

## PAPER – 4 : TAXATION

Answer **all** questions.

Working notes should form part of the answer.

Wherever necessary, suitable assumptions may be made by the candidates.

### Question 1

Mr. Dinesh Karthik, a resident individual aged 45, furnishes the following information pertaining to the year ended 31.3.2010:

(i) He is a partner in Badrinath & Co. He has received the following amounts from the firm:

|                                                   |   |             |
|---------------------------------------------------|---|-------------|
| Interest on capital at 15%                        | : | Rs.3,00,000 |
| Salary as working partner (at 1% of firm's sales) | : | Rs. 90,000  |

(ii) He is engaged in a business of manufacturing wheat flour from wheat. The Profit and Loss account pertaining to this business (summarised form) is as under:

| To                | Rs.              | By                  | Rs.              |
|-------------------|------------------|---------------------|------------------|
| Salaries          | 1,20,000         | Gross profit        | 12,50,000        |
| Bonus             | 48,000           | Interest on Bank FD | 45,000           |
| Car expenses      | 50,000           | (Net of TDS 5,000)  |                  |
| Machinery repairs | 2,34,000         | Agricultural income | 60,000           |
| Advance tax       | 70,000           | Pension from LIC    |                  |
| Depreciation      |                  | Jeevan Dhara        | 24,000           |
| Car               | 3,00,000         |                     |                  |
| Machinery         | 1,25,000         |                     |                  |
| Net profit        | 4,32,000         |                     |                  |
|                   | <u>13,79,000</u> |                     | <u>13,79,000</u> |

Opening WDV of assets are as under:

|                                               | Rs.      |
|-----------------------------------------------|----------|
| Car                                           | 3,00,000 |
| Machinery (Used during the year for 170 days) | 6,50,000 |
| Additions to machinery                        |          |
| New purchased on 23.9.2009                    | 2,00,000 |
| New purchased on 12.11.2009                   | 3,00,000 |
| Old purchased on 12.4.2009                    | 1,25,000 |

(All assets added during the year were put to use immediately after purchase)

The Suggested Answers for Paper 4: - Taxation are based on the provisions applicable for A.Y. 2010-11, which is the assessment year relevant for May, 2010 examination.

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*Of the total bonus amount, Rs. 15,000 was paid on 11.10.2009.*

*One-fifth of the car expenses are towards estimated personal use of the assessee.*

- (iii) *In March, 2008, he had sold a house at Chennai. Arrears of rent relating to this house amounting to Rs. 75,000 was received in February, 2010.*
- (iv) *Details of his Savings and Investments are as under:*

|                                                                                                                                                                                 | Rs.    |
|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------|
| <i>Life insurance premium for policy in the name of his major son employed in LMN Ltd. at a salary of Rs.6 lacs p.a. (Sum assured Rs.2,00,000)</i>                              | 50,000 |
| <i>Contribution to Pension Fund of National Housing Bank</i>                                                                                                                    | 70,000 |
| <i>(This was met partially from out of premature withdrawal of deposit in Post Office Time Deposit made on 12.3.2006 Principal component Rs. 55,000 and Interest Rs. 5,000)</i> |        |
| <i>Medical Insurance premium for his father aged 70, who is not dependent on him</i>                                                                                            | 22,000 |

*You are required to compute the total income of Mr. Dinesh Karthik for the assessment year 2010-11 and the tax payable by him. Also indicate whether interest, if any, under sections 234A and 234B are payable, assuming that the return was filed on 28<sup>th</sup> September, 2010.*

*Computation of interest, if any, is NOT required. (20 Marks)*

**Answer**

### Computation of total income of Mr. Dinesh Karthik for the A.Y. 2010-11

| Particulars                                                                                                                           | Rs.      | Rs.      |
|---------------------------------------------------------------------------------------------------------------------------------------|----------|----------|
| <b>Income from house property</b>                                                                                                     |          |          |
| Arrears of rent received in respect of the Chennai house taxable under section 25B                                                    | 75,000   |          |
| Less: Deduction @ 30%                                                                                                                 | 22,500   |          |
|                                                                                                                                       |          | 52,500   |
| <b>Profits and gains of business or profession</b>                                                                                    |          |          |
| (a) <b>Own business</b>                                                                                                               | Note 3   | 5,33,250 |
| (b) <b>Income from partnership firm (See Note 1)</b>                                                                                  |          |          |
| Interest on capital                                                                                                                   | 2,40,000 |          |
| [As per section 28(v), chargeable in the hands of the partner only to the extent allowable as deduction in the firm's hand i.e. @12%] |          |          |
| Salary of working partner [Assumed as fully allowed in firm's hands]                                                                  | 90,000   | 3,30,000 |

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### Income from other sources

|                                   |        |                 |
|-----------------------------------|--------|-----------------|
| (a) LIC Jeevan Dhara pension      | 24,000 |                 |
| (b) Interest from bank FD (gross) | 50,000 |                 |
|                                   |        | <u>74,000</u>   |
| <b>Gross Total Income</b>         |        | <b>9,89,750</b> |

### Less: Deductions under Chapter VIA

#### Section 80C

|                                                                                                                                                     |                 |          |
|-----------------------------------------------------------------------------------------------------------------------------------------------------|-----------------|----------|
| Life insurance premium for policy in the name of major son not dependent on the assessee, restricted to 20% of sum assured i.e. 20% of Rs.2,00,000. | 40,000          |          |
| Contribution to pension fund of NHB                                                                                                                 | 70,000          |          |
| Total qualifying amount                                                                                                                             | <u>1,10,000</u> |          |
| Restriction as per section 80CCE (A)                                                                                                                |                 | 1,00,000 |

#### Section 80D

|                                                                                                                                    |        |               |
|------------------------------------------------------------------------------------------------------------------------------------|--------|---------------|
| Mediclaime premium for father, a senior citizen (qualifies for deduction, even though the father is not dependent on the assessee) | 22,000 |               |
| Maximum amount allowable (B)                                                                                                       |        | <u>20,000</u> |

|                                              |                 |
|----------------------------------------------|-----------------|
| Total deduction under Chapter VI-A (A) + (B) | <u>1,20,000</u> |
|----------------------------------------------|-----------------|

|                     |                        |
|---------------------|------------------------|
| <b>Total Income</b> | <b><u>8,69,750</u></b> |
|---------------------|------------------------|

### Computation of tax payable

|                                                                                                                               |          |                        |
|-------------------------------------------------------------------------------------------------------------------------------|----------|------------------------|
| Tax on aggregate of non-agricultural income and agricultural income i.e., Rs.9,29,750 (being, Rs.8,69,750 + Rs.60,000)        | 1,82,925 |                        |
| Less: Tax on the aggregate of agricultural income and basic exemption limit i.e., Rs.2,20,000 (i.e., Rs.60,000 + Rs.1,60,000) |          | <u>6,000</u>           |
|                                                                                                                               |          | 1,76,925               |
| Add: Education cess@2%                                                                                                        |          | 3,539                  |
| Secondary and higher education cess@1%                                                                                        |          | <u>1,769</u>           |
|                                                                                                                               |          | 1,82,233               |
| Less: Advance tax                                                                                                             | 70,000   |                        |
| TDS                                                                                                                           | 5,000    | 75,000                 |
| <b>Tax payable</b>                                                                                                            |          | <b><u>1,07,233</u></b> |

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### Interest under section 234A

Mr. Dinesh Karthik receives salary of Rs.90,000 from the firm, Badrinath & Co., which is given as 1% of the firm's sales. Therefore, the turnover of the firm is Rs.90 lakh, being 90,000/1%. Since the turnover of the firm exceeds Rs.40 lakhs, the firm is subject to tax audit. Since Mr. Dinesh Karthik is a working partner in a partnership firm whose accounts are subject to tax audit, his due date for filing of return would be 30<sup>th</sup> September, 2010. Since the return was filed before the due date, no interest is payable under section 234A.

### Interest under section 234B

Under section 208, obligation to pay advance tax arises in every case where the advance tax payable is Rs.10,000 or more. Interest under section 234B is attracted for non-payment of advance tax or payment of advance tax of an amount less than 90% of the assessed tax. Therefore, in this case, interest under section 234B would be attracted on the balance tax payable.

### Notes:

- (1) The income by way of interest on capital and salary of Mr. Dinesh Karthik from the firm, Badrinath & Co., in which he is a partner, to the extent allowed as deduction in the hands of the firm under section 40(b), has to be included in the business income of the partner as per section 28(v). Accordingly, Rs.3,30,000 [i.e., Rs.90,000 (salary) + Rs.2,40,000 (interest@12%)] should be included in his business income. It has been assumed that salary has been allowed in full in the hands of the firm.
- (2) As per section 25B, any arrears of rent received will be chargeable to tax, after deducting a sum equal to 30% of such arrears, as income from house property in the year of receipt, whether or not the assessee remains the owner of the house property.
- (3) **Computation of income from own business**

| Particulars                                                                          | Rs.           | Rs.             |
|--------------------------------------------------------------------------------------|---------------|-----------------|
| Net profit as per profit and loss account                                            |               | 4,32,000        |
| Less: Items credited to profit and loss account not treated as business income       |               |                 |
| Interest on bank FD (net of TDS 5,000)                                               | 45,000        |                 |
| Agricultural income                                                                  | 60,000        |                 |
| Pension from LIC Jeevan Dhara                                                        | <u>24,000</u> | <u>1,29,000</u> |
|                                                                                      |               | 3,03,000        |
| Add: Items debited to profit and loss account to be disallowed/considered separately |               |                 |
| Advance tax                                                                          | 70,000        |                 |

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|                                             |               |                        |
|---------------------------------------------|---------------|------------------------|
| Depreciation                                |               |                        |
| Car                                         | 3,00,000      |                        |
| Machinery                                   | 1,25,000      |                        |
| Car expenses disallowed                     | <u>10,000</u> | <u>5,05,000</u>        |
|                                             |               | <b>8,08,000</b>        |
| Less: Depreciation (See Working Note below) |               | <u>2,74,750</u>        |
| <b>Income from own business</b>             |               | <b><u>5,33,250</u></b> |

**Working Note**

**Computation of depreciation allowable under the Income-tax Act, 1961**

**Block I Car**

|                                          |              |        |
|------------------------------------------|--------------|--------|
| 15% on 3,00,000                          | 45,000       |        |
| Less: 1/5 <sup>th</sup> for personal use | <u>9,000</u> | 36,000 |

**Block II Machinery**

|                                                         |                 |          |
|---------------------------------------------------------|-----------------|----------|
| Opening WDV                                             | 6,50,000        |          |
| Additions during the year (Used for more than 180 days) | <u>3,25,000</u> |          |
| Depreciation at 15% on                                  | 9,75,000        | 1,46,250 |

Additions during the year (used for less than 180 days)

|                                |          |               |
|--------------------------------|----------|---------------|
| Hence, depreciation at 7.5% on | 3,00,000 | <u>22,500</u> |
| Total normal depreciation (A)  |          | 2,04,750      |

Where an asset acquired during the year is put to use for less than 180 days, 50% of the rate of depreciation is allowable. This restriction does not apply to assets acquired in an earlier year.

**Additional depreciation**

|                                    |          |        |
|------------------------------------|----------|--------|
| New machinery                      |          |        |
| Used for more than 180 days at 20% | 2,00,000 | 40,000 |

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|                                                 |          |                 |
|-------------------------------------------------|----------|-----------------|
| Used for less than 180 days at 10%              | 3,00,000 | 30,000          |
| Total additional depreciation (B)               |          | 70,000          |
| <b>Total permissible depreciation (A) + (B)</b> |          | <b>2,74,750</b> |

**(4) Withdrawal from Post Office Time Deposit**

The deduction under section 80C is allowable in respect of any sum deposited in a five year time deposit in an account under Post Office Time Deposit Rules, 1981 w.e.f. A.Y.2008-09. Clause (xxiv) was inserted by the Finance Act, 2008 in section 80C(2) providing this deduction with effect from A.Y.2008-09. Simultaneously, sub-section (6A) was inserted in section 80C w.e.f. A.Y.2008-09 to bring to tax pre-mature withdrawal (before five years) of the amount so deposited and interest thereon. In the question, it is clearly mentioned that the deposit was made on 12.3.2006. Therefore, no deduction under section 80C would have been allowable in the P.Y.2005-06 in respect of such deposit, since clause (xxiv) providing for deduction was inserted by the Finance Act, 2008 only w.e.f. A.Y.2008-09. Consequently, sub-section (6A) bringing to tax the withdrawal would not apply in respect of such deposit for which no deduction was allowed under section 80C.

**Question 2**

- (a) *Mr. Tenzingh is engaged in composite business of growing and curing (further processing) coffee in Coorg, Karnataka. The whole of coffee grown in his plantation is cured. Relevant information pertaining to the year ended 31.3.2010 are given below:*

|                                             |           |
|---------------------------------------------|-----------|
|                                             | Rs.       |
| WDV of car as on 1.4.2009                   | 3,00,000  |
| WDV of machinery as on 31.3.2009 (15% rate) | 15,00,000 |
| Expenses incurred for growing coffee        | 3,10,000  |
| Expenditure for curing coffee               | 3,00,000  |
| Sale value of cured coffee                  | 22,00,000 |

*Besides being used for agricultural operations, the car is also used for personal use; disallowance for personal use may be taken at 20%. The expenses incurred for car running and maintenance are Rs.50,000. The machines were used in coffee curing business operations.*

*Compute the income arising from the above activities for the assessment year 2010-11. Show the WDV of the assets as on 31.3.2010. (6 Marks)*

- (b) *Mr. Raj Kumar sold a house to his friend Mr. Dhuruv on 1<sup>st</sup> November, 2009 for a consideration of Rs. 25,00,000. The Sub-Registrar refused to register the document for the said value, as according to him, stamp duty had to be paid on Rs. 45,00,000, which was the Government guideline value. Mr. Raj Kumar preferred an appeal to the Revenue Divisional Officer, who fixed the value of the house as Rs. 32,00,000 (Rs. 22,00,000 for land and the balance for building portion). The differential stamp duty was paid,*

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accepting the said value determined. Assuming that the fair market value is Rs. 32,00,000, what are the tax implications in the hands of Mr. Raj Kumar and Mr. Dhuruv for the assessment year 2010-11? Mr. Raj Kumar had purchased the land on 1<sup>st</sup> June, 2006 for Rs. 5,19,000 and completed the construction of house on 1<sup>st</sup> October, 2007 for Rs. 14,00,000.

Cost inflation indices may be taken as 519 for the financial year 2006-07, 582 for the financial year 2007-08 and 632 for the financial year 2009-10.

Note – Cost inflation of index for the financial year 2007-08 has been wrongly printed as 582 instead of 551. (6 Marks)

Answer

- (a) Where an assessee is engaged in the composite business of growing and curing of coffee, the income will be segregated between agricultural income and business income, as per Rule 7B of the Income-tax Rules, 1962.

As per the above Rule, income derived from sale of coffee grown and cured by the seller in India shall be computed as if it were income derived from business, and 25% of such income shall be deemed to be income liable to tax. The balance 75% will be treated as agricultural income.

| Particulars                                                           | Rs.             | Rs.             | Rs.                     |
|-----------------------------------------------------------------------|-----------------|-----------------|-------------------------|
| Sale value of cured coffee                                            |                 |                 | 22,00,000               |
| Less: Expenses for growing coffee                                     |                 | 3,10,000        |                         |
| Car expenses (80% of Rs.50,000)                                       |                 | 40,000          |                         |
| Depreciation on car (80% of 15% of Rs.3,00,000)                       |                 | <u>36,000</u>   |                         |
| Total costs of agricultural operations                                |                 | 3,86,000        |                         |
| Expenditure for coffee curing operations                              | 3,00,000        |                 |                         |
| Add: Depreciation on machinery<br>(15% of 15,00,000) (See Note below) | <u>2,25,000</u> |                 |                         |
| Total cost of the curing operations                                   |                 | <u>5,25,000</u> |                         |
| Total cost of composite operations                                    |                 |                 | <u>9,11,000</u>         |
| <b>Total profits from composite activities</b>                        |                 |                 | <b><u>12,89,000</u></b> |
| Amount regarded as business income (25% of above)                     |                 |                 | 3,22,250                |
| Amount treated as agricultural income (75% of above)                  |                 |                 | 9,66,750                |

### Computation of value of depreciable assets as on 31.3.2010

| Particulars                             | Rs. | Rs.      | Rs. |
|-----------------------------------------|-----|----------|-----|
| <b>Car</b> Opening value as on 1.4.2009 |     | 3,00,000 |     |

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|                                               |                 |           |
|-----------------------------------------------|-----------------|-----------|
| Depreciation thereon at 15%                   | 45,000          |           |
| Less: Disallowance @20% for personal use      | 9,000           |           |
| Depreciation actually allowed                 | <u>36,000</u>   |           |
| Closing value as on 31.3.2010                 |                 | 2,64,000  |
| <b>Machinery</b> Opening value as on 1.4.2009 | 15,00,000       |           |
| Less: Depreciation @ 15%                      | <u>2,25,000</u> |           |
| Closing value as on 31.3.2010                 |                 | 12,75,000 |

Explanation 7 has been inserted in section 43(6) to provide that in cases of 'composite income', for the purpose of computing written down value of assets acquired before the previous year, the total amount of depreciation shall be computed as if the entire composite income of the assessee (and not just 25%) is chargeable under the head "Profits and gains of business or profession". The depreciation so computed shall be deemed to have been "actually allowed" to the assessee.

**Note** – It has been assumed that the written down value of machinery as on 31.3.2009 i.e., Rs.15 lakh given in the question represents the closing balance after providing depreciation for the previous year 2008-09. It is also possible to assume that the written down value of Rs.15 lakh as on 31.3.2009 represents the written down value on which depreciation has to be charged for the previous year 2008-09 and solve the problem accordingly.

**(b) In the hands of the seller, Mr. Raj Kumar**

As per section 50C(1), where the consideration received or accruing as a result of transfer of land or building or both, is less than the value adopted or assessed or assessable by the stamp valuation authority, the value adopted or assessed or assessable by the stamp valuation authority shall be deemed to be the full value of consideration received or accruing as a result of transfer.

Where the assessee appeals against the stamp valuation and the value is reduced in appeal by the appellate authority (Revenue Divisional Officer, in this case), such value will be regarded as the consideration received or accruing as a result of transfer.

In the given problem, land has been held for a period exceeding 36 months and building for a period less than 36 months immediately preceding the date of transfer. So land is a long-term capital asset, while building is a short-term capital asset.

| Particulars                                                        | Rs.                     |
|--------------------------------------------------------------------|-------------------------|
| <b>Long term capital gain on sale of land</b>                      |                         |
| Consideration received or accruing as a result of transfer of land | 22,00,000               |
| Less: Indexed cost of acquisition $5,19,000 \times 632/519$        | <u>6,32,000</u>         |
| <b>Long-term capital gain (A)</b>                                  | <u><b>15,68,000</b></u> |



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### Short-term capital loss on sale of building

|                                                              |                 |
|--------------------------------------------------------------|-----------------|
| Consideration received or accruing from transfer of building | 10,00,000       |
| Less: Cost of acquisition                                    | 14,00,000       |
| <b>Short term capital loss (B)</b>                           | <b>4,00,000</b> |

As per section 70, short-term capital loss can be set-off against long-term capital gains. Therefore, the net taxable long-term capital gains would be Rs.11,68,000 (i.e., Rs.15,68,000 – Rs.4,00,000).

### In the hands of the buyer Mr. Dhuruv

As per section 56(2)(vii), inserted by the Finance (No.2) Act, 2009, where an individual receives on or after 1st October, 2009, from a non-relative, any immovable property for inadequate consideration, and the difference between the stamp value (or the value reduced by the appellate authority, as in this case) and the consideration exceeds Rs.50,000, such difference is chargeable to tax as income from other sources. The problem states that the immovable property in question was received on 1<sup>st</sup> November, 2009 from a non-relative. Hence the above provisions will be attracted. The inadequate consideration to the tune of Rs.7 lacs (32 lacs less 25 lacs) will be assessed as income from other sources.

**Note :** The Finance Act, 2010 has amended section 56(2)(vii) to remove transfer of immovable property for inadequate consideration from its scope right from the date of introduction of this provision i.e., date of insertion of section 56(2)(vii), being 1<sup>st</sup> October, 2009. Therefore, transfer of immovable property for inadequate consideration would never fall within the scope of section 56(2)(vii). Accordingly, the provisions of section 56(2)(vii) would not be attracted in such a case.

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

### Question 3

From the following particulars of income furnished by Mr. Anirudh pertaining to the year ended 31.3.2010, compute the total income for the assessment year 2010-11, if he is:

- (i) Resident and ordinary resident;
- (ii) Resident but not ordinarily resident;
- (iii) Non-resident

| Particulars                                                        | Amount (Rs.) |
|--------------------------------------------------------------------|--------------|
| (a) Profit on sale of shares in Indian Company received in Germany | 15,000       |
| (b) Dividend from a Japanese Company received in Japan             | 10,000       |

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|                                                                                                                              |            |
|------------------------------------------------------------------------------------------------------------------------------|------------|
| (c) Rent from property in London deposited in a bank in London, later on remitted to India through approved banking channels | 75,000     |
| (d) Dividend from RP Ltd., an Indian Company                                                                                 | 6,000      |
| (e) Agricultural income from lands in Gujarat                                                                                | 25,000     |
|                                                                                                                              | (10 Marks) |

Answer

**Computation of total income of Mr. Anirudh for the A.Y. 2010-11**

| Particulars                                                                        | Resident &<br>ordinarily<br>resident | Resident<br>but not<br>ordinarily<br>resident | Non-<br>Resident |
|------------------------------------------------------------------------------------|--------------------------------------|-----------------------------------------------|------------------|
| 1) Profit on sale of shares of an Indian company, received in Germany              | 15,000                               | 15,000                                        | 15,000           |
| 2) Dividend from a Japanese company, received in Japan.                            | 10,000                               | -                                             | -                |
| 3) Rent from property in London deposited in a bank in London [See Note (i) below] | 52,500                               | -                                             | -                |
| 4) Dividend from RP Ltd., an Indian Company [See Note (ii) below]                  | -                                    | -                                             | -                |
| 5) Agricultural income from land in Gujarat [See Note (iii) below]                 | -                                    | -                                             | -                |
| <b>TOTAL INCOME</b>                                                                | <b>77,500</b>                        | <b>15,000</b>                                 | <b>15,000</b>    |

**Notes**

- (i) It has been assumed that the rental income is the gross annual value of the property. Therefore, deduction @30% under section 24, has been provided and the net income so computed is taken into account for determining the total income of a resident and ordinarily resident.

|                                                     |               |
|-----------------------------------------------------|---------------|
| Rent received (assumed as gross annual value)       | 75,000        |
| Less: Deduction under section 24 (30% of Rs.75,000) | 22,500        |
| Income from house property                          | <u>52,500</u> |

- (ii) Dividend from Indian company is exempt under section 10(34)

- (iii) Agricultural income is exempt under section 10(1).

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### Question 4

Answer the following questions with regard to the provisions of the Income-tax Act, 1961:

- (a) State the concessions granted to transport operators from 1<sup>st</sup> October, 2009 onwards in the context of cash payments under section 40A(3) and deduction of tax at source under section 194-C.
- (b) What are the conditions to be fulfilled by a Charitable Trust under section 12A for applicability of exemption provisions contained in sections 11 and 12?
- (c) What are the particulars required to be furnished with the return of income, as per section 139(6)?  
(3 x 4 = 12 Marks)

### Answer

- (a) Section 40A(3) provides for disallowance of expenditure incurred in respect of which payment or aggregate of payments made to a person in a day exceeds Rs.20,000, and such payment or payments are made otherwise than by account payee cheque or account payee bank draft.

This limit of Rs.20,000 has been raised to Rs.35,000 in case of payment made to transport operators for plying, hiring or leasing goods carriages. Therefore, payment or aggregate of payments up to Rs.35,000 in a day can be made to a transport operator otherwise than by way of account payee cheque or account payee bank draft, without attracting disallowance under section 40A(3).

Under section 194C, tax had to be deducted in respect of payments made to contractors including contractors in transport business at the rate of 2% up to 30.9.2009.

However, with effect from 1.10.2009, no deduction is required to be made from any sum credited or paid or likely to be credited or paid during the previous year to the account of a contractor, during the course of the business of plying, hiring or leasing goods carriages, if the contractor furnishes his permanent account number (PAN) to the person paying or crediting such sum.

- (b) **Conditions for applicability of sections 11 and 12 [Section 12A]**

The exemption provisions contained in sections 11 and 12 shall not apply in relation to the income of any trust or institution unless the following conditions are fulfilled -

- (i) An application for registration of the trust or institution in the prescribed form and in the prescribed manner should be made to the Commissioner and the trust or institution should be registered under section 12AA.
- (ii) The requirement of filing an application for registration within one year of creation of the religious or charitable trust or institution has been removed. The application can be filed at any time now.
- (iii) Accordingly, in respect of applications made on or after 1st June, 2007, the provisions of sections 11 and 12 shall apply from the assessment year relevant to the financial year in which the application is made i.e. the exemption would be available only with effect from

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the assessment year relevant to the previous year in which the application is filed. It would not be available in respect of any earlier assessment year.

- (iv) Where the total income of the trust or institution, without giving effect to the provisions of sections 11 and 12, exceeds the maximum amount which is not chargeable to income-tax in any previous year, the accounts of the trust or institution must be audited by a Chartered Accountant and the report of such audit in the prescribed form duly signed and verified by such accountant setting forth such prescribed particulars, should be furnished along with the return of income.

### (c) Particulars to be furnished with the return of income [Section 139(6)]

As per section 139(6), the prescribed form of return of income, shall in certain prescribed cases, require the assessee to furnish the particulars of:

- (i) income exempt from tax;
- (ii) assets of the prescribed nature and value, belonging to the assessee;
- (iii) details of bank account and credit card held by the assessee;
- (iv) expenditure exceeding the prescribed limits incurred by the assessee under prescribed heads; and
- (v) such other outgoings, as may be prescribed.

### Question 5

*Provide brief answer to the following questions on service tax:*

- (a) *Is service tax payable in respect of services provided in the Indian territorial waters?*
- (b) *Is service tax leviable on fee collected by public authorities while performing statutory functions under the provisions of law?*
- (c) *Can an assessee file a revised service tax return?*
- (d) *Explain the term "commercial training or coaching center".* (4 x 2 = 8 Marks)

### Answer

- (a) Yes, services provided within Indian territorial waters are liable to service tax, as the levy of service tax extends to the whole of India except Jammu and Kashmir and India includes Indian territorial waters. Indian territorial waters extend upto 12 nautical miles from the Indian land mass.
- (b) Circular No. 96/7/2007 ST dated 23.08.2007 has clarified that service tax shall not be leviable on fee collected by public authorities while performing statutory functions under the provisions of law.

However, if the service is not in the course of statutory function but is undertaken for a consideration, service tax may be leviable if it is a taxable service.

- (c) An assessee can submit a revised return, in Form ST-3 in triplicate, to correct a mistake or omission in the original return, within a period of 90 days from the date of submission of the original return.

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- (d) Commercial training or coaching centre” means any institute or establishment providing commercial training or coaching for imparting skill or knowledge or lessons on any subject or field other than the sports, with or without issuance of a certificate and includes coaching or tutorial classes but does not include preschool coaching and training centre or any institute or establishment which issues any certificate or diploma or degree or any educational qualification recognised by law for the time being in force [Section 65(27)].

### Question 6

- (a) Virat Kohli & Co., a partnership firm, is providing taxable legal consultancy services, for the second consecutive assessment year. The firm furnishes the following information relating to the services rendered, bills raised, amounts received relating to this service, for the year ended 31.3.2010:

|       |                                                                                                                                                                                                                                                                                                                                                               | Rs.       |
|-------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------|
| (i)   | Free services rendered to poor people (Value of the services computed on comparative basis)                                                                                                                                                                                                                                                                   | 40,000    |
| (ii)  | Advances received from clients for which no taxable service has been rendered so far                                                                                                                                                                                                                                                                          | 5,00,000  |
| (iii) | Services billed to clients – Gross amount (Service tax has been charged separately in all the bills; the firm follows mercantile system of accounting)                                                                                                                                                                                                        | 12,00,000 |
| (iv)  | The firm has received the following amounts during the year: Relating to taxable services rendered in March, 2009 (excluding service tax at applicable rates and TDS under section 194-J of the IT Act, 1961 to the tune of Rs. 45,320)                                                                                                                       | 5,44,680  |
|       | Relating to taxable services rendered in current year 2009 (excluding service tax at applicable rates and TDS under section 194-J of the IT Act, 1961 to the tune of Rs. 1,20,000)<br>(*includes Rs. 50,000 as appearance fee before Labour Court received from another firm)<br>Service tax has been separately received for applicable items in (iv) above. | 9,80,000* |

You are required to compute the value of taxable services for the year ended 31.3.2010 and the service tax payable, briefly explaining the treatment of each item above. (8 Marks)

- (b) Answer the following questions on service tax:
- What is the scope of taxable service in respect of membership of clubs or associations? State the exception to the same.
  - Does a service provider have an option to pay service tax at a rate different from the general rate applicable on gross value of taxable services, in the case of purchase or sale of foreign currency?

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- (iii) *What is the late fee payable for delay in furnishing the service tax return? Can the same be waived?* (3 × 3 = 9 Marks)

Answer

- (a) The legal consultancy services were brought under service tax net only with effect from 01.09.2009. Thus, service tax would be leviable only on the services rendered on or after 01.09.2009.

Assuming that all receipts are evenly distributed throughout the year, the calculations have been made on pro-rata basis.

- (i) **Break up of amounts received during the year between the periods – April 09 to August 09 and September 09 to March 2010:-**

| Particulars                                                                                                                                             | Receipts during April 09 to August 09 (Rs.) | Receipts during September 09 to March 10 (Rs.) | Total (Rs.)             |
|---------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------|------------------------------------------------|-------------------------|
| Free services rendered to poor people                                                                                                                   | -                                           | -                                              | -                       |
| Advances received from clients                                                                                                                          | 2,08,333                                    | 2,91,667                                       | 5,00,000                |
| Consideration received for services rendered in earlier year [Rs.5,44,680 + Rs.45,320]                                                                  | 2,45,833                                    | 3,44,167                                       | 5,90,000                |
| Consideration received for services rendered in current year excluding fee for appearing before Labour Courts [(Rs.9,80,000 + Rs.1,20,000) – Rs.50,000] | <u>4,37,500</u>                             | <u>6,12,500</u>                                | <u>10,50,000</u>        |
| Fee for appearing before Labour Courts                                                                                                                  | <u>20,833</u>                               | <u>29,167</u>                                  | <u>50,000</u>           |
| <b>Total</b>                                                                                                                                            | <b><u>9,12,499</u></b>                      | <b><u>12,77,501</u></b>                        | <b><u>21,90,000</u></b> |

- (ii) **Computation of value of taxable services and service tax payable thereon:**

| Particulars                                                                   | Rs.      |
|-------------------------------------------------------------------------------|----------|
| Free services rendered to poor people (Note 1)                                | -        |
| Taxable advances received from clients (Note 2)                               | 2,91,667 |
| Consideration received for services rendered in earlier year (Note 3)         | -        |
| Consideration received for taxable services rendered in current year (Note 4) | 6,12,500 |
| Fee for appearing before Labour Courts (Note 5)                               | -        |
| Total value of taxable services                                               | 9,04,167 |
| Service tax payable (Note 6)                                                  | Nil      |

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### Notes:-

1. Service tax is chargeable on the value of service. Thus, service tax is not payable in case of free services as there is no consideration in such case.
  2. Service tax is payable on advances as taxable service includes "service to be provided" and the payments received before, during or after provision of the taxable service form part of the gross amount charged for the taxable services. Since, the turnover of taxable services do not exceed Rs.10,00,000 for the taxable period i.e., from September 09 to March 2010, it is logical to presume that the taxable advances of Rs.2,91,667 received from client are exclusive of service tax.
  3. Consideration received for services rendered in March 2009 will not be liable to service tax as the service became taxable only with effect from 01.09.2009.
  4. Service tax is payable on the value of taxable services charged by the assessee. Any income tax deducted at source is included in the charged amount. Thus, service tax is to be paid on TDS also. It is presumed here that amount of Rs.1,20,000 represents only TDS.
  5. The definition of taxable legal consultancy service specifically excludes the services provided for appearance before any Court, Tribunal or authority.
  6. Taxable services up to Rs.10,00,000 are exempt from service tax during the year 2009-10 as there was 'nil' turnover of taxable services in the year 2008-09.
- (b) (i) The scope of taxable service shall include any service provided or to be provided to its members by any club or association in relation to provision of services, facilities or advantages for a subscription or any other amount.
- Taxable service provided or to be provided by a resident welfare association to its members are exempt from service tax, provided the consideration received from an individual member does not exceed Rs.3000 per month.
- Further, service provided by twenty two prescribed export promotion councils to its members are also exempt from service tax.
- (ii) Yes, there is an option to pay an amount calculated at 0.25% of the gross amount of currency exchanged, instead of paying service tax at 10% on the value of taxable services.
- The option is available to a person liable to pay service tax in relation to purchase or sale of foreign currency, including money changing provided by a foreign exchange broker, including an authorized dealer in foreign exchange.
- However such option is not available in a case where the consideration for the service provided or to be provided is shown separately in the invoice, bill/challan issued by the service provider.

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- (iii) The late fee payable for delay in submitting the service tax return is furnished below:

| S.No. | Period of delay (No. of days from the due date of filing the return) | Late fee (Rs.)                                             |
|-------|----------------------------------------------------------------------|------------------------------------------------------------|
| (a)   | 15 days                                                              | 500                                                        |
| (b)   | 16 – 30 days                                                         | 1000                                                       |
| (c)   | Beyond 30 days                                                       | Rs.1000 plus Rs.100 for every day of delay beyond 30 days. |

However, the total late fee payable shall not exceed Rs.2,000.

**Waiver of late fee:** Where the gross amount of service tax payable is nil, the Central Excise Officer may, on being satisfied that there was sufficient cause for the delay, reduce or waive the late fee.

**Question 7**

*Answer the following questions on VAT:*

- (a) *What are the items aggregated in the addition method to calculate the VAT payable? When is this method mainly used?*
- (b) *Is any threshold exemption limit fixed for dealers to obtain VAT registration, as per the White Paper? If yes, why is the same provided?*
- (c) *Is the VAT chain continued when a purchasing dealer opts for VAT composition scheme? What is the loss to the seller and buyer opting for the composition scheme, and the subsequent buyers?*
- (d) *Can it be said that VAT brings about certainty to a great extent in the matter of interpretational issues? If so, how?*

**Answer**

- (a) In the addition method,
  - (i) All the factor payments, and
  - (ii) Profit, are added to arrive at the value addition on which VAT rate is applied to compute the VAT payable.This method is mainly used with income variant of VAT.
- (b) The threshold limit for small traders, as per the White Paper is Rs.5 lakh. The same was subsequently increased to Rs.10 lakh.  
The same is fixed to provide relief to small traders.
- (c) As soon as the dealer opts for the composition scheme, the VAT chain is broken.  
When a composition scheme is availed by a seller or buyer, he cannot claim input credit of the tax paid on the purchases. This will add to the cost of the goods.  
The benefit of tax paid earlier will not be passed on to subsequent buyers.



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- (d) VAT is a system, based simply on transactions; hence there is no need to go through complicated definitions like sales, turnover, etc.  
The tax is also broad based and is applicable to all sales of the commodity in question, leaving little room for different interpretations.  
Hence it can be said that VAT brings certainty to a great extent.

### Question 8

- (a) Mr. X, a dealer in Mumbai dealing in consumer goods, submits the following information pertaining to the month of March, 2010:
- (i) Exempt goods 'A' purchased for Rs. 2,00,000 and sold for Rs. 2,50,000.
  - (ii) Goods 'B' purchased for Rs. 2,25,000 (including VAT) and sold at a margin of 10% profit on purchases (VAT rate 12.5%)
  - (iii) Goods 'C' purchased for Rs. 1,00,000 (excluding VAT) and sold for Rs. 1,50,000 (VAT rate 4%);
  - (iv) His unutilized balance of VAT input credit on 1.3.2010 was Rs. 1,500.
- Compute the turnover, Input VAT, Output VAT and Net VAT payable by Mr. X. (8 Marks)
- (b) Answer the following questions on VAT:
- (i) What are the merits of VAT in the context of tax evasion, neutrality and transparency?
  - (ii) State the importance of VAT invoice/tax invoice in administering VAT.
  - (iii) Discuss the tax consequences of stock transfer under the VAT scheme.

### Answer

(a)

| Goods            | Purchases       | Input VAT credit | Sales (Turnover) | Output VAT    |
|------------------|-----------------|------------------|------------------|---------------|
|                  | Rs.             | Rs.              | Rs.              | Rs.           |
| A                | 2,00,000        | -                | 2,50,000         | -             |
| B (See Note)     | 2,00,000        | 25,000           | 2,20,000         | 27,500        |
| C                | <u>1,00,000</u> | <u>4,000</u>     | <u>1,50,000</u>  | <u>6,000</u>  |
|                  | <u>5,00,000</u> | <u>29,000</u>    | <u>6,20,000</u>  | <u>33,500</u> |
|                  |                 |                  | Rs.              | Rs.           |
| Exempt turnover  |                 |                  | 2,50,000         |               |
| Taxable turnover |                 |                  | <u>3,70,000</u>  |               |
| Total turnover   |                 |                  | <u>6,20,000</u>  |               |

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|                                              |               |
|----------------------------------------------|---------------|
| Opening balance of Input VAT credit          | 1,500         |
| Add: Input VAT credit for March, 2010        | <u>29,000</u> |
| Total Input VAT credit available             | 30,500        |
| Less: Output VAT payable on taxable turnover | <u>33,500</u> |
| Net VAT payable                              | <u>3,000</u>  |

|                                                     |          |
|-----------------------------------------------------|----------|
| <b>Note:</b> Goods B purchase value (including VAT) | 2,25,000 |
| Less: VAT included in above                         | 25,000   |

$$2,25,000 \times \frac{12.5}{112.5}$$

|                              |               |
|------------------------------|---------------|
| Purchase price excluding VAT | 2,00,000      |
| Add: Profit on above @ 10%   | <u>20,000</u> |
| Selling price before VAT     | 2,20,000      |
| VAT @ 12.5% on selling price | 27,500        |

**Note :** Profit margin of 10% is taken at purchase value excluding VAT.

- (b) (i) (1) **No tax evasion:** - Under VAT, credit of duty paid is allowed against the liability on the final product manufactured or sold. Therefore, unless proper records are kept in respect of various inputs, it is not possible to claim credit. Hence, suppression of purchases or production will be difficult because it will lead to loss of revenue.
- (2) **Neutrality:** - The greatest advantage of VAT system is that it does not interfere in the choice of decision for purchases. This is because the system has anti-cascading effect. How much value is added and at what stage it is added in the system of production/distribution is of no consequence. The system is neutral with regard to choice of production technique, as well as business organization. All other things remaining the same, the issue of tax liability does not vary the decision about the source of purchase.
- (3) **Transparency:** - Under VAT system, the buyer knows the tax component out of the total consideration paid for purchase of material. Thus, the system ensures transparency also.
- (ii) Invoices are crucial documents for administering VAT. In the absence of invoices VAT paid by the dealer earlier cannot be claimed as set off.
- A VAT invoice:
- (i) helps in determining the input tax credit and prevents cascading effect of taxes;
  - (ii) facilitates multi-point taxation on the value addition;

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- (iii) promotes assurance of invoices;
- (iv) assists in performing audit and investigation activities effectively and checks evasion of tax.
- (iii) Inter-State stock transfers do not involve sale and, therefore they are not subjected to sales tax. The same position is continued under VAT.

However, the tax paid on:

- (i) inputs used in the manufacture of finished goods which are stock transferred;  
or
  - (ii) purchases of goods which are stock transferred
- is available as input tax credit after retention of 2% of such tax by the State Governments.