

PAPER – 5 : TAXATION

Question No. 1 is compulsory.

Attempt any **five** questions from the remaining **six** questions.

Working notes should form part of the answer.

Wherever necessary suitable assumptions may be made by the candidates.

Question 1

- (a) Mr. Ram, an Indian citizen, left India on 22.09.2009 for the first time to work as an officer of a company in Germany.

Determine the residential status of Ram for the assessment year 2010-11 and explain the conditions to be fulfilled for the same under the Income-tax Act, 1961.

- (b) Mrs. Kasturi transferred her immovable property to ABC Co. Ltd. subject to a condition that out of the rental income, a sum of Rs. 36,000 per annum shall be utilized for the benefit of her son's wife.

Mrs. Kasturi claims that the amount of Rs.36,000 (utilized by her son's wife) should not be included in her total income as she no longer owned the property.

State with reasons whether the contention of Mrs. Kasturi is valid in law.

- (c) Determine the total income of Mr. Chand from the following information for the Assessment Year 2010-11:

	Rs.
(i) Interest received on enhanced compensation (It relates to transfer of land in the financial year 2004-05. Out of the above, Rs.65,000 relates to financial year 2009-10 and the balance relate to preceding years)	4,00,000
(ii) Business loss relating to discontinued business of the assessment year 2004-05 brought forward and eligible for set off	1,50,000
(iii) Current year business income (i.e. financial year 2009-10) (computed)	1,10,000

The Suggested Answers for Income-tax are based on the provisions applicable for A.Y.2010-11, which is the assessment year relevant for November 2010 examination. The suggested answers for Service-tax and VAT are based on the provisions as amended by the Finance (No.2) Act, 2009 and notifications/circulars issued up to 30.04.2010 which are relevant for November 2010 examination.

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(d) Compute net VAT liability of Rishi from the following information:

Particulars	Rs.	Rs.
Raw materials from foreign market (includes duty paid on imports @ 20%)		1,20,000
Raw material purchased from local market		
Cost of raw material	2,50,000	
Add: Excise duty @ 16%	<u>40,000</u>	
	2,90,000	
Add: VAT @ 4%	<u>11,600</u>	3,01,600
Raw material purchased from neighbouring State (includes CST @ 2%)		51,000
Storage and transportation cost		9,000
Manufacturing expenses		30,000
Rishi sold goods to Madan and earned profit @ 12% on the cost of production. VAT rate on sale of such goods is 4%.		(4 x 5 = 20 Marks)

Answer

- (a) Under section 6(1), an individual is said to be resident in India in any previous year if he satisfies any one of the following conditions -
- He has been in India during the previous year for a total period of 182 days or more, or
 - He has been in India during the 4 years immediately preceding the previous year for a total period of 365 days or more and has been in India for atleast 60 days in the previous year.

In the case of Indian citizens leaving India for employment, the period of stay during the previous year must be 182 days instead of 60 days given in (ii) above.

During the previous year 2009-10, Mr. Ram, an Indian citizen, was in India for 175 days only (i.e 30+31+30+31+31+22 days). Thereafter, he left India for employment purposes.

Since he does not satisfy the minimum criteria of 182 days, he is a non-resident for the A.Y. 2010-11.

- (b) The clubbing provisions under section 64(1)(viii) are attracted in case of transfer of any asset, directly or indirectly, otherwise than for adequate consideration, to any person to the extent to which the income from such asset is for the immediate or deferred benefit of son's wife. Such income shall be included in computing the total income of the transferor-individual.

Therefore, income of Rs. 36,000 meant for the benefit of daughter-in-law is chargeable to tax in the hands of transferor i.e., Smt. Kasturi in this case.

The contention of Smt. Kasturi is, hence, not valid in law.

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Note – In order to attract the clubbing provisions under section 64(1)(viii), the transfer should be otherwise than for adequate consideration. In this case, it is presumed that the transfer is otherwise than for adequate consideration and therefore, the clubbing provisions are attracted.

(c) Computation of total income of Mr. Chand for A.Y.2010-11

Particulars	Amount (Rs.)	Amount (Rs.)
Profits and gains of business or profession		
Current year business income	1,10,000	
Less: Brought forward business loss of discontinued business Rs.1,50,000 set-off to the extent of current year business income as per section 72	<u>1,10,000</u>	
		Nil
Income from other sources		
Interest on enhanced compensation taxable on receipt basis under section 56(2)(viii)	4,00,000	
Less: Deduction under section 57(iv) @ 50%	<u>2,00,000</u>	
		<u>2,00,000</u>
Total Income		<u>2,00,000</u>

The unabsorbed business loss of Rs. 40,000 (Rs.1,50,000 – Rs.1,10,000) of A.Y.2004-05 relating to discontinued business will be carried forward for set-off against income from any business in the next year i.e. A.Y.2011-12.

(d) Computation of VAT liability of Rishi:-

Particulars	Rs.	Rs.
Raw materials purchased from foreign market (including duty paid on imports @ 20%)		1,20,000
Raw material purchased from local market:-		
Cost of raw material	2,50,000	
Add: Excise duty @ 16%	<u>40,000</u>	2,90,000
Raw material purchased from neighbouring State (including CST @ 2%)		51,000
Storage and transportation cost		9,000
Manufacturing expenses		<u>30,000</u>
Cost of production		5,00,000
Add: Profit @ 12% of cost of production		<u>60,000</u>
Sale Price		<u>5,60,000</u>

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VAT @ 4% on Rs. 5,60,000	22,400
Net VAT liability of Rishi:-	
VAT on sale price	22,400
Less: Input tax credit	
Duty paid on imports	Nil
CST paid on inter-state purchases	Nil
VAT paid on local purchases	<u>11,600</u>
Net VAT payable by Rishi	<u>10,800</u>

Question 2

- (a) Mr. Raju, a manufacturer at Chennai, gives the following Manufacturing, Trading and Profit & Loss Account for the year ended 31.03.2010.

Manufacturing, Trading and Profit & Loss Account for the year ended 31.03.2010

	Rs.		Rs.
To Opening Stock	71,000	By Sales	32,00,000
To Purchase of Raw Materials	16,99,000	By Closing stock	2,00,000
To Manufacturing Wages & Expenses	5,70,000		
To Gross Profit	<u>10,60,000</u>		
	<u>34,00,000</u>		<u>34,00,000</u>
To Administrative charges	3,26,000	By Gross Profit	10,60,000
To State VAT penalty	5,000	By Dividend from domestic companies	15,000
To State VAT paid	1,10,000	By Income from agriculture (net)	1,80,000
To General Expenses	54,000		
To Interest to Bank (On machinery term loan)	60,000		
To Depreciation	2,00,000		
To Net Profit	<u>5,00,000</u>		
	<u>12,55,000</u>		<u>12,55,000</u>

Following are the further information relating to the financial year 2009-10:

- (i) Administrative charges include Rs. 46,000 paid as commission to brother of the assessee. The commission amount at the market rate is Rs. 36,000.

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- (ii) The assessee paid Rs.33,000 in cash to a transport carrier on 29.12.2009. This amount is included in manufacturing expenses (Assume that the provisions relating to TDS are not applicable to this payment.)
- (iii) A sum of Rs. 4,000 per month was paid as salary to a staff throughout the year and this has not been recorded in the books of account.
- (iv) Bank term loan interest actually paid upto 31.03.2010 was Rs. 20,000 and the balance was paid in October 2010.
- (v) Housing loan principal repaid during the year was Rs. 50,000 and it relates to residential property occupied by him. Interest on housing loan was Rs. 23,000. Housing loan was taken from Canara Bank. These amounts were not dealt with in the profit and loss account given above.
- (vi) Depreciation allowable under the Act is to be computed on the basis of following information:

Plant & Machinery (Depreciation rate @ 15%)	Rs.
Opening WDV (as on 01.04.2009)	12,00,000
Additions during the year (used for more than 180 days)	2,00,000
Total additions during the year	4,00,000
Note: Ignore additional depreciation under section 32(1)(iia)	

Compute the total income of Mr. Raju for the assessment year 2010-11.

Note: Ignore application of section 14A for disallowance of expenditures in respect of any exempt income. (12 Marks)

- (b) Prasad & Co. seeks your advise for the following in the context of service tax:
- (i) It wants to file revised service tax return even though the original return was filed belatedly.
- (ii) It will pay service tax only on actual receipt of money from the customers, though it maintains its books of account on mercantile basis.
- Your answer must be with reasons. (4 Marks)

Answer

- (a) **Computation of total income of Mr. Raju for the A.Y. 2010-11**

Particulars	Rs.	Rs.
Profits and gains of business or profession		
Net profit as per profit and loss account		5,00,000

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Add:	Excess commission paid to brother disallowed under section 40A(2)	10,000	
	Disallowance under section 40A(3) is not attracted since the limit for cash payment has been increased from Rs.20,000 to Rs.35,000 w.e.f. 1.10.2009 in respect of payment to transport operators. Therefore, amount of Rs.33,000 paid in cash to a transport carrier is allowable as deduction.	Nil	
	Salary paid to staff not recorded in the books (Assuming that the expenditure is in the nature of unexplained expenditure and hence, is deemed to be income as per section 69C – no deduction allowable in respect of such expenditure) [See Note 1 below]	48,000	
	Bank term loan interest paid after the due date of filing of return under section 139(1) – disallowed as per section 43B	40,000	
	State VAT penalty paid disallowed [See Note 2 below]	5,000	
	Depreciation debited to profit and loss account	<u>2,00,000</u>	<u>3,03,000</u>
			8,03,000
Less:	Dividend from domestic companies [Exempt under section 10(34)]	15,000	
	Income from agriculture [Exempt under section 10(1)]	1,80,000	
	Depreciation under the Income-tax Act, 1961 (As per working note)	<u>2,25,000</u>	
			<u>4,20,000</u>
			3,83,000
	Income from house property		
	Annual value of self-occupied property	Nil	
Less:	Deduction under section 24(b) – interest on housing loan	<u>23,000</u>	
			<u>(23,000)</u>
	Gross Total Income		3,60,000
Less:	Deduction under section 80C in respect of Principal repayment of housing loan		<u>50,000</u>
	Total Income		<u>3,10,000</u>

Working Note:

Computation of depreciation under the Income-tax Act, 1961

Particulars	Rs.
Depreciation@15% on Rs.14 lakh (Opening WDV of Rs.12 lakh plus assets purchased during the year and used for more than 180 days Rs.2 lakh)	2,10,000

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Depreciation @7.5% on Rs.2 lakh (Cost of assets used for less than 180 days)

15,000

2,25,000

Notes (Alternate views):

1. It is also possible to take a view that the salary not recorded in the books of account was an erroneous omission and that the assessee has offered satisfactory explanation for the same. In such a case, the same should not be added back as unexplained expenditure, but would be allowable as deduction while computing profits and gains of business and profession.
2. Where the imposition of penalty is not for delay in payment of sales tax or VAT but for contravention of provisions of the Sales Tax Act (or VAT Act), the levy is not compensatory and therefore, not deductible. However, if the levy is compensatory in nature, it would be fully allowable. Where it is a composite levy, the portion which is compensatory is allowable and that portion which is penal is to be disallowed.

Since the question only mentions "State VAT penalty paid" and the reason for levy of penalty is not given, it has been assumed that the levy is not compensatory and therefore, not deductible. It is also possible to assume that such levy is compensatory in nature and hence, allowable as deduction. In such a case, the total income would be Rs.3,05,000.

- (b) (i) Revised service tax returns may be filed within 90 days from the date of filing original return. Even if the original return is filed belatedly, the return could be revised by filing a revised return.
- (ii) The concern - Prasad & Co. is absolutely justified in its contention. The liability to pay service tax is on actual receipt of money for the services rendered regardless of the fact that the service provider maintains his books of account on mercantile basis.

Question 3

- (a) *Two brothers Arun and Bimal are co-owners of a house property with equal share. The property was constructed during the financial year 1997-98. The property consists of eight identical units and is situated at Cochin.*

During the financial year 2009-10, each co-owner occupied one unit for residence and the balance of six units were let out at a rent of Rs. 12,000 per month per unit. The municipal value of the house property is Rs. 9,00,000 and the municipal taxes are 20% of municipal value, which were paid during the year. The other expenses were as follows:

	Rs.
(i) Repairs	40,000
(ii) Insurance premium (paid)	15,000
(iii) Interest payable on loan taken for construction of house	3,00,000

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One of the let out units remained vacant for four months during the year.

Arun could not occupy his unit for six months as he was transferred to Chennai. He does not own any other house.

The other income of Mr. Arun and Mr. Bimal are Rs. 2,90,000 and Rs.1,80,000, respectively, for the financial year 2009-10.

Compute the income under the head 'Income from House Property' and the total income of two brothers for the assessment year 2010-11. (12 Marks)

(b) ABC & Co. received the following amounts during the half year ended 31-3-2010:

	Rs.
(i) For services performed prior to the date of levy of service tax (Assume service tax was levied from a specified date by change of law)	3,50,000
(ii) Advance amount received in March, 2010 (No service was rendered and the amount was refunded to the client in July 2010)	75,000
(iii) For free services rendered to customers, amount reimbursed by the manufacturer of such product. (for the period after the imposition of service tax)	50,000
(iv) Amounts realized and on which service tax is payable (excluding the items (i) to (ii) above)	14,26,500
Calculate the service tax liability duly considering the threshold limit.	(4 Marks)

Answer

(a) **Computation of total income for the A.Y. 2010-11**

Particulars	Arun Rs.	Bimal Rs.
Income from house property		
I. Self-occupied portion (25%)		
Annual value	Nil	Nil
Less: Deduction under section 24(b)		
Interest on loan taken for construction Rs.75,000 (being 25% of Rs.3 lakh) in total restricted to maximum of Rs. 30,000 for each co-owner	<u>30,000</u>	<u>30,000</u>
Loss from self occupied property	(30,000)	(30,000)
II. Let-out portion (75%) – See Working Note below	<u>1,25,850</u>	<u>1,25,850</u>
Income from house property	95,850	95,850
Other Income	<u>2,90,000</u>	<u>1,80,000</u>
Total Income	<u>3,85,850</u>	<u>2,75,850</u>

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Working Note – Computation of income from let-out portion of house property

Particulars	Rs.	Rs.
Let-out portion (75%)		
Gross Annual Value		
(a) Municipal value (75% of Rs.9 lakh)	6,75,000	
(b) Actual rent [(12000 x 6 x 12) – (Rs.12,000 x 1 x 4)] = Rs. 8,64,000 - Rs. 48,000	8,16,000	
- whichever is higher		8,16,000
Less: Municipal taxes 75% of 1,80,000 (20% of Rs.9 lakh)		<u>1,35,000</u>
Net Annual Value (NAV)		6,81,000
Less: Deduction under section 24		
(a) 30% of NAV	2,04,300	
(b) Interest on loan taken for the house [75% of Rs.3 lakh]	<u>2,25,000</u>	
		<u>4,29,300</u>
Income from let-out portion of house property		<u>2,51,700</u>
Share of each co-owner (50%)		1,25,850

(b) Computation of service tax liability of ABC & Co.:-

Particulars	Rs.
Amount received for the services rendered prior to levy of service tax is not taxable though the amount is realized after the change of law levying service tax	Nil
Advance received is liable to service tax. On refund of amount received for the services; service tax so paid would be adjusted against service tax liability of the subsequent period.	75,000
Amount received from manufacturer for free services rendered to customers is liable for service tax	50,000
Amount realized for services rendered after imposition of service tax	<u>14,26,500</u>
Total	15,51,500
Less: Threshold limit	<u>10,00,000</u>
Value of taxable service	<u>5,51,500</u>
Service tax payable = Rs. 5,51,500 × $\frac{10.30}{110.30}$	<u>51,500</u>

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Question 4

- (a) Mukesh (aged 55 years) owned a residential house at Nagpur. It was acquired by Mukesh on 10.10.1984 for Rs. 4,00,000. It was sold for Rs.55,00,000 on 4.11.2009. The State stamp valuation authority fixed the value of the property at Rs.60,00,000. The assessee paid 2% of the sale consideration as brokerage for the sale of said property.

Mukesh acquired a residential house at Chennai on 10.12.2009 for Rs.15,00,000 and deposited Rs.10,00,000 on 10.4.2010 in the capital gain bond of Rural Electrification Corporation Ltd. (RECL). He deposited Rs. 5,00,000 on 6.07.2010 in the Capital Gain Deposit Scheme in a nationalized bank for construction of additional floor on the residential house property acquired at Chennai.

Compute the capital gain chargeable to tax in the hands of Mr. Mukesh for the assessment year 2010-11. Calculate the income-tax payable on the assumption that he has no other income chargeable to tax.

Cost inflation index : Financial year 1984-85 = 125

Financial year 2009-10 = 632 (7 Marks)

- (b) M/s Arora Ltd., submits the following details of expenditure pertaining to the financial year 2009-10:

- (i) Payment of professional fees to Mr. Mani Rs. 50,000. Tax was not deducted at source.
- (ii) Interior works done by Mr. Hari for Rs.2,00,000 on a contract basis. Payment made in the month of March 2010. Tax deducted in March 2010 was paid on 30.06.2010.
- (iii) Factory Rent paid to Mr. Rao Rs.15,00,000. Tax deducted at source and paid on 01.10.2010.
- (iv) Interest paid on Fixed Deposits Rs.2,00,000. Tax deducted on 31.12.2009 and paid on 28.09.2010.
- (v) Payment made to M/s Green & Co. towards import of raw materials Rs.25,00,000. No tax was deducted at source. The supplier, Green & Co., is located in London.

Examine the above with reference to allowability of the same in the assessment year 2010-11 under the Income-tax Act, 1961. Your answer must be with reference to section 40(a) read with relevant tax deduction at source provisions. (5 Marks)

- (c) X & Co. is a service provider. It received Rs. 19,80,000 during the financial year 2009-10 after deduction of tax at source under section 194 J of the Income-tax Act, 1961.

The rate of tax deduction is 10% (i.e. after deduction of Rs. 2,20,000)

- (i) Calculate the service tax liability of X & Co.
- (ii) Can a multiple service provider use a single challan for payment of service tax for various services rendered by it? (4 Marks)

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Answer

(a) Computation of capital gains in the hands of Mukesh for the A.Y. 2010-11

Particulars	Rs.	Rs.
Deemed sale consideration (under section 50C)		60,00,000
Less: Brokerage @ 2% of Rs. 55,00,000		<u>1,10,000</u>
Net sale consideration		58,90,000
Less: Indexed cost of acquisition 4,00,000 × $\frac{632}{125}$		<u>20,22,400</u>
		38,67,600

Less: Exemption under sections 54 and 54EC

Under section 54:

(i) Residential house acquired at Chennai on 10.12.2009	15,00,000
(ii) Amount deposited in Capital Gains Accounts Scheme on 06.07.2010 (before the due date of filing of return) for construction of additional floor on the residential house property acquired at Chennai	<u>5,00,000</u>
	20,00,000

Under section 54EC:

Amount deposited in RECL bonds on 10.04.2010 (within six months from the date of transfer)	<u>10,00,000</u>
	<u>30,00,000</u>
Taxable long-term capital gain	<u>8,67,600</u>

Computation of tax liability of Mr. Mukesh for A.Y.2010-11

Tax on Rs.7,07,600 (i.e., long term capital gain Rs. 8,67,600 less basic exemption limit of Rs. 1,60,000) @20%	1,41,520
Add: Education cess @ 2%	2,830
Secondary and higher education cess@1%	<u>1,415</u>
Total tax liability	<u>1,45,765</u>

(b) Allowability of expenses of M/s. Arora Ltd for the A.Y. 2010-11

- (i) Payment of professional fees is subject to TDS under section 194J. Since no tax is deducted at source, the expenditure of Rs.50,000 is disallowed under section 40(a).
- (ii) Since the tax was deducted in March, 2010 and paid on or before the due date of filing the return (i.e., on or before September 30th, 2010), the expenditure on interior works will be allowed as deduction. Hence, disallowance under section 40(a) is not attracted.

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- (iii) The maximum time allowable for deposit of tax deducted at source is upto the due date of filing of return i.e., 30th September, 2010 and that too, only in respect of tax deducted during the month of March, 2010. In this case, since tax deducted under section 194-I was paid after the due date of filing the return, the expenditure can be claimed only in the subsequent year i.e., P.Y. 2010-11. Hence, for the P.Y.2009-10, the expenditure of Rs.15,00,000 is disallowed under section 40(a).
- (iv) If tax has been deducted during the months of April to February of a financial year, then the same has to be deposited on or before 31st March of the financial year, to avoid disallowance under that section. Only the tax deducted during the month of March could be deposited on or before the due date of filing of return to avoid such disallowance. In this case, disallowance would be attracted since tax deducted during December 2009 was not deposited on or before 31st March 2010. **(See Note below)**
- (v) Since payment towards import of raw materials does not attract the provisions of deduction of tax at source, the expenditure will be allowed as deduction. Hence, no disallowance is attracted under section 40(a).

Note - The Finance Act, 2010 has amended section 40(a)(ia) to allow time upto the due date of filing of return for deposit of tax deducted at any time during the financial year (April to March). Consequently, if tax deducted at any time during the previous year is deposited on or before the due date of filing of return (i.e., before 30th September), disallowance under section 40(a)(ia) would not be attracted. However, amendments made by the Finance Act, 2010, including retrospective amendments, are not applicable for November 2010 examination. Therefore, the answer for sub-part (iv) has been given on the basis of the position prior to amendment by the Finance Act, 2010.

(c) (i) Calculation of service tax liability of X & Co.:-

Particulars	Rs.
Amount received (Net)	19,80,000
Add: Tax deducted at source under section 194J	<u>2,20,000</u>
Gross amount (including service tax)	<u>22,00,000</u>
Service tax liability = $22,00,000 \times \frac{10.3}{110.3}$	<u>2,05,439.71</u>
Service tax payable (rounded off)	2,05,440

- (ii) A multiple service provider (a service provider rendering more than one taxable service) can use single GAR-7 challan for payment of service tax on different services. However, amounts attributable to each such service alongwith accounting codes should be mentioned clearly in the column provided for this purpose in GAR-7 challan. Alternatively, separate GAR-7 challans may be used for payment of service tax for each service provided by the service provider.

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Question 5

- (a) Mr. Raghu, Marketing Manager of KL Ltd., based at Mumbai furnishes you the following information for the year ended 31.03.2010:

Basic salary -	Rs. 1,00,000 per month
Dearness allowance -	Rs. 50,000 per month
Bonus -	2 Months basic salary
Contribution of employer to Recognised Provident Fund -	15% of basic salary plus dearness allowance

Rent free unfurnished accommodation was provided by the company at Mumbai (accommodation owned by the company).

	Rs.
(i) Recognised Provident Fund contribution made by Raghu	1,50,000
(ii) Health insurance premium for his family	20,000
(iii) Health insurance premium in respect of parents (senior citizens)	28,000
(iv) Medical expenses of dependent brother with 'severe disability' (covered by Section 2(o) of National Trust for Welfare of Persons with Autism, Cerebral Palsy, Mental Retardation and Multiple Disabilities Act, 1999).	6,000
(v) Interest on loan taken for education of his son studying B.Com (full-time) in a recognized college.	24,000
(vi) Interest on loan taken for education of a student for whom Mr. Raghu is the legal guardian for pursuing B.Sc. (Physics) (full-time) in a recognized university.	20,000

Compute the total income of Mr. Raghu for the assessment year 2010-11. (8 Marks)

- (b) State the conditions for deductibility of bad debt written off under the Income-tax Act, 1961. (4 Marks)
- (c) State how the service tax paid would be adjusted when the service is not provided either wholly or partially? (4 Marks)

Answer

- (a) **Computation of total income of Mr. Raghu for the assessment year 2010-11**

Particulars	Rs.	Rs.
Basic salary		12,00,000
Dearness allowance		6,00,000
Bonus		2,00,000

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Employer contribution to RPF in excess of 12% is taxable (3% of 18,00,000) [See Note below]	54,000
Rent free accommodation @ 15% of Rs.20 lakh (basic salary + dearness allowance + bonus) [See Note below]	<u>3,00,000</u>
	23,54,000

Less: Deductions under Chapter VI-A

Section 80C

Contribution to RPF Rs.1,50,000 restricted to	1,00,000
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Section 80D – Health insurance premium

Family Rs.20,000 restricted to	15,000
Parents (Senior Citizens) Rs.28,000 restricted to	<u>20,000</u> 35,000

Section 80DD

Medical treatment of dependent brother with severe disability (flat deduction irrespective of expenditure incurred)	1,00,000
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Section 80E – Interest on loan taken for full-time education of

- his son studying B.Com.	24,000
- a student studying B.Sc. for whom he is the legal guardian	<u>20,000</u>
	44,000

2,79,000

Total income

20,75,000

Note - It is assumed that dearness allowance forms part of salary for retirement benefits. Hence, the same is taken into consideration for computation of Employer's contribution to RPF and Rent Free Accommodation.

(b) The conditions for deductibility of bad debts written off under the Income-tax Act, 1961 are -

- (1) There must be a debt – i.e., a bad debt presupposes the existence of a debt and relationship of a debtor and creditor.
- (2) The debt must be incidental to the business or profession of the assessee.
- (3) The debt must have been taken into account in computing the assessable income – No such deduction shall be allowed unless such debt or part thereof was taken into account in computing the income of the assessee of the previous year in which it was written off or of an earlier previous year or it represents money lent in the ordinary course of business of banking or money lending carried on by the assessee.
- (4) The debt must have been written off as irrecoverable in the books of account of the assessee.

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- (5) Where the amount ultimately recovered is less than the difference between the debt and the amount deducted, the deficiency shall be deductible in the previous year in which the ultimate recovery is made.
- (c) Where an assessee has deposited service tax in respect of a taxable service which is not provided by him wholly/partially for any reason, he may adjust the excess service tax so paid by him against his service tax liability for the subsequent period.

However, for carrying out such adjustment, the assessee must have refunded the value of taxable service and the service tax thereon to the person from whom it was received earlier. In the case of adjustment, the details of such suo motu adjustment must be disclosed in Form ST -3.

Question 6

- (a) State with reasons the taxability/deductibility of the following items in the context of Income-tax Act, 1961:
- (i) Agricultural income to a resident of India from a land situated in Malaysia.
 - (ii) Bad debt of Rs. 50,000 written off and allowed in the financial year 2007-08 recovered in the financial year 2009-10.
 - (iii) Allowance received by an employee working in a transport system at Rs. 10,000 per month to meet his personal expenditure while in duty. He is not receiving any daily allowance.
 - (iv) Amount withdrawn from Public Provident Fund as per relevant rules.
 - (v) Telephone provided at the residence of employee and the bill aggregating to Rs.25,000 paid by the employer. Determine the perquisite value taxable in the hands of employee.
 - (vi) Payment of Rs.50,000 to an electoral trust by an Indian company.

Assume that all the facts given above relate to financial year 2009-2010. (12 Marks)

- (b) Raj and Co., a manufacturer of product 'X', sold its goods to a distributor at Rs. 11,250 (inclusive of tax). The distributor sold the goods to wholesaler for Rs. 13,500. The wholesaler sold the goods to a retailer for Rs. 16,875. The retailer sold the goods to consumer at Rs. 22,500. All the sales were inclusive of VAT @ 12.5%.

Compute the total VAT payable under the subtraction method. (4 Marks)

Answer

- (a) (i) Agricultural income from a land in any foreign country is taxable in the case of resident taxpayers as income under the head "Income from other sources". Exemption under section 10(1) is not available in respect of such income.
- (ii) As per section 41(4), any amount recovered by the assessee against bad debt earlier allowed as deduction shall be taxed as income in the year in which it is

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received. Therefore, in this case, Rs.50,000 would be taxable in the F.Y.2009-10 (A.Y.2010-11).

- (iii) Under section 10(14), any allowance granted to an employee working in a transport system to meet his personal expenditure during his duty is exempt provided he is not in receipt of daily allowance. The exemption is 70% of such allowance (i.e., Rs.7,000 per month, being 70% of Rs.10,000) or Rs. 6,000 per month, whichever is less. Hence, Rs.72,000 (i.e., 6,000 × 12) is allowable as deduction under section 10(14).
- (iv) Any amount withdrawn from public provident fund as per relevant rules is not exigible to tax. Such exemption is provided in section 10(11).
- (v) Telephone provided at the residence of the employee and payment of bill by the employer is a tax free perquisite
- (vi) Amount paid by an Indian Company to an electoral trust is eligible for deduction under section 80GGB from gross total income.

(b) Calculation of VAT payable by Raj & Co. under subtraction method:-

Particulars	Turnover under VAT (Rs.)	VAT (Rs.)
Sale by manufacturer to distributor	11,250	$\frac{11,250 \times 12.5}{112.5} = 1,250$
Sale by distributor to whole seller	13,500 - 11,250 = 2,250	$\frac{2,250 \times 12.5}{112.5} = 250$
Sale by whole seller to retailer	16,875 - 13,500 = 3,375	$\frac{3,375 \times 12.5}{112.5} = 375$
Sale by retailer to consumer	22,500 - 16,875 = 5,625	$\frac{5,625 \times 12.5}{112.5} = 625$
Total VAT payable	22,500	2,500

Question 7

Answer any **four** out of the following:

- (a) Explain the tax treatment of Limited Liability Partnership under the Income-tax Act, 1961.
- (b) Sachin received Rs.15,00,000 on 23.01.2010 on transfer of his residential building in a transaction of reverse mortgage under a scheme notified by the Central Government. The building was acquired in March 1991 for Rs.8,00,000.

Is the amount received on reverse mortgage chargeable to tax in the hands of Sachin under the head 'Capital gains'?

Cost inflation index for the Financial year 1990-91 - 182

Financial year 2009-10 - 632

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- (c) *AB Co. Ltd. allotted 1000 sweat equity shares to Sri Chand in June 2009. The shares were allotted at Rs.200 per share as against the fair market value of Rs.300 per share on the date of exercise of option by the allottee viz. Sri Chand. The fair market value was computed in accordance with the method prescribed under the Act.*
- (i) *What is the perquisite value of sweat equity shares allotted to Sri Chand?*
- (ii) *In the case of subsequent sale of those shares by Sri Chand, what would be the cost of acquisition of those sweat equity shares?*
- (d) *Discuss briefly on carry forward and set off of losses in the case of change in constitution of firm or on succession under section 78 of the Income-tax Act, 1961.*
- (c) *List out the merits of VAT.* (4 x 4 = 16 Marks)

Answer

- (a) The Finance (No. 2) Act, 2009 has incorporated the taxation scheme of LLPs in the Income-tax Act, 1961 on the same lines as applicable for general partnerships.

The definition of the terms "partner", "firm" and "partnership" have been amended to include a limited liability partnership.

Since the tax treatment accorded to a LLP and a general partnership is the same, the conversion from a general partnership to an LLP will have no tax implications if the rights and obligations of the partners remain the same after conversion and there is no transfer of asset or liability after conversion.

An LLP is eligible for deduction of remuneration paid to working partners, if the same is authorized by the partnership deed, and subject to the limits specified in section 40(b)(v), i.e., on the first Rs.3 lakh of book profit or in case of loss, the limit would be the higher of Rs.1,50,000 or 90% of book profit and on the balance of book profit, the limit would be 60%.

An LLP is entitled to deduction of interest paid to partners if such payment is authorized by the partnership deed and the rate of interest does not exceed 12% simple interest per annum.

- (b) As per section 47(xvi), any transfer of a capital asset in a transaction of Reverse Mortgage under a scheme made and notified by the Central Government will not be regarded as a transfer. Therefore, capital gains tax liability is not attracted.

Section 10(43) provides that the amount received by a senior citizen as a loan, either in lump sum or in installments, in a transaction of Reverse Mortgage would be exempt from income-tax. Therefore, the amount received by Sachin in a transaction of Reverse Mortgage of his residential building is exempt under section 10(43).

- (c) (i) As per section 17(2)(vi), the value of sweat equity shares chargeable to tax as perquisite shall be the fair market value of such shares on the date on which the option is exercised by the assessee as reduced by the amount actually paid by, or recovered from, the assessee in respect of such shares.

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Particulars	Rs.
Fair market value of 1000 sweat equity shares @ Rs. 300 each	3,00,000
Less: Amount recovered from Sri Chand 1000 shares @ Rs. 200 each	2,00,000
Value of perquisite of sweat equity shares allotted to Sri Chand	1,00,000

- (ii) As per section 49(2AA), where capital gain arises from transfer of sweat equity shares, the cost of acquisition of such shares shall be the fair market value which has been taken into account for perquisite valuation under section 17(2)(vi).

Therefore, in case of subsequent sale of sweat equity shares by Sri Chand, the cost of acquisition would be Rs.3,00,000.

(d) Carry forward and set off of losses in case of change in constitution of firm or on succession [Section 78]

- (i) Where there is a change in the constitution of firm, so much of the loss, proportionate to the share of a retired or deceased partner remaining unabsorbed, shall not be allowed to be carried forward by the firm.
- (ii) Where any person carrying on any business or profession has been succeeded in such capacity by another person otherwise than by inheritance, such other person shall not be allowed to carry forward and set off against his income, any loss incurred by the predecessor.
- (iii) Where there is a succession by inheritance, the legal heirs (assessable as BOI) are entitled to set off the business loss of the predecessor. Such carry forward and set off is possible even if the legal heirs constitute themselves as partnership firm. In such a case, the firm can carry forward and set off the business loss of the predecessor.

(e) Merits of VAT

1. No tax evasion is possible as the credit of duty paid is allowed against the liability on the final product manufactured or sold. Under VAT, unless proper records are kept in respect of various inputs, it is not possible to claim credit. A perfect system of VAT is a perfect chain where tax evasion is difficult.
2. Neutrality is the greatest advantage of VAT. VAT does not interfere in the choice of decision for purchases because it has anti - cascading effect. The system is neutral with regard to choice of production technique, as well as business organisation. All other things remaining the same, the issue of tax liability does not vary the decision about the source of purchase.
3. It has a certainty as it is based simply on transactions. There is no need to go through complicated definitions like sales, sales price, turnover of purchases and turnover of sales. The tax is also broad-based and applicable to all sales in business leaving little room for different interpretations.

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4. Transparency is ensured as the buyer knows, out of the total amount paid for purchases of material, what is the amount paid towards VAT. This transparency enables the State Governments to know as to what is the exact amount of tax coming at each stage. Thus, it is a great aid to the Government while taking decisions with regard to rate of tax etc.
5. For Government, better revenue collection and stability is achieved as the tax credit will be given only if the proof of tax paid at an earlier stage is produced. This means that if the tax is evaded at one stage, full tax will be recoverable from the person at the subsequent stage or from a person unable to produce proof of such tax payment.
6. Since the tax paid on an earlier stage is to be received back, the system promotes better accounting systems.

Note: Any four points may be given.

