

PAPER – 4 : TAXATION

Question No.1 is compulsory.

Attempt any five questions from the remaining six questions.

Wherever required, suitable assumptions may be made by the candidate and stated clearly in the answer. Working notes should form part of the answer.

All questions relate to the assessment year 2011-12, unless stated otherwise in the question.

Question 1

- (a) On 21-3-2010, Mr. Janak gifted to his wife Mrs. Thilagam 200 listed shares, which had been bought by him on 19-4-2009 at ₹ 2,000 per share. On 1-6-2010, bonus shares were allotted in the ratio of 1:1. All these shares were sold by Mrs. Thilagam as under:

Date of sale	Manner of sale	No. of shares	Net sales value (₹)
21.5.2010	Sold in recognized stock exchange, STT paid	100	2,20,000
21.7.2010	Private sale to an outsider	All bonus shares	1,25,000
28.2.2011	Private sale to her friend Mrs. Hema (Market value on this date was ₹ 2,10,000)	100	1,70,000

Briefly state the income-tax consequences in respect of the sale of the shares by Mrs. Thilagam, showing clearly the person in whose hands the same is chargeable, the quantum and the head of income in respect of the above transactions. Detailed computation of total income is NOT required.

Net sales value represents the amount credited after all taxes, levies, brokerage, etc., and the same may be adopted for computing the capital gains.

Cost inflation index for the FY 2010-11 is 711 and for the FY 2009-10 is 632. (5 marks)

- (b) Nathan Aviation Ltd. is running two industrial undertakings, one in a SEZ (Unit S) and another in a normal area (Unit N). The brief summarized details for the year ended 31.3.2011 are as under:

The Suggested Answers for Paper 4: Taxation are based on the provisions of law as amended by the Finance Act, 2010 and applicable for A.Y. 2011-12 (in the case of Income-tax), which is the assessment year relevant for May, 2011 examination.

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	(₹ in lacs)	
	S	N
Domestic turnover	10	100
Export turnover	120	Nil
Gross profit	20	10
Less: Expenses and depreciation	7	6
Profits derived from the unit	13	4

The brought forward business loss pertaining to Unit N is ₹ 2 lacs. Briefly compute the business income of the assessee. (5 Marks)

- (c) Pareesh & Co., is a partnership firm engaged in the business of recruitment and supply of labourers. The firm, which had rendered taxable services to the tune of ₹ 20.2 lacs in the financial year 2009-10, furnishes the following details pertaining to the half year ended on 30.9.2010 :

	(₹)
(i) Amounts collected from companies for pre-recruitment screening	2,50,000
(ii) Amounts collected from companies for recruitment of	
Permanent staff	3,00,000
Temporary staff	4,00,000
(iii) Advances received from prospective employers for conducting campus interviews in colleges	1,00,000

Wherever applicable, service tax has been charged separately and received from clients. Compute the value of taxable services rendered and the service tax payable by the assessee for the relevant half year. (5 Marks)

- (d) The following are details of purchases, sales, etc. effected by Vasudha & Co., a registered dealer, for the year ended 31.3.2011 :

Particulars	Amount (₹)
Purchase of raw materials within State, 1000 units, inclusive of VAT levy at 6%	5,30,000
Inter-State purchases of raw materials, inclusive of CST at 2%	2,04,000
Import of raw materials, inclusive of customs duty of ₹ 35,000	4,35,000
Capital goods purchased on 1.5.2010, inclusive of VAT levy at 10% (input credit to be spread over 2 financial years)	3,30,000

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Other manufacturing expenses	1,50,000
Sale of taxable goods within State, inclusive of VAT levy at 4%	7,28,000
Sale of goods within State, exempt from levy of VAT (Goods were manufactured from the Inter-State purchase of raw materials)	1,20,000
Closing stock as on 31.3.2011 was 100 units of raw materials purchased within the State	

Input credit is allowed only on raw materials used in manufacture of the taxable goods.
Compute the VAT liability of the dealer for the year ended 31.3.2011. (5 Marks)

Answer

- (a) Where an asset has been transferred by an individual to his spouse otherwise than for adequate consideration, the income arising from the sale of the said asset by the spouse will be clubbed in the hands of the individual.

Where there is any accretion to the asset transferred, income arising to the transferee from such accretion will not be clubbed. Hence, the profit from sale of bonus shares allotted to Mrs. Thilagam will be chargeable to tax in the hands of Mrs. Thilagam.

Therefore, the capital gains arising from the sale of the original shares has to be included in the hands of Mr. Janak, and the capital gains arising from the sale of bonus shares would be taxable in the hands of Mrs. Thilagam.

Where an asset received by way of gift has been sold, the period of holding of the previous owner should be considered for determining whether the capital gain is long term or short term. The cost to the previous owner has to be taken as the cost of acquisition.

Income/loss to be clubbed in the hands of Mr. Janak

Long-term capital gains/loss

	Particulars	₹
(i)	100 shares sold on 21.5.2010 in a recognized stock exchange, STT paid. Long-term capital gains on sale of such shares is exempt under section 10(38)	Nil
(ii)	Shares sold to a friend on 28.2.2011	
	Sale consideration	1,70,000
	Less: Indexed cost of acquisition of 100 shares ($\text{₹ } 2,000 \times 100 \times 711/632$)	<u>2,25,000</u>
	Long term capital loss to be included in the hands of Mr. Janak	<u>(55,000)</u>

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Income taxable in the hands of Mrs. Thilagam

Short-term capital gains (on sale of 100 bonus shares)

Particulars		₹
Sale consideration		1,25,000
Less: Cost of acquisition of bonus shares		<u>Nil</u>
Short-term capital gains		<u>1,25,000</u>

Taxability in the hands of Mrs. Hema under the head “Income from other sources”

Mrs. Hema has received shares from her friend, Mrs. Thilagam, for inadequate consideration. Even though shares fall within the definition of “property” under section 56(2)(vii), the provisions of section 56(2)(vii) would not be attracted in the hands of Mrs. Hema, since the difference between the fair market value of shares and actual sale consideration does not exceed Rs.50,000.

(b) Computation of business income of Nathan Aviation Ltd.

Particulars	₹ in lacs
Total profit derived from Units S & N (Rs.13 lacs + Rs.4 lacs)	17
Less: Exemption under section 10AA [See Working Note below]	<u>12</u>
	5
Less: Brought forward business loss	<u>2</u>
	<u>3</u>

Working Note

Computation of exemption under section 10AA in respect of Unit S located in a SEZ	₹ in lacs
Domestic turnover of Unit S	10
Export turnover of Unit S	<u>120</u>
Total turnover of Unit S	<u>130</u>
Profit derived from Unit S	13
Exemption under section 10AA	
Profit of Unit S x $\frac{\text{Export turnover of unit S}}{\text{Total turnover of Unit S}} = 13 \times \frac{120}{130} =$	12

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Note – 100% of the profit derived from export of articles or things or from services is eligible for deduction under section 10AA, assuming that F.Y.2010-11 falls within the first five year period commencing from the year of manufacture or production of articles or things or provision of services by the Unit in SEZ.

- (c) Computation of value of taxable services and service tax payable by M/s Pareesh & Co.:-

Particulars	Taxable services (₹)	Service tax (₹)
Amounts collected from companies for pre-recruitment screening	2,50,000	25,750
Amounts collected from companies for recruitment of permanent staff	3,00,000	30,900
Amounts collected from companies for recruitment of temporary staff (It is also a taxable service)	4,00,000	41,200
Advances received from prospective employers for conducting campus interview in colleges (Note – 1)	<u>1,00,000</u>	<u>10,300</u>
Total	<u>10,50,000</u>	<u>1,08,150</u>

Notes:

- Since the question specifically provides that wherever applicable, service tax has been charged separately, advance has also been taken as exclusive of service tax. However, it may be noted that in actual practice, advance for a taxable service is generally inclusive of service tax and accordingly service tax is computed by making back calculations.

In such a case, the amount of service tax and the value of taxable service in relation to the advance received for conducting campus interview would be ₹ 9,338 and ₹ 90,662 respectively. Therefore, the total service tax payable and total value of taxable service would be ₹ 1,07,188 and ₹ 10,40,662 respectively.

- Since the value of taxable services rendered in the preceding year is more than ₹ 10 lakh (i.e. ₹ 20.2 lakh), the assessee is not a small service provider. Hence, it is not eligible for the exemption available to the small service provider.

- (d) Computation of VAT liability of Vasudha & Co. for the year ended 31.3.2011:-

Particulars	Amount (₹)
Input tax credit: Intra-State purchases of 1000 units of raw materials [Refer Note 1]	30,000

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Inter-State purchases of raw materials [Refer Note 2]	-
Import of raw materials [Refer Note 3]	
Purchase of Capital Goods [Refer Note 4]	15,000
Other manufacturing expenses [Refer Note 5]	
Total input tax credit available (A):	45,000
Output VAT payable:	
Sale of taxable goods within State [(7,28,000 x 4)/104]	28,000
Sale of exempted goods within State [Refer Note 6]	
Total VAT payable (B)	28,000
Net VAT liability (VAT credit to be carried forward) [(B) - (A)]	<u>(17,000)</u>

Notes:-

- VAT paid on intra-State purchases is eligible for input tax credit $\frac{₹5,30,000 \times 6}{106} = ₹30,188.73$
- CST paid on intra-State purchases is not eligible for input tax credit.
- Customs duty is not eligible for input tax credit.
- VAT paid on purchase of capital goods is eligible for input tax credit. However, the same has to be spread over a period of two years $\frac{₹3,30,000 \times 10}{110 \times 2} = ₹15,000$
- No input tax credit can be availed on expenses incurred on manufacturing.
- No VAT will be payable on sale of goods exempted from levy of VAT. Further, since these goods are manufactured from the inter-State purchases of raw materials (non-vatable inputs), input tax credit is not affected.
- VAT system allows credit in respect of purchases made during a period to be set-off against the taxable sales during that period, irrespective of when the supplies/inputs purchased are utilized/sold. Therefore, input tax credit in respect of closing stock of raw materials need not be reduced from total input tax credit available.

Note: The statement in the question, "Input credit is allowed only on raw materials used in manufacture of the taxable goods", implies that the same is not allowable in respect of sale of goods within the State which are exempt from levy of VAT.

Question 2

- (a) (i) Miss Vivitha paid a sum of 5000 USD to Mr. Kulasekhara, a management consultant practising in Colombo, specializing in project financing. The payment was made in Colombo. Mr. Kulasekhara is a non-resident. The consultancy is related to a project in India with possible Ceylonese collaboration. Is this payment chargeable to tax in India in the hands of Mr. Kulasekhara, since the services were used in India? (4 Marks)

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- (ii) Mr. Praveen Kumar has furnished the following particulars relating to payments made towards scientific research for the year ended 31.3.2011 :

		(₹ in lacs)
(i)	Payments made to K Research Ltd.	20
(ii)	Payment made to LMN College	15
(iii)	Payment made to OPQ College	10
	Note: K Research Ltd. and LMN College are approved research institutions and these payments are to be used for the purposes of scientific research.	
(iv)	Payment made to National Laboratory	8
(v)	Machinery purchased for in-house scientific research	25
(vi)	Salaries to research staff engaged in in-house scientific research	12

Compute the amount of deduction available under section 35 of the Income-tax Act, 1961 while arriving at the business income of the assessee. (4 Marks)

- (b) During the year ended 31.3.2010, Kohli & Co., running a coaching centre, has collected a sum of ₹ 10.2 lacs as service tax. ₹ 70,000 was met through Cenvat credit and the balance was paid by cheques on various dates. The details pertaining to the quarter ended 30.6.2010 are as under:

Particulars	Amount (₹)
Value of free coaching rendered	20,000
Coaching fees collected from students (Service tax collected separately)	14,50,000
Advance received from a college for coaching their students, on 30.6.2010. However, no coaching was conducted and the money was returned on 12.4.2011	3,00,000

Determine the service tax liability for the quarter and indicate the date by which the service tax has to be remitted by the assessee. (4 Marks)

- (c) Which variant of VAT is most widely used in the world and why? Are some services also included in the VAT net by such countries? (4 Marks)

Answer

- (a) (i) A non-resident is chargeable to tax in respect of income received outside India only if such income accrues or arises or is deemed to accrue or arise to him in India.

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The income deemed to accrue or arise in India under section 9 comprises, *inter alia*, income by way of fees for technical services, which includes any consideration for rendering of any managerial, technical or consultancy services. Therefore, payment to a management consultant relating to project financing is covered within the scope of “fees for technical services”.

The *Explanation* below section 9(2) has been substituted to clarify that income by way of, *inter alia*, fees for technical services, from services utilized in India would be deemed to accrue or arise in India in case of a non-resident and be included in his total income, whether or not such services were rendered in India.

In the instant case, since the services were utilized in India, the payment received by Mr. Kulasekhara, a non-resident, in Colombo is chargeable to tax in his hands in India, as it is deemed to accrue or arise in India.

(ii) Computation of deduction allowable under section 35

Particulars	Amount (₹ in lacs)	Section	% of weighted deduction	Amount of deduction (₹ in lacs)
Payment for scientific research				
K Research Ltd. [See Note 3]	20	35(1)(ii)	175%	35.00
LMN College	15	35(1)(ii)	175%	26.25
OPQ College [See Note 1]	10	-	Nil	Nil
National Laboratory	8	35(2AA)	175%	14.00
In-house research [See Note 2]				
Capital expenditure	25	35(1)(iv) r.w. 35(2)	100%	25.00
Revenue expenditure	12	35(1)(i)	100%	<u>12.00</u>
Deduction allowable under section 35				<u>112.25</u>

Notes :-

1. Payment to OPQ College

Since the note in the question below item (iii) clearly mentions that only K Research Ltd. and LMN College (mentioned in item (i) and (ii), respectively) are approved research institutions, it is a logical conclusion that OPQ College mentioned in item (iii) is not an approved research institution. Therefore, payment to OPQ College would not qualify for deduction under section 35.

2. Deduction for in-house research and development

Only company assessee are entitled to weighted deduction@200% under

section 35(2AB) in respect of in-house research and development. However, in this case, the assessee is an individual. Therefore, he would be entitled to deduction@100% of the revenue expenditure incurred under section 35(1)(i) and 100% of the capital expenditure incurred under section 35(1)(iv) read with section 35(2), assuming that such expenditure is laid out or expended on scientific research related to his business.

3. Payment to K Research Ltd. (Alternative Answer)

Any sum paid to a company registered in India which has as its main object scientific research, as is approved by the prescribed authority, qualifies for a weighted deduction of 125% under section 35(1)(ia). Therefore, it is also possible to take a view that payment of ₹ 20 lakhs to K Research Ltd. qualifies for a weighted deduction of 125% under section 35(1)(ia) since K Research Ltd. is a company. The weighted deduction under section 35(1)(ia) would be ₹ 25 lacs (i.e., 125% of ₹ 20 lacs), in which case, the total deduction under section 35 would be ₹ 102.25 lacs.

(b) Computation of service tax liability of Kohli & Co. for the quarter ended 30.06.2010:-

Particulars	Amount of service tax (₹)
Free coaching rendered	Nil
Coaching fees collected from students $\frac{₹14,50,000 \times 10.3}{100}$	1,49,350
Advance received from a college for coaching their students	<u>28,015</u>
Total service tax liability for the quarter ended 30.06.2010	<u>1,77,365</u>

Notes:

- Free coaching is not exigible to service tax
- Coaching fees collected from students will be liable to service tax @ 10.3%.
- Advance receipt is chargeable to service tax. It is immaterial that no coaching was conducted and the money was returned on 12.4.2011. Advance would be chargeable to service tax in the quarter ended 30.06.2010. Advance has been assumed to be inclusive of service tax $\frac{₹3,00,000 \times 10.3}{110.3}$

During the preceding financial year, the service tax liability met by the assessee, inclusive of CENVAT credit availed was more than ₹ 10 lakh. Hence, during the

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current financial year, for all quarters, payment of service tax will have to be made electronically. Therefore, the last date for making the payment of service tax by Kohli & Co. (non-corporate assessee) for the quarter ended 30.06.2010 is 6th July, 2010.

- (c) Among the three variants of VAT, the consumption variant is widely used. Several countries of Europe and other countries have adopted this variant. The reasons for preference of this variant are:

Firstly, it does not affect decisions regarding investment because the tax on capital goods is also set-off against the VAT liability. Hence, the system is tax neutral in respect of techniques of production (labour or capital-intensive).

Secondly, the consumption variant is convenient from the point of administrative expediency as it simplifies tax administration by obviating the need to distinguish between purchases of intermediate and capital goods on the one hand and consumption goods on the other hand.

In practice, therefore, most countries use the consumption variant. Also, most VAT countries include many services in the tax base. Since the business gets set-off for the tax on services, it does not cause any cascading effect.

Question 3

- (a) Mr. Vidyasagar, a resident individual aged 64, is a partner in Oscar Musicals & Co., a partnership firm. He also runs a wholesale business in medical products. The following details are made available for the year ended 31.3.2011 :

		₹	₹
(i)	Interest on capital received from Oscar Musicals & Co., at 15%		1,50,000
(ii)	Interest from bank on fixed deposit (Net of TDS ₹1,500)		13,500
(iii)	Income-tax refund received relating to assessment year 2009-10 including interest of ₹2,300		34,500
(iv)	Net profit from wholesale business		5,60,000
	Amounts debited include the following:		
	Depreciation as per books	34,000	
	Motor car expenses	40,000	
	Municipal taxes for the shop	7,000	
	(For two half years; payment for one half year made on 12.6.2011 and for the other, on 14.11.2011)		
	Salary to manager for whom single cash	21,000	

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	payment was made for		
(v)	The WDV of the assets (as on 1.4.2010) used in above wholesale business is as under:		
	Computers	1,20,000	
	Motor car (20% used for personal use)	3,20,000	
(vi)	LIP paid for major son	60,000	
	PPF of his wife	70,000	
	Long-term infrastructure bonds (Approved)	30,000	

Compute the total income of the assessee for the assessment year 2011-12. The computation should show the proper heads of income. Also compute the WDV of the different blocks of assets as on 31.3.2011. (8 Marks)

- (b) (i) Where any transaction of taxable service is entered into with an associated enterprise, receipt of service tax is not material for levy of service tax. Explain with reasons, whether you agree or disagree with this statement. (2 Marks)
- (ii) Briefly discuss about the adjustment of excess amount of service tax paid in case of renting of immovable property service, owing to property tax payment. (2 Marks)
- (c) M/s. Staruss & Co., a registered dealer under the local VAT law, having stock of goods purchased from outside the State, wishes to opt for the Composition Scheme. Advise him whether the same is possible. Will the VAT chain be broken if the dealer opts for the said scheme? (4 Marks)

Answer

- (a) Computation of total income of Mr. Vidyasagar for the A.Y.2011-12

Particulars	₹	₹
Profits and gains of business or profession		
Income from own business		
Net profit as per books		5,60,000
Add: Depreciation as per books	34,000	
Disallowance of municipal taxes paid for the second half-year under section 43B, since the same was paid after the due date of filing of return (₹ 7,000/2)	3,500	
Disallowance under section 40A(3) in respect of salary paid in cash since the same exceeds ₹ 20,000	21,000	
20% of car expenses for personal use	<u>8,000</u>	<u>66,500</u>
		6,26,500
Less: Depreciation allowable (Note 1)		<u>1,10,400</u>
		5,16,100

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Income from firm		
Interest on capital from partnership firm (Note 2)		<u>1,20,000</u>
		6,36,100
Income from other sources		
Interest on bank fixed deposit (Gross)	15,000	
Interest on income-tax refund	<u>2,300</u>	
		<u>17,300</u>
Gross total income		6,53,400
Less: Deductions under Chapter VIA (Note 3)		<u>1,20,000</u>
Total Income		<u>5,33,400</u>

Notes:

(1) Depreciation allowable under the Income-tax Rules, 1962

		Opening WDV	Rate		Depreciation	Closing WDV
Block 1	Computers	1,20,000	60%		72,000	48,000
Block 2	Motor Car	3,20,000	15%	48,000		
	Less: 20% disallowance for personal use			<u>9,600</u>	<u>38,400</u>	2,81,600
					<u>1,10,400</u>	

(2) Only to the extent the interest is allowed as deduction in the hands of the firm, the same is includible as business income in the hands of the partner. Maximum interest allowable as deduction in the hands of the firm is 12% p.a. It is assumed that the partnership deed provides for the same and hence is allowable to this extent in the hands of the firm. Therefore, interest @12% p.a. amounting to ₹ 1,20,000 would be treated as the business income of Mr. Vidyasagar.

(3) Deduction under Chapter VI-A

Particulars	₹	₹
Under section 80C		
LIP for major son	60,000	
PPF paid in wife's name	<u>70,000</u>	
	1,30,000	
As per section 80CCE, deduction is restricted to		1,00,000
Under section 80CCF		
Approved Infrastructure bonds (₹ 30,000 but restricted to		

₹ 20,000, being the maximum deduction allowable u/s 80CCF)		<u>20,000</u>
Total deduction		<u>1,20,000</u>

- (b) (i) Yes, I agree with the statement. Section 68 casts the liability to pay service tax upon the person liable to pay service tax. This liability is not contingent upon the service provider realizing or charging the service tax rate at the prevailing rate. The statutory liability does not get extinguished if the service provider fails to realize or charge service tax from the service receiver.

It may be noted that in case of transactions of taxable services involving any associated enterprise service tax is liable to be paid even if the value of taxable service has not been received. This is so because in such a case any payment received towards the value of taxable service includes any amount credited or debited to any account, whether called "Suspense account" or by any other name, in the books of account of a person liable to pay service tax. Thus, service tax would be payable on such credits as well.

- (ii) In case of renting of immovable property service, a deduction of property taxes paid in respect of the immovable property is allowed from the gross amount charged for renting of the said immovable property vide *Notification No.27/2007 ST dated 22.05.2007*. However, where any amount in excess of the amount required to be paid towards service tax liability has been paid on account of non-availment of such deduction, such excess amount may be adjusted against the service tax liability within one year from the date of payment of such property tax.

The details of such adjustment have to be intimated to the Superintendent of Central Excise having jurisdiction over the service provider within a period of 15 days from the date of such adjustment.

- (c) As per the principles laid down in the White Paper, a dealer desirous of availing the benefits of VAT Composition Scheme should not have stock of the goods purchased from outside the State. Therefore, if the dealer wishes to avail the benefit of the scheme, he must ensure that he does not possess stock of such goods as on the date of exercise of option. Advice is to be tendered on above lines.

The selling dealer will not be able to pass on the benefit of the input credit when he opts for the Composition Scheme. A purchasing dealer buying goods from a dealer operating under the Composition Scheme will not get any tax credit for the goods purchased. Hence, as soon as any dealer opts for the Composition Scheme, the VAT chain is broken.

Question 4

- (a) *The following are the details relating to Mr. Srivatsan, a resident Indian, aged 57, relating to the year ended 31.3.2011 :*

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	₹
Income from salaries	2,20,000
Loss from house property	1,90,000
Loss from cloth business	2,40,000
Income from speculation business	30,000
Loss from specified business covered by section 35AD	20,000
Long-term capital gains from sale of urban land	2,50,000
Long-term capital loss from sale of listed shares in recognized stock exchange (STT paid)	1,10,000
Loss from card games	32,000
Income from betting	45,000
Life Insurance Premium paid	1,20,000

Compute the total income and show the items eligible for carry forward. (8 Marks)

- (b) State the provisions which enable the Central Government to make rules for administering service tax. For what purposes are such rules made? Name any four such rules issued by the Central Government so far. (4 Marks)
- (c) What is meant by input tax credit in the context of VAT provisions? How does input tax credit help in achieving the essence of VAT? (4 Marks)

Answer

- (a) Computation of total income of Mr. Srivatsan for the A.Y.2011-12

Particulars	₹	₹
Salaries		
Income from salaries	2,20,000	
Less: Loss from house property	<u>1,90,000</u>	
		30,000
Profits and gains of business or profession		
Income from speculation business	30,000	
Less: Loss from cloth business set off	<u>30,000</u>	
		Nil
Capital gains		
Long-term capital gains from sale of urban land	2,50,000	
Less: Loss from cloth business set off	<u>2,10,000</u>	
		40,000

Income from other sources		
Income from betting		<u>45,000</u>
Gross total income		1,15,000
Less: Deduction under section 80C (life insurance premium paid)		<u>30,000</u>
Total income		<u>85,000</u>
Losses to be carried forward		₹
(1) Loss from cloth business (2,40,000-30,000-2,10,000)		Nil
(2) Loss from specified business covered by section 35AD		20,000

Notes

- (i) Long-term capital gains from sale of listed shares in a recognized stock exchange is exempt under section 10(38). Loss from an exempt source cannot be set off against profits from a taxable source. Therefore, long-term capital loss on sale of listed shares cannot be set-off against long-term capital gains from sale of urban land.
 - (ii) Loss from specified business covered by section 35AD can be set-off only against profits and gains of any other specified business. Therefore, such loss cannot be set off against any other income. The unabsorbed loss has to be carried forward for set-off against profits and gains of any specified business in the following year.
 - (iii) Business loss cannot be set off against salary income. However, the balance business loss of ₹ 2,10,000 (₹ 2,40,000 – ₹ 30,000 set-off against income from speculation business) can be set-off against long-term capital gains of ₹ 2,50,000 from sale of urban land. Consequently, the taxable long-term capital gains would be ₹ 40,000.
 - (iv) Loss from card games can neither be set off against any other income, nor can it be carried forward.
 - (v) For providing deduction under Chapter VIA, gross total income has to be reduced by the amount of long-term capital gains and casual income. Therefore, the deduction under section 80C in respect of life insurance premium paid has to be restricted to ₹ 30,000 [i.e., Gross Total Income of ₹ 1,15,000 – ₹ 40,000 (LTCG) – ₹ 45,000 (Casual income)].
 - (vi) Income from betting is chargeable at a flat rate of 30% under section 115BB and no expenditure or allowance can be allowed as deduction from such income, nor can any loss be set-off against such income.
- (b) Section 94 of Chapter V and section 96-I of Chapter VA of the Finance Act, 1994 grant powers to Central Government to make rules for carrying out the provisions of these

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Chapters. Rules should be read with the statutory provisions contained in the Act. Rules can never override the Act and cannot be in conflict with the same.

So far, the Central Government has issued the following rules for administering service tax –

- (a) Service Tax Rules, 1994
- (b) Service Tax (Advance Ruling) Rules, 2003
- (c) CENVAT Credit Rules, 2004
- (d) Export of Service Rules, 2005
- (e) Service Tax (Registration of Special Category of Persons) Rules, 2005
- (f) Service Tax (Determination of Value) Rules, 2006
- (g) Taxation of Services (Provided from Outside India and Received in India) Rules, 2006
- (h) Works Contract (Composition Scheme for Payment of Service Tax) Rules, 2007
- (i) Service Tax (Publication of Names) Rules, 2008
- (j) Service Tax (Provisional Attachment of Property) Rules, 2008 and
- (k) Dispute Resolution Scheme Rules, 2008.

Note: Any four rules may be mentioned.

- (c) The tax paid by a registered dealer at the earlier point is called input tax. This amount is adjusted/rebated against the tax payable by the purchasing dealer on his sales. This credit availability is called input tax credit (ITC). It can also be referred to as tax credit on a sale within the State or in the course of intra-State trade or commerce.

The essence of VAT is in providing set-off for the tax paid earlier, and this is given effect through the concept of input tax credit/rebate. Thus, input tax credit in relation to any period can be set off by the registered dealer against the amount of his output tax.

Question 5

- (a) *Mr. Rakesh purchased a house property on 14th April, 1979 for ₹ 1,05,000. He entered into an agreement with Mr. B for the sale of house on 15th September, 1982 and received an advance of ₹ 25,000. However, since Mr. B did not remit the balance amount, Mr. Rakesh forfeited the advance.*

Later on, he gifted the house property to his friend Mr. A on 15th June, 1986.

Following renovations were carried out by Mr. Rakesh and Mr. A to the house property:

	Amount (₹)
By Mr. Rakesh during FY 1979-80	10,000
By Mr. Rakesh during FY 1983-84	50,000
By Mr. A during FY 1993-94	1,90,000

The fair market value of the property as on 1.4.1981 is ₹ 1,50,000.

Mr. A entered into an agreement with Mr. C for sale of the house on 1st June, 1995 and received an advance of ₹ 80,000. The said amount was forfeited by Mr. A, since Mr. C could not fulfil the terms of the agreement.

Finally, the house was sold by Mr. A to Mr. Sanjay on 2nd January, 2011 for a consideration of ₹ 12,00,000.

Compute the capital gains chargeable to tax in the hands of Mr. A for the assessment year 2011-12. Cost inflation indices are as under:

Financial Year	Cost inflation index
1981-82	100
1983-84	116
1986-87	140
1993-94	244
2010-11	711

(8 Marks)

(b) Briefly explain the provisions relating to advance payment of service tax.

(4 Marks)

(c) What are the major deficiencies of VAT system in India ?

(4 Marks)

Answer

(a) Computation of capital gains chargeable to tax in the hands of Mr. A

Particulars	Amount (₹)
Sale consideration	12,00,000
Less: Indexed cost of acquisition (Note 1)	<u>3,55,500</u>
	8,44,500
Less: Indexed cost of improvement (Note 2)	<u>8,60,114</u>
Long term capital loss	<u>(15,614)</u>

Note 1

Indexed cost of acquisition is determined as under:

Cost to the previous owner i.e. Mr. Rakesh is ₹ 1,05,000

Fair Market Value on 1st April, 1981 is ₹ 1,50,000

Cost to the previous owner or FMV on 1st April, 1981, whichever is more, is to be taken as cost of acquisition of Mr. A

1,50,000

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Less: Advance money forfeited by Mr. A (as per section 51)

(Note : Advance forfeited by Mr. Rakesh, the previous owner, should, however, not be deducted)

80,000

Cost of acquisition

70,000

Indexed cost of acquisition $(70,000 \times 711/140)$

3,55,500

140 is the Cost Inflation Index for F.Y. 1986-87, being the first year in which property is held by Mr. A and 711 is the Cost Inflation Index for F.Y. 2010-11, being the year in which the property is sold.

Note 2

Indexed cost of Improvement is determined as under:

Expenditure incurred before 1st April, 1981 should not be considered

NIL

Expenditure incurred on or after 1st April, 1981

During 1983-84 Indexed cost of Improvement

$[50,000 \times 711/116]$

3,06,466

During 1993-94 Indexed cost of Improvement

$[1,90,000 \times 711/244]$

5,53,648

Total indexed cost of improvement

8,60,114

- (b) Service tax law provides the assessee a facility to make advance payment of service tax on his own volition and adjust the amount so paid against the service tax which he is liable to pay for the subsequent period. Such facility is available when the assessee:
- (i) intimates the details of the amount of service tax paid in advance, to the Jurisdictional Superintendent of Central Excise within a period of 15 days from the date of such payment, and
 - (ii) indicates the details of the advance payment made, and its adjustment, if any in the subsequent return to be filed under section 70.
- (c) The major deficiencies of VAT system in India are as under:
- (1) There is lack of uniformity in the rates of VAT in different States. Distortion occurs on account of different rates of VAT, composition scheme, exemptions, difference in classification of goods, etc.
 - (2) Central Sales Tax is not integrated with the State VAT. Therefore, it is difficult to put the purchases from other States at par with the purchases within the State. Consequently, the advantage of neutrality is confined only for purchases within the State.

- (3) For complying with the VAT provisions, the accounting cost has increased which may not be commensurate with the benefits to traders and small firms.
- (4) VAT is paid at various stages and not at last stage. This has increased the requirement of working capital and the interest burden on the same.
- (5) VAT, being a consumption tax, tends to be regressive since the proportion of income spent on consumption is large for the poor than the rich.
- (6) As a result of introduction of VAT, the administrative cost to the States has increased on account of number of dealers going up significantly.

Note: Any four points may be mentioned.

Question 6

- (a) *Harish Jayaraj Pvt. Ltd. is converted into Harish Jayaraj LLP on 1.1.2011. The following particulars are available to you:*

		₹
(i)	WDV of land as on 1.4.2010	5,00,000
(ii)	WDV of machinery as on 1.4.2010	3,30,000
(iii)	Patents acquired on 1.6.2010	3,00,000
(iv)	Building acquired on 12.3.2009 for which deduction was allowed under section 35AD.	7,00,000
(v)	Above building was revalued as on the date of conversion into LLP as	12,00,000
(vi)	Unabsorbed business loss as on 1.4.2010 (A.Y. 2007-08)	9,00,000

Though the conversion into LLP took place on 1.1.2011, there was disruption of business and the assets were put into use by the LLP only from 1st March, 2011 onwards.

The company earned profits of ₹ 8 lacs prior to computation of depreciation.

Assuming that the necessary conditions laid down in section 47(xiiib) of the Income-tax Act, 1961 have been complied with, explain the tax treatment of the above in the hands of the LLP.

(8 Marks)

Note – “WDV of land as on 1.4.2010” may be read as “Cost of land”.

- (b) *Nigamanth Cargo Handlers Pvt. Ltd. is a cargo handling agency, in existence since 2003. For the quarter ended 31.3.2011, total collections for handling cargo (excluding service tax) was ₹ 32,00,000. The same included the following receipts also:*

		₹
(i)	Handling of cargo containing life saving drugs	2,00,000
(ii)	Handling of export cargo	3,00,000

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(iii)	Handling of cargo for storage in cold storage	1,00,000
(iv)	Towards providing service of packing together with transportation of cargo	4,00,000

Ascertain the quantum of taxable cargo handling services for the quarter ended 31.3.2011. Wherever applicable, service tax was charged separately and received in full.

(4 Marks)

- (c) How can a Chartered Accountant help a client in the handling of VAT audit called for by the Department and in conducting external audit of VAT records? (4 Marks)

Answer

- (a) Tax treatment of depreciation and unabsorbed business loss of a private company on its conversion into a LLP

The LLP would be allowed to carry forward and set-off the business loss and unabsorbed depreciation of the predecessor company [Section 72A(6A)].

1. Depreciation

The aggregate depreciation allowable to the predecessor company and successor LLP shall not exceed, in any previous year, the depreciation calculated at the prescribed rates as if the conversion had not taken place. Such depreciation shall be apportioned between the predecessor company and the successor LLP in the ratio of the number of days for which the assets were used by them [Section 32(1)]

Therefore, depreciation has to be first calculated as if the conversion had not taken place and then apportioned between the company and the LLP in the ratio of the number of days for which the assets were used by them.

		₹		₹
Block I	Machinery	3,30,000	15%	49,500
Block II	Patents	3,00,000	25%	<u>75,000</u>
				<u>1,24,500</u>

Allocation of depreciation

Depreciation on machinery and patents have to be apportioned between the company and the LLP in the ratio of the number of days for which the assets were used by them. Since patents were acquired only on 1.6.2010, it could have been used by the company for 214 days only. Therefore, the depreciation on assets has to be allocated between the company and LLP as follows –

Asset	Total depreciation for the year	Company		LLP	
		No. of days of usage	Depreciation	No. of days of usage	Depreciation
Machinery	49,500	275	44,485	31	5,015
Patents	<u>75,000</u>	214	<u>65,510</u>	31	<u>9,490</u>
	<u>1,24,500</u>		<u>1,09,995</u>		<u>14,505</u>

Therefore, depreciation to be allowed in the hands of the company is ₹ 1,09,995 and depreciation to be allowed in the hands of the LLP is ₹ 14,505.

2. Unabsorbed business loss to be carried forward by the LLP.

Particulars	₹
Profits of the company before depreciation	8,00,000
Less: Current year depreciation	<u>1,09,995</u>
Business income of the company after depreciation	6,90,005
Brought forward business loss	<u>9,00,000</u>
Unabsorbed business loss as on 31.12.2010 to be carried forward by the LLP	<u>2,09,995</u>

3. Actual cost of assets to the LLP

- (1) The actual cost of the block of assets in case of the LLP shall be the WDV of the block of assets as in the case of the company on the date of conversion. The WDV as on 1.1.2011 for Machinery and Patents are ₹ 2,85,515 and ₹ 2,34,490, respectively, which would be the actual cost in the case of the LLP.

WDV of Machinery as on 1.1.2011 = 3,30,000 – 44,485 = ₹ 2,85,515

WDV of Patents as on 1.1.2011 = 3,00,000 – 65,510 = ₹ 2,34,490

- (2) Land is not a depreciable asset. The cost of acquisition of land to the LLP would be the cost for which the company acquired it, as increased by the cost of improvement.
- (3) In respect of the building, deduction had been allowed in the earlier year under section 35AD. Hence, there is no question of depreciation during the current year. The actual cost of the building to the LLP would be Nil.

- (b) Quantum of taxable cargo handling services for the quarter ended 31.3.2011:-

Particulars	Amount (₹)	Amount (₹)
Total collections for handling cargo (excluding service tax)		32,00,000

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<i>Less:</i>		
(i)	Receipts for handling of cargo containing life saving drugs [<i>Refer Note 1</i>]	
(ii)	Receipts for handling of export cargo [<i>Refer Note 2</i>]	3,00,000
(iii)	Receipts for handling of cargo for being stored in cold storage [<i>Refer Note 3</i>]	1,00,000
(iv)	Receipts towards providing service of packing together with transportation of cargo [<i>Refer Note 4</i>]	
		<u>4,00,000</u>
	Value of taxable services	<u>28,00,000</u>

Notes:

1. Handling of cargo containing life saving drugs is taxable service as there is no specific exemption available for such activity.
2. The definition of cargo handling service specifically excludes handling of export cargo.
3. Cargo handling service provided in relation to goods intended to be stored in a cold storage is exempt from payment of service tax vide *Notification No. 10/2002 ST dated 01.08.2002*.
4. Service of packing together with transportation of cargo is covered by the definition of cargo handling service. Hence, the same is liable to service tax and no adjustment is needed.

(c) *Handling audit by Departmental Auditors*

There are audit wings in VAT Departments and certain percentage of dealers are taken up for audit every year on scientific basis. Chartered Accountants can ensure proper record keeping to satisfy the Departmental auditors. The professional expertise of a Chartered Accountant will help him in effectively replying audit queries and sorting out audit objections.

External audit of VAT records

Under VAT system, trust has been reposed on tax payers as there will be no regular assessment of all VAT returns, but only few returns will be scrutinized. In other cases, returns filed by dealers will be accepted. Thus, a check on compliance becomes necessary. Chartered Accountants can play a very vital role in ensuring tax compliance by audit of VAT accounts.

Question 7

- (a) *Answer any two of the following three sub divisions:*

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- (1) Specify the persons who are authorized to sign and verify under section 140, the return of income filed under section 139 of the Income-tax Act, 1961 in the case of:
- (i) Political party;
 - (ii) Local authority;
 - (iii) Association of persons, and
 - (iv) Limited Liability Partnership (LLP). (4 Marks)

- (2) The following details have been furnished by Mrs. Hemali pertaining to the year ended 31.3.2011 :

- (i) Cash gift of ₹ 51,000 received from her friend on the occasion of her "Shastiaptha Poorthi", a wedding function celebrated on her husband completing 60 years of age. This was also her 25th wedding anniversary.
- (ii) On the above occasion, a diamond necklace worth ₹ 2 lacs was presented by her sister living in Dubai.
- (iii) When she celebrated her daughter's wedding on 21.2.2011, her friend assigned in Mrs. Hemali's favour, a fixed deposit held by the said friend in a scheduled bank; the value of the fixed deposit and the accrued interest on the said date was ₹ 51,000.

Compute the income, if any, assessable as income from other sources. (4 Marks)

- (3) During the financial year 2010-11, the following payments/expenditure were made/incurred by Mr. Yuvan Raja, a resident individual (whose turnover during the year ended 31.3.2010 was ₹ 39 lacs) :

- (i) Interest of ₹ 12,000 was paid to Rehman & Co., a resident partnership firm, without deduction of tax at source;
- (ii) Interest of ₹ 4,000 was paid as interest to Mr. R.D. Burman, a non-resident, without deduction of tax at source;
- (iii) ₹ 3,00,000 was paid as salary to a resident individual without deduction of tax at source;
- (iv) He had sold goods worth ₹ 5 lacs to Mr. Deva. He gave Mr. Deva a cash discount of ₹ 12,000 later. Commission of ₹ 15,000 was paid to Mr. Vidyasagar on 2.7.2010. In none of these transactions, tax was deducted at source.

Briefly discuss whether any disallowance arises under the provisions of section 40(a)(i)/40(a)(ia) of the Income-tax Act, 1961. (4 Marks)

- (b) State the due dates for filing of service tax returns. Will the delayed filing of service tax return result in payment of any late fee? If so, how much? (4 Marks)
- (c) Briefly list out the contents of VAT invoice. (4 Marks)

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Answer

- (a) (1) The following persons (mentioned in Column III below) are authorised as per section 140, to sign and verify the return of income filed under section 139.

I	II	III
(i)	Political party	Chief Executive Officer of such party (whether known as secretary or by any other designation).
(ii)	Local authority	Principal Officer thereof.
(iii)	Association of Persons	Any member of the association or the principal officer thereof.
(iv)	LLP	Designated partner, or Any partner, - where the designated partner is not able to sign and verify the return for any unavoidable reason; - where there is no designated partner.

- (2) (i) Any sum of money received by an individual on the occasion of the marriage of the individual is exempt. This provision is, however, not applicable to a cash gift received during a wedding function celebrated on completion of 60 years of age.

The gift of ₹ 51,000 received from a non-relative is, therefore, chargeable to tax under section 56(2)(vii) in the hands of Mrs. Hemali.

- (ii) The provisions of section 56(2)(vii) are not attracted in respect of any sum of money or property received from a relative. Thus, the gift of diamond necklace received from her sister is not taxable under section 56(2)(vii), even though jewellery falls within the definition of “property”.

- (iii) To be exempt from applicability of section 56(2)(vii), the property should be received on the occasion of the marriage of the individual, not that of the individual’s son or daughter. Therefore, this exemption provision is not attracted in this case.

Any sum of money received without consideration by an individual is chargeable to tax under section 56(2)(vii), if the aggregate value exceeds ₹ 50,000 in a year. “Sum of money” has, however, not been defined under section 56(2)(vii).

Therefore, there are two possible views in respect of the value of fixed deposit assigned in favour of Mrs. Hemali –

- (1) The first view is that fixed deposit does not fall within the meaning of “sum of money” and therefore, the provisions of section 56(2)(vii) are not

attracted. It may be noted that fixed deposit is also not included in the definition of "property".

- (2) However, another possible view is that fixed deposit assigned in favour of Mrs. Hemali falls within the meaning of "sum of money" received.

Income assessable as "Income from other sources"

If the first view is taken, the total amount chargeable to tax as "Income from other sources" would be ₹ 51,000, being cash gift received from a friend on her Shastiaptha Poorthi.

As per the second view, the provisions of section 56(2)(vii) would be attracted in respect of the fixed deposit assigned and the "Income from other sources" of Mrs. Hemali would be ₹ 1,02,000 (₹ 51,000 + ₹ 51,000).

- (3) Disallowance under section 40(a)(i)/40(a)(ia) of the Income-tax Act, 1961 is attracted where the assessee fails to deduct tax at source as is required under the Act, or having deducted tax at source, fails to remit the same to the credit of the Central Government within the stipulated time limit.

The assessee is a resident individual, who was not subjected to tax audit during the immediately preceding previous year i.e., P.Y.2009-10 (as his turnover is less than ₹ 40 lakh in that year) and the TDS obligations have to be considered bearing this in mind.

- (i) The obligation to deduct tax source from interest paid to a resident arises under section 194A in the case of an individual, only where he was subject to tax audit under section 44AB in the immediately preceding previous year, i.e., P.Y.2009-10. From the data given, it is clear that he was not subject to tax audit under section 44AB in the P.Y.2009-10. Hence, disallowance under section 40(a)(ia) is not attracted in this case.
- (ii) In the case of interest paid to a non-resident, there is obligation to deduct tax at source under section 195, hence non-deduction of tax at source will attract disallowance under section 40(a)(i).
- (iii) Disallowance under section 40(a)(ia) is not attracted for failure to deduct tax at source under section 192 from salaries.
- (iv) The obligation to deduct tax at source under section 194-H from commission paid in excess of ₹ 5,000 w.e.f. 1.7.2010 to a resident arises in the case of an individual, only where he was subject to tax audit under section 44AB in the immediately preceding previous year. From the data given, it is clear that he was not subject to tax audit under section 44AB in the P.Y.2009-10. Hence, there is no obligation to deduct tax at source under section 194H during the P.Y. 2010-11. Therefore, disallowance under section 40(a)(ia) is not attracted in this case.

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- (b) The service tax return (in Form ST-3) should be filed on half yearly basis by the 25th of the month following the particular half-year. The due dates on this basis are as under:

Half year	Due date
1 st April to 30 th September	25 th October
1 st October to 31 st March	25 th April

In case the due date of filing of return falls on a public holiday, the assessee can file the return on the immediately succeeding working day.

Yes, late fee will be levied for delay in furnishing of the service tax return. The prescribed late fee is given hereunder:

S. No.	Period of delay	Late fee
	Particulars	₹
(a)	15 days from the date prescribed for submission of the return	500
(b)	Beyond 15 days but not later than 30 days from the date prescribed for submission of the return.	1,000
(c)	Beyond 30 days from the date prescribed for submission of the return	An amount of ₹ 1,000 plus ₹ 100 for every day from the 31 st day till the date of furnishing the said return.

However, the total late fee for delayed submission should not exceed ₹ 2,000.

- (c) VAT legislations of all the States provide for the tax invoice. Generally, the various legislations provide that the tax invoice should have the following contents:

- (i) the words tax invoice in a prominent place;
- (ii) name and address of the selling dealer;
- (iii) registration number of the selling dealer;
- (iv) name and address of the purchasing dealer;
- (v) registration number of the purchasing dealer (may not be required under all VAT legislations);
- (vi) pre-printed or self-generated serial numbers;
- (vii) date of issue;
- (viii) description, quantity and value of goods sold;
- (ix) rate and amount of tax charged in respect of taxable goods;
- (x) signature of the selling dealer or his regular employee duly authorized by him for such purposes.