April, 2000 out of sale proceeds of motor car brought from abroad and sold	*4,00,000*
(iii)	*Value of interest in urban land held by a firm in which he is a partner*	*7,00,000*
(iv)	*Bonds held in companies*	*5,00,000*
(v)	*Motor car used for own business*	*2,50,000*
(vi)	*Vacant house plot of 400 sq.mts (purchased in December 1995) market value*	*9,00,000*
(vii)	*Cash in hand*	*80,000*
(viii)	*Urban land purchased in the year 1999 out of withdrawals from NRE account*	*10,00,0000*

(10 Marks) (May 2001)

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10. Let us assume that Bhaskar returned to India in May 2005 and hence he is eligible for the benefits of section 5(v) for 7 assessment years next following the date of return. For the assessment year 2010-11 he is eligible for the benefits of section 5(v). The solution is prepared accordingly.

Answer

Section 5(v) gives special concession to persons of Indian origin or citizen of India, who ordinarily reside in a foreign country upon their return to India with the intention of permanently residing in India. The value of assets acquired one year before the date of return to India out of moneys remitted from foreign country is exempt from wealth tax. Similarly, assets brought in to India upon their return are exempt from wealth tax. However, this exemption is only for a period of 7 successive assessment years commencing with the assessment year next following the date on which such person returned to India.

Computation of Net Wealth of Bhaskar as on valuation date 31.03.2010

		Amount Rs.
1.	Building let out for 270 days during the year less than 300 days and hence includible in net wealth	
	Market value is irrelevant unless Rule 8 is invoked	
	Net maintainable rent Rs.40,000	
	12.5 times thereof (vide rule 3 schedule III)	5,00,000
	Adjustment for unbuilt area under Rule 6(c) – 40 per cent thereof	2,00,000
	Total	7,00,000
2.	Vacant plot 400 sq.mtrs market value [Exempt u/s 5(vi)]	Nil
3.	Urban land held by firm – value of interest therein	7,00,000
4.	Urban land purchased out of withdrawals of NRE account (Under explanation 2 to clause (v) section 5, moneys standing to the credit in NRE account shall be deemed to be moneys brought to India)	Nil
5.	Jewellery purchased in July 2004 out of moneys remitted to India from Kenya [Exempt under section 5(v)]	Nil
6.	Jewellery purchased in April 2000 out of sale proceeds of motor car [Exempt under section 5(v) in view of CWT vs. K.O. Mathews (2003) 261 ITR 702]	Nil
7.	Motor car used for own business	2,50,000
8.	Cash on hand Rs.80,000 – exempt Rs.50,000	30,000
	Total	16,80,000

Notes :

1. Bonds held in companies do not come within the definition of the term 'asset'.
2. Motor car is exempt only if it is held as stock in trade or used in the business of running them on hire.

Question 24

(i) What are the conditions to be satisfied before the Assessing Officer is statutorily required to refer the valuation to the Valuation Officer under section 16A of the Wealth Tax Act?

(3 Marks (Nov.2000)

(ii) The assessee was a Trust, whose objects were wide-ranging including imparting education, running free library, to raise the status of humanity and also advancement of general public utility. The trust was also conducting chits and collection of deposits from the public, but it was not its predominant or primary object. Is the trust exempt from Wealth-tax? (2 Marks) (Nov.2000)

(iii) Mrs. W, wife of a coparcener, unilaterally executed a release deed stating that she relinquished her status as a member of HUF, but still maintaining her marital status. It

was claimed by the HUF, that in view of this unilateral declaration by Mrs.W, her wealth should not be included in the wealth of the HUF. Discuss the validity of the claim.

(2 Marks) (Nov.2000)

Answer

(i) Section 16A of the Wealth Tax Act says when the Assessing Officer may make a reference to the Valuation Officer for valuation of any asset. They are

(a) If the Wealth-tax Officer is of the opinion that the value of the assets as valued by the registered valuer is less than the fair market value of the asset.

(b) If the fair market value of the asset exceeds the value of the asset as returned by the assessee by more than such percentage of the value of the asset or by more than such amount as may be prescribed in this behalf. (Rule 3B the percentage as 33 1/3% and the amount by Rs.50,000 respectively) and

(c) Having regard to the nature of the asset and other relevant circumstances of the case, it is necessary to do so.

(ii) Under section 5 clause (i), wealth tax is not payable by an assessee in respect of property held by him under trust or other legal obligation for any public purpose of a charitable or religious nature. Unlike section 11 of the Income-tax Act, the word “wholly” is not to be found in section 5 clause (i). Thus, for claiming exemption it is not necessary that all the objects should fall within the expression “public purpose of a charitable nature”. It is sufficient if the trust can be said to be primarily or dominantly for a public purpose of a charitable nature. [*Trustees of K.B.H.M.Bhiwandiwala Trust v. C.W.T.(1977) 106 ITR 709 (Bom)*].

(iii) The claim is totally untenable. The High Court in *CIT v. M.A.R.Rajkumar (1997) 226 ITR 804 (AP)* held that the wife of the karta cannot relinquish her status as a member of HUF by a unilateral declaration while retaining her marital tie.

Question 25

Y Ltd is engaged in the construction of residential flats. For the valuation date 31.3.2000, furnishes the following data and requests you to compute the taxable wealth:

		Rs. (in lakhs)
(a)	*Land in urban area (construction is not pemitted as per Municipal Laws in Force)*	*20*
(b)	*Motor-cars (in the use of company)*	*5*
(c)	*Jewellery (investment)*	*10*
(d)	*Cash balance (as per books)*	*2*
(e)	*Bank Balance (as per books)*	*3*
(f)	*Guest house (situated in rural area)*	*4*

(g)	*Residential flat occupied by Managing Director (annual remuneration of whom is Rs.6 lakhs excluding perquisites)*	*8*
(h)	*Residential house let out for 100 days in the financial year*	*7*
(i)	*Loans obtained:*	
	For purchase of motor-car	*2*
	For purchase of jewellery	*2*

The reasons for inclusion or exclusion should be stated in the computation.

(8 Marks) (Nov.2000)

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

Computation of net wealth as on valuation date 31.3.2010

		Rs.in lakh
(a)	Land in urban area (not taxable as the construction is not possible under the municipal tax laws, hence not an asset)	NIL
(b)	Guest house in rural area (This is an asset under section 2(ea)(i)	4
(c)	Residential flat occupied by Managing Director (This is falling outside the exceptions of section 2(ea)(i)(1), hence includible since the gross annual salary is exceeding Rs.5 lakhs)	8
(d)	Residential house let out for 100 days (this is includible as the asset is falling outside the exception 4) to section 2(ca)(i) of the Wealth Tax Act	7
(e)	Motor cars (used by the company). This asset is includible as per clause (ii) of section 2(ea) as it does not fall under the exceptions.	5
(f)	Jewellery	10
	This is includible as it is an asset under clause (iii) of section 2(ea) and is not stock in trade of the business. The assessee is engaged in construction of flats and the jewellery may be kept as an investment and not as stock in trade of business.	
(g)	Cash balance and bank balance as per books are not taxable and not includible as an asset as per clause (vi) of section 2(ea)	Nil
		34
	Less: Debts incurred in relation to assets	
	Both the loans obtained are in the case of assets that are includible as	

wealth as they are assets under section 2(ea) of the Act. They satisfy the conditions of deductibility of debts from the aggregate of assets.

On motor cars	2
On Jewellery	2
Net Wealth	**30**

Question 26

(a) *Mr.Vinod assessed to Wealth-tax furnished the following particulars as a valuation date 31st March 2000:*

(i) *His father Anand, who had both immovable and movable assets and assessed to wealth tax executed a will during his life-time appointing executors, related to Anand as uncles. Anand died on 30.09.1999.*

(ii) *The executors of the will pointed out that Late Anand did not file his returns of wealth for the valuation date 31.03.1998 and 31.03.1999.*

(iii) *The executors had completed partial distribution of Estate by 31st March 2000 and tax a consequence he was in receipt of immovable and movable assets valued at Rs.20 lakhs.*

On these facts, you are consulted as to (a) How Vinod should proceed for filing his return of wealth as at 31.3.2000 and (b) What is his liability in respect of his late father's Wealth-tax assessment, under the provisions of the Act.

(iv) *In the above facts, what would be position under the Wealth tax Act, if Anand has not executed any will?.* *(6 Marks) (May 2000)*

(b) *Discuss treatment for Wealth-tax as on valuation date 31.3.2000 on the following issues in the hands of Raghu:*

A private specific trust was created by 'Ramu' in the month of September, 1994 settling immovable assets from which rental income is derived. According to the trust, Ramu's only major son 'Raghu' is entitled to receive rental income upto 31st March 2000 and thereafter the income shall be received by Raghu's children. Ramu died in 1996. The capitalized value of the property as at 31.3.2000 is Rs.15 lakhs. The property is rented at an income of Rs.75,000 per year. In the financial year 1999-2000, there was unrealized rent of Rs.50,000 *(4 Marks) (May 2000)*

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10.

Answer

(a) Section 19A of the Wealth-tax Act provides for assessment of net wealth of a deceased person on the hands of his executors. This provision shall apply only in a case where the assessee had died after executing a will and appointed an executor. An assessment in the status of an executor concerned shall be made in the status of individual. For the purpose of assessment, the residential status of the executor shall be the same as that of the deceased on the valuation date immediately preceding his death. Separate assessments shall be made in respect of net wealth as on each valuation date which is included in the period from the date of death of the deceased to the date of complete distribution to the beneficiaries of the estate according to their several interests.

In computing the net wealth on any valuation date, any assets of the estate distributed or applied to the benefit of any specific legatee of the estate prior to the valuation date shall be excluded. Such excluded assets held by the legatee on the valuation date shall be included in the wealth of the legatee on the valuation date.

Section 19 of the Wealth-tax Act imposes a liability on the executor, administrator or the other legal representatives of the deceased person in respect of wealth tax as also any other sum such as penalty, interest etc., which the deceased person would have been liable to pay if he had not died. However, the liability is limited to the extent to which the estate of the deceased is capable of meeting it.

If a person dies without furnishing the return under section 14, the Assessing Officer may assess the net wealth of such person and determine the tax payable by him on the basis of such assessment. The Assessing Officer for the purpose require the executor, administrator of the deceased person to produce accounts, documents and other evidences which could have been required from the deceased person he had not died.

Considering the above provisions of the Wealth-tax Act, Mr.Vinod is advised as under:

(i) He should proceed filing his return of wealth including the wealth of Rs.20 lakhs that was distributed to him by the executors before the valuation date subject to the other exemptions etc.,

(ii) On the balance of estate of the deceased, the executors shall be assessed to wealth tax and he has no responsibility as legal representative.

(iii) In respect of the valuation dates preceding the demise of his father late Anand, the executors shall be responsible for filing the return of net wealth and Vinod has no liability or responsibility thereof.

(iv) If Anand died intestate, to the extent of share of wealth succeeded by him as per the Succession Act, will considered as his wealth on the valuation date.

(b) In computing the net wealth of an individual, there shall be included, as belonging to that individual the value of certain deemed assets which on the valuation date are held by the persons as specified. In the given facts of the case, the first issue that arises for consideration is whether capitalized value of the property settled on trust is taxable under section 4(1)(a)of the Wealth-tax Act by deeming those assets as held by Raghu.

As per the deed of trust, the income is receivable by Raghu's children within 6 years. Therefore, before the period of six years as contemplated in the provisions of the Act, the settlement in favour of Raghu stands revoked and hence the provisions of section 4(1)(a) shall not apply and accordingly, the capitalized value of Rs.15 lakhs cannot be taxed as wealth of Raghu. It is chargeable in the hands of trust only. There is unrealized income from trust property of Rs.50,000/- The question that arises is whether the same is chargeable as wealth of Raghu. It will not be chargeable as wealth as it is not an asset under section 2(ea) of the Wealth-tax Act.

Question 27

The net wealth of a firm consisting of three partners Balu, Kausik and Deepu having equal shares and a capital contribution of Rs.7,00,000/- Rs.3,00,000 and Rs.2,00,000/- respectively is as under:

		Rs.
(i)	*Value of assets located outside India*	*20,00,000*
(ii)	*Value of assets located in India*	*50,00,000*
(iii)	*Debts incurred in relation to assets in India*	*10,00,000*

Determine the value of interest of the partners in the firm under the Wealth-tax Act, 1957.

(5 Marks)(May 2000)

Answer

Net wealth of the firm

(Rs.20,00,000 + 50,00,000 - 10,00,000) = Rs.60,00,000

Interest of the partners in the above firm shall be :

	A	*B*	*C*
Upto Rs.12,00,000 – distributed in capital ratio	7,00,000	3,00,000	2,00,000
Balance Rs.48,00,000 in profit sharing ratio	16,00,000	16,00,000	16,00,000
	23,00,000	19,00,000	18,00,000

Out of the above, the value of assets located in India shall be computed as under:

Ratio in which the firm holds the assets in India

$$\left(\frac{(50,00,000 - 10,00,000)}{60,00,000}\right) = \frac{2}{3}$$

Assets located in India (2/3)	15,33,333	12,66,667	12,00,000
Assets located outside India (1/3)	7,66,667	6,33,333	6,00,000