

The Suggested Answers for Paper 7: Direct Taxes are based on the provisions applicable for A.Y. 2006-07, which is the assessment year relevant for November, 2006 examination.

PAPER – 7 : DIRECT TAXES

Answer all questions

Question 1

RST Ltd. is engaged in the manufacture and sale of drugs and pharmaceuticals. Its net profit for the year ending 31-3-2006 after debit/credit of the following items to the Profit and Loss Account was Rs.28,00,000.

- (i) Income-tax paid on non-monetary perquisites provided to the employees Rs.1,00,000.
- (ii) Legal fees incurred in defending title to factory premises Rs.2,00,000.
- (iii) Expenditure on scientific research (not in respect of cost of land or building) on in-house research and development facility approved by the prescribed authority Rs.10,00,000.
- (iv) Interest paid on arrears of sales tax Rs.1,00,000.
- (v) Cash payment of Rs.20,000 made on 10.10.2005 to a supplier towards purchase of raw material.
- (vi) Rent received from letting out vacant land Rs.1,00,000.
- (vii) Arrears of rent received in respect of a house property, which was let out in the earlier years and which was not charged to tax in any earlier year, Rs.2,00,000. The said property was sold during the year ending 31.3.2004.

The company had paid royalty in India to a foreign company amounting to Rs.3,00,000 on 1.5.2004, which was disallowed by the Assessing Officer for the assessment year 2005-06 since tax was not deducted thereon. The company deducted and paid tax at source on the said amount of royalty on 1.1.2006.

The company has brought forward loss from property relating to the assessment year 2004-05 amounting to Rs.40,000.

Compute the total income of RST Ltd. for the assessment year 2006-07.

Furnish explanations for the treatment of the various items given above. (16 Marks)

Answer

Computation of total income of RST Ltd for the assessment year 2006-07

Particulars	Rs.	Rs.
Profits and gains of business or profession		
Net profit as per profit and loss account		28,00,000
Add: Income-tax paid on non-monetary perquisites provided to employees not allowable [See Note (i)]		<u>1,00,000</u>
		29,00,000

Less: Deduction / Additional deduction allowable		
Additional sum allowable towards scientific research expenditure [See Note (iii)]	5,00,000	
Royalty paid during the year ending 31.3.2005, without deduction of tax, disallowed in A.Y. 2005-06, now allowable as tax thereon is deducted and paid [See Note (viii)]	<u>3,00,000</u>	8,00,000
		<u>21,00,000</u>
Less: Income credited in the profit and loss account to be considered under other heads of income		
Rent received from letting out vacant land [See Note (vi)]	1,00,000	
Arrears of rent received in respect of property let out in the earlier years [See Note (vii)]	<u>2,00,000</u>	3,00,000
		<u>18,00,000</u>
Income from house property		
Arrears of rent received in respect of property let out in earlier years	2,00,000	
Less: 30% of Rs.2,00,000	<u>60,000</u>	
	1,40,000	
Less: Brought forward loss from property relating to A.Y.2004-05 set off [See Note (ix)]	<u>40,000</u>	1,00,000
Income from other sources		
Rent received from letting out vacant land [See Note (vi)]		<u>1,00,000</u>
Total Income		<u>20,00,000</u>

Explanations for the treatment of the various items are furnished herein below -

- (i) Income-tax paid by an employer on non-monetary perquisites provided to the employees is not deductible as per section 40(a)(v).
- (ii) Legal fees incurred in defending title to factory premises is an expenditure incurred wholly and exclusively for the purpose of business and is, therefore, allowable under section 37(1). This was held by the Supreme Court in *Dalmia Jain & Co. Ltd. v. CIT* (1971) 81 ITR 754.
- (iii) Expenditure on scientific research incurred by the company is entitled to deduction at 1- $\frac{1}{2}$ times as per section 35(2AB)(1). Since the company has debited Rs.10,00,000 in the profit and loss account, the additional deduction of Rs.5,00,000 is claimed while computing its total income.

- (iv) Interest paid on arrears of sales tax is not penal in nature but is compensatory in character and is an allowable deduction under section 37(1) as held by the Supreme Court in *Lachmandas Mathurdas v. CIT* (2002) 254 ITR 799.
- (v) Disallowance under section 40A(3) is attracted where cash payment in excess of Rs.20,000 is made in respect of any expenditure. In such a case, 20% of the expenditure is disallowed. Since the cash payment made by the company is Rs.20,000, that is, not exceeding Rs.20,000, the expenditure does not attract disallowance under section 40A(3).
- (vi) Rent received from letting out vacant land is assessable under the head "Income from other sources".
- (vii) Arrears of rent received in respect of the house property let out in earlier years is deemed to be income from house property in the year of receipt. Such arrears of rent, after deduction of 30% thereof, is assessable as income from house property even though the assessee is not the owner of the property in the year of its receipt as provided in section 25B.
- (viii) Royalty paid during the year ending 31.3.2005 in respect of which tax was deducted and paid during the previous year ending 31.3.2006 is allowable as deduction for the assessment year 2006-07 as per the proviso to section 40(a)(i).
- (ix) Brought forward loss from house property relating to the assessment year 2004-05 is set off against the deemed income from house property for the assessment year 2006-07 in accordance with the provisions of section 71B.

Question 2

- (a) What is a zero coupon bond? State briefly the treatment of zero coupon bonds in the hands of the issuer and the investor under the Income-tax Act, 1961. (8 Marks)
- (b) A Hindu undivided family is carrying on the business of purchase and sale of food grains. The Karta of the family manages the business. Can the Hindu undivided family pay salary to the Karta and claim the payment made as a deduction from the profits of its business? If so, what are the conditions and limitations for such payment? (4 Marks)

Answer

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

Discount, which is the difference between the amount received or receivable by the issuer on issue of the zero coupon bond and the amount payable by the issuer on maturity or redemption thereof, would be allowed as deduction in the hands of the issuer on a pro rata basis having regard to the period of life of the bond as provided in section

36(1)(iiia). No tax is required to be deducted at source under section 194A in respect of income paid or payable in relation to a zero coupon bond.

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

- (b) The Supreme Court has, in *Jugal Kishore Baldeo Sahai v. CIT* (1967) 63 ITR 238, held that if remuneration is paid to the karta of a Hindu undivided family (HUF) under –
- (i) a valid agreement which is bona fide and
 - (ii) is in the interest of, and expedient for, the business of the family and
 - (iii) the payment is genuine and not excessive,

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

Question 3

- (a) ABC Club, a members' club, registered as a society under Orissa State Societies Registration Act, derived surplus from the sale of refreshments, beverages, etc. and letting out rooms to its members. The club provided these facilities and amenities to its members as part of advantage attached to the membership. The club claims that the said surplus accruing to it is not income at all for the purpose of the Income-tax Act, 1961. Examine the validity of the claim made by the club. Would your answer be different, if the club was incorporated as a company or if some members alone took advantage of the facilities and amenities it provided? (6 Marks)
- (b) State whether the following persons have to mandatorily furnish their return of income for the assessment year 2006-07.
- (i) Mr. A, an individual, aged 50 years, whose gross total income before deduction under section 80C is Rs.1,90,000 and total income after deduction under section 80C is Rs.95,000.

(ii) M/s. XYZ, a firm, which has incurred a loss.

(4 Marks)

Answer

- (a) ABC Club can claim that the surplus derived by it from the various facilities and amenities provided to its members does not constitute income on the basis of the principle of mutuality. The basic principle of mutuality is that no one can trade with himself and no one can make profit out of himself. The essence of mutuality is complete identity between the contributors and the participators. A mutual concern or association stands on this principle. ABC Club provided various facilities to its members as part of the usual privileges attached to the membership of the club and derived surplus from such activity. Such surplus cannot be called as income for the purpose of the Income-tax Act, 1961. The Supreme Court has, in CIT v. Bankipur Club Ltd. (1997) 226 ITR 97 and Chelmsford Club v. CIT (2000) 243 ITR 89, where the facts were similar, held that such surplus was not taxable as income on the principle of mutuality. The claim of ABC Club is, therefore, valid.

The answer would be the same even if the club was incorporated as a company as the incorporation does not destroy the identity of the contributors and the participators. The answer would also not be different even if some members of the club alone took advantage of the facilities offered by it. In fact, the Supreme Court in the two decisions cited above, has observed that if there is complete identity between the contributors and the participators, it is immaterial what particular form the association takes and where the activity is mutual, the fact that, as regards certain activities, only certain members of the association take advantage of the facilities which it offers, does not affect the mutuality of the enterprise.

- (b) (i) The fourth proviso to section 139(1) requires every person, whose total income without giving effect to the provisions of section 10A, 10B, 10BA and Chapter VIA exceeds the maximum amount not chargeable to tax, to compulsorily furnish the return of income for the relevant assessment year on or before the due date. The total income of Mr.A before deduction under section 80C exceeds the taxable limit of Rs.1,00,000. Therefore, Mr. A has to compulsorily furnish his return of income for the assessment year 2006-07.
- (ii) The Finance Act, 2005 has made it compulsory for firms to furnish their returns of income and loss on or before the due date. Therefore, M/s XYZ has to furnish its return of loss for the assessment year 2006-07 on or before the due date.

Question 4

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

- (ii) J, a citizen of India, is employed in the Indian Embassy at Tokyo, Japan. He received salary and allowances at Tokyo from the Government of India during the year ending 31.3.2006 for services rendered by him in Tokyo. Besides, he was allowed perquisites by the Government. He is a non-resident for the assessment year 2006-07. Examine the taxability of salary, allowances and perquisites in the hands of J for the assessment year 2006-07. (3 Marks)
- (iii) Q, a non-resident, made an application to the Authority for Advance Rulings on 2.1.2006 in relation to a transaction proposed to be undertaken by him. On 31.3.2006, he decides to withdraw the said application. Can he withdraw the application on 31.3.2006? (2 Marks)

Answer

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

In this case, the site is a long-term capital asset since it is held by S for more than 36 months and the building is a short-term capital asset since it is held by S for less than 36 months. The site is an independent capital asset and continues to be so even after the construction of the building thereon. Even though the property consisting of site and building was sold as a single asset for a consolidated price of Rs.20,00,000, such price can be attributed to the site and building separately. Therefore, in the case of S, the capital gain attributable to the site is assessable as long-term capital gain and the capital gain attributable to the building is assessable as short-term capital gain for the assessment year 2006-07. On identical facts, the Rajasthan High Court in CIT v. Vimal Chand Golecha (1993) 201 ITR 442, the Madras High Court in CIT v. Dr. D. L. Ramachandra Rao (1999) 236 ITR 51 and the Karnataka High Court in CIT v. C.R. Subramanian (2000) 242 ITR 342 have taken this view.

- (ii) Section 9(1)(iii) of the Income-tax Act, 1961 provides that salaries payable by the Government to a citizen of India for service outside India shall be deemed to accrue or arise in India. As such, salary received by J is liable for taxation, even though he was a non-resident for A.Y.2006-07.

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

- (iii) Section 245Q(3) of the Income-tax Act, 1961 provides that an applicant, who has sought for an advance ruling, may withdraw the application within 30 days from the date of the application. Since more than 30 days has elapsed since the date of application by Q to the Authority for Advance Rulings, he cannot withdraw the application on 31.3.2006.

Question 5

- (a) Can an order of assessment, which was in accordance with the law as it stood on the date when it was passed, be rectified by the Assessing Officer under section 154 of the Income-tax Act, 1961, on account of a subsequent amendment of the law with retrospective effect? (4 Marks)
- (b) An appeal was preferred by the assessee to the Commissioner (Appeals) against the order of assessment made by the Assessing Officer. The appeal was allowed by the Commissioner (Appeals). The assessee later found that he was entitled to a certain deduction, which was neither claimed by him nor allowed by the Assessing Officer in the course of assessment. The issue of deduction was not raised by the assessee in the appeal before the Commissioner (Appeals) and was not considered by the Commissioner (Appeals). Examine the power of the Commissioner to revise under section 264 the order of assessment in order to allow such deduction on an application by the assessee. (4 Marks)
- (c) M, an individual, had let out his building on a monthly rent of Rs.12,000. The tenant deducted tax under section 194-I from the rent paid to M, but did not remit such tax to the credit of the Central Government. M filed his return of income for the assessment year 2006-07 including therein the rental income from the said building and paid the balance tax on his total income after taking credit for tax deducted at source by the tenant. The Assessing Officer has called upon M to pay the tax to the extent of tax deducted at source. Is the Assessing Officer justified in doing so? (4 Marks)

Answer

- (a) An order of assessment, which was in accordance with the law as it stood on the date when it was passed, becomes erroneous on account of a retrospective amendment of the law made subsequently. Such an order falls within the scope of section 154. The Supreme Court has, in IAC of Agricultural I.T. v. V.K. Ravi Namboodiripad (1974) 96 ITR 73, held that an assessment based on the law as it stood on the date of assessment could be rectified after an amendment of the law with retrospective effect within the period of limitation. In CIT v. E. Sefton & Co. (P.) Ltd. (1989) 179 ITR 435, the Calcutta High Court observed that if the assessment order is plainly and obviously inconsistent with the specific and clear provision as amended retrospectively, indisputably there is a mistake apparent from record. In the light of the retrospective amendment, the assessment order had to be revised. In view of this, it can be said that the Assessing Officer can, under section 154 of the Income-tax Act, 1961, rectify the order of assessment in the light of the later amendment of the law with retrospective effect, subject to limitation provided under sub-section (7) of section 154.
- (b) Section 264(4)(c) provides that the Commissioner shall not revise an order which has been made the subject of an appeal to the Commissioner (Appeals). This bar remains unaffected by the scope of the appeal to the Commissioner (Appeals). Therefore, the fact that the relief claimed in the application filed by the assessee under section 264(1)

was not the subject matter of appeal to the Commissioner (Appeals) does not alter the position that the order of assessment was the subject of the appeal.

The word 'order' in section 264(4)(c) refers to the order appealed against and not to the relief claimed in appeal. In view of this, the Commissioner cannot exercise his powers under section 264 to revise the order of assessment and allow the deduction claimed by the assessee in his application.

- (c) Section 205 of the Income-tax Act, 1961 provides that where tax is deductible at source under the provisions of Chapter XVII, the assessee shall not be called upon to pay the tax himself to the extent to which tax has been deducted from that income. Section 205, therefore, bars a direct demand being made on an assessee to the extent of tax deducted from the income. The Income-tax Department can recover the tax deducted at source from the tenant and not from M in view of the clear mandate in section 205. The Karnataka High Court has in *Smt. Anusuya Alva v. DCIT* (2005) 278 ITR 206 ruled that tax deducted at source by the tenant from the rent paid but not remitted to the credit of the Central Government can be recovered only from the tenant and not from the landlord. Therefore, in view of the clear mandate in section 205, the Assessing Officer is not justified in law in calling upon M to pay the said tax.

Question 6

- (a) Write a brief note on filing of memorandum of cross-objections before the Income-tax Appellate Tribunal. (5 Marks)
- (b) C, an individual, resident in India, paid medical insurance premium amounting to Rs.20,000 by cash during the year ending 31.3.2006 out of his income chargeable to tax in respect of the policy taken on the health of his dependent father in accordance with the scheme framed by the General Insurance Corporation of India and approved by the Central Government. Besides, he paid Rs.90,000 during the year ending 31.3.2006 for the medical treatment of his dependent mother, aged 69 years, in respect of a disease specified in Rule 11DD(1) of the Income-tax Rules, 1962. He received Rs.20,000 from the insurance company for the said medical treatment of his mother. C seeks your advice on the deductions, if any, available in respect of these two payments. (6 Marks)
- (c) An Assessing Officer entered a hotel run by a person, in respect of whom he exercises jurisdiction, at 8 p.m. for the purpose of collecting information, which may be useful for the purposes of the Act. The hotel is kept open for business every day between 9 a.m. and 9 p.m. The hotelier claims that the Assessing Officer could not enter the hotel after sunset. The Assessing Officer wants to take away with him the books of account kept at the hotel. Examine the validity of the claim made by the hotelier and the proposed action of the Assessing Officer with reference to the provisions of section 133B of the Income-tax Act, 1961. (4 Marks)

Answer

- (a) Section 253(4) of the Income-tax Act, 1961 gives the respondent, in every appeal filed before the Income-tax Appellate Tribunal, a right to file a memorandum of cross-objections against any part of the order of the Commissioner (Appeals). This right of filing a memorandum of cross-objections is an independent right given to the respondent in an appeal and is in addition to the right of appeal which may or may not be exercised by the assessee or the Assessing Officer under section 253(1) or section 253(2). The memorandum of cross-objections has to be in the prescribed form and verified in the prescribed manner and has to be filed within 30 days of the receipt of notice of the appeal. The Tribunal is empowered to permit filing of memorandum of cross-objections after the expiry of the prescribed period if sufficient cause is shown. Such memorandum of cross-objections will be disposed of by the Appellate Tribunal as if it were an appeal presented within the time specified in section 253(3). There is no fee for filing a memorandum of cross-objections.

- (b) Section 80D of the Income-tax Act, 1961 provides for deduction in respect of medical insurance premium paid by an individual or a Hindu undivided family subject to certain conditions and limitations. One of the conditions for allowance of the deduction is that the premium should be paid by cheque. C has paid the premium by cash and not by cheque. C is, therefore, not eligible for deduction under section 80D.

However, C is eligible for deduction under section 80DDB in respect of the payment made by him during the relevant previous year for the medical treatment of his dependent mother in respect of the specified disease. The ceiling limit of deduction is Rs.60,000 since the payment made is in respect of his dependent mother who is above 65 years of age. Section 80DDB provides that the assessee shall be allowed a deduction of the amount actually paid for medical treatment of the specified disease or Rs.60,000 (since the payment is in respect of a senior citizen), whichever is less, in respect of that previous year in which such amount was actually paid. The second proviso to that section provides that deduction under that section shall be reduced by the amount received under an insurance. From a combined reading of the section and the proviso, it can be inferred that in this case, Rs.20,000, being the amount received from the insurer, should be deducted from Rs.60,000, which is the deduction allowable as per section 80DDB (since it is lower than the amount of Rs.90,000 actually paid). Therefore, Rs.40,000 [i.e. Rs.60,000 minus Rs.20,000] is the deduction available under section 80DDB.

- (c) Section 133B(2) of the Income-tax Act, 1961 empowers an income-tax authority to enter any place of business during the hours at which such place is open for the conduct of business. The hotel is open from 9.00 a.m. to 9.00 p.m. for the conduct of business. The Assessing Officer entered the hotel at 8.00 p.m. which falls within the working hours. The claim made by the hotelier to the effect that the Assessing Officer could not enter the hotel after sunset is not in accordance with law.

Section 133B(3) provides that an income tax authority acting under this section shall, on no account, remove or cause to be removed from the place wherein he has entered, any

books of account. In view of this clear prohibition in section 133B(3), the proposed action of the Assessing Officer to take away with him the books of account kept at the hotel is not valid in law.

Question 7

- (a) What is an adventure in the nature of trade? State the factors which are relevant in deciding whether a transaction is an adventure in the nature of trade. (7 Marks)
- (b) The assessment of B, an individual, for the assessment year 2004-05 was made under section 143(3) of the Income-tax Act, 1961 on 18.3.2005. The assessment has become final and is not the subject-matter of an appeal or revision. The Assessing Officer issued a show cause notice for levy of penalty under section 271(1)(c) to B on 25.3.2005. B furnished a reply to the said notice on 30.3.2005. There was a change in incumbent and the Assessing Officer, who made the assessment and issued the show cause notice, was succeeded by another. The successor-Assessing Officer suo motu issued a notice under section 129 to B on 20.9.2005. B did not respond to the said notice. The successor-Assessing Officer passed an order on 4.10.2005 levying penalty under section 271(1)(c). Examine the validity of the order of penalty passed with reference to the aspect of limitation. (8 Marks)

Answer

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

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

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

- (b) Section 275(1) provides for the time limit for passing an order of penalty. Clause (c) thereof requires that the order of penalty should be passed before the expiry of the

financial year in which the proceedings, in the course of which action for the imposition of penalty has been initiated, are completed, or six months from the end of the month in which action for imposition of penalty is initiated, whichever period expires later. The time limit in this case, as per section 275(1)(c), is 30.9.2005. Explanation to section 275 states that in computing the period of limitation, the time taken in giving an opportunity to the assessee to be re-heard under the proviso to section 129 shall be excluded. A plain reading of the proviso to section 129 indicates that it is the assessee who may demand to be re-heard before any order is passed against him. In the instant case, notice under section 129 was not issued by the successor- Assessing Officer at the instance of B. B did not request him to provide an opportunity of re-hearing. The Supreme Court has in *Pradip Lamps Works v. CIT* (2001) 249 ITR 797 ruled that where the assessee replied to the show cause notice issued by the predecessor-Assessing Officer, the successor-Assessing Officer can levy penalty without giving a fresh notice of hearing to the assessee in the absence of a demand by the assessee for re-hearing. The Karnataka High Court, in *B. N. Amarnath v. CIT* (2003) 259 ITR 590, held that the Explanation to section 275 could not be invoked by the Department unilaterally to compute the period of limitation on its own, by issue of notice under section 129, without there being any request for re-hearing by B.

Therefore, in this case, the order of penalty should have been passed by the successor-Assessing Officer on or before 30.9.2005 as per the provisions of section 275(1)(c). The order of penalty having been passed on 4.10.2005 is barred by limitation and therefore, invalid.

Question 8

D, an individual, has the following assets and liabilities as on 31.3.2006

Assets	Rs. in lakhs
Plot of land at Bhopal comprising an area of 1,200 square metres on which building has been constructed without the approval of the appropriate authority	25
Building constructed on land at Bhopal without the approval of the appropriate authority and used for his business purposes.	10
Motor cars held as stock-in-trade	60
Gold jewellery brought into India from Singapore, where he was residing, on his return to India on 1.11.2002 for permanently residing in India.	6
Jewellery made of Platinum.	9
Interest in the coparcenary property of the Hindu undivided family of which he is a member	15`
Cash in hand recorded in the books of account	5
Fixed deposits in a co-operative bank	10

Liabilities	
Loan borrowed for marriage of daughter	6
Loan borrowed for construction of building at Bhopal	5

The minor married daughter of D holds a plot of land at Indore valued at Rs.20 lakhs.

The amounts stated against the assets, except cash in hand, are the values determined as per section 7 of the Wealth-tax Act, 1957 read with Schedule III thereto.

Compute the net wealth of D for the assessment year 2006-07.

State the reasons for inclusion or exclusion of the various items. (10 Marks)

Answer

Computation of net wealth of Mr. D for the A.Y.2006-07

Particulars	Note	Rs.
Plot of land of 1,200 sq. mts. at Bhopal	(a)	25,00,000
Building constructed on land at Bhopal – construction without the approval of appropriate authority – not an asset under section 2(ea) since used for business purposes	(b)	Nil
Motor cars held as stock-in-trade – not an asset under section 2(ea)	(c)	Nil
Gold jewellery brought from Singapore on 1.11.2002 on his return to India for permanently residing in India – Exempt under section 5(v)	(d)	Nil
Jewellery made of platinum	(e)	9,00,000
Interest in coparcenary property of the HUF– Exempt under section 5(ii)	(f)	Nil
Cash in hand in excess of Rs.50,000	(g)	4,50,000
Fixed deposits in a co-operative bank–not an asset under section 2(ea)	(h)	Nil
Gross wealth		38,50,000
Less: Liabilities		
Loan borrowed for marriage of daughter – not deductible	(i)	Nil
Loan borrowed for construction of building at Bhopal – not deductible	(j)	Nil
Net wealth		38,50,000

The reasons for the inclusion or exclusion of the various items are furnished below -

- (a) Plot of land at Bhopal on which building has been constructed without the approval of the appropriate authority is an asset under section 2(ea) and is, therefore, includible in the net wealth. Since the plot of land comprises an area of more than 500 square meters, it is not eligible for exemption under section 5(vi).

- (b) Building constructed on land at Bhopal without the approval of the appropriate authority is not a specified asset under section 2(ea) since it is used for business purposes by D. It is, therefore, not includible in the net wealth.
- (c) Motor cars held as stock-in-trade do not fall under the purview of 'asset' under section 2(ea) and are, therefore, outside the net of wealth tax.
- (d) Gold jewellery brought into India on 1.11.2002 from Singapore is exempt for seven successive assessment years beginning with the assessment year 2003-04 under section 5(v).
- (e) Jewellery made of platinum is an asset under section 2(ea) and is, therefore, included in the net wealth.
- (f) Interest in the coparcenary property of the Hindu undivided family of which D is a member is exempt under section 5(ii).
- (g) Cash in hand, in excess of Rs.50,000, is includible in the net wealth of an individual, whether such cash is recorded in the books of account or not.
- (h) Fixed deposits in a co-operative bank do not constitute 'assets' within the meaning of section 2(ea) and, therefore, are excluded from net wealth.
- (i) Only loans borrowed in relation to the 'assets' as per section 2(ea) are deductible. Hence, loan borrowed for marriage of daughter is not deductible.
- (j) Since building at Bhopal is used for business purposes and is, therefore, not an asset and excluded while computing the net wealth, the loan borrowed for its construction is not a deductible debt.
- (k) Assets held by a minor married daughter are not includible in the net wealth of any parent as per section 4(1)(a)(ii). Hence, the value of the plot of land at Indore, held by the minor married daughter, does not form part of the net wealth of D.