

MOCK TEST PAPER – 2

IPCC: GROUP – I

PAPER – 4 : TAXATION

SUGGESTED ANSWERS / HINTS

1. (a) Computation of taxable income of Mrs. Sita and Mrs. Geeta for the A.Y.2012-13

S. No.	Particulars	Mrs. Sita	Mrs. Geeta
		₹	₹
(I)	Salaries Pension received from State Government Pension received from Australian Government is not taxable in the case of a non-resident since it is earned and received outside India	Nil	10,000
		<u>Nil</u>	<u>10,000</u>
(II)	Income from house property Rent received from house property at Delhi (assumed to be the annual value in the absence of other information i.e. municipal value, fair rent and standard rent) Less: Deduction under section 24(a)@30%	60,000 <u>18,000</u> <u>42,000</u>	30,000 <u>9,000</u> <u>21,000</u>
(III)	Capital gains Long-term capital gain on sale of land at Delhi Short term capital gain on sale of shares of Indian listed companies in respect of which STT was paid	1,00,000 <u>20,000</u> <u>1,20,000</u>	50,000 <u>2,00,000</u> <u>2,50,000</u>
(A)	Gross Total Income [(I)+(II)+(III)] Less: Deductions under Chapter VIA	1,62,000	2,81,000
1.	Deduction under section 80C		
	1. LIC Premium paid	-	10,000
	2. Premium paid to Australian Life Insurance Corporation	10,000	
	3. Tax Saving Bond (assuming that they are notified infrastructure bonds)		

	eligible for deduction under section 80C)	<u>30,000</u>	<u>20,000</u>
		40,000	30,000
2.	Deduction under section 80D – Medici claim premium paid (assuming that the same is paid by cheque)	<u>Nil</u>	<u>5,000</u>
		40,000	35,000
(B)	Total deduction under Chapter VIA is restricted to income other than capital gains taxable under sections 111A & 112	<u>40,000</u>	<u>31,000</u>
(C)	Total income (A-B)	<u>1,22,000</u>	<u>2,50,000</u>
	Tax liability of Mrs. Sita for A.Y. 2012-13		
	Tax on long-term capital gains @ 20%	20,000	
	Tax on short-term capital gains @ 15%	<u>3,000</u>	
		23,000	
	Tax liability of Mrs. Geeta for A.Y.2012-13		
	Tax on short-term capital gains @ 15% of ₹60,000 [i.e. ₹ 2,00,000 less ₹ 1,40,000, being the unexhausted basic exemption limit as per proviso to section 111A]		9,000
	Education cess @ 2% & SHEC@ 1%	<u>690</u>	<u>270</u>
	Total tax payable	<u>23,690</u>	<u>9,270</u>

Note :

- (1) Long-term capital gains is chargeable to tax @ 20% as per section 112.
- (2) Short-term capital gains on transfer of equity shares in respect of which securities transaction tax is paid is subject to tax @ 15% as per section 111A.
- (3) In case of resident individuals, if the basic exemption limit is not fully exhausted against other income, then the long-term capital gains/short-term capital gains will be reduced by the unexhausted basic exemption limit and only the balance will be taxed at 20%/10% respectively. However, this benefit is not available to non-residents. Therefore, while Mrs. Geeta can set-off unexhausted basic exemption limit against long-term capital gains and short-term capital gains taxable under section 111A, Mrs. Sita cannot do so.
- (4) Since long-term capital gains is taxable at the rate of 20% and short-term capital gains is taxable at the rate of 15%, it is more beneficial for Mrs. Geeta to first exhaust her basic exemption limit of ₹ 1,90,000 against long-term

capital gains of ₹ 50,000 and the balance limit of ₹ 1,40,000 (i.e., ₹ 1,90,000 – ₹ 50,000) against short-term capital gains.

(b)

Particulars	₹
Professional advice to one of his friend	8,000
Consultancy services in computer hardware engineering	20,000
Technical assistance in computer software engineering	15,000
Advice in relation to mechanical engineering	<u>7,000</u>
Value of taxable services	<u>50,000</u>

Service tax @10%	5,000
Add: Education cess @ 2%	100
Add: Secondary and higher education cess @ 1%	<u>50</u>
Service tax liability	5,150
Less: Cess paid under section 3 of the Research and Development Cess Act, 1986	<u>5,000</u>
Service tax payable	<u>150</u>

Notes:

1. Advice to friend is taxable as service rendered to any person is taxable.
2. Consultancy and technical assistance in relation to both computer hardware and software engineering are taxable
3. Advice in relation to any branch of engineering is taxable
4. Services rendered free of charge are not liable to service tax
5. Service tax equivalent to amount of the cess payable under section 3 of the Research and Development Cess Act, 1986 is exempt **[Notification No.18/2002 ST dated 16.12.2002]**.
6. Since cess has been paid at the time of service. Hence condition to claim exemption for cess is satisfied. **[Notification No. 46/2011 ST dated 19.09.2011]**

Answer will not be different as consulting engineer *inter alia* means any body corporate as well.

(c) Computation of VAT payable for the quarter ending 31st March, 2012:-

Particulars	₹	₹
Output tax payable = ₹ 1,00,00,000 × 4%		4,00,000
Less: Input tax credit		
On raw material purchased @ 12.5%		
(₹ 60,00,000 × 12.5%)	7,50,000	
Less: Inputs used in the manufacture of exempted goods sold (₹ 20,00,000 × 12.5%) [Note – 1]	<u>2,50,000</u>	<u>5,00,000</u>
Net VAT payable		(1,00,000)
CST payable on inter state sale adjusted (₹ 10,00,000 × 2%)		20,000
Balance of input tax credit carried forward to next quarter (₹ 20,000-₹ 1,00,000)		80,000

Note:

1. If the goods manufactured from raw material are exempt from tax, no input tax credit is available on such raw material.
2. Import duty paid on high seas purchases is not eligible for input tax credit.
3. Purchases of raw material within the State on which VAT has been paid @ 4% are not eligible for input tax credit because invoice for the said purchases does not show the amount of tax separately.

2. (a) Computation of Relief under section 89 for the Assessment Year 2012-13

Particulars	₹	₹
Salary Income for the year excluding the arrears		5,60,000
Add: Arrears relating to Financial Year 2005-06		<u>40,000</u>
Gross Total Income		6,00,000
Less: Deduction under chapter VI-A		
Contribution to Public Provident Fund		<u>35,000</u>
Total Income		<u>5,65,000</u>
Assessment year 2012-13		
Tax on ₹ 5,65,000		
First ₹ 1,80,000	Nil	NIL
Next ₹ 3,20,000	10%	32,000
Balance ₹ <u>65,000</u>	20%	<u>13,000</u>
<u>5,65,000</u>		45,000
Add: Education cess @ 2%		900

Secondary and higher education cess @1%	450	
Tax on total income (including arrears) (A)	<u>46,350</u>	
Total Income excluding arrears		5,25,000
Tax on ₹ 5,25,000		
First ₹ 1,80,000 Nil	NIL	
Next ₹ 3,20,000 10%	32,000	
Balance ₹ <u>25,000</u> 20%	<u>5,000</u>	
<u>5,25,000</u>	<u>37,000</u>	
Add : Education cess @ 2%	740	
Secondary and higher education cess @ 1%	<u>370</u>	
Tax on total income (excluding arrears) (B)	<u>38,110</u>	
Difference between A & B I		8,240
Assessment Year 2006-07		
Total Income assessed		1,40,000
Add: Arrears relating to Financial year 2005-06		<u>40,000</u>
Total income (including arrears)		1,80,000
Tax on ₹ 1,80,000	11,000	
Add: Education Cess @ 2%	<u>220</u>	
Tax on total income (including arrears) (C)	<u>11,220</u>	
Total Income excluding arrears		1,40,000
Tax on ₹ 1,40,000	4,000	
Add: Education Cess @ 2%	<u>80</u>	
Tax on total income (excluding arrears) (D)	<u>4,080</u>	
Difference between C & D II		7,140
Relief under section 89 (I – II)		1,100
Tax payable for A.Y. 2012-13 (₹ 46,350 – ₹ 1,100)		45,250

- (b) As per section 64(1) of the Finance Act, 1994 as amended, service tax provisions do not extend to the State of Jammu and Kashmir. Therefore, service tax will not be payable if service is provided in Jammu & Kashmir. However, since service tax is a destination based consumption tax, if a person from Jammu & Kashmir provides the taxable service outside Jammu & Kashmir in any other part of India, the service will be liable to service tax, as the location where service is provided is relevant. Hence, the services provided by a person having a place of business in the State of Jammu and Kashmir providing services in any other place in India are taxable under the Finance Act, 1994 as amended.

(c) Tax rates under VAT:

1. **Exempted category:-** There are about 50 commodities which are legally barred from taxation and items which have social implications.
 2. **4% VAT category:-** Under 4% VAT rate category, there are largest number of goods comprising of items of basic necessities, all agricultural and industrial inputs, capital goods and declared goods.
 3. **12.5% category:-** The remaining commodities, common for all the States, fall under the general VAT rate of 12.5%.
 4. **1% Category:-** The special rate of 1% is meant for precious stones, bullion, gold and silver ornaments etc.
 5. **Non-VAT goods:-** Petrol, diesel, ATF, other motor spirit, liquor and lottery tickets are kept outside VAT. The States may or may not bring these commodities under VAT laws.
3. (a) There are two units of the house. Unit I with 2/3rd area is used by Manoj for self-occupation throughout the year and no benefit is derived from that unit, hence it will be treated as self-occupied and its annual value will be nil. Unit 2 with 1/3rd area is let-out through out the previous year and its annual value has to be determined as per section 23(1).

Computation of Income from house property of Mr. Manoj for A.Y. 2012-13

Particulars	Amount in rupees	
Unit I (2/3rd area – self-occupied)		
Annual Value		Nil
Less: Deduction u/s 24(b) 2/3 rd of ₹ 1,20,000		80,000
Income from Unit I (self-occupied)		-80,000
Unit II (1/3rd area – let out)		
Computation of Gross Annual Value		
Step I – Compute Annual Value		
Annual Value = Higher of municipal value and fair rent, restricted to standard rent. However, in this case, standard rent of ₹ 1,20,000 (1/3 rd of ₹ 3,60,000) is more than the higher of municipal value of ₹ 80,000 (1/3 rd of ₹ 2,40,000) and fair rent of ₹ 1,00,000 (1/3 rd of ₹ 3,00,000). Hence the higher of municipal value and fair rent is the Annual Value. In this case, it is the fair rent.	1,00,000	

Step 2 – Compute actual rent received/ receivable ₹ 7,500 × 12 = ₹ 90,000	90,000	
Step3 –Gross Annual Value is the higher of Annual Value and actual rent received/receivable i.e. higher of ₹ 1,00,000 and ₹ 90,000	1,00,000	
Gross Annual Value (GAV)		1,00,000
Less: Municipal taxes paid by the owner during the previous year relating to let-out portion 1/3 rd of (12.5% of ₹ 2,40,000) = ₹ 30000/3 = ₹ 10,000		10,000
Net Annual Value (NAV) = (₹ 1,00,000 - ₹ 10,000)		90,000
Less: Deductions under section 24		
(a) 30% of NAV = 30% of ₹ 90,000	27,000	
(b) Interest paid on borrowed capital (relating to let out portion) 1/3 rd of ₹ 1,20,000	40,000	67,000
Income from Unit II (let-out)		23,000
Loss under the head “Income from house property” = -₹ 80,000 + ₹ 23,000		-57,000

- (b) Computation of taxable value of services provided by the C.J. Professionals for the half year ending on 30.09.2011:

Particulars	₹
Total bills raised(Note 1)	7,65,000
Less: Bill raised on an approved International Organisation (Note 2)	<u>65,000</u>
	7,00,000
Add: Advance received for the services to be provided in October '11 (Note 3)	<u>1,50,000</u>
Taxable value of services	<u>8,50,000</u>
Computation of service tax payable	
Taxable value of services	8,50,000
Service tax @ 10%	85,000
Add: Education cess @ 2%	1,700
Add: Secondary and higher education cess @ 1%	<u>850</u>
Total service tax payable	87,550

Notes:

- Point of taxation is date of issue of invoice or receipt of payment whichever is earlier [Rule 3 of Point of Taxation Rules, 2011]

2. Services provided to an International Organisation are exempt from the service tax *vide Notification No. 16/2002 ST dated 02.08.2002*.
 3. Any advance received for providing any taxable services forms part of the value of taxable service [Section 67 of the Finance Act, 1994]. Further in case of advance, point of taxation is the date of receipt of advance.[Rule 3 of Point of Taxation Rules, 2011].
- (c) It is generally optional for a dealer to opt for this composition scheme. A dealer who intends to avail such composition scheme shall exercise the option in writing for a year or a part of the year in which he gets himself registered. For this the dealer has to intimate to the Commissioner.

If a dealer avails this scheme, he need not maintain any statutory records as prescribed under the Act. Only the records for purchase, sales, inventory should be maintained. However, if a dealer does not avail the scheme, he has to maintain the prescribed statutory records as per the respective State VAT Acts.

The dealer should not have any stock of goods which were brought from outside the State on the day he exercises his option to pay tax by way of composition and shall not use any goods brought from outside the State after such date. The dealer should also not claim input tax credit on the inventory available on the date on which he opts for composition scheme.

4. (a) 1. As per section 35(2AB), where a **company** engaged in, inter alia, the business of biotechnology incurs any expenditure on scientific research during the current year, it is eligible for claiming weighted deduction of a sum equal to 200% of the eligible expenditure. However this weighted deduction is not available to any assessee other than company.

The eligible expenditure and quantum of deduction will be:

Any expenditure incurred during earlier 3 years immediately preceding the date of commencement of business on payment of salary or purchase of materials, or capital expenditure incurred other than expenditure on acquisition of land [actual expenditure qualifies for deduction under section 35(1)].

The deduction available under section 35 for scientific research will, therefore, be:

	Particulars	₹
(a)	Land	Nil
(b)	Building	22,80,000
(c)	Revenue expenses of last 3 years	4,40,000
(d)	Capital expenditure of last 3 years: Plant and machinery	5,00,000

(e) Current year revenue expenditure	1,80,000
Total deduction under section 35	34,00,000

2. Section 41(3) provides that where a capital asset used for scientific research is sold, without having been used for other purposes, the lower of sale proceeds or the total amount of deduction earlier allowed under section 35 will be considered as income from business of the previous year in which the sale took place.

Therefore, the income chargeable to tax under section 41(3) should be lower of the following:

- (1) Sale proceeds i.e. ₹ 8,00,000
- (2) Total amount of deduction earlier allowed under section 35 i.e. ₹ 5,00,000 will be deemed to be the income chargeable to tax under section 41(3).
3. The difference between sale proceeds and business income under section 41(3) will be treated as short-term capital gain.

₹

Sale proceeds of plant and machinery	8,00,000
Less: Business Income as per section 41(3)	<u>5,00,000</u>
Short-term capital gain	<u>3,00,000</u>

- (b) Yes, the 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 authorised dealer in foreign exchange or an authorized money changer, referred to in section 65(105)(zm) and section 65(105)(zzk) as amended has the option to pay an amount at the following rates instead of paying service tax @ 10%:-

S.No.	For an amount	Service tax shall be calculated at the rate of
1.	Upto ₹ 100,000	0.1 % of the gross amount of currency exchanged or ₹ 25 whichever is higher
2.	Exceeding ₹ 1,00,000 and upto ₹ 10,00,000	₹ 100 + 0.05 % of the gross amount of currency exchanged
3.	Exceeding ₹ 10,00,000	₹ 550 + 0.01 % of the gross amount of currency exchanged or ₹ 5,000 whichever is lower

However, the person providing the service shall exercise such option for a financial year and such option shall not be withdrawn during the remaining part of that financial year

- (c) Yes, the given proposition is true. 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.

Besides, 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).

In practice, therefore, most countries use the consumption variant.

5. (a) **Computation of taxable capital gain of Mr. Pankaj for A.Y. 2012-13**

Particulars	₹	₹
Sale consideration received on sale of 20,000 shares @ ₹ 175 each		35,00,000
Less: Indexed cost of acquisition		
(a) 10,000 shares received as gift from father on 5.4.1981		
Indexed cost $10000 \times ₹ 25 \times 785/100$	19,62,500	
(b) 5,000 bonus shares received from XYZ Ltd	Nil	
Bonus shares are acquired on 17.3.1986 (i.e after the year 1979-80 when the original shares were purchased). Hence, the cost is Nil.		
(c) 5000 shares purchased on 31.12.1993 @ ₹ 75 per share. The indexed cost is $5000 \times ₹ 75 \times 785/244$	<u>12,06,455</u>	<u>31,68,955</u>
Long term capital gain		3,31,045
Less : Exemption under section 54F (See Note below)		
₹ 3,31,045 x ₹ 25,00,000 / ₹ 35,00,000		<u>2,36,461</u>
Taxable long term capital gain		<u>94,584</u>

Note:

Exemption under section 54F can be availed by the assessee subject to fulfillment of the following conditions :

- (a) The assessee should not own more than one residential house on the date of transfer of the long-term capital asset;
- (b) The assessee should purchase a residential house within a period of 1 year before or 2 years after the date of transfer or construct a residential house

within a period of 3 years from the date of transfer of the long-term capital asset.

In this case, the assessee has fulfilled the two conditions mentioned above. Therefore, he is entitled to exemption under section 54F.

- (b) Service tax paid by Lucky Associates Private Limited in the financial year 2010-11 is ₹ 10,30,000 (10.30% of ₹ 1,00,00,000). Proviso to rule 6(2) of the Service Tax Rule, 1994 has been amended to provide that an assessee shall deposit the service tax electronically through internet banking if he has paid the total service tax of ₹ 10 lakh or more (including the amount of service tax paid by utilisation of CENVAT credit) in the preceding financial year. Therefore, Lucky Associates Private Limited is required to make the e-payment of service tax in the financial year 2011-12.

The due date for payment of service tax by a company is the 6th day of the month, if the duty is deposited electronically through internet banking immediately following the calendar month in which the payments are received, towards the value of taxable services. Hence, in the given case, Lucky Associates Private Limited is required to make the e-payment of the service tax by 6th May, 2011.

- (c) **Computation of purchases eligible for input tax credit:-**

Particulars	Rupees
Inputs purchased for being used in the execution of a works contract	1,00,000
Goods purchased for sale to other parts of India in the course of inter-State trade or commerce	<u>50,000</u>
Purchases eligible for input tax credit	<u>1,50,000</u>

Note: For the purpose of computation of value of purchases eligible for input tax credit, following have not been included:-

- (1) Inputs purchased from a registered dealer who opts for composition scheme under the provisions of the Act of worth ₹ 25,000.
 - (2) Raw material purchased from unregistered dealers of worth ₹ 60,000.
 - (3) The inputs imported from outside the territory of India commonly known as high seas purchases of worth ₹ 1,50,000.
6. (a) Section 64(1) of the Income-tax Act, 1961 provides for the clubbing of income in the hands of the individual, if the income earned is from the assets transferred directly or indirectly to the spouse of the individual, otherwise than for adequate consideration. In this case Smt. Jaya received a gift of ₹ 2,00,000 from her husband which she invested in her business. The income to be clubbed in the hands of Smt. Jaya's husband for A.Y.2012-13 is computed as under :

Particulars	Smt.Jaya's Capital Contribution	Capital Contribution Out of gift from husband	Total
	₹	₹	₹
Capital as at 1.4.2010	2,50,000	--	2,50,000
Investment on 04.05.2010 out of gift received from her husband		2,00,000	2,00,000
	2,50,000	2,00,000	4,50,000
Profit for F.Y. 2010-11 to be apportioned on the basis of capital employed on the first day of the previous year i.e. on 1.4.2010	2,00,000		2,00,000
Capital employed as at 1.4.2011	4,50,000	2,00,000	6,50,000
Profit for F.Y.2011-12 to be apportioned on the basis of capital employed as at 1.4.2011 (i.e. 45 : 20)	2,70,000	1,20,000	3,90,000

Therefore, the income to be clubbed in the hands of Smt.Jaya's husband for A.Y.2012-13 is ₹ 1,20,000.

- (b) Where an assessee has issued an invoice, or received any payment, against a service to be provided which is not so provided by him either wholly or partially for any reason or where the amount of invoice is renegotiated due to deficient provision of service, or any terms contained in a contract, the assessee may take the credit of such excess service tax paid by him, if the assessee:
- has refunded the payment or part thereof, so received for the service provided to the person from whom it was received; or
 - has issued a credit note for the value of the service not so provided to the person to whom such an invoice had been issued.
- (c) The VAT is a system based simply on transactions. Thus 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. Thus, this system brings certainty to a great extent.

Also, under a VAT system, the buyer knows, out of the total consideration paid for purchase of material, what is tax component. Thus, the system ensures

transparency also. 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.

7. (a) (i) The liability to deduct tax at source under section 194A is not attracted in respect of interest paid to a banking company. Therefore, XYZ Ltd. is not liable to deduct tax at source on interest payment to the corporation bank.
- (ii) Freight Payment to Flyking not subject to TDS as the value of contract does not exceed ₹ 30,000. Again, payment to Railways is exempt from TDS;
- (iii) Provisions for deduction of tax at source under section 194J are attracted in respect of payment of fees for professional services, if the amount of such fees exceeds ₹ 30,000 in the relevant financial year. The service rendered by a commentator in relation to sports activities has been notified by the CBDT as professional service for the purpose of section 194J vide its *Notification No. 88 dated 21st August, 2008*. Therefore, tax is required to be deducted@10% from the fee of ₹ 2.5 lacs payable to the former cricketer.
- (iv) Under section 194G, the person responsible for paying to any person stocking, distributing, purchasing or selling lottery tickets shall at the time of credit of the commission or payment thereof, whichever is earlier, amounting to more than ₹ 1,000, deduct income-tax at 10%.

Therefore, the State Government shall deduct tax on payment of commission made to the agent on sale of lottery tickets.

- (b) Yes, in the instant case, Durga Consultants Ltd. is required to file its return electronically. Service Tax Rules, 1994 have been amended to provide that with effect from 01.10.2011, every assessee will have to submit half-yearly service tax return electronically, irrespective of the amount of service tax paid by him in the preceding financial year. Hence, now all assesses are required to file service tax returns electronically. Therefore, for the half year ended September 30, 2011, Durga Consultants Ltd. shall file its return electronically.

- (c) Difference between compulsory registration and voluntary registration:-

Compulsory registration: If an assessee fails to obtain registration under the VAT Act, he may be registered compulsorily by the Commissioner. The Commissioner may assess the tax due from such person on the basis of evidence available with him. In this event the assessee shall have to forthwith pay such amount of tax. Further, failure to get registered shall result in attracting default penalty and forfeiture of eligibility to set off all input tax credit related to the period prior to the compulsory registration.

Voluntary registration: A dealer otherwise not eligible for registration may also obtain registration if the Commissioner is satisfied that the business of the applicant requires registration. The Commissioner may also impose any terms or conditions that he thinks fit.