

PAPER – 7 : DIRECT TAX LAWS

Answer **all** questions.

Question 1

Aditya, Avirup and Avigyan carried on business of running hotels in partnership from 1st April, 2000 to 31st March, 2007. In order to increase its scale of operation and meet its fund requirement, the firm decided to carry on its business through corporate route. For that purpose, a company under the name and style "Triple A Hospitality Private Limited" was formed on 1st April, 2008 and the business of the partnership firm as a whole was succeeded to by the company with effect from 1st June, 2008.

The company's profit and loss account for the year ended 31st March, 2010 shows a net profit of Rs.450 lacs after debit/credit of the following items:

- (a) Interest of Rs. 3 lacs paid to Allahabad Bank on a term loan taken for the purpose of acquiring a land at Bhubaneswar for a new hotel to be set up.
- (b) Depreciation charged Rs. 40 lacs.
- (c) Rs. 2 lacs credited on account of waiver of dues obtained from a supplier of the erstwhile firm against supply of certain materials.
- (d) Rs. 1.18 lacs being the aggregate of amounts paid in cash to Rajaram, a transport contractor as follows:

Date of Payment	Rs. In lacs
5 th June, 2009	0.15
20 th July, 2009	0.21
20 th September, 2009	0.22
3 rd November, 2009	0.26
5 th November, 2009	0.36

Tax was not deducted at source as Rajaram submitted a certificate under section 197(1) which he had obtained from the TDS circle of the Income-tax Department.

- (e) Rs. 0.50 lac, being proportionate part of the cost of animals (purchased and kept for entertainment of the guests of hotel) amortised as per the accounting policy of the company.
- (f) Rs. 0.10 lacs credited on account of sale proceeds of carcass of animal which died during the year.
- (g) Provision for bad and doubtful debts Rs.12 lacs.

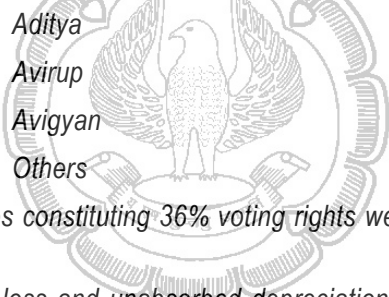
The Suggested Answers for Paper 7: - Direct Tax Laws are based on the provisions applicable for A.Y. 2010-11, which is the assessment year relevant for May, 2010 examination.

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- (h) Payment of Rs. 25 lacs to some employees as compensation for voluntary retirement, as per scheme
- (i) Foreign exchange fluctuation loss (net) amounting to Rs. 30 lacs arising from restatement of the year-end liabilities to foreign suppliers of provisions and beverages as per the requirement of Accounting Standard 11 of the Institute of Chartered Accountants of India.

Other Information:

- (i) Depreciation as per the Income-tax Act, 1961 Rs. 65 lacs.
- (ii) Cost of animal died as referred to in (f) above was Rs. 2 lacs.
- (iii) Debt of Rs.4 lacs due from one corporate customer for three months has been written off during the year after giving few reminders by debiting provision for bad and doubtful debts account.
- (iv) The erstwhile firm was allowed exemption of Rs.50 lacs under section 47(xiii) in respect of long-term capital assets transferred to the company.
- (v) The company's voting rights till 31st March, 2009 were held as follows:



Aditya	40%
Avirup	30%
Avigyan	15%
Others	15%

During the year, shares constituting 36% voting rights were sold by Aditya to his son-in-law, Avishek.

- (vi) Unabsorbed business loss and unabsorbed depreciation of Rs.10 lacs each have been carried forward from Assessment Year 2008-09.
- (vii) The company has a subsidiary company, Tours & Travels Private Limited (a closely held company). During the year, the company obtained a temporary loan of Rs. 12 lacs from its subsidiary company. Accumulated profit of the subsidiary company was Rs. 30 lacs at the time of payment of the loan. The loan was repaid by the company before the end of the year.

Compute total income of Triple A Hospitality Private Limited for the Assessment Year 2010-11 indicating reason for treatment of each of the items. Ignore the provisions relating to minimum alternate tax. (20 Marks)

Answer

Computation of Total Income of Triple A Hospitality (P) Ltd. for the A.Y.2010-11

Particulars	Amount in Rs.
A. Profits and Gains from Business and Profession	
Net Profit as per Profit & Loss Account	4,50,00,000

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Add: Items debited but to be considered separately or to be disallowed

Interest on loan taken for acquiring land (Note 1)	3,00,000	
Depreciation debited in accounts	40,00,000	
Disallowance for payment exceeding the limit prescribed in section 40A(3) (Note 3)	79,000	
Amortisation of cost of animals (Note 4)	50,000	
Provisions for bad and doubtful debts (Note 5)	12,00,000	
Compensation for voluntary retirement (Note 6)	20,00,000	76,29,000
		5,26,29,000

Less : Items credited but to be considered separately or to be allowed

Sale proceeds of carcass of animal treated separately (Note 4)	10,000	
Depreciation allowable under the Income-tax Act, 1961	65,00,000	
Deduction under section 36(1)(vi) in respect of dead animal (Note 4)	1,90,000	
Bad debts written off under section 36(1)(vii) (Note 5)	4,00,000	71,00,000

Business Income 4,55,29,000

B. Capital Gains

Deemed long-term capital gain under section 47A(3) (Note 8) 50,00,000

C. Income from other sources

Deemed dividend under section 2(22)(e) (Note 9) 12,00,000

Gross Total Income 5,17,29,000

Deduction under Chapter VI-A Nil

Total Income **5,17,29,000**

Notes:

- (1) Interest on term loan taken from bank for acquiring land for new hotel to be set up is not allowable under section 36(1)(iii). As per the proviso to section 36(1)(iii), interest paid in respect of capital borrowed for acquisition of an asset for extension of existing business or profession (whether capitalized in the books of account or not) for the period from the date on which the borrowing was made till the date on which such asset is first put to use shall not be allowed as deduction. Setting up of a new hotel is an extension of the

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existing business of the assessee and as the land is yet to be put to use, deduction for interest is not allowable.

- (2) Under section 41(1), where any expenditure or loss or a trading liability was allowed as deduction to the predecessor-firm and the successor in business has obtained (in cash or in any other manner), any amount in respect of which loss or expenditure was incurred by the predecessor-firm or some benefit by way of remission or cessation of such trading liability, the amount obtained by the successor in business (the company, in this case) or the value of benefit accruing to the successor shall be deemed to be profits and gains of business or profession and would be chargeable to tax in the year in which the amount is so obtained or the benefit accrued. In view of this provision, the amount of waiver i.e. Rs.2,00,000 obtained from the supplier of the predecessor firm is deemed as business income of the assessee company. Since the amount is already credited to profit and loss account, no adjustment is necessary.
- (3) Section 40A(3) provides that where the assessee incurs any expenditure for which a payment or aggregate of payments made to a person in a single day, otherwise than by account payee cheque or account payee bank draft exceeds Rs.20,000, the whole of such expenditure shall be disallowed. The Finance (No.2) Act, 2009 has, with effect from 1st October, 2009, raised this limit to Rs.35,000 for payment to transporters engaged in the business of plying, hiring or leasing of goods carriages. Therefore, the amount to be disallowed is Rs.79,000 (i.e. Rs.21,000 paid on 20th July, 2009 + Rs.22,000 paid on 20th September, 2009 + Rs.36,000 paid on 5th November, 2009).

Note – It is also possible to take a view that though this amendment is effective from 1st October, 2009, since this is not an amendment in procedural law, it would apply for the whole of the P.Y.2009-10 (A.Y.2010-11) and all transactions during the year would be governed by the amended provision. In such a case, the amount of disallowance under section 40A(3) would be only Rs.36,000, being the amount paid on 5th November, 2009. Consequently, if this view is taken, the total income would be Rs.5,16,86,000.

- (4) Under section 36(1)(vi), deduction is allowable in computing business income in respect of animals which have been used for the purpose of business, otherwise than as stock-in-trade and have died or become permanently useless for such purpose. The amount to be allowed is the difference between the actual cost of the animals to the assessee and the amount realized in respect of the carcasses.

Therefore, Rs.50,000 debited to profit and loss account has to be added back and Rs.10,000 credited to profit and loss account has to be deducted. The difference between the cost of animal died (Rs.2 lakh) and the sale proceeds of carcasses (Rs.0.10 lakh) is allowable as deduction under section 36(1)(vi). Therefore, Rs.1,90,000, is allowable as deduction under section 36(1)(vi).

- (5) Provision for bad and doubtful debts is allowable as deduction under section 36(1)(viii) only in the case of specified banks and financial institutions. Therefore, a company engaged in hotel business is not eligible for deduction in respect of provision for bad and doubtful debts and accordingly, Rs.12 lakh, debited to profit and loss account has to be added back.

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A bad debt written off is allowed as deduction under section 36(1)(vii) if such debt is written off as irrecoverable in the books of account. Therefore, the amount of Rs.4 lacs written off during the year by debiting provision for bad and doubtful debts is allowable as deduction under section 36(1)(vii).

- (6) As per section 35DDA, where in any previous year, any expenditure is incurred by way of payment of any sum to an employee in connection with voluntary retirement, one-fifth of the amount so paid shall be deducted in computing profits and gains of business for that previous year, and the balance shall be deducted in four equal instalments in the immediately succeeding four previous years. Therefore, out of Rs.25,00,000, an amount of Rs.5,00,000 is deductible in assessment year 2010-11 and the balance shall be disallowed in this assessment year. Therefore, Rs.20 lakh has to be added back.
- (7) Where the assessee regularly follows accrual system of accounting and the assessee provides loss suffered on account of foreign exchange fluctuation according to accepted Accounting Standard and not with a view to reduce incidence of taxation, the same is allowable as deduction under section 37(1).

This was the decision of the Supreme Court in the case of *CIT v. Woodward Governor India Pvt. Limited (2009) 312 ITR 254 (SC)*. In this case, as the exchange loss has already been debited to profit & loss account, no adjustment is required.

- (8) It is stated that the erstwhile firm was allowed exemption under section 47(xiii) in respect of long-term capital gain from transfer of capital assets to the assessee company. One of the conditions as per the proviso to clause (xiii) of section 47 is that the aggregate of the shareholding in the company of the partners of the firm should be at least 50% of the total voting power in the company and their shareholding continues to be as such for 5 years from the date of succession.

According to section 47A(3), where any of the conditions laid down in the proviso to clause (xiii) of section 47 are not complied with, the capital gain which not charged to tax under section 45 shall be chargeable to tax in the hands of the successor company for the previous year in which the requirements of the proviso to clause (xiii) of section 47 are not complied with.

In the instant case, on sale of shares carrying 36% voting rights by Aditya to his son-in-law, the aggregate of shareholding of the partners in the company has become less than 50% of the total voting power in the company and such change has taken place before expiry of 5 years from the date of succession. Therefore, the long-term capital gain which was not charged to tax in the hands of the firm in the year of succession shall be deemed to be long term capital gain of the assessee company in the assessment year 2010-11.

- (9) Section 2(22)(e) provides that dividend includes any payment to the extent of accumulated profits by a company, in which the public are not substantially interested, of any sum by way of loan or advance to a shareholder who holds the beneficial ownership of equity shares carrying not less than 10% of the voting power.

In the instant case, the assessee company having more than 10% voting power in Tours & Travel Private Limited (a closely held company) received loan of Rs. 12 lacs from the

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latter which had an accumulated profit of Rs.30 lacs. Therefore, the amount of loan shall be deemed to be dividend in the hands of the assessee company. The fact that the loan was repaid before end of the previous year is not relevant.

The amount deemed to be dividend under section 2(22)(e) is not exempt under section 10(34).

- (10) Since the unabsorbed business loss and unabsorbed depreciation relate to P.Y.2007-08, which is prior to incorporation of the company on 1.4.2008, such loss and depreciation would relate to the predecessor firm, and consequently, the provisions of section 72A(6) would be attracted.

As per section 72A(6), accumulated loss and depreciation of the predecessor firm would become the loss and depreciation of the successor company of the previous year in which the conversion takes place (i.e., P.Y.2008-09, in this case), provided the conditions laid down in section 47(xiii) are fulfilled. In this case, the conditions are fulfilled in the P.Y.2008-09. It appears that the assessee-company did not have sufficient profits during the P.Y.2008-09, against which the brought forward loss and unabsorbed depreciation can be set-off and for this reason, the same has been carried forward to the P.Y.2009-10 (A.Y.2010-11).

However, in the P.Y.2009-10, one of the conditions as per the proviso to clause (xiii) of section 47 is not satisfied, namely, the condition requiring the aggregate of the shareholding in the company of the partners of the firm to be at least 50% of the voting power in the company and to continue to remain as such for 5 years from the date of succession. Therefore, since in the P.Y.2009-10, this condition is not satisfied on account of sale of shares by Aditya to Avishek, and consequent reduction in the holding from 85% to 49%, the business loss and unabsorbed depreciation cannot be set-off.

Question 2

- (a) Explain in brief, the treatment as to their taxability and/or allowability, under the provisions of Income-tax Act, 1961, for the assessment year 2010-2011, in the following cases:
- (i) 'A' Ltd., an investment company, received dividend income of Rs.1,00,000 on its investment in shares. It incurred interest expenditure of Rs.2,00,000 on the borrowed capital utilized in the investment of shares. (4 Marks)
 - (ii) 'B' Ltd. is a company engaged in the business of financing and investment in shares. It suffered loss of Rs.3,00,000 on account of futures and options, a transaction in the form of derivatives in which the underlying asset was shares. (3 Marks)
 - (iii) 'C' Ltd., which did not have any active business carried on by it incurred capital expenditure on scientific research amounting to Rs.5,00,000 that related to its subsidiary companies. (3 Marks)
- (b) State the situations under which the clubbing provisions of income-tax operate as to the incomes of husband and wife. (4 Marks)

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Answer

- (a) (i) The dividend income earned by 'A' Ltd. on the shares held as investment is exempt under the provisions of section 10(34), assuming that such dividend is received from an Indian company. As per section 14A, no expenditure is allowable in respect of income which does not form part of total income. The interest paid on borrowed capital is an expenditure incurred in respect of shares purchased for investment. Since the dividend income received on shares is exempt and does not form part of total income of 'A' Ltd., the interest expenditure is not allowable as deduction.
- (ii) A transaction in derivatives, in which underlying asset is shares, is exempt from the purview of the speculative transaction, in terms of clause (d) of the proviso to section 43(5). As per the said clause, an eligible transaction in respect of trading in derivatives carried out in a recognized stock exchange shall not be deemed to be a speculative transaction. Accordingly, in the given case, if the transaction falls within the meaning of "eligible transaction" as defined in the *Explanation* therein, then the loss would be treated as an ordinary business loss eligible for set-off loss as per normal set-off provisions. On the other hand, if the transaction does not fall within the meaning of "eligible transaction", the loss would be treated as a speculation loss and can be set-off only against speculative income.
- (iii) As per section 35(1)(iv), deduction in respect of capital expenditure on scientific research would be admissible under the provisions of section 35(2) only if the scientific research relates to the business carried on by the assessee.
- However, in the given case, 'C' Ltd., did not have any active business carried on by it to which the said scientific research related to. The capital expenditure incurred by 'C' Ltd. related to its subsidiary companies. Therefore, 'C' Ltd. is not eligible for deduction under the provisions of section 35(1)(iv) read with section 35(2).
- (b) As per section 64(1), in computing the total income of any individual, there shall be included all such income arising directly or indirectly to the spouse by way of –
- (1) salary, commission, fees or any other form of remuneration, whether in cash or in kind, from a concern in which such individual has substantial interest;
 - (2) income from any asset transferred to the spouse by the individual otherwise than for adequate consideration or in connection with an agreement to live apart.

As per section 27(i), an individual who transfers, otherwise than for adequate consideration, any house property, to his or her spouse, not being a transfer in connection with an agreement to live apart, is deemed to be the owner of the house property so transferred. Accordingly, in such a case, the income from house property would be taxable in the hands of the individual.

Question 3

- (a) *Indian Gas Limited commenced its operation of the business of laying and operating a cross country natural gas pipeline network for distribution on 1st July, 2008. The company incurred capital expenditure of Rs.300 lacs (including cost of land Rs.45 lacs and cost of*

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financial instrument Rs. 5 lacs) during the period from 1st April, 2007 to 30th June, 2008. The company did not claim deduction for such expenditure in the earlier assessment years. The entire expenditure was capitalised on 1st July, 2008. Further, during the previous year 2009-10, the company incurred capital expenditure of Rs. 200 lacs exclusively for the said business.

- (i) Compute the amount of deduction allowable under section 35AD assuming that the company has fulfilled all the conditions specified in section 35AD.
- (ii) If the company has loss from such business in the assessment year 2010-11, how the same is to be set off and carried forward? (6 Marks)
- (b) (i) An electoral trust approved by the Central Board of Direct Taxes is not liable to income-tax in respect of voluntary contribution received and other income - Discuss the correctness of the statement. (2 Marks)
- (ii) What is the effect of contribution made by an individual to electoral trust on his taxable income? (1 Mark)
- (c) Kala purchased a residential flat from her friend Bala at Rs. 10 lacs in the city of Jaipur on 3rd October, 2009. The value determined by the Stamp Duty Authority for stamp duty purpose amounted to Rs. 15 lacs. Bala had purchased the flat on 1st January, 2007 at a cost of Rs.3.50 lacs. Kala sold the flat for Rs.20 lacs on 30th March, 2010.
Determine the effect of the above transactions on the assessments of Bala and Kala for assessment year 2010-11, assuming that value for stamp duty purpose in case of the second sale was not more than the sale consideration. (5 Marks)

Answer

- (a) (i) Section 35AD has been introduced by the Finance (No.2) Act, 2009, with effect from A.Y.2010-11. It seeks to provide investment-linked tax incentive for specified business. One such specified business is business of laying and operating a cross-country natural gas or crude or petroleum oil pipeline network for distribution, including storage facilities being an integral part of such network. The benefit will be available in a case where the business relates to laying and operating a cross country natural gas pipeline network for distribution, if such business commences its operations on or after 1st April, 2007.

Under section 35AD, 100% of the capital expenditure incurred during the previous year, wholly and exclusively for the above business would be allowed as deduction from the business income. However, expenditure incurred on acquisition of any land, goodwill or financial instrument would not be eligible for deduction.

Further, the expenditure incurred, wholly and exclusively, for the purpose of specified business prior to commencement of operation would be allowed as deduction during the previous year in which the assessee commences operation of his specified business. A condition has been inserted that such amount incurred prior to commencement should be capitalized in the books of account of the assessee on the date of commencement of its operations.

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Therefore, the deduction admissible under section 35AD for A.Y. 2010-11 would be:

	Rs.
Capital expenditure incurred during the previous year 2009-10	200 lacs
Capital expenditure incurred during the period from 1st April 2007 to 30th June, 2008 (i.e. prior to commencement of business) and capitalized in the books of account on 1st July, 2008 (Rs.300 lacs - Rs.50 lacs)	250 lacs
Total deduction under section 35AD for A.Y.2010-11	<u>450 lacs</u>

- (ii) Section 73A provides that any loss computed in respect of the specified business shall be set off only against profits and gains, if any, of any other specified business. The unabsorbed loss, if any, will be carried forward for set off against profits and gains of any specified business in the following assessment year and so on. There is no time limit specified for carry forward and set-off and therefore, such loss can be carried forward indefinitely for set-off against income from specified business.

- (b) (i) The Finance (No.2) Act, 2009 has inserted section 13B, with effect from assessment year 2010-11, to provide exemption in respect of voluntary contribution received by an electoral trust approved by the CBDT in accordance with the scheme to be made by the Central Government.

Voluntary contribution received by an electoral trust would be treated as its income under section 2(24), but shall be exempt under section 13B if the trust distributes to a registered political party during the year, 95% of the aggregate donations received by it during the year, along with surplus brought forward from any earlier year. Another condition for availing the benefit under this section is that the electoral trust should function in accordance with the rules framed by the Central Government.

It may be noted that the exemption under section 13B will be available only in respect of voluntary contribution received by an electoral trust. The exemption cannot be claimed in respect of any other income of the electoral trust.

Therefore, the given statement is not correct.

- (ii) The scope of section 80GGC has been widened so as to enable an individual to claim deduction from gross total income in respect of amount of contribution made by him to an electoral trust during the year.

(c) Tax treatment in the hands of the seller, Mr. Bala

Section 50C provides that where the consideration received or accruing as a result of transfer of a capital asset, being land or building or both, is less than the value adopted or assessed or assessable by an authority of a State Government for the purpose of payment of stamp duty in respect of such transfer, the value so adopted or assessed or assessable shall be deemed to be the full value of the consideration received or accruing as a result of such transfer for computing capital gain.

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In the instant case, Bala sold the residential flat at Jaipur to his friend Kala for Rs.10 lacs, whereas the stamp duty value was Rs.15 lacs. Therefore, stamp duty value shall be deemed to be the full value of consideration for sale of the property. Therefore, short-term capital gain arising to Bala for assessment year 2010-11 will be Rs.11.50 lacs (i.e. Rs.15 lacs - Rs.3.50 lacs).

Tax treatment in the hands of the buyer, Ms. Kala

The Finance (No.2) Act, 2009 has inserted clause (vii) in section 56(2) to bring within its scope the value of any property received without consideration or for inadequate consideration by an individual or HUF. The definition of "property" includes immovable property, being land or building or both.

If an immovable property is received by an individual or Hindu undivided family for inadequate consideration, and the difference between the stamp duty value and such consideration exceeds Rs.50,000, such difference would be treated as income under section 2(24) and charged to tax as the income of the recipient under the head "Income from other sources".

Income from other sources

In this case, the difference between stamp duty value and the consideration is Rs.5 lacs (i.e. Rs. 15 lacs - Rs.10 lacs), which exceeds Rs.50,000. Hence, the amount of Rs.5 lacs shall be charged to tax under section 56(2)(vii) as "Income from other sources".

Capital Gains

Kala sold the flat for Rs.20 lacs on 30th March, 2010 and this price is higher than the stamp duty value as on that date. Hence, section 50C is not attracted on sale of flat by Kala.

Section 49(4) provides that where the capital gain arises from the transfer of such property which has been subject to tax under section 56(2)(vii), the cost of acquisition of the property shall be deemed to be the value taken into account for the purpose of section 56(2)(vii).

Therefore, the cost of acquisition of the flat, in this case, would be Rs.15 lacs. The short-term capital gain of Kala from sale of the property is, therefore, Rs.5 lacs (i.e. Rs.20 lacs-Rs.15 lacs).

Note : The Finance Act, 2010 has amended section 56(2)(vii) to remove transfer of immovable property for inadequate consideration from its scope right from the date of introduction of this provision i.e., date of insertion of section 56(2)(vii), being 1st October, 2009. Therefore, transfer of immovable property for inadequate consideration would never fall within the scope of section 56(2)(vii). Accordingly, the provisions of section 56(2)(vii) would not be attracted in such a case and in the assessment of Kala, Rs.10 lacs (i.e. Rs.20 lacs – Rs.10 lacs) would be chargeable to tax as short-term capital gains.

It may be noted that the amendments made by the Finance Act, 2010, including retrospective amendments, are not applicable for May 2010 examination. Therefore, this amendment has not been considered in the answer given above, even though the same is applicable retrospectively from 1st October, 2009, being the date of introduction of this provision.

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Question 4

- (a) *Explain the applicability of the provision relating to the deduction of tax at source in the following transactions:*
- (i) *Max Limited pays Rs.1 lac to Mini Limited, a resident contractor who, under the contract dated 15th October, 2009, manufactures a product according to specification of Max Limited by using materials purchased from Max Limited.*
(2 Marks)
- (ii) *A company operating a television channel makes payment of Rs.5 lacs to a former cricketer for making running commentary of a one-day cricket match.* (2 Marks)
- (iii) *EL Ltd., a foreign company, pays outside India, salary to its employee, Mr. Raghavan, a foreign national and a non-resident, for services rendered in India.*
(2 Marks)
- (b) *Discuss the taxability of the balance amount withdrawn by an employee from the recognized provident fund at the time of leaving the service?* (5 Marks)
- (c) *The Assessing Officer has the power to make an assessment to the best of his judgment, in certain situations. What are they?* (3 Marks)

Answer

- (a) (i) The definition of "work" under section 194C has been amended with effect from 1st October, 2009 to include manufacturing or supplying a product according to the requirement or specification of a customer by using material purchased from such customer. In the instant case, Mini Limited manufactures the product as per the specification given by Max Limited by using the raw materials purchased from Max Limited. Therefore, it falls within the definition of "work" under section 194C. Consequently, tax is to be deducted on the invoice value excluding the value of material purchased from such customer if such value is mentioned separately in the invoice. If the material component is not mentioned separately in the invoice, tax is to be deducted on the whole of the invoice value.
- (ii) Provisions for deduction of tax at source under section 194J are attracted in respect of payment of fees for professional services, if the amount of such fees exceeds Rs.20,000 in the relevant financial year. The service rendered by a commentator in relation to sports activities has been notified by the CBDT as professional service for the purpose of section 194J vide its Notification No. 88 dated 21st August, 2008. Therefore, tax is required to be deducted @10% from the fee of Rs.5 lacs payable to the former cricketer.
- (iii) Section 192(1) requires "any person" responsible for paying income under the head "Salaries" to deduct tax at source. Therefore, even if the payer is a foreign company, section 192 would be applicable.

TDS provisions under section 192 are attracted, if the salary payable to a non-resident is chargeable to tax in India. Under section 9(1)(ii), income which falls

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under the head "Salaries" shall be deemed to accrue or arise in India, if it is earned in India. Salary payable for service rendered in India shall be regarded as income earned in India. Therefore, salary paid to Mr. Raghavan, a non-resident, attracts tax liability in India, as he has rendered services in India and the salary is attributable to such services.

Therefore, the foreign company, EL Limited, is liable to deduct tax at source under section 192 from the salary of Mr. Raghavan.

Note : It may be noted that the provisions of section 195 are not applicable in case of payment of salary to non-resident. This is because section 195 requires deduction of tax at source by any person responsible for making payment to a non-resident, any interest or any other sum chargeable under the provisions of the Income-tax Act, 1961 (other than income chargeable under the head "Salaries").

- (b) The accumulated balance withdrawn from the recognised provident fund account would not be taxable in the hands of the employee, if any of the following conditions are satisfied -
- (a) the employee has rendered continuous service with his employer for a period of five years or more; or
 - (b) the employee is not able to fulfill the above condition of such continuous service due to his/ her service having been terminated by reason of his/her ill health, or by the contraction or discontinuance of the employer's business or due to some other reason beyond the control of the employee; or
 - (c) on cessation of employment, the employee obtains another employment and the accumulated balance due and becoming payable to him, is transferred to his individual account in any recognized provident fund maintained by such other employer;

If the accumulated balance becomes taxable due to non-fulfillment of any of the aforesaid conditions, the total income of the employee will be recomputed by the Assessing Officer, as if the fund was not recognized from the beginning, and the employee shall be liable to pay the additional tax due.

- (c) Under section 144, the Assessing Officer, after taking into account all relevant material which he has gathered, is under an obligation to make an assessment of the total income or loss to the best of his judgment and determine the sum payable by the assessee in the following cases –
- (1) Where any person fails to make the return under section 139(1) and has not filed a belated return under section 139(4) or a revised return under section 139(5).
 - (2) Where any person fails to comply with all the terms of a notice issued under section 142(1) or fails to comply with a direction issued under section 142(2A) for getting the accounts audited.
 - (3) Where any person, having made a return, fails to comply with all the terms of a notice issued under section 143(2).

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Further, section 145(3) of the Income-tax Act, 1961 permits the Assessing Officer to make an assessment in the manner provided in section 144:

- (i) where the Assessing Officer is not satisfied about the correctness or completeness of the accounts of the assessee; or
- (ii) where the method of accounting under section 145(1) has not been regularly followed by the assessee;
- (iii) where the accounting standards notified by the Central Government under section 145(2) have not been regularly followed by the assessee.

Question 5

- (a) *Does the Income-tax Appellate Tribunal have the following powers?*
- (i) *Power to allow the assessee to urge any ground of appeal which was not raised by him before the Commissioner (Appeals);*
 - (ii) *Power to review its own order.* (4 Marks)
- (b) *Ankit Private Limited has, in its return of income, claimed a sum of Rs. 40,000 as a deduction on account of payments for stamp duty and registration charges from the income shown under the head "Income from house property". The Assessing Officer disallowed the claim of the assessee company in the assessment order passed under section 143(3). Examine the correctness of the action of the Assessing Officer. (3 Marks)*
- (c) *Following issues have been raised by Navi Limited in connection with its eligibility for claiming deduction under section 80-IB for your consideration and advise for the assessment year 2010-2011.*
- (i) *It operates two separate industrial units. One unit is eligible for deduction under section 80-IB, while the other unit is not eligible for such deduction. If the eligible unit has profit and the other unit has loss, should it claim deduction after setting off the loss of the other unit against profit of the eligible unit?*
 - (ii) *Its profit from one unit includes sale of import entitlement, duty drawback and interest from customers for delayed payment. Is it permissible to claim deduction on these items of income?* (7 Marks)

Answer

- (a) (i) The Income-tax Appellate Tribunal has the power to entertain question raised for the first time. The Tribunal is not confined only to the issues arising out of the appeal before the Commissioner (Appeals). The Tribunal has the power to allow the assessee to urge any ground not raised before the Commissioner (Appeals). However, the relevant facts in respect of such ground should be on record. The decision of the Supreme Court in the case of *National Thermal Power Company Limited vs. CIT (1998) 229 ITR 383 (SC)* supports this view.
- (ii) The Income-tax Appellate Tribunal does not have an inherent power to review its own order. It merely has the power to amend its order under section 254(2). While

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exercising the said power, it cannot review its own order. The expression "amendment" is to be assigned its true meaning. When an order of amendment is passed, the order remains, but when an order is reviewed it stands obliterated. The review of its own order by the Tribunal is forbidden by law. It cannot be permitted to achieve the same object by exercising its power under section 254(2) [*Sahni (J.N.) vs. ITAT (2002) 257 ITR 16 (Del)*].

- (b) In the determination of annual value of house property under section 23, what is to be deducted is provided in the section itself. For example, where the property is let-out, the municipal taxes paid by the owner is allowed to be deducted in the determination of the net annual value of the property. Once the net annual value is determined, the deductions which are admissible are specified in section 24, namely statutory deduction @30% of net annual value and deduction in respect of interest on borrowed capital taken for the purpose of acquiring, constructing, renewing or repairing the house property. Thus, the amount spent by the assessee towards stamp duty and registration charges cannot be allowed as deduction in determining the income from house property.

Therefore, the action of the Assessing Officer in disallowing the deduction in respect of stamp duty and registration charges, is correct.

- (c) (i) The issue for consideration is whether the profit of eligible undertaking under section 80-IB is to be reduced by the loss of non-eligible undertaking for the purpose of computation of deduction under this section. The issue was considered by the Supreme Court in *CIT vs Canara Workshop Private Limited (1986) 161 ITR 320* and *English Electric Company Limited vs CIT (1997) 249 ITR 793*. It was held that in computing the profit qualifying for deduction in respect of an eligible undertaking, the loss incurred by other non-eligible undertakings should not be set off. The income computed before set off should be the basis for determining the amount of deduction. The deduction so quantified shall be allowed subject to gross total income.

Therefore, Navi Limited should claim deduction on profit from the eligible unit without setting off loss suffered in the other unit. It may be noted that the aggregate deduction under Chapter VIA, however, cannot exceed the gross total income of the assessee.

- (ii) Under section 80-IB, where the gross total income of an assessee includes any profits and gains derived from an industrial undertaking referred to in the section, there shall be allowed, in computing the total income of the assessee, a deduction from such profits and gains at the specified percentage and for such number of years as specified in the section. In *CIT vs. Sterling Foods (1999) 237 ITR 579 (SC)* and *Liberty India vs. CIT (2009) 317 ITR 218 (SC)*, it was held that sale of import entitlement and duty drawback cannot be construed as income derived from industrial undertaking. Therefore, such income cannot be included in computing income for the purpose of deduction under section 80-IB.

Interest income derived by an undertaking on delayed collection of sale proceeds shall be treated as income derived from the industrial undertaking, and therefore, the same would be eligible for deduction under section 80-IB. [*Phatela Cotgin Industries Private Limited vs CIT (2008) 303 ITR 411 (P & H)*].

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Question 6

- (a) The assessment of CNK Associates, a partnership firm for the assessment year 2007-08 was made under section 143(3) on 31st July, 2009. The Assessing Officer made two additions to the income of the assessee viz. (a) addition of Rs. 2 lacs under section 40(a)(ia) due to non-furnishing of evidence of payment of TDS and (ii) addition of Rs.5 lacs on account of unexplained cash credit. The assessee contested addition on account of unexplained cash credit in appeal to the Commissioner (Appeals). The appeal was decided in January, 2010 against the assessee. The assessee approaches you for your suggestion as to whether it should apply for revision to the Commissioner under section 264 or rectification to the Assessing Officer under section 154 as regards disallowance under section 40(a)(ia). What should be your suggestion? (4 Marks)
- (b) Cosmos Limited, a company incorporated in Mauritius, has a branch office in Hyderabad opened in April, 2008. The Indian branch has filed return of income for assessment year 2009-10 disclosing income of Rs.50 lacs. It paid tax at the rate applicable to domestic company i.e. 30% plus education cess on the basis of paragraph 2 of the Article 24 (Non-Discrimination) of the Double Taxation Avoidance Agreement between India and Mauritius, which reads as follows:
- "The taxation on a permanent establishment which an enterprise of a Contracting State has in the other Contracting State shall not be less favourably levied in that other State than the taxation levied on enterprises of that other State carrying on the same activities in the same circumstances."*
- However, the Assessing Officer computed tax on the Indian branch at the rate applicable to a foreign company i.e. 40% plus education cess.
- Is the action of the Assessing Officer in accordance with law? (4 Marks)
- (c) Asha Memorial Trust running hospitals is registered under section 12A. Following particulars relevant for the previous year ended 31st March, 2010 are furnished to enable you to compute tax liability of the trust.
- (i) Income from running of hospitals Rs. 14.25 lacs.
- (ii) Donation received (including anonymous donation Rs.3 lacs) Rs. 5.75 lacs.
- (iii) Amount applied for the purposes of hospital Rs.13 lacs.
- (iv) The trust had accumulated Rs.15 lacs under section 11(2) in the financial year 2003-04 for a period of five years for extension of one of its hospitals. The trust has spent Rs. 13.50 lacs for the said purpose till 31st March, 2009.
- Compute the taxable income of the trust and tax payable by Asha Memorial Trust for the assessment year 2010-11. (6 Marks)

Answer

- (a) The Commissioner cannot exercise his power of revision under section 264 where the order sought to be revised has been made the subject of an appeal to the Commissioner (Appeals) or to the Appellate Tribunal [Section 264(4)], even if the relief claimed in the

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revision is different from the relief claimed in the appeal. This was the view of the Supreme Court in the case of *Hindustan Aeronautics Limited vs. CIT (2000) 243 ITR 808 (SC)*. It is not open to the assessee to seek recourse to revision under section 264 after the appeal is decided. Therefore, although the matter of addition of Rs.2 lacs under section 40(a)(ia) was not taken before the Commissioner (Appeals), the assessee, CNK Associates cannot apply for revision under section 264 in respect of the same.

Under section 154(1A), where any matter had been considered and decided in any proceeding by way of appeal or revision, rectification of such matter cannot be done by the Assessing Officer. However, in respect of the matter which has not been considered and decided in the appeal or revision, the order of the Assessing Officer can be rectified under section 154. Thus, the assessee can apply to the Assessing Officer for rectification of the order in respect of addition under section 40(a)(ia), as this matter has not been considered and decided in any proceeding by way of appeal or revision.

In view of above, the assessee, CNK Associates should seek rectification under section 154.

- (b) Under section 90(2), where the Central Government has entered into an agreement for avoidance of double taxation with the Government of any country outside India or specified territory outside India, as the case may be, 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 the assessee. Thus, in view of paragraph 2 of the Article 24 (Non-Discrimination) of the Double Taxation Avoidance Agreement (DTAA), it appears that the Indian branch of Cosmos Limited, incorporated in Mauritius, is liable to tax in India at the rate applicable to domestic company (30%), which is lower than the rate of tax applicable to a foreign company (40%).

However, *Explanation 1* below sub-section (3) of section 90 clarifies that the charge of tax in respect of a foreign company at a rate higher than the rate at which a domestic company is chargeable, shall not be regarded as less favourable charge or levy of tax in respect of such foreign company. Therefore, in view of this Explanation, the action of the Assessing Officer in levying tax@40% on the Indian branch of Cosmos Ltd. is in accordance with law.

- (c) **Computation of taxable income of Asha Memorial Trust for A.Y. 2010-11**

Particulars	Amount in Rs.	
Income from running of hospitals	14,25,000	
Donation other than anonymous donation	<u>2,75,000</u>	17,00,000
Less: 15% of income of Rs.17 lacs accumulated or set apart under section 11(1)(a)	2,55,000	
Amount applied for the purposes of hospital	<u>13,00,000</u>	<u>15,55,000</u>
		1,45,000

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Add: Amount accumulated for extension of a hospital but not spent deemed to be income under section 11(3) (Rs.15 lacs – Rs.13.50 lacs) (See Note 1 below)	<u>1,50,000</u>
	2,95,000
Add: Anonymous donation taxable @30% under section 115BBC (See Note 2 below)	<u>3,00,000</u>
Total Income	<u>5,95,000</u>
Tax on above:	
Tax on anonymous donation of Rs.2 lacs at 30% (See Note 2 below)	60,000
Tax on other income of Rs.2,95,000 at normal rates	
Upto Rs.1,60,000	Nil
Over Rs.1,60,000 but up to Rs.3,00,000 @ 10%	<u>13,500</u>
	73,500
Education cess @2%	1,470
Secondary and higher education cess@1%	<u>735</u>
Tax payable	<u>75,705</u>

Notes:

- (1) Section 11(3) provides that if the income accumulated for certain purpose is not utilized for the said purpose within the period (not exceeding 5 years) for which it was accumulated, or in the year immediately following the expiry thereof, then the unutilised amount is deemed to be the income of the charitable institution for the previous year immediately following the expiry of the period of accumulation. In the instant case, Asha Memorial Trust accumulated Rs.15,00,000 in the previous year 2003-04 for extension of one of its hospitals for a period of 5 years. Period of accumulation thus expired on 31.3.2009. The assessee has spent Rs.13,50,000 out of accumulated sum of Rs.15,00,000 up to 31.3.2009. Therefore, the unutilised amount of Rs.1,50,000 is deemed to be income of the previous year 2009-10 (A.Y. 2010-11). It is assumed that the amount of Rs.1,50,000 was not utilized during the P.Y.2009-10 also.
- (2) The Finance (No.2) Act, 2009 has introduced an exemption limit for anonymous donations. Consequently, only the anonymous donations in excess of this limit would be subject to tax@30%.

The exemption limit is the higher of the following –

- (1) 5% of the total donations received by the assessee (i.e., Rs.28,750 in this case); or
- (2) Rs.1 lakh.

Therefore, in this case the exemption would be Rs.1 lakh.

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The total tax payable by such institution would be –

- (1) tax@30% on the anonymous donations exceeding the exemption limit as calculated above [i.e., tax@30% on Rs.2,00,000, being Rs.3,00,000 – Rs.1,00,000]; and
- (2) tax on the balance income of Rs. 2,95,000 i.e., total income as reduced by the aggregate of anonymous donations received [Rs. 5,95,000 – Rs.3,00,000].

Question 7

- (a) *NKP Limited engaged in industrial activity has furnished the following particulars of its assets as at the valuation date 31st March, 2010. Compute the net wealth and wealth-tax liability of the company for the assessment year 2010-11.*
- (i) *One hectare of vacant land was allotted to the company at Ahmedabad by the State Government for industrial purpose in May, 2006 on permanent lease basis on payment of a non-refundable premium of Rs. 4 lacs. The terms of allotment includes that in the event the lessee transfers the lease, 50% of the unearned increase in the value should be made over to the lessor. The construction work for the proposed factory has not been started. The value of the land as on 31st March, 2010 is Rs.50 lacs.*
 - (ii) *The company is a partner of a firm with 30% share, whose net assets as on 31st March, 2010 is Rs. 150 lacs. Its capital as on that date is Rs.20 lacs out of total capital of Rs.70 lacs.*
 - (iii) *It has let out a building with effect from 1st October, 2009 at a monthly rent of Rs. 1 lac for a period of 10 years. The tenant has made a deposit of Rs. 3 lacs. Annual Corporation Tax of Rs. 1 lac is borne by the tenant. The building is on a freehold land. The written down value of the building is Rs. 80 lacs. (7 Marks)*
- (b) *'H' filed his return of net wealth for the assessment year 2006-07. Penalty proceeding under section 18 for concealing particulars of net wealth was initiated by the Assessing Officer in 2008. 'H' died in January, 2009. The estate of 'H' devolved on his wife, 'W', who also died in October, 2009. Thereafter, the estate devolved on their daughter 'D'. The Assessing Officer passed penalty order on 28th February, 2010 and served notice of demand for penalty on 'D'. Is the action of the Assessing Officer valid in law? (3 Marks)*

Answer

- (a) **Computation of net wealth and wealth tax liability of NKP Ltd.**
for the A.Y. 2010–11

Particulars	Amt. in Rs.
Land for industrial purpose (Note 1)	27,00,000
Interest in the assets of partnership firm (Note 2)	44,00,000
Building (Note 3)	1,30,40,625
Net Wealth	<u>2,01,40,625</u>

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Wealth-tax@1% of Rs.1,71,40,625, being the net wealth in excess of Rs.30 lakh **1,71,406**

Notes :

- (1) Unused land held for industrial purpose for more than two years from the date of acquisition is an asset under section 2(ea). As such, wealth tax incidence is attracted **Rs.**
- Market value of land as on 31.3.2010 50,00,000
- Less: 50% of the unearned increase payable to the lessor
[i.e. 50% of (50 lakhs – 4 lakhs)] 23,00,000
- Value for wealth tax purpose 27,00,000
- (2) Interest in assets of the firm of which the assessee is a partner is deemed to be asset of the partner under section 4(1)(b) of the Wealth-tax Act, 1957 **Rs.**
- Value of interest in the firm as per Rule 15 of Schedule III:
Rs.20,00,000 + [(Rs.150 lakh – Rs.70 lakh) x 30%]
= [20,00,000 + 24,00,000, being 30% of 80,00,000] 44,00,000
- (3) **Value of Building [Rule 3 to 5 of Part-B of Schedule III]:** **Rs.**
- Actual Rent (Rs.1,00,000 x 6) 6,00,000
- Interest on deposit@15% p.a. for 6 months 22,500
- Corporation tax borne by tenant (for 6 months) 50,000
- 6,72,500**
- Annual Rent (6,72,500 x 12/6) 13,45,000
- Gross Maintainable Rent (GMR) 13,45,000
- Less: Corporation Tax 1,00,000
- 15% of GMR 2,01,750
- Net Maintainable Rent** **10,43,250**
- Capitalised value for wealth tax purpose
(Rs.10,43,250 x 12.5) **1,30,40,625**

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Note - As per Rule 14, relating to valuation of assets of a business, the value of a depreciable asset disclosed in the balance sheet shall be taken to be its written down value. In this case, written down value of the building is Rs.80 lakh. However, if the value of the asset determined in accordance with the relevant rule of Schedule III which is applicable to the asset, exceeds the above value by more than 20%, the higher value shall be taken to be the value of the asset. In this case, the capitalized value of Rs.1,30,40,625 exceeds Rs.80,00,000 by 63%. Therefore, Rs.1,30,40,625 should be taken as the value of the building. It is presumed that building is disclosed in the Balance Sheet.

- (b) The issue under consideration in this case is whether penalty can be levied under the Wealth-tax Act, 1957 against the legal representative after the death of the assessee, in respect of penalty proceedings initiated against the assessee prior to his death.

Section 19(3), which provides for application of certain provisions of the Wealth-tax Act, 1957, to the legal representatives does not refer to the applicability of the provisions of section 18 relating to imposition of penalty. Therefore, penalty under section 18 cannot be levied on the legal representatives. The Delhi High Court, in *CWT v. H.S. Chauhan* (2000) 245 ITR 784, has also held that penalty proceedings initiated against an assessee cannot be continued on the legal heirs on the demise of such assessee. This view is also supported by the Gujarat High Court in *ACIT vs. Late Shrimant F.P. Gaekwad* (2009) 313 ITR 192. Therefore, penalty cannot be levied under the Wealth-tax Act, 1957 on the legal representatives for defaults committed by the deceased for which penalty proceedings have been initiated against the deceased prior to his death.

In view of above, the action of the Assessing Officer is not valid in law.