REVISIONARY TEST PAPER

JUNE 2011

GROUP I

THE INSTITUTE OF
COST AND WORKS ACCOUNTANTS OF INDIA

12, SUDDER STREET, KOLKATA-700 016

INTERMEDIATE EXAMINATION

(REVISED SYLLABUS - 2008)

GROUP - I

Paper-5 : FINANCIAL ACCOUNTING

Q. 1. M/s Suba Chemicals has imported a machine on 1st July 2007 for $ 6,000, paid customs duty and freight Rs. 52,000 and incurred rection charges Rs. 20,000. Another local machinery costing Rs. 1,00,000 was purchased on January 1, 2008. On 1st July 2009, a portion of the imported machinery (value one-third) got out of order and was sold for Rs. 34,800. Another machinery was purchased to replace the same for Rs. 50,000. Depreciation is to be calculated at 20% p.a. on straight-line method. Prepare the Machinery Account and Machinery Disposal Account for 2007, 2008 and 2009. Exchange rate is Rs. 38 per $.

Answer 1.

Books of M/s. Suba Chemicals

Dr. MACHINERY ACCOUNT *Cr.*

Date	Particulars	Amount	Date	Particulars	Amount
2007		Rs.	2007		Rs.
July 1	To Bank — purchase (6000×Rs. 38)	2,28,000	Dec. 31	By Depreciation —for 6 months (Rs. 3,00,000 × 20/100 × 1/2	30,000
	To Bank —Duty etc.	52,000			
	To Bank — Erection charges	20,000		By Balance c/d	2,70,000
		3,00,000			3,00,000
2008			2008		
Jan. 1	To Balance b/d	2,70,000	Dec. 31	By Drpreciation	
	To Bank—purchase	1,00,000		(i) 3,00,000 × 20/100	60,000
				(ii) 1,00,000 × 20/100	20,000
				By Balance c/d	2,90,000
		3,70,000			3,70,000
2009			2009		
Jan. 1	To Balance b/d	2,90,000	July 1	By Machinery Disposal A/c	70,000
	To Bank—purchase	1,00,000	Dec. 31	By Decpreciation :	
				(i) 2,00,000 × 20/100	40,000
				(ii) 1,00,000 × 20/100	20,000
				(iii) 50,000 × 20/100×½	5,000
				By Balance c/d	2,05,000
		3,40,000			3,40,000
2010					
Jan. 1	To Balance b/d	2,05,000			

Dr. MACHINERY DISPOSAL ACCOUNT *Cr.*

Date	Particulars	Amount	Date	Particulars	Amount
2009		Rs.	2009		Rs.
July 1	To Machinery A/c	70,000	July 1	By Depreciation (1,00,000×20/100×½)	10,000
				By Bank — sale proceeds	34,800
				By Profit & Loss A/c —Loss	25,200
		70,000			70,000

Note : 1. Written down value of Machinery as on July 1, 2009 will be as follows :

	Rs.
Original cost on July 1, 2007 (3,00,000 × 1/3)	1,00,000
Less : Depreciation for 2007 (for 6 months)	
(1,00,000 × 20/100 × ½)	10,000
	90,000
Less : Depreciation for 2008	
(1,00,000 × 20/100)	20,000
	70,000

2. If 'Machinery Disposal Account' is not kept, then, Machinery account for the year 2009 will be prepared as under :

Dr. MACHINERY ACCOUNT (for 2009) *Cr.*

Date	Particulars	Amount	Date	Particulars	Amount
2009		Rs.	2009		Rs.
Jan. 1	To Balance b/d	2,90,000	July 1	By Depreciation (For 6 months)	10,000
July 1	To Bank	50,000		By Bank — sale proceeds	34,800
				By Profit & Loss A/c Loss on sale (70,000–44,800)	25,200
			Dec. 31	By Depreciation	65,000
				By Balance c/d	2,05,000
		3,40,000			3,40,000
2010					
Jan. 1	To Balance b/d	2,05,000			

Q. 2. The financial year of Mr. Chalaman ends on 31st March, 2008 but the stock in hand was physically verified only on 8th April, 2008. You are required to determine the value of Closing Stock (at cost) as at 31st March, 2008 from the following information.

(i) The stock (valued at cost) as verified on 8th April, 2008 was Rs. 15,000.

(ii) Sales have been entered in the Sales Day Book only after the despatch of goods and sales returns only on receipt of goods.

(iii) Purchases have been entered in the Purchase Day Book on receipt of the purchase invoice irrespective of the date of receipt of the goods.

(iv) Sales as per the sales day book for the period 1st April, 2008 to 8th April, 2008 (before the actual verification) amounted to Rs. 6,000 of which goods of a sale value of Rs. 1,000 had not been delivered at the time of verification.

(v) Purchases as per the purchase day book for the period 1st April, 2008 to 8th April, 2008 (before the actual verification) amounted to Rs. 6,000 of which goods for purchases of Rs. 1,500 had not been received at the date of verification and goods for purchases of Rs. 2,000 had been received prior to 31st March, 2008.

(vi) In respect of goods costing Rs. 5.000 received prior to 31st March, 2008, invoices had not been received up to the date of verification of stocks.

(vii) The gross profit is 20% on sales.

Answer 1.

Mr. Chalaman

Statement showing Value of Stock on 31.3.2008

Particulars	**Amount Rs.**	**Amount Rs.**
Stock as on 8.4.08		15,000
Add :		
(a) Cost of Goods Sold and sent Out between 1.4.08 and 8.4.08		
Sales in this period .	6,000	
Less: Goods sold but not delivered (at Selling Price)	1,000	
	5,000	
Less : Gross Profit included [20% of 5,000]	1,000	4,000
		19,000
Less :		
(a) Goods purchased and received between 1.4.08 and 8.4.08 :		
Purchases in this period	6,000	
Less : Goods not received till 8.4.08	1,500	4,500
(b) Goods received before 31 .3.08 for which the invoice is yet to be received		5,000
Stock on 31.3.2008		9,500

Q. 3. (a) State with reasons whether the following items relating to Parvati Sugar Mill Ltd. are capital or revenue:

1. **Rs 50,000 received from issue of shares including Rs 10,000 by way of premium.**
2. **Purchased agricultural land for the mill for Rs 60,000. Rs 500 also paid for land revenue.**
3. **Rs 5,000 paid as contribution to PWD for improving roads of sugar producing area.**
4. **Rs 40,000 paid for excise duty on sugar manufactured.**
5. **Rs 70,000 spent for constructing railway siding.**

Answer 3. (a)

(1) Rs 40,000 (Rs 50,000 - Rs 10,000) received from issue of shares will be treated as a *Capital Receipt.* The premium of Rs 10,000 should be treated as a *Capital Profit.*

(2) Cost of land Rs 60,000 to be treated as *Capital Expenditure* and land revenue of Rs 500 to be treated as *Revenue Expenditure.*

(3) Contribution paid to PWD should be treated as a *Revenue Expenditure.*

(4) Excise duty of Rs 40,000 should be treated as a *Revenue Expenditure.*

(5) Rs 70,000 spent for constructing railway siding to be treated as a *Capital Expenditure.*

Q. 3. (b) State with reasons whether the following are Capital Expenditure or Revenue Expenditure:

(i) Expenses incurred in connection with obtaining a licence for starting the factory were Rs 10,000.

(ii) Rs. 1,000 paid for removal of stock to a new site.

(iii) Rings and Pistons of an engine were changed at a cost of Rs 5,000 to get full efficiency.

(iv) Rs. 2,000 spent as lawyer's fee to defend a suit claiming that the firm's factory site belonged to the Plaintiff. The suit was not successful.

(v) Rs 10,000 were spent on advertising the introduction of a new product in the market, the benefit of which will be effective during four years.

(vi) A factory shed was constructed at a cost of Rs 1,00,000. A sum of Rs 5,000 had been incurred for the construction of the temporary huts for storing building materials.

Answer 3. (b)

(i) Rs 10,000 incurred in connection with obtaining a license for starting the factory is a *Capital Expenditure.* It is incurred for acquiring a right to carry on business for a long period.

(ii) Rs 1,000 incurred for removal of stock to a new site is treated as a *Revenue Expenditure* because it is not enhancing the value of the asset and it is also required for starting the business on the new site.

(iii) Rs 5,000 incurred for changing Rings and Pistons of an engine is a *Revenue Expenditure* because, the change of rings and piston will restore the efficiency of the engine only and it will not add anything to the capacity of the engine.

(iv) Rs 2,000 incurred for defending the title to the firm's assets is a *Revenue Expenditure.*

(v) Rs 10,000 incurred on advertising is to be treated as a *Deferred Revenue Expenditure* because the benefit of advertisement is available for 4 years, Rs 2,500 is to be written off every year.

(vi) Cost of construction of Factory shed of Rs 1,00,000 is a *Capital Expenditure,* similarly cost of construction of small huts for storing building materials is also a *Capital Expenditure.*

Q. 3. (c) State clearly how you would deal with the following in the books of a Theatrical Company:

(i) The redecoration expenses Rs 6,000.

(ii) The installation of a new wine bar for Rs 10,000.

(iii) The building of an extension of the club dressing room for Rs 15,000.

(iv) The purchase of wines and spirits Rs 2,000.

(v) The purchase of V.C.R. and T.V. for the use in the club lounge for Rs 15,000.

Answer 3. (c)

(i) The redecoration expenses of Rs 6,000 shall be treated as a *Deferred Revenue Expenditure.*

(ii) The installation of a new wine bar is a *Capital Expenditure* because it is the acquisition of an asset.

(iii) Rs 15,000 spent for the extension of club dressing room is a *Capital Expenditure* because it creates an asset of a permanent nature.

(iv) The purchase of wines and spirits of Rs 2,000 is a *Revenue Expenditure.*

(v) The purchase of V.C.R. and T.V. for Rs 15,000 is a *Capital Expenditure,* because it is the acquisition of assets.

Q. 4. A fire occurred in the office premises of lessee in the evening of 31.3.2009 destroying most of the books and records. From the documents saved, the following information is gathered :

Short-working recovered :

2006-07 Rs. 2,000 (towards short-workings which arose in 2003-04)

2008-08 Rs. 4,000 (including Rs. 1,000 for short-working 2004-05)

2008-09 Rs. 1,000

Short-working lapsed :

2005-06 Rs. 1,500

2006-07 Rs. 1,800

2008-09 Rs. 1,000

A sum of Rs. 25,000 was paid to the landlord in 2005-06. The agreement of Royalty contains a clause of Minimum Rent payable for fixed amount and recoupment of short-workings within 3 years following the year in which Short-workings arise.

Information as regards payments to landlord subsequent to the year 2005-06 is not four years ended 31.3.2009.

Answer 4.

Before preparing the respective ledger accounts we are to compute the following information :

Year	Royalty	Short-working	Short-working recovered	Short-working Lapsed	Payment to Landlord
	Rs.	**Rs.**	**Rs.**	**Rs.**	**Rs.**
2005-06	—	—	—	1,500	25,000
2006-07	—	—	Rs. 2,000 (for 2003-04)	8,800	—
2007-08	—	—	Rs. 4,000 (including Rs. 1,000 for 2004-05)	—	—
2008-09	—	—	1,000	1,000	—

From the above statement it is quite clear that :

(i) Short-working lapsed in 2008-09 Rs. 1,000 which relates to 2005-06 as per terms, short-working should be recouped within three years i.e., 2008-09 is the last year for recoupment.

(ii) Short-working recovered in 2007-08 Rs. 4,000, out of which Rs. 1,000 for 2004-05 and the balance Rs. 3,000 for the year 2005-06.

(iii) Short-working recovered in 2008-09 Rs. 1,000 which is also related to 2005-06 in which year actually is arose.

Thus, the total short-working balance in 2005-06 amounted to Rs. 5,000 (i.e., Rs. 1,000 + Rs. 3,000 + Rs. 1,000).

Now, we can prepare our usual statement as under :

Hence,	Actual Royalty	= Payment to Landlord + Recoupment – Short-working
For,	2005-06	= Rs. 25,000 + Nil – Rs. 5,000
		= Rs. 20,000.
For,	2006-07	= Rs. 25,000 + Rs. 2,000 – Nil
		= Rs. 27,000
For,	2007-08	= Rs. 25,000 + Rs. 4,000 – Nil
		= Rs. 29,000
For,	2008-09	= Rs. 25,000 + Rs. 1,000 – Nil
		= Rs. 26,000

Year	Royalty	Short-working	Recoupment	Tr. to P&L A/c	Payment to Landlord
	Rs.	**Rs.**	**Rs.**	**Rs.**	**Rs.**
2005-06	20,000	5,000	—	1,500	25,000
2006-07	27,000	—	2,000	1,800	25,000
2007-08	29,000	—	4,000	—	25,000
2008-09	26,000	—	1,000	1,000	25,000

In the books of ....
Royalty Account

Dr. *Cr.*

Date	Particulars	Amount	Date	Particulars	Amount
		Rs.			Rs.
31.3.06	To Landlord A/c	20,000	31.3.06	By Profit and Loss A/c	20,000
		20,000			20,000
31.3.07	To Short-working A/c	2,000	31.3.07	By Profit and Loss A/c	27,000
	" Landlord A/c	25,000			
		27,000			27,000
31.3.08	To Short-working A/c	4,000	31.3.08	By Profit and Loss A/c	29,000
	" Landlord A/c	25,000			
		29,000			29,000
31.3.09	To Short-working A/c	1,000	31.3.09	By Profit and Loss A/c	26,000
	" Landlord A/c	25,000			
		26,000			26,000

Short-working Account

Dr. *Cr.*

Date	Particulars	Amount	Date	Particulars	Amount
		Rs.			Rs.
31.3.06	To Balance b/d	6,300	31.3.06	By Profit and Loss A/c	1,500
	" Landlord A/c	5,000		" Balance c/d	9,800
		11,300			11,300
31.3.07	To Balance b/d	9,800	31.3.07	By Royalty A/c	2,000
				" Profit and Loss A/c	1,800
				" Balance c/d	6,000
		9,800			9,800
31.3.08	To Balance b/d	6,000	31.3.08	By Royalty A/c	4,000
	" Landlord A/c	25,000		" Balance c/d	2,000
		6,000			6,000
31.3.09	To Balance b/d	2,000	31.3.09	By Royalty A/c	1,000
				" Profit and Loss A/c	1,000
		2,000			2,000

This is includes the following :

		Rs.
Lapsed :	in 2005-06	1,500
	in 2006-07	1,800
Recoupment :	in 2006-07	2,000
	in 2007-08	1,000
		6,300

Q. 5. Mr. Gulab sells goods on hire purchase basis. He fixes hire purchase price at $33^{1/3}$%profit on invoice price of the goods. The following are the fugures relating to his hire purchase business for the year ending on 31st March 2008 :

	01.04.2007	**31.03.2008**
	Rs	**Rs**
Hire Purchase Stock	**60,000**	**?**
Hire Purchase Debtors	**1,500**	**?**
Shop Stock	**50,000**	**75,000**

Goods purchased during the year Rs 3,27,000, Cash received from customers during the year Rs 4,62,000. Total amount of instalments that fell due during the year Rs 4,63,500.

One customer to whom goods had been sold for Rs 6,000 paid only 5 instalments of Rs 500 each. On his failure to pay the monthly instalment of Rs 500 each on 4th March 2008, the goods were repossessed on 27th March 2008 after due legal notice.

***Required :* Prepare the Hire Purchase Trading Account.**

Answer 5.

Dr. **Hire Purchase Trading Account** *Cr.*

Particulars	*Rs*	*Particulars*	*Rs*
To Opening Balances:		By Hire Purchase Stock Reserve	
Hire Purchase Stock	60,000	[60,000 x 50/150]	20,000
Hire Purchase Debtors	1,500	By Bank A/c	4,62,000
To Goods Sold on Hire Purchase	4,53,000	By Goods Sold on Hire Purchase A/c	1,51,000
To Hire Purchase Stock Reserve A/c	15,500	[4,53,000 x 50/150]	
[46,500 x50/150]		By Goods Repossessed A/c	2,333
To Profit t/f to General		[At Revalued Figure]	
P & L A/c	1,54,333	By Closing Balances :	
		Hire Purchase Stock	46,500
		Hire Purchase Debtors	2,500
	6,84,333		6,84,333

Working Notes :

Dr. **(i) Shop Stock Account** *Cr.*

Particulars	*Rs*	*Particulars*	*Rs*
To Balance b/d	50,000	By Goods Sold on Hire Purchase A/c	3,02,000
To Purchases	3,27,000	By Balance c/d	75,000
		[Excluding Goods Repossessed]	
	3,77,000		3,77,000

Dr. **(ii) Goods Sold on Hire Purchase Account** *Cr.*

Particulars	*Rs*	*Particulars*	*Rs*
To Stop Stock A/c	3,02,000	By Hire Purchase Trading A/c	4,53,000
To Hire Purchase Trading A/c	1,51,000		
	4,53,000		4,53,000

Dr. **(iii) Memorandum Hire Purchase Stock Account** *Cr.*

Particulars	*Rs*	*Particulars*	*Rs*
To Balance b/d	60,000	By Hire Purchase Debtors A/c	4,63,500
To Goods Sold on Hire Purchase	4,53,000	By Goods Repossessed A/c	3,000
		By Balance c/d	46,500
	4,65,000		4,65,000

Dr. **(iv) Memorandum Hire Purchase Debtors Account** *Cr.*

Particulars	*Rs*	*Particulars*	*Rs*
To Balance b/d	1,500	By Bank A/c	4,62,000
To Hire Purchase Stock A/c	4,63,500	By Goods Repossessed A/c	500
		By Balance c/d	2,500
	4,65,000		4,65,000

Working Note :

Calculation of the value of Goods Repossossed Value of Goods Repossessed

$$= \frac{\text{Cost Price}}{\text{H.P. Price}} \times \text{Unpaid Amount (whether due or not)}$$

$$= \frac{4{,}000}{6{,}000} \times 3{,}500 = 2{,}333/-$$

Q. 6. The Accountant of City Club furnished the following information about the Receipts and Payments of the club for the year ended 31st March, 2008 :

Receipts	**Rs.**	**Payments**	**Rs.**
To Subscriptions	**62,130**	**By Premises**	**30,000**
" Fair Receipts	**7,200**	**" Rent**	**2,400**
" Variety show Receipts (net)	**12,810**	**" Rates and Stationery**	**3,780**
" Interest	**690**	**" Printing & Stationery**	**1,410**
" Bar Collections	**22,350**	**" Sundry Expenses**	**5,350**
		" Wages	**2,520**
		" Fair Expenses	**7,170**
		" Honorarium to Secretary	**11,000**
		" Bar Purchases (Payment)	**17,310**
		" Repairs	**960**
		" New Car (less proceeds of old car Rs. 9,000)	**37,800**

The following additional information could be obtained :

	1.4.07(Rs.)	31.3.08 (Rs.)
Cash in hand	450	NIL
Bank Balance as per Cash Book	24,420	10,350
Cheque issued for Sundry Expenses not presented to the bank (entry has been duly made in the Cash book)	270	90
Subscriptions Due	3,600	2,940
Premises at cost	87,000	117,000
Provision for Depreciation on Premises	56,400	
Car at cost	36,570	46,800
Accumulated Depreciation on Car	30,870	
Bar Stock	2,130	2,610
Creditors for Bar Purchases	1,770	1,290

Annual Honorarium to Secretary is Rs. 12,000 Depreciation on Premises is to be provided at 5% on written down value. Depreciation on new car is to be provided at 20%.

You are required to prepare Receipts and Payments Account and Income and Expenditure Account for the year ended 31.3.08.

Answer 6.

Working Notes :

		Rs.
(1) Depreciation on New Car :		
	Net Amount	37,800
Add :	Sale proceeds of Old Car	9,000
	Actual Cost	46,800
Less :	Depreciation @ 20%	9,360
		37,440
(2) Profit on sale of Old Car :		
	Sale proceeds	9000
Less:	Written Down Value : Cost - 36,570	
	Provision for Depreciation - 30,870	
		5700
	Profit on Sale	3300

(3) Cheques issued for Sundry Expenses not presented to the Bank need not be considered as Bank Balance as per Cash Book is given and the entry for the expenses have been duly made in the Cash Book.

(4) Calculation of Bar Parchases

Dr. **Creditors for Bar Purchases Account** **Cr.**

Particulars	Rs	Particulars	Rs
31.3.08 To cash Payment for Bar Purchases	17,310	1.4.07 By Balance b/d	1,770
31.3.08 To Balance c/d	1,290	31.3.08 By Purchases (Balance Figure)	16,830
	18,600		18,600

(5)

Dr. **Bar Trading Account for the year ended 31.03.08** **Cr.**

Particulars	Rs	Particulars	Rs
To Opening stock	2,130	By Bar collections	22,350
To Bar Purchases	16,830	By Close stock	2,610
To Income & Expenditure A/c profit from Bar transfered	6,000		
	24,960		24,960

City Club

Dr. **Receipts and Payments Account for the year ended 31 March, 2008** **Cr.**

Receipts	Amount Rs.	Payments	Amount Rs.
ToBalance b/d :		By Premises	30,000
" Cash in hand	450	" Rent	2,400
" Cash at Bank	24,420	" Rates & Taxes	3,780
" Subscriptions	62,130	" Printing & Stationery	1,410
		" Sundry Expenses	5,350
" Fair Receipts	7,200	" Wages	2,520
" Variety Show Receipts (Net)	12,810	" Fair Expenses	7,170
" Interest	690	" Honorarium to Secretary	11,000
" Bar Collections	22,350	" Payments for Bar Purchases	17,310
" Sale Proceeds of Old Car	9,000	" Repairs	960
		" Cost of New Car	46,800
		" Balance c/d : Cash at Bank	10,350
	1,39,050		13,9050

City Club

Income and Expenditure Account for the year ended 31st March, 2008

Dr. Cr.

Expenditure	Amount Rs.	Amount Rs.	Income	Amount Rs.	Amount Rs.
To Rent		2,400	By Subscription	62,130	
Rates & Taxes		3,780	Add: Amount Due		
			On 31.3.08	2,940	
" Printing & Stationery		1,410		65,070	
" Wages		2,520	Less: Amount Due		
" Honorarium to Secy.	11000		On 31.3.07	3,600	61470
" Add: O/S on 31.3.08	1000	12,000	" Profit on Sale of		
" Sundry Expenses		5,350	Old Car [Note 1]		3300
" Repairs		960	" Profit from Bar		
" Depreciation :			[Note 5]		6000
On Car [Note 1]	9360		" Variety Show		
On Premises					
[5% of 60600]	3030	12,390	Receipts (net)		12810
			" Income from Fair :		
" Surplus (Excess of			Receipts	7200	
Incomes over			Less : Expenses	7170	30
Expenditure, transfer		43,490	" Interest		690
to Capital Fund)					
		84,300			84,300

Q. 7.

Baisakhi and Srabarni are partners sharing profits and losses in proportion to their capitals. Their Balance Sheet as on 31st March, 2008 is given below :

Liabilities	**Rs.**	**Assets**	**Rs.**
Creditors	**15,000**	**Freehold Premises**	**10,000**
General Reserve	**2,100**	**Machinery**	**3,500**
Capitals :		**Furniture**	**1.750**
Baisakhi	**20,000**	**Office Equipments**	**550**
Srabani	**15,000**	**Stock**	**14,100**
		Bill Receivable	**3,060**
		Debtors	**17,500**
		Bank	**1,590**
		Cash	**50**
	52,100		**52,100**

On 1st April, 2008 they admit Poushali on the following conditions :

(i) Poushali should bring in Rs. 10,000 as capital and to pay Rs. 3,500 for goodwill as she will get 1/4th share in profits.

(ii) A provision of 2% to be raised against debtors, stock to be reduced by 5%, Freehold Premises to be revalued at Rs. 12,650, Machinery at Rs. 2,800, Furniture at Rs. 1,540 and Office equipments at Rs. 495.

(iii) Partners agreed that the values of assets and liabilities should remain unaltered.

Show the necessary accounts and prepare the opening Balance Sheet of the new firm.

Points to be noted

1. The Partners have decided not to alter the book values of the assets and liabilities. The effects of revaluation may be ascertained by preparing a Memorandum Revaluation Account as follows.

(a) Calculation of Profit/Loss on Revaluation

Memorandum Revaluation Account

Dr. **Cr.**

Rs.		Rs.	
To Provision for bad debts	350	By Freehold Premises	2,650
(@ 2% of 17,500)			
To Stock	705		
To Machinery	700		
To Funiture	210		
To Office Equipments	55		
To Partners Capital A/c's			
Baisakhi : (4/7)	360		
Sarbani : (3/7)	270		
	2,650		2,650
To Reversal of Items b/d	2650	By Reversal of Items b/d	2,020
		By Partners Capital A/c	
		(In New Ratio)	
		[Loss on Revaluation]	
		Baisakhi 270	
		Sarbani 203	
		Poushali 157	630
	2,650		2,650

(b) As General Reserve is to remain unaltered, similar adjustment will be required to be shared among old partners in old ratio and then written back among all partner's in new ratio

2. Calculation of net effects on Capital Accounts

New Profit Sharing Ratio : 12 : 9 : 7

Answer 7.

Capital Accounts

Dr. *Cr.*

Date	Baisakhi Particulars Rs.	Srabani Amt Rs.	Poushli Amt Rs.	Amt	Date	Particulars	Baisakhi Amt Rs.	Srabani Amt Rs.	Poushali Amt Rs.
31.3.08	To Gen. Res.	900	675	525	1.4.07	By Balance b/d	20000	15000	-
	To M. Rev.					By General Reserve	1,200	900	-
	A/c	270	203	157	31.3.08	By Bank A/c	-	-	10000
						By M.Rev. A/c	360	270	-
						By Bank A/c (Premium) at 4:3.	2000	1500	-
	“Balance c/d	22,390	16,792	9,318					
		23,560	17,670	10,000			23,560	17,670	10,000

Balance Sheet as on 1.4.2008

Liabilities	Amount Rs.	Amount Rs.	Assets	Amount Rs.	Amount Rs.
Capitals:			Freehold Premises		10,000
Baisakhi	22,390		Machinery		3,500
Srabani	16,792		Furniture		1,750
Poushali	9,318	48,500	Office Equipments		550
General Reserve		2,100	Stock		14,100
Sundry Creditors		15,000	Bill Receivable		3,060
			Debtors		17,500
			Bank		15,090
			[1,590 + 10,000 + 3,500]		50
			Cash		
		65,600			65,600

Q. 8. Kalyani and Ranu commenced business on 1st July, 2005 as partners with capitals of Rs. 1,80,000 and Rs. 1,20,000 respectively. The capitals would remain fixed and carry interest at 10% p.a. profit and losses were to be shared in proportion to their capitals.

They appointed Anita as their Manager on 1st July, 2005 at a salary of Rs. 9,600 per annum plus a bonus of 5% of the net profits after charging such bonus and interest as a partner from the commencement of the business. She had to deposit Rs. 80,000 as security, carrying an interest @ 12%p.a. It was agreed that she would be entitled to one-fifth share of the profits and her security deposit would be treated as her capital carrying interest @ 10% p.a. It was further agreed that this new arrangement should not result in Anita’s share for any of these years being less than what she had already received under the original agreement and terms of her appointment.

The profits before charging Anita’s bonus and interest on Capital of the partners or giving effect to the new arrangement were – (a) for the year 2005-06 - Rs. 60,000; (b) for the year 2006 – 07 – Rs. 1,20,000; (c) for the year 2007-08 – Rs. 1,60,000

Show by a single journal entry to give effect to the new arrangement with explanatory computation.

Points to be noted :

1. **As a Manager, Anita received (a) bonus @ 5% on Net Profits after charging such bonus and interest on capital at 10% p.a. to Kalyani and Ranu (b) Salary Rs. 9,600 p.a. (c) Interest on security deposit at 12% p.a.**
2. **As a Partner Anita is entitled to (a) Interest on Capital at 10% p.a. (b) 1/5th of profit after providing interest on capital at 10% p.a. to all partners including herself.**
3. **If total dues of Anita under (2) above is more than that under (1) above, she should get the difference. But if such dues under (1) above is more, she would not refund the excess already received.**

Answer 8.

Workings (1) – Calculation of Anita's Dues as Manager

	2005-06 Rs.	**2006-07 Rs.**	**2007-08 Rs.**
Salary	9,600	9,600	9,600
Interest on Security Deposit : 12% of 80,000	9,600	9,600	9,600
Bonus 5/105 of profit after charging interest on capitals of Kalyani and Ranu			
2005-06 = 5/105 of (60,000 - 10% of 3,00,000)	1,429		
2006-07 = 5/105 of (1,20,000 – 10% of 3,00,000)		4,286	
2007-08 = 5/105 of (1,60,000 – 10% of 3,00,000)			6,190
	20,629	23,486	25,390

(2) Calculation of Distributable profit under the new arrangement

	2005-06 Rs.	2006-07 Rs.	2007-08 Rs.
Net profits given (after charging interest on security deposit and Anita's salary but before charging interest on capitals)	60,000	1,20,000	1,60,000
Add : Anita's Salary and Interest on Deposit no more payable [9,600 +9,600]	19,200	19,200	19,200
	79,200	1,39,200	1,79,200
Less : Interest on Capitals to all partners @ 10% of [1,80,000 + 1,20,000 + 80,000]	38,000	38,000	38,000
Distributable Profits	41,200	1,01,200	1,41,200
Anita's Share of Profit = 1/5th of Distributable Profit	8,240	20,240	28,240

(3) – Difference in Payments to Anita

	2005-06 Rs.	2006-07 Rs.	2007-08 Rs.
A. Anita's Dues as Partner :			
Interest on Capital @ 10% of 80,000	8,000	8,000	8,000
Share of Profit [as per workings 2]	8,240	20,240	28,240
	16,240	28,240	36,240
B. Anita's Dues as manager [as per workings 1]	20,629	23,486	25,390
Difference Payable to Anita	-	4,754	10,850
Total			15,604

Journal

Date	Particulars	L.F	Dr. Amount Rs.	Cr. Amount Rs.
	Kalyani's Current A/c [3/5 of 15,604]..................Dr.		9,362	
	Ranu's Current A/c [2/5 of 15,604].....................Dr.		6,242	
	To Anita's Current A/c			
	[Adjustments made through Partners' Current A/cs to the to new arrangement regarding profits]			15,604

As capitals remained fixed and interest was calculated every year on these fixed capitals,the necessary adjustment has been made through current accounts.

Q. 9. The following was the Balance Sheet of A, B and C who shared profits in the ratio of 1 : 2 : 2 as on 31st December, 2007.

Sundry Creditors		**10,000**	**Goodwill**	**15,000**
Capital A/c :			**Debtors**	**10,000**
A	**10,000**		**Machinery**	**20,000**
B	**20,000**		**Buildings**	**30,000**
C	**20,000**	**50,000**	**Stock**	**10,000**
General Reserve		**5,000**	**Cash at Bank**	**5,000**
Investment Fluctuation Fund		**3,000**	**Investments**	**10,000**
Bad Debts Reserve		**2,000**	**Bank Loan**	**30,000**
		1,00,000		**1,00,000**

C died on 31st March, 2008. His account is to be settled under the following terms :

Goodwill is to be calculated at the rate of 2 years purchase on the basis of the average of 5 years profit or loss. Profit for January to March' 08 is to be calculated proportionately on the average profit of 3 years. The profits were : 2003 Rs. 3,000, 2004 Rs. 7,000, 2005 Rs. 10,000, 2006 Rs. 14,000, 2007 loss Rs. 12,000. During 2007 a Moped costing Rs. 4,000 was purchased and debited to Travelling Expenses Account on which depreciation is to be calculated @ 25%/. Other values agreed on assets are : Stock Rs. 12,000, Building Rs. 35,000, Machinery Rs. 25,000 and Investments Rs. 8,000. Debtors are considered good.

Prepare new Balance Sheet of the firm, necessary Journal entries and Ledger Accounts of the Partners.

Working Notes :

1. Adjusted profit for 2007

Profit		**(12,000)**
Add :	**Cost of Moped Wroughly treated as Travelling Expense**	**4,000**
Less :	**Depreciation not charjed on Moped @25% on Rs. 4,000**	**(1,000)**
	Adjusted Profit	**(9,000)**

2. Valuation of Goodwill

Total Profit/Loss for the last 5 years = 3,000 + 7,000 + 10,000 + 14,000 – 9,000 = Rs. 25,000
Average Profit = Rs. 25,000/5 = Rs. 5,000; Goodwill = 2 × Rs. 5,000 = Rs. 10,000

But Goodwill is appearing at Balance Sheet at Rs. 15,000. Over valuation of Goodwill Rs. 5,000 should be written off among A, B & C as 1 : 2 : 2.

The balance of Goodwill between A & B in the ratio 1:2

3. Share of Profit of Deceased Partner till his date of death

Average Profit of the last 3 years [2005, 2006 & 2007] = (10,000 + 14,000 – 9,000)/3 = Rs. 5,000

Estimated Profit for 3 months [Jan to March, '08] = Rs. 5,000 x 3/12 = Rs. 1,250

C's share of profit = Rs. 1,250 x 2/5 = Rs. 500

Answer 9.

Books of A, B & C

Journal Entries

Date	Particulars		Amount (Rs)	Amount (Rs)
	Stock A/c	Dr.	2,000	
	Buildings A/c	Dr.	5,000	
	Machinery A/c	Dr.	5,000	
	Moped A/c [4,000 –Depr. 1,000]	Dr.	3,000	
	To Revaluation A/c			15,000
	[Values of assets increased on revaluation]			
	General Reserve A/c	Dr.	5,000	
	Investment Fluctuation Fund A/c	Dr.	3,000	
	Bad Debts Reserve A/c	Dr.	2,000	
	To A's Capital A/c			2,000
	To B's Capital A/c			4,000
	To C's Capital A/c			4,000
	[Transfer of Reserves etc. to Partners Capitals in 1:2:2]			
	Revaluation A/c	Dr.	2,000	
	To Investment A/c			2,000
	[Value of investments reduced]			
	Revaluation A/c	Dr.	13,000	
	To A's Capital A/c			2,600
	To B's Capital A/c			5,200
	To C's Capital A/c			5,200
	(Being profit on revaluation shared in 1:2:2)			
	A's Capital A/c	Dr.	1,000	
	B's Capital A/c	Dr.	2,000	
	C's Capital A/c	Dr.	2,000	
	To Goodwill A/c			5,000
	[Value of Goodwill reduced]			
	Profit & Loss Suspense A/c	Dr.	500	
	To C's Capital A/c			500
	[Estimated share of Profit till his date of death transferred to the decreased partner's Capital]			
	C's Capital A/c	Dr.	27,700	
	To C's Executors A/c			27,700
	[Total dues to the deceased partner transferred to his Executor's A/c]			

Date	Particulars	A Rs.	B Rs.	C Rs.	Date	Particulars	A Rs.	B Rs.	C Rs.
31.3	To Goodwill A/c	1,000	2,000	2,000	1.1	By Balance b/d	10,000	20,000	20,000
	To C's Executors A/c (Balance transferred)	3,333	6,667	–	31.3	" Revaluation A/c	2,600	5,200	5,200
						" Sundry Reserves A/c	2,000	4,000	4,000
	To Balance c/d	10,267	20,533	–		" P/L Suspense A/c	–	–	500
		14,600	29,200	29,700			14,600	29,200	29,700

A and B

Balance Sheet as at 31.3.2008

Liabilities	Amt Rs.	Amt Rs.	Assets	Amt Rs.	Amt Rs.
Capital A/cs :			Buildings		35,000
A	10,267		Machinery		25,000
B	20,533	30,800	Moped (cost less depreciation)		3,000
C's Executor's A/c		27,700			
Bank Loan		30,000	Investments		8,000
Sundry Creditors		10,000	Stock		12,000
			Debtors		10,000
			Bank		5,000
			Profit &Loss Suspense A/c (Dr.)		500
		98,500			98,500

Q. 10. Discuss the applicability of Section 37 of the Partnership Act :

In case of retirement, the retiring partner or in case of death, the executor of the deceased partner, if the dues are not settled, then such retired partner or the executor is entitled to the following :

Maximum of :

Interest @ 6% p.a. on the amount due to them(i.e. if the amount is unsettled, like, rate of interest on loan to be allowed to the retired partner or the executor is not mentioned)

Or

The share of profit earned for the amount due to the partner

Conditions:

(a) The surviving partners/continuing partners continue to carry on the business of the firm.

(b) The business is carried on without any final settlement of accounts between the continuing partners and the outgoing partners or his estate.

(c) There is no contract to the contrary of the options contained in Section 37 i.e. share in the profits or interest @ 6% p.a. on the unsettled capital.

Example: Unsettled capital of C Rs.52,000 (Date of retirement : 30.9.08, financial year 2008-09). Net Profit earned by the firm after C's retirement Rs.25,000. Capitals of A:Rs.57,000 and B Rs.76,000)

C is entitled to the maximum of the following :

(i) interest on unsettled capital = Rs.52,000 x 6% x 6 months = Rs.1,560

(ii) Profit earned out of unsettled capital = Profit x Retired or Deceased Partner's unsettled Dues /Total Capital of the firm(including the amount due to the retired or deceased partner)

= Rs.(25,000 x 52,000) / (Rs.52,000 + 57,000 + 76,000) = Rs.7,027.

Q. 11. The firm of M/s LMS was dissolved on 31.3.2008, at which date its Balance Sheet stood as follows :

Liabilities	*Rs.*	*Assets*	*Rs.*
Creditors	**2,00,000**	**Fixed Assets**	**45,00,000**
Bank Loan	**5,00,000**	**Cash and Bank**	**2,00,000**
L's Loan	**10,00,000**		
Capitals :			
L	**15,00,000**		
M	**10,00,000**		
S	**5,00,000**		
	47,00,000		**47,00,000**

Partners share profits equally. A firm of Chartered Accounts is retained to realise the assets and distributed the cash after discharge of liabilities. Their fees which are to include all expenses is fixed at Rs. 1,00,000. No loss is expected on realisation since fixed assets include valuable land and building.

Realisations are : 1st Rs. 5,00,000, 2nd Rs. 15,00,000, 3rd Rs. 15,00,000, 4th Rs. 30,00,000, 5th Rs. 30,00,000.

The Chartered Accountant firm decided to pay off the partners in 'Higher Relative Capital Method'. You are required to prepare a statement showing distribution of cash with necessary workings.

Answer 11.

Statement showing the Distribution towards Firm's Outside Debts' and Partner's Loan

	Particulars	*Ratio*	*Total Rs.*	*Creditors Rs.*	*Bank Loan Rs.*	*L 's Loan Rs.*
A	Balance Due		17,00,000	2,00,000	5,00,000	10,00,000
B	*Less* : Amount paid out of its instalment	2 : 5	6,00,000	1,71,429	4,28,571	—
C	Balance Due (A-B)		11,000,000	28,571	71,429	10,00,000
D	*Less* : Amount paid out of 2nd installment					
	First Rs. 1,00,000	2 : 5	1,00,000	28,571	71,429	—
	Next Rs. 10,00,000	0 : 0 : 1	10,00,000	—	—	10,00,000
E	Balance Due (C-D)		Nil	Nil	Nil	Nil

Statement showing the Distribution of Cash among Partners
(According to Proportionate Capital Method)

Particular	*Ratio*	*Total* *Rs*	*L* *Rs*	*M* *Rs*	*S* *Rs*
A Balance Due		30,00,000	15,00,000	10,00,000	5,00,000
B *Less* : Amount paid out of					
2nd instalment	1 : 0 : 0	4,00,000	4,00,000	—	—
C Balance Due (A-B)		26,00,000	11,00,000	10,00,000	5,00,000
D *Less* : Amount paid out of					
3rd Instalment					
First Rs. 1,00,000		1,00,000	1,00,000	—	—
Next Rs. 10,00,000	1 : 1 : 0	10,00,000	5,00,000	5,00,000	—
Balance Rs. 4,00,000	1 : 1 : 1	4,00,000	1,33,334	1,33,333	1,33,333
		15,00,000	7,33,334	6,33,333	1,33,333
E Balance Due (C-D)		11,00,000	3,66,666	3,66,666	3,66,667
F *Add* : Realisation Profit credited					
(Rs. 30,000,000 – Rs. 11,00,000)	1 : 1 : 1	19,00,000	6,33,334	6,33,334	6,33,333
G Balance Due (after taking into					
Realisation Profit (E + F)		30,00,000	10,00,000	10,00,000	10,00,000
H *Less* : Amount paid out of					
4th Instalment	1 : 1 : 1	30,00,000	10,00,000	10,00,000	10,00,000
I Balance Due (G - H)		Nil	Nil	Nil	Nil
J *Add* : Realisation Profit credited	1 : 1 : 1	30,00,000	10,00,000	10,00,000	10,00,000
K Balance due (after taking into					
Realisation profit) (I + J)		30,00,000	10,00,000	10,00,000	10,00,000
L *Less* : Amount paid out of					
5th Instalment	1 : 1 : 1	30,00,000	10,00,000	10,00,000	10,00,000
M Balance Due (K - L)		Nil	Nil	Nil	Nil

Working Notes :

(i) Statement showing the computation of Highest Relative Capital

Particulars	*L*	*M*	*S*
A Actual Capitals	15,00,000	10,00,000	5,00,000
B Profit Sharing Ratio	1	1	1
C Actual Capital × Profit Sharing Ratio	15,00,000	10,00,000	5,00,000
D Proportionate Capital taking S's Capital			
as Base Capital	5,00,000	5,00,000	5,00,000
E Surplus Capital (A - D)	10,00,000	5,00,000	—
F Profit Sharing Ratio	1	1	—
G Surplus Capital × Profit Sharing Ratio	10,00,000	5,00,000	—
H Revised Proportional Capital taking			
M's Capital as Base Capital	5,00,000	5,00,000	—
I Revised Surplus Capital (E - G)	5,00,000	—	—

(ii) *Scheme of Distribution* : First Rs. 5,00,000 will be paid to *L*, next Rs. 10,00,000 will be distributed between *L* and *M* in their profit sharing (i.e. 1 : 1) and the balance will be distributed among *L, M* and *S* in their profit sharing ratio (i.e. 1 : 1 : 1).

(iii) It has been assumed that the amounts of realisation given in the question pertain to realisation of fixed assets.

(iv) *Calculation of amount available for distribution at the time of first realisation of fixed asset*

= Cash & Bank Balance + 1st Realisation – Liquidator's remuneration

= Rs. 2,00,000 + Rs. 5,00,000 – Rs. 1,00,000 = Rs. 6,00,000.

Q. 12. Ajay, Rama, Adesh and Sharad were partners in a firm. The capital of the firm consisted of Rs. 40,000 contributed originally in the proportion of 4 : 3 : 2 : 1. The profits and losses were shared in the same proportion. The firm was dissolved on 31st March, 2008. The Balance Sheet as on that date was as under :

Liabilities	***Rs.***	***Assets***	***Rs.***
Capitals :		**Cash**	**6,000**
Ajay	**20,000**	**Debtors**	**50,000**
Rama	**14,000**	**Stock**	**19,000**
Adesh	**10,500**		
Sharad	**2,500**		
Loans :			
Ajay	**5,000**		
Adesh	**8,000**		
Creditors	**15,000**		
	75,000		**75,000**

It was decided on 15th April that the net realisations should be distributed on the first of each month in the appropriate order. The realisation and expenses at the end of each month were as under :

	Debtors Rs.	***Stock Rs.***	***Expenses Rs.***
April	**15,000**	**7,000**	**500**
May	**8,500**	**5,000**	**1,000**
June	**11,000**	**Nil**	**250**
July	**5,500**	**4,000**	**150**
August	**7,000**	**2,500**	**100**

The Stock was completely disposd off. It was further agreed that Rama should take over the remaining debts for Rs. 2,500.

Required : Show how the cash was distributed according to Maximum Loss Method.

Answer 12.

Statement showing the Distribution of Cash
(According to Maximum loss method)

	Particular	*Creditors* Rs.	*Ajay's Loan* Rs.	*Adesh's Loan* Rs.	*Ajay* Rs.	*Rama* Rs.	*Adesh* Rs.	*Sharad* Rs.
A	Balance Due	15,000	5,000	8,000	20,000	14,000	10,500	2,500
B	Cash balance Rs. 6,000 paid to creditors	6,000	—	—	—	—	—	—
C	Balances Due (A-B)	9,000	5,000	8,000	20,000	14,000	10,500	2,500
D	Paid to Creditors & Ajay & Adesh	9,000	4,808	7,692	—	—	—	—
E	Balance unpaid (C - D)		192	308	20,000	14,000	10,500	2,500
F	First Rs. 500 out of Net Collection to Ajay & Adesh Loan		192	308	—	—	—	—
G	Balance Unpaid				20,000	14,000	10,500	2,500
	Max. Loss distributd [Rs. 47,000 – Rs. 12,000]				(14,000)	(10,500)	(7,000)	(3,500)
					6,000	3,500	3,500	(1,000)
	Sharad's deficiency charged to other Partners				(450)	(315)	(235)	1,000
H	Amount paid on 1st June				5,550	3,185	3,265	Nil
I	Balance unpaid [G - H]				14,450	10,815	7,235	2,500
	Max Loss distributed [Rs. 35,000 – Rs. 10,750]				(9,700)	(7,275)	(4,850)	(2,425)
J	Amount paid on 1st July				4,750	3,540	2,385	75
K	Balance Unpaid (I - J)				9,700	7,275	4,850	2,425
	Max. Loss distributed [Rs. 24,250 – Rs. 9,350]				(5,960)	(4,470)	(2,980)	(1,490)
L	Amount paid on 1st Aug.				3,740	2,805	1,870	935
M	Balances unpaid [K - L]				5,960	4,470	2,980	1,490
N	Max Loss distributed [Rs. 14,900 – Rs. 9,400 – Rs. 2,500]				(1,200)	(900)	(600)	(300)
O	Balances payable				4,760	3,570	2,380	1,190
P	Cash paid on 1st Sept.				(4,760)	(1,070)	(2,380)	(1,190)
Q	Book debts taken over on 1st Sept.				—	(2,500)	—	—
R	Balances unpaid being los on realisation [N - P - Q]				1,200	900	600	300

Q. 13. M/s AB & Co., having A and B as equal partners, decided to amalgamate with M/s CD & Co., having C and D as equal partners on the following terms and conditions :

1. **The new firm XY and Co. to pay Rs 12,000 to each firm for Goodwill.**
2. **The new firm to take over investments at 90% of the value, land at Rs 66,800, premises at Rs 53,000, machinery at Rs 9,000 and only the trade liabilities of both the firms and the debtors at book value. Typewriters, worth Rs 800, belonging to CD & Co., not appearing in the Balance Sheet. That is not taken over by the new firm.**
4. **Bills payable pertaining to trade transactions only.**
5. **All the four partners in the new firm to bring in Rs 1,60,000 as capital in equal shares.**

The following were the Balance Sheets of both the firms on the date of amalgamation :

Liabilities	AB&Co. Rs.	CD&Co. Rs.	Assets		AB&Co. Rs.	CD&Co. Rs.
Trade creditors	20,000	10,000	Cash		15,000	12,000
Bills payable	5,000	-	Investments		10,000	8,000
Bank overdraft	2,000	10,000	Debtors	10,000		
A's Loan	6,000	-	Less: Provision	1,000	9,000	4,000
Capitals:			Furniture		12,000	6,000
A	35,000	-	Premises		30,000	-
B	22,000	-	Land		-	50,000
C	-	36,000	Machinery		15,000	15,000
D	-	20,000	Goodwill		9,000	9,000
General Reserve	8,000	3,000				
Investment Fluctuation Fund	2,000	1,000				
	1,00,000	80,000			1,00,000	80,000

Assuming immediate discharge of bank overdraft, pass necessary Journal entries to close the books *of* A B & Co. Also pass Journal entries in the books of XY & Co. and prepare the Balance Sheet of the firm.

Answer 13.

In the books of AB & Company

Journal

Date	Particulars		Rs	Rs
	Bank Overdraft A/c	Dr.	2,000	
	To Cash A/c			2,000
	(Payment *of* overdraft)			
	Realisation A/c	Dr.	99,000	
	To Cash A/c			13,000
	To Investments A/c			10,000
	To Debtors A/c			10,000
	To Furniture A/c			12,000
	To Premises A/c			30,000
	To Machinery *A/c*			15,000
	To Goodwill A/c			9,000
	(Transfer of different assets)			

	Provision for Bad Debts A/c	Dr.	1,000	
	Trade Creditors A/c	Dr.	20,000	
	Bills Payable A/c	Dr.	5,000	
	To Realisation A/c			26,000
	(Transfer of different Liabilities)			
	M/s Lucky & Co. A/c	Dr.	80,000	
	To Realisation A/c (Note 1)			80,000
	(Purchase consideration due)			
	A Capital A/c	Dr.	6,000	
	B Capital A/c	Dr.	6,000	
	To Realisation *A/c*			12,000
	(Furniture taken over by the partners)			
	General Reserve A/c	Dr.	8,000	
	Investment Fluctuation Fund A/c	Dr.	2,000	
	To A Capital A/c			5,000
	To B Capital A/c			5,000
	(Reserve and surplus distributed)			
	Realisation A/c	Dr.	19,000	
	To A Capital A/c			9,500
	To B Capital A/c			9,500
	(Profit on realisation transferred)			
	A's Loan A/c	Dr.	6,000	
	To A Capital A/c			6,000
	(A's loan transferred to his Capital A/c)			
	Cash A/c	Dr.	9,500	
	To B Capital A/c			9,500
	(Cash brought in by B)			
	Capital in M/s XY & Co. A/c	Dr.	80,000	
	To M/s XY & Co. A/c			80,000
	(Settlement of purchase consideration)			
	A Capital A/c	Dr.	49,500	
	To Capital in XY & Co. A/c			40,000
	To Cash A/c			9,500
	(Final adjustment to close the books)			
	B's Capital A/c	Dr.	40,000	
	To B's Cap. In XY & Co. A/c			40,000
	(Final adjustment to close the books)			

Q. 14. Journalise the following transactions in the books of Head Office. Delhi Branch and Agra Branch :

(a) Goods worth Rs. 50,000 are supplied by Delhi Branch to Agra Branch under the instructions of Head Office. (b) Delhi Branch draws a bill receivable for Rs 40,000 on Agra Branch which sends its acceptance. (c) Delhi Branch received Rs 10,000 from Agra Branch. (d) Goods worth Rs. 20,000 were returned by a customer of Agra Branch to Delhi Branch. (e) Agra Branch collected Rs 20,000 from a customer of Delhi Branch.

Answer 14.

Journal of Head Office

Particulars		L.F.	Dr. (Rs)	Cr. (Rs)
(a) Agra Branch A/c	Dr.		50,000	
To Delhi Branch A/c				50,000
(Being the goods supplied by Delhi Branch to Agra Branch)				
(b) Delhi Branch A/c	Dr.		40,000	
To Agra Branch A/c				40,000
(Being a B/R drawn by Delhi upon Agra Branch)				
(c) Delhi Branch A/c	Dr.		10,000	
To Agra Branch A/c				10,000
(Being Cash sent by Agra Branch to Delhi Branch)				
(d) Delhi Branch A/c	Dr.		20,000	
To Agra Branch A/c				20,000
(Being the goods returned by customer of Agra Branch to Delhi Branch)				
(e) Agra Branch A/c	Dr.		20,000	
To Delhi Branch A/c				20,000
(Being the Cash collected by Agra Branch from a customer of Delhi Branch				

Journal of Delhi Branch

Particulars		L.F.	Dr. (Rs)	Cr. (Rs)
(a) H.O. A/c	Dr.		50,000	
To Goods sent to Branch A/c				50,000
(Being the goods supplied to Agra Branch)				
(b) Bills Receivable A/c	Dr.		40,000	
To H.O. A/c				40,000
(Being the acceptance of a B/R received from Agra Branch)				
(c) Cash A/c	Dr.		10,000	
To H.O. A/c				10,000
(Being the cash received from Agra Branch)				
(d) Goods Sent to Branch A/c	Dr.		20,000	
To H.O. A/c				20,000
(Being the goods received from a customer of Agra Branch)				
(e) H.O. A/c	Dr.		20,000	
To Debtors A/c				20,000
(Being the cash collected by Agra Branch from our customer)				

Journal of Agra Branch

Particulars		L.F.	Dr. (Rs)	Cr. (Rs)
(a) Goods sent to Branch A/c	Dr.		50,000	
To H.O. A/c				50,000
(Being the goods received from Delhi Branch)				
(b) H.O. A/c	Dr.		40,000	
To Bill Payable A/c				40,000
(Being a B/P accepted for Delhi Branch)				
(c) H.O. A/c	Dr.		10,000	
To Cash A/c				10,000
(Being cash paid to Delhi Branch)				
(d) H.O. A/c	Dr.		20,000	
To Debtors A/c				20,000
(Being the goods returned by customer of Delhi Branch)				
(e) Cash A/c	Dr.		20,000	
To H.O. A/c				20,000
(Being the Cash received from a customer of Delhi Branch				

Q. 15. The Head Office of Z Ltd. and its Branch keep their own books prepare own Profit and Loss Account. The following are the balances appearing in teh two sets of the books as on 31.3.2009 after ascertainment of profits and after making all adjustments except those referred to below :

Particulars	Head Office		Branch Office	
	Dr.	Cr.	Dr.	Cr.
Capital	—	1,00,000	—	—
Fixed Assets	36,000	—	16,000	—
Stock	34,200	—	10,740	—
Debtors & Creditors	7,820	3,960	4,840	—
Cash	10,740	—	1,420	—
Profit & Loss	—	14,660	—	3,060
Branch Account	29,860	—	—	—
Head Office Account	—	—	—	28,020
Total	1,18,620	1,18,620	33,000	33,000

Prepare the Balance Sheet of the business as on 31.3.2009 and the journal entries necessary (in both sets of books) to record the adjustments dealing with the following :

1. **On 31.3.2009, the branch had sent a cheque for Rs. 1,000 to the head office, not received by them nor credited to the branch till next month.**
2. **Goods valued at Rs. 440 had been forwarded by the head office to the branch and invoiced on 30.3.2009, but were not received by the branch nor dealt with in their books till next month.**
3. **It was agreed that the branch should be charged with Rs. 300 for Administration Services, rendered by the Head Office during the year.**

4. **Stock stolen in transit from the Head Office to the Branch and charged to the Branch by the Head Office but not credited to the Head Office in the Branch Books as the Manager declined to admit any liability, Rs. 400 (not covered by insurance).**
5. **Depreciation of Branch Assets, of which accounts are maintained by the Head Office, not provided for Rs. 250.**
6. **The balance of Profits shown by the Branch is to be transferred to HO Books.**

Answer 15.

1. Balance Sheet of Z Ltd. as at 31.03.2009

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Capital	1,00,000		**Fixed Assets :**		
Add : Net Profit of :			—Head Office	36,000	
—Head Office	14,560		—Branch	16,000	
—Branch	2,510	1,17,070	**Less :** Depreciation	(250)	51,750
Creditors :			**Stock :**		
—Head Office	3,960		—Head Office	34,200	
—Branch	1,920	5,880	—Branch	10,700	45,380
			Debtors :		
			—Head Office	7,820	
			—Branch	4,840	12,660
			Cretors :		
			—Head Office	10,740	
			—Branch	1,420	
			—In Transit	1,000	13,160
Total		**1,22,950**	**Total**		**1,22,950**

2. Journal Entries in the books of Head Office

S. No.	Particulars		Dr.	Cr.
1	Goods in Transit A/c	Dr.	440	
	To Branch A/c			440
	(Being the goods invoiced on 30.3.2009 not yet received by the branch as the Balance Sheet date)			
2	Branch A/c	Dr.	300	
	To Profit & Loss A/c			300
	(Being amount of Administrative Services rendered by the HO to the Branch)			
3	Profit & Losss A/c	Dr.	400	
	To Branch A/c			400
	(Being the amount of uninsurd stock stolen on way to Branch)			

4	Branch A/c Dr. To Branch Fixed Assets (Being depreciation on Branch Fixed Assets for which accounts are maintained in the Head Office books)	250	 250
5	Branch Profit & Loss A/c Dr. To Profit & Loss A/c (Being Profit shown by the Branch Profit & Loss Account transferred to (General) Profit & Loss Account)	2,510	 2,510

3. Head Office Profit and Loss Account

Particulars	Rs.	Particulars	Rs.
To Branch — Uninsured Stock stolen	400	By Balance b/d	14,660
To Profit—Transferred	14,560	By Branch Administration Expenses	300
Total	**3,060**	**Total**	**3,060**

4. Journal Entries in the books of Branch Office

S. No.	Particulars	Dr.	Cr.
1	Cash in Transit A/c Dr. To Head Office A/c (Being cash sent on 31.3.2009 not yet received by the HO)	1,000	 1,000
2	Profit & Loss A/c Dr. To Head Office A/c (Being administrative services rendered by the Head Office)	300	 300
3	Profit & Loss A/c Dr. To Head Office A/c (Being depreciation on Branch Fixed Assets for which accounts are maintained in the Head Office books)	250	 250
4	Profit & Loss Account Dr. To Head Office A/c (Bieng profit transferred to Head Office Account)	2,510	 2,510

5. Branch Profit and Loss Account

Particulars	Rs.	Particulars	Rs.
To HO A/c–Administrative Services	300	By Balance b/d	3,060
To HO A/c–Depn. on Branch Assets	250		
To Profit–Transferred to HO Account	2,510		
Total	**3,060**	**Total**	**3,060**

Q. 16. *X* Ltd., has a factory with two manufacturing Departments '*X*' and '*Y*'. Part of the output of Department *X* is transferred to Department *Y* for further procesing and the balance is directly transferred to selling Department. The entire production of Department *Y* is directly transferred to the selling Department. Inter departmental stock transfers are made as follows :

_X_ Department to _Y_ Department at 33-1,3% over Departmental Cost.
_X_ Department to selling department at 50% over Departmental Cost.
_Y_ Department to selling department at 25% over Departmental Cost.

The following information is given for the year ended 31st March, 2008.

Particulars	***Detp. X***		***Dept. Y***		***Selling Dept.***	
	Units	***Rs.***	***Units***	***Rs.***	***Units***	***Rs.***
Opening Stock of Finished Goods	**60**	**60,000**	**20**	**40,000**	**50**	**1,28,000**
Opening Stock of Raw Materials	**—**	**—**	**—**	**—**	**—**	
Raw material Consumed	**—**	**1,82,000**	**—**	**20,000**	**—**	**—**
Labour Charges	**—**	**70,000**	**—**	**32,000**	**—**	**—**
Sales	**—**	**—**	**—**	**—**	**120**	**4,80,000**
Closing Stock of Finished Goods	**40**	**—**	**50**	**—**	**60**	**—**

Out of the total transfer by _X_ Department, 30 units were transferred to selling department, while the reamining to Department _Y_. The per unit material and labout consumption in _X_ Department on production to be transferred directly to selling department is 300 per cent of the labour and material consumption on units transferred to _Y_ Department. General Administration expenses Rs. 80,000.

Required : Prepare Departmental Profit and Loss Account and General Profit and Loss Account for the year ended 31.3.2008.

Answer 16.

Departmental Profit and Loss Account

Dr. *for the year ended 31st March, 2008* *Cr.*

	X Dept.		*Y Dept.*		*Selling Dept.*			*X Dept.*		*Y Dept.*		*Sell Dept.*	
Particulars	*Qty.*	*Rs.*	*Qty.*	*Rs.*	*Qty.*	*Rs.*	*Particulars*	*Qty.*	*Rs.*	*Qty.*	*Rs.*	*Qty.*	*Rs.*
To Opening stock	60	60,000	20	40,000	50	1,28,000	By Stock						
To Raw Material								160	3,70,000	100	2,50,000	—	—
consumed		1,82,000	—	20,000	—	—	By Sales	—	—	—	—	120	4,80,000
To Units							By Closing						
produced	140	—	—	—	—	—	Stock	40	48,000	50	1,00,000	60	1,80,000
To Labour Charges		70,000	—	32,000	—	—							
To Stock Transferred From *X* Dept.			130	2,08,000	30	1,62,000							
To Stock Transferred From *Y* Dept.					100	2,50,000							
To Departmental Profit t/f to General P & L A/C		1,06,000	—	50,000	—	1,20,000							
	200	4,18,000	150	3,50,000	180	6,60,000		200	4,18,000	150	3,50,000	180	6,60,000

General Profit and Loss Account

Dr. *for the year ended 31st March, 2008* *Cr.*

Particulars	*Rs.*	*Particulars*	*Rs.*
To General Adm. Expenses	80,000	By Profit transferrd from :	
To Stock Reserve for Closing Stock		X Dept.	1,06,000
on Dept. Y	12,000	Y Dept.	50,000
on Selling Dept.	18,175	Selling Dept.	1,20,000
To Net profit	1,65,825		
	2,76,000		2,76,000

Working Notes :

(a) Selling Dept.

Dr. *Cr.*

Particulars	*Units*	*Particulars*	*Units*
To Opening Stock	50	By Sales	120
To T/f from X Dept.	30	By Closing Stock	60
To T/f from Y Dept. (Balancing figure)	100		
	180		180

(b) *Y* Dept.

Dr. *Cr.*

Particulars	*Units*	*Particulars*	*Units*
To Opening Stock	20	By T/f to Selling Dept.	100
To T/f from X Dept.	130	By Closing Stock	50
	150		150

(c) *X* Dept.

Dr. *Cr.*

Particulars	*Units*	*Particulars*	*Units*
To Opening Stock	60	By T/f to Selling Dept.	30
To Production (Balancing figure)	140	By T/f to Y Dept.	130
		By Closing Stock	40
	200		200

(d) Total Equivalent units produced in *X* Dept. in terms of those t/f to *Y* Dept.

= Equivalent units of those t/f to Sell Dept. + t/f to Y Dept. + Closing Stock.

= $(30 \times 300/100) + 130 + 40 = 260$

(e) Calculation of Transfer Prices and Closing Stock.

		X Dept. *Rs.*	*Y Dept.* *Rs.*	*Selling Dept.* *Rs.*
A	Cost of Opening Stock	60,000	40,000	1,28,000
B	*Add* : Cost of Raw Materials Consumed	1,82,000	20,000	—
C	*Add* : Labour Charges	70,000	32,000	—
D	*Add* : T/f from X Dept.	—	2,08,000	1,62,000
E	*Add* : T/f form Y Dept.	—	—	2,50,000
F	Total Cost (A+B+C+D+E)	3,12,000	3,00,000	5,40,000
G	Equivalant Units	260	150	180
H	Average Cost per Equivalent Unit (F/G)	1,200	2,000	3,000
I	Transfer Price of 130 Units t/f to Dept. Y			
	(a) Cost of 130 Units (130×Rs. 1,200)	1,56,000		
	(b) *Add* : Profit element @ 33-1/3%	52,000		
		2,08,000		
J	Transfer Price of Units t/f to Selling Dept.			
	(a) Cost of Units t/f	1,08,000		
	(b) *Add* : Profit element	54,000	50,000	
		1,62,000	2,50,000	
K	Closing Stock	48,000	1,00,000	1,80,000
		(40×Rs. 1,200)	(50×Rs. 2,000)	(60×Rs. 3,000)

(f) *Unrealised Profit on Increase in Closing Stock of Y Dept.* (Rs. 1,00,000 – Rs. 40,000)

A Current Cost incurred by Dept. *Y*

= Rs. 20,000 + Rs. 32,000 + Rs. 2,08,000 = Rs. 2,60,000

B Profit charged by Dept. *X* included in above (Rs. 2,08,000 × 1/4) = Rs. 52,000

C Profit included in Increase in Closing Stock.

= (Rs. 52,000 × Rs. 60,000/Rs. 2,60,000) = Rs. 12,000

(g) *Profit Included in output transferred by Y Deptt. to Selling Dept.*

A Transfer Price = Rs. 2,50,000

B Profit of Dept. *Y* included in Above (Rs. 2,50,000 × 25/125) = Rs. 50,000

C Cost Element of Dept. *X* in Transfer Price (Rs. 2,50,000 – Rs. 50,000) = Rs. 2,00,000

D Profit of Dept. *X* included in above

(Rs. 2,00,000 × Rs. 52,000/Rs. 2,60,000) = Rs. 40,000

E Total Profit Included in Transfer price (Rs. 50,000 + Rs. 40,000) = Rs. 90,000

(h) Profit Included in output transferred by *X* Dept. to Selling Dept.

= (Rs. 1,62,000 × 50/150) = Rs. 54,000

(i) Total Profit included in output transferred to Selling Dept.

= Rs. 90,000 + Rs. 54,000 = Rs. 1,44,000

(j) Total Transfer Price for the Transfer made by *X* Dept. and *Y* Dept.

= Rs. 1,62,000 + Rs. 2,50,000 = Rs. 4,12,000

(k) Unrealised Profit included in increas in Closing Stock of Sell Dept.

= Rs. 1,44,000 × Rs. 52,000/Rs. 4,12,000 = Rs. 18,175

Q. 17. (a) B Ltd. Purchased certain plant and machinery for Rs.50 lakhs. 20% of the cost net of CENVAT credit is the subsidy component to be realized from a State Government for establishing industry in a backward district. Cost includes excise Rs. 8 lakhs against which CENVAT credit can be claimed. Compute depreciable amount.

Answer 17. (a)

We shall have to determine the historical cost of the plant and machinery.

Purchase Price	Rs.50 lakhs
Less: Specific Excise duty against which CENVAT is available	Rs. 8 lakhs
Original Cost of the machinery for accounting purposes	Rs. 42 lakhs
Less: Subsidy @ 20% of Rs.42 lakhs	Rs. 8.4 lakhs
Depreciable Amount	Rs. 33.6 lakhs

Note : As CENVAT Credit on Capital Goods can be availed upto 50% in the first year of acquisition and the balance in the next year, an alternative treatment may also be considered.

The original cost of the plant and machinery can be taken at Rs. 50 lakhs and a sum of Rs.8.4 lakhs can be transferred to deferred income account by way of subsidy reserve. The portion of unavailed CENVAT Credit is also required to be reduced from cost.

Q. 17. (b) A company undertook to pay contract for a building for Rs.40lakhs. As on 31.3.2008, it incurred it incurred a cost of Rs.6 lakhs and expects that there will be Rs.36 lakhs more for completing the building. It has received Rs.4 lakhs as progress payment. What is the degree of completion?

Answer 17. (b)

$$\text{Percentage of Completion} = \frac{\text{Cost to date}}{\text{Cumulative cost incurred} + \text{Estimated cost to complete}} \times 100$$

$$= 6/(6 + 36) \times 100 = 14.28\%$$

Q. 17. (c) Advise D Ltd.about the treatment of the following in the final statement of accounts for the year ended 31st March,2008.

A claim lodged with the Railways in March,2006 for loss of goods of Rs.5 lakhs had been passed for payment in March,2008 for Rs.4 lakhs. No entry was passed in the books of the company, when the claim was lodged.

Answer 17. (c)

The financial statements of the company are prepared for the year ended 31.3.08.

There was a loss of goods of Rs.5 lakhs in 2005-06 and the claim was lodged in March 2006 with the Railway authorities. No entry was passed in the books of the company when the claim was lodged and the said treatment was correct in view of AS-9, which states that if uncertainty exists as to collectability, the revenue recognition should be postponed.

Since, the claim is passed for payment of Rs.4 lakhs in March,2008, it should be recognized as revenue in the financial statements prepared for the year ended 31.3.08.

As per AS-5 Revised, the claim amount received will not be treated as extraordinary item. AS-5 Revised further states that when items of income and expense within profit 0r loss from ordinary activities are of such size, nature, or incidence that their disclosure is relevant to explain the performance of the enterprise for the period, the nature and amount of such items should be disclosed separately. Accordingly, the nature and amount of this item should be disclosed separately.

Q. 18. (a) Hero Ltd. purchased a machine of Rs.50 lakhs including excise duty of Rs. 10 lakhs. The excise duty is Cenvatable under the excise laws. The enterprise intends to avail CENVAT credit and it is reasonably certain to utilize the same with reasonable time. How should the excise duty of Rs.10 lakhs be treated?

Answer 18. (a)

The following journal entries should be recorded :

In the year of acquisition:		(Rs. Lakhs)	
Machinery A/c	Dr.	40	
CENVAT Credit Receivable A/c	Dr.	5	
CENVAT Credit Deferred A/c	Dr.	5	
To Supplier's A/c			50
In the next year:			
CENVAT Credit Receivable A/c	Dr.	5	
To CENVAT Credit Deferred A/c			5

Q. 18. (b) Z Ltd. acquired a machine on 1.4.2006 costing US $ 1,00,000. The suppliers agreed to the follwing terms of payment :

1.4.2006	**:**	**down payment 50%**
1.4.2007	**:**	**25%**
1.4.2008	**:**	**25%**

The company depreciates machinery @ 10% on the Straight Line Method. The rate of exchange is steady at US $ 1= Rs.40 upto 30.9.2007. On 1.10.07, due to an official revaluation of rates, the exchange rate is adjusted to US $ 1= Rs.48.

Show the extracts of the relevant entries in the Profit and Loss Account for the year ending 31st March,2008 and the Balance Sheet as on that date, showing such workings as necessary.

Answer 18. (b)

Working Notes :

2006-07 :

1. Original Cost of the machine = $ 1,00,000 × Rs. 40 = Rs. 40,00,000
2. Depreciation (SLM) @ 10% = Rs. 4,00,000

2007-08 :

1. Original Cost of the machine upto 30/9/2007 = Rs. 40,00,000
2. Revised cost of the machine as on 1.10.2007

Due to official revaluation of exchange rates, the US $ 1 = Rs.48. There is a foreign exchange loss of Rs. 8 for each dollar liability. The total loss on foreign currency fluctuation was $25,000 x Rs.8 = Rs.2,00,000. This has to be added to the original cost of the machine. Therefore, revised cost of the machine as on 1.10.2007 is Rs.42,00,000 (i.e. Rs.40,00,000 + Rs.2,00,000)

The revised cost of the machine as on 1.10.2007 :

			Rs.
Original Cost on 1.4.2006			40,00,000
Less: Depreciation:			
1.4.2006 to 31.3.2007		4,00,000	
1.4.2007 to 30.9.2007		2,00,000	6,00,000
			34,00,000
Add: Loss on foreign exchange fluctuation as on 1.10.2007			2,00,000
			36,00,000
Depreciation:			
1.4.2007 to 30.9.2007	$(40,00,000 \times 10/100 \times 6/12)$	2,00,000	
1.10.2007 to 31.3.2008	$\left(\frac{36,00,000 \times 6}{8.5 \times 12}\right)$	2,11,765	
Total Depreciation for the year 2007-08		4,11,765	

Note : As per AS-6 Revised, 'Depreciation Accounting', in case of change in historical cost due to foreign exchange fluctuation, depreciation on the revised unamortized depreciable amount should be provided prospectively over the residual life of the asset. In this case, the residual life is 8.5 years.

Profit and Loss Account (extract)

for the year ended 31st March, 2008

Particulars	Rs.	Particulars	Rs.
To Depreciation on Machinery	4,11,765		

Balance Sheet (extract) as at 31st March, 2008

Liabilities	Rs.	Assets		Rs.
Current Liabilities	12,00,000	**Fixed Assets**		
Creditors for Supply		Machinery (at cost)	40,00,000	
of Machinery		Add: Adj.for foreign		
		Exchange fluctuation	2,00,000	
				42,00,000
		Less: Accumulated		
		Depreciation	8,11,765	
				33,88,235

Q. 18. (c) MAGIC Bank has classified its total investment on 31.3.2008 into three categories: (a) held to maturity (b) available for sale (c) held for trading.

Held to maturity investment is carried at acquisition cost less amortised amount. Available for sale are carried at marked to market. Held for trading investments are valued at weekly intervals at market rates or as per the prices declared by FIMMDA. Net depreciation, if any, is charged to revenue and net appreciation, if any, is ignored. Comment on the policy of the bank in accordance with AS-13.

Answer 18. (c)

As per para 2(d) of AS-13, the accounting standard is not applicable to bank, insurance company, mutual funds. In this case, MAGIC Bank is a bank, therefore AS-13 does not apply here. For the banks, the RBI has issued guidelines for classification and valuation of the investment. Therefore, the MAGIC Bank should comply with RBI guidelines.

Q. 18. (d) X Ltd. having a share capital of Rs.20 lakhs and Y Ltd.having a share capital of Rs.30 lakhs. Z Ltd. was formed to take over the business of X Ltd and Y Ltd. at a purchase consideration of Rs. 25 lakhs and Rs.28 lakhs, payable in shares of Z Ltd. The assets and liabilities were taken at their carrying amounts.

Answer 18. (d)

Since the purchase consideration is payable in shares of the transferee company and all the assets and liabilities are taken over at their carrying amounts, the amalgamation is in the nature of merger, i.e. pooling of interests method.

For X Ltd. Purchase consideration = Rs.25 lakhs

Less: Share capital of X Ltd = Rs.20 lakhs

Excess of purchase consideration = Rs.5 lakhs. This shall have to be adjusted against the Reserves of Z Ltd.

For Y Ltd. Purchase Consideration = Rs.28 lakhs

Less: Share Capital of Y Ltd = Rs.30 lakhs

since purchase consideration is less than share capital of the transferor company, Rs.2 lakhs shall be treated as Capital Reserve.

Note: In case of amalgamation in the nature of purchase, goodwill shall have to be shown in the Balance Sheet of the Transferee company. Such goodwill shall have to be written off over a maximum period of 5 years.

Q. 19. (a) On 30.4.2008 MNC Ltd.obtained a loan from the bank for Rs.50 lakhs to be utilized as under:

(i)	**Construction of a factory shed**	**Rs. 2 crores.**
(ii)	**Purchase of Machinery**	**Rs. 1.5 crores.**
(iii)	**Working Capital**	**Rs. 1 crore.**
(iv)	**Advance for Purchase of truck**	**Rs. 50 lakhs.**

In March 2008, construction of shed was completed and machinery installed. Delivery of truck was not received. Total interest charged by the bank for the year ended 31.3.08 was Rs.90 lakhs. Show the treatment of interest as per AS-16.

Answer 19. (a)

As per AS-16, borrowing cost(interest) should be capitalized if borrowing cost is directly attributable to the acquisition, construction or production of qualifying asset. Rs.5 crores borrowed from Bank was utilized for four different purposes, only construction of factory shed is a qualifying asset as per AS-16, while the other three payments are not for the qualifying asset. Therefore, borrowing cost attributable to the construction of a factory shed should only be capitalized which will be equal to Rs. 90 lakhs × 2/5= Rs.36 lakhs.

The balance of Rs. 54 lakhs (Rs.90 lakhs – Rs.36 lakhs) should be treated as an expense and debited to Profit and Loss Account.

Q. 19. (b) H Ltd. sold machinery having WDV of Rs. 400 Lakhs to B Ltd. for Rs. 500 Lakhs and the same machinery was leased back by B Ltd. to H Ltd. The Lease back is operating lease.

Comment if –

a) Sale price of Rs. 500 lakhs is equal to fair value

b) Fair value is Rs. 600 lakhs

c) Fair value is Rs. 450 lakhs and sale price is Rs. 380 lakhs

d) Fair value is Rs. 400 lakhs and sale price is Rs. 500 lakhs

e) Fair value is Rs. 460 lakhs and sale price is Rs. 500 lakhs

f) Fair value is Rs. 350 lakhs and sale price is Rs. 390 lakhs

Answer 19. (b)

a) H ltd. should immediately recognize the profit of Rs. 100 lakhs in its books.

b) Profit Rs. 100 lakhs should be immediately recognized by H Ltd.

c) Loss of Rs. 20 lakhs to be immediately recognized by H Ltd. in its books provided loss is not compensated by future lease payment.

d) Profit of Rs. 100 lakhs is to be amortized over the lease period.

e) Profit of Rs. 60 lakhs (460-400) to be immediately recognized in its books and balance profit of Rs. 40 lakhs (500-460) is to be amortized / deferred over lease period.

f) Loss of Rs. 50 lakhs (400-350) to be immediately recognized by H Ltd. in its books and profit of Rs. 40 lakhs (390-350) should be amortized / deferred over lease period.

Q. 19. (c) Compute EPS:

a) Net profit for 2006 Rs 11,00,000

Net profit for 2007 Rs 15,00,000

b) Nos. of shares outstanding prior to Right Issue: 5,00,000 shares

c) Right Issue: one new share for 5 outstanding i.e. 1,00,000 new shares

d) Right price: Rs 15/-

e) Last date of right option: 1st March 2007

f) Fair value prior to the right option on 1st march 2007: Rs 21/- per equity share

Answer 19. (c)

Computation :

1) Theoretical ex-right fair value per share:

[(Rs 21 x 5,00,000) + (Rs 15 x 1,00,000)] / (5,00,000+ 1,00,000)

i.e. 1,20,00,000/6,00,000 = Rs 20/

2) Adjustment factor:- fair value prior to exercise of rights/theoretical ex-right value. i.e. 21/20=1.05

3) Computation of EPS:

Year 2006	*Year 2007*
EPS as originally reported	
Rs. 11.00,000/5,00,000 shares	Rs 2.20
EPS restated for right issue	
Rs. 11,00,000/(5,00,000×Rs 1.05)	Rs 2.10
EPS-for 2007 including rights	
Rs. 15,00,000/(5,00,000× 1.05x2/12)+(6.00,000× 1 0/12)	Rs 2.25

Q. 19. (d) From the following information for R Ltd. for the year ended 31st March,2008, calculate the deferred tax asset/liability as per AS-22

Accounting Profit	**Rs. 10,00,000**
Book Profit as per MAT(Minimum Alternate Tax)	**Rs. 9,00,000**
Profit as per Income Tax Act	**Rs. 1,00,000**
Tax Rate	**30%**
MAT Rate	**10%**

Answer 19. (d)

Tax as per accounting profit : 10,00,000 × 30% = 3,00,000

Tax as per Income Tax profit : 1,00,000 × 30% = 30,000

Tax as per MAT : 9,00,000 × 10% = 90,000

Tax expense = Current tax + deferred tax

3,00,000 = 30,000 + deferred tax

Therefore, Deferred Tax Liability as on 31.3.08 = Rs.3,00,000 – Rs.30,000 = Rs.2,70,000.

Amount of tax to be debited in Profit and Loss Account for the year 31.3.08:

= Current tax + deferred tax liability + Excess of MAT over current tax

= 30,000 + 2,70,000 + (90,000 – 30,000)

= 3,60,000

Q. 20. (a) Style Ltd. acquired 30% of Ugly Ltd.'s shares on April 10,2007, the price paid was Rs.20,00,000.

	Rs.
Equity shares(Paid up)	**5,00,000**
Securities Premium	**5,00,000**
Reserve	**5,00,000**
	25,00,000

Further, Ugly Ltd reported a net income of Rs.3,00,000 and paid dividends of Rs.1,00,000. Style Ltd. has subsidiary on 31.3.08. Calculate the amount at which the investment in Ugly Ltd should be shown in the consolidated Balance Sheet of Style Ltd. as on 31.3.08

Answer 20. (a)

Answer: As per AS-23, when the investor company prepares the consolidated Balance Sheet, the investment in associate i.e. Ugly Ltd. shall be carried by equity method and goodwill and capital reserve to be identified and disclosed separately.

Value of the investment as per equity method

= 20,00,000 + 30% (3,00,000 – 1,00,000)= Rs.20,40,000.

Goodwill identified = (20,00,000 – 30% of 25,00,000) = Rs. 12,50,000

Q. 20. (b) B Ltd. is a software company, has subsidiary C Ltd. B Ltd.hold 70% shares in C Ltd. During 2007-08, B Ltd. sold its entire investment in C Ltd. Is it a discontinuing operation?

Answer 20. (b)

As per the definition and scope of 'discontinuing operation', the sell of investments in subsidiary company does not attract the provisions of AS-24.

Hence, it is not a discontinuing operation.

Q. 20. (c) M Ltd. presents interim financial report(IFR) quarterly, earns Rs.800 lakhs pre-tax profit in the first quarter ending 30.6.08 but expect to incur losses of Rs.250 lakhs in each of the remaining three quarters. Effective income tax rate is 35%. Calculate the income-tax expense to be reported for each quarter as per AS-25.

Answer 20. (c)

Tax expense to be reported in each of the quarters are :

1st quarter= 800 × 35% = Rs.280.00 lakhs

2nd quarter= (250) × 35% = Rs. (87.5)lakhs

3rd quarter = (250) × 35% = Rs. (87.5)lakhs

4th quarter = (250) × 35% = Rs.(87.5) lakhs

Annual Tax Expense = Rs.17.5 lakhs

Q. 20. (d) On February 2008, J Ltd.bought a trademark from I Ltd. for Rs.50 lakhs. J Ltd. retained an independent consultant, who estimated the trademark's remaining life to be 14 years. Its unamortized cost on I ltd. records was Rs.35 lakhs. J Ltd.decided to amortize the trademark over the maximum period allowed. In J Ltd.'s Balance Sheet as on 31st December 2008, what amount should be reported as accumulated amortization?

Answer 20. (d)

As per para 23 of AS-26, intangible assets should be measured initially at cost therefore. J Ltd. should amortize the trademark at its cost of Rs.50 lakhs. The unamortized cost on the seller's books Rs.35 lakhs is irrelevant to the buyer. Although the trademark has a remaining useful life of 14 years, intangible assets are generally amortized over a maximum period of 10 years as per AS-26. Therefore, the maximum amortization expense and accumulated amortization is Rs.5 lakhs (Rs.50 lakhs /10)

Q. 20. (e) N Ltd has 80% shares in a joint venture with Suzuki Ltd. N Ltd. sold a plant WDV Rs.20 lakhs for Rs.30 lakhs. Calculate how much profit N Ltd. should recognize in its book in case joint venture is:

(a) jointly controlled operation;

(b) jointly controlled asset;

(c) jointly controlled entity.

Answer 20. (e)

As per AS-27, in case of jointly controlled operation and jointly controlled assets joint venture, the venture should recognize the profit to the extent of other venturer's interest.

In the given case, N Ltd. should recognize profit of :

= Rs.(30 – 20)lakhs = Rs.10 x 20%= Rs.2 lakhs only.

However, in case of jointly controlled entities N Ltd. should recognize full profit of Rs.10 lakhs in its separate financial statement. However, while preparing consolidated financial statement it should recognize the profit only to the extent of 20% i.e. Rs. 2 lakhs only.

Q. 21. (a) Carrying amount Rs.200 lakhs. Net Selling Price Rs.210 lakhs. Value in use Rs. 220 lakhs. What is the impairment loss?

Answer 21. (a)

Carrying amount Rs.200 lakhs

Recoverable amount Rs. 220 lakhs (being the higher of net selling price and value in use)

Since, recoverable amount is more than carrying amount of the asset, there will arise no impairment loss.

Q. 21. (b) C Ltd.acquired a machine for Rs.3.2 crores on 1.1.2005. It has a life of 5 years with a salvage value of Rs.40 lakhs. Apply the test of impairment on 31.3.2008:

(a) Present value of future cash flow Rs.1.3 crores

(b) Net selling price Rs.1.2crores

Answer 21. (b)

Carrying amount of the asset: [3.2 – (3.2 – 0.4) x 39⁄60] = 1.38 crores.

Time period for use of the asset: 1.1.2005 to 31.3.2008 = 39 months

Total life period of the asset= 5 years = 60 months.

Recoverable amount: being the higher of present value and net selling price = Rs.1.3 crores.

Impairment Loss= Rs(1.38 – 1.3) crores= Rs.0.08 crores.

Q. 21. (c) There is a income tax demand of Rs.2.5 lakhs against the company relating to prior years against which the company has gone on appeal to the appellate authority in the department. The ground of appeal deals with the points covering Rs.1.8 lakhs of the demand. State how the matter will have to be dealt with in the financial account for the year.

Answer 21. (c)

A provision of Rs.0.7 lakhs and a contingent liability of Rs. 1.8 lakhs should be provided in the financial accounts for athe year.

Q. 21. (d) A company follows a policy of refunding money to the dissatisfied customers if they claim within 15 days from the date of purchase and return the goods. It appears from the past experience that in a month only 0.10% of the customers claim refunds. The company sold goods amounting to Rs.20 lakhs during the last month of the financial year. Is there any contingency?

Answer 21. (d)

There is a probable present obligation as a result of past obligating event. The obligating event is the sale of the product. Provision should be recognized as per AS-29. The best estimate for provision is Rs. 2,000 (Rs.20 lakhs × 0.1%)

Q. 22. (a) Hero Limited issued 10,000 equity shares of Rs. 100 each at premium of Rs. 25 per share. Under the terms of the isue, the shares were to be paid for as follows :

	Rs.
2008 January 1, on application (including Rs. 25 premium on issue per share)	**50**
February 1, on allotment	**50**
April 1, balance of	**25**

The issue was over subscribed. The applications received are summarised below :

	A	*B*	*C*
Number of applicants in categories	**40**	**20**	**1**
Applied for by each applicant in the three categories	**200**	**2000**	**8000**
Issued to each applicant	**100**	**200**	**2000**

One of the conditions of the issue was that amounts over-paid on application were to be retained by the company and used in redudction of further sums due on shares allotted. All surplus contributions were refunded on 15th February, 2008.

Ramesh who had subscribed 100 on an application for 200 shares was unable to meet the claim due on April 1. On May 5, the directors forfeited his shares. All other shareholders paid the sums requested on the due dates. On June 10, 2008 the directors re-issued the forfeited shares as fully paid to Mohan, on receiving a payment of Rs. 10,500.

(a) To prepare a statement as on February 1, 2008, showing the over-payment, under-payment to in respect of category of applicants : and

(b) To show how the above transactions would appear in the journal of the company.

Answer 22. (a)

(a) **Hero Ltd.**

Statement of Shares Applied, Allotted and Amounts Adjusted

	Catetories		
	A	**B**	**C**
(a) Applied (Nos.)	8,000	40,000	8,000
(b) Allotted (Nos.)	4,000	4,000	2,000
	Rs.	Rs.	Rs.
(c) Application money Received (Applied ×Application per share)	4,00,000	20,00,000	4,00,000
(d) Application Money required (Alloted × Application per share)	2,00,000	2,00,000	1,00,000
(e) Excess Application Money to be Adjusted with Allotment [c-d]	2,00,000	18,00,000	3,00,000
(f) Allotment Money Due (Alloted × Allotment per share)	2,00,000	2,00,000	1,00,000
(g) Balance of Excess Application Money for Adjustment with calls [e-f]	Nil	16,00,000	2,00,000
(h) Call Money Due (Allotment × Call per share)	1,00,000	1,00,000	50,000
(i) Excess/(Shortage)	(1,00,000)	15,00,000	1,50,000

In case of shortage, the shareholders will deposit the dues.

(b) **Journals**

2008	*Particulars*		*L.F.*	*Dr. (Rs.)*	*Cr. (Rs.)*
Jan. 01	Bank A/c	Dr.		28,00,000	
	To Equity Share Application A/c				28,00,000
	(Application money received on 56,000 shares @ Rs. 50 per share)				
Feb. 01	Equity Share Application A/c	Dr.		5,00,000	
	To Equity Share Capital A/c				2,50,000
	To Securities Premium A/c				2,50,000
	(Being application money on 10,000 shares transferred to share Capital and Securities Premium vide Board's resolution no. dated...)				
	Equity Share Application A/c	Dr.		16,50,000	
	To Bank A/c				16,50,000
	(Being excess application money refunded of vide Board's resolution no. dated...)				
	Equity Share Allotment A/c	Dr.		5,00,000	
	To Equity Share Capital A/c				5,00,000
	(Being allotment money due on 10,000 shares @ Rs. 50 per share vide Board's resolution no. dated...)				
	Equity Share Application A/c	Dr.		5,00,000	
	To Equity Share Allotement A/c			5,00,000	
	(Being excess of Equity share application money adjusted with allotment)				
	Equity Share First & Final Call A/c	Dr.		2,50,000	
	To Equity Share Capital A/c				2,50,000
	(Being first & final call money due on 10,000 shares @ Rs. 25 per share vide Board's resolution no. dated...)				
Apr. 01	Bank A/c	Dr.		97,500	
	Calls in Arrear A/c	Dr.		2,500	
	Equity Share Application A/c	Dr.		1,50,000	
	To Equity Share First & Final Call A/c				2,50,0000
	(Being amount received and adjusted, except a holder of 100 share who failed to pay the call)				

	Equity Share Capital A/c Dr. To Shares Forfeited A/c To Calls in Arrear A/c (Being 100 shares held by Ramesh forfeited for non-payment of call @ Rs. 25 per share vide Board's resolution no. dated...)		10,000	7,500 2,500 7,500
May 05	Bank A/c Dr. To Equity Share Capital A/c To Securities Premium A/c (Being 100 forfeited shares resissued at Rs. 10,500)		10,500	10,000 500
	Share Forfeited A/c Dr. To Captial Reserve (Being balance of shares forfeited transferred to captial reserve)		7,500	7,500

Q. 22. (b) A Company is planning to raise funds by making rights issue of equity shares to finance its expansion. The existing equity share capital of the company is Rs. 50,00,000. The market value of its share is Rs. 42. The company offers to its shareholders the right to buy 2 shares at Rs. 11 each for every 5 shares held. You are required to calculate :

(i) Theoretical market price after rights issue;

(ii) The value of rights; and

(iii) Percentage increase in share capital.

Answer 22. (b)

	Rs.
Market value of 5 shares already held by a shareholder @ Rs. 42	210
Add : Price to be paid by him for acquiring 2 more shares @ Rs. 11 per share	22
Total price of 7 shares after rights issue	232
(i) Therefore, theoretical market price of one share, *(i.e.,* 232/7)	= 33.14
(ii) Value of Rights = Market Price - Theoretical Market Price	= Rs. 42 - Rs. 33.14. = Rs. 8.86
(iii) Percentage Increase in Share Capital	
Present Capital	50,00,000
Rights Issue Rs. 50,00,000 × 2/5	20,00,000
% Increase In Share Capital (20,00,000/50,00,000) × 100 40%	

Q. 22. (c) State the Conditions of buy-back.

Answer 22. (c)

As per Section 77A(2) of the Companies Act,1956 the conditions for buy-back are:

The company's articles should authorize the buy-back. If not, the same has to be amended to include a provision to that effect;

A special resolution should be passed in the general meeting authorizing the buy-back;

a. The buy-back should be less than 25% of the total paid-up capital and free reserves of the company;

b. The buy-back of equity shares in any financial year should not exceed 25% of its total paid-up equity capital in that financial year;

c. The Companies (Amendment) Act, 2001 has authorized the buy-back by means of a resolution at the company's Board provided the buy-back does not exceed 10% of the total paid-up equity capital and free reserves of the company. But, there cannot be more than one such buy-back in a period of 365 days.

d. *D*ebt-equity ratio shall not exceed 2:1 after such buy-back. The Central Government may however, prescribe a higher ratio for a class or classes of companies;

e. All the shares or other specified securities are fully paid up;

f. The buy-back of the shares or other securities listed on any recognized stock exchange is in accordance with the regulations made by the Securities and Exchange Board of India in this behalf;

g. The buy-back of shares or other securities not listed on any recognized stock exchange is in accordance with the guidelines as may be prescribed.

Q. 22. (d) The following was the balance sheet of Diamond Ltd. as at 31st March, 2009.

Liabilities	**Rs, in lakhs**
10% Redeemable Preference Shares of Rs. 10 each, fully paid up	**2,500**
Equity Shares of Rs. 10 each fully paid up	**8,000**
Capital Redemption Reserve	**1,000**
Securities Premium	**800**
General Reserve	**6,000**
Profit and Loss Account	**300**
9% Debentures	**5,000**
Sundry creditors	**2,300**
Sundry Provisions	**1,000**
	26,900

Assets	**Rs, in lakhs**
Fixed assets	**14,000**
Investments	**3,000**
Cash at Bank	**1,650**
Other Current assets	**8,250**
	26,900

On 1st April, 2009 the company redeemed all of its preference shares at a premium of 10% and bought back 25% of its equity shares @ Rs. 20 per share. In order to make cash available, the company sold all the investments for Rs.3, 150 lakh and raised a bank loan amounting to Rs. 2,000 lakhs on the security of the company's plant.

Pass journal entries for all the above mentioned transactions including cash transactions and prepare the company's balance sheet immediately thereafter. The amount of securities premium has been utilized to the maximum extent allowed by law.

Answer 22. (d)

Journal Entries

	Particulars		*Debit Rs.*	*Credit Rs.*
1.	Bank A/c	Dr.	3,150	
	To Investment A/c			3,000
	To Profit and Loss A/c			150
	(Being sale of investments and profit thereon)			
2.	Bank A/c	Dr.	2,000	
	To Bank Loan A/c			2,000
	(Being loan taken from bank)			
3.	10% Redeemable preference Share capital A/c	Dr.	2,500	
	Premium on redemption of preference shareholder A/c	Dr.	200	
	To Preference shareholder A/c			2,750
	(Being redemption of preference shares)			
4	Preference shareholders A/c	Dr.	2,750	
	To Bank A/c			2,750
	(Being payment of amount due to preference shareholders)			
5.	Securities premium A/c	Dr.	250	
	To Premium on redemption of preference share A/c	Dr.		250
	(Being use of securities premium to provide premium on redemption of preference shares)			
6.	Equity Share capital A/c	Dr.	2,000	
	Securities premium A/c [800 - 250]	Dr.	550	
	General reserves A/c [(200×20) - 2000 - 550]	Dr.	1,450	
	To Equity shareholders A/c			4,000
	(being buy back of equity shares)			
	Note : Balance of General Reserve [6000 - 1450] = Rs. 4550.			
7.	General Reserves A/ c	Dr.	4,500	
	To Capital redemption reserve A/c (2000 + 2500)			4,500
	(Being creation of capital redemption reserve to the extent of the face value of preference share redeemed and equity shares bought back).			
	Note: Balance in General reserve as on 01.04.03 (4550 - 4500) = Rs. 50.			
8.	Equity shareholders A/c	Dr.	4,000	
	To Bank A/c			4,000
	(Being payment of amount due to equity shareholders).			
	Note : Cash at Bank [1650+3150+2000-2750-4000] = Rs.50			

Balance Sheet of Diamond Ltd., as on 01.04.09

Liabilities	***Rs.***	***Assets***	***Rs.***
Share capital		Fixed assets	
Issued, subscribed and paid up	6,000	Current asset, Loans and	14,000
equity shares of Rs. 10 each		Advances	
Reserves and surplus			
Capital Redemption Reserve	5,500	Cash at Bank	50
(1000 + 4500)		Other Current assets	8,250
General Reserves	50		
Profit and Loss A/c (300+ 150)	450		
Secured Loans			
9% Debentures	5,000		
Bank Loan	2,000		
Current liabilities and Provisions			
Sundry creditors	2,300		
Provisions	1,000		
Total	**22,300**	**Total**	**22,300**

Q. 23. The promoters of proposed Horizon Ltd. purchased a running business on 1st January, 2009 from Mr. Ultra Modern. Horizon Ltd was incorporated on 1st May, 2009. The combined Profit and Loss Account of the company prior to and after the date of incorporation is as under :

Profit & Loss Account for the year ended on 31.12.2009

	Rs.		**Rs.**
To Rent, rates, insurance, electricity & salaries	**1,20,000**	**By Gross profit**	**15,00,000**
To Directors' sitting fees	**36,000**	**By Discount received from creditors**	**60,000**
To Preliminary expenses	**49,000**		
To Carriage outwards and selling expenses	**55,000**		
To Interest paid to Vendors	**1,00,000**		
To Profit	**12,00,000**		
	15,60,000		**15,60,000**

Following further information is available :

(1) Sales up to 30.4.2009 were Rs. 30,00,000 out of total sales of Rs. 1,50,00,000 of the year.

(2) Purchases up to 30.4.2009 were Rs. 30,00,000 out of total purchases of Rs. 90,00,000 of the year.

(3) Interest paid to Vendors on 1.11.2009 @ 12% p.a on Rs. 10,00,000 being purchase consideration.

From the above information, prepare Profit and Loss Account for the year ended 31st December, 2009, showing the profit earned prior to and after incorporation and also show the transfer of the same to the appropriate accounts.

Answer 23.

Horizon Ltd.

Dr. Profit and Loss Account for the year ended 31st December, 2009 Cr.

Particulars	Note	Total Rs.	Pre-incor-poration	Post-incor-poration	Particulars	Note	Total Rs.	Pre-incor-poration	Post-incor-poration
To Rent, Rates					By Gross Profit	1	15,00,000	3,00,000	12,00,000
Insurance, Electricity & Salaries	2	1,20,000	40,000	80,000	By Discount received	7	60,000	20,000	40,000
To Directors' sitting fees	3	36,000	—	36,000					
To Preliminary Expenses	4	49,000	—	49,000					
To Carriage Outward	5	55,000	11,000	44,000					
To Interest to Vendor	6	1,00,000	40,000	60,000					
To Net Profit —		12,00,000	—	—					
Transferred to :									
— Capital Reserve		—	2,29,000	—					
— P&L Appropriation		—	—	9,71,000					
		15,60,000	3,20,000	12,40,000			15,60,000	3,20,000	12,40,000

Working Notes :

(1) For 4 months to 30th April, sales amounted to Rs. 30,00,000 and for the remaining 8 months, sales were (Rs. 1,50,00,000 - Rs. 30,00,000) Rs. 1,20,00,000. Gross profit is apportioned in the ratio of 3 : 12 or 1 : 4 assuming the gross rate was uniform throughout the year). Therefore, the gross profit is apportioned as :

Pre : $\frac{15,00,000}{5} \times 1 = \text{Rs. } 3,00,000.$ Post : $\frac{15,00,000}{5} \times 4 = \text{Rs. } 12,00,000.$

(2) These expenses generally accrue evenly throughout the year and are therefore divided on the time basis, pre : post 4 months : 8 months or 1 : 2.

(3) Directors' sitting fees and preliminary expenses are generally found in case companies. These must naturally be shown in post- incorporation period.

(5) Carriage outward has been apportioned in the ratio of sales, i.e.

Pre : Rs. $\frac{55,000}{5} \times 1 = \text{Rs. } 11,000$ Post : Rs. $\frac{55,000}{5} \times 4 = \text{Rs. } 44,000$

(6) Interest accrues on the basis of time. Therefore it is divided on the time basis. Interest has been paid for a total of 10 months (January to October). 4 months related to pre-incorporation period and 6 months to post-incorporation period. Therefore, it is split as :

Pre : Rs. $\frac{1,00,000}{10} \times 4 = \text{Rs. } 40,000$ Post : Rs. $\frac{1,00,000}{10} \times 6 = \text{Rs. } 60,000$

(7) For 4 months to 30th April, purchases amounted to Rs. 3,00,000 and for the remaining 8 months, purchases were : (Rs. 90,00,000 – 30,00,000) = Rs. 60,00,000.

Discount received is apportioned in the ratio of 3 : 6 or 1 : 2. Therefore, discount received is apportioned as :

Pre : $\frac{60,000}{3} \times 1 = \text{Rs. } 20,000$ Post : $\frac{60,000}{3} \times 2 = \text{Rs. } 40,000$

Q. 24. Give the necessary journal entries both at the time of Issue and Redemption of Debentures in each of the following alternative cases :

(a) *P* Ltd. issued 1,000, 10% Debentures of Rs. 110 each at par and redeemeable at par at the end of 4 years.

(b) *S* Ltd. issued Rs. 1,00,000, 12% Debentures at a discount of 5% repayable at par at the end of 4 years.

(c) *Z* Ltd. issued 10% Debentures of the total face value of Rs. 1,00,000 at a premium of 5% to be redeemed at par at the end of 4 years.

(d) *K* Ltd. issued 1,000, 14% Debentures of Rs. 100 each at par but redeemable at 5% premium at the end of 4 years.

(e) *D* Ltd. issued Rs. 1,00,000, 18% Debentures at a discount of 5% but redeemable at a premium of 5% at the end of 4 years.

Answer 24.

Case (a) **Journal of *P* Ltd.**

Particulars	*L.F.*	*Dr. (Rs.)*	*Cr. (Rs.)*
On Issue			
Bank A/c	Dr.	1,00,000	
To 10% Debenture A/c			1,00,000
(Being the issue of Debentures at par)			
On Redemption			
Profit & Loss Application A/c	Dr.	1,00,000	
To Debentures Redemption Reserve A/c			1,00,000
(Being the transfers of an amount equivalent to the nominal value of Debentures redeemed to Debenture Redemption Reserve A/c out of profits)			
10% Debentures A/c	Dr.	1,00,000	
To Debentureholders' A/c			1,00,000
(Bening the the amount due on redemption)			
Debentureholders A/c	Dr.	1,00,000	
To Bank A/c			1,00,000
(Being the payment made to Debentureholders)			

Case (b) **Journal of *S* Ltd.**

Particulars	*L.F.*	*Dr. (Rs.)*	*Cr. (Rs.)*
On Issue			
Bank A/c	Dr.	95,000	
Discount on issue of Debentures A/c	Dr.	5,000	
To 12% Debentures A/c			1,00,000
(Being the issue of Debentures at 5% discount)			
On Redemption			
Profit & Loss Appropriation A/c	Dr.	1,00,000	
To Debenture Redemption Reserve A/c			1,00,000
(Being the transfer of an amount equivalent to the nomial value of Debentures redeemed to Debenture Redemption Reserve A/c out of profits)			

12% Debentures A/c To Debentureholders' A/c (Being the amount due on redemption)	Dr.	1,00,000	 1,00,000
Debentureholders A/c To Bank A/c (Being the payment made to Debentureholders)	Dr.	1,00,000	 1,00,000

Case (c) **Journal of *Z* Ltd.**

Particulars	*L.F.*	*Dr. (Rs.)*	*Cr. (Rs.)*
On Issue Bank A/c To 10% Debentures A/c To Securities Premium A/c (Being the issue of Debentures at 5% discount)	 Dr.	 1,05,000	 1,00,000 5,000
On Redemption Profit & Loss Appropriation A/c To Debenture Redemption Reserve A/c (Being the transfer of an amount equivalent to the nominal value of Debentures redeemed to Debenture Redemption Reserve A/c out of profits)	 Dr.	 1,00,000	 1,00,000
10% Debentures A/c To Debenture holders A/c (Being the amount due on redemption)	Dr.	1,00,000	 1,00,000
Debentureholders A/c To Bank A/c (Being the payment made to Debentureholders)	Dr.	1,00,000	 1,00,000

Case (d) **Journal of *K* Ltd.**

Particulars	*L.F.*	*Dr. (Rs.)*	*Cr. (Rs.)*
On Issue Bank A/c Loss on Issue of Debentures A/c To 14% Debentures A/c To Premium on Redemption of Debentures A/c (Being the issue of Debentures at par and redeemable at 5% premium)	 Dr. Dr.	 1,00,000 5,000	 1,00,000 5,000
On Redemption Profit & Loss Appropriation A/c To Debenture Redemption Reserve A/c (Being the transfer on an amount equivalent to the nominal value of Debentures redeemed to Debenture Redemption Reserve A/c out of profits)	 Dr.	 1,00,000	 1,00,000
14% Debentures A/c Premium on Redemption of Debentures A/c To Debentureholder's A/c (Being the amount due on redemption)	Dr. Dr.	1,00,000 5,000	 1,05,000
Debentureholders' A/c To Bank A/c (Being the payment made to Debentureholders)	Dr.	1,05,000	 1,05,000

Case (e) **Journal of *D* Ltd.**

Particulars	*L.F.*	*Dr. (Rs.)*	*Cr. (Rs.)*
On Issue			
Bank A/c	Dr.	95,000	
Loss on Issue of Debentures A/c	Dr.	10,000	
To 18% Debentures A/c			1,00,000
To Premium on Redemption of Debentures A/c			5,000
(Being the issue of Debentures at 5%discount & redeemable at 5% premium)			
On Redemption			
Profit & Loss Appropriation A/c	Dr.	1,00,000	
To Debenture Redemption Reserve A/c			1,00,000
(Being the transfer of an amount equivalent to the nominal value of Debenures redeemed to Debenture Redemption Reserve A/c out of profits)			
18% Debentures A/c	Dr.	1,00,000	
Premium on Redemption of Debentures A/c	Dr.	5,000	
To Debentureholders' A/c			1,05,000
(Being the amount due on redemption)			
Debentureholders' A/c	Dr.	1,05,000	
To Bank A/c			1,05,000
(Being the payment made to Debentureholders)			

Q. 25. From the following information and details relating to the year ended 31 st March, 2005 and bearing in mind the provisions of the Electricity (Supply) Act, 1948, indicate the disposal of profits of Electricity Company :

Particulars	**Rs**	**Particulars**	**Rs**
Net profit before charging debenture interest	35,00,100	Security deposits of Customers	4,64,000
Fixed Assets	4,20,00,000	Customers Contribution to Main lines	3,20,000
Depreciation written-off on fixed assets	98,00,000	Preliminary expenses	1,40,000
Loan from Electricity Board	1,20,00,000	Average of current assets excluding customers' balances of Rs 6,20,000	23,70,000
6% Investments of the Reserve fund (F.v. Rs 90,00,000)	90,00,000	Development Reserve	4,40,000
6% Investments of the Contingencies Reserve	76,00,000	10% Debenture interest paid in the year	7,50,000
Tariffs and Dividends Control Reserve	8,40,000		

The Reserve Bank of India rate of the relevant date was 8%.

Answer 25.

Calculation of Capital Base

Particulars	Rs	Rs
(i) Original cost of fixed assets	4,20,00,000	
Less: Amount contributed by the customers' for main lines	3,20 000	4,16,80,000
(ii) Preliminary expenses		1,40,000
(iii) Investment against contingency reserve		76,00,000
(iv) Average of current assets (excluding customers' balance Rs 6,20,000)		23,70,000
		5,17,90,000
Deduct		
(i) Depreciation written-off on Fixed assets	98,00,000	
(ii) Loan from SEB	1,20,00,000	
(iii) 10% Debentures (Note 1)	75,00,000	
(iv) Security deposits of customers	4,84,000	
(v) Balance of Tariff and Dividend Control Reserve	8,40,000	
(vi) Balance of Development Reserve	4,40,000	3,10,64,000
Total		2,07,26,000

Reasonable Return

	Rs.
(i) Yield at standard rate, i.e., 8% + 2% on capital base	20,72,600
(ii) Income from Reserve Fund Investments (6% of Rs 90,00,000)	5,40,000
(iii) 1/2% on Loans from SEB	60,000
(iv) 1/2% on Debentures	37,500
(v) 1/2% on Development Reserve	2,200
	27,12,300
Final Distribution	
(i) Refunded to customers	12,600
(ii) Transferred to Tariff and Dividend Control Reserve	12,600
(iii) At the disposal of the Co. (Rs 27,12,300 + 12,600)	27,24,900
	27,50,100

Disposal of Surplus

	Rs.
Profit before debenture interest	35,00,100
Less: Debenture interest	7,50,000
	27,50,100
Less: Reasonable return	27,12,300
Surplus	37 800
Allocation of Surplus	
(i) 1/3 (being less than 5% of Reasonable return at the disposal of the company)	12,600
(ii) Of the bal., 1/2 to Tariff and Dividend Control Reserve	12,600
(iii) 1/2 to be credited to Customers Rebate Reserve	12,600
	37,800

Working : (I) Face value of Debentures Rs 7,50,000/10 × 100 = Rs 75,00,000

INTERMEDIATE EXAMINATION

(REVISED SYLLABUS - 2008)

GROUP - I

Paper-6 : COMMERCIAL AND INDUSTRIAL LAW AND AUDITING

SECTION - I

(Commercial and Industrial Law)

Indian Contract Act, 1872 :

Q. 1. Comment on the following :

- **(a) As per Section 10 of the Contract Act 'consideration ' is an important element for a contract to be valid. Hence all contracts without consideration are void.**
- **(b) An offer must be communicated to the acceptor.**
- **(c) Minor under Contract Act is always beneficiary.**
- **(d) D owes F Rs. 50,000/- only guaranteed by S. The debt becomes payable on 26th December 2009. F does not sue D for a year after the debt has become payable. Is S discharged from his surety ship?**
- **(e) X, a partner acting as an agent of the partnership firm transfers the firm 's immovable property, by virtue of implied authority.**
- **(f) H lends a sum of Rs. 15,000 to D, on the security of two shares of a Limited Company on 1st April 2010. On 15th September, 2010, the company issued two bonus shares. D returns the loan amount of Rs.15,000 with interest but H returns only two shares which were pledged and refuses to give the two bonus shares. Advise D in the light of the provisions of the Indian Contract Act, 1872.**
- **(g) G started "self service" system in his shop. P entered the shop, took a basket and after taking articles of his choice into the basket reached the cashier for payments. The cashier refuses to accept the price. Can G be compelled to sell the said articles to P?**
- **(h) 'A' rides an autorickshaw for going to his destination and takes a seat. The fare chart is displayed boldly in the auto stand. Whether A is bound to pay the fare displayed in the chart?**
- **(i) C delivered furniture items to AB Transport Co. for transporting the goods from Asansol to Kolkata. On the way the truck carrying the items met with an accident due to rash driving on part of the driver and the goods got damaged. C sued the owner of the Co. for the loss.**
- **(j) F advances money to E. E uses the money to smuggle pirated CDs and DVDs. F unaware of the purpose, sues E to recover the amount.**

Answers 1.

(a) A contract without consideration is valid under following circumstances:

(i) Love and affection [Sec. 25(1)] A written and registered agreement based on natural love and affection between near relatives is enforceable even if there is no consideration.

(ii) Compensation for voluntary services [Sec.25(2)]. A promise to pay for past voluntary service is binding on the promissor.

(iii) A promise to pay a time barred debt is binding provided it is in writing and signed by debtor or his authorized agent. [Sec.25(3)]

(iv) A completed gift between donor and donee [Exp. 1 to Sec 25]

(v) Contract to create an agency [Sec. 185]

(vi) Charitable subscription where the promisee has made commitments on the strength of the promise.

(b) The statement is true. An offer must be communicated to the offeree for his acceptance. When a person fulfils the terms of offer without any knowledge of the offer having been made, there is no contract under the Indian Contract Act.

(c) As per Indian Contract Act, 1872 an agreement with a minor is void ab initio. However there is nothing that debars him from becoming a beneficiary i.e. payee, endorsee or promisee in a contract. The law does not regard him incapable of accepting a benefit. It should be however remembered that his property is liable for meeting the liability arising out contracts to supply him his necessaries.

(d) The contract between the surety and the creditor is independent contract and not a collateral one and there is no such thing that the surety will be liable only if principal debtor is liable. If the creditor does not sue the principal debtor within the period of limitation, surety is not discharged. So, S is not discharged in the given case.

(e) X, the partner can act as an agent of the firm for the purpose of its business. He has implied authority to act on behalf of the firm but the implied authority does not empower him to transfer immovable property belonging to the firm.

(f) As per provisions of Section 163(4) of the Indian Contract Act,1872, "in the absence of any contract to the contrary, the bailee is bound to deliver to the bailor, any increase or profit which may have accrued from the goods bailed."

Applying the provisions to the given case, the bonus shares are an increase on the shares pledged by D to H. So H is liable to return the shares along with the bonus shares and hence D the bailor, is entitled to them also.

(g) The offer should be distinguished from an invitation to offer. An offer is the final expression of willingness by the offeror to be bound by his offer should the party chooses to accept it. Where a party, without expressing his final willingness, proposes certain terms on which he is willing to negotiate, he does not make an offer, but invites only the other party to make an offer on those terms. This is the basic distinction between offer and invitation to offer.

The display of articles with a price in it in a self-service shop is merely an invitation to offer. It is in no sense an offer for sale, the acceptance of which constitutes a contract. In this case, P in selecting some articles and approaching the cashier for payment simply made an offer to buy the articles selected by him. If the cashier does not accept the price, the interested buyer cannot compel him to sell.

(h) As per law, acceptance can be both express and implied. From the circumstances, one can infer that there is an implied acceptance on part of 'A' to pay the fare on reaching his destination.

(i) The position of owner of the transport company is that of a bailee. He is responsible to take reasonable care of the goods. The goods got damaged due to negligence of his employed driver. So he is liable to pay C for the loss.

(j) The agreement is void as the purpose is illegal. However, as F was not aware of the purpose, F can recover his money.

Q. 2. (a) When is communication of acceptance complete?

(b) Silence is fraudulent. Do you agree?

(c) Who cannot enter into a contract?

(d) State the difference between coercion and undue influence.

(e) When does an agent incur personal liability?

(f) What is meant by Anticipatory Breach of Contract?

Answer 2. (a)

Communication of acceptance is complete :

- As against the proposer, when it is put in a course of transmission to him, so as to be out of power of the acceptor.
- As against the acceptor, when it comes to the knowledge of the proposer.

Answer 2. (b)

Mere silence on the part of proposer so as to affect willingness of the acceptor is not fraud general. However silence is fraudulent in certain cases as follows:

(i) Where it is duty of the proposer to speak.

(ii) Where silence is equivalent to speech.

Answer 2. (c)

Section 11, of Contract Act ,1872 lays down the qualifications that make a person competent to contract. Accordingly, the following persons cannot enter into a contract :

(i) Minor, who has not attained 18 years of age.

(ii) A person with unsound mind-lunatics, idiots,drunken or intoxicated persons.

(iii) A person who is disqualified by law from contracting partially or wholly. Incompetency may arise from political status, corporate status or legal status.

Contract with a person who is resident of a hostile nation is void. (political status)

A company cannot enter into a contract which is ultra vires its Memorandum of

Association. (Corporate status)

An insolvent person cannot enter into a contract unless discharged. (legal status)

Answer 2. (d)

Coercion	Undue Influence
(i) It involves the physical force or threat. The aggrieved party is compelled to make the contract against its will.	It involves moral or mental pressure. The aggrieved party believes that he or she would make the contract.
(ii) It involves committing or threatening to commit an act forbidden by Indian Penal Code for detaining or threatening to detain property of another person.	No such illegal act is committed or a threat is given.
(iii) It is not necessary that there must be some relationship between the parties.	Some sort of relationship between the parties is absolutely necessary.
(iv) Coercion need not proceed from the promisor nor need it be directed against the promisor.	Undue influence is always essential between the parties to the contract.

Coercion	Undue Influence
(v) The contract is voidable at the option of the party whose consent has been obtained by the coercion.	Where consent is induced by undue influence, the contract is either voidable or the court may set it sale or enforce it in a modified form.
(vi) In case of coercion where the aggrieved party, as per Section 64, rescinds the contract any benefit received has to be restored back to the other party.	The court has the distinction to direct the aggrieved party to return the benefit in whole or in part or not to give any such directions.

Answer 2. (e)

(i) When he represents that he has authority to act on behalf of his principal, but who does not actually posses such authority or who has exceeded that authority and the alleged employer does not ratify his acts. Any loss sustained by a third party by the acts of such a person (agent) and who relies upon the representation is to be made good by such an agent.

(ii) Where a contract is entered into by a person apparently in the character of agent, but in reality on his own account, he is not entitled to require performance of it.

(iii) Where the contract expressly provides for the personal liability of the agent.

(iv) When the agent signs a negotiable instrument in his own name without making it clear that he is signing as an agent.

(v) Where the agent acts for a principal who cannot be sued on account of his being a foreign Sovereign, Ambassador, etc.

(vi) Where the agent works for a foreign principal.

(vii) Where a Government Servant enters into a contract on behalf of the Union of India in disregard of Article 299 (1) of the Constitution of India, In such a case the suit against the agent can be instituted by the third party only and not by the principal *(Chatturbhuj v. Moheshwar).*

(viii) Where according to the usage of trade in certain kinds of business, agents are personally liable.

Answer 2. (f)

Anticipatory breach of contract occurs when the promisor refuses altogether to perform his promise and signifies his unwillingness even before the time for performance has arrived. In such a situation the promisee can claim compensation by way of loss or damage caused to him by the refusal of the promisor. For this, the promisee need not wait till the time stipulated in the contract for fulfillment of the promise by the promissor is over.

Sale of Goods Act, 1930 :

Q. 3. Comment on the following :

(a) G has bought 20 kgs of foodstuff against cash payment from N under a contract of sale. But half the consignment is rotten and N is refusing to refund the money.

(b) X buys goods from Y on payment but leaves the goods in the possession of X. X then pledges the goods to Z who has no notice of the sale to Y. State whether the pledge is valid and whether Z can enforce it as per provisions of the Sale of Goods Act, 1930.

(c) Risk is transferred only on delivery.

(d) R sells 200 bales of cloth to S and sends 150 bales by lorry and 50 bales by Railway. S receives delivery of 150 bales sent by lorry, but before he receives the delivery of the bales sent by railway, he becomes bankrupt. R being still unpaid, stops the goods in transit. The official receiver, on S's insolvency claims the goods.

Answer 3. (a)

The quantity of foodstuff (20 kgs) indicates that these were bought for trade or business and not for personal consumption. Hence G cannot take a plea of "implied condition of fitness". The doctrine of 'Caveat Emptor' would apply and G does not have a case.

Answer 3. (b)

The case is based on the provisions of Section 30 (1) of the Sale of Goods Act, 1930 which provides an exception to the general rule that no one can give a better title than he himself possesses. As per the provisions of the section, if a person has sold goods but continues to be in possession of them or of the documents of title to them, he may pledge them to a third person and if such person obtains them in good faith without notice of the previous sale, he would have good title to them. Accordingly ,Z, the pledgee who obtains the goods in good faith from X without notice of the previous sale, gets a good title. Thus the pledge is valid.

Answer 3. (c)

Risk is transferred only when sale is complete, irrespective of whether the goods are delivered or not. (Sec 26). Sec 26 provides that, unless otherwise agreed, the goods are at buyer's risk when the property in the goods passes to the buyer whether delivery has been made or not. Until then, buyer is not responsible for loss or damage of goods.

Answer 3. (d)

The case is based on section 50 of the Sale of Goods Act,1930 dealing with the right of stoppage of the goods in transit available to an unpaid seller. The section states that the right is exercisable by the seller only if the following conditions are fulfilled.

(i) The seller must be unpaid

(ii) He must have parted with the possession of goods

(iii) The goods must be in transit

(iv) The buyer must have become insolvent

(v) The right is subject to the provisions of the Act.

Applying the provisions to the given case, R being still unpaid, can stop the 50 bales of cloth sent by railway as these goods are still in transit.

Q. 4. (a) What are the implied conditions in a contract of 'Sale by sample' under the Sale of Goods Act, 1930?

(b) No one can give a better title than he himself has. State the exceptions to the rule.

(c) What are the consequences of "destruction of goods" under the Sale of Goods Act, 1930, where the goods have been destroyed after the agreement to sell but before the sale is affected.

(d) Distinguish between 'Sale' and 'Hire Purchase Agreement'

Answer 4. (a)

The-following are implied conditions in a contract of sale by sample in accordance with Section 17 of the Sale of Goods Act, 1930;

(i) that the bulk shall correspond with the sample in quality;

(ii) that the buyer shall have a reasonable opportunity of comparing the bulk with the sample.

(iii) that the goods shall be free from any defect, rendering them unmerchantable, which would not be apparent on a reasonable examination of the sample [Section 17(2)].

Answer 4. (b)

The exceptions to the rule are given vide Sections 27 to 30 of Sale of Goods Act,1930 These are as follows :

(i) Sale by a mercantile agent who is in possession of the goods with consent of the seller and sells the goods in ordinary course of business.

(ii) Sale by a joint owner in possession of goods with consent of other joint owners. (Sec 28)

(iii) Sale by a person in possession of goods under a contract which may be voidable on the ground of fraud, misrepresentation, coercion or undue influence provided sale is made before voidable contract is avoided. (Sec 29)

(iv) Sale by seller who is in possession of the goods after sale but not in capacity of buyer's bailee. The subsequent buyer must buy in good faith and for value. (Sec 30)

(v) Sale by buyer who is in possession of the goods before actual purchase if the subsequent buyer buys bona fide and for value. (Sec 30(2))

(vi) Sale made by unpaid seller exercising his right of lien and stoppage in transit. (Sec 54(3))

(vii) Sale made by finder of lost goods u/s 169 of Indian Contract Act.

(viii) Sale by pawnee or pledge u/s 176 of Indian Contract Act.

(ix) Sale made by Official Receiver or Official Assignee or Liquidator.

Answer 4. (c)

The consequences are as follows :

(i) In accordance with the provisions of the Sale of Goods Act, 1930 as contained in Section 7, a contract for the sale of specific goods is void if at the time when the contract was made; the goods without the knowledge of the seller, perished or become so damaged as no longer to answer to their description in the contract, then the contract is void ab initio. This section is based on the rule that where both the parties to a contract are under a mistake as to a matter of fact essential to a contract, the contract is void.

(ii) In a similar way Section 8 provides that an agreement to sell specific goods becomes void if subsequently the goods, without any fault on the part of the seller or buyer, perish or become so damaged as no longer to answer to their description in agreement before the risk passes to the buyer. This rule is also based on the ground of impossibility of performance as stated above.

It may, however, be noted that section 7 & 8 apply only to specific goods and not to unascertained goods. If the agreement is to sell a certain quantity of unascertained goods, the perishing of even the whole quantity of such goods in the possession of the seller will not relieve him of his obligation to deliver the goods.

Answer 4. (d)

The differences between sale and hire purchase are as follows :

Sale	Hire Purchase Agreement
1. Ownership is transferred from the seller to the buyer as soon as the contract is entered into.	1. Ownership is transferred from the seller to the hire-purchaser only when a certain agreed number of instalments are paid.
2. The position of the buyer is that of the owner.	2. The position of the hire-purchaser is that of the bailee.
3. The buyer cannot terminate the contract and as such is bound to pay the price of the goods.	3. The hire-purchaser has an option to terminate the contract at any stage, and cannot be forced to pay the further instalments.
4. If the payment is made by the buyer in instalments, the amount payable by the buyer to the seller is reduced, for the payment made by the buyer is towards the price of the goods.	4. The instalments paid by the hire-purchaser are regarded as hire charges and not as payment towards the price of the goods till option to purchase the goods is exercised.
5. The Sale agreements are governed by the Sales of Goods Act, 1930.	5. The hire-purchase agreements are governed by the Hire-Purchase Act, 1972.

Industrial Laws :

Q. 5. Comment on the following :

(a) **X is owner of a cotton mill. The mill has certain persons on contract basis in putting the ginned cotton into *bojhas* . These persons are employed not by X but by merchants who owned the cotton. Their names do not appear in attendance register of the mill. Whether these persons can claim to be worker of the mill as per *Factories Act, 1948* ?**

(b) **As per *Industrial Disputes Act, 1947*, the Charitable Institutions are not industry.**

(c) **X , had undertaken a piece of work in course of his ordinary business. He sub- contracted a part of his work to Y who in turn sub-contracted a part to Z. F a employee of Z got killed in an accident while working at a machine. The widow of F applied to the Commissioner for an order on X under the *Workmen's Compensation Act, 1923* to deposit the amount of compensation for the death of her husband.**

(d) **FBG(P) Ltd. imposed a fine on Q , one of its employees for regularly reporting late for work. The fine was imposed on 4th April, 2010. The management wanted to recover the amount in September, 201*0 during half yearly increment. Can the Company recover as per the Payment of Wages Act, 1936* ?**

(e) ***The Minimum Wages Act, 1948* prescribes payment of wages in cash only.**

(f) **The balance to the credit of Provident Fund Account of an employee is attachable by the decree of a Court as per *Employees' Provident Funds and Miscellaneous Provisions Act,1952*.**

(g) **Bonus payment under the *Payment of Bonus Act,1965* may be linked to production or productivity.**

(h) **Gratuity can be withheld by the employer non-vacation of official quarter by the employee under the *Payment of Gratuity Act, 1972*.**

(i) An A.C installed in office of P, a practicing Cost Accountant stopped working within 2 months of purchase. There was a warranty of free service for one year which the seller refused to comply with. P made an complaint with District forum against seller under the *Consumer Protection Act, 1986*.

Answer 5. (a)

As per Sec. 2(*l*) of the Factories Act, a worker means a person employed directly or by or through any agency (including a contractor) with or with out the knowledge of principal employer. But he must be employed in a manufacturing process, or in cleaning some part of machinery or premises used in manufacturing process , or in some other kind of work incidental to or connected with the manufacturing process or subject of the manufacturing process.

So, in the given case the persons are workers of the mill as the work performed is incidental to or connected with the manufacturing process.

Answer 5. (b)

The statement is correct. As per Industrial Dispute Act,1947, institutions owned or managed by organizations wholly or substantially engaged in any charitable, social or philanthropic service is not included in the term industry.

Answer 5. (c)

As per Sec. 12, where an employer (known as principal)takes help of a contractor in order to engage some workmen, a workman is entitled to claim compensation from principal if he satisfies the following conditions :

(i) The principal must have contracted with contractor for execution for execution by latter of whole or any part of work of the principal.

(ii) Such work must ordinarily be a part of the trade or business of the principal.

(iii) The workman employed in the execution of work must have been injured by accident arising out of and in course of his employment.

(iv) Injury must have been caused to the workman within or about the vicinity of the employer's premises.

Where the principal is liable to pay compensation, he is entitled to be indemnified by the contractor. Further, nothing in this section shall be construed as preventing a workman from recovering compensation from the contractor instead of the principal.

In the given case, X is liable to pay compensation but he can recover it from Y or Z. If X recovers the amount from Y, Y can recover the same from Z.

Answer 5. (d)

As per Sec. 8(7) of The Payment of Wages Act, 1936 no fines can be recovered after expiry of 90 days from the date on which it is imposed. So FBG(P) Ltd. will not be able to recover the fine in September, 2010 as the gap exceeded 90 days.

Answer 5. (e)

Sec . 11 (1)of the Minimum Wages Act,1948 states that minimum wages shall be paid in cash. But where it has been the custom to pay wages wholly or partly in kind, the Appropriate Government being of the opinion that it is necessary in the circumstances of the case may by notification in the Official Gazette authorize the payment of minimum wages either wholly or partly in kind [Sec 11(2)].

If appropriate government is of the opinion that provision should be made for the supply of essential commodities at concession rates the appropriate government may by notification in the Official Gazette authorize the provision of such supplies at concessional rates[Sec 11(3)].

The cash value of wages in kind and of concessions in respect of supplies of essential commodities at concessional rates authorized under sub-sections (2) and (3) shall be estimated in the prescribed manner.

Answer 5. (f)

According to Section 10 of Employee's Provident Fund and Miscellaneous Provisions Act 1952, the amount standing to the credit of any member in the fund or credit of any exempted employee in provident fund shall not in any way capable or, being assigned or charged and shall not be liable to attachment under any decree or order of any court in respect of any debt or liability incurred by the member on the exempted employee.

The amount standing to the credit of the aforesaid categories of persons at the time of their death and payable to their nominees under the scheme or the rules vests in nominees. And the amount shall be free from any debt or other liability incurred by the deceased or the nominee before the death of the member or the exempted employee and shall also not be liable to attachment under any decree or order of any court.

Answer 5. (g)

As per Section 31A of the Payment of Bonus Act, 1965, there may be an agreement or settlement by the employees with their employer for payment of an annual bonus linked with production or productivity in lieu of bonus based on profits, as is payable under the Act. Accordingly, when such an agreement has been entered into the employees are entitled to receive bonus as per terms of the agreement/settlement, subject to the following restriction imposed by Section 31A;

(i) any such agreement/settlement whereby the employees relinquish their right to receive minimum bonus under Section 10, shall be null and void in so far as it purports to deprive the employees of the right of receiving minimum bonus.

(ii) If the bonus payable under such agreement exceed 20% of the salary/wages earned by the employees during the relevant accounting year, such employees are not entitled to the excess over 20% of salary/wages.

Answer 5. (h)

Gratuity cannot be withheld for non-vacation of service quarters by retiring employees. Gratuity can only be forfeited to the extent of damage or loss where services have been terminated for any act of willful omission or negligence causing damage /loss/destruction of employer's property and not for non-vacation of service quarters.

Gratuity is exempted from attachment in execution of any decree or order in any Civil, Revenue or Criminal Court.

Answer 5. (i)

P was using the A.C for commercial purpose. Hence, he is not a consumer and not entitled to complain under Consumer Protection Act.

Q. 6. Comment on the following :

- **(i) Who is a 'occupier' under the *Factories Act, 1948*?**
- **(ii) Distinguish between employee under the *Payment of Bonus Act, 1965* and under *Employees Provident Fund and Miscellaneous Provisions Act, 1952*.**
- **(iii) Differentiate between lay off and retrenchment under *Industrial Dispute Act, 1947*.**
- **(iv) How do you define 'disablement' under the *Workmen's Compensation Act, 1923*?**
- **(v) On whom does the responsibility for payment of wages lie under the *Payment of Wages Act, 1936*?**
- **(vi) Normal wages of X along with his colleagues were reduced by his employer for a particular day in a month. The reason provided by management was that as they had worked for less than normal working hours on account of power failure, their wages have been proportionately reduced. Explain the rule in this context as per the Minimum Wages Act, 1948.**
- **(vii) Explain the provisions of *Employees' Provident Funds and Miscellaneous Provisions Act, 1952* with regard to determination of 'Escaped Amount' after an officer has passed an order concerning 'Determination of Amount' due from an Employer under the Act.**
- **(viii) Explain the provisions of the *Payment of Bonus Act, 1965* relating to :**
  - **(a) Adjustment of customary bonus against bonus payable under the Act.**
  - **(b) A earns a salary of Rs 10,000 per month. Bonus declared by employer was 10% of salary. Bonus received by A was Rs 4200.**
- **(ix) Explain the following terms in relation to *Payment of Gratuity Act, 1972*:**
  - **(a) Wages**
  - **(b) Rate of Gratuity.**
- **(x) 'Complaint' means any person under *Consumer Protection Act, 1986*. Do you agree?**

Answer 6. (i)

'Occupier' of Factory implies the person who has ultimate control over the affairs of the factory. Provided that :

In case of a firm or AOP any partner or member shall deemed to be occupier.

In case of a company, the directors are occupiers.

In case of a factory owned by Central or State Government or Local Authority, the persons employed to manage the affairs of the factory will deemed to be the occupiers.

In short, an occupier may be owner, lessee or licensee but he should have the right to occupy

the property and dictate terms of management. An employee charged with specific machinery, workers or office is not an occupier.

Answer 6. (ii)

Employee under the Payment of Bonus Act	Employee under EPF and Misc. Pro. Act.
Defined under Section 2(13) of Payment of Bonus Act, 1965.	Defined under Section 2(f) of EPF and Misc. Pro. Act., 1952.
Any person (other than apprentice) employed with salary or wage not exceeding Rs. 10,000/- per month w.e.f 1.4.2006.	Any person who is employed and gets his wages directly or indirectly from employer including an apprentice not being an apprentice engaged under Apprentice Act or under standing orders of establishment.

Answer 6. (iii)

Lay off	Retrenchment
Means failure, refusal or inability of an employer to give employment to a workmen whose name appear in muster rolls of his establishment and who has not been retrenched.	It is termination of service of a workman for any reason other than as a punishment by way of disciplinary action but doesnot include : (a) VRS (b) Retirement on reaching the age of superannuation. (c) Termination due to non renewal of contract. (d) Termination on the ground of illness.
U/s 2(kkk) of Industrial Dispute Act	U/s 2(oo) of Industrial Dispute Act
Worker is entitled to compensation which is 50%of Basic +DA payable to him in case he was not laid of for all days of lay-off excluding weekly holidays.	Compensation is 15 days average pay for each year of completed service or part there of in excess of six months.

Answer 6. (iv)

Disablement implies loss of capacity to work or move. Disablement leads to loss or reduction in earning capacity of workman. Disablement may be partial or total. Further it may be temporary or permanent.

Partial disablement reduces the earning capacity of workman as a result of some accident. It may be temporary or permanent. Temporary partial disablement reduces the earning capacity of workman in **any** employment in which he was engaged at the time of employment.

Permanent partial disablement reduces the earning capacity in every employment the worker was capable of doing at the time of employment.

Total disablement u/s 2(1) (l) means worker becomes incapable in performing any work which he could perform before accident. Total disablement is deemed to result from every injury specified in Part I of Schedule I or combination of injuries specified in Part II resulting in loss of earning capacity to the extent of 100% or more.

Answer 6. (v)

Every employer shall be responsible for payment to persons employed by him of all wages required to be paid under the Payment of Wages Act, 1936 (Sec 3). But in the case of persons employed (otherwise than by a contractor) in factories, industrial establishments or upon railways, the following persons shall also be responsible for the payment of wages:

(i) in factories if a person has been named as the manager of the factory under clause (f) of sub-section (1) of section 7 of the Factories Act, 1948;

(ii) in industrial or other establishments if there is a person responsible to the employer for the supervision and control of the industrial or other establishments;

(iii) upon railways (other than in factories) if the employer is the railway administration and the railway administration has nominated a person in this behalf for the local area concerned.

(iv) in the case of contractor, a person designated by such contractor who is directly under his charge; and

(v) in any other case, a person designated by the employer as a person responsible for complying with the provisions of the Act, the person so named, the person responsible to the employer, the person so nominated or the person so designated, as the case may be, shall be responsible for such payment.

Notwithstanding anything contained in sub-section (1), it shall be the responsibility of the employer to make payment of all wages required to be made under this Act in case the contractor or the person designated by the employer fails to make such payment.

Answer 6. (vi)

As per Sec.15 of Minimum Wages Act, an employee is entitled to receive the minimum wages fixed by the day even if he has worked for less than requisite number of hours constituting a normal working day except –

(i) where his failure to work was result of his unwillingness to work;

(ii) such other cases as may be prescribed.

So the employer cannot reduce the minimum rate of wages fixed by a day at his will.

Answer 6. (vii)

'Escaped amount' is determined under section 7C of the Employees Provident Funds and Miscellaneous Provisions Act, 1952**.** Where an order determining the amount due from an employer under Section 7A or Section 7B has been passed and if the officer who passed the order:

(a) has reasons to believe that by reason of omission or failure on the part of the employer to make any document or report available, or to disclose, fully and truly, all material facts necessary for determining the correct amount due from the employer, any amount so due from such employer for any period has escaped his notice.

(b) has in consequence of information in his possession, reason to believe that any amount to be determined under Section 7A or Section 7B has escaped from his determination for any period notwithstanding that there has been no omission or failure as mentioned in clause (a) on the part of the employer.

He may, within a period of five years from the date of communication of the order passed under Section 7A or Section 7B, re-open the case and pass appropriate order re-determining the amount due from the employer in accordance with provisions of this Act. However, no order re-determining the amount due from the employer shall be passed under this section unless the employer is given a reasonable opportunity of representing his case.

Answer 6. (viii)

(a) The Payment of Bonus Act, 1965 provides that if in any accounting year, an employer has paid any customary bonus to an employee, then the former shall be entitled to deduct the amount of bonus so paid from the amount of bonus payable by him to employee under the Act in respect of that accounting year. The employee shall be entitled to receive only the balance. The employer can do the same thing even in a case where he has paid off the bonus payable under the Act to an employee before the date on which such bonus payable becomes payable. (Section 17)

(b) As per Section 12 for calculation of bonus, where the salary or wage of an employee exceeds Rs. 3500 per mensem, the bonus payable to such employee under Sec 10 or as the case may be, under Sec 11, will be calculated as if his salary or wage were Rs. 3500/- per mensem.

Answer 6. (ix)

(a) The term wages as per sec.2 of Payment of Gratuity Act, 1972 includes basic plus D.A but does not include bonus, commission, house rent allowance, overtime wages or any other allowance. The main feature of **wages** as described aforesaid is that it refers to payment made in cash and not in any other form. Thus supply of food at factory canteen free is not included in wages.

(b) Rate of Gratuity: Gratuity is payable @ 15 days wages for every year of completed service or part thereof in excess of six months. In case of seasonal industries it is payable @ 7days wages for each season.

Answer 6. (x)

According to Section 2(1)(b) of the Act , 'complainant' means—

(i) a consumer;

(ii) any voluntary consumer association registered under the Companies Act, 1956 or any other Act for the time being in force;

(iii) the Central Government or State Government, making a complaint;

(iv) one or more consumers where all have the same interest;

(v) legal heir or representative of a consumer in case of his death (The clause, has been introduced vide Consumer Protection (Amendment), Act, 2002.)

As, such a complainant cannot be any person under Consumer Protection Act, 1986.

Other Laws :

Q. 7. Comment on the following :

(a) Limited Liability Partnership is distinct from limited partnership according to Limited *Liability Partnership Act, 2008*.

(b) Right to Information Act, 2005 is not applicable to whole of India.

(c) SBS Ltd. made an initial public offer of certain number of equity shares. Can these shares can be considered as 'Goods' under the *Competition Act, 2002* before allotment?

(d) (i) A promissory note is made without specifying the time for payment. The holder added 'on demand' on face of the instrument. Does that amount to changing character of the instrument as per the *Negotiable Instrument Act, 1881*?

(ii) X has balance of Rs 5,500/- in YZ Bank. He draws a cheque of Rs. 20,000/- in favour of C knowing fully that he has no O/D facility. The cheque is dishonoured. Is notice of dishonour to X necessary?

(iii) P draws a bill on Q. Q accepts the bill without any consideration. The bill is transferred to R without consideration. R transferred it to S for value . Can S sue the prior parties of the bill ?

Answer 7. (a)

The statement is true. The distinction between the two are as follows :

Limited Liability Partnership	Limited Partnership
(i) Limited liability partnership is granted to all partners.	(i) Limited partnership is granted to a set of non managing partners only.
(ii) The law relating to partnership is not applicable.	(ii) The law relating to partnership is very much applicable.

Answer 7. (b)

The Act extends to the whole of India except the State of Jammu and Kashmir.

Answer 7. (c)

Section 2(i) of Competition Act, 2002 defines 'goods' as follows :

'Goods' means goods as defined the Sale of Goods Act, 1930 and includes –

(I) products manufactured, processed or mined;

(II) debentures, stock and shares after allotment;

(III) in relation to goods supplied, distributed or controlled in India, goods imported into India.

Hence, debentures and shares can be considered as 'goods' within the meaning of section 2(i) of Competition Act, 2002 only after allotment and not before allotment.

Answer 7. (d)

(i) A promissory note made without specifying time is payable on demand. So adding "on demand' on face of the instrument does not change the character of the instrument.

(ii) Notice of dishonour is not necessary when the party charged could not suffer damage for want of notice. As such notice of dishonour to X is not necessary.

(iii) Section 43 of the Negotiable Instruments Act, 1881 provides that a negotiable instrument made, drawn, accepted, indorsed or transferred without consideration, or for a consideration which fails, creates no obligation of payment between the parties to the transaction. But if any such party has transferred the instrument with or without endorsement to a holder for consideration, such holder, and every subsequent holder deriving title from him, may recover the amount due on such instrument from the transferor for consideration or any prior party thereto.

In the given case, P has drawn a bill on Q and Q accepted the bill without consideration and transferred it to R without consideration. Later on in the next transfer by R to S is for value.

According to provisions of the aforesaid section 43**,** the bill ultimately has been transferred to S with consideration. Therefore, S can sue any of the parties i.e. P, Q or R, as S arrived a good title on it being taken with consideration.

Q. 8. (a) When is a LLP not bound by act of its members?

(b) What is meant by 'Right to Information' under RTI Act, 2005?

(c) Examine with reference to the relevant provisions of the Competition Act, 2002 the following :

(i) Whether a Government Department supplying water for irrigation to the Agriculturists after levying charges for water supplied (and not a water tax) can be considered as an 'Enterprise'

(ii) Whether a person purchasing goods, for resale can be considered as a 'consumer.'

(d) Answer the following in respect of the *Negotiable Instrument Act, 1881*.

(i) Ascertain the date of maturity of a bill payable hundred days after sight and which is presented for sight on 4th May, 2010.

(ii) What is the difference between holder and holder-in-due-course?

(iii) What is a 'Sans Recourse' endorsement? A bill of exchange is drawn payable to X or order. X indorses it to Y, Y to Z, Z to A.A to B and B to X. State with reasons whether X can recover the amount of the bill from Y. Z, A and B, if he has originally indorsed the bill to Y by adding the words 'Sans Recourse'.

Answer 8. (a)

A limited liability partnership is not bound by any act of a member in dealing with a person if –

(i) the member in fact has no authority to act for the limited liability partnership by doing that thing;

(ii) the person knows that the member has no authority or does not know or believe him to be a member of limited partnership.

Answer 8. (b)

"Right to Information" means the right to information accessible under this Act which is held by or under the control of any public authority and includes the right to—

(i) inspection of work, documents, records;

(ii) taking notes, extracts or certified copies of documents or records;

(iii) taking certified samples of material;

(iv) obtaining information in the form of diskettes, floppies, tapes, video cassettes or in any other electronic mode or through printouts where such information is stored in a computer or in any other device;

Answer 8. (c)

(i) The term 'enterprise' is defined in Section 2(h) of Competition Act, 2002. Accordingly 'enterprise' means a person or a department of the Government, who or which is engaged in any activity, relating to the production, storage, supply, distribution, acquisition or control of articles or goods, or the provision of services of any kind. But the term does not include any activity of the Government relatable to sovereign functions of the Government including all activities carried on by the departments of the Central Government dealing with atomic energy, currency, defence and space.

Certain specific activities of Government departments like dealing with atomic energy, etc,. and sovereign functions of the Government (like police, defence, etc.) are excluded from the purview of the said terms. Hence, a Government department engaged in the activity of providing service in the form of supply of water for irrigation to the agriculturists after levying charges can be considered as an 'enterprise' within the meaning of Section 2(h) of Competition Act, 2002.

(ii) The term 'consumer' is defined in Section 2(f) of Competition Act, 2002. Accordingly 'consumer' means any person who buys any goods for a consideration, which has been paid or promised or partly paid and partly promised, whether such purchase of goods is for resale or for any commercial purpose or for personal use.

Hence, it is not necessary that a person must purchase the goods for personal use in order to be considered as a 'consumer' under Competition Act, 2002. Even a person purchasing goods for resale or for any commercial purpose will also be considered as a 'Consumer' within the meaning of Section 2(f) of Competition Act, 2002.

Answer 8. (d)

(i) In this case the day of presentment for sight is to be excluded i.e. 4th May, 2010. The period of 100 days ends on 12th August, 2010(May 27 days + June 30 days + July 31 days + August 12 days). Three days of grace are to be added. It falls due on 15th August, 2000 which happens to be a public holiday. As such it will fall due on 14th August, 2010 i.e. the preceding business day.

(ii)

Holder	Holder in due course.
(1) Holder is entitled in his own name to possess the instrument and the amount thereon from parties involved.	Holder in due course possesses the instrument for consideration before maturity and in good faith.
(2) Title of the holder is subject to title of the transferor.	Holder in due course gets a better title than transferor.
(3) Holder may receive the instrument without consideration.	Holder in due course always receives the instrument for consideration.
(4) Holder does not get certain privileges available to the holder in due course.	Holder in due course always gets privileges not available to holder.

(iii) It is a type of endorsement on a Negotiable Instrument by which the endorser absolves himself or declines to accept any liability on the instrument of any subsequent party. The endorser signs the endorsement putting his-signature along with the words, SANS RECOURS.

In the problem X, the endorser becomes the holder after it is negotiated to several parties. Normally, in such a case, none of the intermediate parties is liable to X. Tills is to prevent 'circuitry of action'. But in this case X's original endorsement is 'without recourse' and therefore, he is not liable co Y, Z, A and B. But the bill is negotiated back to X, all of them are liable to him and he can recover the amount from all or any of them (Section 52 para 2).

SECTION - II
(Auditing)

Q. 1. Comment on the following based on legal position :

(a) In auditing, the concept of materiality can be judged only in relative context.

(b) Auditor's primary job is to detect errors and frauds.

(c) Steps in an Audit may be represented by a flow chart to reduce complexity.

(d) Audit is concerned with ethics of business.

(e) A company can refuse to provide access to its books of accounts to the company's auditor outside normal working hours of the company , as it will inconvenience the accounts staff.

(f) Auditing in depth means checking all the transactions in minute details.

(g) Contingent Gains are recognized in Financial Statements.

(h) The appointment of Mr. A as statutory auditor was held to be void ab initio. So the company holds another annual general meeting and appoints Mr. B, through a special resolution.

(i) Foreign branch of a company can be audited only by an auditor of that country.

(j) The auditor of a company who attended the general meeting spoke first about the accounts of the company. Later he wanted to express his views about a matter relating to proposed expansion plans; the Board of Directors has the power to prevent him from expressing such views.

(k) In the Balance Sheet of the Company , Debenture to be redeemed during the subsequent year are shown under the head " Current Liabilities and Provisions".

(l) Working Papers of the auditor are to be returned to his client after audit since these are the property of the client.

(m) Where an auditor fails to obtain sufficient information to warrant an expression of opinion, he gives an adverse opinion.

(n) Operational audit is merely an extension of Internal Audit.

(o) The overall objectives and scope of an audit change drastically in an EDP environment.

Answer 1. (a)

The statement is true. Materiality can be judged only in relative context. In a small business, Rs 5000/- may be a material amount, whereas in a giant undertaking, Rs. 50,000 may not be so material as to merit a separate disclosure.

Answer 1. (b)

The statement is false. The primary job of an auditor is to express opinion on financial statements of client regarding 'true and fair' view regarding financial statements. Detection of error and fraud is only secondary job of an auditor and will be investigated only when his/her suspicions arose regarding certain matters/actions/ transactions.

Answer 1. (c)

The statement is true. Flow Chart is a graphic representation of a system. It enables one to understand even complicated system easily. The flow chart as an approach to audit was advocated by the American Institute of Certified Public Accountants in 1990.

Answer 1. (d)

The statement is false. Audit is not concerned with ethics of business unless the business itself is illegal or unlawful.

Answer 1. (e)

The statement is false. Section 227(1) of the Companies Act, 1956, provides that every auditor of a company shall have a right of access to books , accounts and vouchers of the company at all times and shall be entitled to require from the officers of the company such information and explanations as he may think necessary for proper performance of his duties. The auditor thus has the right of access to the records kept by the company at all times and may therefore, inspect them in the course of performance of his duties as auditor. As per law, the company cannot refuse to provide such access after regular office hours.

Answer 1. (f)

The statement is false. Auditing in depth means the tracing of a transaction through its various stages from origin to conclusion, examining the supporting records at each stage and ascertaining whether all the requirements laid down in the system of internal check have been complied with.

Answer 1. (g)

The statement is false. As per para 12 of AS 4, contingent gains should not be recognised in the financial statements till it is realized.

Answer 1. (h)

Where the appointment of an auditor is void ab initio, it is as if no auditor has been appointed at all. Section 224(3) of the Companies Act , 1956 will come into play. As per this subsection, where at an annual general meeting, no auditors are appointed or reappointed, the Central Government shall appoint a person to fill the vacancy. Hence, in the given situation, the vacancy cannot be filled up by the company, but only by the Central Government. Accordingly, the appointment of Mr. B as new auditor at subsequent meeting will not be valid.

Answer 1. (i)

The statement is false. As per Section 228(1) of the Companies Act, 1956, where a company has a branch office, the accounts of that office shall be audited by the company’s auditor appointed under section 224 or by a person qualified for appointment as auditor of the company under section 226 . Where the branch office is situated in a country outside India, any of the above or an Accountant Qualified to act as auditor in the country concerned can be appointed as branch auditor.

Answer 1. (j)

The statement is true. Section 231 of the Companies Act provides that the auditor shall be entitled to attend any general meeting and to be heard at any general meeting which he attends on any part which concerns him as auditor. He is empowered to speak about company’s accounts. The statement which he wanted to make on the company’s proposed expansion plans does not relate to a business which concerns him as auditor, he does not have the right to be heard on the expansion plans. Board can prevent him from speaking on such subject.

Answer 1. (k)

The statement is false. The amount should be shown under the first sub- head under “Secured Loans” irrespective of the due date of redemption as per Part – I, Schedule VI of the Companies Act, 1956.

Answer 1. (l)

The statement is false. Working Papers are the property of the Auditor. He may, at his discretion, take portions or extracts from his working papers and make available to his client. However, the auditor should take reasonable care for custody and keep confidentiality of his working papers and retain for a necessary period of time to meet future needs, if any.

Answer 1. (m)

The statement is false. In such a situation, disclaimer opinion is given by the auditor.

Answer 1. (n)

The statement is true. In operational audit function, the internal auditor goes beyond financial controls and looks into operational areas also. Operational auditing having scope and objectives similar to that of Internal Audit is therefore an extent ion of Internal Audit.

Answer 1. (o)

The statement is false. The overall objectives and scope of an audit does not change in an EDP environment. However, the use of a computer changes the processing and storage of financial information and may affect the organization and procedure employed by the entity to achieve internal control.

Q. 2. (a) What is an "Audit Evidence"?

(b) What are the assertions with which an auditor is concerned with while obtaining audit evidence from substantive procedures?

Answers 2.

(a) Audit evidence refers to any information, verbal or written, obtained by the auditor on which he bases his opinion on financial statements.

The audit evidence may be of varied nature and can assume various forms. For example, a signature on the voucher of a designated official, the payee's receipt, etc. Even the information obtained by the auditor by discussing with the officials of the company also constitutes audit evidence.

(b) An auditor is concerned with following assertions :

(i) **Existence :** That an asset or liability exists at a given date.

(ii) **Rights and obligations :** That an asset is a right of the concern and a liability is an obligation at a given date.

(iii) **Occurrence :** That a transaction or event which took place pertains to the entity during the relevant period.

(iv) **Completeness :** That there are no unrecorded assets, liabilities or transaction.

(v) **Valuation :** That an asset or liability is recorded at an appropriate carrying value.

(vi) **Measurement :** That a transaction is recorded in the proper amount and revenue or expense is allocated to the proper period.

(vii) Presentation and disclosure that an item is disclosed classified and described in accordance with recognized accounting policies and practices and relevant statutory requirements.

Q. 3. Auditors of M/s FBG (P) Ltd. were changed for the accounting year 2009-10. The closing stock of the company as on 31.3.2009 amounting to Rs. 200 lacs continued as it is and became closing stock as on 31.3.2010. The auditors of the company propose to exclude from their audit programme the audit

of closing stock of Rs. 200 lacs on the understanding that it pertains to the preceding year which was audited by another auditor. Give your comments.

Answers 3.

According to SA 510 "Initial Engagements – Opening Balances", requires that for initial audit engagements, the auditor should obtain sufficient appropriate audit evidence that:

(a) the closing balances of the preceding period have been correctly brought forward to the current period;

(b) the opening balances do not contain misstatements that materially affect the financial statements for the current period; and

(c) appropriate accounting policies are consistently applied.

When the financial statements for the preceding period were audited by the another auditor, the current auditor may be able to obtain sufficient appropriate audit evidence regarding opening balances by perusing the copies of the audited financial statements. Ordinarily, the current auditor can place reliance on the closing balances contained in the financial statements for the preceding period, except when during the performance of audit procedures for the current period the possibility of misstatements in opening balances is indicated.

General principles governing verification of assets require that the auditor should confirm that assets have been correctly valued as on the balance sheet date. The contention of the management that the stock has not undergone any change cannot be accepted, it forms part of normal duties of auditor to ensure that the figures on which he is expressing opinion are correct and properly valued. Moreover, it is also quite likely that the stock lying as it is might have deteriorated and the same need to be examined. The auditor is advised not to exclude from his audit programme the audit of closing stock.

Q. 4. "Secret Reserves can remain no longer secret". Discuss.

Answers 4.

Secret Reserves are hidden reserves which do not appear on the face of the Balance Sheet. Secret reserves arise with omission or under valuation of assets or overstatement of liabilities. Such a situation is opposite of 'Window Dressing'.

Before the Companies Act , 1956 , Auditors could wink at secret reserves because they are required to state whether the financial statements reveal the 'correct view' of the state of affairs of the company.

That means that the auditors were concerned only with arithmetical accuracy of the statements, instead of substantial accuracy.

After passing of the Companies Act , 1956, the financial statements should televise a "True and Fair" view of the financial position of the company. All the reserves and provisions (as defined in the Schedule to the Companies Act, 1956) should be fully disclosed in the Company's Accounts, so that there cannot be any understatement of assets or overstatement of liabilities.

For transactions found in the company's account, disclosures wherever required have to be made in terms of Accounting Standards. Hence Secret Reserves can no longer be created by general class of companies.

However, in case of Banking, Insurance, and Electricity Companies, The Companies Act provides for exceptions to some limited extent and to that extent secret reserves may exist in such classes of companies.

Q. 5. How will you vouch/verify the following :

(a) Foreign travel expenses.

(b) Receipt of capital subsidy.

(c) Machinery acquired under Hire-purchase system.

(d) Bills Payable.

(e) Sales Return.

Answer 5. (a)

Foreign travel expenses :

(i) Examine T.A. bills submitted by the employees stating the details of tour, details of expenses, etc.

(ii) Verify that the tour programme was properly authorised by the competent authority.

(iii) Check the T.A. bills along with accompanying supporting documents such as air tickets, travel agents bill, hotel bills with reference to the internal rules for entitlement of the employees and also make sure that the bills are properly passed.

(iv) See that the tour report accompanies the T.A. bill. The tour report will show the purpose of the tour. Satisfy that the purpose of the tour as shown by the tour report conforms with the authorisation for the tour.

(v) Check Reserve Bank of India's permission, if necessary, for withdrawing the foreign exchange. For a company the amount of foreign exchange spent is to be disclosed separately in the accounts as per requirement of Part I of Schedule VI to the Companies Act, 1956.

Answer 5. (b)

Receipt of capital subsidy :

(i) Refer to application made for the claim of subsidy to ascertain the purpose and the scheme under which the subsidy has been made available.

(ii) Examine documents for the grant of subsidy and note the conditions attached with the same relating to its use, etc.

(iii) See that conditions to be fulfilled and other terms especially whether the same is for a specific asset or is for setting up a factory at a specific location.

(iv) Check relevant entries for receipt of subsidy.

(v) Check compliance with requirements of AS 12 on "Accounting for Government Grants" i.e. whether it relates to specific amount or in the form of promoters' contribution and accordingly accounted for as also compliance with the disclosure requirements.

Answer 5. (c)

Machinery acquired under Hire-purchase system :

(i) Examine the Board's Minute Book approving the purchase on hire-purchase terms.

(ii) Examine the hire-purchase agreement carefully and note the description of the machinery, cost of the machinery, hire purchase charges, terms of payment and rate of purchase.

(iii) Ascertain that the machinery has been included in the related assets account at its cash value. Also instalments due have been paid and the hire-purchase charges applicable to the period from the commencement of the agreement to the end of the financial year have been charged against current profits.

(iv) Ensure that machinery acquired on hire purchase basis has been included at its cash value in the balance sheet and depreciation has been calculated on the cash value from the date of the purchase. The amount due to the hire purchase company in respect of the capital outstanding has either been shown as a deduction from the machinery account or as a separate amount under current liabilities.

Answer 5. (d)

Bills Payable : These are acknowledgements of debts payable. For their verification, it is necessary to see that bills paid have been cancelled and the liability in respect of those outstanding has been correctly ascertained and disclosed. Steps involved in their verification are:

(i) Vouch payments made to retire bills on their maturity or earlier and confirm that the relevant bills have been duly cancelled.

(ii) Trace all the entries in the Bills Payable Book to the Bills Payable Account to confirm that the liability in respect of the bills has been correctly recorded.

(iii) Reconcile the total of the schedule of bills payable outstanding at the end of the year with the balance in the Bills Payable Account.

(iv) Obtain confirmation from the drawers or holders of the bills in respect of amount due on the bills accepted by the client that are held by them.

(v) Verify that the charge, if any, created on any asset for the due payment of bills has been appropriately disclosed.

Answer 5. (e)

Sales Return :

(i) Examine the accounting basis for such transactions with reference to corresponding Debit Note to Debit Note. The relevant correspondence may also be examined.

(ii) Verify by reference to relevant corresponding record in goods inward book or the stores records. Further, the figures in these documentary evidences should be compared with the original invoices for rates and other charges and calculation should also be checked.

(iii) Examine in depth to eliminate the possibility of fictitious sales returns for covering bogus sales recorded earlier when such returns outwards are in substantial figure either at the start or end of the accounting year.

(iv) Cross-check with reference to original invoices any rebates in price or allowances if any given by buyers on strength of their Debit Notes.

Q. 6. In the course of audit of a SDF Ltd. , the auditor noticed that although there was no change in either selling or purchase price of the goods, there was considerable increase in Gross Profit Ratio in comparison to previous year. What matters would the auditor examine to assess the reason for such increase?

Answers 6.

In assessing the reason for considerable increase in Gross Profit Ratio, the auditor should examine the followings:

(i) Under valuation of opening stock due to non-inclusion of certain items or applying lower rate to one or more items of stock.

(ii) Over valuation of closing stock either by the inclusion of fictitious items or over valuing some of the items of Stock.

(iii) Change in the method of valuation of opening and closing stock. For example, opening stock was valued at lower of cost and market value, whereas closing stock has been valued at market price which is higher than cost.

(iv) Goods sold but not delivered are included in stock.

(v) Goods delivered last year but sales invoice raised in current year.

(vi) Recording of fictitious sales to boost up profits.

(vii) Goods returned to supplier awarding dispatch and included in closing stock.

(viii) Goods returned by customers but not debited to sales return and included in closing stock.

(ix) Inclusion in the closing stock of goods received for sale on approval or consignment basis.

(x) Treatment of goods sent on consignment basis as regular sales.

(xi) Non-provision of outstanding expenses like wages, carriage inward etc.

(xii) Wrong allocation of expenses in Trading and Profit & Loss Account.

Q. 7. ABC Enterprises entered into a contract for sale of its goods worth Rs. 66 lacs with ADLtd. The goods were inspected, approved and finalised by the inspection team of AD Ltd. AD Ltd. made the whole payment of Rs. 66 lacs. However, it requested ABC Enterprises to dispatch the goods in six equal monthly instalments from October, 2009 to March, 2010. In the month of January,2010, due to labour problems, AD Ltd. informed ABC Enterprises to stop dispatches of the remaining three instalments until further notice. At the time of finalising its accounts for the financial year 2009-10, ABC Enterprises booked sales amounting to Rs. 33 lacs and showed remaining Rs. 33 lacs as Advance against Sales.

Answers 7.

AS 9 requires that revenue from sale of goods should be recognized when the following conditions are followed:

(i) The seller has transferred the property in the goods for a price to the buyer or all significant risks and rewards of ownership have been transferred to the buyer, and the seller has not retained effective control of the goods transferred to a degree usually associated with ownership.

(ii) No significant uncertainty exists regarding the amount of the consideration that will be derived from the sale of goods.

In the given case, the sale transaction carried by SMT Enterprise fulfills all the condition stated above. Hence, the accounting entry passed by SMT Enterprise recognising partial revenue to the extent of goods dispatched is not correct. The entire amount of Rs. 66 lacs should be recognised as sales.

Q. 8. As an auditor, what would you do to verify in the following situations?

(a) The company has sent semi-finished goods to third parties for further processing, which is lying with them at the end of the year.

(b) The management has obtained a certificate from an actuary regarding provision of gratuity payable to employees.

(c) Cost of structural alterations amounting to Rs. 120,000 to self-owned factory premises has been charged to Building Repairs.

(d) The debit balance in the profit and loss account is shown as a deduction from Investment Allowance Reserve on the liabilities side of the Balance Sheet.

Answer 8. (a)

Semi-finished goods being composite part of the inventories, normally, constitute significant item in case of any entity. It is the duty of the auditor to ensure that entire inventories which are owned by the enterprise exist on that date and valuation thereof is also proper. Since the semi-finished goods belong to the company, it is necessary to ensure that the same have been included for in valuation of inventories. The auditor should also obtain direct confirmation about the quantity of inventories lying with the processors at the end of the year. Also, the auditor should see that the valuation has been made properly with reference to the stage of completion in respect of work-in-process inclusive of expenses incurred in sending the goods for processing. In case, the amount happens to be material, such stock may be disclosed separately as stocks with processors.

Answer 8. (b)

The computation of gratuity liability payable to employees is dependent upon several factors such as age of the employee, expected span of service in the organisation, life expectancy of the employee, prevailing economic environment, etc. Thus, it gives rise to uncertainty in the determination of provisions of liabilities. Under such circumstances, the management is required to make an assessment and estimate the amount of provision. In view of this, the management may engage an expert in the field to assist them in arriving at fair estimation of the liability. Therefore, it is an accepted auditing practice to use the work of an expert. SA 620 on "Using the Work of an Expert" also states that an expert may be engaged/employed by the client. It further requires the auditor to assess skill, competence and objectivity of the expert amongst other factors and evaluate the work of an expert independently to conclude whether or not to rely upon such a certificate obtained by the management from the actuary. Therefore, the auditor must follow the requirements of SA 620 before relying upon the certificate obtained by the management from the actuary.

Answer 8. (c)

Any subsequent expenditure on fixed assets which increases the future benefits arising from them beyond their previously assessed standards of performance amounts to capital expenditure and, thus, must form part of the cost of the asset. The words "structural alteration" would generally signify that some significant changes have taken place in the design of building to provide more strength to the building or expansion in the capacity of the building. Therefore, cost of Rs.120,000 represents the cost of expansion or extension or may increase the life span of premises, it is a capital expenditure, and an adjustment entry debiting Buildings Account and crediting Building Repairs Account should be made and depreciation should also be provided accordingly.

Answer 8. (d)

Part - I of Schedule VI to the Companies Act, 1956 read with the instructions for the preparation of the Balance Sheet of a company clearly stipulates that the debit balance in the Profit and Loss Account should be shown as a deduction from the general reserves or any other uncommitted reserve. Therefore, the treatment followed by the company by deducting the debit balance of profit and loss account from investment allowance reserve is not correct. Accordingly, the auditor will have to qualify the report since the information has not been presented in the manner required by Section 211(5) of the Companies Act, 1956.

Q. 9. At the AGM of DEF Ltd., Mr M was appointed as the statutory auditor. He, however, resigned after 3 months. State, how the new auditor will be appointed by DEF Ltd.

Answers 9.

Section 224(6) of the Companies Act, 1956 deal with provisions relating to appointment of auditor caused due to casual vacancy. A casual vacancy normally arises when an auditor ceases to act as such after he has been validly appointed, e.g., death, disqualification, resignation, etc. In the instance case, Mr X has been validly appointed and thereafter he had resigned.

Thus a casual vacancy had been created on account of resignation. The law provides that in case a casual vacancy has been created by the resignation of the auditor (as in this case), the Board cannot fill in that vacancy. The company in a general meeting can only fill the same.

Thus, in this case ICI Ltd will have to call an extra-ordinary general meeting (EGM) and appoint another auditor. The new auditor so appointed shall hold office only till the conclusion of the next annual general meeting.

The provisions of the Companies Act, 1956 applicable for the appointment of an auditor in place of a retiring auditor would equally applicable in the instant case are given below :

(i) *Section 225(1)*: Special notice shall be required for a resolution at an annual general meeting appointing as auditor a person other than a retiring auditor.

(ii) *Section 190(2)*: Special notice is to be sent to all members of the company at least 7 days before the date of the AGM.

(iii) *Section 225(2)*: On receipt of notice of such a resolution, the company shall forthwith send a copy thereof to the retiring auditor.

(iv) *Section 225(3)*: Representation if any, received from the retiring auditor should be sent to the members of the company.

(v) *Section 224A*: Special resolution as required under this section should be duly passed.

(vi) *Section 224(1B)*: Before any appointment or reappointment of auditors is made at an annual general meeting, a written certificate is to be obtained from the auditor proposed to be appointed that his appointment will be in accordance with the limits specified in Section 224(1B).

(vii) The incoming auditor should also satisfy himself that the notice provided for under Sections 224 and 225 has been effectively served on the outgoing auditor.

Q. 10. Comment on the following :

(a) PQR Limited with its registered office at Bangalore has two branch offices located at Mumbai and Kolkata. The accounting transactions of the branches are recorded and the accounting records are maintained in the branches themselves. Only quarterly summarized Trial balance, Profit and Loss account and Balance Sheet are sent to Bangalore office by the branch Accountants. Do you think that the Company is at fault of not maintaining proper books at registered office as per the Company law provisions.

(b) R and S were appointed as Joint Auditors of GBF Ltd. What will be their professional responsibility in a case where the company has cleverly concealed certain transactions that escaped the notice of both the Auditors.

(c) 'X' owes Rs. 1001 to 'YZ' Ltd., of which he is an auditor. Is his appointment valid? Will it make any difference, if the advance is taken for meeting-out travelling expenses?

(d) The members of XYZ Ltd. preferred a complaint against the auditor stating that he has failed to send the auditors report to them.

Answer 11. (a)

According to Section 227 of the Companies Act, 1956, the auditor has to report whether the company has maintained proper books of account. According to section 209 of the Companies Act, the company has to keep at its registered office all the accounting records specified therein.

As regards, the records of the branch, Section 209 permits that the same may be maintained at branches provided summarized returns of the branch are sent to registered office at such frequent intervals not less than a quarter.

In the present case, since the branches are sending quarterly summarized returns of accounting details, it is deemed that proper books of accounts are maintained at registered office.

Hence, there is no statutory violation committed by the company.

It may be noted, still the company auditor has right of access (at registered office itself by calling for records) and right to visit the branch.

Answer 10. (b)

In conducting a joint audit, the auditor(s) should bear in mind the possibility of existence of any fraud or error or any other irregularities in the accounts under audit. The principles laid down in SA 200A, SA 240 and SA 299 need to be read together for arriving at any conclusion. The principle of joint audit involves that each auditor is entitled to assume that other joint auditor has carried out his part of work properly. However, in this case, if it can be assumed that the joint auditors R and S have exercised reasonable care and skill in auditing the accounts of GBF Ltd. and yet the concealment of transaction has taken place, both joint auditors cannot be held responsible for professional negligence. However, if such concealment could have been discovered by the exercise of reasonable care and skill, the auditors would be responsible for professional negligence. Therefore, it has to be seen that while dividing the work, the joint auditors have not left any area unattended and exercised reasonable care and skill while doing their work.

Answer 10. (c)

As per Section 226(3)(d) of the Companies Act, 1956, a person who is indebted to the company for an amount exceeding Rs. 1,000/- or who has given any guarantee or provided any security in connection with the indebtedness of any third person to the company for an amount exceeding Rs. 1,000/- then he is not qualified for appointment as an auditor of a company. Accordingly, X's appointment is not valid and he is disqualified as the amount of debt exceeds Rs.1000. Even if the advance was taken for meeting out travelling expenses particularly before commencement of audit work, his appointment is not valid because in such a case also the auditor shall be indebted to the company. The auditor is entitled to recover fees on a progressive basis only.

Answer 10. (d)

Section 227 of the Companies Act, 1956 lays down the powers and duties of auditor. As per provisions of the law, it is no part of the auditor's duty to send a copy of his report to members of the company. The auditor's duty concludes once he forwards his report to the company. It is the responsibility of company to send the report to every member of the company. It will be for the secretary or the director to convene a general meeting and send the balance sheet and report to the members (or other person) entitled to receive it. Hence in the given case, the auditor cannot be held liable for the failure to send the report to the shareholders.

Q. 11. Write short notes on :

(a) Qualified audit report

(b) "Auditor's Lien".

Answer 11. (a)

Qualified reports is issued by an auditor when the auditor is not satisfied as to the truth and fairness of the accounts in certain respects which are reserved and so indicated in his report. Such reservations or exceptions are called qualifications. The auditors reports that the accounts do exhibit true and fair view of the affairs and financial status subject to or except the matters of reservations. Such type of reporting is called qualified report. In majority of cases, items which are the subject matter of qualification, are not so material as to affect the truth and fairness of the whole of the accounts but merely create uncertainty about a particular item. All qualifications should be contained in the auditor's report. The words 'subject to' are essential to state any qualification on the financial statements in clear and unambiguous manner. The auditors should state all qualifications independently in their report in an adequate manner so that a reader can assess the significance of these qualifications.

Answer 11. (b)

Under the general principles of law, if any person has lawful possession of the property of another person, on which he has worked, he may retain such property for non payment of any amount outstanding in respect of work done on the property.

Accordingly, the auditor may exercise lien on the client's documents in his possession for non payment of fees for work done for the client. As per SA 230, "Documentation", the working papers are the property of the auditor. The auditor at his discretion may make extracts from his working papers available to his clients. The auditor should also adopt reasonable procedures for custody and confidentiality of his working papers and should retain them for a period of time sufficient to meet the needs of his practice and satisfy any pertinent and legal or professional requirement of record retention.

However, regarding books of account of a company, it may be noted that as per section 209 of the Companies Act, 1956, these must be kept at the registered office of the company.

However, all or any of the books of account may be kept at any other place in India pursuant to a Board's Resolution, and notice must be filed with the Registrar.

Thus, as per such a resolution, if the Board of a company hands over the books of account to the auditor, the auditor may exercise his lien for non payment of fees. However, reasonable facilities must be provided for inspection of the books of account by the directors, members and other authorised persons.

The auditor needs to observe provisions of the Companies Act, 1956. Further, in respect of auditor exercising the lien, the views of the Institute of Chartered Accountants of England and Wales are worth noting :

(i) Documents must belong to the client who owes the money, and these documents must come to the possession of the auditor on the client's authority.

(ii) The auditor can retain such documents, only if he has done work on such documents, on which fees have not been paid.

Q. 12. Give your comments and observations on the following :

(a) No depreciation provided on a machinery costing Rs. 85 lacs imported three years back, since it is yet to be put into use.

(b) A portion of Share Premium utilised to declare 33% dividend.

(c) Sundry debtors of a company as an 31-3-10 include Rs. 16 lacs from M/s UT, who have been declared as insolvent on 3-4-2010.

(d) The register of members of AP Ltd. has not been written up-to-date and as a result, the balances in the register do not agree with the amount of issued Share Capital.

Answer 12. (a)

As per AS 6 on "Depreciation Accounting", depreciation is a measure of the wearing out, consumption or other loss of value of a depreciable asset arising from use, effusion of time or obsolescence through technology and market changes.

Thus, depreciation has to be charged even in case of these assets which are not used at all during the year but by mere effusion of time provided such assets qualify as depreciable assets. When the machinery has been imported by one entity, it means it was intended to be used for the purpose of business.

Depreciation in respect of this machinery ought to have been provided in the accounts for all the previous years. If there is an intention to use an asset, though it may not have actually been used, it is a 'constructive' or 'passive' use and eligible for claim of depreciation.

Further Part-II of Schedule VI to the Companies Act requires that if no provision is made for depreciation, the fact that no provision has been made and quantum of arrears of depreciation computed in accordance with Section 205(2) of the Companies Act should be disclosed. Provision of depreciation is essential to show a true and fair picture of financial statement.

Thus, the auditor should ensure compliance with all these requirements.

Answer 12. (b)

Section 78 of the Companies Act, 1956 deals with application of premium received on issues of shares. Section 78(1) required creation of Securities Premium Account and states that the provisions of this Act relating to the reduction of the share capital of a company shall, except as provided in this section, apply as if the premium account were paid-up share capital of the company. Sec. 78(2) lays down that the securities premium account may be applied by the company :

(i) in paying up unissued shares of the company to be issued to members of the company as fully paid bonus shares;

(ii) in writing off the preliminary expenses of the company;

(iii) in writing off the expenses of, or the commission paid or discount allowed on, any issue of shares or debentures of the company; or

(iv) in providing for the premium payable on the redemption of any redeemable preference shares or of any debentures of the company.

Thus, it is clear from the above that share premium can be utilised only for specific purposes. Further, section 205 of the Companies Act, 1956 also specifies the sources from which dividends can be paid and requires the same to be only paid out of past profits, general reserve or any other free reserve. Hence, declaration of dividends out of share premium is not proper and, consequently, the auditor shall have to qualify the audit report.

Answer 12. (c)

According to AS 4, "Contingencies and Events Occurring after the Balance Sheet Date", any significant event occurring after the date Balance Sheet date but before the date of approval of financial statements by the Board requires adjustments to assets/liabilities as on the date of Balance Sheet in case additional evidence is available in respect of conditions existed on the date of the balance sheet. In this case, the debtors balance has to be suitably adjusted since conditions existed on the date of the balance sheet in respect of which additional evidence has been provided by the insolvency of M/s UT. Thus, the auditor must ascertain that requirements of AS 4 have been followed.

In case of non-observance of the same, the auditor should qualify the report.

Answer 12. (d)

Register of members is a statutory book, which should be maintained by every company. The auditor should ascertain whether the company updates the register and then examine whether it is in agreement with the amount of issued capital. Because in the audit of share capital, it constitutes one of the internal documentary evidence. The auditor may also consider applying alternative audit procedures because If the company fails to update the register and the auditor fails to obtain sufficient appropriate audit evidence, the auditor may qualify his report.

Q. 13. Explain how following are dealt in Auditor's Report as per CARO :

(a) Fraud.

(b) Transactions in which Directors are interested.

(c) Guarantees for loan taken by others.

(d) Sickness.

Answer 13. (a) Fraud :

The auditor should state whether any fraud on or by the company has been noticed or reported during the year, if yes, the nature and the amount involved.

Answer 13. (b) Transactions in which Directors are interested.

Auditors statements are required on the following :

(i) Whether transactions that need to be entered into register in pursuance of Sec. 301 of Companies Act, have been entered.

(ii) Whether each of these transactions have been made at prices which are reasonable having regard to the prevailing market prices relevant at that time. These should be commented only when value of transactions exceed Rs. 5 crores.

Answer 13. (c) Guarantees for loan taken by others.

The auditor should comment whether the company has given any guarantee for loans taken by others from banks, financial institutions, the terms and conditions of which are prejudicial to the interest of the company.

Answer 13. (d) Sickness :

The auditor should point out in case of a company incorporated for more than five years and having accumulated losses at the end of financial year amounting to more than 50% of net worth on whether it has incurred cash losses also in such financial year and in the financial year immediately preceding such financial year.

Q. 14. What are the inherent limitations of Internal Control system?

Answer 14.

Internal control can provide only reasonable but not absolute assurance that its objective relating to prevention and detection of errors/frauds, safeguarding of assets etc., are achieved. This is because it suffers from some inherent limitations, such as:-

(i) Management's consideration that cost of an internal control does not exceeds the expected benefits.

(ii) Most controls do not tend to be directed at unusual transactions.

(iii) The potential of human error due to carelessness, misjudgment and misunderstanding of instructions.

(iv) The possibility that control may be circumvented through collusion with employees or outsiders.

(v) The possibility that a person responsible for exercising control may abuse that authority.

(vi) Compliance with procedures may deteriorate because the procedures becoming inadequate due to change in condition.

(vii) Manipulation by management with respect to transactions or estimates and judgments required in the preparation of financial statements.

(viii) Inherent limitations of Audit.

Q. 15. How would you audit 'Inventory Control and Management' as an Internal Auditor?

Answers 15.

The Internal Auditor should ensure the following as regards 'Inventory Control and Management' :

(i) Has the inventory been classified for proper control? Is A, B, C system of inventory classification followed?

(ii) How the inventory levels – maximum, minimum, reorder, economic order quantity fixed?

(iii) Is material budget prepared in advance to regulate purchase?

(iv) Study the opening/closing stocks of the last few years.

(v) Study the procurement of materials for the last 2/3 years and see whether the same compares favourably with production.

(vi) Is there any regular system to assess slow-moving/non-moving stores items for early disposal in cases considered necessary?

(vii) Who is the person to declare some material as surplus? Who authorizes its disposal?

(viii) Review whether value analysis, PERT etc. are applied for better management of stores.

(ix) Work out inventory ratios to judge the reasonableness of inventory build up —

- (a) Working capital to store inventory
- (b) Current assets to store inventory
- (c) Inventory turnover.

Some General Aspects :-

(i) Sometimes used materials are returned to stores. In such cases procedure for recording would be the same as followed in case of unused materials except that these may or may not be priced. Usually separate stores ledger / bin cards are opened. See whether the procedure in this regard has been observed.

(ii) Review whether any study has been made in regard to mechanization in stores receipt/issue, store accounting.

(iii) Review whether proper numerical accounts have been kept in respect to stand by spares.

(iv) See whether there are any Material Receiving Report pending disposal – recording valuation in stores ledger/bin card, accounting the accounts records etc.

(v) Review the mode of valuation of closing stock.

(vi) How soon the stores schedule is prepared for annual accounts purpose?

(vii) Are the stores materials adequately covered by insurance against loss from fire and other risks?

(viii) Is there proper coordination between –

- (a) Central Purchase Department
- (b) Local Purchase Department
- (c) Stores Department
- (d) Stock – verification Department

(ix) In case there are number of factories producing same / similar products make comparative study regarding –

(a) Surplus materials

(b) Obsolete/slow-moving materials.

(c) Finished/work-in-progress stock

(d) Opening/closing stock of raw material, etc.

Apart from the above O and M study may be carried out for standardization of forms, modification of work flow for improvement in efficiency in various directions etc.

Q. 16. Write short note on :

(a) Audit Risk

(b) Utility Routine

(c) Test packs

Answer 16. (a)

Audit risk is the risk that an auditor may give an inappropriate opinion on financial information which is materially misstated. An auditor may give an unqualified opinion on financial statements without knowing that they are materially misstated. Such risk may exist at overall level, while verifying various transactions and balance sheets items. There are three components of audit risk :

(i) **Inherent Risk :** is a risk that material errors will occur. Inherent risk is the susceptibility of an account balance or class of transactions to misstatement that could be material, individually or when aggregated with misstatements in other balances or classes, assuming that there were no related internal controls.

(ii) **Control Risk :** is the risk that the client's system internal control will not prevent or correct such errors, to assess control risk, the auditor should consider the adequacy of control design as well as test adherence to control procedure.

(iii) **Detection Risk :** is the risk that an auditor's procedures will not detect a misstatement that exists in an account balance or class of transactions that could be material, individually or when aggregated with misstatements in other balances or classes. The level of detection risk relates directly to the auditor's procedures, Some detection risk would always be present.

The inherent and control risks are functions of the entity's business and its environment and the nature of the account balances or classes of transactions, regardless of whether an audit is conducted. Even though inherent and control risks cannot be controlled by the auditor, the auditor can assess them and design his substantive procedures to produce on acceptable level of detection risk, thereby reducing audit risk to an acceptable low level.

Answer 16. (b)

Utility Routines are generally supplied by the computer manufacturer and are available for call up by the operating system. These routines play a key role in an electronic data processing. These are generalised programmes that perform necessary but routine jobs in a computer installation. These routines are sufficiently flexible to handle needs of all users. They are controlled by parameters to indicate the particular characteristics of the data or the requirements. Generally, three types of utility routines are made available by computer vendors-data set utilities, system utilities and independent utilities.

Answer 16. (c)

Test pack is a technique to determine the correctness of the computer programming used to record transactions through the computer. Preparation of test pack requires a great deal of expertise. It may be prepared by the auditor himself with the help of the entity's staff or by the Internal Control department of the entity. Normally test packs are used where :

(i) a significant part of the control system is embodied in the programme;

(ii) there are gaps in audit trail making it difficult to trace output from input and to verify intermediate calculation; and

(iii) the volume of records is large, so that it may be more economical and more effective to use test packs rather than to trace the transactions manually.

Q. 17. (a) Explain : Tagging and Tracing.

(b) What are the steps involved in carrying out Management Audit?

(c) Discuss the importance of Audit Working Papers.

(d) Discuss the limitations of an Audit Programme.

Answer 17. (a)

This involves tagging the client's input data in such a way that relevant information is displayed at key points. It uses the actual data, and so the question of elimination of 'special entries' test data designed under Integrated Test Data Facility does not arise. The hard copy, so produced is available only to the auditor and may describe such inputs as hours worked in a pay period in excess of 50; or sales orders processed in excess of Rs.1,00,000. This enables the auditor to examine transactions at the intermediate steps in processing. The advantage of the tagging and tracing approach lies in the use of actual data and elimination of the need for reversing journal entries. The disadvantage is that the erroneous data will not necessary be tagged. An effective combination approach may be to use the ITF approach (integrated test facility) for a few hypothetical transactions and the tagging and tracing approach to follow line data through a complex system.

Answer 17. (b)

Management audit basically comprises of following three steps :

(i) Examination of management performance. This involves-	• Detailed diagnosis and study of activities. • Determination of purpose and relationships.
(ii) Reporting defects and irregularities	• Looking for shortcomings • Searching for problems
(iii) Presenting suggestions for improvement.	• Determination of alternatives • Testing of effectiveness • Ascertainment of solutions to problems • Presenting methods of improvement.

Answer 17. (c)

Audit working papers constitute the basic records for the auditor in respect of the audit carried out by him. They constitute the link between the auditor's report and clients' record.

These include retention of permanent record in the nature of a document to show the actual audit work executed, the nature of the work, the extent of the work and important points, facts, dates and decisions having bearing on the audit of the accounts audited. The working papers, if properly maintained, can be used as defence in case of need. The audit working papers are found very useful in the following aspects as they :

(i) aid in the planning and performance of the audit;

(ii) aid in the supervision and review of the audit work;

(iii) provide evidence of the audit work performed to support the auditor's opinion; and

(iv) act as an evidence in the Court of law when a charge of negligence is brought against the auditor.

Answer 17. (d)

Limitations of the use of an Audit Programme

(i) The work may become mechanical and particular parts of the programme may be carried out without any understanding of the object of such parts in the whole audit scheme.

(ii) The programme often tends to become rigid and inflexible following set grooves; the business may change in its operation of conduct, but the old programme may still be carried on.

(iii) Inefficient assistants may take shelter behind the programme i.e. defend deficiencies in their work on the ground that no instruction in the matter is contained therein.

(iv) A hard and fast programme may kill the initiative and innovation of efficient and enterprising assistants.

Q. 18. (a) Discuss the importance of Audit Working Papers.

(b) Discuss the limitations of an Audit Programme.

Answer 18. (a)

Audit working papers constitute the basic records for the auditor in respect of the audit carried out by him. They constitute the link between the auditor's report and clients' record.

These include retention of permanent record in the nature of a document to show the actual audit work executed, the nature of the, work, the extent of the work and important points, facts, dates and decisions having bearing on the audit of the accounts audited. The working papers, if properly maintained, can be used as defence in case of need. The audit working papers are found very useful in the following aspects as they :

(i) aid in the planning and performance of the audit;

(ii) aid in the supervision and review of the audit work;

(iii) provide evidence of the audit work performed to support the auditor's opinion; and

(iv) act as an evidence in the Court of law when a charge of negligence is brought against the auditor.

Answer 18. (b)

Limitations of the use of an Audit Programme :

(i) The work may become mechanical and particular parts of the programme may be carried out without any understanding of the object of such parts in the whole audit scheme.

(ii) The programme often tends to become rigid and inflexible following set grooves; the business may change in its operation of conduct, but the old programme may still be carried on.

(iii) Inefficient assistants may take shelter behind the programme i.e. defend deficiencies in their work on the ground that no instruction in the matter is contained therein.

(iv) A hard and fast programme may kill the initiative and innovation of efficient and enterprising assistants.

Q. 19. State your views as an auditor with regard to each of the following :

(a) No depreciation has been charged for the year ended 31st March 2010, in respect of a Car purchased during the year and kept ready by the company for use as a stand-by on the ground that it was not used during the year.

(b) Balance confirmations from debtors/creditors can only be obtained for balances standing in their accounts at the year-end.

(c) Fixed assets have been revalued and the resulting surplus has been adjusted against the brought forward losses.

(d) Verification of Patent rights.

Answer 19. (a)

As per AS 6 on "Depreciation Accounting", depreciation is a measure of the wearing out, consumption or other loss of value of a depreciable asset arising from use, effluxion of time or obsolescence through technology and market changes. Thus, depreciation has to be charged even in case of these assets which are not used at all during the year but by mere effluxion of time provided such assets qualify as depreciable assets. When the car was kept ready for use as stand-by, it means it was intended to be used for the purpose of business. Depreciation in respect of this car ought to have been provided in the accounts for the year ended 31st March, 2010. If there is an intention to use an asset, though it may not have actually been used, it is a 'constructive' or 'passive' use and eligible for claim of depreciation.

Answer 19. (b)

Confirmation of Balances : Direct confirmation of balances from debtors/creditors in respect of balances standing in their accounts at the year-end is, perhaps, the best method of ascertaining whether the balances are genuine, accurately stated and undisputed particularly where the internal control system is weak. The confirmation date, method of requesting confirmation, etc. are to be determined by the auditor.

The date should be settled by the auditor in consultation with the entity. Where the auditor decides to confirm the debtors at a date other than the balance sheet date, he should examine the movements in debtor balances which occur between the confirmation date and the balance sheet date and obtain sufficient evidence to satisfy himself that debtor balances stated in the balance sheet are not materially mis-stated".

Therefore, it is not necessary that balances of debtors/ creditors should necessarily be verified only at the end of the year only. In fact, in order to incorporate an element of surprise, the auditor may consider different confirmation dates periodically, i.e., Dec, 31 as a cut-off date in one year and June 30 in another year and so on. Therefore, the statement that balance confirmation from debtors/creditors can only be obtained for balances standing in their accounts at the year-end is not correct.

Answer 19. (c)

Revaluation of Fixed Assets : The revaluation of fixed assets is a normally accepted practice which involves writing up the book value of fixed assets. AS 10 on 'Accounting for Fixed Assets' requires that "an increase in net book value arising on revaluation of fixed assets is normally credited directly to owner's interests under the heading of revaluation reserves and is regarded as not available for distribution". Thus, creation of revaluation reserves does not result into any cash inflows and represents unrealised gains. However, brought forward losses are in the nature of revenue losses. As a matter of prudence, revenue losses can be adjusted against revenue reserves only and not the capital reserves. Therefore, the accounting treatment followed by the entity is not correct and the auditor should qualify the audit report by mentioning the above fact.

Answer 19. (d)

The auditor should take the following steps :

(i) Obtain the schedule containing particulars of the patents owned by the client as on the balance sheet date. The particulars should contain the dates of registration of the patents with the related authorities and the dates in respect of the last renewal.

(ii) See that the total of the values of the patent rights shown in each list agree with the values shown in the respective ledger accounts.

(iii) Examine the cost of patent rights. In case of outright purchase of patent rights, the purchase consideration, legal fees and registration charges should be included in cost. When they are developed within the organisation, all costs incurred on their development including legal and registration expenses for registration of the patent should constitute the cost.

(iv) See that the renewal fees in respect of the patent rights have been paid and the same has been treated as a revenue charge.

(v) Examine the valuation of the patent rights. It should be seen that the patent rights have been valued at cost less depreciation attributable to the expired legal life of the patent rights. However, if it is found that the patent rights have already lost substantial part of their commercial value, it would be proper to value it at their residual commercial value, when it is less than the book value for their unexpired legal life. In case the product covered by the patent rights does not have any sale value then patents should be shown at nil valuation notwithstanding any residual life.

Q. 20. (a) Draft the audit programme for audit of receipt of participation fees from delegates to the National Convention.

(b) The SBH College, an institution managed by MT Trust, has received a grant of Rs. 3 crore from Government nodal agencies for funding a project of research on rural health systems in India. Draft an audit programme for auditing this fund in the accounts of the college.

Answer 20. (a)

The organization of three-day National Convention at Kolkata is a one-time event. Normally, in view of mega-size of the event, a special cell is made in the organization to handle the entire event. Since few people would be handling the event, the internal controls may not be that strong and, thus, more emphasis is required to be given on substantive procedure. Audit of receipt of participation fees should be under the following areas :

(I) **Internal Control System :**

(i) Examine the organization structure of special cell created for the National Convention, if any, and division of responsibilities amongst persons and control/custody over receipt books.

(ii) Verify the internal control system for restricting the participation of unregistered **delegates.**

(II) **Rate of Participation Fees :**

(i) Verify with reference to resolution passed by the Organizing Committee

(ii) Also verify the rate from the literature/registration form circulated for promotion of conference.

(III) **Receipts of Participation Fees :**

(i) Verify counter foil of the receipts issued for individual registration.

(ii) Ensure that receipts are issued for all the registration received in cash.

(iii) Trace the receipts in Bank Statement or Cash Book – as the case may be.

(iv) Verify Bank Reconciliation Statement and list out dishonoured cheques.

(v) Verify subsequent recovery in respect of dishonoured cheques.

(IV) **Overall Checking :**

(i) Verify the total receipts of participation fees shown in the financial statements with reference to total number of receipts issued to participants.

(ii) Cross check the total number of delegates with reference to the following:

(a) Kits distributed to participants.

(b) Bill of caterer for providing meals during conference.

(c) Capacity of the Hall.

(d) Participation Certificate if any issued.

(V) **Foreign Delegates :**

In case of foreign delegates – if registration fees are higher – ensure that they are registered at higher fees.

(VI) **Special Issues** *:*

(i) Take out list of absentees and in case of nil absentees, probe the issue further.

(ii) If certain participants are exempted from payment of fees – obtain the list along with proper authorization in this regard.

Answer 20. (b)

Audit of grant fund of a college :

1. The auditor should obtain the basic documents about the constitution of the college, objectives of the trust, rules of college etc.
2. The government policy on grant should be checked with the relevant application, brochure, and sanction advices.
3. The conditions stipulated in award of grant should be studied.
4. The receipt of grant should be vouched with bank statement.
5. The budgeted heads of expenses for the project and actual utilization of the fund should be checked.
6. The purchase of capital items covered within the project should be correctly capitalized. The same should be properly and distinctly shown in the balance sheet of the college. The cost of the asset should be adjusted for the grant amount.
7. The expenses of revenue nature incurred from and out of grant in the form of salaries to field staff, materials purchased, traveling, survey and field work expenses and analysis and preparation of reports etc should be vouched with the relevant vouchers.
8. The expenses should be accounted as withdrawal of amounts from the fund. It is to be checked that these expenses are not accounted in income and expenditure of the college.
9. In balance sheet, the fund account should be shown as a liability with a separate schedule indicating the receipts, payments and balance as on the date of closing of accounts.
10. The fund balance should be cross checked with the periodical statements of accounts submitted to the nodal agencies.
11. The physical verification of assets pertaining to the project should be done by the management of the college.
12. The progress of the project may be ascertained from the minutes, committee meeting extracts and reports. This must be done to ensure that the project fund is genuinely utilized for the purposes it intended for.

PAPER 7

APPLIED DIRECT TAXATION

Question No.1

(a)Define RESULTING COMPANY [Sec. 2(41A)]

Answer:

Resulting Company means one or more companies (including a wholly owned subsidiary thereof) to which the undertaking of the demerged company is transferred in a demerger and, the resulting company in consideration of such transfer of undertaking, issues shares to the shareholders of the demerged company and includes any authority or body or local authority or public sector company or a company established, constituted or formed as a result of demerger.

(b) Explain the concept of "Application of Income" and "Diversion of Income".

Answer:

Application of Income

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

1. Income accrues to the assessee
2. Income reaches the assessee
3. Income is applied to discharge an obligation, whether self-imposed or gratuitous.

Diversion of Income

An obligation to apply the income in a particular way before it is received by the assessee or before it has arisen or accrued to the assessee results in diversion of income. The source is charged with an overriding title, which diverts the income. Therefore the essentials are the following:

1. Income is diverted at source,
2. There is an overriding charge or title for such diversion, and
3. The charge / obligation is on the source of income and not on the receiver.

Examples of diversion by overriding title are -

(a) Right of maintenance of dependants or of coparceners on partition

(b) Right under a statutory provision

(c) A charge created by a decree of a Court of law.

(c) What is Gross Total Income and Total Income?

Answer:

TOTAL INCOME [Sec. 2(45)]

"Total income" means the total amount of income as referred to in sec. 5 and computed in the manner laid down in the Act. Total income constitutes the tax with reference to which income tax is charged.

GROSS TOTAL INCOME [Section 80B]

Gross Total Income means total income computed in accordance with the provisions of the Income Tax Act before making any deduction under Chapter VIA.

(d) Explain the significance of "Heads of Income" and the method of accounting to be followed.

Answer:

Significance of Heads of Income (u/s 14)

1. The income chargeable under a particular head **cannot be charged under any other head.**
2. The Act has **self contained** provisions in respect of each head of income.
3. If any income is **charged under a wrong head** of income, the assessee will **lose the benefit** of deduction available to him under that head.

Relevance of method of accounting for heads of income:

Heads of Income	**Relevance of Method of Accounting**
Chapter IV-A **Salaries** **(15 - 17)**	1. Taxable on **due basis or on receipt basis,** whichever is earlier. 2. Method of accounting is **irrelevant.**
Chapter IV-C **House Property** **(22 - 27)**	1. Income from house property is **taxable** only on **accrual basis.** 2. Method of accounting is **not relevant.**
Chapter IV-D **Business Income** **(28-44DB)**	1. U/s 145 assessee may follow either **Cash or Mercantile system** of accounting **regularly employed** by the assessee. **2. Exceptions:** Certain payments are allowable only on actual payment basis. Accrual concept does not hold good - (a)Employer's contribution to PF, ESI, Tax, Duty, Cess, Fees to Government, Interest on loans and advances from banks and financial institutions, provision for leave encashment, bonus or commission etc. (b)Telecommunication Licence Fee is allowable in instalments only from the year of payment. (c)Preliminary Expenses distributed over five years (d)Amalgamation / Demerger Expenses distributed over five years (e)Amount paid in connection with Voluntary Retirement Scheme distributed over five years
Chapter IV-E **Capital Gains** **(45 - 55A)**	1. Income from capital gains shall be taxable during the **previous year Capital Gains in which the Capital Asset is transferred (i.e) year of accrual.** 2. The method of accounting is not relevant for taxing the income under the head capital gains.
Chapter IV-F **Other Sources** **(56- 60)**	U/s 145 assessee may follow either on **Cash or Mercantile system** of accounting **regularly employed** by the assessee.

Question No. 2(a):

Mr. X furnishes the following particulars of his income earned during previous year ended on 31 March 2011:
(i) Income from agriculture in Bangladesh, received there ₹ 3,80,000, but later on remitted to India,
(ii) Interest on Pakistani Development Bonds, ₹ 60,000, one-sixth of which received in India,
(iii) Gift of ₹ 70,000 received in foreign currency from a relative in India,
(iv) Arrears of salary ₹ 1,50,000 received in Pakistan from a former employer in India.
(v) Income from property received outside India ₹ 3,00,000 (₹ 1,00,000 is used in Bahrain for the educational expenses of his son in Bahrain, and ₹ 2,00,000 later on remitted to India).
(vi) Income from business in Iran which is controlled from India (₹ 1,00,000 being received in India) ₹ 2,00,000.
(vii) Dividends received on 30.06.2010 outside India from an Indian company, ₹ 2,50,000.
(viii) Untaxed profit of the FY 2003-2004 brought to India in July 2010, ₹ 2,50,000.

(ix) Profit (computed) on sale of building in India received in Pakistan ₹ 21,00,000.

(x) Profit from business in Kolkata managed from outside India ₹ 90,000, 60% of which is received outside India.

Find out gross total income of Mr. X for AY 2011-2012, if Mr. X is (a) resident and ordinarily resident; (b) resident but not ordinarily resident; (c) non-resident.

Solution: Computation of gross total income for AY 2011-2012

Particulars	ROR ₹	RNOR ₹	Non-resident ₹
(i) Income from agriculture in Bangladesh, received there but later on remitted to India	3,80,000	—	—
(i) Interest on Pakistan Development Bonds:			
1/6th of ₹60,000 received in India	10,000	10,000	10,000
5/6th of ₹ 60,000 being received in India	50,000	-	-
(iii) Gift received from a relative in India: Exempt [Sec. 57(v)]	—	—	—
(iv) Salary arrears received in Pakistan from a former employer in India	1,50,000	1,50,000	1,50,000
(v) Income from property received outside India but later on remitted to India	3,00,000	—	—
(vi) Profit from Iran business controlled from India:			
(a) Profits received in India	1,00,000	1,00,000	1,00,000
(b) Profits received outside India	1,00,000	1,00,000-	—
(vii) Dividends received from an Indian company, outside India, deemed to accrue or arise in India but exempt under Sec. 10(34)	—	—	—
(viii) Untaxed foreign profit of PY 2003-2004 brought to India	–	—	—
(ix) Profit on sale of building in India, received outside India deemed to accrue or arise in India	21,00,000	21,00,000	21,00,000
(x) Profit from Kolkata business, managed from outside India: 60% received outside India	90,000	90,000	90,000
Gross Total Income	32,80,000	25,50,000	24,50,000

Question No. 2(b):

X, after about 30 years stay in India, returns to America on January 29, 2008. He returns to India in June 2010 to join an American company as its overseas branch manager. Determine his residential status for the assessment year 2011-12.

Solution: For the assessment year 2011-12, the year 2010-11 is the previous year. During 2010-11, X is in India for more than 274 days. He is, therefore, resident in India. He is resident in India for 2 years out of 10 years (i.e., 2000-2001 to 2009-10), and he has stayed for more than 730 days during the seven years preceding the previous year 2010-11. He is, therefore, resident and ordinarily resident in India for the assessment year 2011-12.

Question No.3

X, is employed at Delhi as Finance Manager of R Ltd. The particulars of his salary for the previous year 2010-11 are as under: Basic Salary ₹ 16,000 p.m.. Dearness allowance ₹ 12,000 p.m. Conveyance Allowance for personal purpose ₹ 2,000p.m.; Commission @2% of the turnover achieved which was ₹ 9,00,000 during the previous year and the same was evenly spread. HRA ₹ 6,000 pm. The actual rent paid by him ₹ 5,000 pm for an accommodation at till 31.12.10. From 1.1.11 the rent was increased to ₹ 7,000 pm. Compute taxable HRA.

Note : If there is an increase in rent paid, it is advisable to calculate the exemptions separately based on the time period. Rent before and after increase.

Solution :

Salary for HRA (for 9 months) = Basic Pay + DA(considered for retirement benefits) + Commission (if received as a fixed percentage on turnover as per terms of employment)

= (16,000 × 9) + (12,000 × 9) + (2% of 9,00,000 × 9/12) = 2,65,500

Taxable HRA: (April to December 2010). Total time= 9 months

Particulars	₹	₹
Amount received during the financial year for HRA		**54,000**
Less: Exemption u/s 10(13A) Rule 2A.		
Least of the followings:		
(a) Actual amount received	**54,000**	
(b) 50% of Salary	**1,32,750**	
(c) Rent paid less 10% of Salary	**18,450**	**18,450**
[5,000 × 9 – 10% of 2,65,500]		
Taxable HRA		**35,550**

Salary for HRA (for 3 months) = Basic Pay + DA (considered for retirement benefits) + Commission (if received as a fixed percentage on turnover as per terms of employment)

= (16,000 × 3) + (12,000 × 3) + (2% of 9,00,000 × 3/12) = 88,500

Taxable HRA :

Particulars	₹	₹
Amount received during the financial year for HRA		**18,000**
Less: Exemption u/s 10(13A) Rule 2A		
Least of the followings:		
(a) Actual amount received	**18,000**	
(b) 50% of Salary	**44,250**	
(c) Rent paid less 10% of Salary		
[7,000 × 3 – 10% of 88,500]	**12,150**	**12,150**
Taxable HRA		**5,850**

Question No.4

Mr. Hari retires on 15th October 2010, after serving 30 years and 7 months. He gets ₹ 4,80,000 as gratuity. His salary details are given below:

FY 2010-11	Salary ₹ 16,000 pm	D.A. 50% of salary. 40% forms part of retirement benefits.
FY 2009-10	Salary ₹ 15,000 pm	D.A. 50% of salary. 40% forms part of retirement benefits

Determine his gross salary in the following cases:

(i) He retires from government service

(ii) He retires from seasonal factory in a private sector, covered under Payment of Gratuity Act, 1972.

(iii) He retires from non-seasonal factory, covered by Payment of Gratuity Act, 1972

(iv) He retires from private sector, not covered by payment of Gratuity Act

Solution :

(i) The amount of gratuity received as a Government employee is fully exempt from tax u/s 10(10)(i)

(ii) As an employee of a seasonal factory, in a private sector, covered under the Payment of Gratuity Act, 1972

Computation of Taxable Gratuity

Particulars	**₹**	**₹**
Amount received as Gratuity		**4,80,000**
Less: Exemption u/s 10(10)(ii)		
Least of the followings:		
(i) Actual amount received	**4,80,000**	
(ii) 7/26 x Last drawn salary × No. of years of completed service or part thereof in excess of 6 months [31 × 7/26 × 24,000]	**2,00,308**	
(iii) Maximum Limit	**10,00,000**	**2,00,308**
Taxable Gratuity		**2,79,692**

(iii) As an employee of a non-seasonal factory, covered by Payment of Gratuity Act, 1972

Computation of Taxable Gratuity

Particulars	**₹**	**₹**
Amount received as Gratuity		**4,80,000**
Less: Exemption u/s 10(10)(ii)		
Least of the followings:		
(i) Actual amount received	**4,80,000**	
(ii) 15/26 × Last drawn salary × No. of years of completed service or part thereof in excess of 6 months [15/26 × 31 × 24,000]	**4,29,231**	
(iii) Maximum Limit	**10,00,000**	**4,80,000**
Taxable Gratuity		**NIL**

Note : Salary = Basic Pay + Dearness Allowance

In case of seasonal employment, instead of 15 days, 7 days shall be considered.

(iv) As an employee of a private sector, not covered by Payment of Gratuity Act, 1972

Computation of Taxable Gratuity

Particulars	**₹**	**₹**
Amount received as Gratuity		4,80,000
Less: Exemption u/s 10(10)(iii) Least of the followings:		
(i) Actual amount received	4,80,000	
(ii) 1/2 × Average salary × No. of fully completed years of service [½ × 18,720 × 30]	2,80,800	
(iii) Maximum Limit	10,00,000	2,80,800
Taxable Gratuity		1,99,200

Note: Salary = 10 months average salary preceeding the month of retirement.

= Basic Pay + Dearness Allowance considered for retirement benefits + commission (if received as a fixed percentage on turnover)

Salary for the months December'09 till September '10 shall have to be considered.

	₹
Basic Salary:	
December '09 to March '10 = 15,000 × 4	= 60,000
April '10 to September '10 = 16,000 × 6	= 96,000
Total Basic Salary	1,56,000
Add: D.A. [50% of 1,56,000 × 40%, forming part of superannuation benefits]	31,200
Salary for 10 months	1,87,200

Therefore, **Average salary for 10 months = 1,87,200/10 = 18,720**

Question No.5:

Mr.Ritesh is provided with an accommodation in Kolkata since April 2010. Salary ₹ 40,000 p.m. Cost of furniture provided ₹ 80,000. On 1st September, 2010, following a promotion with a increase in Salary by ₹15,000, he was transferred to Jharkhand (population less than 25 lakhs but more than 10 lakhs), and was also provided an accommodation there. Mr.Ritesh was allowed to retain the Kolkata accommodation till March, 2011. Compute taxability.

Solution :

Phase 1: Value of Furnished Accommodation (Kolkata) (April to September 2010)

Particulars	**₹**
Value of unfurnished accommodation (15% of 40,000 × 6 months)	**36,000**
Add: Value of Furniture provided:	
• 10%p.a. of original cost of such furniture (10% of 80,000 x 6 months)	**8,000**
Value of Furnished Accommodation	**44,000**

Phase 2: Valuation of accommodation (October 2010 to December 2010)

(a) For the first 90 days of transfer: Where accommodation is provided both at existing place of work and in new place, the accommodation, which has lower value, shall be taxable.

(b) After 90 days: Both accommodations shall be taxable.

Computation for the first 90 days of transfer: (October 2010 to December 2010)

Lower of :

(i) Value of accommodation at existing place of work

(ii) Value of accommodation at new place

Value of accommodation at existing place of work (Kolkata)

15% of salary for 3 months (i.e. 90 days) = 15% of 55,000 × 3 months	= 24,750
Add: Cost of furniture provided: 10% of 80,000 x 3 months	= 24,000
Total Value of Perquisite	**48,750**

Question No.6

A was employed with Z Ltd. He retired w.e.f. 1.2.2011 after completing a service of 24 years and 5 months. He submits the following information:

Basic Salary	₹ 5,000 per month (at the time of retirement)
Dearness Allowance	100% of Basic Salary (60% of which forms part of salary for retirement benefits).
Last increment	₹ 500 w.e.f. 1.7.2010

His pension was determined at ₹ 3,000 per month. He got 50% of the pension commuted w.e.f. 1.3.2011 and received a sum of ₹ 1,20,000 as commuted pension. In addition to this, he received a gratuity of ₹ 1,50,000 and

leave encashment amounting to ₹ 56,000 on account of accumulated leave of 240 days. He was entitled to 40 days leave for every year of completed service.
Compute his Gross Salary for assessment year 2011-12 assuming that he is not covered under Payment of Gratuity Act.

Solution:

Computation of Gross Salary for the Assessment Year 2011-12

		₹	₹
Basic Pay: April '10 to June '10 = 3 months @ ₹ 4,500 pm		13,500	
July 10 to June '11 = 7 months @ ₹ 5,000 pm		35,000	48,500
Dearness Allowance @ 100% of Basic Pay			48,500
Uncommuted Pension			
February @ ₹ 3,000 pm		3,000	
March @ ₹ 1,500 pm		1,500	4,500
(Since 50% commuted)			
Commuted Value of Pension			
Amount Received		1,20,000	
Less : Exemption u/s 10(10A)			
1/3 of Value of Commuted Pension		80,000	40,000
Full value of Commuted Pension			
= (1,20,000 / 50%) = 2,40,000			
Gratuity:			
Amount received		1,50,000	
Less : Exempt (*See* note No. 1)		93,120	56,880
Least of the followings:			
(i) Actual Amount Received	1,50,000		
(ii) Maximum limit	10,00,000		
(ii) 1/2 months average salary	93,120		
for each years of completed service (½ x 7,760 x 24)			

Salary for Gratuity (not covered by Payment of Gratuity Act)

= Basic Pay + D/A (Forming part for retirement benefit)

Average Salary = (Total Salary of 10 months preceeding the month of retirement)/10

= (48,500 + 50% 0f 48,500) /10 = (48,500 + 29.100)/10 =7,760

Leave Encashment			
Amount received		56,000	
Less : Exemption u/s 10(10AA)			
Least of the followings:			
(i) Actual Average Salary	56,000		
(ii) 10 months average salary (10×7760)	77,600		
(iii) Maximum limit	3,00,000		
(iv) Leave Credit as per Note	NIL	NIL	56,000

Notes :

Calculation of Leave Credit

	Total leave entitlement (24 yrs × 40 days p.a.	= 960 days
Less :	Leave Availed during service	720 days
	= Total leave entitlement – Leave encashment	
	= (960 – 240)	240 days
Less :	Excess Leave in excess of 30 days p.a.	240 days
	[24 (40 – 30)]	
	Leave credit	**NIL**

Question No.7

Hema, aged about 66 years is a Finance Manager of Udyog Pvt. Ltd. based at Mumbai. She is in continuous service since 1969 and received the following from the Company during the year ending 31.3.2011.

(a) Basic Pay (50,000 × 12) = ₹ 6,00,000
(b) D.A (20,000 × 12) = ₹ 2,40,000
(c) Bonus 2 months Basic Pay
(d) Commission — 0.1% of Company's Turnover. Turnover for financial year 2010-2011 was ₹ 15 crores.
(e) Contribution of the Employer and Employee to the PF Account ₹ 3,00,000 each
(f) Interest credited to P.F Account at 10% ₹ 60,000
(g) Rent Free Unfurnished Accommodation provided by the Company (Company pays ₹ 70,000 p.a. rent)
(h) Entertainment Allowance ₹ 30,000
(i) Children's Education Allowance to meet the hostel expenditure of three children ₹ 5,000 each.

Hema makes the following payments and Investments :

(a) Premium paid to insure the life of her major son ₹ 15,000
(b) Medical Insurance Premium for Self — ₹ 15,000, Spouse ₹ 15,000 (Aged 70 years)
(c) Donation to Public Charitable Institution registered under Section 80G ₹ 2,00,000
(d) LIC Pension Fund ₹ 12,000
(e) Long-term Infrastructure Bond —₹ 25,000

Determine the tax liability for the Assessment Year 2011-12.

Assessee : Mr. Lakshmi **Previous Year: 2010-2011** **Assessment Year : 2011-12**

Computation of Total Income

Particulars		**₹**	**₹**
Basic Salary	(₹ 50,000×12)		6,00,000
Dearness Allowance	(₹ 20,000×12)		2,40,000
Bonus	(₹ 50,000×2)		1,00,000
Commission	(₹ 15 Crores×0.1%)		1,50,000
Employer's Contribution to Provident Fund		3,00,000	
Less : Exemption u/s 10(14) upto 12% of Salary		(1,18,800)	1,81,200
(12% × 9,90,000) **(WN 1)**			
Interest credited to Provident Fund Account at 10%		60,000	
Less : Exempted u/s 10(14) upto 9.5%		57,000	3,000
Entertainment Allowances			30,000
Children Education Allowance (₹ 5,000×3)		15,000	
Less : Exempt u/s 10(14) [₹ 300 p.m.×12 months		(7,200)	7,800
× 2 Children (maximum)]			
Taxable Salary before Perquisites			**13,12,000**

Value of Perquisites				
Rent Free Unfurnished Accommodation				
Least of the following—				
	Rent paid by the Employer 70,000			
	15% of Salary [15% of ₹ 11,27,800] **(WN 2)** (assumed that Mumbai population > 25 Lakhs as per latest census)		1,69,170	70,000
	Gross Salary			**13,82,000**
Less :	Deduction u/s 16			
	Entertainment Allowance			
	u/s 16(ii) [Not a Govt. Employee]			Nil
	Income under the head Salary			**13,82,000**
Gross Total Income				**13,82,000**
Less :	Deduction Under Chapter VI-A			
	U/s 80C LIC Premium paid	15,000		
	Contribution to PF Account	3,00,000		
	U/s 80CCC Contribution to Pension Fund	12,000		
	[The maximum amount along with deduction u/s 80CCC and 80CCC or u/s 80C, restricted to ₹ 1,00,000]	1,00,000		
	U/s 80CCF Subscription to long term Infrastructure Bond	20,000		
	U/s 80D Medical Insurance Premium paid		20,000	
	U/s 80G **(WN 3)**		63,450	**(2,03,450)**
	Total Income			**11,78,550**

Computation of Tax Liability

Particulars		₹	₹
Total Income			**11,78,550**
Upto ₹ 1,90,000			NIL
1,90,000 – 5,00,000	= @ 10% of 3,10,000		31,000
5,00,000 – 8,00,000	= @ 20% of 3,00,000		60,000
8,00,000 – 11,78,550	= @ 30% of 3,78,550		1,13,565
			2,04,565
(+) Deduction Cess @ 2%			4,091
(+) SHEC @ 1%			2,046
			2,10,702
Rounded off u/s 288A			**2,10,700**

Working Notes :

1. Salary for the purpose of computation of Taxable Portion of Employer's Contribution to Provident Fund

   = Basic Salary + DA considered for Retirement Benefits + Commission

   = ₹ 6,00,000 + ₹ 2,40,000 + ₹ 1,50,000 = ₹ 9,90,000

2. Salary for the purpose of computation of Taxable Value of Rent Free Unfurnished Accommodation

   = Basic Pay (+) D.A (forming part of Salary) (+) All other Taxable Allowances (+) Any other monetary benefits

= 6,00,000 + 2,40,000 + 1,00,000 + 1,50,000 + 30,000 + 7,870 = 11,27,800

3. **Computation of deduction u/s 80G:**

		₹
50% of least of the followings:		
(a) Amount Donated		2,00,000
(b) 10% of Adjusted Gross Total Income		
Gross Total Income	13,82,000	
Less : Deduction under Chapter VI-A excluding sec. 80G		
u/s 80C		
80CCC	1,10,000	
(retired u/s 80CCF)		
u/s 80CCF	20,000	
u/s 80D	20,000	

Question No.8

Mr. L is the owner of a commercial property let out at ₹ 30,000 p.m. The municipal tax on the property is ₹ 15,000 annually, 60% of which is payable by the tenant. This tax was actually paid on 15.4.2011. He had borrowed a sum of ₹ 10 Lakhs from his cousin, resident in USA (in dollars) for the construction of the property on which interest at 18% is payable. He has also received arrears of rent of ₹ 40,000 during the year, which was not charged to tax in the earlier years. What is the Property Income of X for A.Y. 2011-12?

Solution :

Assessee : Mr. L **Previous Year : 2010-2011** **Assessment Year : 2011-12**

Computation of Income from House Property

	Particulars		₹	₹
	Let Out : So, Annual Value u/s 23(1)(a)/(b) = Actual Rent = ₹ 30,000×12		3,60,000	
Less :	Municipal Taxes Paid during the F.Y. 2010-11			NIL
	Net Annual Value			**3,60,000**
Less :	**Deduction u/s 24**			
	– 30% of NAV –	₹ 3,60,000 × 30%	1,08,000	
	– Interest on Housing Loan (Note)	₹ 20,00,000 × 8%	1,60,000	(2,68,000)
	Income from House Property before considering Arrears of Rent			**92,000**
	Arrears of Rent Received		40,000	
Less :	Deduction u/s 25B – 30% of Arrears received – ₹ 40,000 × 30%		(12,000)	28,000
	Net Income from House Property			**64,000**

Note : It is presumed that the tax has been deducted at source on the amount of interest payable outside India.

Question No.9

Mr. G and N constructed their houses on a piece of land purchased by them at Kolkata. The built-up area of each house was 1,000 sq ft. Ground floor and an equal area in the First floor. Mr. G started construction on 1.7.2009. Mr. G occupied the entire house on 1.4.2010. Mr. N occupied the Ground floor on 1.7.2010 and let-out the first floor for a rent of ₹ 20,000 p.m. However, the tenant vacated the house on 31.12.2010 and Mr. N occupied entire house during 1.1.2011 to 31.3.2011.

Following are the other information:

(i)	Fair Rental Value of each unit (Ground floor/First floor)	₹ 2,00,000 p.a.
(ii)	Municipal Value of each unit (Ground floor/First floor)	₹ 90,000 p.a.
(iii)	Municipal taxes paid by	G – ₹ 12,000

	N – ₹ 12,000
(iv) Repairs and Maintenance charges paid by	G – ₹ 40,000
	N – ₹ 50,000

Mr. G has availed a housing loan of ₹ 16.00 Lakhs @ 12% p.a. on 1.4.2009. N has availed a housing loan of ₹ 18.00 Lakhs @ 10% p.a. on 1.7.2009. No repayment was made by either of them till 31.3.2011. Compute Income from House Property for G and N for the A.Y. 2011-12.

Solution:

Assessee: Mr. G **Previous Year: 2010-2011** **Assessment Year: 2011-12**

Computation of Income from House Property

	Particulars	₹
	Nature : Self Occupied – Annual Value u/s 23(2)	NIL
Less :	**Deduction u/s 24 :** Interest – ₹ 16 Lakhs × 12% = ₹ 1,92,000 (Restricted to ₹ 1,50,000)	1,50,000
	Loss from House Property	**(1,50,000)**

Note : Since construction of property is completed in the year of borrowal of loan itself, prior period interest does not arise.

Assessee : Mr. N **Previous Year : 2010-2011** **Assessment Year : 2011-12**

Computation of Income from House Property

	Particulars	₹	₹	₹
Ground Floor	**Nature : Self Occupied**		NIL	
	Annual Value u/s 23(2)			
Less :	**Deduction u/s 24 :** Interest on Borrowed Capital			
	Current Year : ₹ 18,00,000 × 10% × 50%	90,000		
	Prior Period : ₹ 18,00,000 × 10% × 9/12 × 50% ×1/5	13,500	(1,03,500)	(1,03,500)
First Floor	**Nature : Let-Out**			
	Annual Value u/s 23(1)(a)/(b)			
	Higher of Fair Rent vs. Municipal Rent **[See Note 1]**	1,50,000		
	Higher of Rent selected above vs. Acual Rent received **[See Note 2]**	1,80,000	1,80,000	
Less :	Municipal Taxes – (₹ 12,000 × 50%)		(6,000)	
	Net Annual Value		**1,74,000**	
Less :	Deduction u/s 24			
	(a) 30% of Net Annual Value	52,200		
	(b) Interest on borrowed Capital			
	Current Period Interest – (₹ 18,00,000 × 10% × 50%)	90,000		
	Prior Period Interest – (₹ 18,00,000×10% ×9/12×50% ×1/5)	13,500	(1,55,700)	18,300
	Net Income from House Property			**(85,200)**

Note :

1. Since the construction of property was completed on 1.7.2009, Fair rent, Municipal Rent and Actual Rent receivable are to be considered only for a period of **9 months**.

   Fair Rent = = 1,50,000
   Municipal Value = = 67,500

2. Since the house is self occupied for part of the year and let out for part of the year, income from house property shall be calculated for the whole year as deemed let out property. Therefore Rent receivable is ₹ 1,80,000 (₹ 20,000 × 9).

Question No.10 : Define Deemed Owner

Answer: DEEMED OWNER [Section 27]

1. **Owner:** An Individual shall be considered as owner of a property when the document of title to the property is registered in his name.
2. **Deemed Owner:** Under the following circumstances, Income from House Property is taxable in the hands of the Individual, even if the property is not registered in his name —
   (a) Where the Property has been transferred to **spouse for inadequate consideration** other than in pursuance of an agreement to live apart.
   (b) Where the Property is transferred to a **minor child for inadequate consideration (except a transfer** to minor married daughter)
   (c) Where the Individual holds an **impartible estate.**
   (d) Where the Individual is a **member** of Co-operative Society, Company, or other Association and has been allotted a house property by virtue of his being a member, even though the property is registered in the name of the Society / Company / Association.
   (e) Where the property has been transferred to the individual's name as part-performance of a contract u/s 53A of the Transfer of Property Act, 1882. (i.e. Possession of the Property has been transferred to Individual, but the Title Deeds have not yet been transferred).
   (f) Where the Individual is a **holder of a Power of Attorney** enabling the right of possession or enjoyment of the property.
   (g) Where the property has been constructed on a **leasehold land.**
   (h) Where the **ownership** of the Property is under **dispute.**

Question No.11 (a)

The WDV of plant and machinery on 1.4.2010 of Z Ltd. engaged in manufacturing of PVC granules is ₹ 2000 lacs. Company purchased additional plant and machinery for ₹ 1,600 lacs on 18.4.2010 inclusive of second-hand machine imported from Ireland of ₹ 400 lacs to increase its installed capacity of production from 1000 TPA to 1500 TPA. The production from new machine commenced w.e.f 1.12.2010. Work out by giving reasons the amount of allowable depreciation.

Assessee : Z Ltd. **Previous Year : 2010-11** **Assessment Year : 2011-12**

Computation of Depreciation

Particulars		**Lakhs**	
		₹	₹
	Opening WDV		2,000
Add :	Additions During the year		<u>1,600</u>
	Net Value for the purpose of Depreciation		3,600
Less :	**Depreciation of the Year**		
—	On Opening Block – ₹ 2,000 Lakhs × 15%	300	
—	On Additions (Period of usage less than 180 days) — ₹ 1,600 lakhs × 15% × 50%	120	
—	Additional Depreciation on Eligible Assets (Notes)	<u>120</u>	<u>540</u>
	Closing WDV		**<u>3,060</u>**

Notes:

1. Second hand machinery imported from China is not an eligible asset for the purpose of Additional Depreciation computation. Therefore, cost of eligible assets = ₹ 1,600 lakhs – ₹ 400 lakhs = ₹ 1,200 lakhs.
2. Period of usage of new machine is less than 180 days. Therefore, they are entitled to only 50% of additional depreciation rate of 20%.

Question No.11 (b)

W.D.V. of Machinery (Rate of Depreciation @15%) = ₹ 5,00,000

New Machinery Purchased (on 31.12.10) = ₹ 1,00,000, having same rate of depreciation.

Calculate Depreciation u/s 32

Block A : Machinery

(Rate of Depreciation = 15%)

W.D.V. of the Machinery		5,00,000
Add :	Cost of New Asset Purchased (relating to the Block) [Put to Use > 180 Days]	Nil
Less :	Government Subsidy Received for Purchase/Acquisition Asset	Nil
Less :	Adjustment for CENVAT Credit	Nil
Less :	Sale of Asset from the Block	Nil
	W.D.V for Charging Depreciation	5,00,000
Less :	Depreciation @ 15%	75,000
	Closing WDV	**4,25,000**

Block B : Machinery

(Rate of Depreciation = 7.5% of 15%, since Acquired & Put to Use for less than 180 Days)

	Cost	1,00,000
Less :	Depreciation @ 7.5%	7,500
	Closing WDV	**92,500**

Total Depreciation u/s 32 = 75,000

7,500

82,500

Question No.12

Kalpataru power Projects is a power generating unit. On 1.4.2008, it purchased a plant of ₹ 50,00,000, eligible for depreciation @15% on SLM. Compute balancing charge or terminal deprecation assuming the plant is sold on 21.4.2010 for : (a) ₹ 8,50,000 (b) ₹ 32,00,000 (c) ₹ 45,00,000 (d) ₹ 52,00,000

Solution :

Computation of Terminal Depreciation or Balancing Charge, Capital Gains.

Particulars	**A**	**B**	**C**	**D**
W.D.V. as on 1.4.2010	35,00,000	35,00,000	35,00,000	35,00,000
Less: Sale Proceeds	8,50,000	32,00,000	45,00,000	52,00,000
Balance	26,50,000	30,00,000	(10,00,000)	(17,00,000)
Terminal depreciation	26,50,000	3,00,000	NIL	NIL
Balancing charge	NIL	NIL	10,00,000	15,00,000
Short term capital Gain	NIL	NIL	NIL	2,00,000
Computation of Depreciation:				
Original cost	50,00,000			
Less: Depreciation	7,50,000			
WDV as on 1.4.2009	42,50,000			
Less: Depreciation for the year 2009-2010	7,50,000			
WDV as on 1.4.2010	35,00,000			

Question No.13(a)

Z Ltd. purchased machinery (rate of depreciation 15%) from Japan for US$ 2,50,000 on 17. 08.2009 (US $ = 43.25) by borrowing from Hero Bank Ltd. Z Ltd. took a forward contract on 11.07.2009, when the exchange rate was ₹ 45.70 per US$. This was put to use from 23.11.2009. Compute Depreciation for the previous years 2009-10 and 2010-11.

Assessee: Z Ltd

Previous Year: 2009-10 & 2010-11

Computation of Depreciation and Written Down Value

Particulars	**Amount (₹)**
Cost of the Asset (US$ 2,50,000 × ₹ 43.25)	1,08,12,500
Less : Depreciation @ 50% of 15% (since Put to Use < 180 days) for previous year 2009-10 (₹ 1,08,12,500 × 50% × 15%)	(8,10,938)
WDV as on 01.04.2010	1,00,01,562
Add : Exchange Rate Difference [US$ 2,50,000 × ₹ (45.70 – 43.25)]	6,12,500
WDV for claiming depreciation	1,06,14,062
Less : Depreciation @ 15% for the previous year 2010-11 (₹ 1,06,14,062 × 15%)	15,92,109
WDV as on 01.04.2011	90,21,953

Question No.13 (b)

Pharma Ltd. imported machinery from Germany on 27.8.10 at a cost of ₹ 40 crores. Customs Duty paid @ 20%. Government granted subsidy of ₹ 25 crores. The entire logisitics was supported by Nexgen Courier Ltd., an Indian Company. Total Service charges paid to them ₹20 lacs including service tax of ₹ 2,20,000.

Compute Actual Cost, if assessee, avail CENVAT credit adjustment.

Assessee : Pharma Ltd **Previous Year : 2010-11**

Computation of Depreciation and Written Down Value

Particulars	**Amount** (₹ crores)
Cost of Purchase	40.00
Add: Customs Duty @ 20% on ₹ 40 crores	8.00
Less: Government subsidy granted	25.00
Less: CENVAT Credit (Service Tax paid included in the payment made to Nexgen Courier Ltd.)	0.22
Actual Cost for the purpose of charging depreciation	**22.78**

Question No.14 (a)

ZED Ltd. imported machinery from South Korea on 12.5.2010 for US$ 50,000. Exchange rate on that date : US$ = ₹ 44. 70. Customs Duty paid @ 20%. Government granted subsidy of ₹ 15,00,000. The assessee had a forward contract on 2.4.2010 at US$ 45.30. Logistics services was provided by Carrywell Courier Ltd. Service Charges paid ₹ 2,00,000 including service tax of ₹ 25,000. Engineers and labourers were engaged at site for installation of the machinery. Salary and wages paid for site engineers and labourers including their travelling expenses amounted to ₹ 4,60,000. Expenses incurred during trial run period ₹ 1,50,000. Sale of output produced during trial run period ₹ 90,000. Interest earned on deposits made to open Letter of Credit for purchase of this machinery ₹ 15,000 . The machine was put to use from 05.10.10. Depreciation @ 15%. Compute Actual Cost and Written Down Value.

Assessee: ZED Ltd. **Previous Year: 2010-11**

Computation of Actual Cost and Written Down Value

Particulars	**Amount (₹ crores)**
Cost of the Asset (US$ 50,000 × ₹ 44.70)	22,35,000
Add : Customs Duty paid @ 20% on ₹ 22,35,000	4,47,000
Less : Government Subsidy granted	(15,00,000)
Add : Exchange Rate Difference [US$ 50,000 × ₹ (45.30 - 44.70)]	30,000
Add : Transportation charges paid ₹ 2,00,000 (including Service Tax ₹ 25,000)	2,00,000
Less : CENVAT credit adjustment (credit for Service tax included in service charges paid to Carrywell Courier Ltd.)	(25,000)
Add : Installation expenses incurred for payment of site engineers & labourers including travelling expenses	4,60,000
Add : Expenses incurred during trial run period	1,50,000
Less : Sale of output generated during trial run period	(90,000)
Less : Interest earned on deposits made to open Letter of Credit for purchase of this machinery	(15,000)
Actual Cost for the purpose of determining depreciation	**18,92,000**
Less : Depreciation @ 50% of 15% (since Put to Use < 180 days) for previous year 2010-11 (₹ 18,92,000 × 50% x 15%)	1,41,900
WDV as on 01.04.2011	**17,50,100**

Question No.14(b)

A Bros., a sole-proprietorship concern, was converted into a A Ltd. on 20.9.2010. Before the conversion, the concern had a block of furniture (rate of depreciation @ 10%), whose WDV as on 01.04.2010 was ₹ 6,50,000. On 01.05.2010, a new furniture of the same block was purchased for ₹ 50,000. A Ltd. purchased another furniture of the same type on 20.12.2010 for ₹ 48,000. Compute depreciation that would be claimed by A Bros. and A Ltd for the previous year 2010-11.

Solution :

(1) Depreciation shall have to be calculated at the prescribed rates, as is applicable for a going concern, without considering the event of amalgamation or demerger.

(2) Depreciation shall have to be apportioned between the predecessor and the successor in the ratio of number of days for which such assets were held for their business purpose and used by them.

Depreciation to be apportioned = [W.D.V. as on 1.4.2010 + New Purchases on 01.05.2010]

= ₹ (6,50,000 + 50,000) = ₹ 7,00,000 × 10% = ₹ 70,000

Apportionment of Depreciation and Allowable Depreciation

Assessee	**No. of Days**	**Depreciation on Assets on the date of succession**	**Depreciation on Assets acquired after Succession**	**Total Depreciation for the Previous Year 2010-11**
A Bros. (Sole-Proprietorship concern)	01.04.2010 to 30.9.2010 = 173 days	₹ 70,000 × 173/365 = ₹ 33,178	Nil	₹ 33,178
A Ltd. (Company)	21.09.2010 to 31.3.2011	₹ 70,000 × 192 × 365 ₹ 36,822	₹ 48,000 × 50% × 10% = ₹ 2,400 (Put to use < 180 days)	₹ 39,222

Question No.15(a)

P Ltd. was taken over by Q Ltd. with effect from 31.7.2010. This satisfies the conditions of Sec. 2(1B) of the Income Tax Act, 1961. From the following information, compute deductions admissible u/s 32 to P Ltd and Q Ltd. for the previous year 2010-11.

Assets	Rate of Depreciation	WDV in the hands of P Ltd (as on 01.04.2010)	Transfer Value to Q Ltd. (₹)
Building	10%	30,00,000	45,00,000
Plant & Machinery	15%	20,00,000	15,00,000
Motor Car	15%	8,00,000	6,00,000
Computers	60%	5,00,000	2,00,000
Furniture	10%	3,00,000	1,40,000

Solution :

(1) Depreciation shall have to be calculated at the prescribed rates, as is applicable for a going concern, without considering the event of amalgamation or demerger.

(2) Depreciation shall have to be apportioned between the predecessor and the successor in the ratio of number of days for which such assets were held for their business purpose and used by them.

Depreciation to be apportioned = [W.D.V. as on 1.4.2010 + New Purchases on 01.05.2010]

= ₹ (6,50,000 + 50,000) = ₹ 7,00,000 × 10% = ₹ 70,000

Depreciation Statement as per Income Tax Act, 1961

Particulars of Block of Assets	Rate Of Dept.	W.D.V as on 01.04.2010	Additional Actual Cost	Debenture	Net Value of Block	Depreciation for the Current Year	W.D.V. as on 31.3.2011
1	**2**	**3**	**4**	**5**	**6**	**7**	
Block I – Building	10%	30,00,000	**Nil**	**Nil**	30,00,000	**3,00,000**	**27,00,000**
Block – II Plant & Machinery	15%	20,00,000	**Nil**	**Nil**	20,00,000	**3,00,000**	**17,00,000**
Block – III Motor Car	15%	8,00,000	**Nil**	**Nil**	8,00,000	**1,20,000**	**6,80,000**
Block – IV Computers	60%	5,00,000	**Nil**	**Nil**	5,00,000	**3,00,000**	**2,00,000**
Block – V Furniture	10%	3,00,000	**Nil**	**Nil**	3,00,000	**30,000**	**2,70,000**
		56,00,000			**56,00,000**	**10,50,000**	**45,50,000**

TOTAL DEPRECIATION ADMISSIBLE ₹ 10,50,000

<u>Statement showing Apportionment of Depreciation and Allowable Depreciation</u>

Assessee	No. of Days	Depreciation on Assets on the date of amalgamation	Depreciation on Assets acquired after amalgamation	Total Depreciation for the Previous Year 2010-11
P Ltd.	01.04.2010 to 31.7.2010 = 122 days	₹ 10,50,000 × 173/365 = ₹ 4,97,671	Nil	₹ 4,97,671
Q Ltd.	01.08.2010 to 31.3.2011 = 243 days	₹ 10,50,000 × 243 × 365 = ₹ 6,99,041	Nil	₹ 6,99,041

Question No.15(b)

Mr. Hari purchased a house property on 18.11.2006 for ₹ 15,00,000. Till 1.7.2010, the same was self-occupied for own residence. Thereafter, the said building was brought into use for the purpose of his profession. Determine the amount of depreciable admissible for the Assessment Year 2011-12, given rate of depreciation @ 10%.

Solution :

(a)Property acquired by the assessee himself: As per Sec. 43(1), if a building/asset used for private purpose of the assessee is subsequently put to use for the purpose of business, the cost of acquisition shall be determined in the following manner:

Assessee: Mr. Hari **Previous Year: 2010-11** **Assessment Year: 2011-12**

	₹
Cost of acquisition of Residential House Property as on 18.11.2006	15,00,000
Less: Deemed depreciation for the Financial year 2006-07 @ 50% of 10% on ₹ 15,00,000 (since period of usage is less than 180 days)	75,000
WDV as on 01.04.2007	14,25,000
Less: Deemed Depreciation for Financial year 2007-08 @ 10% on ₹14,25,000	1,42,500
WDV as on 01.04.2008	12,82,500
Less: Deemed Depreciation for Financial year 2008-09 @ 10% on ₹12,82,500	1,28,250
WDV as on 01.04.2009	11,54,250
Less: Deemed Depreciation for Financial year 2009-10 @ 10% on ₹11,54,250	1,15,425
WDV as on 01.04.2010 = Actual cost for the purpose of charging depreciation	**10,38,825**
Less: Deemed Depreciation for Financial year 2010-11 @ 10% on ₹10,38,825	1,03,883
WDV as on 01.04.2011	**9,34,942**

Illustration 16(a):

X Ltd., is a company engaged in the business of growing, manufacturing and selling of tea. For the accounting year ended 31st March, 2010, its composite business profits, before an adjustment under section 33AB of the Income-tax Act, were ₹ 60 lakhs. In the year, it deposited ₹ 25 lakhs with NABARD. The company has a business loss of ₹ 10 lakhs brought forward from the previous year.The company withdrew in February, 2010 ₹ 20 lakhs from the deposit account to buy a non-depreciable asset for ₹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, 2010 for ₹ 29 lakhs. Indicate clearly the tax consequences of the above transactions and the total income for the relevant years.

Computation of Total Income of X Ltd. for A.Y. 2010-11

Particulars	₹
Net profits before adjusting deduction u/s 33AB	60,00,000
Less: Deduction u/s 33AB	24,00,000
[Lower of	
(i) 40% of ₹60 lakhs = ₹ 24 lakhs; or	
(ii) actual amount deposited with NABARD = ₹ 25 lakhs	
Profits after adjusting deduction u/s 33AB	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 ₹36 lakhs	14,40,000
Add: Non-utilisation of amount withdrawn: ₹ 2 lakhs [i.e. (₹20 lakhs – ₹18 lakhs)]	
40% is taxable as business income (the balance 60% is treated as agricultural income).	80,000
Business income	15,20,000
Less: Business loss brought forward from the previous year	10,00,000
Total Income	**5,20,000**

Computation of Total Income of X Ltd. for A.Y.2011-12

Particulars	**₹**
Business income **(See Note 2)**	7,20,000
Capital gains (Short-term) **(See Note 1)**	11,00,000
Total Income	**18,20,000**

Note 1 - Computation of capital gains

Particulars	**₹**
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**

Question No.16(b)

Free Call Ltd. obtained a telecom licence on 15.6.07 for a period of 8 years ending on 31.3.2015 against a fee of ₹30 crores to be paid in four instalments of ₹12 crores, ₹7 crores, ₹6 crores, ₹5 crores by June 2008, June 2009, June 2010 and June 2011 respectively. Explain how the payment for licence fee shall be dealt under the Income Tax Act, 1961.

Solution :

Assessee : Free Call Ltd. **Previous Year 2010-11** **Assessment Year: 2011-12**

(a) U/s 35ABB, expenditure incurred for the purpose ofacquiring any right to operate telecommunication services is allowed equally as deduction throughout the unexpired life of the licence. Deduction shall be allowed **only for the actual payment made.**

(b) If only part payment is made, amortization is based on the amount paid and not on the basis of total consideration. For any further payments, deduction/amortization is allowed equally for the remaining unexpired useful life.

(c) Computation of amount of eligible deduction u/s 35 ABB:

Previous year	**Amount paid (₹ crores)**	**Unexpired Period of Licence on the date of actual payment**	**Amount of Deduction (₹ crores)**
2007-08	12.00	8 years	1.50
2008-09	7.00	7 years	[1.50 + (7.00/7)] = 2.50
2009-10	6.00	6 years	[2.50 + (6.00/6)] = 3.50
2010-11	5.00	5 years	[3.50 + (5.00/5)] = 4.50

Question No.17(a)

Hello International Ltd. incurs an expenditure of ₹ 240 crores for acquiring the right to operate telecommunication services for Assam & Sikkim. The payment was made in November 2009 and the licence to operate the services was valid for 15 years. In December 2010, the company transfers part of the licence, in respect of Assam, to Hi International Ltd. for a sum of ₹56 crores and continue to operate the licence in Sikkim. What is the deduction allowable u/s 35ABB to Hello International Ltd. for the Assessment Year 2011-12?

Solution :

Assessee: Hello International Ltd. Previous Year: 2010-11 Assessment Year : 2011-12

(a) u/s 35ABB, where part of the Telecom Licence is transferred and Net Consideration received on such transfer, is less than the expenditure remaining unallowed, the amount of deduction shall be computed as follows :

(i)	Unallowed amount as on 01.04.2010	= Total Expenditure Less Deduction for Financial Year 2009-10
		= ₹240 crores Less (₹240 crores/licence period of 15 years)
		= ₹240 crores less ₹16 crores = ₹224 crores.
(ii)	Net Consideration received	= ₹60 crores
(iii)	Remaining period of licence	= 14 years (including current previous year)
(iv)	Deduction u/s 35 ABB	= ₹ (224 crores less 56 crores) / 14 years= ₹12 crores.

Question No.17(b)

Jammer International Ltd. incurs an expenditure of ₹ 300 crores for acquiring the right to operate telecommunication services for Orissa and Jharkhand. The payment was made in August 2009 and the licence to operate the services was valid for 12 years. In December 2010, the company transfers part of the licence, in respect of Orissa to Hammer International Ltd. for a sum of ₹280 crores and continue to operate the licence in Jharkhand What is the deduction allowable u/s 35ABB to Jammer International Ltd. for the Assessment Year 2011-12?

Solution:

Assessee: Jammer International Ltd. Previous Year: 2010-11 Assessment Year : 2011-12

(a) u/s 35ABB, where part of the Telecom Licence is transferred and Net Consideration received on such transfer, is more than the expenditure remaining unallowed, the amount of deduction shall be computed as follows :

(i)	Unallowed amount as on 01.04.2010	= Total Expenditure Less Deduction for Financial Year 2009-10
		= ₹ 300 crores Less (₹ 300 crores / licence period of 12 years)
		= ₹ 300 crores less ₹ 25 crores= ₹ 275 crores.
(ii)	Net Consideration received	= ₹ 280 crores
(iii)	Remaining period of licence	= 11 years (including current previous year)
(iv)	Deduction u/s 35 ABB	= ₹ (224 crores less 56 crores) / 14 years
		= ₹ 12 crores.

Question No.18(a)

Sleepwell Ltd. is an existing Indian Company, which sets up a new industrial unit. It incurs the following expenditure in connection with the new unit:

	₹
Preparation of project report	4,00,000
Market survey	5,00,000
Legal and other charges for issue of additional capital required for the new unit	2,00,000
Total	**11,00,000**
The following further data is given:	
Cost of project	30,00,000
Capital employed in the new unit	40,00,000

What is the deduction admissible to the company under section 35D for Assessment Year 2011-12?

Solution:

The deduction admissible under section 35D is one-fifth of the expenditure incurred for the project. This works out to ₹ 2,20,000.

However, such expenditure should not exceed the following limits as prescribed in section (3):

(a) 5% of cost of the project or

(b) 5% of the capital employed in the new industrial undertaking (being a company) — whichever is higher.

In this case

(a) 5% of the project cost is ₹ 1,50,000 and

(b) 5% of the capital employed is ₹ 2,00,000.

Hence, the expenditure eligible for amortization under section 35D would be ₹ 2,00,000.

And the admissible deduction for the current assessment year is 2,00,000 × 1/5 = ₹ 40,000.

Question No.18(b)

Ms.Chitralekha, a retail trader of Kolkata furnishes the following Trading and Profit and Loss Account for the year ending 31st March, 2011:

Trading and Profit and Loss Account for the year ended 31.03.2011

		₹			₹
To	Opening stock	90,000	By	Sales	12,11,500
To	Purchases	10,04,000	By	Income from UTI	2,400
To	Gross Profit	3,06,000	By	Other business receipts	6,100
			By	Closing stock	1,80,000
		14,00,000			14,00,000
To	Salary	60,000	By	Gross profit b/d	3,06,000
To	Rent and rates	36,000			
To	Interest on loan	15,000			
To	Depreciation	1,05,000			
To	Printing & stationery	23,200			
To	Postage & telegram	1,640			
To	Loss on sale of shares (Short term)	8,100			
To	Other general expenses	7,060			
To	Net Profit	50,000			
		3,06,000			**3,06,000**

Additional Information:

(i) It was found that some stocks were omitted to be included in both the Opening and Closing Stock, the values of which were

Opening stock ₹ 9,000

Closing stock ₹ 18,000

(ii) Salary includes ₹10,000 paid to his brother, which is unreasonable to the extent of ₹2,000.

(iii) The whole amount of printing and stationery was paid in cash.

(iv) The depreciation provided in the Profit and Loss Account ₹ 1,05,000 was based on the following information :

The written down value of plant and machinery is ₹4,20,000. A new plant falling under the same Block of depreciation of 25% was bought on 1.7.2010 for ₹70,000. Two old plants were sold on 1.10.2010 for ₹ 50,000.

(v) Rent and rates includes sales tax liability of ₹3,400 paid on 7.4.2010.

(vi) Other business receipts include ₹2,200 received as refund of sales tax relating to 2008-09.

(vii) Other general expenses include ₹ 2,000 paid as donation to a Public Charitable Trust.

You are required to advise Ms.Chitralekha whether he can offer his business income under section 44AF.

Solution:

Let us assume that the facts relate to previous year relevant to assessment year 2011-12 and accordingly compute the income of Ms.Chitralekha.

Computation of business income of Ms. Chitralekha for the assessment year 2011-12.

		₹	₹
Net Profit as per profit and loss account			50,000
Add :	Inadmissible expenses / losses		
	Under valuation of closing stock	18,000	
	Unreasonable salary paid to brother (section 40A(2)	2,000	
	Printing and stationery paid in cash [Section 40A(3)] 100% of ₹23,200	43,200	
	Depreciation (considered separately)	1,05,000	
	Short term capital loss on shares	8,100	
	Donation to public charitable trust	2,000	1,78,300
			2,28,300
Less :	**Deductions items:**		
	Under valuation of opening stock	9,000	
	Income from UTI	2,400	
	Refund of sales tax [Taxable u/s.41(1) – No adjustment necessary]	—	11,400
	Business income before depreciation		**2,16,900**
Less :	Depreciation (see note 1)		**66,000**
			1,50,900

Computation of business income as per section 44AF

As per section 44AF, the business income would be 5% of turnover

12,11,500 × 5 /100 = ₹60,575

The business income under section 44AF is **₹ 60,575.**

As the business income under section 44AF is lower than the business income as per the normal provisions of the Act, it is advisable for Mr. Sivam to offer the business income under section 44AF of the Act

Note 1

Calculation of depreciation

WDV of the block of plant & machinery as on the first day of previous year	4,20,000
Add : Cost of new plant & machinery	70,000
	4,90,000
Less : Sale proceeds of assets sold	50,000
WDV of the block of plant & machinery as on the last day of previous year	4,40,000
Depreciation @ 15%	66,000

Note : No additional depreciation is allowable as the assessee is not engaged in manufacture or production of any article.

Note 2

Since sales-tax liability has been paid before the due date of filing return of income under section 139(1), the same is deductible.

Question No.19(a)

Mukund is a person carrying on profession as film artist. His gross receipts from profession are as under :

Financial year	2008-2009	1,25,000
Financial year	2009-2010	1,60,000
Financial year	2010-2011	1,80,000

Is he required to maintain any books of account under Section 44AA of the Income-tax Act? If so, what are these books?

Answer :

Section 44AA requires every person carrying on any profession, notified by the Board of the Official Gazette (in addition to the professions already specified) to maintain such books of account and other documents as may enable the Assessing Officer to compute his total income in accordance with the provisions of the Income-tax Act. The CBDT has notified the profession of film artists as one such profession (S.O. No.17E/12-1-77). Hence section 44AA applies to Mukund.

Sub-section (3) of section 44AA authorizes the Board to prescribe by rules, the books of account and other documents (including inventories) to be kept and maintained under sub-section (1), the particulars to be contained therein etc. The prescribed rule is Rule 6F, under which every person carrying on the specified profession, including a film artist, is required to maintain the books of account and other documents specified in sub-Rule (2).

However, under the proviso to Sub-Rule (1), nothing contained therein shall apply in the case of a person, if his gross receipts do not exceed ₹ 1,50,000/- in any one of the three years, immediately preceding the previous year.

The significance of this rule is that if the gross receipts from profession do not exceed ₹ 1,50,000 in any one of the previous 3 years, he is not required to maintain the books of account specified in sub-rule (2) of Rule 6F. Since in one of the three previous years the gross receipts are below ₹ 1,50,000, the assessee is not required to maintain books of account and other documents as he is not governed by section 44AA.

Question No.19(b)

Discuss the tax implications of the following transactions in the case of a doctor running a nursing home :

		₹
(1)	Amount paid to a scientific research association approved by the Central Government and run by a drug manufacturing company	20,000
(2)	Amounts received from the employees of the nursing home as contributions towards provident fund for the month of March, 2011 paid to the PF Commissioner on 25th April, 2011	25,000
(3)	Repayment made in cash towards purchases of medicines	50,000
(4)	Repayment of loan taken from a bank for doing a post-graduate course in medicine – instalment	50,000
	Interest	10,000

Answer :

(i). Under section 35(ii), 125% of the sums paid to scientific research association, which has as its object the undertaking of scientific research is deductible.

Deduction admissible = 20,000 + (1/4 × 20,000)

= ₹ 25,000.

(ii) Under clause (x) of sub section 24 of section 2, any sum received by an assessee from his employees as contribution to any provident fund is deemed to be his income. Such income is deductible under section 36(1) (va) only if it is credited to the employees' account in the relevant fund by the due date.

Under Employees' Provident Fund Act, the due date for the payment of the contribution is the 15th of the month following the month for which the contribution is due. A grace period of 5 days is also allowed. Hence the payment of the employee's contribution for the P.F. Commissioner should have been made by 20th April. Since the payment has been made on 25th April, the deduction is not available.

(iii) Under section 40A(3) payments made in cash exceeding ₹ 20,000 are not allowable in computing the income from business or profession. 20% of such expenditure is liable to be disallowed. Hence ₹ 10,000 will be disallowed. It is assumed that the case is not covered by the exceptions under Rule 6DD.

(iv) Under section 80E, a deduction is admissible in the case of an individual towards any amount paid in the previous year by way of interest on loan taken from any financial institution for the purpose of pursuing his higher education. The purpose stated in the question is covered by the section. The deduction is allowable only towards payment of interest. The amount deductible under section 80-E would be ₹10,000.

Question No.20(a)

Suppose the payment of voluntary retirement is made to X as under :

Previous year	**Amount paid (₹)**
2007-08	20,00,000
2008-09	12,00,000
2009-10	14,00,000
	46,00,000

In this case the deduction of expenses incurred under voluntary retirement scheme shall be allowed as under :

Assessment year 2008-09 : ₹ 4,00,000 (1/5th of ₹ 20,00,000) and balance ₹ 16,00,000 in 4 equal instalments in the next four assessment years i.e. assessment years 2009-10 to 2012-13.

Assessment year 2009-10 : ₹ 6,40,000 i.e. ₹ 4,00,000 on account of payment made in previous year 2007-08 and ₹ 2,40,000 (1/5th of ₹ 12,00,000 paid on previous year 2008-09).

Assessment year 2010-11 : ₹ 9,20,000 i.e. ₹ 6,40,000 (₹ 4,00,000 + ₹ 2,40,000 for payment made in previous year 2007-08 and 2008-09 respectively) and ₹ 2,80,000 on account of payment made in previous year 2009-10.

Assessment year 2011-12 : ₹ 9,24,000 (₹ 4,00,000 + ₹ 2,40,000 + ₹ 2,80,000)

Assessment year 2012-13 : ₹ 9,20,000 (₹ 4,00,000 + ₹ 2,40,000 + ₹ 2,80,000)

Assessment year 2013-14 : ₹ 5,20,000 (₹ 2,40,000 + ₹ 2,80,000)

Assessment year 2014-15 : ₹ 2,80,000
Total amount allowed in various assessment years ₹ 46,00,000.

Question No.20(b)

Mr Sudhir Sharma, resident in India, for the year ending on 31 March 2011. Compute his income from business and his gross total income for the assessment year 2011-2012.

Profit & Loss Account for the year ended 31.3.10

Dr. | *Cr.*

Expenditure	**₹**	**Receipts**	**₹**
To purchases	1,90,000	By sales less returns	5,69,300
To salaries and wages	1,40,000	By bad debts recovered, allowed in earlier years by the Assessing Officer	2,000
To trade expenses	1,000		
To purchase of trademarks	50,000		
To registration of trademarks	2,000	By interest on securities (gross)	892
To rent, rates and taxes	5,000	By dharmada, mandir and gaushala receipts	2,000
To discount allowed	1,500		

To household expenses	6,000	By refund on income tax	1,008
To advertisement bill paid in cash	30,000	By proceeds of life insurance policy on maturity	43,500
To income tax	10,000		
To sales tax paid	3,000		
To purchased technical know-how	12,000		
To expenses incurred on income tax and sales tax proceedings	15,100		
To contribution paid to a trust for staff welfare	1,000		
To staff welfare expenses incurred	700		
To OYT deposit	5,000		
To postage and telegrams	1,300		
To donation to National Defence Fund	2,500		
To life insurance premium on the life of the assessee	2,000		
To interest on capital	5,000		
To interest on loan taken to pay income tax	500		
To wealth tax	500		
To audit fee	1,000		
To entertainment expenditure	30,000		
To gifts and present to five customers, costing ₹ 3,000 each	15,000		
To expenses on apprentice training	4,000		
To emergency risk insurance	200		
To fire insurance premium for stock	200		
To provision for bad and doubtful debts	3,000		
To reserve for pecuniary losses	5,000		
To net profit	76,000		
Total	**6,18,700**		**6,18,700**

Solution :

Computation of Gross Total Income for the Assessment Year 2011-2012

Particulars	**₹**	**₹**
Income from Business		
Net profit as per profit and loss account		76,000
Add: Expenses inadmissible in computing profits and gains from business or profession:		
Purchase of trademarks	50,000	
Household expenses [Sec. 37(1)]	2,500	
Advertisement bills paid in cash [Sec. 37(1) r.w. Sec. 40A (3)] @ 100% of ₹ 30,000	30,000	
Income tax [Sec. 40(a)(ii)]	10,000	
Purchase of technical know-how	12,000	
Contribution to a Trust for staff welfare fund [Sec. 40A (9)]	1,000	
Donation for National Fund [Sec. 37(1)]	2,500	
Life Insurance premium [Sec. 37(1)]	2,000	
Interest on capital [Sec. 36(1)(iii)]	5,000	
Interest on loan to pay income tax [Sec. 37(1) r.w. 40{a)(ii)]	500	
Wealth tax [Sec. 40(a)(iii)]	500	

Provision for bad and doubtful debts [Sec. 37(1) r.w. 36(1)(vii)(2)]	2,000	
Reserve for pecuniary losses [Sec. 37(1)]	6,000	1,24,000
		2,00,000
Less:		
(a) Income not relating to business or profession: [Sec. 28(i)] Interest on government securities	892	
(b) Dharada, mandir and gaushala receipts	2,000	
(c) Refund of income tax	1,008	
(d) Proceeds of L.I.P.: It is not a business receipt and exempt [Sec. 10(10)]	43,500	
(e) Depreciation on trademarks; 25% of ₹ 50,000	12,500	
(f) Depreciation on know-how: 25% of ₹ 12,000	3,000	59,400
Income from business		**1,40,600**

Statement of Gross Total Income for the Assessment Year 2010-2011

1. Income from business	1,40,600
2. Income from other sources— Interest on securities	892
Gross total income	**1,41,492**

Note :

1) Bad debts deducted in earlier years and now recovered, has been rightly included in the profit and loss account as business income [Sec. 41(4)].
2) Since payment of income tax is not deductible, its refund cannot be taxed as deemed profits [Sec. 41(1)].
3) OYT (own your telephone) deposit is an allowable deduction in the year in which it is paid.
4) "Dharmada", "mandir" and "gaushala" receipts are customarily levies by trader for charitable purposes. Amount received under these heads are not trading receipts. The fact that the amount collected under these heads are spent for other purposes would amount to breach of trust but it would not affect the initial nature and character of the receipt. Such receipts are not taxable.
5) The assessee is entitled to the deduction in respect of donation to National Defence Fund under Sec. 80G.
6) Life insurance paid by assessee on his life is allowed to be deducted in imputing total income under Sec. 80C.
7) Any payment on advertisement exceeding ₹ 20,000 should be made by on account payee cheque or account payee bank draft. Since the payment has been made in cash, 100% of advertisement has been disallowed [Sec. 37(1) r.w. Sec. 40A(3)]. 'Crossed cheque' requirement has been amended by 'account payee' cheque. It is operative from 13-07-2008.
8) From the assessment year 2001-2002, intangible assets also fall within the scheme of depreciation. Hence, depreciation has been allowed on trademarks and know-how.
9) Registration expense of trademarks is revenue expenditure, allowed under Sec. 37(1).

Question No.21: Dr L. Kochagaway is a renowned medical practitioner. He furnishes his receipts and payments account for the financial year 2010-2011:

Dr. *Cr.*

Receipts		₹	Payments		₹
To balance b/d		35,000	By rent of clinics:		
To consultation fees :			2008-2009	13,600	
2007-2008	25,000		2009-2010	44,800	
2008-2009	1,80,000		2010-2011	26,600	85,000
2009-2010	2,62,000	4,67,000	By electricity and water		12,000
To visiting fees		1,30,000	By purchase of professional books		18,000
To loan from bank for		2,25,000	By household expenses		97,800

professional purposes		By municipal taxes paid in respect of property	12,000
To sale of medicines	1,73,000		
To gift/presents from patients	15,000	By purchase of motor car	2,45,000
To remuneration from articles published in professional magazines	26,000	By Telephone Charges	10,000
		By fire insurance in respect of property	3,200
To rent from house property	96,000	By surgical equipment	44,700
To interest on Post Office National Savings Certificates	17,000	By advance income tax	43,000
		By salary and perquisite to compounder	72,000
		By entertainment expenses	16,000
		By purchase of X-ray machine	2,00,000
		By expenses of income-tax proceedings	15,000
		By life insurance premium	25,000
		By gifts to wife	25,000
		By interest on loan	12,000
		By loan a/c—instalment paid	25,000
		By donation to Political Party	2,500
		By car expenses	36,000
		By purchase of medicines	1,05,000
		By balance c/d	79,800
	11,84,000		**11,84,000**

Compute his income from profession and gross total income for the assessment year 2011-2012 after taking into account the following additional information:

1. One-third of the car expenses are in connection with personal use.
2. Depreciation on motor car is allowed at the rate of 15%.
3. The construction of the house property was completed in March 2006. It was let out for residential purposes.
4. Expenses on income tax proceeding include ₹ 1,000 paid for the preparation of return of income.
5. Receipts outstanding from patients for 2010-2011, amount to ₹ 8,000.
6. Closing stock of medicines is ₹ 8,000 but its current market price is ₹ 12,000.
7. Books purchased include annual publications of ₹ 12,000, purchased in December 2010.

Solution :

Computation of Income from Profession for the Assessment Year 2011-2012

Particulars	**₹**	**₹**
Income from Profession :		
(a) Receipt from profession:		
1. Consultation fees: [Sec. 28(i)]: (₹ 25,000 + ₹ 1,80,000 + ₹ 2,62,000)		4,67,000
2. Visiting fees [Sec. 28(i)]		1,30,000
3. Sale of medicines [Sec. 28(i)]		1,73,000
4. Gifts and presents from patients [Sec. 28(iv)]		15,000
5. Remuneration from articles published in professional magazines [Sec, 28(i)]		26,000 8,11,000
(b) Closing stock of medicines		8,000
Total receipts and closing stock		**8,19,000**
Less: Expenses allowable:		
1) Rent of clinic [Sec. 30]	85,000	

2) Electricity and water [Sec. 37(1)]		12,000	
3) Salary of compounder [Sec. 37(1)]		72,000	
4) Entertainment expenses [Sec. 37(1)]		16,000	
5) Expenses on income-tax proceedings [Sec. 37(1)]		15,000	
6) Interest on loan [Sec. 37(1)(iii)]		12,000	
7) Purchase of medicines [Sec. 37(1)]		1,05,000	
8) Car expenses [Sec. 37(1)] (2/3 x ₹ 36,000)		12,000	
9) Depreciation on professional books :			
(i) Annual publications: 12,000 × 100% × 50%		6,000	
(ii) Other books: 6,000 × 60%		3,600	
10) Depreciation on car [Sec. 32 r.w. Sec. 38] : 15% of 2,45,000 × 2/3		24,500	
11) Depreciation on plant and machinery:			
(i) X-ray machine	2,00,000		
(ii) Surgical equipment	44,700		
Depreciation @ 15% of	2,44,700	36,705	
12) Telephone Charges		10,000	4,09,805
Taxable Income from Profession			**4,09,195**
Computation of Income from House Property :			
Gross annual value on the basis of rental valuation		96,000	
Less*:* Full municipal taxes paid by the owner		12,000	
Net annual value		**84,000**	
Less: Statutory deduction: 30% of net annual value		25,200	
Income from House Property			58,800
Gross Total Income			**4,67,995**
Less: Deduction u/s 80C (LIC premium paid)			**25,000**
Less: Deduction u/s 80GGC			**2,500**
(Actual amount of donation to political party)			
Total Income			**4,40,495**
Total Income rounded off u/s 288A			**4,40,490**

Notes :

1. Purchase of motor car is capital expenditure. Hence, it is not deductible. Depreciation has been allowed on motor car.

2. Plant includes books and surgical equipment. Depreciation on professional books is allowed @ 60% but annual publications are written off @ 100%. However, as annual publications have been put to use for less than 180 days during the year, depreciation has been allowed @ 50%. The assessee can claim depreciation on surgical equipment at general rate.

3. Contribution of articles to periodicals and magazines constitutes income from vocation of the assessee.

4. Expenses in income-tax proceedings are wholly deductible [Sec. 37(1)].

5. One-third of car expenses and proportionate deprecation in respect of motor car have been disallowed as they are in connection with the personal use of the assessee.

6. Interest on Post Office National Saving Certificates is exempt from income tax [Sec. 10(15)].

7. Profits and gains of the business or profession are computed according to the method of the accounting regularly followed by the assessee (Sec. 145). Since the assessee has adopted cash system of accounting. "Income" is taxable on receipt basis and "expenditure" is allowed to be deducted on payment basis,

irrespective of the previous year to which the receipt of payment belongs. Receipts outstanding for the previous year 2010-2011 will not be taken into consideration.

8. Profits and gains of business profession is required to be computed according to the system of accounting regularly followed by the assessee but if the income cannot be properly deduced therefrom, the Assessing Officer may compute the income on such basis and in such manner as he may deem fit [Proviso to Sec. 145(1)].

   In view of this, the Assessing Officer may take into account the value of closing stock while determining profits even under cash system of accounting

9. Donation to Political Party is allowed to be deducted from gross total income under Sec. 80GGC.

Question No.22

The Profit and Loss Account of RAI & Co. for the previous year 2010-2011 is given as follows :

Particulars	₹	Particulars	₹
Purchases of goods	10,00,000	Sale of goods	26,00,000
Salaries, bonus and commission	8,00,000	Closing stock	50,000
Rent, rates and taxes	60,000	Interest on drawings	7,000
Depreciation @ 16% on WDV	20,000	Interest on securities	20,000
Travelling expenses	1,50,000		
Interest on capital	25,000		
Advertisement	1,20,000		
Entertainment expenses	60,000		
Expenditure on neon-sign board	50,000		
New telephone deposit under OYT scheme	5,000		
Compensation for cancelling purchase order of an outdated machine	10,000		
Expenses for promoting family planning among employees	20,000		
Net profit	3,57,000		
	26,77,000		**26,77,000**

Additional Information :

(i)Salaries, bonus and commission include:	₹
(a)Salary to the proprietor	1,50,000
(b)Bonus paid to employees on 15-10-2011	75,000

(c)Salary of ₹ 1,20,000 was paid in India to B, a non-resident employee but neither any tax was deducted at source nor paid thereon. However, B is a PAN holder and has cleared his tax liability.

(d)Advertisement includes:

(i) A hoarding bill paid in cash, ₹ 38,000

(ii) Advertisement published in souvenir, published by a political party ₹10,000

(e)Depreciation has been charged on plants and machinery and furniture and fittings in proportion of 3:2. Depreciation @ 15% on plant and @10% on furniture.

(f)Purchases include goods of ₹1,00,000, imported without a licence and confiscated by the customs authorities.

(g)Travelling expenses include a sum of ₹1,00,000 on foreign travel to purchase a machine. Negotiations have not been finalized.

(h)Annual stock taking revealed a theft of goods, costing ₹ 30,000.

(i)This year stock valuation was deviated from the market price to cost price which is 20% less than its market price.

Compute taxable business profits for the Assessment year 2011-12.

Computation of Taxable Business Profits for the Assessment Year 2011-2012

Solution :

Particulars	₹	₹
Income from Business		
Net profit as per profit and loss account		3,57,000
Add: Inadmissible Expenses		
(a) Salary paid to Proprietor	1,50,000	
(b) Bonus paid to employees: Deduction will be allowed in Previous Year 2011-12 (Sec.43B, being disallowance of unpaid liability)	75,000	
(c) Salary paid to non-resident employee, without deducting or paying TDS[Sec.40(a)(iii)]	1,20,000	
(d) Advertisement bills paid in cash [Sec. 37(1) r.w. Sec. 40A(3)] @100% of ₹ 38,000	38,000	
(e) Advertisement in sourvenir published by political party [Sec.37(2B)]	10,000	
(f) Depreciation to be treated separately	20,000	
(g) Expenses on family planning: allowable only to a company assessee [Sec.36(1)(ix)]	20,000	
(h) Foreign travel to acquire a new machine, (being capital in nature, deal not yet finalized. It may be added to the cost of the asset when such asset is actually procured)	1,00,000	
(i) Interest on capital [Sec. 36(1)(iii)] [There is no borrowings]	25,000	
(j) Expenditure on neon sign board, being a capital expenditure on advertisement, hence disallowed.	50,000	
(k) Compensation paid to cancel a capital liability, capital in nature, hence disallowed u/s 37(1)	10,000	
(l) Under valuation of closing stock:[50,000/80% - 50,000]	12,500	
	12,500	6,30,550
		9,87,500
Less: Expenses allowed :		
Interest on Drawings		7,000
Depreciation u/s 32:		
(a) Plant and machinery:		
WDV on 01.04.2010 : 20,000 × 4/5 × 100/16	1,00,000	
Add: Cost of neon-sign board	50,000	
	1,50,000	
Less: Depreciation @15%	22,500	22,500
WDV as on 31.3.11	1,27,500	
(b) Furniture and Fittings:		
WDV on 01/04/10: 20,000 × 1/5 × 100/16	25,000	
Less: Depreciation @10%	2,500	2,500
WDV on 31.3.2011	22,500	
Less: Incomes credited to Profit and Loss A/c to be treated under separate Head of Income		
Interest on Government Securities		20,000
Taxable Business Profits		**9,35,500**

Note :

(1) Loss due to theft of stock-in-trade is allowable in computing business profits u/s 29. Such loss is incidental to business operation. Since purchase of goods have already been debited to profit and loss account, no separate adjustment is required.

(2) Loss in illegal business may be allowed u/s 29. Explanation to Sec.37(1) does not apply to Sec. 29.

(3) Deposit for new telephone connection is allowable u/s 37(1). Hence, no adjustment is required.

Question No.23

The Profit & Loss Account of Mr. Pratam Basu for the previous year 2010-2011 is given below :

Dr. *Cr.*

Particulars	₹	Particulars	₹
Cost of goods sold	16,00,000	Sales	34,70,000
Salaries wages	9,00,000	Rent of staff quarters	3,00,000
Rent of business premises, owned by the assessee	2,50,000	Sale price of machinery block on 31-03-2011	5,00,000
Repairs and renewals	1,40,000		
Income tax paid	60,000		
Excise duty paid	1,00,000		
Sales tax payable	2,00,000		
Legal expenses	3,00,000		
Municipal taxes payable for staff quarters	10,000		
Provision for bad debts	60,000		
Contingency reserve	1,00,000		
Employees contribution to recognised fund	50,000		
Net profit	5,00,000		
	42,70,000		**42,70,000**

Additional Information :

(i) Salaries include:

(a) ₹ 1,20,000 was paid outside India to an employee, "resident" in India but neither tax was deducted nor tax has been paid thereon,

(b) ₹ 90,000 was paid in India to an employee "resident" in India but neither tax deducted therefrom nor paid thereon.

(ii) Excise duty of ₹ 50,000 for the assessment year 2010-2011 was paid on 1 January 2011 but it was not included in the profit and loss a/c.

(iii) Sales tax amounting ₹ 1,30,000 was paid on 31 July 2011 and the balance was paid on 1 August 2011, the due date of furnishing return of income is 31 July 2011.

(iv) Repairs/renewals include remodelling and renovation costing ₹ 80,000.

(v) Legal expenses include:

(a) Lawyer fee of ₹ 50,000 paid by bearer cheque to K, nephew of the proprietor. The Assessing Officer disallowed a sum of ₹ 10,000, being found in excess of the desired qualifications;

(b) Gift of ₹ 1,20,000, made to wife, a tax-advisor, but disallowed by the A.O.

(vi) Employees contribution include:

(a) ₹ 30,000 credited to their account on due date under Provident Fund rules,

(b) ₹ 20,000 credited to their account in November 2011.

(vii) Commission receipts of ₹ 2,00,000 have not been credited to the profit and loss account as their recovery seems to be doubtful.

(viii) WDV of machinery on 01-04-2010 was ₹ 6,50,000.

(ix) WDV of business premises and staff quarters as on 01-04-2010 : ₹ 10,00,000 and ₹ 30,00,000, respectively. Depreciation @ 10% on Business Premises and @ 5% on staff quarters

Compute taxable profits for the previous year 2010-2011.

Solution :

Computation of Business Profits for the Assessment Year 2011-12

	Particulars	**₹**	**₹**
	Net profit as per profits and loss a/c		5,00,000
	Add: Inadmissible Expenses:		
(i)	Rent of business premises owned by the assessee (Sec. 30)	2,50,000	
(ii)	Remodelling and renovation, being repairs of capital nature	60,000	
(iii)	Income tax paid [Sec. 40(a)(ii)l	60,000	
(iv)	Sales tax remaining unpaid up to due date of furnishing return of income	70,000	
(v)	Legal expense includes:		
	(a) Gift made to wife, Sec. 37(1)	1,00,000	
	(b) Fees paid to lawyer (being a relative) Sec. 40A(2)	10,000	
(vi)	Salaries paid outside India to a "resident" employee TDS [Sec. 40(a)(iii)]	1,20,000	
(vii)	Salaries paid in India to a resident employer without TDS	—	
(viii)	Municipal tax payable for staff quarters [Sec. 43B]	10,000	
(ix)	Provision for bad debts [Sec. 36]	60,000	
(x)	Contingency reserve [Sec. 37(1)]	1,00,000	
(xi)	Employees' contribution credited to their account after due date	20,000	
(xii)	Commission receipts which have accrued during the year but recovery seems doubtful seems doubtful	1,00,000	
(xiii)	Employees' contribution not credited to—profit and loss a/c	50,000	10,30,000
			15,30,000
	Less: Inadmissible receipts/ admissible claims:		
(i)	Excise duty (Sec. 43B)	50,000	
(iii)	Sale price of machine, being capital receipts	5,00,000	
(iv)	Depreciation: (a) Staff quarters: 5% of 30,00,000	1,50,000	
	(b) Business Premises: 10% of 10,00,000	1,00,000	8,00,000
	Taxable Business Profits		**7,30,000**

Note :

Sale of machinery block: Sale of machinery block results into short-term capital loss of ₹ 1,50,000 (₹ 6,50,000 -₹ 1,00,000) under Sec. 50. No capital loss, whether short-term or long term, can be set- off against any income. It is to be carried forward for next 8 assessment years

Question No.24

The firm of M/s Amal & Associates is engaged in the business of growing and manufacturing tea. The Profit & Loss Account for the year 2010-2011 is given as follows:

Dr. *Cr.*

Particulars	**₹**	**Particulars**	**₹**
Cost of growing and manufacturing tea	40,00,000	Sales	95,00,000
Salaries and wages	15,00,000	Stock	13,50,000

Advertising	5,00,000	
Entertainment expenses	1,00,000	
Travelling expenses	3,00,000	
Fine and penalties	50,000	
Cost of patent rights	6,00,000	
Expenses on scientific research	6,00,000	
General and sundry expenses	2,00,000	
Net profit	30,00,000	
	1,08,50,000	**1,08,50,000**

You are further informed :

(i) Advertising includes payment of ₹ 2,00,000 made to a political party for insertion of advertisement in party's journal. The payment has been made by bearer cheque,

(ii) Travelling expenses include a visit of the director to UK for 10 days (including 2 days for travelling). Five days were utilized for business purpose. Permission for foreign exchange was granted for ₹ 50,000. Total expenditure on the visit is ₹ 1,00,000 (including air fare of ₹ 40,000).

(iii) Expenses on scientific research include:

(a) Purchase of land ₹ 1,50,000

(b) Contribution to Agricultural Research Institute, New Delhi which is a National Laboratory ₹ 20,000.

(c) Contribution to Bhaba Atomic Research Centre (an approved research association) for statistical research, which is not related to business ₹ 30,000.

(iv) Refund of custom duty, deducted in the previous year, 2008-2009, amounting to ₹ 50,000, has not been credited to the profit and loss account.

(v) Sundry expenses include a contribution of ₹ 60,000 to Kolkata Municipal Corporation for undertaking a Drinking Water Project for slum-dwellers The Project has been approved by National Committee but KMC has not issued any certificate indicating the progress of the project.

(vi) A deposit of ₹ 12,00,000 was made in instalments with National Bank for Agriculture and Rural Development (a) ₹ 4,00,000 in September 2010, (b) ₹ 6,00,000 in July 2011 and (c) ₹ 2,00,000 in December 2011. It has not been included in the profit and loss account. Date of submitting return of income 30/09/2011.

(vii) (a) W.D.V. of machinery on 01-04-2010 (Rate of depreciation 15%) ₹15,00,000

(b) Machinery purchased in December 2010 for scientific research ₹ 5,00,000

(c) Purchase of five small drier machine, each costing ₹10,000

(d) Sale price of an old machinery (Rate of depreciation 15%) ₹ 6,00,000

(viii) Lump sum payment of ₹ 5,00,000 was made to acquire a licence regarding technical information to improve tea-flavour. It has not been charged to P/L a/c.

Compute the taxable business profits for the assessment year 2011-2012.

Solution :

Computation of Business Profits for the Assessment Year 2011-2012

Particulars	**₹**	**₹**
Net profit		30,00,000
Add: Inadmissible Expenses:		
1. Advertisement payment to a political party [Sec. 37(2B)]	2,00,000	
2. Travelling outside India [Sec. 37(1)]. Proportionate expenses of foreign travel, (excluding air fare) not relating to business: (60,000 × 3/8)	22,500	
3. Fine and penalties	50,000	

4. Cost of patent rights		6,00,000	
5. Expenditure on scientific research (Sec. 35): Purchase of land		1,50,000	
6. Contribution to Bombay Municipal Committee (Sec. 35 AC):		60,000	10,82,500
Since the Certificate indicating progress in the prescribed form has not been issued, no deduction is allowed.			40,82,500
Add: Deemed profit: Refund of Customs Duty, deducted in earlier years, not credited in the profit and loss a/c [Sec.41(1)]			50,000
Less: Admissible expenses:			
Capital expenditure on scientific research [Sec.35(1)(iv)(2)]		4,00,000	
Depreciation on Patent rights @ 25% of ₹ 6,00,000		1,50,000	
Depreciation on know-how: @ 25% of ₹ 5,00,000		1,25,000	
Depreciation on Machinery:			
WDV as on 01/04/2010:	15,00,000		
Add: Purchase of driers	50,000		
	15,50,000		
Less: Sale of Old Machinery	5,00,000		
WDV as on 31/3/2011	**10,50,000**		
Depreciation @ 15% on ₹ 10,50,000			
Weighted Deduction for scientific research:		1,57,500	
(i) National Laboratory: @ 125% of ₹ 20,000= ₹ 25,000 – ₹ 20,000 = ₹ 5,000			
(ii) Bhaba Atomic Research Laboratory: @ 125% of ₹ 30,000 = ₹ 37,500 – ₹ 30,000 = ₹ 7,500			
Therefore, total deduction ₹(5,000 + 7,500)		12,500	8,45,000
Composite Profits before making deduction u/s 33AB			**32,87,500**
Less: Deposit with NABARD (Sec.33AB)			
Least of the followings:			
(i) Deposit of ₹ 10,00,000 (within the due date of submission of return)			
(ii) 40% of Business Profits: 40% of ₹ 32,87,500 = ₹ 13,15,000			10,00,000
Composite Profits after deduction u/s 33AB			**22,87,500**
Apportionment of profits into agricultural income and business income (As per Rule 8)[since the assessee is engaged in the business of growing and manufacturing tea: 40% of ₹ 22,87,500			**9,15,000**

Question No.25 (a) : State whether the provisions or Sec. 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.

Answer: This question has been answered by the Apex Court in Polyflex (India) Pvt. Ltd. *v.* CIT [2003] 257 ITR 343. (SC)

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

Question No.25 (b) 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 the year. Discuss the validity of the claim.

Answer: 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 No.26

A firm comprising of four partners A, B, C and D carrying on business in partnership, sharing profits/losses equally shows a profit of ₹ 2,00,000 in its books after deduction of the following amounts for the year :

	Particulars	**₹**
(a)	Remuneration to partner 'A' who is not actively engaged in business	60,000
(b)	Remuneration to partners 'B' & 'C' actively engaged in business	
	Partner 'B'	80,000
	Partner 'C'	90,000
(c)	Interest to partner 'D' on loan of ₹ 1,50,000	36,000

The deed of partnership provides for the payment of above remuneration and interest to partners. You are required to work out the taxable income of the firm as well as partners for assessment year 2011-12.

Solution :

Computation of Income under the head Profits and Gains of Business or Profession

Particulars				**₹**
Net profit as per P/L A/c				2,00,000
Add : **Inadmissible expenses —**				
(i)	Remuneration to A (not an active partner) – disallowed u/s 40(b)			60,000
(ii)	Remuneration to B and C – (considered separately [₹ 80,000 + 90,000]			1,70,000
(iii)	Interest paid to D on Loan advanced			36,000
Net Profit before Interest and Remuneration to Partners				**4,66,000**
Less : Maximum Permissible Interest u/s 40(b) @ 12% on Loan from D = ₹ 1,50,000 × 12% p.a.				18,000
Book Profit				**4,48,000**
Less : Maximum Permissible Remuneration to **B** and **C** u/s 40(b)				
(i)	upto ₹ 3,00,000 – ₹ 1,50,000 or 90% of Book Profits, whichever is higher	= 2,70,000		
	Balance of Book Profits – 60% of Book Profits = 60% of 1,48,000	= 88,800	3,58,000	
(ii)	Actual Remuneration paid			
	lower of (i) & (ii), allowed as deduction		1,70,000	1,70,000
	Taxable Income			**2,78,000**

Taxable income of the partners

Particulars	**A**	**B**	**C**	**D**
Remuneration	Nil	80,000	90,000	Nil
Interest	Nil	Nil	Nil	18,000
Taxable income	Nil	80,000	90,000	18,000

Working notes :

(1) In the case of a firm, remuneration to a partner who is not a working partner is not eligible for deduction. In the case of working partners the remuneration paid is disallowed if it exceeds the limit prescribed u/s 40(b) with reference to "book profit".

Book working partners remuneration is worked out as under :

	₹
First ₹ 3,00,000 of the book profit @ 90%	2,70,000
On the balance ₹ 1,98,000 of book profit @ 60%	1,18,800
Total	**3,88,800**

(2) Any interest and salary to partners disallowed in the firm's case shall not be included in the total income of the partner and shall not be chargeable to tax in the partner's hands.

(3) Share of profits of the partners is exempt u/s 10(2A) of the Income-tax Act and therefore, not included in the partner's taxable income.

Question No.27: Bharat, owner of Great India Roadways, furnishes following details for the A.Y. 2011-12.

	₹
Revenue from customers	31,00,000
Less : **Expenses**	
Rent of office premises	1,80,000
Rent of godown	2,40,000
Truck Driver salary	5,00,000
Allowance to truck driver	1,20,000
Cost of petrol, diesel, etc	7,50,000
Other expenses other than depreciation	2,00,000
Income from business without charging depreciation	**11,10,000**

Additional Information :

Great India Roadways have following details of its assets —

Assets	Written down value as on 1.4.2010
Office Premises	₹ 2,50,000
Machinery block (30%) consists of —	₹ 20,00,000
— 2 Diesel engine trucks of 13000 kgs each	
— 2 Diesel engine trucks of 10000 kgs each	
— 1 Petrol engine truck of 12000 kgs	

During the year, he purchased 2 medium-size-truck (petrol engine) for ₹ 3,50,000 each on 13.7.2010. However, 1 petrol engine truck of 12,000 kgs was sold on 9.9.2010 for ₹ 1,00,000.

Compute his income under the head Profits & gains of business or profession.

Solution :

Computation of Profits & Gains of Business or Profession of Shri Bharat for the A.Y. 2011-12

Particulars	Amount
Net profit as per Profit and Loss A/c	11,10,000
Less : **Expenditure allowed but not debited to P & L A/c**	
Depreciation u/s 32 (Note)	8,05,000
Profits & gains of business or profession	**3,05,000**

Note : Computation of depreciation allowed u/s 32

Particulars	Details	Amount
Block 1 : **Office Premises @ 10%**		
W.D.V. as on 1.4.2010	2,50,000	
Add : Purchase during the year	Nil	
	2,50,000	
Less : Sale during the year	Nil	
	2,50,000	
Depreciation @ 10% on ₹ 2,50,000		25,000
Block 2 : **Trucks @ 30%**		
W.D.V. as on 1.4.2009	20,00,000	
Add : Purchase during the year	7,00,000	
	27,00,000	
Less : Sale during the year	1,00,000	
	26,00,000	
Depreciation @ 30% on ₹ 26,00,000		7,80,000
Depreciation allowed u/s 32		8,05,000

Alternative II: Computation of income u/s 44AE

No. of vehicle	Type of goods carriage	Month including part of month	Details	Income ₹
2 Diesel engine trucks of 13000 kgs each	Heavy	12	3500×12×2	84,000
2 Diesel engine trucks of 10000 kgs each	Other vehicle	12	3150×12×2	75,600
1 Petrol engine truck of 12000 kg	Other vehicle	6	3150×6×1	18,900
2 medium size truck	Other vehicle	9	3150×9×2	56,700
Profit and gains of business or profession				**2,35,200**

Income of the assessee under the head Profits & gains of business or profession shall be ₹ 2,35,200 u/s 44AE.

Question No.28:

During the previous year 2010-11, profit and loss account of Shri Amarnath, proprietor of Free Bird Enterprises engaged in the business of dye-made garments, shows profits of ₹ 4,50,000. With the following information, compute his taxable income from business -

(a) Interest on capital ₹ 5,000

(b) Purchases include goods of ₹ 42,000 from his younger brother in cash. However, market value of such goods is ₹ 35,000.

(c) Interest paid outside India ₹ 1,00,000 without deducting tax at source.

(d) Penalty paid to local government for non-filing of sales tax return ₹ 5,000

(e) Penalty paid to customer for non-fulfilling of order within time ₹ 10,000

(f) Bad debts ₹ 1,00,000. Money has been advanced for purchase of Building.

(g) Revenue expenditure on promoting family planning among employees ₹ 10,000.

(h) Premium paid on health of employees ₹ 6,000 in cash

(i) Premium paid on health of his relatives ₹ 6,000 in cheque

(j) Employer's contribution to RPF ₹ 12,000. One-half of the amount is paid after due date as per relevant Act but before 31.3.2010

(k) Employees contribution to RPF ₹ 10,000. ½ of the amount is paid after due date as per relevant Act.

(l) Interest on late payment of sales tax ₹ 1,000 (yet to be paid)

(m) Interest on loan from State Bank of India ₹10,000 (₹ 5,000 is not paid till due date of filing of return)

(n) Interest on late refund from income tax department ₹ 500

(o) He received ₹ 80,000 from a debtor at a time in cash.

(p) Recovery of bad debt ₹10,000 (out of which ₹ 8,000 was allowed as deduction during AY. 2006-07)

(q) Depreciation (being not debited in accounts) ₹ 20,000 allowed as deduction u/s 32

Solution :

Computation of Profits and gains of business or profession of Shri Amarnath for the AY. 2011-12

Particulars	Note	Details	Amount
Net profit as per Profit and Loss account			4,50,000
Add : **Expenditure disallowed but debited in P &L A/c**			
Interest on capital	1	15,000	
Payment to relative in excess of market value of goods	2	7,000	
Interest paid outside India without deducting tax at source	3	1,00,000	
Penalty paid to local government for non-filling of sales tax return	4	5,000	
Bad debt	6	1,00,000	
Premium paid on health of employees in cash	8	6,000	
Premium paid on health of his relatives in cheque	9	6,000	
Employees contribution to RPF	11	5,000	
Interest on loan from State Bank of India	13	5,000	2,49,000
			6,99,000
Less : Expenditure allowed but not debited in P & L A/c			
Depreciation u/s 32		20,000	
Less : Income not taxable but credited to P & L A/c			
Recovery of bad debts	14	2,000	
Less : Income taxable under other head but credited to P & L A/c			
Interest on late refund from income tax department	15	500	22,500
Profits and gains of business or profession			**6,76,500**

Notes :

(1) Interest on capital to proprietor is not allowed as no one can earn from a transaction with himself. The provider of loan and receiver of loan are same hence does not involves any actual expenses.

(2) Any unreasonable payment to relative is disallowed u/s 40A(2). Hence, ₹ 3,000 is disallowed. Since cash payment towards allowed expenditure (i.e. ₹ 19,000) does not exceed ₹ 20,000, hence provision of sec. 40A(3) is not applicable.

(3) Any salary paid outside India without deducting tax at source is disallowed u/s 40(a).

(4) Any payment made for infringement of law is disallowed.

(5) Payment made for non-fulfilling of contract is not a payment for infringement of law Hence, allowed u/s 37(1).

(6) Bad debt is allowed only when such debt has been taken into account as income of previous year or any earlier previous year(s) [Sec. 36(1)(vii)]. Since, the debt is in respect of purchase of a building, which was not considered as income of any previous year, hence it is disallowed.

(7) Any expenditure for promoting family planning is allowed to company assessee [Sec. 36(1)(ix)]. However, such expenditure (revenue in nature) incurred by assessee other than company shall be allowed u/s 37(1).

(8) Payment of insurance premium on health of employees in cheque is allowed u/s 36(1)(ib).

(9) Payment of insurance premium on health of relative is not related to business, hence disallowed.

(10) Employer's contribution towards RPF is allowed if payment is made before due date of filing of return irrespective of fact that such payment was made after due date prescribed in the relevant Act.

(11) Any sum received from employees as their contribution towards RPF is allowed only when such sum has been credited to such fund within the due date prescribed in the relevant Act [Sec. 36(1)(va)].

(12) Interest on late payment of sales tax is not a penalty but compensatory in nature. Hence, it is allowed u/s 37(1) Further such interest is not governed by the provisions of sec. 43B.

(13) Any interest payable to any scheduled bank is allowed on cash basis [Sec. 43B]. Hence, unpaid amount is disallowed.

(14) Bad debt recovery is treated as income in the year of recovery to the extent of bad debt allowed in the earlier year [Sec. 41(4)]

(15) Interest on late refund of income tax is taxable under the head 'Income from other sources'.

(16) Receipt from debtor ₹ 80,000 in cash is not attracted by provision of sec. 40A(3).

Question No.29

X Ltd., carrying on business in manufacture and sale of textiles, showed a net profit of ₹ 10,50,000 in its Profit and Loss Account for the period ending March 31, 2011. On the basis of the following particulars noted from the company's accounts and ascertained on enquiry, compute, giving reasons, the total income of the company for the assessment year 2011-12. The company maintains books of account on the basis of mercantile system.

1. The general reserve account shows a credit of ₹ 2,75,000 under the head "Surplus on devaluation". The enquiries show that the company had exported textile to U.S.A. during the year 1995-96. The sale proceeds were placed in a separate bank account in U.S.A. which were utrlized for import of cotton from time to time After obtaining permission from the Reserve Bank of India, in January 2011 the company remitted to India a sum of ₹ 2 lakh, being the balance standing to its credit in the said bank account which included the above surplus realized on account of devaluation of the rupee in June 1996. The company claims that the said surplus is not taxable, firstly, on the ground that the said surplus did not relate to the previous year and secondly, the said surplus is not a trading receipt.
2. The company had imported automatic looms under a special permission granted by the Textile Commissioner under the Cotton Textile (Control) Order, 1948. One of the conditions laid down while granting the permission was that the company should execute a bond in favour of President of India agreeing to export an agreed quantify of cloth and in default pay a sum calculated at the rate of 10 paise per metre to cover the shortfall. The company fell short of the target during the previous year as a result of which it was required to pay a sum of ₹ 40,000 towards the shortfall. The company has debited the said amount to "General expenses account".
3. The company has set up a laboratory for conducting research in textile technology. It has incurred a capital expenditure of ₹ 1,00,000 for the said purpose. The amount is shown in the balance sheet us "Laboratory equipment account" but is claimed as deduction in the return of income for the assessment year 2011-12.
4. The interest account includes payments amounting to ₹ 50,000 on deposits made by non-resident buyers of textile manufactured by the company. The said payments were made outside India without deduction of tax.
5. The legal charge includes a sum of ₹ 60,000 paid to solicitors for framing a scheme of amalgamation of all other textile mill with the assessee-company. The scheme is approved by the Central Government in public interest.
6. Travelling expenses include a sum of ₹ 1,25,000 being expenditure incurred by the directors of the company in connection with their tour to USA and UK for the purchase of new machinery for setting up a new plant for manufacture of caustic soda.
7. ₹ 1,00,000 (debited to profit and loss account) is paid to an approved Notional Laboratory with a specific direction that it shall be used for on approved scientific research programme.

Solution :

		₹
Net profit as per Profit and Loss Account		10,50,000
Adiustments :		
Surplus arose on conversion of foreign currency into Indian currency (since foreign currency was kept for purchasing stock-in-trade, it will be revenue receipt)		(+) 2,75,000
Payment of ₹ 40,000 towards the shortfall in export (allowable as deduction since the payment is not penalty)		—
Capital expenditure on scientific research		(–) 1,00,000
Interest to non-residents [not deductible under section 40(a) since payment was made without deducting tax at source]		(+) 50,000
Legal charges for framing amalgamation scheme [deductible u/s 35DD in five years)		(+) 48,000
Travelling expenses of directors [section 37(1) does not permit a deduction of capital expenditure]		(+) 1,25,000
Weighted deduction under section 35(2AA) in respect of ₹ 1,00,000 paid to a National Laboratory [amount deductible is 125% of ₹ 1,00,000,		(–) 25,000
(–) Amount	1,25,000	
Show in P/L A/c	1,00,000	
Expenses not debited earlier	25,000	
Net Income		**14,23,400**

Question 30: Bharat, owner of Great India Roadways, furnishes following details for the A.Y. 2011-12.

	₹
Revenue from customers	40,00,000
Less : **Expenses**	
Rent of office premises	1,80,000
Rent of godown	2,40,000
Truck Driver salary	5,00,000
Allowance to truck driver	1,20,000
Cost of petrol, diesel, etc	7,50,000
Other expenses other than depreciation	2,00,000
Income from business without charging depreciation	20,10,000

Additional Information :

Great India Roadways have following details of its assets —

Assets	Written down value as on 1.4.2010
Office Premises	₹ 2,50,000
Machinery block (30%) consists of —	₹ 22,00,000
— 2 Diesel engine trucks of 13000 kgs each	
— 2 Diesel engine trucks of 10000 kgs each	
— 1 Petrol engine truck of 12000 kgs	

During the year, he purchased 2 medium-size-truck (petrol engine) for ₹ 3,50,000 each on 13.7.2010. However, one petrol engine truck of 12,000 kgs was sold on 9.9.2010 for ₹ 1,00,000.

Compute his income under the head Profits & gains of business or profession.

Solution :

Computation of Profits & Gains of Business or Profession of Shri Bharat for the A.Y. 2011-12

Particulars	Amount
Net profit as per Profit and Loss A/c	20,10,000
Less : **Expenditure allowed but not debited to P & L A/c**	
Depreciation u/s 32 (Note)	8,65,000
Profits & gains of business or profession	**11,45,000**

Note : Computation of depreciation allowed u/s 32

Particulars	Details	Amount
Block 1 : **Office Premises @ 10%**		
W.D.V. as on 1.4.2010	2,50,000	
Add : Purchase during the year	Nil	
	2,50,000	
Less : Sale during the year	Nil	
	2,50,000	
Depreciation @ 10% on ₹ 2,50,000		25,000
Block 2 : **Trucks @ 30%**		
W.D.V. as on 1.4.2009	22,00,000	
Add : Purchase during the year	7,00,000	
	29,00,000	
Less : Sale during the year	1,00,000	
	28,00,000	
Depreciation @ 30% on ₹ 26,00,000		8,40,000
Depreciation allowed u/s 32		8,65,000

Alternative II : Computation of income u/s 44AE

No. of vehicle	Type of goods carriage	Month including part of month	Details	Income ₹
2 Diesel engine trucks of 13000 kgs each	Heavy	12	3500×12×2	84,000
2 Diesel engine trucks of 10000 kgs each	Other vehicle	12	3150×12×2	75,600
1 Petrol engine truck of 12000 kg	Other vehicle	6	3150×6×1	18,900
2 medium size truck	Other vehicle	9	3150×9×2	56,700
Profit and gains of business or profession				**2,35,200**

Income of the assessee under the head Profits & gains of business or profession shall be ₹ 2,35,200 u/s 44AE.

Question No.31 (a):

The depository account shows the following details of M's holdings:

Date of Credit	Particulars	Quantity
10.11.2001	Shares of XYZ LTD.purchased in physical form on 10.11.2001 @ ₹ 20 per share	300
30;11.2002	Purchased dematerialised shares of Y Ltd. on 25.11.2002 @ ₹ 70 per share	500
06.12.2004	Shares of XYZ LTD. held in physical form, were got dematerialised on 01.12.2004	

M sold 600 dematerialised shares on 6th June 2010 @ ₹ 200 per share. Brokerage is paid @2% of sale price. Compute capital gains.

Solution :

(a) Person Liable : The sale of shares held under Dematerialized format with a depository is chargeable to tax as the income of the beneficial owner.

(b) Cost of Acquisition and period of holdings : The cost of acquisition and the period of holding shall be determined on FIFO Method. [Circular No. 768 datd 24.6.1998]

(i) FIFO method will be applied for each account independently.

(ii) When physical stock is dematerilized, the date of credit into the depository account shall be considered for the purpose of FIFO method, but indexed cost of acquisition shall be computed on the basis of year of acquisition.

			₹
Consideration for Transfer			
600 Share @ ₹ 180 per share			1,20,000
Less :	Indexed Cost of Acquisition		(55,671)
	(i)	(500 x 70 x 711 / 447)	
	(ii)	(100 x 20 x 711/480)	(2,693)
	Long Term Capital Gain		**61,636**

Question No.31(b)

Nisith acquired a property by way of gift from his father in the previous year 1988-89 when its FMV was ₹ 3 lacs. His father had acquired the property during 1981-82 for ₹ 4 lacs. This property was introduced as capital contribution to a partnership firm in which Nisith became a partner on 15.6.2010. The market value of the asset as on that date was ₹ 20 lacs, but it was recorded in the books of account of the firm at ₹ 17 lacs. Is there any capital gain chargeable in the hands of Mr. Nisith?

Solution :

Computation of Capital Gains

		₹
Consideration for Transfer		17,00,000
Less :	Indexed Cost of Acquisition (4,00,000 x 711/191)	17,66,460
	Long Term Capital Loss	**66,460**

(a) Full value of consideration is taken as the value at which it is recorded in the books of accounts of the firm.

(b) Cost of acquisition is taken as cost to the previous owner but indexation has ben done from the date it was first held by the assessee.

(c) Market value of the aset on the date of transfer is not relevant.

Question No.32(a):

PQR & Co. is a partnership firm, consisting 3 partners P, Q and R. the firm is dissolved on 31.12.10. The assets of the firm were distributed to the partners as under :

Particulars	Block of machinery (given to P)	Stock (given to Q)	Land (given to R)
Year of acquisition	1990-91	2002-03	1978-79
Cost of acquisition (₹)	7,20,000	4,00,000	10,000
Market value as on 31.12.10	15,00,000	6,00,000	25,00,000

WDV as on 31.12.10	10,40,000	—	—
Value at which given to partners as per agreement	10,00,000	4,50,000	18,00,000
Market value as on 1.4.81	—	—	2,70,000

Compute the income taxable in the hands of the firm for the assessment year 2011-12. What shall be the cost of acquisition of such assets to the partners of the firm?

Solution :

Computation of Short Term Capital Gains on block of Machinery

		₹
Sale consideration (i.e. the market value)		15,00,000
Less :	Cost of Acquisition (WDV of the block)	10,40,000
	Short Term Capital Gains	**4,60,000**

Income from Business (on transfer of stock)

	₹
Market value of stock	6,00,000
Less : Cost of Acquisition	4,00,000
	2,00,000

Computation of Capital Gains on transfer of Land

		₹
Consideration for transfer		25,00,000
Less :	Indexed cost of Acquisition :	19,19,700
	(2,70,000 x 711/100)	
	Long term capital gains	**5,80,300**

Cost of acquisition of assets to the Partners

		₹
Partner "P"		1,00,000
Partner "Q"		4,50,000
Partner "R"		18,00,000
Less :	Indexed cost of Acquisition :	
	(2,70,000x711/100)	(19,19,700)
Long Term Capital Gains		**4,80,300**

Question No.32 (b):

A firm consists of 3 partners X, Y & Z. Z retires from the firm on 15.10.2009. His capital balance and the profits till the date of retirement stood at ₹ 16 lacs. The firm transferred Its land to Z in settlement of his account. The market value of the land as on that date was ₹ 30 lacs. The land was acquired by the firm on 1.5.93 for ₹ 4 lacs.

Compute the capital gains in the hands of the firm.

Solution:

Computation of Long Term Capital Gains for the A.Y. 2011-12

		₹
Consideration for Transfer		30,00,000
Less :	Indexed Cost of Acquisition (4,00,000 x 711/244)	11,65,574
	Long Term Capital Gains	**18,34,421**

Question No.33 (a):

A holds 15,000 shares (10% of total share holding) in B Ltd. which he had purchased on 10.2.96 for ₹ 6,00,000. The company went into liquidation on 16.7.2010 and paid a sum of ₹ 20 per share in cash and an asset whose market value as on the date of distribution i.e. 5.10.10 was ₹ 18,20,000 to A. the accumulated profits of the company were ₹ 15 lacs.

(a) Compute the income of A for the A.Y. 2011-12 assuming that he has no other income.

(b) Compute the capital gain chargeable to tax if the asset of B Ltd. is sold by A for ₹ 15 lacs on 28.3.11.

Solution :

Computation of Capital Gains of Mr. B for the A.Y. 2011-12

		₹
(a)	(i) Capital Gain on transfer of shares	
	Total consideration (15,000×20+18,20,000)	21,20,000
	Less : Proportionate amount of deemed dividend	
	(10% of ₹ 12,86,353)	(1,28,635)
	Less : Indexed Cost of Acquisition	(15,18,149)
	(6,00,000 x 711 /281)	
	Long Term Capital Gains	**4,73,216**
	(ii) **Income from others Sources**	
	Dividend from Indian Company	Exempted
		4,73,216
(b)	**Capital Gain on transfer of asset (B Ltd.)**	
	Full Value of Consideration	15,00,000
	Less : Cost of Acquisition (being the market value as on the date of distributions)	13,20,000
	Short Term Capital Gains	**1,80,000**
	Accumulated Profits	**15,00,000**

Dividend tax @ 16.60875% (= 15% + 7.5% + 2% Education Cess + 1% SHEC)

Hence, the amount to be distributed plus tax @ 16.60875%

on such amount should be ₹ 15,00,000

Amount of tax = ₹ 2,13,6470

Profits available for distribution = ₹ (15,00,000 – 2,13,647) = ₹ 12,86,353.

Question No 33(b):

Rohit purchased a house in Delhi in December 2004 for ₹ 2,50,000. In March 2010, he entered into an agreement to sell the property to Z for a consideration of ₹ 5,00,000 and received an earnest money of ₹ 50,000. As per the terms of agreement, the balance payment was to be made within 30 days of the agreement. If the intending purchaser does not make the payment within 30 days, the earnest money would be forfeited. As Z could not make the payment within the stipulated time the amount of ₹ 50,000 was forfeited by Rohit. Subsequently, on 16.6.10, Rohit sold the house to Mohit for ₹ 6,00,000. He paid 3% brokerage on sale of the house. Compute capital gains chargeable to tax for the assessment year 2011-12.

Solution :

Computation of Capital Gains for the A.Y. 2011-12

	₹
Consideration for transfer	6,00,000
Less : Expenses on transfer (Brokerage @ 3% on 6,00,000)	18,000
Net Consideration	**5,82,000**

Less : **Indexed Cost of Acquisition**		
Cost of Acquisition	2,50,000	
Less : Amount received and forfeited (u/s 51 to be adjusted against cost)	50,000	
Net Cost of Acquisition	2,00,000	
Indexed Net cost of Acquisition		
(2,00,000 x 711/480)		2,96,250
Long Term Capital Gains		**2,85,750**

Question No.34(a): On 16th January 2011, Suman sold agricultural land for ₹ 22 lacs. He incurred selling expenses for ₹50,000. Compute capital gains :

If the land sold, was purchased on 1st February 1995 for ₹ 4 lacs, and the land was used for agricultural purposes by his mother.

He again purchased agricultural land of ₹ 8 lacs on 25th January 2011.

Amount deposited in a scheduled bank under "Capital Gains Deposit Scheme. ₹ 4 lacs on 6th April 2011.

Solution : **Computation of Capital Gains for the A.Y. 2011-12**

	₹
Consideration for transfer	22,00,000
Less : Expenses on transfer	50,000
Net Consideration	**21,50,000**
Less : Indexed Cost of Acquisition	(10,98,069)
(4,00,000 x 711/259)	
Long-term Capital Gains	10,51,931
Less : **Exemption u/s 54B**	
Cost of New Land purchased	8,00,000
Less : Amount deposited in "Capital Gains Account Scheme" before due date of furnishing return specified u/s 139(1) ₹ 4,00,000	
or the balance amount of capital gains, ₹ (10,51,931–8,00,000) = ₹ 2,51,931 whichever is less	2,51,931
Taxable long term Capital Gains	**NIL**

Question No.34 (b)

Anand sold a residential building at Kolkata for ₹ 25,60,000 on 1.11.2010. The building was purchased during 1979-80 for ₹ 1,45,000. FMV as on 1.4.81 ₹ 2,75,000. Brokerage paid on sales @ 2%. deposited ₹ 8 lakhs in NHAI Capital Gains Bond in February 2011. Compute Taxable Capital Gains.

Assessee: Anand

Computation of Taxable Capital Gains for the A.Y. 2011-12

Particulars		**Amount (₹)**
	Consideration for Transfer	25,60,000
Less:	Expenses on Transfer (i.e. Brokerage @ 2% on ₹ 25,60,000)	51,200
	Net Consideration	**25,08,000**
Less:	Indexed Cost of Acquisition	19,55,250
	= ₹ (2,75,000 × 711/100)	
	Long term Capital Gains	**5,52,750**
Less:	Exemption u/s 54 EC	

Amount invested in NHAI Bonds ₹ 8 lakhs. Deduction restricted upto the balance of LTCG	5,52,750
Taxable Capital Gains	**Nil**

Question No.35

Bipasha purchased jewellery worth ₹ 2,20,000 during 1985-86. During the year 1990-91, she further purchased jewellery worth ₹ 3,50,000. All the jewellery was sold by her on 15.6.10. The jewellery purchased in 1985-86 was sold for ₹ 20 lacs and that purchased in 1990-91 was sold for ₹ 32 lacs. On 26.6.10 she deposited ₹50 lacs in Capital Gains Scheme account. On 21.10.10 withdrawing from the Deposit Account, she utilised ₹ 48 lacs for purchase of a residential house property in Kolkata. On the date of transfer she owns only one residential house.

Solution :

Computation of Capital Gains for the A.Y. 2011-12

		₹
(a)	**On transfer of jewellery purchased during 85-86**	
	Consideration for transfer	20,00,000
	Less : **Indexed Cost of Acquisition**	
	(2,20,000 x 711/133)	(11,76,090)
	Long-term Capital Gains	**8,23,910**
(b)	**On transfer of jewellery purchased during 1990-91**	
	Consideration for transfer	32,00,000
	Less : **Indexed Cost of Acquisition**	
	(3,50,000 x 711/ 182)	(13,67,308)
	Long term capital gains	**18,32,692**

In order to avail the maximum benefit u/s 54F, the exemption should be computed as follows :

	Total long-term Capital Gain (8,23,910 + 18,32,692)	26,56,602
Less :	Exemption u/s 54F	
		25,54,425
	Taxable Long-term Capital Gains	**1,02,177**

Note :

1. In this case, Bipasha has not fully utilised the deposit account for acquiring a residential house property. Out of ₹ 50 lacs deposited for acquiring the house, it is utilised to the extent ₹ 48 lacs.

Tax treatment of unutilised amount, will be as follows :-

		₹
(a)	Unutilised amount	2,00,000
(b)	Net sale consideration	52,00,000
(c)	Original Capital Gain	26,56,602
(d)	Notional Long-term Capital Gain	1,02,177
(e)	Effective exemption u/s 54F	24,52,248
	[₹ 25,54,425 – 1,02,177]	

₹ 1,02,177 will be chargeable to tax as long-term capital gain after expiry of 3 years from the date of transfer of jewellery (i.e. 15.6.10). Consequently it will be taxable for the assessment year 2014-15.

2. The unutilised amount of ₹ 2 lacs can be utilised by Bipasha at any time after 15.6.10.
3. If Bipasha sells this new house property before 21.10.13, then ₹ 24,52,248 (exemption u/s 54F) will be to tax as long-term capital gain of the year in which the house is sold.

4. If Bipasha purchases another house before 15.6.12 or constructs any other house (income of which is taxable u/s 22) before 15.6.13, then ₹ 24,52,248 (exemption u/s 54F) will be deemed as long-term Capital gain of the year in which another house is purchased or constructed.

Question No.36

P Ltd. owns an industrial undertaking manufacturing chemicals in Bangalore owns the following assets

(a) Plant and machinery (WDV ₹5 lacs) sold for ₹15 lacs.

(b) Building (WDV ₹ 12 lacs) sold for ₹ 60 lacs.

(c) Furniture and fixtures (WDV ₹ 50,000) sold for ₹ 1,80,000

(d) Land cost of acquisition ₹ 5,00,000 during 1984-85 and sold for ₹ 30 lacs

The industrial undertaking was shifted as per policy of the Government from urban area to other area. The new assets acquired during the period 1.1.11 to 31.3.11 are as under:

Plant and machinery ₹ 20 lacs; Buildings ₹ 40 lacs.

Compute capital gain chargeable to tax for the assessment year 2011-12.

Solution :

Short-term Capital Gains on Depreciable assets

			₹
(i)	Plant & Machinery (15,00,000 – 5,00,000)	10,00,000	
(ii)	Buildings (60,00,000 – 12,00,000)	48,00,000	
(iii)	Furniture & Fixtures (1,80,000 – 50,000)	1,30,000	59,30,000
	Long-term Capital Gains on Industrial Land :		
	Consideration for transfer	30,00,000	
	Less : **Indexed Cost of Acquisition**		
	(5,00,000 x 711/125)	28,44,000	2,56,000
	Total Capital Gains		**59,86,000**
	Less : **Exemption u/s 54G**		
	Plant & Machinery	20,00,000	
	Building	40,00,000	
		65,00,000	
	but restricted to ₹ 58,56,000		
	[= ₹ 59,86,000 —1,30,000, being STCG on furniture,		
	not eligible for the purpose of claining exemption u/s 54G		58,56,000
	Short term Capital Gains (on furniture)		**1,30,000**

Question No.37(a)

Mr JK gets the following gifts during the previous year 2010-2011.

	Date of gift	Name of the donor	Amount of gift (₹)
1.	01.07.2008	Gift from R, a friend, by cheque	50,000
2.	01.09.2008	Cash gift from N, nephew	1,00,000
3.	01.12.2008	Gift of diamond ring on his birthday, by a friend, C	75,000
4.	15.12.2008	Cash gifts of ₹ 31,000 each made by four friends on the occasion of his marriage	1,24,000
5.	01.12.2009	Cash gift made by wife's sister on house opening ceremony	51,000

6.	15.01.2009	Cash gift from a close friend of father-in-law.	1,51,000
7.	31.01.2009	Cash gift made by great-grandfather	1,51,000
8.	01.02.2009	Cash gift received under the Will of a friend, who is seriously ill.	51,000
9.	15.02.2009	Cash gift made by a business friend on his birthday	75,000
10.	31.03.2009	Cash gifts made by three friends of ₹ 25,000 each	

Besides this, JK is engaged in the business of sale and purchase of retail goods. He maintains no account books. Gross turnover from retail trading is ₹ 35,00,000. Compute his total income for the assessment year 2011-2012.

Solution : Computation of taxable income for the AY 2011-2012

Particulars	Amount (₹)
1. Income from retail trading business [Sec. 44 AF] 5% ₹ 35,00,000	1,75,000
2. Income from other sources (money gifts):	
(i) Cash gift from a friend, by cheque	50,000
(ii) Cash gift from nephew, not covered by the definition of relative	1,00,000
(iii) Gift of diamond ring — non-monetary gift not taxable	—
(iv) Cash gifts on the occasion of marriage are not chargeable even if such gifts are made by unrelated persons	—
(v) Cash gift made by wife's sister, a relative, not taxable	—
(vi) Cash gift by a friend of father-in-law, unrelated person	1,51,000
(vii) Cash gift made by great-grand father, a relative	—
(viii) Cash gift received under Will in contemplation of death of a friend	—
(ix) Cash gift made by a business friend on his birthday	51,000
(x) Cash gifts, made by three friends, of ₹ 25,000 each	75,000
Total Income	**6,02,000**

Question No.37(b)

The shareholding of Mr K and Mrs K in S Ltd, is given as follows:

(i)	Shareholding of K	7%
(ii)	Shareholding of Mrs K	9%
(iii)	Shareholding of M, brother of K	8%
(iv)	Shareholding of F, father of Mrs K	5%

Mr K and Mrs K are employed with S Ltd. None of them hold technical qualification. Mr K gets salary @ ₹ 10,000 p.m and Mrs K gets @ ₹ 12,000 p.m.

Income from other sources:	₹
Mr K	80,000
Mrs K	1,00,000

Compute Total Income for the assessment year 2011-2012

Solution : **Computation of Total Income for the AY 2011-12**

Particulars	Mr.K	Mrs.K
1. Gross Salary	1,20,000	1,44,000
Salary income of Mr.K to be included in the total income of Mrs.K as her income from other sources is greater and both of them have substantial interest alongwith their relative in s Ltd.		1,20,000
2. Income from other sources	80,000	1,00,000
Total Income	2,00,000	3,64,000

Question No.38(a): XYZ & Co., a partnership firm, submits the following particulars of its income and carry forward losses for the previous year 2010-2011:

Particulars	Betting on race horses made lawfully (₹)	Betting on race horses made illegally (₹)
1. Gross prize on race horses	15,00,000	5,00,000
2. Expenses incurred:		
(i) Horses purchased during the year	6,00,000	75,000
(ii) Medical expenses	1,00,000	20,000
(iii) Animal trainer fees	50,000	15,000
(iv) Fodder expenses	2,60,000	50,000
(v) Stable-rent/insurance	1,20,000	36,000
(vi) Depreciation in the value of horses	4,60,000	1,50,000
(vii) Staff salaries	1,00,000	40,000
3. Loses brought forward from the assessment year 2009-2010	6,00,000	2,00,000

Solution:

Computation of Total Income for the Assessment Year 2011-12

Particulars	Betting on race horses made lawfully (₹)	Betting on race horses made illegally (₹)
Gross prize		
Less*:* Expenses incurred:	15,00,000	15,00,000
(i) Horses purchased—not allowed	—	—
(ii) Medical expenses	(-) 1,00,000	(-) 20,000
(iii) Animal trainer fees	(-) 50,000	(-) 15,000
(iv) Fodder expense	(-) 2,60,000	(-) 50,000
(v) Stable rent/insurance	(-) 1,20,000	(-) 36,000
(vi) Staff salaries	(-) 1,00,000	(-) 40,000
(vii) Depreciation in the value of horses—not allowed	—	—
	8,70,000	**3,39,000**
Less: Brought forward loss	6,00,000	Nil
	2,70,000	**3,39,000**

Total income of the firm = (2,70,000 + 3,39,000) = 6,09,000

Note:

"Horse race" means a horse race upon which wagering or betting may be lawfully made [Explanation (b) to Sec. 74A]. Thus, where wagering or betting is not lawfully made on race horses, any loss incurred on such betting can neither be set-off nor carried forward. Hence, the carried forward loss of ₹ 2,00,000 cannot be set-off.

Question No.38(b):

A discloses the following incomes from business or profession for the previous year 2011-2012:

		₹
(i)	Profit from X business	6,00,000
(ii)	Loss from Y business	(-) 2,00,000
(iii)	Loss from profession Z	(-) 2,50,000
(iv)	Profit from speculation business – M	2,00,000
(v)	Loss from speculation business – N	(-) 3,00,000

Determine the income from business or profession for the assessment year 2011-2012

Solution: Income from business-profession for the AY 2011-2012

Particulars	**₹**
(i) X	6,00,000
(ii) Y	(-) 2,00,000
(iii) Z	(-) 2,50,000
Total Income from Non-Speculation Business and Profession	1,50,000
Income from Speculation Business	
(i) M	2,00,000
(ii) N	(-)3 ,00,000
Loss from speculation business	(-) 1,00,000

Speculation loss cannot be set-off against the income from business profit, though both of them fall under the same head of income.

Thus, taxable business profits for the assessment year 2011-2012 is ₹ 1,50,000. The speculation loss will be carried forward for future set-off for 4 assessment years, immediately succeeding the assessment year for which it was first computed [Sec. 73(4)].

The time-limit of 4 years is applicable from the assessment year 2012-2013 and subsequent year.

Question No.39(a)

Mr. N is employed at a gross salary of ₹ 8,00,000. He gets ₹ 15,000 interest on bank deposit. He has made the following investment/deposit during the year 2010-2011.

		₹
1.	Life insurance premium:	
	(i) Own life, insured for ₹ 80,000	15,000
	(ii) Brother's life, dependent on him	5,000
	(iii) Major son, not dependent on him	4,000
2.	Contribution to unrecognised provident fund	60,000
3.	Contribution to public provident fund	20,000
4.	Contribution to ULIP	5,000
5.	Repayment of loan to SB1 to purchase a residential house: 50% repayment	1,20,000

is towards interest.

6. Infrastucture bonds of an Indian public company under Sec. 80C(2)(xix) 10,000

He has paid education fees for his 3 children:

A	12,000
B	9,000
C	6,000

Besides, interest of ₹ 1,632 on NSC-VIII, (purchased during the year 2008-2009) has been credited on them during the year 2010-2011.

Compute deduction u/s 80C for the assessment year 2011-2012

Computation of Deduction u/s 80C of Mr. N for the assessment year 2011-2012

Particulars	₹	₹
Deduction in respect of contribution to approved savings (Sec. 80C) :		
1. Life insurance premium;		
(i) Own life-	15,000	
(ii) Brother's life	—	
(iii) Major son	4,000	
2. Contribution to unrecognised provident fund	—	
3. Contribution to ULIP	5,000	
4. Contribution to public provident fund	20,000	
5. Repayment of housing loan to SBI	60,000	
6. Infrastucture bonds of Indian public company [Sec. 80C(xix)]	10,000	
7. Accrued interest on NSC- VIII issue	1,632	
8. Education fees for two children:		
A	12,000	
B	9,000	
	1,33,632	
Deduction restricted upto ₹ 1,00,000		**1,00,000**

Question No.39(b):

Mr. C, manager of L Ltd., has paid ₹ 38,000 during the previous year 2010-2011 by way of medical insurance under GIC approved medical policies. The details are given as below:

(i) For himself. ₹ 6,000

(ii) For Mrs C, a Canadian citizen resident in Toronto and not dependent on him ₹ 5,000

(iii) For B, married son living with him and dependent on him ₹ 3,000

(iv) For D, minor son resident in Toronto and not dependent on him ₹ 3,000

(v) For Mrs B, daughter-in-law, dependent on him ₹ 5,000

(vi) For E, a minor grandson dependent on him ₹ 3,000

(vii) For K, father, 67 years, resident and dependent on him ₹ 3,000

(viii) For M, mother, 66 years, resident in Toronto and dependent on him ₹ 6,000

(ix) For Grandfather, dependent on him, 95 years of age and resident in India ₹ 4,000.

C has earned gross salary of ₹ 2,50,000 during the year and also earns ₹ 95,000 as interest from 7% Capital Investment Bonds, purchased on 31 May 2003. Compute his eligible deduction u/s 80D for the previous year 2010-2011 assuming the following situations:

I. Premium is paid by cheque from his salary income.

II. Premium is paid in cash from his salary income. He holds a valid receipt for cash payment.

III. Premium is paid by cheque out of interest from 7% Capital Investment Bonds, acquired on 31-5-2003.

IV. Premium is paid in cash out of interest from 7% Capital Investment Bonds, acquired on 1-6-2003.

Computation of Deduction for Medical Insurance Premium u/s 80D

Particulars of Medical Insurance premium paid	I ₹	II ₹	III ₹	IV ₹
For himself	6,000	Nil	Nil	Nil
For Mrs. C, a Canadian citizen resident in Toronto and not dependent on him	3,000	Nil	Nil	Nil
For B, married son living with him and dependent on him	2,000	Nil	Nil	Nil
For D, minor son resident in Toronto and not dependent on him	Nil	Nil	Nil	Nil
For Mrs. B, daughter-in-law, dependent on him	Nil	Nil	Nil	Nil
For E a minor grandson, dependent on him	Nil	Nil	Nil	Nil
For K, father, 67 years, resident, a senior citizen and dependent on him	2,000	Nil	Nil	Nil
For M, mother, 66 years, resident in Toronto -not a senior citizen but dependent on him	6,000	Nil	Nil	Nil
For Grandfather, 95 years of age, dependent on him, resident in India, and senior citizen (not a parent, hence not eligible)	Nil	Nil	Nil	Nil
Eligible premium for Deduction u/s 80 D	19,000	Nil	Nil	Nil

Working Notes :

1. Medical insurance premium on spouse's health is always eligible irrespective of whether the spouse is dependent on the assessee or not. The condition of dependency applies only in case of children and parents.
2. Medical premium on health of grandson, grandparents, daughter-in-law or son in-law are not eligible for deduction u/s 80D.
3. Only the premium on health of dependent father will qualify for relaxation as a senior citizen. Since dependent mother is non-resident and, therefore, outside the purview of being a "senior citizen". However, the premium for health of mother will qualify for the normal limit irrespective of the residential status.
4. Any premium paid in cash or by cheque out or exempted income does not quality for deduction u/s 80D.

Question No. 40: Maity, a resident individual, furnishes the following particulars of his income/expenditure for the previous year 2010-2011 :

		₹
(i)	Gross salary	3,00,000
(ii)	Income from house property	1,70,000
(iii)	Share of profit from an AOP	25,000
(iv)	Long-term capital gain	50,000

He has paid medical insurance on his life, his wife and his dependent children. Total premium paid under GIC approved policies is ₹ 10,000 but a sum of ₹ 1,000 was paid in cash due to a prolonged bank clearing strike. He has spent ₹ 20,000 on the treatment of his brother, a dependant with disability. He has also deposited ₹ 25,000 with a specified company u/s 2(h) of Unit Trust of India (Transfer of Undertaking and Repeal) Act, 2003 for maintenance of his brother.

He has paid the following donations during the year:

Particulars of donations made during the year	₹
• Donation to P.M.'s National Relief Fund	10,000
• Donation to Jamia Milia University	5,000

• Donation to National Cultural Fund, set up by Central Government	5,000
• Donation to Delhi Municipal Corporation for Family Planning	12,000
• Donation to Birla Temple (notified)	
• for repair and renovation of the temple	2,000
• for religious ceremonies, prasad, etc. for the benefit of devotees in general	5,000
• Donation to a temple managed by the Residents Welfare Association for its much needed repair and maintenance. The Association is a non-profit entity registered with the Registrar of Societies.	5,000
• Following donations to Pt. Pyare Lai Charitable Trust recognised by the Commissioner u/s 80G(5)(vi).	
(i) Donation in form of equity shares of blue chip companies: The shares were sold by the Trust at their market value of ₹ 75,000 and used wholly towards its charitable objectives. However, shares were transferred at cost,	25,000
(ii) Donation paid in cash,	5,000
(iii) Donation made by cheque,	7,000
(iv) 50 blankets costing ₹ 100 each.	5,000
• Donation made to Indian Olympic Association 80G(2)(c) paid by a/c payee cheque,	7,500
• Donation for developing low cost homes for slum-dwellers, paid	
(i) Delhi Development Authority, and	3,000
(ii) Delhi Slum-dwellers Rehabilitation Society duly registered with the Registrar,	2,500
• The Rajiv Gandhi Foundation	6,000
• National Children's Fund	3,000

Mr Maity borrowed a sum of ₹ 2,00,000 in 2003 @ 9% interest from Harsh Vardhan Charitable Trust (registered under Sec. 80G) to complete his B.Tech. Degree from Nalanda University. In March 2010, he repaid a sum of ₹ 75,000 (including ₹ 20,000 interest) to the said trust.

Compute his total income for the assessment year 2011-2012.

Solution:

Computation of Total Income of Mr. Maity for the Assessment Year 2011-2012

Particulars	₹	₹
1. Income from salary		3,00,000
2. Income from house property		1,70,000
3. Share of profits from an AOP : Exempt (Sec. 86)		Nil
4. Long-term capital gains		50,000
Gross total income		**5,20,000**
5. Deduction from gross total income :		
(i) Medical insurance premium (Sec. 80D)	9,000	
(ii) Expenditure on medical treatment and deposit for maintenance of a handicapped dependent relative (Sec. 80DD) :	50,000	

(iii)	Repayment of interest on loan for higher studies (Sec. 80E) (No deduction is allowed for repayment of principal amount of educational loan w.e.f. A.Y. 2008-2009)	20,000	
		79,000	
(iv)	Charitable donations Sec. 80G – [See Note below]	42,500	**1,21,500**
Total Income			**3,89,500**

Working Note :

		₹	₹
Goss Total Income			5,20,000
Less : Aggregate of :			
(i)	Share of profit in AOP entitled to rebate u/s 86.	Nil	
(ii)	Any amount qualifying for deduction from GTI exempt for deduction for donation u/s 80G itself.	79,000	
(iii)	Long-term capital gain	50,000	
(iv)	Any to a NRI from dividend and interest etc. on foreign currency investment referred to u/s 115A, 115AB, 115AC, 115ACA, 115AD.	Nil	
		1,29,000	1,29,000
Adjusted Gross Total Income			**3,91,000**

Computation of Deduction for Donations u/s 80G

		₹	₹
A.	Donations not subject to qualifying amount, eligible for deduction @ 100% of the amount donated :		
	(i) Donation to P.M.'s National Relief Fund	10,000	
	(ii) Donation to National Cultural Fund, set up by Central Government	5,000	15,000
B.	Donation not subject to qualifying amount, eligible for deduction @ 50% of the amount donated :		
	(i) The Rajiv Gandhi Foundation	6,000	
	(ii) National Children's Fund	3,000	
	Only 50% of the amount of donation available as deduction	9,000	4,500
C.	Donation subject to qualifying amount :		
	(i) Donation to Delhi Municipal Corporation for Family Planning	12,000	
	(ii) Donation made to Indian Olympic Association 80G (2)(C) (available only to a company assessee)	Nil	
	(iii) Donation to Jamia Milia University	5,000	
	(iv) Donation to Birla Temple (notified) for repair and renovation of the temple.	2,000	
	(v) Monetary donation to Pt. Pyare Lal Charitable Trust recognised by the Commissioner u/s 80G (5) (vi).	12,000	
	(vi) Donation to Delhi Development Authority	3,000	
	Aggregate of donations subject to qualifying amount	**34,000**	

Qualifying amount :

Lower of the following :

(a) 10% of Adjusted Gross Total Income, i.e. 39,100, or

(b) Aggregate of donations, 34,000

Whichever is less, is qualifying amount = 34,000		
100% of ₹ 12,000 out of the QA of 34,000	12,000	
50% of the balance of the QA i.e. 50% of (34,000-12,000)	11,000	23,000
Total deduction for donations u/s 80G		**42,500**

1. Medical Insurance Premium paid in cash is not allowable as a deduction.
2. Donation to a notified temple is allowed only if it is towards its repairs or maintenance and not otherwise.
3. Only donations paid in monetary terms that is, either in cash or by cheque are eligible for deduction. Conversion of donations in kind into cash by the donee or mere possibility of their conversion is immaterial.

Question No.41 (a): Mr Jamal, a resident assessee, runs a manufacturing business in Delhi. For the previous year 2010-2011, he disclosed his taxable income as below:

	₹
Business profits	2,55,000
Long-term capital gains	25,000
Short-term capital gain	15,000

He has hired furnished accommodation for his own use and pays ₹ 4,000 p.m. He has paid donation amounting to ₹10,000 to National Defence Fund. He has deposited ₹ 50,000 under a scheme framed by the Life Insurance Corporation for maintenance of his dependant brother with a disability. The disability is certified by the medical authority. Compute his total income for the assessment year 2011-2012.

Solution:

Computation of total income of Mr Jamal — Assessment Year 2011-2012

Particulars	₹	₹
Income from business (computed)		2,55,000
Long-term capital gain (computed)		25,000
Short-term capital gain (computed)		15,000
Gross Total Income		**2,95,000**
Deductions from gross total income:		
(i) Deposit for maintenance of a dependent with disability [Sec. 80DD]:	50,000	
(ii) Charitable donations to National Defence Fund [Sec. 80G]:		
Amount of Deduction @ 100% of ₹ 10,000	10,000	
	60,000	
(iii) Expenditure incurred on rent [Sec. 80GG] [W.N.1]	17,000	77,000
Total income		**2,18,000**

Workings Note 1:

Particulars	₹	₹

Expenditure incurred on rent [Sec. 80GG]:

- [Rent paid -10% of ATI], i.e. 48,000 -21,000 = 17,000, or
- 25% of AGTI, i.e. 25% of 2,10,000 = 52,500, or

- ₹ 2,000 p.m. = ₹ 24,000

whichever is less, is to be deducted, i.e. ₹ 17,000

Adjusted Total Income for Sec. 80GG:

Gross total income		
Less: Aggregate of		2,95,000
(i) All permissible deduction from GTI except for deduction for u/s 80GG	60,000	
(ii) Any long-term capital gain	25,000	85,000
Adjusted Gross Total Income [AGTI] for Sec. 80GG		**2,10,000**

Question No.41(b) M, resident in India, furnishes the following particulars of his receipts and outgoings during the previous year 2010-2011.

		₹
Receipts:		
(i)	Income from salary	2,00,000
(ii)	Income from house property	3,00,000
(iii)	Gross winning from crossword puzzle	3,50,000
Payments:		
(i)	Contribution to LIC annuity plan	15,000
(ii)	Medical insurance premium:	
(a)	For himself	4,000
(b)	His wife, not dependent	3,000
(c)	Mother, non-resident, 67 years, dependent	5,000
(d)	Nephew, wholly dependent with disability	3,000
(e)	Grandson, dependent	2,000
(iii)	Expenditure on medical treatment and maintenance of the nephew referred to	30,000
(iv)	Medical treatment for grandson, suffering from a disease specified under income-tax rules(v)	50,000
(v)	Donation to Gujarat government for family planning	50,000
(vi)	Scholarship to a poor but meritorious student	20,000
(vii)	Contribution to approved scientific research association	30,000
(viii)	Contribution to Delhi Municipal Corporation for sewage scheme for slum-dwellers, approved by National Committee	50,000
(ix)	Donation to Political party paid during November 2010 assembly elections	

Compute his total income for the assessment year 2011-2012. Make necessary assumptions and clarify them. 20,000

Solution:

Computation of Total Income for AY 2011-2012

Particulars		₹	₹
Income from salary			2,00,000
Income from house property			3,00,000
Gross winnings from crossword puzzle			3,50,000
Gross Total Income			**8,50,000**
Less: Deductions under Chapter VIA :			
Contribution to LIC annuity plan [Sec. 80CCC]		10,000	
Medical insurance premium [Sec, 80D]			
Self	4,000		

His wife	3,000		
Mother, 67 years old	5,000		
Nephew dependent with disability	x		
Grand son	x	**12,000**	
Maintenance and medical treatment of a dependent with disability [Sec. 80DD]			
Expenditure for medical treatment of grandson [Sec. 80DDB]		Nil	
Donations for scientific research or rural development [Sec. 80-GGA]			
(a) Donation to approved scientific research association		30,000	
(b) Contribution to MCD for slum-dwellers scheme, approved by National Committee		50,000	
Donations to political party [Sec. 80GGC w.e.f. 22.9.2004]		20,000	
Charitable donations [Sec. 80G]			
(a) Scholarship to a poor meritorious student		xxx	
(b) Gujarat government for family planning: 100% of qualifying amount			
1. Actual donation = 50,000, or			
2. 10% of specified GT1 = 37,800			
8,50,000 – (3,50,000 + 10,000 + 12,000 + 30,000 + 50,000 + 20,000) = ₹3,78,000			
whichever is less, is QA 37,800= 100% of 37,800		37,800	1,59,800
Total Income			**6,90,200**

Previous year	Particulars	X	Y
2005-2006	Business profits or loss before depreciation	(–) 6,00,000	14,00,000
	Depreciation	4,00,000	2,00,000
2006-2007	Business profits or loss before depreciation	5,00,000	2,00,000
	Depreciation	4,00,000	1,00,000
2008-2009	Business profits or loss before depreciation	8,00,000	10,00,000
	Depreciation	4,00,000	2,00,000
2009-2010	Business profits or loss before depreciation	28,00,000	12,00,000
	Depreciation	4,00,000	6,00,000

Compute the amount of deduction for X u/s 80-IA and total income of C Ltd. for all four previous years.

Computation of deduction u/s 80-IA for undertaking X

Particulars	2005-2006	2006-2007	2007-2008	2009-2010
Profits or loss before depreciation	(-) 6,00,000	5,00,000	8,00,000	28,00,000
Less: Depreciation		(-) 4,00,000	(-) 4,00,000	(-) 4,00,000
	6,00,000	**1,00,000**	**4,00,000**	**24,00,000**
Set-off of carry forward business loss		(-) 1,00,000	(-) 4,00,000	(-) 1,00,000
Set-off of carry forward depreciation		xxx	xxx	(-) 4,00,000
Profits eligible for deduction u/s 80-IA	Nil	Nil	Nil	19,00,000
Amount of deduction @ 100% of profits	**Nil**	**Nil**	**Nil**	**19,00,000**

Computation of profits of undertaking Y and total income of C Ltd.

Particulars	2005-2006	2006-2007	2007-2009	2009-2010
Profits or loss before depreciation:	14,00,000	2,00,000	10,00,000	12,00,000
Less: Depreciation of Y	(-) 2,00,000	(-) 1,00,000	(-) 2,00,000	(-) 6,00,000
	12,00,000	1,00,000	8,00,000	6,00,000
Profits of X after depreciation	Nil	1,00,000	4,00,000	24,00,000
Set-off of business loss of X	(-) 6,00,000			
Set-off of unabsorbed depreciation of X	(-) 4,00,000			
Gross Total Income	**2,00,000**	**2,00,000**	**12,00,000**	**30,00,000**
Less: Deduction u/s 80-IA	Nil	Nil	Nil	19,00,000
Total income of C Ltd.	**2,00,000**	**2,00,000**	**12,00,000**	**11,00,000**

Note: 1.

Even though the business loss and unabsorbed depreciation of X were set-off during the PY 2006-2007 itself in computation of total income of C Ltd., for the purpose of deduction u/s 80-IA, they will still be carried forward on notional basis and set-off only against the profits of business eligible u/s 80-IA.

Question No.42 (a) : SK Industries, a diversified group, discloses profit from the following sources for the previous year 2010-2011 :

		(₹ in lakhs)
(i)	Profits from small-scale unit, started in 2001-2002	6.00
(ii)	Profit from industrial undertaking 2002-2003, in Vidisha, a B-class industrially backward district.	10.00
(iii)	Profit from multiplex theatre, started in 2006-2007	
	(a) Delhi	4.00
	(b) Allahabad	2.00
(iv)	Profits from convention centre, started in 2007-2009	
	(a) Delhi	5.00
	(b) Allahabad	3.00
(v)	Profits from Hill View, a hotel started in 2002-2003 at Manali in Himachal Pradesh. Hotel is approved by prescribed authority	10.00
(vi)	Profits from undertakings engaged in refining of mineral oil since 1 January 2004 in Uttar Pradesh, not listed in backward state in Eighth Schedule.	10.00

Compute the total income for the assessment year 2011-2012.

Computation of Total Income

	Particulars	(₹ lakhs)	(₹ lakhs)
(i)	Profits from SSI		6.00
(ii)	Profits from undertaking located in industrially backward B-class district		10.00
(iii)	Profits from multiplex theatre: (4 + 2) =		6.00
(iv)	Profits from convention centre : (5+3) =		3.00
(v)	Profits from Hill View Hotel		10.00

(vi) Profits from refining undertaking		10.00
Gross Total Income		**50.00**
Less : Deduction in respect of profits and gains from certain industrial undertaking, other than infrastructure undertakings (Sec. 80-IB) :		
1. Profits from SSI [Sec. 80-IB (3)] : 25% of ₹ 6 Lakh :	1.50	
2. Profits from undertaking in B-class industrially backward district [Sec. 80-IB (4)] 25% of ₹ 10 lakh	2.50	
3. Profits from multiplex theatre [Sec. 80-IB(7A) 50% of ₹ 2 lakh (No deduction for Delhi)	1.00	
4. Profits from convention centre [Sec. 80-IB(7B)] 50% of ₹ 8 lakh	4.00	
5. Profits from Hill View Hotel [Sec. 80-IB(7)] Allowed only for Indian company	Nil	
6. Profits from refining undertaking [Sec. 80-IB(9)]-100% of profits for 7 assessment years	10.00	**19.00**
Total Income		**31.00**

Question No.42(b): Evergreen Construction (P) Ltd. has earned profits during the PY 2010-2011 from construction and sale of f lats under three housing projects, developed at Rajarhat, Kolkata, details of which are given below:

		(₹ in lakhs)
(a)	Profits from construction and sale of flats, built up on a plot of 1.5 acres, built up area of the flat 1400 sq feet, located 30 km from Kolkata.	80.00
(b)	Profits from construction and sale of flats, built up on a plot of 1 acre, built up area 1050 sq feet, located within 25 km from Delhi.	60.00
(c)	Profits from construction and sale of flats, built on a plot of 0.90 acre, built up area 1000 sq feet, located 35 km from Kolkata.	40.00

The housing projects have been approved by the Kolkata Industrial Development Authority in the year 1 April 2006. Compute its total income for the previous year 2010-2011 relevant for the AY 2011-2012. Would your answer be different in the following cases:

(i) The housing projects were not approved.

(ii) The housing project is carried out in accordance with a scheme approved by West Bengal Government for redevelopment of buildings in slum areas.

(iii) The company was engaged only in the sale of flats and not developing and building the housing project.

Computation of Total Income for the AY 2011-2012

Particulars	**(₹ in lakh)**	**(₹ in lakh)**
Profits from Project (a)		80.00
Profits from Project (b)		60.00
Profits from Project (c)		40.00
Less :		180.00
Deductions from profits and gains from certain industrial undertaking other than infrastructure undertaking (Sec. 80-IB):		
(i) Profits from Housing Project (a) are fully deductible as the size of flat not exceeding the prescribed area	80.00	

	1500 sq feet.		
(ii)	Profits from Housing Project (b) not deductible as the area of the flat exceeds the prescribed area of 1000 sq feet.	x	
(iii)	Profits from Housing Project (c) not deductible as the size of the Housing plot is less than 1 acre.	x	(–) 80.00
Total income			**100.00**

Question No.43(a) : Mekon Ltd., an Indian company, starts an industrial undertaking on 1 April 2010. During the previous year, it earns profits of ₹ 80 lakh before allowing any deduction for wages. Compute its total income for the previous year 2010-2011 taking into account the following employment schedules of workers:

Date of employment	Number of workers	Status of workers	Rate of wages
1-5-2010	90	Casual	300 p.m.
1-6-2010	20	Reuglar	4000 p.m.
1-7-2010	10	Regular	4000 p.m.

Solution:

Computation of total income for the AY 2011-2012

Particulars	₹	₹
Profits before allowing deduction for wages		80,00,000
Less: Wages paid to workers [Sec. 37(1)] :		
(i) 90 × ₹ 3000 × 11	29,70,000	
(ii) 20 × ₹ 4000 × 10	8,00,000	
(iii) 10 × ₹4000 × 9	3,60,000	(-) 41,30,000
Business Profits and Gross Total Income		**38,70,000**
Less: Deduction in respect of employment of new workmen		(-) 1,20,000
[Sec. 80 JJAA] 30% (₹ .4000 x 10 x 10)		
Total Income		**37,50,000**

Question No.43(b): Mr. R has developed an improved economical model of a motor cycle and got it patented on 31-3-2010 under the Patent Act, 1970. He allowed Z Ltd. to use his patent rights and licenses has been granted to it under the Patent Act, 1970. He has received royalty of ₹ 8,00,000 during the previous year 2010-2011. However, the royalty in accordance with the terms and conditions of the license settled by the Controllers under the said Act is ₹ 2,80,000. He has incurred ₹ 1,00,000 expenses in developing his invention and getting it patented.

Compute his total income for the assessment year 2011-2012 (i) if he is resident in India, (ii) non-resident India.

Computation of Total Income for the Assessment Year 2011-2012

Particulars	(i) ₹	(ii) ₹
Income from other sources	8,00,000	8,00,000
Less : Expenses	1,00,000	1,00,000
Gross Total Income (GTI)	7,00,000	7,00,000
Less : Deduction for respect of royalty on patent (Sec. 80-RRB)		
Least of the followings:		
(a) Income from royalty 5,00,000; or		
(b) Royalty under the terms of license settled by the Controller 2,80,000;		
(c) Maximum limit ₹ 3,00,000		
Whichever is less, is to be deducted	2,80,000	xxx
Total Income	**4,20,000**	**7,00,000**

Question No.43(c) : Mr. J is suffering with 60% locomotor disability which is certified by medical authority. He is employed as Technical Supervisor with Air Tel at a salary of ₹ 20,000 p.m.

	Particulars	₹
(i)	Income from government securities	20,000
(ii)	Long-term capital loss	(-) 40,000
(iii)	Short-term capital gain (Sec. 111A)	1,00,000
(iv)	Insurance commission (gross)	1,00,000
(v)	Interest on Saving Fund a/c from bank	10,000

He has incurred the following expenses:

(i)	Medical insurance paid by cheque for his father, resident in India and 70 years	18,000
(ii)	Deposit with LIC for maintenance of father, mainly dependant on him for support and maintenance and suffering from low-vision with a severe disability of 80%, as per certificate of the medical authority	
(iii)	Rent paid for the year 2010-2011 for accommodation hired by him.	40,000

Compute his total income for the assessment year 2011-2012.

Solution:

Computation of Total Income for the Assessment Year 2011-2012

Particulars	**₹**	**₹**
1. Income from salaries		2,40,000
2. Income from capital gains :		
(a) Short-term capital gains (Sec. 111A)		
(b) Long-term capital loss to be carried forward		1,00,000
3. Income from others sources :		Nil
(a) Interest government securities	20,000	
(b) Interest on savings fund a/c with Bank	10,000	
(c) Insurance commission	1,00,000	1,30,000
Gross Total income		**4,70,000**
Less : Deductions under Chapter VIA:		
Medical insurance (Sec. 80D)	18,000	
Deduction in respect of maintenance including medical treatment of a department, a person with severe disability (Sec. 80DD)	1,00,000	
Deduction in case of a person with disability (Sec. 80U) :	50,000	
Deduction u/s 80GG :(Least of the followings)		
(a) (i) Rent paid less 10% of Adjusted Gross Total Income = 40,000-23,300 = 16,700,		
(b) (ii) 25% of 2,33,000 Adjusted Gross Total Income=58,250,		
(iii) 2,000 p.m. × 12 = 24,000	16,700	**1,84,700**
Whichever is less, is or be deducted		
Total income		**2,85,300**

Question No.44

M, an individual, retired from the services of a Company on 31.10.2010. He joined another employer on 1.11.2010 and was in service till end of March 2011, when he furnishes the following details and information —

1. Salary and Allowances for the period

From First Employer	₹ Per month
Basic Salary	30,000
Dearness Allowance	16,000
Conveyance Allowance	6,000
From Second Employer	₹ Per month
Basic Salary	35,000
Fixed Conveyance Allowance	8,000

2. While he was with the first employer, M contributed 10% of his basic salary to a Provident Fund Account with the Regional Provident Fund Commissioner. He did not become a member of the Provident Fund maintained by the second employer.
3. M was permitted by the second employer to encash 15 days leave he had accumulated during his service and received ₹ 12,500 from his employer.
4. M had constructed a residential house in Chennai in February 2007 for ₹30 Lakhs. Part of the costs of construction was met by borrowals of ₹ 20 lakhs from the Housing Development Corporation, at interest of 12.5% p.a. The loan was taken on June 2005. The loan outstanding at the beginning of the current year was ₹12,00,000. The rate of interest applicable for the current year was reduced to 9% p.a. due to reduction in rates. [He had also borrowed from some relatives ₹4,00,000 on which interest at 15% p.a. was due.] The property had been let-out soon after completion.
5. In the Assessment Year 2007-08, M was allowed a deduction of ₹50,000 for irrecoverable rents. The annual value decided by the Corporation of Chennai for the property is ₹ 80,000. The property was let-out in the current year to a Company on a rent of ₹20,000 p.m. The half-yearly municipal taxes on the property were fixed by the Corporation of Chennai only in August 2010 at ₹15,000 for every half year from 1.4.2007. M paid the taxes due in September 2010 upto the half-year ending 31.3.2010.
6. M also received from the previous tenant ₹ 40,000 (out of the dues of ₹ 50,000).
7. After retirement from the first employer, M received ₹ 4,50,000 from the Regional Provident Fund Commissioner, money was fully invested by him in the 15% Non-Redeemable Debentures issued by the Indian Oil Corporation interest on these had not come in by the end of March 2011.
8. M received interest of ₹ 60,000 on long-term fixed deposits with Banks, ₹ 25,000 as interest on Post Office Savings Bank Accounts and ₹ 20,000 as income from units.
9. M owns a car which is used for office purposes also and it is found that the entire conveyance allowance from his employer had been fully spent on travel for official purposes.
10. One of the policies of insurance taken by M had matured for payment and ₹ 8,00,000 received by him in June 2010 from the LIC was invested by him, in the name of his 16-year old son, in fixed deposits with companies. Interest received upto 31.3.2011 on these deposits was ₹ 90,000. On one of the continuing policies of insurance, M paid a premium of ₹ 60,000 in the year.

Compute M's total income for the Assessment Year 2011-12.

Solution :

Assessee : Mr. M | **Previous Year : 2010-11** | **Assessment Year : 2011-12**

Computation of Total Income

			₹	₹	₹
Income under the head Salaries					
From First Employer					
	Basic Pay	(₹ 30,000 x 7)		2,10,000	
	Dearness Allowance	(₹ 16,000 x 7)		1,12,000	
	Conveyance Allowance	(₹ 6000 x 7)	42,000		
Less:	Exempt u/s 10(14)		(42,000)	Nil	3,22,000

Amount received from Regional Provident Fund Commissioner	4,50,000		
Less: Exempt u/s 10(12)	(4,50,000)	Nil	
From Second Employer			
Basic Salary (₹ 35,000 x 5)		1,75,000	
Conveyance Allowance (₹ 8,000 x 5)	40,000		
Less: Exempt u/s 10(14) (incurred for official performance of duties)	(40,000)	Nil	
Leave Encashment - Fully taxable while in service		12,500	1,87,500
Gross Income from Salary			**5,09,500**
Income from House Property :			
Gross Annual Value u/s. 23(1) — Higher of Municipal Value of ₹80,000 or Actual Rent of ₹ 2,40,000		2,40,000	
Less: Municipal Taxes paid during the year @ ₹ 15,000 for every half year from 1.4.2007 upto 31.3.2010 (Current Year - Not Paid)		(90,000)	
Net Annual Value (NAV)		1,50,000	
Less: Deduction			
@ 30% of NAV u/s 24(a)		(45,000)	
Interest on Borrowed Capital u/s 24(b)			
Loan from Housing Development Corporation:			
Current Period Interest: ₹12,00,000 × 9%	1,08,000		
Prior Period Interest (Interest upto 31.3.2006) [(₹20,00,000 × 12.5%) + (4,00,000 × 15%)] × 10/12 × 1/5	51,667		
Loan from Relative - Current Period Interest (₹ 4,00,000 x 15%)	60,000	(2,19,667)	
Add: Unrealised Rent recovered (taxable in the year of recovery u/s 25AA]		40,000	**(74,667)**
Income from Other Sources			
Interest on Long-term Fixed Deposits with Bank		60,000	
Interest on Post Office Savings Bank A/c	25,000		
Less: Exempt u/s 10(15)	(25,000)	Nil	
Income from Units of UTI	20,000		
Less: Exempt u/s. 10(35)	(20,000)	Nil	
LIC Policy matured	8,00,000		
Less: Exempt u/s. 10(1D)	(8,00,000)	Nil	
Interest from Fixed Deposits with Companies in the name of minor son	90,000		
Less: Exemption u/s. 10(32)	(1,500)	88,500	1,48,500
Gross Total Income			**5,83,333**
Less: Deduction under Chapter VI–A–			
u/s 80C –LIC Premium		(60,000)	
– RPF – 10% of ₹ 1,40,000		(14,000)	74,000
Total Income			**5,09,333**

Total Income (Rounded Off u/s 288A)	**5,09,330**

Assumptions :

1. It is presumed that Mr. M accounts for his interest income on receipt basis.
2. Assumed that there has been no repayment of Housing Loan Principal during the year ending 31.3.2006 for the purpose of calculation of prior period interest.
3. Recognised Provident Fund received on retirement shall not be taxable u/s 10 (assuming conditions are satisfied).
4. **Unrealised Rent recovered :** Since the assessee has been allowed a deduction of ₹ 50,000 from his house property income in ealier years in respect of Unrealised Rent, entire ₹ 40,000 recovered during current year becomes taxable.
5. **Deduction of Interest** u/s 24 shall be allowed even if the amount is borrowed from any person other than the Banks/Financial Institutions in respect of Let Out property.

Question No.45

Mr. A, a Senior Citizen, has furnished the following particulars relating to his House Properties —

Particulars	House I —₹	House II —₹
Nature of Occupation	Self Occupied	Let-out
Municipal Valuation	60,000	1,20,000
Fair Rent	90,000	1,50,000
Standard Rent	75,000	1,40,000
Actual Rent per month	—	12,000
Municipal Taxes paid	6,000	12,000
Interest on Capital borrowed	90,000	80,000

Loan for both Houses were taken on 1.4.2006. House II remained vacant for 4 months.

Besides the above two house, A has inherited during the year 1988-89 an old house from his grandfather. Due to business commitments, he sold the house immediately for a sum of ₹ 250 Lakhs. The house was purchased in 1962 by his grandfather for a sum of ₹ 2 Lakhs. However, the Fair Market Value as on 1.4.1981 was ₹ 30 Lakhs. With the sale proceeds, A purchased a new house in March 2010 for a sum of ₹ 140 Lakhs and the balance was used in his business.

The other income particulars of Mr. A besides the above are as follows (AY 2011–2012) —

- Business Loss ₹ 12 Lakhs
- Income from Other Sources (Bank Interest) ₹ 1 Lakh
- Investments made during the year PF ₹ 70,000
- ICICI Infrastructure Bond Purchased (u/s 80CCF) ₹ 30,000

Compute Total Income of Mr. A and his Tax Liability for the Assessment Year 2011–2012

Solution :

Assessee : Mr. A **Previous Year : 2010-11** **Assessment Year : 2011-12**

Computation of Total Income

	Particulars	₹	₹	₹
1. Income from House Property :				
(a)	**House I :** Self Occupied — Annual Value u/s 23(2)	Nil		
	Less : Deduction u/s 24(b) = Interest on Housing Loan			
	taken on 1.4.2006 (Note 1)	90,000	(90,000)	
(b)	**House II :** Let-out – (Note 2)		(21,000)	(1,11,200)

2. Profits and Gains of Business or Profession – Loss		(12,00,000)
3. Capital Gains — Sale of Residential House Property — Long Term Asset		
Sale Consideration	2,50,00,000	
Less : Expenses on Transfer	Nil	
Net Consideration	2,50,00,000	
Less : Indexed Cost of Acquisition — Fair Market Value as on 1.4.81 × CII of year of Sale /CII of year of first holding (₹ 20 Lakhs × 711/161)	83,32,298	
Long Term Capital Gain	1,61,67,702	
Less : Exemption u/s 54 — New House purchased	1,40,00,000	21,67,702
4. Income from Other Sources : Bank Interest		1,00,000
Gross Total Income		**9,56,502**
Less : Deduction under Chapter VI-A		
u/s 80C – Deposits in PPF	70,000	
u/s 80 CCF – Investments in Long-term Infrastructure Bonds ₹ 30,000		
(restricted upto a maximum of ₹ 20,000)	20,000	90,000
Total Income		**8,66,502**
Tax on total Income of ₹ 8,66,502		
(i) Other Income included in Total Income		
= Income from other sources – Deduction under Chapter VIA		
= 1,00,000 – 90,000 = 10,000		
Tax on ₹ 10,000		Nil
(ii) Balance of LTCG (after adjusting loss from House Property + Business loss) included in Total Income		
= (21,67,702 – 1,11,200 – 12,00,000)		
= 8,56,502		
Tax on LTCG		1,27,100
= 20% [LTCG – Unavailed Basic Exemption limit]		
= 20% [LTCG – (Basic Exemption limit – Other Income)]		
= 20% [8,65,502 – (2,40,000 – 10,000)]		
= 20% [8,65,502 – 2,30,000]		
= 20% of 6,35,502		
(+) EC @ 2%		2,542
(+) SHEC @ 1%		1,271
Tax Payable		1,30,913
Tax Payable (Rounded off u/s 288B)		1,30,910

Notes :

1. It is assumed that the construction of the house was completed **within 3 years** from the end of the financial year in which the loan was taken.
2. **Annual Value of House Property II** is computed as under —

(i) Municipal Value (MV)	1,20,000
(ii) Fair Rental Value (FRV)	1,50,000
(iii) Higher of MV + FRV	1,50,000
(iv) Standard Rent	1,40,000

(v)	Reasonable Expected Rent (RER) [lower of (iii) + (iv)]	1,40,000
(vi)	Annual Rent @ ₹ 12,000 pm	1,44,000
(vii)	Unrealised Rent	Nil
(viii)	Actual Rent [(vi) – (vii)]	1,44,000
(ix)	Vacancy Allowance	48,000
(x)	Gross Annual Value [(viii) – (ix)]	96,000
	Less : Municipal Tax paid	12,000
	Net Annual Value (NAV)	**84,000**
	Less : Standard deduction @ 30% of NAV u/s 24(a)	25,000
	Less : Interest on borrowed Capital u/s 24(b)	80,000
	Income for House II	**(21,200)**

3. **Loss of ₹ 3,18,000** under the head Income from House Property and Business Income has been fully set off against Long Term Capital Gain, since it is beneficial to the assessee.
4. Since Mr. A is liable to tax **only because of LTCG,** Tax on Total Income shall be computed as = 20% (Total Income – Basic Exemption Limit) = 20% (1,26,82,000 – 2,40,000).

Question No.46

Mr Ashok a senior citizen, owns a property consisting of two blocks of identical size. The first block is used for business purposes. The other block has been let out from 14.2010 to his cousin for ₹ 20000 p.m. The cost of construction of each block is ₹ 5 lacs (fully met from bank loan), rate of interest on bank loan is 10% p.a. The construction was completed on 31.3.2010. During the year ended 31.3.2011, he had to pay a penal interest of ₹ 2000 in respect of each block on account of delayed payments to the bank for the borrowings. The normal interest paid by him in respect of each block was ₹ 42,000. Principal repayment for each block was ₹ 23,000 An identical block in the same neighborhood fetches a rent of ₹25,000 per month Municipal Tax paid in respect of each block was ₹ 12,000.

The income from business prior to adjustment towards depreciation on any asset is ₹ 2,20,000. He follows Mercantile system of accounting. Depreciation on equipments used for business is ₹ 30,000.

On 23.2.2011, he sold shares of B Ltd., a listed share in BSE for ₹ 2,30,000. The share had been purchased 10 months back for ₹ 1,80,000. Security transaction tax paid may be taken as ₹ 220.

Brought forward business loss of a business discontinued on 12.1.2009 is ₹ 90,000. This loss has been determined in pursuance of a return of income filed in time and the current year is the seventh year.

The following payments were effected by him during the year :

1. LIP of ₹ 20,000 on his life and ₹ 12,000 for his son aged 22, engaged as a software engineer and drawing salary of ₹ 25,000 per month.
2. Mediclaim premium of ₹ 6,000 for himself & ₹ 5,000 for above son. The premiums were paid by cheque.

You are required to compute the total income for the assessment year 2011-12 and the tax payable. The various heads of income should be properly shown. Ignore the interest on bank loan for the period prior to 1.4.2010, as the bank had waived it.

Solution :

Computation of Total Income of Mr. Ashok for A.Y. 2011-12.

	Particulars	Amount	Amount
(1)	**Income from house property (Let out)**		
	Gross Annual Value (being Fair rent)	3,00,000	
	Less: Municipal tax	12,000	
	Net Annual Value	2,88,000	

	Less: Deduction:-			
	u/s 24(a) Standard Deduction (30% of NAV)	86,400		
	u/s 24(b) Interest on loan	42,000	1,28,400	1,59,600
(2)	**Profits and gains of business or profession**			
	Net profit before depreciation		2,20,000	
	Less: Expenditure allowed but not debited in P & L Account			
	Depreciation on equipment	30,000		
	Depreciation on building i.e. 10% of ₹ 5,00,000	50,000	80,000	
	Profits and gains of business or profession of current year		1,40,000	
	Less: Brought forward losses set off u/s 72		(90,000)	50,000
(3)	**Capital gains**			
	Consideration for Transfer		2,30,000	
	Less: Cost of acquisition		(1,80,000)	
	Short Term Capital Gains			50,000
	Gross Total Income			2,59,600
	Less: Deduction u/s			
	80C: LIC Premium paid	32,000		
	Repayment of bank loan	23,000	55,000	
	80D: Mmedical insurance premium		6,000	61,000
	Total income			**1,98,600**
	Tax payable			**Nil**

Notes :

1. Penal interest is not allowed u/s 24(b)
2. It has been assumed that interest, municipal tax on property used for business have already being charged while computing "business income before depreciation" i.e. ₹ 2,20,000.
3. STT is not allowed as expenditure on transfer.

Question No.47

Thomas took voluntary retirement from State Bank of India on 1st May, 2010 under the Voluntary Retirement Scheme (VRS) and received a sum of ₹ 25 lakh on account of VRS benefits. At the time of his retirement, Thomas was having 47 months of service left and had served the organisation for 18 years 11 months. His last drawn Basic Pay ₹ 60,000, D.A. @ 60% of B/Pay (80% of which forming part of salary). Later, he started a business of plying, hiring and leasing of goods carriages from 1st June, 2010 by acquiring 3 heavy vehicles for ₹ 12 lakh, 2 medium goods vehicle for ₹ 5 lakh and 3 light commercial vehicles for ₹ 6 lakh. Although, he did not maintain regular books of account for his business, the diary maintained by him reveled gross receipts of ₹ 3,12,000 for the financial year ended 31st March, 2011 and he incurred an expenditure of ₹ 1,68,500 on the business towards salaries of drivers, repairs, fuel, etc. Depreciation on vehicle is not included in the said expenditure.

During the financial year 2010-11, he received a sum of ₹ 3,00,000 on account of pension from bank and he contributed a sum of ₹ 65,000 to his PPF account maintained with the said bank in the same year. His PPF account was credited with interest of ₹ 35,000 during the financial year 2010-11. He also purchased long-term infrastructure bonds for ₹ 20,000; Repayment of educational loan interest for the year ₹ 50,000. He also paid medical infrastructure premium of ₹ 14,000.

Further, he had two residential properties, one is self occupied and other is let out. During the financial year 2010-11, Thomas was able to let out his property only for 11 months on a monthly rent of ₹ 17,000. The total municipal taxes on the let out property was ₹ 8,000, 50% of which was paid by the tenant and 50% by him. The interest on loan taken for renovation of the self occupied property paid by him during the year was ₹ 34,000. The insurance premium on the house and actual repairs and collection charges paid are ₹ 1,600 and ₹ 18,000 respectively and the entire expenditure is borne by him. During the financial year 2010-11, he was able to recover the unrealized rent of ₹ 33,000 from old tenant who vacated the house during the August, 2009 after spending litigation expenses of ₹ 15,000. During the financial year 2010-11. Thomas suffered short term capital loss on account of sale of shares on various dates amounting to ₹ 8,50,500.

From the aforesaid information, you are required to compute the total income of Thomas for the AY. 2011-12 giving reasons in respect of each and every item and indicate the relief/rebate/deduction which he is entitled to claim.

Solution : **Computation of Total Income**

Assessee : Mr. Thomas **Previous Year : 2010-2011** **Assessment Year : 2011-2012**

	₹			
(1)	**Income from Salary**			
	Pension Received			3,00,000
	Voluntary Compensation			
	Actual Amount Received		25,00,000	
	Less : Exemption u/s 10(10c)			
	Least of the following :			
	(i) Actual Amount Received	25,00,000		
	(ii) Maximum limit	5,00,000		
	(iii) Higher of the following :			
	(a) Last Drawn Salary × 3 × No. of Fully completed years of service = 88,800 × 3 × 18 = 47,95,200	47,.95,200	5,00,000	
	(b) Last Drawn Salary × Balance of number of months of service left = 88,800 × 47 = 41,73,600			20,00,000
	Last Drawn Salary = B/ Pay + D.A (forming part)			
	= ₹ [60,000 + 60% of 80% of 60,000]			
	= ₹ [60,000 + 28,800]			
	= ₹ 88,800			
(2)	**Income from House Property**			
	(a) **Self occupied :**			
	Annual Value	Nil		
	(–) Interest on Loan u/s 24(b) ₹ 34,000			
	– restricted upto ₹ 30,000	(30,000)	(30,000)	
	(b) **Let-out House Property**			
	Gross Annual Value			
	(being the Rental Value) = 17,000 ×12	2,04,000		
	Less : Municipal Tax Paid by the assessee during the year			
	= 18,000 × 50%	9,000		
	Net Annual Value (NAV)	**1,95,000**		
	Less : Standard deduction @ 30% of NAV u/s 24(a)	58,500		
	Less : Interest on loan u/s 24(b)	Nil	1,36,500	1,06,500
(3)	**Income from Business or Profession**			
	Presumptive Income u/s 44AE			
	in the Business of plying, leasing or hiring trucks			
	(i)Light goods vehicles = 3 × 4,500 × 10 =	1,35,000		
	(ii)Medium goods vehicles = 2 × 4,500 × 10 =	90,000		

	(iii)Heavy goods vehicles = 3 × 5,000 × 10 =	1,50,000	3,75,000
(5)	**Income from Capital Gains**		
	Short Term Capital Loss		(8,50,000)
	Gross Total Income		**19,31,500**
	Less : **Deductions under Chapter VIA**		
	u/s 80 C – Deposits in PPF	65,000	
	u/s 80D – Medical Insurance Premium	14,000	
	u/s 80E – Interest paid on Education loan	50,000	
	u/s 80CCF – Investments in Long-term Infrastructure Bonds	20,000	1,49,000
	Total Income		**17,82,500**
	Tax on Total Income of ₹ 17,82,500		3,88,750
	(+) E/c @ 2%		7,775
	(+) SHEC @ 1%		3,888
	Tax Payable		**4,00,413**
	Tax Payable (Rounded off u/s 288B)		4,00,410

Question No.48

Mr. Anurag is a Cost Accountant in practice. The Income & Expenditure Account for the year ending March 31, 2011 read as follows :

	Expenses	₹		Income	₹
To	Employees cost	1,50,000	By	Professional earnings	16,00,000
To	Travelling & Conveyance	50,000	By	Dividend income	
To	Administration & Office exp.	4,00,000	–	from shares	2,00,000
To	Interest	1,50,000	–	from equity oriented mutual funds	1,00,000
To	Demat charges	10,000			
To	Net profit	11,40,000			
Total		**19,00,000**	**Total**		**19,00,000**

Other Information :

(a) Entire Dividend income is claimed as exempt from taxation by virtue of Section 10(34) and 10(35).

(b) Anurag claims that no expenditure has been incurred against the dividend income, which is claimed as exempt from tax.

(c) The value of investment in shares as on the first day and the last day of the previous year is ₹ 7,50,000 and ₹ 9,00,000 respectively.

(d) The value of investment in units of Mutual Funds as on the first day and the last day of the previous year is ₹ 5,00,000 and 2,00,000 respectively.

(e) All expenditure including interest expenditure of ₹ 1,50,000 incurred by Anurag are relating to taxable and non taxable Income. Demat charges are directly attributable to exempt income.

(f) The value of the total assets as appearing in the Balance sheet of the assessee as on the first day and last day of the previous year is ₹ 60,00,000 and ₹80,00,000 respectively.

You are required to compute the taxable income of Anurag for the assessment year 2011-12.

Solution :

Computation of Taxable Income A.Y. 2011-12

Particulars		**₹**
Income from Profits & Gains of Business or Profession – as per Working Note 1		8,40,000
Income from other sources – as per Working Note 2		Nil
	Total	**4,40,000**
Add : Disallowance u/s 14A – as per Working Note 3		31,804
	Taxable Income	**4,71,804**

Working Note 1 — Profits & Gains of Business or Profession

	₹	₹
Net profit as per Income & Expenditure Account		11,40,000
Less : Income considered under other heads		
– Dividend Income from shares	2,00,000	
– Income from UTI	1,00,000	3,00,000
Taxable professional income		**8,40,000**

Working Note 2 — Income from other sources

		₹	₹
1.	Dividend Income from Shares	2,00,000	
	Less : Exempt under sec 10(34)	2,00,000	Nil
2.	Income from units in Mutual funds	1,00,000	
	Less : Exempt under sec 10(35)	1,00,000	Nil
	Taxable income from other sources		**Nil**

Working Note 3 — Disallowance u/s 14A

		₹
(a)	Amount of expenditure directly relating to exempt income (Other than interest) — Demat charges	10,000
(b)	Amount of interest incurred by way of expenditure other than those included above (1,50,000 × 8,25,000 / 70,00,000)	17,679
(c)	Amount equal to 0.5% of the average value of Investments (8,25,000 × 0.5%)	4,125
	Total amount disallowed u/s 14A (a) + (b) + (c)	**31,804**

Note :

1. Average value of Investment = (7,50,000 + 9,00,000) / 2 = ₹ 8,25,000.
2. Average value of Total Assets = (60,00,000 + 80,00,000) / 2 = ₹ 70,00,000.

Question No.49:

Mr. Samir submits the following information for the A.Y. 2011-12.

Particulars	₹
Taxable Income from Salary	1,64,000
Income from House property :	
House 1 Income	37,000
House 2 loss	(53,000)
Textile Business (discontinued on 10.10.2010)	(20,000)
Brought forward loss of textile business - A.Y. 2008-09	(80,000)
Chemical Business (discontinued on 15.3.2010)	
– b/f loss of previous year 2008-09	(25,000)
– unabsorbed depreciation of previous year 2008-09	(15,000)
– Bad debts earlier deducted recovered in July '2010	40,000
Leather Business	62,000
Interest on securities held as stock in trade	10,000

Determine the gross total income for the assessment year 2011-12 and also compute the amount of loss that can be carried forward to the subsequent years.

Solution :

Computation of Gross Total Income A.Y. 2011-12

	Particulars		₹	₹
I.	Income from Salary :			1,64,000
II.	Income from House property :			
	House 1 Income		37,000	
	House 2 loss		(53,000)	(26,000)
III.	Profits and Gains of Business or Profession :			
	(i) Textile business loss		(20,000)	
	(iii) Chemical business – Bad debts recovered taxable u/s 41(4)	40,000		
	Less : (i) Set off of brought forward loss of P.Y. 2008-09 u/s. 72	(25,000)	15,000	
			(5,000)	
	(iii) Leather Business Income	62,000		
	(iv) Interest on securities held as stock-in-trade	10,000	72,000	
			67,000	
	Less : B/f. business loss ₹ 80,000 restricted to balance of profits		67,000	Nil
	Gross Total Income			**1,38,000**

Note :

1.The unabsorbed loss of ₹ 13,000 (80,000-67,000) of Textile business can be carried forward to A.Y. 2011-12 for setoff u/s. 72, even though the business is discontinued.

2. The unabsorbed depreciation of ₹ 15,000 is eligible for set off against any income other than salary income. Since, Gross total income contains the balance of Income from Salary only, Unabsorbed depreciation cannot be adjusted. Hence, carried forward for adjustment in the subsequent years.

Question No. 50(a):

B Ltd. owns a new industrial undertaking, located in industrially backward State. It has been approved 100% EOU by the Board, constituted by the Central Government. It is engaged in the export of computer software and started functioning from the previous year 2006-2007.

During the first three years it earned a profits and claimed deduction under Sec. 10B. During the fourth year it suffered a loss of ₹ 10 lakh.

It furnishes the following particulars for the previous year 2010-2011.

	₹ (in lakh)
(i) Business profit	40
(ii) Export sales – FOB	100
(iii) Domestic sales	50
(iv) Receipt of convertible foreign exchange in India :	
(a) Receipt up to 30 September 2011	70
However, foreign exchange of ₹ 10 lakh is on account of sale to a foreign customer in India and ₹ 5 lakh is on account of reimbursement of freight, insurance, relating to export export and expenses incurred in Malaya in foreign exchange in providing technical services.	
(b) Receipt in November 2011 but approved by the competent authority	10
(c) Receipt in January 2012 but competent authority has not granted its approval	10
(v) Converted foreign exchange kept in Malaya in State Bank of India in a separate account with the approval of RBI.	10

Compute its total income in the following cases :

(a) it claims deduction under Sec. 10B;

(b) it revises its option under Sec. 10B(8) and wants not to claim deduction under Sec. 10B. it proposes to claim deduction under Sec. 80 IB.

Solution: (i) Claiming deduction under Sec. 10B

	₹ (in lakh)
Business profits	40
Less : Deduction for export profits :	20
	20
Less : Carried forward business loss [Sec. 72 (2)]	10
Total income	10

Working Note :

1. Export turnover :

Convertible foreign exchange received up to 30 September 2011		
Less :	(i) Convertible foreign exchange received from a foreign customer for sale in India	70
	(ii) Reimbursement of foreign insurance relating to export and expenses incurred in	(–) 10
	foreign exchange outside India in providing technical services.	(–) 5
Add:	(i) Convertible foreign exchange received after prescribed time limit but approved by the competent authority	(+) 10
	(ii) Convertible foreign exchange kept outside India with the permission of	(+) 10
	Reserve Bank of India	75

2. Total turnover :	100
(i) Export sales	50
(ii) Domestic Sales	150

(ii) Claiming deduction under Sec. 80-IB

Business profits	40
Less : Carried forward business loss	(–) 10
Gross total income	30
Less : Deduction under Sec. 80-IB 100% of profits derived from undertaking and included in GTI	30
Total Income	**Nil**

Question No.50 (b):

H Bros., an HUF, started an undertaking in "Special Economic Zone" during the previous year 2007-2008. From the following particulars relating to the previous year 2010-2011, compute the total income for the assessment year 2011-2012.

		₹ (in lakh)
(i)	Total turnover	30
(ii)	Export sales	25
(iii)	Business profits	15
(iv)	Receipt of convertible foreign exchange in India up to 30 September 2011	
(v)	Convertible foreign exchange kept outside India with the permission of RBI for importing a new machinery	16
(vi)	Receipt of convertible foreign exchange in December 2011	4
(vii)	Convertible foreign exchange received for reimbursement for freight, insurance attributable to export	2

Solution : Computation of total income

	₹ (in lakh)
Business profits	15
Less : Deduction for export profits : [Sec. 10A]	10
Total income	5

Note :

1. Convertible foreign exchange received in December 2011 has not been included in Export turnover, because it is received after the prescribed time limit without approval of the competent authority.
2. Convertible foreign exchange kept outside India with the permission of RBI is included in Export turnover.
3. Reimbursement of freight and insurance in convertible foreign exchange is not included in Export turnover.

Question No.51 (a):

Z has set up a new undertaking at Durgapur during the year 2010-2011.
Compute taxable profits from the information given below:

	Particulars	**₹ (in lakh)**
(i)	Total turnover	50
(ii)	Export sales	48
(iii)	Export turnover	40
(iv)	Business profit	30
(v)	20 workers were employed during the year, and 18% plant and machinery are second-hand.	

(vi) Imported raw material was not used.

Will your answer be different in the following cases :

(i) Number of workers employed during the year is 19.

(ii) Number of permanent workers are 15 and number of temporary workers are 5.

(iii) Export sales are ₹ 44.99 lakh.

(iv) Percentage of old plant and machinery is 20.5%

(v) 5% raw material was imported from Japan due to domestic shortage.

(vi) ₹ 5 lakh convertible foreign exchange was received but kept outside India to import new machinery without the approval of RBI.

Solution:

Computation of Total Income

	₹ (in lakh)
Business profits	30
Less : Deduction for export profits [Sec. 10BA] :	24
Income	6

Comments :

(i) No deduction will be available as the number of workers is below 20

(ii) Deduction will be allowed. Number of workers should 20 whether permanent or temporary, regular or casuals.

(iii) No deduction will be allowed. Export sales are less than 90% of total turnover.

(iv) No deduction will be allowed. Percentage of old plant and machinery is more than 20% of the total investment in new plant and machinery.

(v) No deduction will be allowed as raw material has been imported.

Amount of deduction will be worked out as below:

	₹ (in lakh)
Business profits	30
Less : Deduction for export profits [Sec. 10BA] :	21
Total income	9

Question No.51(b): The books of account maintained by a National Political Party registered under the Representation of the People Act, 1951 for the year ended on 31-3-2011 disclose the following receipts :

(a) Rent of property let out to a departmental store at Chennai.	10,00,000
(b) Interest on deposits other than banks.	2,00,000
(c) Contribution from 100 persons (who have secreted their names) of ₹ 33,000 each	33,00,000
(d) Contribution @ ₹ 22 each from 1,00,000 members in cash	22,00,000
(e) Net profit of cafeteria run in the premises at Delhi	3,00,000

Compute the total income of the political party for the assessment year 2011-2012, with reason for inclusion or otherwise.

Solution :

Computation of Income of National Political Party: AY 2011-2012

Particulars	₹
(a) Rent from property: Exempt under Sec. 13A	—
(b) Income from business—Profits of cafeteria	3,00,000
(c) Income other sources:	—
(i) Interest on deposit other than banks: Exempt under Sec. ISA	—
(ii) Contributions from 100 persons exceeding ₹ 22,000 each—See Note below,	33,00,000
(iii) Contributions from 1,00,000 members: Exempt Sec. 13A.	—
Total income	**36,00,000**

Note : Any income of a political party received by way of voluntary contributions is exempt, provided:

(i) it keeps and maintains such books of account and other documents as would enable the Assessing Officer to properly deduce its income therefrom;

(ii) it keeps and maintains a record, name and address of the person who has contributed in excess of ₹ 20,000; and

(iii) its accounts are audited by an accountant defined in Explanation below Sec. 288(2).

Thus, in order to claim exemption in respect of voluntary contributions exceeding ₹ 20,000, a political party is required to keep and maintain a record, and names, address of persons who have made such contributions. The legislative intention is to ensure that there is transparency in the process of collection of funds [Common Cause *v.* Vol. 222 ITR 260 (SC)]. Hence, no exemption can be allowed in respect of contributions exceeding ₹ 20,000 from persons who have secreted their names.

Question No.52 (a):

A company is engaged in the development and sale of computer software applications. It has started a new undertaking for which approval as a 100% export-oriented undertaking has been obtained from the CBDT. It furnishes the following data and requests you to compute the deduction allowable to it under Sec. 10B is respect of assessment year 2011-2012.

Particulars	₹ (in lakh)
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

Solution :

Computation of Income of a 100% export-oriented undertaking: AY 2011-2012

Particulars	₹ (in lakh)
Total profit	50
Less: Deduction under Sec. 10B:	25
Taxable profits	25

Note :

Export turnover	(₹ in lakh)
(i) Sale proceeds of software received in convertible foreign exchange within the prescribed perio	250
(ii) Sale proceed in convertible foreign exchange kept outside India with the approval of RBI	50
	300
Less : (i) Telecom and insurance attributable to export turnover	(-) 10
(ii) Expenses incurred in foreign exchange outside India to provide technical assistance to a client there	(-) 40
Export turnover	**250**

Question No.52 (b):

XY & Co., a partnership concern had established an undertaking for manufacturing computer software in Free Trade Zone. It furnishes the following particulars of its second year operations, ending on 31-03-2011:

Particulars	₹ (in lakh)
Total sales of business	100.00
Export sales	80.00
Profit of the business	10.00

Out of the total sales, realisation of sale of ₹ 5 lakh is difficult because of the deficiency of the 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 of depreciation and depreciation of ₹ 3 lakh was charged to the Profit and Loss Account.

Compute the taxable income of XY & Co for the assessment year 2011-2012.

Solution:

Computation of Taxable Income for the A.Y. 2011-12

Particulars	₹ (in lakh)
Profit of business	10,00,000
Add : Depreciation charged on SLM basis	30,000
	1,30,000
Less : Depreciation on WDV basis @ 15% of 17,00,000 – [See Note below]	2,55,000
	10,45,000
Less : Deduction under Sec. 10A : 10,45,000 × 75 ÷ 100	7,83,750
Taxable income	**2,61,250**

Note :

	₹
1. Computation of Depreciation :	
Total purchase price of machine : 3,00,000 15 × 100	20,00,000
Less : Depreciation in the first year @ 15%	3,00,000
WDV at the end of first year	17,00,000
Less: Depreciation for second year @ 15%	2,55,000
WDV at the end of second year	**14,45,000**
2. Export Turnover:	
Export Sales	80,00,000
Less: Remittance not received due to insolvency of buyer	5,00,000
	75,00,000

Question No.53 (a) :

Mr. Gangaprasad, resident in India, turns out 65 years of age on 31st December 2010. He furnishes the following particulars of his income for the previous year 2010-2011:

Particulars		**₹**
(i)	Rent from agriculture land, located in a village of Jharkhand district	2,50,000
(ii)	Rent from building, located in the vicinity of agriculture land, which is assessed to land to revenue and the tenant, cultivating the agricultural land, occupies it for his dwelling and storing purposes	60,000
(iii)	Income from business	3,00,000
(iv)	Long-term capital gain	1,00,000

He maintains a motor car which is used 70% for business purpose, 10% for collecting rent from building and 20% for collecting rent from agriculture land. He has incurred and expenditure of ₹1,00,000 by way of petrol, repair and salary of the driver. He also claims depreciation on the written down value of the motor car on 1.4.2010. ₹ 2,00,000 @ 15%. He has paid ₹ 2000 as local tax to the village panchayat in respect of the building. He also paid ₹ 30,000 land revenue to the Government on account of agriculture land.

Determine his total income and tax liability in the following cases:

(i) Agriculture produce goes under marketing process to fetch better rates in the market,

(ii) Agriculture produce goes under marketing process to make it saleable in the local market.

Solution :

Computation of Total Income for the Assessment Year 2011-2012

(i) Income from house property:		
Gross annual value based on rent	60,000	
Less : Local tax to village panchayat: No deduction is allowed as— it is not a municipal tax	*Nil*	
Net annual value	**60,000**	
Less: (i) Statutory deduction @ 30% of NAV	18,000	
Income from House Property		42,000
Income from house property to be treated as agriculture income provided the agriculture produce is not subjected to marketing produce to fetch better rates [Sec. 2(1A)(c)]		
(ii) Income from business		3,00,000
(iii) Long-term capital gain		1,00,000
(iv) Income from other sources :		
Rent from agriculture land	2,50,000	
Less: Permissible deduction (Sec. 57) :		
(a) Land revenue	(-) 30,000	
(b) Realisation expenses	(-) 20,000	
(c) Depreciation: Not admissible Sec. 57(ii) see Note below		
Income from agriculture [Sec. 2(1A)(a)]	**2,00,000**	
Total income, subject to increase by ₹ 42,000 when produce is subjected to marketing process to fetch better rates.		**4,42,000**

Solution:

Computation of Tax Liability: AY. 2011-2012

Particulars	**Senior citizen**	
	Case I Produce subjected to marketing process for better rates ₹	**Case II** Produce subjected to marketing process to make it saleable ₹
Non-agriculture income	4,42,000	4,00,000
Agriculture income	2,00,000	2,42,000
Total Income	**6,42,000**	**6,42,000**
(a) Tax on non-agriculture income + agriculture income as if it is the total income:		
(i) Tax on long-term capital gain	20,000	20,000
(ii) Tax on balance of total income at slab rates	34,400	34,400
Gross Tax Liability (i) + (ii)	54,400	54,400
(b) Tax on agriculture income + basic exemption limit	20,000	24,200
(c) Tax payable: (a) – (b)	34,400	30,200
Add: Education cess @ 2%	688	604
SHEC @ 1%	344	302
Tax payable	**35,432**	**31,106**
Tax payable to be rounded off to the nearest multiple of ₹ 10 (Sec. 288B)	35,430	31,110

Note :

While computing income under "other sources" depreciation is allowed only in case where plant, machinery or furniture is let out on hire or building along with plant, machinery or furniture is let out on hire [Sec. 57(ii)]

Hence no depreciation is allowed in respect of motor car.

Proportionate depreciation on motor car is permissible under the head "business or profession":

It is assumed it has been allowed as the expression "income from business" refers to taxable income after permissible deductions.

Question No.53 (b) :

RP (HUF), furnishes the following particulars of its income and outgoing for the previous year 2010-2011.

Receipts :	4,00,000
(i) Short-term capital gain	1,00,000
(ii) Gross winning from lottery	12,00,000
(iii) Sale consideration of 3/4th of agriculture produce, derived from land located in India, the balance produce has been kept for family use.	50,000
(iv) Net sale proceeds of wild grass and fruits from trees of spontaneous growth	
Payments:	
(i) Repair of tube-well	60,000
WDV of tuble-well on 1-4-2010	10,00,000
(ii) Wages paid to agriculture labour	6,00,000

(iii) Manuring and spraying charges	50,000
(iv) Rent of the building, used for storing agriculture produce on site	50,000
(v) Petrol, repair, salary of driver and insurance of motor car. WDV of motor car on 1-4-2010	1,50,000 2,00,000
50% use of the motor car is for personal purpose of the family	
(vi) LIP paid to insure members of the family	20,000
(vii) School fees paid for 3 children of the family @ ₹ 15,000 per child	45,000
(viii) Purchase of infrastructure bonds, covered under Sec. 80C(2)(xix)	90,000
(ix) Deposit with LIC for maintenance of a dependant member with disability:	
Unabsorbed losses brought forward:	
AY: 2001-2002	40,000
AY: 2003-2004	5,00,000
AY: 2006-2007	1,00,000

Determine the total income of the HUF and its tax liability for the assessment year 2011-2012.

Solution :

Assessee : R P (HUF)

Computation of Total Income: AY 2010-2011

Particulars	**₹**	**₹**
Computation of net agriculture income for the purpose of aggregation to determine the rate of tax applicable to non-agriculture income of the HUF. Such computation is done under the head business profession:		
(1) Sale proceeds of agriculture produce		12,00,000
Add: Market value of produce kept for family use:		4,00,000
12,00,000 × (4/3) × (1/4)		16,00,000
Less: Permissible deductions:		
(i) Repair of tube-well	60,000	
(ii) Wages	6,00,000	
(iii) Rent	50,000	
(iv) Petrol, repair, salary of driver— 50%	75,000	
(v) Manuring and spraying	50,000	
(vi) Depreciation on tube-well @ 10% on WDV	1,00,000	
(vii) 50% depreciation on motor car: (15% of 2,00,000) x 50%	15,000	9,50,000
Less: Adjustment for Carry Forward Losses :		
(i) Loss 2001-2002-not allowed	Nil	
(ii) Loss from AY 2003-2004	1,00,000	
(iii) Loss from AY 2006-2007	45,000	1,45,000
Net Agriculture Income		**5,05,000**
(2) Computation of Total Income		
(a) Short-term capital gain		4,00,000
(b) Income from other sources:		
(i) Winnings from lottery	1,00,000	

(ii) Net sale proceeds of non-agriculture produce	50,000	1,50,000
Gross Total Income (excluding Agricultural Income)		**5,50,000**
Less: Contributions paid for approved savings [Sec. 80C(2)]:		
(i) LIP on the life of members	20,000	
(ii) School fees for 3 children of the HUF [Sec. 80(4)(c)]	Nil	
(iv) Purchase of NSC	90,000	
	1,10,000	
But deduction restricted upto a maximum of ₹1,00,000		1,00,000
2. Deposit for maintenance (including medical treatment) of a dependant with disability (Sec. 80DD)		50,000
Total Non-Agricultural Income		**4,00,000**
Computation of Tax Liability		
(i) Income tax on winnings 30% on ₹ 1,00,000		30,000
(ii) Income tax on non-agriculture + agriculture income: 3,00,000 + 5,05,000 at slab rates (Non-agricultural income = 3,00,000 = 5,50,000 – 1,00,000 – 1,00,000 – 50,000)		
(a) Income tax on 8,05,000 as if it is the total income	95,500	
(b) Income tax on agriculture income + exemption limit as if it is the total income: 5,05,000 + 1,60,000 = 6,65,000	67,000	
Income tax on non-agriculture income: (a) – (b)	28,500	28,500
Tax on total income		58,500
Add:		
(i) Education cess @ 2%		1,170
(ii) SHEC @ 1%		585
Tax payable		**60,255**

Question No.54(a) :

B Ltd. grows sugarcane to manufacture sugar. The data for the financial year 2010-11 is as follows :

Cost of cultivation of sugarcane	₹ 6,00,000
Market value of sugarcane when transferred to factory	₹ 10,00,000
Other manufacturing cost	₹ 6,00,000
Sales of sugar	₹ 25,00,000
Salary of Managing Director who looks after all operations of the Company	₹ 3,00,000

Solution :

(1) **Business Income :**	
Sales of Sugar	₹ 25,00,000
Less: Market value of sugarcane when transferred to factory	₹ 10,00,000
Other manufacturing cost	₹ 6,00,000
Salary of Managing Director	₹ 3,00,000
	₹ 6,00,000
(2) **Agricultural Income :**	
Market value of sugarcane when transferred to factory	₹ 10,00,000
Less: Cost of cultivation	₹ 6,00,000
	₹ 4,00,000

Question No.54 (b) :

Mr. P has estates in Rubber, Tea and Coffee. He has also a nursery wherein he grows plants and sells. For the previous year ending 31.3.2011, he furnishes the following particulars of his sources of income from estates and sale of Plants. You are requested to compute the taxable income for the Assessment year 2011-2012:

Manufacture of Rubber	₹ 5,00,000
Manufacture of Coffee grown and cured	₹ 3,50,000
Manufacture of Tea	₹ 7,00,000
Sale of Plants from Nursery	₹ 1,00,000

Solution :

Computation of Taxable Income

Rule	Nature of Business	Agl Inc.	Non-Agl. Inc.
7A	Sale of centrifuged latex or cenex manufactured from rubber	3,25,000	1,75,000
7B	Sale of grown and cured coffee by seller in India	2,62,500	87,500
8	Growing and Manufacturing Tea	4,20,000	2,80,000
	Sale of plants from nursery	1,00,000	—
	Total	**11,07,500**	**5,42,500**

Computation of Tax Liability :

		₹
(a)	Total Income (Agricultural Income + Non-agricultural Income)	16,50,000
(b)	Tax on (a) above	3,49,000
(c)	Total of (Agricultural Income + Basic Exemption Limit)	12,67,500
(d)	Tax on (c) above	2,34,250
(e)	Tax Payable (b) – (d)	1,14,750
	Add: Education Cess @ 2%	2,295
	Add: SHEC @ 1%	1,148
	Total Tax Liability	1,18,193
Tax payable rounded off u/s 288B		**1,18,190**

Question No.55

D Ltd., a closely-held Indian company, is engaged in the business of manufacture of chemical goods (value of plant and machinery owned by the company is ₹ 55 lakh). The following information for the financial year 2010-11 are given :

D Ltd. is engaged in the business of manufacture of garments.

	₹
Sale proceeds of goods (domestic sale)	25,00,000
Sale proceeds of goods (export sale)	7,00,000
Amount withdrawn from general reserve (reserve was created in 1996-97 by debiting P&L A/c)	2,00,000
Amount withdrawn from revaluation reserve	1,50,000
Total	**35,50,000**
Less : Expenses	
Depreciation (normal)	6,16,000
Depreciation (extra depreciation because of revaluation)	2,70,000
Salary and wages	2,10,000

Wealth tax	10,000
Income-tax	3,50,000
Outstanding customs duty (not paid as yet)	17,500
Proposed dividend	60,000
Consultation fees paid to tax expert	21,000
Other expenses	1,39,000
Net Profit	**18,56,500**

For tax purposes the company wants to claim the following :

—Deduction under section 80-1B (30 per cent of ₹ 14,56,500).

—Depreciation under section 32 (₹ 5,36,000)

The company wants to set off the following losses/allowances :

	For tax purposes ₹	**For accounting purposes** ₹
Brought forward loss of 2003-04	14,80,000	4,00,000
Unabsorbed depreciation	—	70,000

Compute the net income and tax liability of D Ltd. for the assessment year 2011-12 assuming that D Ltd. has a (deemed) long-term capital gain of ₹ 60,000 under proviso (i) to section 54D(2) which is not credited in profit and loss account.

Solution :

Computation of Tax Liability u/s 115 JB

	₹
Net profit as per P&L A/c	18,56,500
Add :	
Excess depreciation [i.e., ₹ 6,16,000 + ₹ 2,70,000 — ₹ 5,36,000]	3,50,000
Wealth tax	10,000
Income tax	3,50,000
Customs duty which is not paid	17,500
Proposed dividend	60,000
Total	**26,44,000**
Less : Amount withdrawn from reserve (i.e., ₹ 2,00,000+₹ 1,50,000)	3,50,000
Business income	**22,94,000**
Less : Unabsorbed loss	14,80,000
Business Income	8,14,000
Long-term capital gain	60,000
Gross total income	**8,74,000**
Less : Deductions under section 80-IB [30% of ₹ 4,14,000]	1,24,200
Net Income (rounded off)	7,49,800
Tax liability (under normal provisions) [20% of ₹ 60,000 + 30% of ₹ 6,89,800, plus 3% of tax as cess]	2,25,508

Computation of Book profits

Net Profit	18,56,500
Add :	
Depreciation (i.e. ₹ 6,16,000 + ₹ 2,70,000)	8,86,000
Wealth tax	Nil
Income-tax	3,50,000
Proposed dividend	60,000
Less : Amount withdrawn from general reserve	(–) 2,00,000
Unabsorbed depreciation	(–) 70,000
Depreciation (normal)	(–) 6,16,000
Amount withdrawn from revaluation reserve to the extent it does not exceed extra depreciation because of revaluation	(–) 1,50,000
Book profit	**21,16,500**
Tax liability (18.54% of book profit)	3,92,399

D Ltd. will pay ₹ 3,92,399 as tax for the assessment year 2011-12 as per section 115JB. Tax credit is however, available in respect excess tax (i.e., ₹ 1,66,891) under section 115JB.

Question No.56 (a):

What is the due date of filling of return of income in case of a non-working partner of a firm whose accounts are not liable to be audited?

Answer : Due date of furnishing return of income in case of non-working partner shall be 31st July of the assessment year whether the accounts of the firm are required to be audited or not.

A working partner for the above purpose shall mean an individual who is actively engaged in conducting the affairs of the business or profession of the firm of which he is a partner and is drawing remuneration from the firm.

Question No.56 (b):

What do you mean by annexure less return? What is the manner of filling the return of income?

Answer : The return of income and return of fringe benefits required to be furnished in Form No.ITR-1,ITR-2,ITR-3,ITR-4,ITR-5, ITR-6 or ITR-8 shall not be accompanied by a statement showing the computation of the tax payable on the basis of the return, or proof of the tax, if any, claimed to have been deducted or collected at source or the advance tax or tax on self-assessment, if any, claimed to have been paid or any document or copy of any account or Form or report of audit required to be attached with the return of income or the return of fringe benefits under any of the provisions of the Act.

Manner of filling the return: The return of income or return of fringe benefits referred to in sub-rule (1) may be furnished in any of the following manners, namely:-

(i) Furnishing the return in a paper form;

(ii) Furnishing the return electronically under digital signature;

(iii) Transmitting the data in the return electronically and thereafter submitting the verification of the return in Form ITR-V;

(iv) Furnishing a bar-coded return in paper form.

Question No.56(c):

Is e-filling of return mandatory? State the assessee's for whom e-filling of returns is mandatory?

Answer : It shall be mandatory for the following assessee's to file the return electronically:

(a) A firm required to furnish the return in Form ITR-5 and to whom provisions of Section.44AB are applicable, or

(b) A company required to furnish the return in Form ITR-6

Question No.56(d):

Can unabsorbed depreciation be carried forward even if the return is filed after due date?

Answer : Unabsorbed depreciation can be carried forward even if the return of loss is submitted after the due date, as it is not covered under Chapter VI of set off or carry forward of losses but covered u/s 32(2).[East Asiatic Co.(India) Pvt. Ltd. vs.CIT (1986) 161 ITR 135(Mad.)]

Question No.56 (e):

Can a belated return of income filed u/s 139(4) be revised?

Answer : There was a difference of opinion among various courts regarding filling of revised return in respect of belated returns. However, it has been held that a belated return filed u/s 139(4) cannot be revised as section 139(5) provides that only return filed u/s 139(1) or in pursuance to a notice u/s 142(1) can be revised [Kumar Jagdish Chandra Sinha vs.CIT(1996) 220 ITR 67(SC)].

Question No.56 (f):

Can a revised return be further revised?

Answer : If the assessee discovers any omission or any wrong statement in a revised return, it is possible to revise.

Question No.56 (g):

What are the different forms used for furnishing return under Income Tax Act, 1961?

Answer: The different forms used for furnishing return of Income are as follows:

ITR - 1	Return of Income for Individuals having salary and interest income and no other Income
ITR-2	Return of income for Individuals and HUFs having income from any source except from business or profession
ITR-3	Return of income for Individuals and HUFs being partners in Firms and not having Proprietary business or profession
ITR -4	Return of Income for Individuals and HUFs having Proprietary business or profession
ITR-5	Combined form of Return of Income and Fringe Benefits for Firms/AOP/BOI.
ITR-6	Combined Form for Return of Income and Frlnge Benefits for Companies
ITR-7	Combined Form For Return of Income and Fringe Benefits For Charitable/Religious Trusts, Political parties and other Non-Profit Organisations
ITR-8	Stand alone form for Return of Fringe Benefits for persons who are not liable to file Return of income but are liable to file Return of Fringe-Benefits
ITR-V	Return of Income/Fringe Benefits transmitted electronically without digital signatures

Question No.56 (h):

Define belated return.

Answer: BELATED RETURN [SECTION 139(4)]

(1) Any person who has not furnished a return within the time allowed to him under section 139(1) or within the time allowed under a notice issued under section 142(1) may furnish the return for any previous year at any time -

 (i) before the expiry of one year from the end of the relevant assessment year; or

 (ii) before the completion of the assessment, whichever is earlier.

(2) Interest is required to be paid under section 234A, as stated above.

Question No.57 (a):

What is a protective assessment under Income-tax law? What is the procedure followed for the recovery of tax in such cases?

Answer: A protective assessment is made in a case where there are doubts relating to the true ownership of the income. If there is an uncertainty about the taxing of an income in the hands of Mr. A or Mr. B, then at the discretion of the Assessing Officer, the same may be added in the hands of one of them on protective basis. This is to ensure that on finality, the addition may not be denied on the ground of limitation of time. Once finality regarding the identity of the tax payer to be taxed is established, the extra assessment is cancelled. But the Department cannot recover the tax from both the assessees in respect of the same income. Penalty cannot be imposed on the strength of a protective assessment.

Question No.57 (b):

Joseph engaged in profession filed his return of income for assessment year 2011-12 on 15th November, 2011. He disclosed an income of ₹4,00,000 in the return. In February, 2012 he discovered that he did not claim certain expenses and filed a revised return on 3rd February, 2012 showing an income of ₹1,80,000 and claiming those expenses. Is the revised return filed by Joseph acceptable?

Answer: Joseph is engaged in profession. The due date for filing income tax return for assessment year 2011-12 as per section 139(1) of the Income-tax Act is 30th September, 2011 if his accounts are required to be audited under any law. The due date is 31st July, 2011 if the accounts are not required to be audited under any law.

The return was filed beyond the due date prescribed in section 139(1). The return so filed is covered by section 139(4) and the time limit is one year from the end of the relevant assessment year. The Apex court in *Kumar Jagadish Chandra Sinha v. CIT 220 ITR 67 (SC)* has held that a return filed under section 139(4) is not eligible for revision and hence a revised return cannot be filed.

Hence, the return filed by Joseph is not valid as the original return was not filed before the due date mentioned in section 139(1).

Question No.57 (c):

An assessee filed a return of income on 31.8.2011 in respect of Assessment year 2011-12 disclosing an income of ₹ 5 lakhs from business. It was not accompanied by proof of payment of tax due on self-assessment. Discuss the validity of such a return.

Answer : As per Explanation to sub-section (9) of section 139 a return is regarded as defective unless it is accompanied by proof of tax deducted at source, advance tax and tax on self-assessment, if any, claimed to have been paid. Therefore, the return is prima facie defective. It is not invalid at that stage. On receipt of the return, the Assessing Officer has to intimate the defect to the assessee and give him an opportunity to rectify the defect within a period of 15 days from the date of such intimation or within such further period which, on application by the assessee, he may, in his discretion allow. If the defect is not rectified within the said period, the return will be treated as an invalid return and the provisions of the Income-tax Act shall apply, as if the assessee has failed to furnish the return.

Also, it may noted that section 140A(3) says that if an assessee fails to pay tax or interest on self assessment he shall be deemed to be an assessee in default in respect of the tax or interest or both remaining un paid and all the provisions of the Act shall apply accordingly.

Question No.57 (d):

If an assessment is remanded back to Assessing Officer, can he introduce new sources of income for assessment?

Answer: Where the assessment is set aside by the Tribunal and the matter remanded to the Assessing Officer, it is not open to him to introduce into the assessment new sources of income so as to enhance the assessment. Any power to enhance is confined to the old sources of income which were the subject matter of appeal [Kartar Singh vs.CIT (1978) 111 ITR 184 (P &H)].

Question No.57 (e):

Can Department make fresh computation, once the assessment is made final?

Answer: It is now a well settled principle that an assessment once made is final and that it is not open to the department to go on making fresh computation and issuing fresh notices of demand to the end of all time. [ITO vs. Habibullah (S.K.) (1962) 44 ITR 809 (SC)]

Question No.57 (f):

Can an Assessing Officer make an assessment for a year other than the assessment year for which the return is filed?

Answer: It is not open to the Assessing Officer to make assessment in respect of a year other than the Assessment Year for which the return is filed. Thus, in respect of a return filed for assessment year 2010-11, assessment cannot be made for the assessment year 2011-12. [CIT vs. Amaimugan Transports Pvt. Ltd.(1995) 215 ITR 553 (Mad.)]

Question No.57 (g):

Can an Assessing Officer assess the income below the returned income or assess the loss higher than the returned loss?

Answer: The Assessing Officer cannot assess income under section 144 for an assessment below the returned income or cannot assess the loss higher than the returned loss.

Question No.58 (a)

A & B are members of AOP, sharing profit and losses in the ratio of 5 : 3 and they are allowed the following payments:

	A ₹	B ₹
(i)Salary	40,000	60,000
(ii)Interest on capital or loan	20,000	10,000

You are required to compute taxable business profits of AOP and share of each member for the previous year 2010-2011 in the following cases:

(a)AOP has earned profit of ₹ 3,00,000 after making the above payments;
(b)AOP has earned profit of ₹ 3,00,000 before making the above payments;

(c)AOP has suffered loss of ₹ 3,00,000 after making the above payments; and
(d)AOP has suffered loss of ₹ 3,00,000 before making the above payments.

Solution: **Computation of Income of AOP for the PY 2010-2011**

Particulars ₹	Case (a) ₹	Case(b) ₹	Case (c) ₹	Case (d) ₹
Profit/ loss	(+) 3,00,000	(+) 3,00,000	(-) 3,00,000	(-) 3,00,000
Add: Inadmissible payments				
[Sec. 40 (ba)]:				
(i) Salary to members (40,000+60,000)	(+) 1,00,000	—	(+) 1,00,000	—
(ii) Interest on capital/loan	(+) 30,000	—	(+) 30,000	—
to members: (20,000 + 10,000)				
Profit/loss as per income-tax law	(+) 4,30,000	(+) 3,00,000	(-) 1,70,000	(-) 3,00,000

Solution:

Computation of Member's share in the Income/Loss of the AOP

Particulars	Case (a)		Case (b)		Case (c)		Case (d)	
	A ₹	B ₹	A ₹	B ₹	A ₹	B ₹	A ₹	B ₹
Salary	40,000	60,000	40,000	60,000	40,000	60,000	40,000	60,000
Interest	20,000	10,000	20,000	10,000	20,000	10,000	20,000	10,000
Divisible profit:								
(a) 4,30,000–1,30,000	1,87,500	1,12,500	X	X	X	X	X	X
(b) 3,00,000–1,30,000	X	X	10,6250	63750	X	X	X	X
(c) (–) 1,40,000 +	X	X	X	X	(1,68,750)	(101250)	X	X
(–)1,30,000= (-)2,70,000								
(d) (-) 3,00,000 +								
(-) 1,30,000= (-) 4,30,000	X	X	X	X	X	X	(2,68,750)	(161250)
Share of profit/loss	2,47,500	1,82,500	1,66,250	1,33,750	(108750)	(31250)	(208750)	(91250)

(i) *Where assessed business income is a profit:* Beneficial payments (i.e. salary, bonus, commission and interest) made to partners should be deducted from assessed profit to arrive at divisible profit, which is to be apportioned among members.

(ii) *Where assessed business income is a loss:* Beneficial payments made to partners should be added to assessed loss to arrive at the divisible loss which is to be apportioned among members.

Question No.58 (b)

Anand and Aniket are equal members in AA & Associates. The profit and loss account of the AOP for the year ending 31st March 2011 is as follows:

Particulars	₹	Particulars	₹
Selling and administrative		Gross Profit	20,00,000
Expenses	8,00,000	Income from house property	3,60,000
Interest to Anand @ 15%	60,000		
Remuneration:			
Anand	1,50,000		

Aniket	1,50,000	
Net profit:		
Anand	6,00,000	
Aniket	6,00,000	
	23,60,000	**23,60,000**

Other information :

1. Selling and administrative expenses include ₹ 60,000 paid to a consultant in cash.
2. The other income/investment details of the members are given as below:

Members	Income	Source of income	Investments
Anand	90,000	Interest on fixed deposit from bank	Purchase of NSC VIII ₹ 30,000
Aniket	1,00,000	Interest on govt. securities	Contribution to PPF ₹ 50,000

Compute the tax liability of the AOP and it members.

Solution:

Computation of Total Income of AOP: PY 2010-2011

Particulars	**₹**
Net profit	12,00,000
Add: Inadmissible payments.	
1. Fees paid to consultants in cash Sec. 40A (3)	60,000
2. Interest paid to members [Sec. 40(ba)]:	60,000
3. Remuneration paid to members Sec. 40(ba)	3,00,000
	16,20,000
Less: Income from house property	3,60,000
Business profits	**12,60,000**
Add: Income from house property	3,60,000
Total income	**16,20,000**
Tax liability of AOP on total income	
Tax on slabs rates	3,90,000
Add:	
Education cess 2%	7,800
SHEC @ 1%	3,900
Tax payable	**4,01,700**

Allocation of income amongst the members:

Particulars	**Anand ₹**	**Aniket ₹**	**Total ₹**
Interest	60,000	—	60,000
Remuneration	1,50,000	1,50,000	3,00,000
Share of divisible profit (12,60,000-60,000-3,00,000)	4,50,000	4,50,000	9,00,000
Share of profit	6,60,000	6,00,000	12,60,000
Share of income from house property	1,80,000	1,80,000	3,60,000
	8,40,000	7,80,000	16,20,000

Computation of Total Income of members:

Particulars	Anand ₹	Aniket ₹
Share income from AOP	8,40,000	7,80,000
Income from other sources:		
Interest on bank deposits	90,000	—
Interest on government securities	—	1,00,000
Gross total income	**9,30,000**	**8,80,000**
Less: Deduction under Sec. 80C	30,000	50,000
Total income	**9,00,000**	**8,30,000**
Tax liability of members : Tax on slab rates	1,74,000	1,53,000
Add: Education Cess @ 2% on income tax	3,480	3,060
Add : SHEC @ 1%	1,740	1,530
	1,79,220	**1,57,590**
Less: Rebate on share of profit at the average: (See Note below)	**1,67,272**	**1,48,097**
Tax payable	11,948	9,493
Tax payable rounded off to the nearest multiple of ₹ 10 (See. 288B)	11,950	9,490
	15,050	12,290

Question No.59 (a)

A, B and C Ltd. are three members of an AOP, sharing profit and losses in the ratio 2:2:1. The AOP discloses its income for the PY 2010-2011 as below:

Particulars	₹
(i) Long-term capital gains	4,00,000
(ii) Business profits	6,00,000

Determine tax liability of AOP in the following cases:

(i) C Ltd. is an Indian company

(ii) C Ltd. is a foreign company

Solution: Allocation of income of AOP among partners

Particulars of income	A ₹	B ₹	C Ltd ₹
Long-term capital gains	1,60,000	1,60,000	80,000
Business profits	2,40,000	2,40,000	1,20,000
Share income of the members	4,00,000	4,00,000	2,00,000

Tax liability of AOP

Particulars	Case – I C Ltd. an Indian company ₹	Case – II C. Ltd. as foreign company ₹
Tax on the share of C Ltd.		
Case I : 1,20,000 x 33.99%	40,788	—
Case II: 1,20,000 x 42.23%	—	50,676
Tax on balance income at AOP:		
(i) Long-term capital gain 4,00,000 x 22.66%	90,640	90,640
(ii) Business profits 6,00,000 x 33.99%	2,03,940	2,03,940
Total tax payable	3,35,368	3,45,256
Total Tax (Rounded off a/c 288B)	3,35,370	3,45,260

Question No.59 (b)

R, S and T Ltd. (a widely held domestic company) are members in an AOP for the previous year 2010-2011. They share profit and losses in the ratio 30%, 40% and 30%. Taxable business income of AOP is determined at ₹ 8,00,000. Personal income of the partners are given below:

	₹
R - House property	90,000
S – Short-term capital gain	1,00,000

R deposites ₹ 20,000 in CTDS-15-year account in Post Office in February 2010. S purchases NSC VIH-Issue for ₹ 25,000 in December 2010.

Determine the tax liability of the AOP and its partners

Solution:

Computation of Tax Liability of AOP for the Previous Year 2010-2011.

Allocation of AOP income among members:

Particulars	**R** ₹	**Y** ₹	**T Ltd.** ₹
Business profit	2,40,000	320000	240000
Tax liability of AOP: 8,00,000 × 33.99%		2,71,920	

Tax liability of members:

Particulars	**R** ₹	**Y** ₹	**T Ltd.** ₹
Share income from AOP	2,40,000	320000	240000
AOP charged at maximum marginal rate	Exempt	Exempt	Exempt
Personal income of members	90,000	75,000	Nil
Personal income below taxable limit	Exempt	Exempt	X

Question No.59 (c)

GMK are partners in a firm assessed as an association of persons. They share profit and losses in the ratio of 4:3:3. The abridged profit and loss for the previous year 2010-2011 is as follows:

Particulars	₹	**Particulars**	₹
Business expenses	5,00,000	Gross profits	6,85,000
Salaries to partners		Short-term capital gain	2,80,000
G	60,000	Interest on drawings	
M	40,000	G	5,000
K	50,000	M	20,000
Bonus to partners:		K	10,000
G	30,000		
M	20,000		
Commission to K	40,000		
Interest to partners:			
G	20,000		
M	15,000		
K	25,000		
Net profit			
G	80,000		
M	60,000		
K	60,000		
	10,00,000		**10,00,000**

Business expenses include donation to Nalanda University ₹ 50,000. Compute the taxable income of AOP, its tax liability and tax liability of its members in the following

Personal Income of Members	Case-I ₹	Case-II ₹
G: Interest on bank deposits	40,000	1,00,000
M: Interest on government securities	65,000	1,20,100
K: Income from house property	50,000	1,10,000
LIP paid by every member on a policy of ₹ 1,00,000.	20,000	20,000

Solution :

Computation of Taxable Business Profits

Particulars	₹
Net profit as per Profit & Loss A/c	2,00,000
Add: (i) Donation to Nalanda University	50,000
(ii) Salaries to partners [Sec. 40(ba)] (60,000 + 40,000 + 50,000)	1,50,000
(iii) Bonus to partners 30,000 + 20,000	50,000
(iv) Interest on capital (Net of Interest on Drawings)	15,000
G 20,000 – 5,000 =	15,000
K 25,000 – 10,000 =	15,000
(v) Commission to K	40,000
	5,20,000
Less: Short-term capital gain	2,80,000
Taxable profits	**2,40,000**
(a) Computation of total income	
Add: (i) Business profits	2,40,000
(ii) Short-term capital gain	2,80,000
Gross total income	**5,20,000**
Less: Deduction for charitabe donation (Sec. 80G)	
(a) Actual donation ₹ 50,000 or,	
(b) 10% of gross total income:	
whichever is less, is qualifying amount. It is ₹ 50,000.	25,000
Amount of deduction 50% of qualifying amount	
Total income	**4,95,000**

Tax liability of AOP :

Particulars	**Case I**	**Case II**
(a) Tax on total income at slab rates including Education Cess and SHEC	1,00,425	—
(b) Tax on total income at maximum marginal rates including surcharge plus education cess plus SHEC	—	1,68,251
Tax payable	1,00,425	1,68,251
Tax payable rounded off (u/s 288 B)	1,00,420	1,68,250

Tax liability of members:

Case:(a) where AOP is taxed at slab rates:

	Share of income from AOP: (₹)	**G** (₹)	**M** (₹)	**K** (₹)	**Total**
(i)	Salary	60,000	40,000	50,000	1,50,000
(ii)	Bonus	30,000	20,000	—	50,000
(iii)	Commission	—	—	40,000	40,000
(iv)	Interest	15,000	—	15,000	30,000
	1,05,000	60,000	1,05,000	2,70,000	
(v)	Divisible loss : (2,40,000-25,000)-270,000				
	= (-) 55,000	(-) 22,400	(-) 16,500	(-) 16,500	(-) 55,000
	Share of business profit	83,000	43,500	88,500	2,15,000
	Share of short-term capital gain	112,000	84,000	84,000	2,80,000
	Share of income from AOP	**1,95,000**	**1,27,500**	**1,72,500**	**4,95,000**

Total income and tax liability of members :

Particulars	**G**	**M**	**K**
Income from house property	—	—	50,000
Income from other sources	40,000	65,000	—
Share income from AOP:	1,95,000	1,27,500	1,72,500
Gross total income	**2,35,000**	**1,92,500**	**2,22,500**
Less: Deduction under Sec. 80C: LIP restricted to 20% of policy	20,000	20,000	20,000
Total income	**2,15,000**	**1,72,500**	**2,02,500**
Gross income tax at slab rate	17,000	8,500	10,500
Add: Surcharge	Nil	Nil	Nil
Add: Education Cess @ 2%	340	170	210
Add : SHEC @ 1%	170	85	105
	17,510	8,755	10,815
Less: Rebate on share of profit from firm at the average rate	15,881	6,471	9,213
Tax payable	1,629	2,284	1,602
Tax payable rounded off (u/s 288B)	**1,630**	**2,280**	**1,600**

Note 1: 17,510 ÷2,15,000 X 195000 = 15881

Note 2: 8,755 ÷ 172500 X 1275000 = 6471

Note 3: 10815 ÷ 202500 X 172500 = 9213

Case (b) where AOP is taxed at maximum marginal rate:

	G	M	K
1. Share of profit from AOP; Since the AOP was assessed at the maximum marginal rate, share of income from AOP is exempt (Sec. 86)	—	—	—
2. Personal income:			
Income from other sources	1,00,000	1,20,100	1,10,000
Less: Deduction u/s 80C	(-) 20,00	(-) 20,000	(-) 20,000
Total income	80,000	1,00,100	90,000
	Nil	Nil	Nil
Total Income	Nil	Nil	Nil

Question No.60 (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 ending 31st March 2011, the profit and loss account of the business was as under:

Particulars	Rupees in thousand	Particulars	Rupees in thousands
Cost of goods sold	6,250.00	Sales	9,900.00
Remuneration to:		Dividend from companies	25.00
T	130.00		
Q	170.00	Long-term Capital gains	1,640.00
Employees	256.00		
Interest to :			
T	48.30		
Q	35.70		
Other expenses	111.70		
Sales-tax penalty due	39.00		
Net profit	4,524.30		
	11,565.00		11,565.00

Additional information furnished:

(i) Other expenses included:

(a) entertainment expenses of ₹ 35,000;

(b) wristwatches costing ₹ 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 ₹ 6,000 to the Provident Fund was paid on 14th January 2011.

(d) ₹ 30,000 was paid in cash to an advertising agency for publicity.

(ii) Outstanding sales tax penalty was paid on 15th April 2011. The penalty was imposed by the sales tax officer for non-filing of returns and statements by the due dates.

(iii) T and Q had, for this year, income from other sources of ₹ 3,50,000 and ₹ 2,10,000, respectively.

Required to:

(i) Compute the total income of the AOP for the previous year 2010-2011.

(ii) Ascertain the tax liability of the Association for that year; and

(iii) Ascertain the tax liability for that year of the individual members.

Solution : (a)(i) Computation of total income of the AOP for PY 2010-2011

Particulars	₹	₹
Profit and gains of business (see Working Note below)		33,12,300
Long term capital gain		16,40,000
Income from other sources [dividend is exempt u/s 10(34), assuming it is from domestic companies]		
Total Income		**49,52,300**
Computation of Profits and Gains of business:		
Net profit as per profit and loss account		45,24,300
Add: Inadmissible payments:		
Interest to members T & Q (₹ 48,300 + ₹ 35,700)	84,000	
Advertising [disallowance u/s 40A(3)	30,000	
Remuneration to members T & Q (₹ 1,30,000 + ₹ 1,70,000)	3,00,000	
Sales tax penalty due (See Note 3 below)	39,000	4,53,000
		49,77,300
Less : Income not taxable under this head		
Dividend from companies	25,000	
Long term capital gain	16,40,000	16,65,000
Profits and gains of business		**33,12,300**

(ii) Computation of Tax Liability of the AOP for PY 2010-2011

Particulars	₹	₹
Long-term capital gain (₹ 16,40,000 × 20%)		3,28,000
Other income (₹ 33,12,300 × 30%)		9,93,690
Tax on total income		13,21,690
Add : Surcharge @ 10%		1,32,169
		14,53,859
Add : Education cess @ 2%		29,077
Add : SHEC @ 1%		14,539
Total tax due		**14,97,445**
Total Tax Rounded off (u/s 288B)		**14,97,440**

Note:

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 and as such surcharge shall be chargeable at the rate of 10%.
2. Since the employer's contribution to PF has been paid during the previous year 2010-2011 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.

(iii) Computation of tax liability of members T & Q for the PY 2010-2011

Particulars	₹	Particulars	₹
Tax on ₹ 3,50,000	54,000	Tax on ₹ 2,10,000	16,000
Add : Surcharge	Nil		Nil
	54,000		16,000
Add : Education cess @ 2%	1,080		320
Add : SHEC @ 1%	540		160
Net Tax Payable	**55,620**		**16,480**

Question No.60 (b)

Shri Dubbawala Charitable Trust (Regd.) submits the particulars of its income/outgoing for the previous year 2010-2011 as below :

		₹
(i)	Income from property held under trust for charitable purposes:	10,00,000
	(₹ 5,20,000 out of ₹ 10,00,000 is received in PY 2011-2012)	
(ii)	Voluntary contributions (out of which ₹ 50,000 will form part of the corpus)	2,00,000

The trust spends ₹ 2,77,500 during the previous year 2010-2011 for charitable purposes. In respect of ₹ 5,20,000, it has exercised its option to spend it within the permissible time-limit in the year of receipt or in the year, immediately following the year of receipt.

The trust spends ₹ 2,00,000 during the previous year 2009-2010 and ₹ 1,00,000 during the previous year 2011-2012. Compute and discuss the chargeability of the income of the trust.

Solution :

(a) Computation of taxable income and tax liability of the charitable trust for the PY 2010-2011/AY 2011-2012

	Particulars			₹
(i)	Income from property held under trust for charitable purposes			10,00,000
(ii)	Voluntary contributions (₹ 2,00,000 - ₹ 50,000)			1,50,000
				11,50,000
	Less: 15% set apart for future application			1,72,500
	Balance			9,77,500
	Less: Amount spent during the previous year for charitable purposes			2,77,500
	Balance			7,00,000
	Less: Income not received during the previous year 2010-2011			5,20,000
	Taxable income			**1,80,000**
	Tax payable:	Rate of tax		
	1,10,000	Nil		nil
	40,000	10%		4,000
	30,000	20%		6,000
				10,000
	Add: Education Cess @ 2%			200
	Add: SHEC @ 1%			
				100
		Tax payable		10,300
(b)	Previous year 2011-2012/AY 2012-2013			
	Income received during the previous year 2010-2011		5,20,000	
(i)	Amount spent for charitable purposes during PY 2010-2011		2,00,000	
(ii)	Amount spent for charitable purposes during 2011-2012		1,00,000	
	Taxable income		**2,20,000**	

Question No.60 (b)

Shri Mungeri Ram Temple Trust (Regd.) derived ₹ 6,00,000 income from the property held under charitable trust during the previous year 2010-2011. About 40% of the income has been received by the end of the financial year. The trust could spend ₹ 60,000 for charitable purposes during the year 2010-2011 and 40% receipts, received by the year end in 2010-2011, are being planned to be applied for charitable purposes during the previous year 2011-2012. Compute its income for the said two years if the amount planned to be spent during previous year 2011-2012 for charitable purposes is ₹ 1,00,000.

Solution :

Computation of Taxable Income of Charitable Trust: PY 2010-2011/AY 2011-2012.

Particulars	₹
Income from property held under trust	6,00,000
Less: 15% set apart for future application for charitable purposes	90,000
Balance	5,10,000
Less : Income applied for charitable purposes during the year 2010-2011	60,0000
Balance	4,50,000
Less: Income realised by the close of the previous year—40% of ₹ 6,00,000	2,40,000
Taxable income	**2,10,000**

(b) Previous year : 2009-2010/AY 2010-2011

Amount set apart in 2010-2011 to be applied for charitable purposes in 2011-2012	= 2,40,000
Less: Amount applied for charitable purposes	= 1,00,000
Taxable income	**1,40,000**

Question No.60(c)

Devdas Charitable Trust submits the particulars of its receipts and outgoing during the previous year 2010-2011. as below :

		₹
(i)	Income from property held under trust for charitable purposes	20,00,000
(ii)	Voluntary contribution (out of which ₹ 5,00,000 will form part of the corpus)	15,00,000
(iii)	Donations paid to blind charitable school	6,00,000
(iv)	Scholarship paid to poor students	4,00,000
(v)	Amount spent on holding free eye camps in urban slums	3,00,000
(vi)	Amount set apart for setting up an old age home by March 2013	10,00,000

Compute the total income of the trust for the previous years 2009-2010 and 2014-2015 if it spends ₹ 5,00,000 during the previous year 2013-2014 and ₹ 3,00,000 during the previous year 2014-2015 in setting up the old age home.

Solution :

Computation of the Taxable Income of the trust for previous year 2010-2011/AY 2011-2012.

	Particulars		₹
(i)	Income from property held under charitable trust		20,00,000
(ii)	Income from voluntary contributions (₹ 15,00,000-₹ 5,00,000)		10,00,000
	Total		**30,00,000**
	Less: 15% set apart for future application		45,00.000
	Balance		**25,50,000**
	Less: Income applied for charitable purposes:		
(i)	Donations to blind charitable school	6,00,000	
(ii)	Scholarship to poor students	4,00,000	
(iii)	Free eye camps in urban slums	3,00,000	
	Total	**13,00,000**	
	Amount set apart for old age home	**10,00,000**	23,00,000
	Taxable income		**2,50,000**
(b)	Previous year 2014-2015 /AY 2015-2016:		
	Amount set apart for old age home	10,00,000	

Less:	
1. Amount spent during 2013-2014	3,00,000
2. Amount spent during 2014-2015	5,00,000
Taxable income	**2,00,000**

Question No.61 (a)

Dinesh Pally Cooperative Society Ltd. furnishes the following particulars of its income for the previous year ended 31st March 2011:

(i)	Interest on government securities	40,000
(ii)	Profits from banking business	3,50,000
(iii)	Income from purchase and sale of agricultural implement and seeds to its members	2,50,000
(iv)	Income from marketing of agricultural produce of its members	4,00,000
(v)	Profits and gains of business	2,20,000
(vi)	Income from cottage industry	3,50,000
(vii)	Interest and dividends (gross) from other cooperative societies	30,000

Compute total income of the society and calculate the tax payable by it for the assessment year 2011-2012.

Solution :

Dinesh Pally Cooperative Society Ltd.

Computation of income of the for the previous year 2010-2011 relating to the Assessment Year 2011-2012 :

Particulars	₹	₹
1. Profits and gains of business or profession:		
a) Banking business	3,50,000	
b) Income from purchase and sale of agricultural implements and seeds to its members	2,50,000	
c) Income from marketing of agricultural produce of its members	4,00,000	
d) Profits and gains of business	2,20,000	
e) Income from cottage industry	3,50,000	15,70,000
2. Income from other sources:		
a) Interest on government securities	40,000	
b) Interest and dividends from other cooperatives	30,000	70,000
Gross Total Income		**16,40,000**
Less: Deduction allowable from gross total income under Sec. 8OP		
1. Banking business	3,50,000	
2. Income from purchase and sale of agricultural implement and seeds to its members	2,50,000	
3. Income from marketing of agricultural produce of its members	4,00,000	
4. Income from cottage industry	3,50,000	
5. Interest on government securities(not eligible for deduction)	Nil	
6. Interest and dividends from other cooperative societies	30,000	13,80,000
Total Income		**2,60,000**

Computation of Tax Liability:

Particulars	Rate	₹
On first ₹ 10,000	10%	1,000
On next ₹ 10,000	20%	2,000
On balance ₹ 2,40,000	30%	72,000
Income tax payable		75,000
Add: Education cess @ 2%		1,500
Add: SHEC @ 1%		750
Tax payable		**77,250**

Question No.61 (b)

The following details have been supplied by the Karta, of an HUF aged 67 years. You are required to compute its total income and tax liability for the assessment year 2011-2012.

	Particulars	₹
(i)	Profits from business (after charging ₹ 1,00,000 salary to Karta for managing the business).	15,00,000
(ii)	Salary received by the member of a family.	60,000
(iii)	Director's fee received by Karta from B Ltd where HUF holds 20% shares but he became director because of his qualifications,	40,000
(iv)	Rental income from house property (after deduction of municipal taxes ₹ 2,000).	78,000
(v)	Dividends (gross) from Indian companies	15,000
(vi)	Long-term capital gain	80,000
(vii)	Short-term capital gain	30,000
(viii)	Donation to a school, which is an approved institution,	1,00,000
(ix)	Deposits in Public Provident Fund	20,000
(x)	NSC-VIII issues purchased	40,000

Solution: Computation of Total Income for the A.Y. 2011-12

Particulars	₹	₹
(i) Income from house property:		
Gross annual value (₹ 78,000 + ₹ 12,000)	90,000	
Less: Municipal taxes paid	12,000	
Annual value	78,000	
Less: Statutory deduction: 30% ×78,000	23,400	54,600
(ii) Profits and gains from business		15,00,000
(iii) Capital gains (a) long-term + (b) short-term		1,10,000
(iv) Income from other sources—gross dividends from Indian companies: Exempt [Sec. 10(34)]		Nil
Gross total income		**16,64,600**
Less:		
1. Contribution to approved savings (Sec. 80C)		
(i) Deposits in Public Provident Fund	20,000	
(ii) NSC-VIII Issue	40,000	60,000
2. Donation to recognised school:		
(a) Actual donation: ₹ 1,00,000 or		

(b) 10% of adjusted total income = (Gross Total Income – Long Term Capital Gains – All deductions under Chapter VIA excluding Sec. 80G) of ₹ 15,24,600 (16,64,600 - 80,000 - 60000) whichever is less, is qualifying amount.		
Amount of deduction: : 50% of ₹ 1,00,000	50,000	1,10,000
Total Income		**15,54,600**

Computation of tax liability:

	Particulars of total income	**Rate of income tax**		₹
		₹	₹	
(a)	Long-term capital gain	80,000	20%	16,000
(b)	Balance of total income: ₹ 14,74,600			
	(i) First	2,40,000	Nil	—
	(ii) Between 2,40,000 – 5,00,000	3,60,000	10%	26,000
	(iii) Between 5,00,000 – 8,00,000	3,00,000	20%	60,000
	(iv) Between 8,00,000 – 14,74,600	6,74,600	30%	2,02,380
Gross income tax				**3,04,380**
Add:	Education cess @ 2% on income tax			6,088
	SHEC @ 1% on income tax			3,044
Tax payable				**3,13,512**
Rounded off u/s 288B				**3,13,510**

Question No.62 (a)

From the following information, determine the tax liability of Z Ltd., domestic company, for the assessment year 2010-2011 and 2011-2012.

Assessment year	Book-profits (₹)	Total income (₹)
2010-2011	2,80,000	1,30,000
2011-2012	3,00,000	2,00,000

Solution :

Surcharge is not considered assuming, net income less than Rs. 1 crore

Assessment year	Book-profit	Total Income	Tax on Book-Profit	Tax on Total Income @ 30.9% rounded off u/s 288B	Tax Credit = Tax on Book Profits (–) Tax on Total Income	Tax Payable after tax credit set off, if any	Tax credit balance
	₹	₹	₹	₹	₹	₹	₹
2010-2011	2,80,000	1,30,000	@ 15.45% on 2,80,000 = 43,260	@ 30.9% on 1,30,000 = 40,170	3,090	43,260	3,090
2011-2012	3,00,000	1,50,000	@ 18.54% on 3,00,000 = 55,620	@ 30.9% on 2,00,000 = 61,800	—	58,710 [61,800 – 3,090]	—

Note : Tax payable is rounded off to the nearest multiple of ₹ 10 (Sec. 288B)

Question No.62 (b)

Classic Exporters Ltd, runs a new industrial undertaking set up in 2005-2006 which satisfies the conditions of Sec. 80-IB. Given below is the profit and loss account for the previous year 2010-2011.

Particulars	₹	Particulars	₹
Stock	4,00,000	Domestic sales	24,00,000
Purchases	23,00,000	Export sales	43,00,000
Salaries and wages	9,70,000	Export incentives Sec. 28(iiia)/(iiic)	50,000
Entertainment expenses	1,30,000	Profit of foreign branch	2,50,000
Freights and insurance attributable to exports	3,00,000	Brokerage/commission/interest/ rent, etc	50,000
Travelling expenses	2,20,000	Transfer from contingency reserve	10,00,000
Depreciation	1,50,000	Stock	3,50,000
Selling expenses	1,20,000		
Income tax paid	90,000		
Income-tax penalty	20,000		
Wealth tax paid	10,000		
Custom duty payable against demand notice	30,000		
Provision for unascertained liabilities	20,000		
Provision for ascertained liabilities	50,000		
Proposed dividend	3,00,000		
Loss of subsidiary company	50,000		
Net profit	32,40,000		
	84,00,000		**84,00,000**

You are further informed:

(i) Excise duty for 2009-2010, amounting ₹ 1,20,000 was paid on 15 December 2010.

(ii) Depreciation under Sec. 32 is ₹ 2,20,000.

(iii) During the year 2007-2008, contingency reserve, amounting ₹ 10,00,000, debited to profit and loss a/c, was added back to the extent of ₹ 4,00,000 in the computation of book-profits. The company has transferred the said reserve to the profit and loss a/c during the year.

(iv) Brought forward business loss/depreciation:

PY	Accounting purposes		Tax purposes	
	Loss	Depreciation	Loss	Depreciation
2006-2007	(-) 10,00,000	(-) 1,00,000	(-) 5,00,000	(-) 2,50,000
2007-2008	(-) 2,00,000	(-) 3,00,000	(-) 1,00,000	(-) 2,00,000

Compute the following: (a) Total income, (b) Book-profits and (c) Tax liability.

Solution:

Computation of Total Income for the AY 2011-2012

Particulars	₹	₹
Net profit as per Profit & Loss A/c		32,40,000
Add : Expenses debited to P/L A/c – disallowed		
(i) Income tax	90,000	
(ii) Wealth tax	10,000	
(iii) Custom duty payable	30,000	

(iv) Provision for unascertained liability	20,000	
(v) Proposed dividend	3,00,000	
(vi) Loss of subsidiary company	50,000	
(vii) Income-tax penalty	20,000	5,20,000
		37,60,000
Less : Allowable Expenses and wrong credits in P/L A/c		
(i) Withdrawals from contingency reserve	10,00,000	
(ii) Excise duty	1,20,000	
(iii) Depreciation	70,000	
(iv) Brokerage, commission, interest and rent, etc.	50,000	12,40,000
Business Profits		**25,20,000**
Add: Income from other sources: Brokerage/ commission, etc.		50,000
Aggregate income		**25,70,000**
Less: (i) Brought forward losses (Sec. 72)	6,00,000	
(ii) Brought forward depreciation [Sec. 32(2)]	4,50,000	10,50,000
Gross Total Income		**15,20,000**
Less: Profit from industrial undertaking Sec. 80IB: 30% of ₹ 15,20,000 as included in GTI		4,56,000
Total Income		**10,64,000**

(b) Computation of Book Profits for the AY 2011-2012

Particulars	₹	₹
Net profits as per Profit & Loss A/c		32,40,000
Add : Expenses disallowed		
(i) Income tax	90,000	
(ii) Provision for unascertained liability	20,000	
(iii) Proposed dividend	3,00,000	
(iv) Loss of subsidiary	50,000	4,60,000
		37,00,000
Less : Allowable expenses and wrong credit in P & L A/c		
(i) Withdrawals from contingency reserve	4,00,000	
(ii) Brought forward business loss or depreciation whichever is less		
2006-2007 Depreciation	1,00,000	
2007-2008 Loss	2,00,000	7,00,000
Book-Profits		**30,00,000**

(c) Computation of Tax liability for the AY 2011-2012

Particulars	₹
(a) Tax on Total Income (including Education Cess and SHEC) = 30.9% of 10,64,000	3,28,776
(b) Tax on Book Profits (including Education Cess and SHEC) = 18.54% on 30,00,000	5,56,200
Tax payable	**5,56,200**

Note :

(i) No adjustment is required for depreciation debited to profit and loss a/c because it is not on account of revaluation of any asset.

(ii) MAT credit available ₹ (5,56,200 – 3,28,776) = ₹ 2,27,424

Question No.63 (a)

A firm made the following payments of advance tax during the Financial Year 2010-11 :

	Figures in ₹ Lakhs
15.09.2010	9.30
15.12.2010	9.0
15.03.2011	13.9
	32.20

The income returned by the firm is ₹ 100 Lakhs under the head "Business" and ₹ 10 Lakhs by way of Long-term Capital Gains on sale of a property effected on 1.3.2011. What is the interest payable by the assessee u/s 234B and 234C of the Income Tax Act for Assessment Year 2011-2012? Assume that the return of income was filed on 31.07.2011 and tax was fully made upon self-assessment.

Solution :

Assessee : Firm **Previous Year : 2010-2011** **Assessment Year : 2011-2012**

(a) **Interest u/s 234B = Nil** [since more than 90% of Tax Payable has been paid before the end of the previous year]

(b) **Interest u/s 234C**

Due date	Advance Tax Payable ₹	Advance Tax paid ₹	Cumulative Advance Tax paid before due date ₹	Shortfall in Payment ₹	Surplus ₹	Months	Interest @ 1% p.m. ₹
15.9.2010	30% of ₹ 30,90,000 = 9,27,000	9,00,000	9,30,000	—	3,000	—	—
15.12.2010	60% of ₹ 30,90,000 = 18,54,000	9,00,000	18,30,000	24,000	—	3	720
15.3.2011	100% of ₹ 32,96,000 = 32,96,000	13,90,000	32,20,000	76,000	—	1	760
							1,480

Note : Tax on LTCG has been considered only for the 3rd instalment as such gain had arisen only on 1.3.2010.

Computation of Actual Tax Payable by the Firm :

Particulars		₹
Profits and Gains of Business or Profession		1,00,00,000
Capital Gains — Long Term Capital Gain		10,00,000
Total Income		**1,10,00,000**
Tax on Total Income including Surcharge and Cess		
On Long Term Gain of ₹ 10 lakhs @ 20%+ EC @ 2%+ SHEC @ 1%	2,06,000	
On Business Income @ of ₹ 100 lakhs @ 30%+ EC @ 2%+ SHEC @ 1%	30,90,000	
Net Tax Payable		**32,96,000**

Note : Tax on Business income alone considered for computation of 1st and 2nd instalment.

Question No.63 (b)

A firm made the following payments of advance tax during the financial year 2010-11 :

	₹ in lakh
September 15, 2010	7.00
December 15, 2010	7.75
March 15, 2011	13.00
	27.75

The return of income is filed on 31.7.2011 showing —

Bonus income	₹ 80 lakh
Long term capital gain taxable @ 20% (as on 1.12.2010)	₹ 20 lakh

Compute interest payable u/s 234C.

Solution :

Computation of tax liability fo A.Y. 2011-12.

₹ in lakh

Particulars	Business income	Long term capital gain
Income	80.00	20.00
Tax rate	30%	20%
Tax liability before surcharge	24.00	4.00
Add : Education Cess & SHEC	0.72	0.12
Tax liability including cess	24.72	4.12

Total Tax Liability = (24.72 + 4.12) lakhs = ₹ 28.94 lakhs.

Computation of interest payable u/s 234

Due date	Advance Tax Payment	Advance Tax paid	Cumulative Advance Tax paid before due date	Shortfall in Payment	Surplus	Months	Interest @ 1% p.m.
	₹	₹	₹	₹	₹		₹
15.9.2010	30% of ₹ 24,72,000 = 7,41,600	7,00,000	7,00,000	41,600	—	3	1,248
15.12.2010	60% of ₹ 24,72,000 = 14,83,200 (+) 60% of 4,12,000 = 2,47,200	7,75,000	14,75,000	2,55,400	—	3	7,662
15.3.2011	100% of ₹ 28,94,000 = 28,94,000	13,00,000	27,75,000	1,19,000	—	1	1,190
							10,100

Question No.63(c)

In the case of Ms. Laxmi, you are required to compute the interest u/s 234A, 234B & 234C from the following details: Tax on total income ₹ 2,00,000; Due date for filing the return 30.09.2011; Actual date of filing the return 1.10.2012 and tax paid on 30.09.2011 ₹ 2,00,000.

Solution :

Computation of interest u/s 234A

Particulars	As per assessed income
Tax	₹ 2,00,000
Less : Advance tax paid	Nil
TDS	Nil
Amount on which interest is payable	₹ 2,00,000
Period of default (October being part of a month shall be considered)	1 month
Interest u/s 234A (1% × ₹ 2,00,000 × 1 month)	**₹ 2,000**

Computation of Interest u/s 234B

Since assessee did not pay any amount by way of advance tax, hence she is liable to pay interest u/s 234B.

Particulars	Assessed income
Shortfall	₹ 2,00,000
Period of default (From April to September)	6 months
Interest (1% × 2,00,000 × 6 months)	**₹ 12,000**

Computation of Interest u/s 234A

Due date	Advance Tax Payment	Advance Tax paid	Cumulative Advance Tax paid before due date	Shortfall in Payment	Surplus	Months	Interest @ 1% p.m.
	₹	₹	₹	₹	₹		₹
15.9.2010	30% of ₹ 2,00,000 = 60,000	Nil	Nil	60,000	—	3	1,800
15.12.2010	60% of ₹ 2,00,000 = 1,20,000	Nil	Nil	1,20,000	—	3	3,600
15.3.2011	100% of ₹ 2,00,000 = 2,00,000	Nil	Nil	2,00,000	—	1	2,000
							7,400

Total interest payable

Particulars	Amount
U/s 234A	2,000
U/s 234B	12,000
U/s 234C	7,400
Total	**21,400**

Question No.63 (d)

During the financial year 2010-11, Mrs. X (aged 46 years) pays the following instalments of advance tax :

	₹
On September 15, 2010	6,000
On December 15, 2010	14,000
On March 15, 2011	16,000
On March 16, 2011	18,000

Mrs. X files return of ₹ 7,01,000. Assessment is also completed on the basis of income returned by Mrs. X after making addition of ₹ 25,000 (date of assessment order : January 20, 2012). Mrs. X is entitled to tax credit of ₹ 12,510 on account of tax deducted at source. Compute interest under sections 234B and 234C.

Solution :

Interest liability under section 234B

	₹
Income (7,01,000 + 25,000) =	7,26,000
Tax on ₹ 7,26,000	76,200
Less : Tax deducted at source	12,510
Assessed tax	63,690
90% of assessed tax	**57,321**

Advance tax paid during 2010-11 (i.e., ₹ 6,000 + 14,000 + 16,000 + 18,000) = ₹ 54,000.

Since advance tax during the financial year 2010-11 is less than 90% of assessed tax, Mrs. X is liable to pay interest under section 234B, i.e., on the shortfall of ₹ 9,690 (being ₹ 63,690 – 54,000) for 10 months (₹ 9,690 × 1/100 × 10) which comes to ₹ 969.

Interest liability under section 234C

Tax on ₹ 7,01,000 =

Due date	Advance Tax Payment	Advance Tax paid	Cumulative Advance Tax paid before due date	Shortfall in Payment	Surplus	Months	Interest @ 1% p.m.
	₹	₹	₹	₹	₹		₹
15.9.2010	30% of ₹ 71,200 = 21,360	6,000	6,000	15,360	—	3	461
15.12.2010	60% of ₹ 71,200 = 42,720	14,000	20,000	22,720	—	3	682
15.3.2011	100% of ₹ 71,200 = 71,200	34,000	54,000	17,000	—	1	172
							1,315

Question No.64 (a)

Compute the Advance Tax payable by R from the following estimated income submitted for the financial year 2010-11.

		₹
(1)	Income from Salary	3,64,000
(2)	Rent from house property (per annum)	1,80,000
(3)	Interest on Government securities	5,000
(4)	Interest on bank deposits	3,000
(5)	Receipt from horse race (net)	14,000
(6)	Agricultural Income	90,000
(7)	Contribution towards PPF	10,000

Tax deducted at source by the employer on salary is ₹ 9,680.

Solution :

Computation of Estimated Total Income for the Previous Year 2010-11

	₹	₹
Income from Salary :		
Gross salary	3,64,000	
Less : Deduction	Nil	3,64,000
Income from House Property :		
Rent received	1,80,000	
Less : (Statutory deduction u/s 24(*a*) @ 30%)	54,000	1,26,000
Income from Other Sources :		
Interest on Government securities	5,000	
Interest on Bank Deposit	3,000	
Horse Races (Gross)	20,000	28,000
Estimated Gross Total Income		5,18,000
Less : Deduction under section 80C		10,000
		5,08,000

Estimated Tax :

Step-1 : Aggregate of Agricultural income + Non-Agricultural income (90,000 + 5,08,000) = 5,98,000		
Tax on : Income from Horse Race of ₹ 20,000 @ 30%	6,000	
Balance income of ₹ 5,78,000	49,600	
		55,600
Step-2 : Aggregate of Basic exemption limit of agricultural income (1,60,000 + 90,000) = 2,50,000		
Tax on ₹ 2,50,000		9,000
Step-3 : Tax on non-agricultural income		
Tax under step-1 - Tax under step-2 (55,600 – 9,000) = 46,900		
Estimated tax payable		46,900
Add : Education cess @ 2%		938
Add : SHEC @ 1%		469
		48,307
Less : Estimated TDS		
on salary	9,680	
on horse races	6,000	15,680
Advance tax payable (rounded off)		32,627
First installment payable by 15.9.2010 (30%)		9,788
Second installment payable by 15.12.2010 (30%)		9,788
Third installment payable by 15.3.2011 (balance 40%)		13,051

Working notes :

Computation of gross winnings from horse races :	₹
Net Amount	14,000
Grossing up	20,000
Tax deducted at source (Gross amount ₹ 20,000 – Amount received ₹ 14,000)	6,000

Question No.64 (b)

X Ltd. estimates its income for the previous year 2009-10 at ₹ 1,20,000. Besides this income, it has also earned long-term capital gain of ₹ 80,000 on transfer of gold on 1.12.2010. Compute the advance tax payable by the company in various instalments.

Solution :

	₹
Tax on ₹ 1,20,000 @ 30%	36,000
LTCG of ₹ 80,000 @ 20%	16,000
	52,000
Add : Education cess @ 2%	1,040
SHEC @ 1%	520
	53,560

Amount payable on 1st and 2nd instalment

For the first two instalments tax on LTCG will not be taken into account as this accrued on 1.12.2010 *i.e.* after the due date of the first 2 instalments.

	₹
Tax including Education Cess and SHEC payable without Long-term Capital Gain (₹ 36,000 + 720 +360)	37,080

Advance Tax Payable

Due Date	Tax Liability as on due date	Amount of Instalment Payable (₹)
15.6.2010	15% of 37,080 = 5,562	₹ 5,562
15.9.2010	45% of 37,080 = 16,680	= 16,680 – 5,560
		= 11,118
15.12.2010	75% of 53,560 = 40,170	= 40,170 – 5,562 – 11,118
		= 23,490
15.3.2011	100% of 53,560 = 53,560	= 53,560 – 5,562 – 11,118 – 23,490
		= 13,390

Question No.64 (c)

Find out the amount of advance tax payable by ABC Ltd. on specified dates for the financial year 2010-11 :

Business income	₹ 1,75,000
Long term capital gain on 31-7-2010	₹ 3,50,000
Bank interest	₹ 10,000
TDS on business income	₹ 19,995

Solution :

Computation of total income of ABC Ltd. for the Previous Year 2010-11

Particulars	Amount ₹
Profits and gains of business or profession	1,75,000
Capital gains: Long term capital gains	3,50,000
Income from other sources: Bank Interest	10,000
Total Income	**5,35,000**

Computation of tax liability of ABC Ltd. for the previous year 2010-11

Particulars	Long term capital gain ₹	Other income ₹
Income	3,50,000	1,85,000
Tax rate	20%	30%
Tax on above	70,000	55,500
Add : Education Cess & SHEC	2,100	1,665
Tax and Cess payable	72,100	57,165
Less : TDS	—	19,995
Advance tax payable	**72,100**	**37,170**

Advance tax to be paid on specified dates

	Advance tax on LTCG		Advance tax on income other than LTCG		
Date	**Workings**	**Amount (a) ₹**	**Workings**	**Amount (b) ₹**	**Total (a+b) ₹**
15.06.2010	As LTCG occurred on 31.7.10	Nil	15% of ₹ 37,170	5,576	5,576
15.09.2010	45% of ₹ 72,100	32,445	30% of ₹ 37,170	11,151	43,596
15.12.2010	30% of ₹ 72,100	21,630	30% of ₹ 37,170	11,151	32,781
15.03.2011	25% of ₹ 72,100	18,025	25% of ₹ 37,170	9,292	27,317
Total		**72,100**		**37,170**	**1,09,270**

Question No.64 (d)

Find out the amount of advance tax payable by Mr. A on specified dates under the Income tax Act, 1961 for the Previous Year 2010-11 :

	₹
Business income	2,75,000
Long term capital gain on 31-7-2010	60,000
Winning from lotteries on 12-9-2010	50,000
Bank interest	10,000
Other income	5,000
Investment in PPF	40,000
Tax deducted at source :	
Case I	48,000
Case II	25,000

Solution :

Computation of Total Income of Mr. A for the previous year 2010-11 :

Particulars	**Details**	**Amount**
Profits and gains of business or profession		2,75,000
Capital gains : Long term capital gains		1,60,000
Income from other sources		
Winning from lotteries	50,000	
Bank interest	10,000	
Other income	5,000	65,000
Gross Total Income		5,00,000
Less : Deduction u/s 80C — Deposits in PPF		40,000
Total Income		**4,60,000**

Computation of Tax liability of Mr. A for the previous year 2010-11 :

Income	**Case 1**	**Case 2**
Long term capital gain (₹ 1,60,000 @ 20%)	32,000	32,000
Winning from lotteries (₹ 50,000 @ 30%)	15,000	15,000
Balance income (₹ 2,50,000)	9,000	9,000
Tax	56,000	56,000
Add : Education Cess & SHEC	1,680	1,680
	57,680	57,680
Less : Tax Deducted at Source	48,000	25,000
Total Tax Payable	**9,680**	**32,680**

Advance tax to be paid on specified dates —

Case I : Since amount of tax payable is less than ₹ 10000, assessee is not liable to pay advance tax.

Case II : Advance Tax Payable

Due Date	**Tax Liability (₹)**	**Amount of Instalment (₹)**
15.6.2010	30% of 32,680 = 9,804	9,804
15.9.2010	60% of 32,680 = 19,608	= 19,608 – 9,804 = 9,804
15.12.2010	100% of 32,680 = 32,680	= 32,680 – 9,804 – 9,804 = 13,072

Question No. 65 (a)

State the responsibilities and liabilities of Tax collector.

Answer:

Responsibility & Liability of the Tax Collector

1. To obtain Tax Collection Account No. [sec. 206CA(1)]
2. To quote TCS No. in all returns, certificates and challans. [Sec. 206CA(2)]
3. To furnish quarterly return in form No. 27EQ within stipulated time i.e. within fifteen days from the end of a quarter for the first three quarters and by 30th April for the last quarter.
4. Failure to furnish TCS return: Penalty @ 100/- per day, during which the default continues, but not exceeding the amount of TCS. [sec. 272A(2)(g)]
5. Failure to deposit TCS in Government treasury, rigorous imprisonment for a term of not less than 3 months, but which may extend to 7 years, in addition to fine [Sec. 276B & 276BB]

Thus, administrative provisions are similar to TDS administration.

Question No. 65 (b)

Discuss procedures in Advance Ruling.

Answer:

Finance Act, 1993 inserted a chapter XIX-B in the Income-tax Act, 1961 to provide provisions of **Advance Rulings** to avoid dispute in respect of assessment of Income-tax liability in the case of non-resident. W.e.f. 1.10.1998, the scheme has been extended to cover notified resident applicants also. The chapter XIX-B contains sections 245N to 245V.

'Advance Ruling' means a determination by the Authority for Advance Rulings, in relation to (i) a transaction which has been undertaken or is proposed to be undertaken by a non-resident or by a resident with a non-resident, including a determination of a question of law or of fact, and (ii) issues relating to computation of income pending before the income-tax authority or the tribunal including a determination of a question of a law or of fact. [Sec. 245N (a)]

An application may be made by (i) non-resident, (ii) a resident entering into transaction with a non-resident, or (iii) a resident of the notified class or category i.e. a public sector company or a person indulging in a transaction with a non-resident. [Sec. 245N (b)]

Application for advance ruling should be in the prescribed form as below duly verified, along with a payment of fee of Rs. 2,500 shall be submitted to the authority for advance rulings.

Form No.	Classes of Assessees
34C	Non- resident desires of obtaining an advance ruling.
34D	Resident persons seeking advance ruling in relation to a transaction with a non-resident.
34E	Resident person of notified class or category.

The application for advance rulings should be in quadruplicate and the applicant may withdraw such application within 90 days from the date of application. [Sec. 245Q]

An advance ruling shall not be allowed where (i) question of law or fact is already pending either before any income-tax authority or the Appellate Tribunal (except in case of a resident applicant of notified class or category) or any court, (ii) a transaction, which is designed for the avoidance of income-tax; or (iii) determination of the fair market value of any property. However, no application shall be rejected unless an opportunity has been given to the applicant of being her and if the application is rejected, reasons for such rejection shall be given in the order. [Sec. 245R]

The Authority shall pronounce the advance ruling within six months after the receipt of the application. [Sec. 245R (6)]

In case an application for advance ruling has been made, in respect of an issue by a resident applicant, no Income-tax authority or the Appellate Tribunal shall give a decision on the same issue. [Sec. 245RR]

The advance ruling shall be binding only on the applicant who has sought it in respect of the specific transaction covered thereunder, on the Commissioner and the income-tax authorities subordinate to him, having jurisdiction over the applicant. The advance ruling will continue to remain in force unless there is a change either in law or in fact on the basis of which the advance ruling was pronounced. [Sec. 245S]

Question No. 65 (c)

State the hierarchy of Income Tax Authorities

Answer:

INCOME TAX AUTHORITIES [Sec. 116]

In order to discharge executive and administrative functions relating to the Act, the following income-tax authorities have been constituted –

(a) The Central Board of Direct Taxes;

(b) Directors General of Income-tax or Chief Commissioners of Income-tax;

(c) Directors of Income-tax or Commissioners of Income-tax or Commissioners of Income-tax (Appeals);

(d) Additional Directors of Income-tax or Additional Commissioners of Income-tax or Additional Commissioners of Income-tax (Appeals);

(e) Joint Directors of Income-tax or Joint Commissioners of Income-tax;

(f) Deputy Director of Income-tax or Deputy Commissioner of Income-tax or Deputy Commissioner of Income-tax (Appeals);

(g) Assistant Directors of Income-tax or Assistant Commissioners of Income-tax;

(h) Income-tax Officers;

(i) Tax Recovery Officers;

(j) Inspectors of Income-tax.

Question No. 66 (a)

Ms. Sania, a resident Indian, furnishes the details for the assessment year 2011-2012.

		₹
(1)	Income from profession	1,04,000
(2)	Share income from a partnership in country X	40,000
	(Tax paid in country X for this income in equivalent Indian rupees ₹ 8,000)	
(3)	Commission income from concern in country Y	30,000
	(Tax paid in country Y at 20% converted in Indian rupee)	
(4)	Interest from scheduled banks	20,000

Ms. Sania wishes to know whether she is eligible to any double taxation relief, if so, its quantum. India does not have any Double Taxation Avoidance Agreement with countries X and Y.

Solution :

Computation of Total Income for the A.Y. 2011-12

	Particulars	**₹**	**₹**
(a)	Income from Business or Profession :		
	(i) Income from Profession	1,04,000	
	(ii) Share income in partnership firm in country X	40,000	1,44,000
(b)	Income from other sources:		
	(i) Interest from schedule bank	20,000	
	(ii) Commission earned in country Y, assumed from other sources	30,000	50,000
	Total Income		**1,94,000**

(b) Computation of tax liability

	Particulars	₹
	Tax on Total Income of ₹ 1,94,000	400
Add:	Surcharge on income tax	Nil
	Education cess @ 2%	400
	SHEC @ 1%	8
		4
Less:	Double taxation relief : 70,000 × 0.21%	(147)
	Tax payable	**265**
	Rounded off u/s 288B	**270**

Note: (i) Average rate of tax in the foreign country : 20%

(ii) Average rate of tax in India : (412/194000 x 100) = 0.21%

Question No. 66(b)
What is Transfer Pricing?

Answer:

Transfer pricing means pricing of goods and services supplied to associated enterprises that belong to the same business group. It concerns prices charged by an enterprise for transfer of goods and services to its related enterprise.

The Organization of Economic Cooperation and Development (OECD) defines "Transfer prices" as "prices at which an enterprise transfers physical goods and intangibles or provides services to associated enterprises."

Question No.66(c)

What is Arm's Length Principle?

Answer:

The arm's length principle seeks to ensure that transfer prices between members of an MNE ("controlled transactions"), which are the effect of special relationships between the enterprises, are either eliminated or reduced to a large extent. It requires that, for tax purposes, the transfer prices of controlled transactions should be similar to those of comparable transactions between independent parties in comparable circumstances ("uncontrolled transactions"). In other words, the arm's length principle is based on the concept that prices in uncontrolled transactions are determined by market forces and, therefore, these are, by definition, at arm's length. In practice, the "arm's-length price" is also called "market price". Consequently, it provides a benchmark against which the controlled transaction can be compared.

The Arm's Length Principle is currently the most widely accepted guiding principle in arriving at an acceptable transfer price. As circulated in 1995 OECD guidelines, it requires that a transaction between two related parties is priced just as it would have been if they were unrelated. The need for such a condition arises from the premise that intra-group transactions are not governed by the market forces like those between two unrelated entities. The principle simply attempts to place uncontrolled and controlled transactions on an equal footing.

Question No.67 (a)

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

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

Solution:

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

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

(b) Computation of Increase in Total Income of CD Ltd

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

Question No.67 (b)

State the methods of computing Arm's Length Price

Answer:

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

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

Question No. 68

Mr. Kushal Sengupta owns a house at Jharkhand, which is let-out at ₹1,35,000 per annum. The annual value of the property as per municipal records also is ₹1,00,000. Municipal taxes are partly borne by the owner (₹5,000) and partly by the tenant (₹6,000). Repair expenses are borne by tenant (₹10,000) the difference between the un-built area and specified area does not exceed 5%. The property was acquired on 10.5.1998 for ₹ 15,00,000.

Determine for purposes of Wealth Tax Act, the value of the property as on 31.3.2011 on the following situations

(a) The house is built on a freehold land.

(b) It is built on a leasehold land, the unexpired period of lease of the land is more than 50 years.

(c) If the area of the plot on which the house is built is 800 sq. meters. FSI, permissible is 1.4 and FSI utilised is 1088 Sq. metres. (136 Sq. metres × 8 Storeys)

(d) The tenant had made interest free deposit of ₹ 1,00,000 with the landlord.

Solution :

Assessee : Mr. Kushal Sengupta   Valuation Date : 31.3.2011   Assessment Year : 2011-12

Computation of Value of House Property

For Situations (a) & (b):

Computation of Gross Maintainable Rent (Amount in ₹)

Particulars	No Rental Deposit	Rental Deposit excess of 3 Mths
Actual Annual Rent	1,35,000	1,35,000
Add: Municipal Taxes borne by the tenant	6,000	6,000
1/9th of Actual Rent Receivable since repair expenses are borne by the tenant (₹1,35,000/ 9)	15,000	15,000
Rental Deposits - 15% Interest on ₹ 1,00,000	Nil	15,000
GROSS MAINTAINABLE RENT	**1,56,000**	**1,71,000**
Less: Municipal Taxes Paid	11,000	11,000
Less: 15% of Gross Maintainable Rent	23,400	25,650
Net Maintainable Rent	**1,90,400**	**2,07,650**
Case (a) Capitalization of Net Maintainable Rent		
-Freehold Land NMR x 12.5	**23,80,000**	**25,56,625**

Case (b) Capitalization of Net Maintainable Rent		
-Leasehold Land - Unexpired Lease 50 Years = NMR×10	**19,04,000**	**20,07,650**
Property Acquired after 31.3.1974 i.e. 10.5.1997	**15,00,000**	**15,00,000**
Therefore, Value of the Property (whether on Lease-hold Land or on Freehold Land)	**15,00,000**	**15,00,000**

For Situation (c) : In case of excess unbuilt area :

Unbuilt Area = (Actual Area of the Land **less** Built up Area) = (800 sq. mt **less** 136 sq. mt). = 664 sq. mt.

Excess Unbuilt Area = (Unbuilt Area **less** Specified Area) = 664 sq. mt. **less** 70% of 800 sq. mt. = 664 Less 560 = 104 sq. mt

% of Excess Unbuilt Area = Excess Unbuilt Area × 100/Aggregate Area = 104 × 100/800 = 13%

Therefore, Value of the Property = Substituted Net Maintainable Rent i.e. ₹15,00,000 + 30% of SNMR = ₹ 19,50,000

Question No. 69 (a):

From the following dated furnished by Mr.Soumitra, determine the value of house property built on leasehold land as at the valuation date 31.3.2011 :

Particulars	₹
Annual Value as per Municipal valuation	1,40,000
Rent received from tenant (Property vacant for 3 months during the year)	1,08,000
Municipal tax paid by tenant	10,000
Repairs on property borne by tenant	8,000
Refundable deposit collected from tenant as security deposit which does not carry any interest	50,000
The difference between unbuilt area and specified area over aggregate area is 10.5%.	

Solution :

Assessee: Mr. Soumitra Valuation Date: 31.3.2011 Assessment Year: 2011-12

Computation of Value of House Property

Step I: Computation of Gross Maintainable Rent(GMR)

Particulars	₹	₹
Actual Annual Rent- ₹ 1,08,000 x 12 Months/9 Months		1,44,000
Add: Municipal tax paid by the Tenant10,000		
1/9th of Actual Rent Receivable as repair expenses are borne by the tenant - ₹ 1,44,000/9	16,000	
Interest on Refundable Security Deposit- ₹ 50,000 x 15% x 9/12	6,000	32,000
GROSS MAINTAINABLE RENT (GMR)		**1,76,000**

Step II: Computation of Net Maintainable Rent (NMR)

Particulars	₹	₹
Gross Maintainable Rent (GMR)		1,76,000
Less: Municipal Taxes levied by the local authority	10,000	
15% of Gross Maintainable Rent - ₹1,76,000 x 15%	26,400	(36,400)
NET MAINTAINABLE RENT (NMR)		**1,39,600**

Step III: Capitalisation of the Net Maintainable Rent (CNMR) (Assumed that unexpired lease period is more than 50 Years)

NMR × Multiple Factor for an Unexpired Lease Period - ₹ 1,39,600 × 10 = ₹ 13,96,000

Step IV: Addition of Premium to SNMR in case of excess inbuilt area:

Particulars	**₹**
Add: Capitalisation of the Net Maintainable Asset	13,96,000
Premium for excess of 10.5% unbuilt area over specified area-30% of CNMR	4,18,800
Value of House Property as per Wealth Tax Act	**18,14,800**

Question No. 69(b):

Property Company Ltd. has let-out a premise with effect from 1.10.2010 on monthly rent of ₹ 1.5 lakh. The lease is valid for 10 years and the tenant has made a deposit equivalent to 3 months rent. The tenant has undertaken to pay the municipal taxes of the premises amounting to ₹ 2 lakh. What will be the value of the property under Schedule III of the Wealth Tax Act for assessment to wealth tax?

Solution :

Assessee: Property Company Ltd. Valuation Date: 31.3.2011 Assessment Year : 2011-12

Computation of Value of Let-out Property

Actual Annual Rent Receivable - ₹ 1,50,000 × 12 Months	18,00,000
Add: Municipal Taxes borne by the Tenant	2,00,000
GROSS MAINTAINABLE RENT	20,00,000
Less: Municipal Taxes levied by the Municipal Authority	2,00,000
Less: 15% of Gross Maintainable Rent (₹ 20,00,000 × 15%)	3,00,000
NET MAINTAINABLE RENT	15,00,000

Value of the Property = Capitalized Value of NMR

NMR × 8 (unexpired period of lease is less than 50 years) = ₹ 15,00,000×8 = ₹ **1,20,00,000**

Question No. 70 (a) Net wealth of firm consisting of three partners Bidyut, Kingshuk and Deepak in 2:2:1 and a capital contribution of ₹ 17 Lakhs, ₹ 13 Lakhs, and ₹ 12 Lakhs respectively is as under -

(a)	Value of assets located outside India	₹ 30,00,000
(b)	Value of assets located in India	₹ 80,00,000
(c)	Debts incurred in relation to assets in India	₹ 40,00,000

Determine the value of interest of the partners in the firm under the Wealth Tax Act, 1957.

Solution :

Assesses: Bidyut, Kingshuk & Deepak Valuation Date: 31.3.2011
Assessment Year: 2011-12

Computation of net wealth of the Firm

Particulars	**₹**	**₹**
Value of Assets located in India	80,00,000	
Less: Liability in relation to assets in India	40,00,000	40,00,000
Value of Assets located outside India		30,00,000
Net Wealth of the Firm		**70,00,000**

Solution :

Computation of Interest of the Partner in the net wealth of the Firm (Amount in ₹)

Particulars	Bidyut	Kingshuk	Deepak
To the extent of Capital Contribution	17,00,000	13,00,000	12,00,000
Balance (Net Wealth-Capital Contribution) in Profit sharing ratio since dissolution ratio is not given	11,20,000	11,20,000	5,60,000
Interest of the Partner in the Net Wealth of the Firm	**28,20,000**	**24,20,000**	**17,60,000**

Computation of the Interest of the Partner in the net wealth of the Firm on the basis of location of assets: (Interest of the Partner in the Firm **apportioned** in the ratio of **4:3)**

Particulars	Bidyut	Kingshuk	Deepak
Assets Located Inside India	16,11,429	13,82,857	10,05,714
Assets Located Outside India	12,08,571	10,37,143	7,54,286
Interest of the Partner in the Net Wealth of the Firm	28,20,000	24,20,000	17,60,000

Question no.70(b)

Satender is aged 35 years. His father settled a property in trust giving whole life interest therein to Satender. The income from the property for the years 2006-07 to 2009-10 was ₹ 70,000, ₹ 84,000, ₹ 90,000, ₹ 108,000, respectively. The expenses incurred each year were ₹ 2,000, ₹ 4,000, ₹ 5,000 and ₹6,000 respectively. Calculate the value of life interest of Mr. Jogi in the property so settled on the valuation date 31.3.2011, with the help of the factor of 9.267.

Step	Procedure
1	Average Income for last three years = (₹ 84,000 + ₹ 90,000 + ₹ 1,08,000)/ 3 = ₹ 94,000.
2	Average Expenses for the last three years = (₹ 4,000 + ₹ 5,000 + ₹ 6,000) / 3 = ₹ 5,000.
3	Maximum Permissible Expenses = Average Expenses **or** 5% of Average Income, whichever is less = 5% of ₹ 70,000 = ₹ 3,500
4	Average Annual Income = ₹ 94,000 Less ₹ 3,500 = ₹ 90,500.
5	Life Interest=Average Annual Income× Life Interest Factor = ₹ 90,500 × 9.267 = ₹ 8,38,664.

Question No. 70 (c): 'X' received a vacant site under his father's will. The value of the site on 31.3.2011 is ₹15 Lakhs. As per terms of the 'Will' in the event 'X' wants to sell the site he should offer it to his brother for sale at ₹10 Lakhs. 'X', therefore, claims that the value of the site should be taken at ₹10 Lakhs as at 31.3.2011. Is the claim correct?

Solution :

1. As per Rule 21 of Schedule III to the Act, the **price or other consideration for which** any property may be **acquired by or transferred to any person under the terms of a deed of trust** or through or under any restrictive agreement in any instrument of transfer **shall be ignored** for the purpose of determining the value under the provisions of the Schedule.
2. In view of the above, the value of the site should be taken as ₹ 15 Lakhs and not as ₹ 10 Lakhs.
3. Therefore, **claim of X is incorrect.**