Gurukripa's Guideline Answers to May 2012 Exam Questions
Final Group II – Direct Taxes

Question No.1 is compulsory **(4 × 5 = 20 Marks).**
Answer **any five** questions from the **remaining six** questions **(16 × 5 = 80 Marks).** [Answer any 4 out of 5 in Q.4]

Question 1(a): Exemption u/s 10AA — M 12 (10 Marks)

Siddarth Ltd has an undertaking (Unit X) in Special Economic Zone (SEZ) and another undertaking (Unit Y) in Free Trade Zone (FTZ) for manufacturing of Computer Software. It furnishes the following particulars of its 2nd year of operations ended on 31st March 2012:

Particulars	Unit X (In Lakhs)	Unit Y (In Lakhs)
Total Sales	180	120
Export Sales (Incl. of ₹ 10 Lakhs Onsite Development of Computer Software outside India by Unit X)	120	10
Profit Earned (After claim of Bad Debts u/s 36(1)(vii) in Unit X)	63	36

Plant and Machinery used in the Business has been depreciated at 15% on Straight Line Method (SLM) basis and depreciation of ₹ 9 Lakhs was charged to Profit and Loss Account in the proportion of Sales during the Previous Year.

₹ 100 Lakhs were realized out of Export Sales in time and balance of ₹ 20 Lakhs becomes irrecoverable due to bankruptcy of one of the foreign buyers in Unit X.

Compute the deduction u/s 10AA of the Income Tax, 1961 & Taxable Income of Siddarth Ltd for the Assessment Year 2012–2013.

Solution: **Similar to Question No. 18, Page 3.10 of "Direct Taxes – A Ready Referencer – AY 2012–2013"**
Assessee: Siddarth Ltd **Previous Year: 2011–2012** **Assessment Year: 2012–2013**

Computation of Total Income

	Particulars	₹ Lakhs	₹ Lakhs
	Profits and Gains of Business or Profession:		
	Profits from Unit X **[See Working Notes]**	28.36	
Add:	Profits from Unit Y	36.54	64.90
	Gross Total Income		**64.90**
Less:	Deduction under Chapter VI A		NIL
	Total Income		**64.90**

Working Note: Computation of Deduction u/s 10AA –

Step 1: Computation of Depreciation on Machinery for FY 2011–2012

	Particulars	₹ Lakhs
	Depreciation at 15% under SLM (Given)	9.00
	Therefore, Original Cost = ₹ 9 Lakhs ÷ 15%	60.00
Less:	Depreciation for FY 2010 – 2011 at 15%	9.00
	WDV as on 1.4.2011	**51.00**
Less:	Depreciation for FY 2011 – 2012 at 15%	7.65
	Closing WDV as on 31.3.2012	**43.35**

Step 2: Computation of Profits of Unit X and Unit Y

	Particulars	Unit X	Unit Y
	Profits as per Profit and Loss Account	63.00	36.00
Add:	Depreciation as per Books (apportioned in the ratio of 3:2, i.e., Sales Ratio)	5.40	3.60
Less:	Depreciation as per Income Tax Act (apportioned in the ratio of 3:2, i.e., Sales Ratio)	(4.59)	(3.06)
	Profits of the Business u/s Section 10AA	**63.81**	**36.54**

Note: Profit includes Profits from On–Site Development of Computer Software outside India for the purpose of determining Profits and Gains derived from export of Computer Software outside India.

Step 3	**Computation of Export Turnover**	Export Turnover = Total Export Sales **Less** Unrealized Forex = ₹120 Lakhs **Less** ₹ 20 Lakhs = **₹ 100 Lakhs**
Step 4	**Computation of Exemption**	Exemption = 100% of Profits of Business × Export Turnover ÷ Total Turnover = ₹ 63.81 Lakhs × ₹ 100 Lakhs ÷ ₹ 180 Lakhs **= ₹ 35.45 Lakhs**
Step 5	**Computation of Taxable Business Income**	Profits of Business **Less** Sec.10AA Deduction = 63.81 lakhs **Less** ₹ 35.45 Lakhs **= 28.36 Lakhs**

Note: Unit Y is located in the Free Trade Zone and is not eligible for deduction u/s 10AA, even though it has made exports during the previous year.

Question 1(b): Valuation of Partners' Interest in a Firm M 12 (4 Marks)

The Net Wealth of a Firm consisting of two partners S & K having 3:1 share and a Capital Contribution of ₹ 7,50,000 and ₹ 2,50,000 respectively is as under,

1. Value of Assets located outside India ₹ 15 Lakhs.
2. Value of Assets located in India ₹ 40 Lakhs.
3. Debts incurred in relation to Assets in India ₹ 5 Lakhs.

Determine the value of Interest of the Partners in the Firm under the Wealth Tax Act, 1957.

Solution: Similar to Question No. 72, Page 45.41 of "Direct Taxes – A Ready Reckoner – AY 2012–2013"

Assesses: S and K Valuation Date: 31.3.2012 Assessment Year: 2012–2013

Computation of Net Wealth of the Firm

	Particulars	Amount	Amount
	Value of Assets located in India	40,00,000	
Less:	Liability in relation to assets in India	5,00,000	35,00,000
	Value of Assets located outside India		15,00,000
	Net Wealth of the Firm		**50,00,000**

Computation of Interest of the Partner in the Net Wealth of the Firm (Amount in ₹)

Particulars	Amount	Amount
To the extent of Capital Contribution	7,50,000	2,50,000
Balance (Net Wealth – Capital Contribution) in Profit Sharing Ratio since Dissolution Ratio is not given	30,00,000	10,00,000
Interest of the Partner in the Net Wealth of the Firm	**37,50,000**	**12,50,000**

Computation of the Interest of the Partner in the Net Wealth of the Firm on the basis of Location of Assets:

Particulars	S	K
Assets Located Inside India (35/50th of Interest of the Partners in the Net Wealth)	26,25,000	8,75,000
Assets Located Outside India (15/50th of Interest of the Partners in the net wealth)	11,25,000	3,75,000
Interest of the Partner in the Net Wealth of the Firm	**37,50,000**	**12,50,000**

Question 1(c): Wealth Escaping Assessment and Reference to Valuation Officer M 12 (3 Marks)

(a) What are the cases where it is deemed that Net Wealth chargeable to tax has Escaped Assessment u/s 17 of the Wealth Tax Act, 1957?

(b) Can the Assessing Officer u/s 16A of Wealth Tax Act, 1957 refer Valuation of Assets to the Departmental Valuation Officer for the purpose of making an Assessment in a case where no return of Wealth has been filed by the Assessee?

Solution:

(a) **The following shall be deemed to be cases where Wealth has Escaped Assessment –**

- Where no return of net wealth had been furnished by the Assessee although his Net Wealth or the Net Wealth of any other person in respect of which he is assessable under this Act on the valuation date, exceeds the maximum amount which is not chargeable to Wealth Tax.
- Where return of Net Wealth has been furnished by the Assessee but no Assessment has been made and it is noticed by the Assessing Officer that the Assessee has understated the Net Wealth or has claimed excessive exemption or deduction in the return.

(b) **Reference to Valuation Officer**:

- **Refer Question No. 80, Page 45.48 of "Direct Taxes – A Ready Reckoner – AY 2012–2013"**
- A reference u/s 16A(1) could be made even where no return has been filed by the assessee u/s 14 or 15. **[Anil Tayal (HUF) 285 ITR 243 (P&H)]**
- Based on the above provisions the Assessing Officer has the power to refer the valuation of asset even if no return of wealth has been filed by the Assessee.

Question 1(d): Schedule III of Wealth Tax Act, 1957 M 12 (3 Marks)

State the circumstances in which Schedule III shall not apply for valuation of Immovable Property.

Solution: Refer Question No. 69, Page 45.39 of "Direct Taxes – A Ready Reckoner – AY 2012–2013"

Question 2: Computation of Normal Tax Payable and MAT M 12 (16 Marks)

S Ltd, engaged in the Business of Manufacturing, shows a Net Profit of ₹ 5 Crores for the Financial Year ended 31.03.2012, after debiting / crediting the following items:

(a) On EPABX and Mobile Phones (exclusively used for the Business Purpose) purchased during the year, on which depreciation amounting to ₹ 18 Lakhs was claimed at higher rate of 60% treating them at par with computer.

(b) ₹ 50 Lakhs paid to N Ltd, towards feasibility study conducted for examining proposals for technological advancement relating to the existing business, where the project was abandoned without creating a new asset.

(c) ₹ 35 Lakhs paid on the higher studies of the Director's son abroad, with a stipulation that he would be appointed as a trainee in the Company under "Apprentice Training Scheme" where there was no evidence of existence of such scheme.

(d) Payment of ₹ 29 Lakhs towards purchase of software from a Non–Resident, meant for subsequent resale in the Indian Market (No Tax deducted at source) was ultimately sold at a profit during Financial Year 2011–2012.

(e) Dividend of ₹ 10 Lakhs received from a Foreign Company in which Company holds 28% in Nominal Value of the Equity Share Capital of the Company. ₹ 0.25 Lakh expended on earning this Income.

(f) A Machine in use since past 7 Financial Years having WDV amounting to ₹ 1.50 Lakhs on 01.04.2010 was discarded on 3rd September, 2010. The depreciation on the block at 15% has been provided and charged to Profit and Loss Account for the Previous Year ended 31st March, 2012. The entire block is used for the purpose of business.

(g) ₹ 45 Lakhs were paid on 3rd June, 2011 to a National Laboratory with a stipulation that the said contribution shall be used for the purpose of an approved Scientific Research Programme only.

(h) Secret Commission of ₹ 13 Lakhs was paid and debited under Commission Account.

(i) Purchased a Brand new Bus and donated to a school where the Employees' Children were studying and debited the same to the Workmen and Staff Welfare Account.

Additional Information:

A Debt of ₹ 10 Lakhs was claimed as Bad Debt in the Previous Year 2010–2011. However, the Assessing Officer allowed only a Sum of ₹ 5 Lakhs as Bad Debts. In the Previous Year 2011–2012, a sum of ₹ 4 Lakhs is recovered ultimately in respect of the debt.

Compute Total Income of S Ltd for the Assessment Year 2012–2013 and work out the amount of tax payable on such Income, indicating reasons for treatment of each item.

Solution:

Assessee: S Ltd **Previous Year: 2011–2012** **Assessment Year: 2012–2013**

1. Computation of Total Income and Tax Payable

Particulars	**Amount in ₹ Lakhs**			
	W.N.	**Add**	**Deduct**	**Amount**
Net Profit as per Profit and Loss A/c				**500**
Depreciation on EPABX and Mobile Phone as per books	**1**	18	–	
Depreciation on EPABX and Mobile Phone as per the Act [(18÷60%)×15%]		–	4.50	
Expenses on Feasibility Study of Project	**2**	NIL	NIL	
Expenditure on Director Son's higher studies	**3**	35	–	
Purchase of Software from Non–Resident for resale	**4**	NIL	NIL	
Dividend from Foreign Company	**5**	0.25	10	
Depreciation on Machinery Discarded	**6**	NIL	NIL	
Donation to National Laboratory [(45×200%)–45]	**7**	–	45	
Secret Commission	**8**	13	–	
Donation of Bus to a School where Employees Children are studying	**9**	NIL	NIL	
Bad debts on Final Settlement of Debt	**10**	–	5	
		66.25	(64.50)	1.75
Profits and Gains of Business or Profession				**501.75**
Income from Other Sources – Dividend Income from Foreign Company **[W.N. 5]**				10
Gross Total Income				**511.75**
Less: Deductions under chapter VIA				NIL
Total Income				**511.75**
Computation of Tax Payable				
Tax on Business Income [501.75 × 30%]				150.525
Tax on Dividend from Foreign Company [10 × 15%]				1.50
Total Tax Payable (A)				**152.025**

2. Computation of MAT u/s 115JB

Particulars	Add	Deduct	₹ Lakhs
Net Profit as Per Profit and Loss A/c			500
Depreciation debited in Profit & Loss Account	18		
Depreciation in books except relating to revaluation of assets		4.50	
	18	4.50	13.50
BOOK PROFITS			**513.50**
MAT at 18.5% u/s 115JB (B)			**95.00**

3. Computation of Tax Liability

	Particulars	Amount
	Tax Payable **(Higher of A or B from above)**	152.025
Add:	Surcharge at 5% (Since Total income exceeds ₹ 1 Crore)	7.601
	Total Tax Payable	159.626
Add:	Education Cess at 2%	3.193
Add:	Secondary and Higher Education Cess at 1%	1.596
	Tax Payable	**164.415**

Working Notes:

1. EPABX and Mobile Phones are not computers and therefore not entitled to higher rate of depreciation at 60% **[Federal Bank Limited Vs ACIT 322 ITR 319].**
2. The feasibility studies were conducted for the existing business with a common administration and common fund and the studies were abandoned without creating a new asset, the expenses were of Revenue Nature. **[CIT Vs Priya Village Roadshows Limited. (2011) 322 ITR 594 (Del.)].** Hence, no adjustment needs to be made.
3. Expenditure incurred on higher studies of Director's son is not allowed as deduction, since there was no evidence of existence of such scheme **[Echjay Forgings Ltd Vs Asst. CIT (2010) 328 ITR 286 (Bom.)].**
4. If Purchase of software from Non Resident is used for subsequent resale in Indian market then such payment cannot be treated as royalty and provision of 40(a)(i) for non deduction of TDS shall not attract. **[CIT Vs Dynamic Vertical Software India P Limited 332 ITR 222 (Del.)].** Hence, no adjustment needs to be made.
5. Dividend Income from Foreign Company in which S Ltd holds 28% of Nominal Value of Equity Capital is taxable under the head Income from Other Sources at 15% u/s 115BBD and expenditure incurred is not deductible.
6. As per provisions of Sec 43(6), amount payable in respect of any asset which is sold, discarded, demolished or destroyed is to be reduced from the WDV of the Block. In the given case no money is received in respect of machinery discarded hence depreciation can be claimed from that block.
7. As per provisions of Sec 35(2AA) contribution to National Laboratory is eligible for weighted deduction at 200%.
8. The secret commission paid by the Assessee to procure business is not deductible u/s 37. **[Tarini Tarpaulin Productions 254 ITR 495 (Guj.), GG Joshi 209 ITR 324 (Guj.)]**
9. Purchase of bus by assessee & donating the same to a school where the children of its employees were studying is an Employee Welfare Expenditure eligible for deduction u/s 37. **[Rajasthan Spinning & Weaving Mills Ltd 281 ITR 408 (Raj.)]**
10. As per provisions of sec 36(1)(vii), if any bad debts written off in books is not fully allowed in any previous year by Assessing Officer and any sum is received in final settlement which is less than Bad debts to be allowed then the balance can be claimed as deduction u/s 36(1)(vii). Allowable expenditure is 1 Lakh (10 – 5 – 4) and the recovery of 4 Lakhs credited in the Profit and Loss Account is also reversed.

Question 3(a): Determination of Expenditure in relation to Exempt Income u/s 14A — M 12 (6 Marks)

Mr. W has provided the following information regarding his income and expenditure of the Previous Year 2011–2012.

Particulars	Amount
Income from Business (computed)	5,00,000
Dividend Income from Money Market Mutual Funds	1,25,000
Share of Profit from Firm	85,000
Consultancy charges to Mutual Fund Agent	15,000
Interest Expenditure relating to both taxable and Non–taxable Income	2,25,000

Value of Investments in Mutual Funds units as on First and Last Day of the Previous Year are ₹ 5,00,000 and ₹ 3,00,000.

Value of Total Assets as appearing in Balance Sheet as on First day & Last day of the Previous Year are ₹ 50,00,000 & ₹ 70,00,000

Mr. W claims that no expenditure was incurred by him for exempt income earned.

Assessing Officer is not satisfied with the correctness of the claim of Assessee in respect of expenditure in relation to exempt income

You are required to compute the amount of expenditure incurred in relation to exempt income and resultant total income, assuming that Mr. W has no other income.

Solution: Computation of Expenditure in relation to Exempt Income –

For Provisions of Section 14A – Refer Question No. 2, Page 3.1 of "Direct Taxes – A Ready Reckoner – AY 2012–13"

Particulars	₹
Expenditure directly related to Exempted Income [Consultancy Charges paid to Mutual Fund Agent]	15,000
Interest Expenditure not directly related to exempted Income [2,25,000 × 4,00,000/60,00,000]	15,000
0.5% of the average Investment, Income from which is exempted [4,00,000 × 0.5%]	2,000
Total	**32,000**

Assessee: W **Previous Year: 2011–2012** **Assessment Year: 2012–2013**

Computation of Total Income

Particulars	₹
Income from Business or Profession (5,00,000 + 32,000)	5,32,000
Share of Profit from Firm [Fully Exempt u/s 10(2A)]	NIL
Income from Other Sources – Dividend from Mutual Fund [Fully Exempt u/s 10(35)]	NIL
Gross Total Income	5,32,000
Less: Deductions under Chapter VIA	Nil
Total Income	**5,32,000**

Question 3(b): Sale of Shares – Capital Gains Vs Business Income M 12 (5 Marks)

Often controversies arise between the Assessee and the department on the Issue of treatment of Gain arising out of transactions of Sale and Purchase of Shares and Securities.

Based on the Judicial Decisions, narrate the significant points of distinction in order to judge the purpose and motive of the Assessee for its different treatment as Income from Business or Income from Capital Gains.

Solution:

1. If the original Intention was to hold the shares as Investment, the Gains resulting from the sale of such shares will be Capital Gains. If the original intention was to carry on the activities of purchase and sale and hold the shares as stock in trade, the gains resulting from the sale of such shares will be taxable under Profits and Gains of Business or Profession.
2. If the intention is to earn profit from the transaction of purchase and sale of shares and securities then the income from purchase and sale of shares and securities will be business income. On the other hand, if the motive is to earn dividend or interest from investment in shares and securities, the income from purchase and sale of shares and securities will be capital gains.

Question 3(c): Revision of Order passed by Settlement Commission M 12 (5 Marks)

On an application made by Mr. Pandey, an order was passed by the Settlement Commission on 03.01.2012 u/s 245D. The said order had a mistake apparent on record. The Settlement Commission passed an amended order dated 30.04.2012 which resulted in modifying the liability of Mr. Pandey.

Mr. Pandey is of the view that order of the Settlement Commission is final and conclusive and it has no power to rectify the said mistake.

You are required to examine the following:

(a) Correctness of claim made by Mr. Pandey.

(b) Validity of the Order amended by the Settlement Commission.

Solution:

1. **Principle: Refer Question No. 8, Point 4, Page 35.6 of "Direct Taxes – A Ready Reckoner – AY 2012–13"**
2. **Analysis:** In the given case Settlement Commission amended an order to rectify a mistake apparent from the record which resulted in modifying the liability, on 30.04.2012 which is within 6 months from the original order passed. The information as to the notice to the applicant and the commissioner is not specified in the given case. Hence it is assumed that the same has not been provided to the Assessee and the Commissioner.
3. **Conclusion:**
   (a) Since Settlement Commission has the power to rectify the mistake apparent from the record within 6 months from the date of the order, the claim made by Mr. Pandey is not correct.
   (b) Settlement Commission has not given an opportunity of being heard to the Assessee and the Commissioner, and hence the order passed by Settlement Commission modifying the Liability is not valid.

Question 4(a): Non Deduction of TDS – Duty for payment of Interest M 12 (4 Marks)

MNO Limited paid a sum of ₹ 15 Lakhs as salary to Mr. X for which no tax was deducted at source by the Company. Mr. X filed his return of income and paid the tax due by way of Self Assessment. Assessing Officer issued notice to Mr. X demanding Interest u/s 234B as no advance tax was paid by him. Your opinion is sought on the following aspects,

(a) Is the action of AO Valid?

(b) If not, is there any other means available to AO to recover the Interest?

Solution:

1. **Principle:** Where the Assessee's Income is chargeable under the head Salaries, person responsible for paying any income chargeable under the head Salaries shall at the time of paying, deduct tax at source and failure on his part entails an obligation to pay Interest u/s 234B in order to compensate loss incurred to revenue and that upon failure on part of employer to deduct the tax at source, assessee only becomes liable to pay tax directly u/s 191 and does not become liable to pay Interest u/s 234B **[DIT Vs Maersk Co. Ltd. (2011) (Uttarakhand – FB)]**
2. **Analysis and Conclusion:**
   (a) In the given case, since MNO Ltd has failed to deduct tax at source for the salary paid to Mr. X, it shall be liable to pay Interest u/s 234B. Mr. X is liable to pay only the tax and not the Interest u/s 234B.
   (b) Thus, the action of the Assessing Officer is **not valid**. However, the Assessing Officer can recover the Interest from the Employer (MNO Ltd).

Question 4(b): Deduction of TDS u/s 194H M 12 (4 Marks)

B Airways Ltd. sold tickets to the travel agents in India at a minimum fixed commercial price. The agents were permitted to sell the tickets at a higher price, however up to a maximum of published price. Commission at the rate of 9% of published price was payable to the agents of the Airlines Company, on which tax was deducted u/s 194H by the Company. The Assessing Officer raised the issue of further liability of tax deduction at source on the amount of difference between the actual sales price and minimum fixed commercial price by treating it as "additional special commission" in the hands of the agents.

Whether the contention raised by the Assessing Officer is tenable in law? Critically examine.

Solution:

1. **Principle:**
   (a) The difference between the Actual Sale Price and Fixed Minimum Commercial Price cannot be taken as additional special commission on the hands of the agents, since the published price was the maximum price and Airline Company granted permission to the agents to sell the tickets at a price lower than the published price.
   (b) In order to deduct tax at source, the exact income in the hands of the agents must necessarily be ascertainable by the Airline Company. However the Airline Company would have no information about the exact rate at which the tickets were ultimately sold by its agents, since the agents had been given discretion to sell the tickets at any rate between the Fixed Minimum Commercial Price and Published Price. The difference cannot be treated as commission or brokerage.
   (c) Tax at source was not deductible on the difference between the Fixed Minimum Commercial Price and the Published Price, even though the amount earned by the agent over and above fixed minimum commercial price would be taxable as Income in his hands. **[CIT Vs Quatar Airways (2011) 322 ITR 255 (Bom.)]**
2. **Analysis and Conclusion:** Hence, B Airways Ltd need not deduct TDS u/s 194H on the difference between Fixed Minimum Commercial Price and the Published Price and therefore, the contention of the Assessing Officer is not tenable in law.

Question 4(c): Revocation of Exemption u/s 10(23C) M 12 (4 Marks)

Teachwell Education is a trust approved u/s 10(23C)(vi) which runs various Educational Institutions. During the course of Assessment u/s 143(3), the Assessing Officer, finds that the trust has carried out its activities in contravention of the Section under which it was approved for exemption. Hence, Assessing Officer wants to pass an order without giving exemption u/s 10, which the Assessee objects. You are required to examine the following with respect to the provisions of the Income Tax Act, 1961.

(a) Whether the Assessing Officer can pass an order without giving exemption u/s 10?

(b) Can the Assessing Officer get any additional time limit in completing this Assessment?

Solution:

1. **Principle:**
   (a) The Assessing officer has the power to recommend for withdrawal of approval to the institutions referred u/s 10(23C), who have not carried their activities as per the approved conditions.
   (b) Period commencing from the date on which the Assessing Officer **intimates the contravention of conditions to the Central Government** or the prescribed authority and ending with the **date of receipt of order withdrawing the approval** under Sections 10(23C) is excluded from the time limit for passing Assessment Order.
   (c) If the number of remaining period available for completing the assessment is less than 60 days, then the minimum remaining period available for completing the assessment will be taken as 60 days.

2. **Analysis and Conclusion:** Based on the above provisions, the Assessing Officer can only recommend for withdrawal of exemption u/s 10(23C) and the Assessing Officer can get additional time for completing the Assessment since the period of intimation to the prescribed Authority is excluded from the time limit of passing Assessment Order.

Question 4(d): Notice u/s 133 to Banks about Customers M 12 (4 Marks)

The Assessing Officer issued notices u/s 133 to four banks requiring particulars relating to a customer in a specific format duly verified in a prescribed manner. One of the Banks refused to part with the information on the ground that the letter did not specify about any proceeding pending against the said customer under the Income Tax Act. Discuss the correctness of action of the Bank in refusing to furnish the particulars as required by the Assessing Officer.

Solution: Refer Question No. 11, Page 30.6 of "Direct Taxes – A Ready Reckoner – AY 2012–2013"

Question 4(e): Determination of Deemed Dividend u/s 2(22)(e) M 12 (4 Marks)

Dhaval is in business of manufacturing customized kitchen equipments. He is also the Managing Director and held nearly 65% of the paid up share capital of Aarav Ltd. A substantial Part of the Business of Dhaval is obtained through Aarav Ltd. For this purpose Aarav Ltd passed on the advance received from its customers to Dhaval to execute the job work entrusted to him.

The Assessing Officer held that the advance money received by Dhaval is in the nature of loan given by Aarav Ltd to him and accordingly is deemed dividend within the meaning of provisions of Section 2(22)(e) of the Income Tax Act, 1961. The Assessing Officer, therefore made the addition by treating advance money as the Deemed Dividend Income of Dhaval.

Examine whether the action of the Assessing Officer is tenable in law.

Solution:

1. **Principle:** Financial transactions cannot under any circumstances be treated as Loans or Advances received by the Assessee from the concerns for the purpose of Section 2(22)(e). **[CIT vs Ambassador Travels Pvt. Ltd. 318 ITR 376]**
2. **Analysis and Conclusion:**
   (a) Based on the above provisions the advance money received by Mr. Dhaval to execute job work in the ordinary course of business shall not be treated as dividend u/s 2(22)(e) and thus the action of the Assessing Officer is not tenable in law.
   (b) The Company's name is Aarav Ltd and information of whether the company is closely held or not is not specified in the question. Therefore if it is assumed that the Company is widely held, the provisions of Section 2(22)(e) will not apply at all.

Question 5(a): Transaction with a Person in Notified Jurisdictional Area u/s 94A M 12 (4 Marks)

RV Ltd, an Indian Co., exports grapes to DK Inc for an amount of ₹ 30 Lakhs. DK Inc is located in a Notified Jurisdictional Area (NJA).

RV Ltd charges ₹ 38 Lakhs and ₹ 40 Lakhs for sale of similar goods to CC Inc and MM Inc respectively which are not located in NJA and both of them are not associated enterprises of RV Ltd.

Assuming that permissible variation notified by Central Government for such class of International Transactions is 6% of the Transaction Price, state the tax implications u/s 94A in respect of the above transaction by RV Ltd to DK Inc.

Solution:

1. **Principle: Refer Page 25.2, Question No. 3 of "Direct Taxes – A Ready Referencer – AY 2012–2013"**
2. **Analysis:**
   (a) Since DK Inc is located in a NJA, the transaction of Export of Grapes by the Indian Company would be deemed to be an International Transaction and DK Inc and RV Ltd would be deemed to be Associated Enterprises. Therefore the Provisions of Transfer Pricing would be attracted in this case.
   (b) The Prices of ₹ 38 Lakhs and ₹ 40 Lakhs for sale of similar goods to CC Inc and MM Inc respectively being independent entities located in a Non Notified Jurisdictional Area country, can be taken into consideration for determining the Arm's Length Price (ALP) under Comparable Uncontrolled Price Method.
3. **Conclusion:**
   (a) Since more than one price is determined by the Method, the ALP would be the Arithmetical Mean of such prices.
   (b) Therefore the ALP = ₹ 39,00,000 [(₹ 38,00,000 + ₹ 40,00,000) ÷ 2]
   (c) Transfer Price = ₹ 30,00,000.
   (d) Since the ALP is more than the Transfer Price, the ALP of ₹ 39,00,000 would be considered as the Income arising from the International Transaction between RV Ltd and DK Inc.

Note: The benefit of permissible variation between the ALP and the Transfer Price at the rate notified by the Central Government (In this case 6%) for a particular class of International Transaction would not be available where Transfer Pricing Provisions are attracted u/s 94A. Therefore, it is not necessary to determine the impact (If any) of such permissible variation.

Question 5(b): Determination of Permanent Establishment M 12 (4 Marks)

The existence of a Website on Indian Soil constitute a Permanent Establishment. Is this statement correct? Examine.

Solution:

1. **Principle:**
   - (a) The term Permanent Establishment **generally** incorporated in Article 5(2) of all DTAA includes – a place of management, branch, office, factory, workshop, sales outlet, warehouse in relation to a person providing storage facilities for others, farm, plantation or other place where agricultural, forestry, plantation or related activities are carried on and a mine, an oil or gas well, a quarry or any other place of exploration or extraction of natural resources.
   - (b) A Non–resident / Foreign Company is treated as having a Permanent Establishment in India if it carries on business in India through –
     - (i) **A Branch, Sales Office**, or
     - (ii) **An Agent** (other than independent agent) who habitually exercises an authority to conclude contracts or regularly delivers goods or merchandise or habitually secures orders on behalf of the non–resident principal.
2. **Analysis and Conclusion:** Based on the above provisions, if the website contains merely information about the concern, the website cannot be regarded as a Permanent Establishment. Where the website is being used as a virtual office transacting orders of purchases or sales or for rendering services, then it could be regarded as a Permanent Establishment.

Question 5(c): Powers of AAR M 12 (4 Marks)

State the powers of the Authority for Advance Ruling under the Income Tax Act, 1961.

Solution:

U/s 245U, Authority for Advances Ruling has all the powers of a Civil Court as defined u/s 131 of the Income Tax Act, 1961. They are as follows, when trying a case –

1. Discovery and Inspection
2. Enforcing attendance of any person
3. Compelling production of books of accounts and documents
4. Issuing Commissions / summons.

Question 5(d): Refund of Excess Tax Paid in case of a DTAA M 12 (4 Marks)

In order to overcome a situation where the tax is deducted at a rate prescribed in the relevant Double Taxation Avoidance Agreement which is higher than the rate prescribed in the Income Tax Act, 1961, CBDT recently has clarified this issue, to avoid genuine hardship faced by the resident deductor. Explain in brief the contents of this CBDT Circular.

Solution: Refer Question No. 52, Page 39.27 of "Direct Taxes – A Ready Reckoner – AY 2012–2013"

Question 6(a): Capital Gains Account Scheme M 12 (3 Marks)

What are the consequences if the amount deposited in Capital Gains Account Scheme to avail exemption from Capital Gains is not utilized within the stipulated time. Is there any difference in the tax treatment in the event of death of the assessee, before the stipulated time?

Solution:

1. Amount deposited in the Capital Gains Account Scheme and **not utilized** within the prescribed period shall be **treated as LTCG or STCG of the previous year in which prescribed period expires**.
2. If the Unutilised money is kept by an Individual in Capital Gain Account Scheme and he died before the prescribed period of investments in the said Sec.54, 54B, 54D, 54G, then it shall **neither be taxed in the hands of the deceased nor in the hands of legal heirs**. **[Circular No. 743 dt. 06.05.1996]**

Question 6(b): Carry Forward of Losses in case of Death of the Assessee M 12 (3 Marks)

X carrying on a Business as Sole Proprietor, died on 31st March, 2011. On his death, the same Business was continued by his Legal Heirs, by forming a Firm. As on 31st March 2011, a determined Business Loss of ₹ 5 Lakhs is to be carried forward, under the Income Tax Act, 1961. Does the Firm consisting of all Legal Heirs of Mr. X, get a right to have this Loss adjusted against its Current Income?

Solution:

1. **Principle:** On death of an individual, if the legal heirs carry on the business of the individual by **forming a Partnership Firm**, the **Firm is entitled to carry forward the loss of the individual**. [Sec.78] **[Madhukant Metha 247 ITR 805 (SC)]**
2. **Analysis:** In the instant case, the carry forward business loss in the hands of late Mr. X can be set off against the income of the firm subject to the following conditions:
   (a) The legal heirs are the only partners and no other outsiders are involved
   (b) The business carried on belongs to the deceased assessee.
3. **Conclusion:** In view of the Supreme Court decision given above, they are entitled to carry forward and set off Mr. X's business loss of ₹ 5 Lakhs.

Question 6(c): Indexation in case of Capital Gains M 12 (7 Marks)

State the cases, where the benefit of Indexation of Cost is not available for determination of Capital Gains.

Solution: Refer Question No. 16, Page 7.7 of "Direct Taxes – A Ready Reckoner – AY 2012–2013"

Question 6(d): Undisclosed Income u/s 69D M 12 (3 Marks)

Mr. C borrowed on Hundi, a sum of ₹ 15,000 by way of bearer cheque on 11.09.2011 and repaid the same with Interest amounting to ₹ 20,000 by Account Payee Cheque on 12.10.2011.

Assessing Officer wants to treat the amount borrowed as Income during the Previous Year. Is the action of Assessing Officer Valid?

Solution:

1. **Principle:**
   (a) The amount is **borrowed** on a **Hundi** or the same was **repaid otherwise** than through an **Account Payee Cheque,** the amount so **borrowed or repaid** shall be **treated as income** of the person borrowing or repaying the amount for the previous year in which the amount was borrowed or repaid.
   (b) The amount repaid shall include the **amount of interest paid** on the amount **borrowed**.
   (c) Any amount borrowed on Hundi and treated as income u/s 69D shall not be taxed once again at the time of repayment.
2. **Analysis and Conclusion:** In the given case, the amount is borrowed by way of Bearer Cheque and the repayment is by way of Account Payee Cheque. Hence the contention of the Assessing Officer to treat the amount borrowed as Income during the Previous Year is valid.

Note: However, the provisions of Section 269SS on Mode of taking or accepting Loans and Deposits allows a limit of ₹ 20,000. Applying those principles in the above scenario, the amount borrowed and repaid shall not be treated as Income.

Question 7(a): TCS Provisions M 12 (5 Marks)

What are the consequences of not collecting Tax at Source (TCS) in respect of sale of scrap by a manufacturing Company? State the circumstances under which the TCS provisions are not applicable in the above case.

Solution: Refer Question No. 78, Page 39.37 of "Direct Taxes – A Ready Reckoner – AY 2012–2013"

Question 7(b): Obligation for Filing of Return of Income M 12 (4 Marks)

State with reasons whether Return of Income is to be filed in the following cases for the Assessment Year 2012–2013:

(a) Mr. X, an Individual aged 80 years has a Gross Total Income of ₹ 6,50,000 and he is eligible for deduction of ₹ 1,60,000 under Chapter VI–A.
(b) ABC, a Partnership Firm, has a loss of ₹ 10,000 during the Previous Year 2011–2012.
(c) A registered Association, eligible for exemption u/s 10(23B), has income from House Property of ₹ 2,10,000.
(d) Mr. Y is an employee of ABC P Ltd, draws a Salary of ₹ 4,90,000 and has income from fixed deposits with Bank of ₹ 10,000.

Solution:

Assessee	**Filing of Return of Income**	**Reason**
Mr. X	Yes	Gross Total Income exceeds maximum amount not chargeable to tax i.e. ₹ **5,00,000**. **[Sec.139(1)]**
ABC, Partnership Firm	Yes	Firms and Companies are **mandatorily required** to file their return of income irrespective of their profitability. **[Sec.139(1)]**
Registered Association u/s 10(23B)	Yes	Gross Total Income exceeds maximum amount not chargeable to tax i.e. ₹ **1,80,000**. **[Sec.139(1)]**
Mr. Y	Yes	Provisions of Section 139(1C) shall apply in cases where the Interest is from a Saving Account. Since, in this case, the Interest is from a Fixed Deposit, and the Assessee has Gross Total Income greater than the Basic Exemption Limit, the Assessee has to file the Return of Income.

Question 7(c): Treatment for various Gifts M 12 (7 Marks)

Mr. X received the following gifts / amounts during the Previous Year 2011–2012,

(a) Gift of Bullion worth ₹ 60,000 on his Birthday from his friend.

(b) Received a Car from his cousin on payment ₹ 1 Lakh, Fair Market Value of which was ₹ 4 Lakhs.

(c) Received Cash Gift of ₹ 18,000 each from three of his friends A, B & C on 24.09.2011.

(d) Acquired an office building on 22.11.2011 from his friend Q for a consideration of ₹ 10 Lakhs, stamp value of which is ₹ 20 Lakhs.

(e) In respect of Land of Mr. X acquired by Railways in the year 2009, he received the following amount on 25.12.2011 as interest on enhanced compensation on the order of the court,

Relating to Previous Year	Amount
2009–2010	1,45,000
2010–2011	1,75,000
2011–2012	1,10,000

You are required to compute the Income of Mr. X chargeable under the head "Income from Other Sources" for the Assessment Year 2012–2013 assuming that he has no other Income.

Solution:

Assessee: Mr. X **Previous Year: 2011–2012** **Assessment year: 2012–2013**

Computation of Income from Other Sources

Particulars	**Reasons**	**₹**
Gift of Bullion from friend on his Birthday	Bullion is received without consideration and aggregate Fair Market Value exceeds ₹ 50,000 and hence taxable u/s 56.	60,000
Receipt of Car	Car is not a notified property as specified in the Explanation to Section 56(2)(vii)	NIL
Cash Gift	Any Sum of money received without consideration and aggregate exceeds Rs 50,000 is taxable u/s 56.	54,000
Acquisition of Building	Immovable Property is acquired for consideration and hence it is not taxable as a gift u/s 56.	Nil
Interest on Enhanced Compensation	Taxable in the year of receipt u/s 145A and a deduction of 50% is allowed u/s 57 (4,30,000 – 2,15,000)	2,15,000
Income from other sources		**3,29,000**

Recent Amendments

Computation of Indexed Cost of Acquisition for LTCG

CII for transfer of Gifted Asset	If an Assessee acquired a Capital Asset by way of Gift and transferred such Asset, then Indexed Cost of Acquisition would be with reference to the year in which previous owner held the asset and not the year in which assessee became the owner. Therefore the CII should be based on the year in which the previous owner acquired the asset and not the year in which the assessee became the owner. **[CIT Vs. Manjula J. Shah 16 Taxmann 42 (Bom.)] and [Arun Shungloo Trust Vs. CIT 205 Taxmann 456 (Del.)]**

Note: FMV = Fair Market Value, **CII** = Cost Inflation Index, **ICA / ICI** = Indexed Cost of Acquisition / Improvement.

When asset is acquired by assessee or Assessee received the Asset u/s 47 from transferor –

A. Indexed Cost of Acquisition (ICA):

1. **Acquired prior to 1.4.1981:**

$$ICA = \frac{\text{FMV on 1.4.1981 or (Cost of Acquisition of Assessee / Previous Owner whichever is high)} \times \text{CII for year of transfer}}{100}$$

2. **Acquired on or after 1.4.1981:**

$$ICA = \frac{\text{Cost of Acquisition incurred by Assessee or Previous Owner} \times \text{CII for year of transfer}}{\text{CII for year of acquisition of Assessee or Previous Owner}}$$

B. Indexed Cost of Improvement (ICI): (in both the above cases A.1 and A.2)

$$ICI = \frac{\text{Cost of improvement incurred by Assessee or Previous Owner} \times \text{CII for year of transfer}}{\text{CII for year of improvement}}$$

Note: ICI can be computed **only** if it is incurred **on or after 01.04.1981.**

Important Case Laws

Face value of DEPB is taxable u/s 28(iiib) in the year in which assessee applies for DEPB credit against exports while the excess of sales proceeds of DEPB over its face value is taxable under section 28(iiid) in the year of transfer. **[Topman Exports vs CIT 18 Taxmann 120 (2012)(SC)]**
• The provisions of Sections 36(1)(vii) and 36(1)(viia) of the Act are distinct and independent items of deduction and operate in their respective fields. • The bad debts written off in debts, other than those for which the provision is made under clause (viia), will be covered under the main part of Section 36(1)(vii), while the proviso will operate in cases under clause (viia) to limit deduction to the extent of difference between the debt or part thereof written off in the previous year and credit balance in the provision for bad and doubtful debts account made under clause (viia). • The proviso would not permit benefit of double deduction, operating with reference to rural loans while under Section 36(1)(vii), the assessee would be entitled to general deduction upon bad debts written off as irrecoverable in his accounts. **[Catholic Syrian Bank Ltd Vs CIT 18 Taxmann 282 (SC)]**
Share Broker is entitled to deduction u/s 36(1)(vii) in respect of Non– payment of purchase price of shares by client. **[CIT Vs Shreyas S Morakhia 19 Taxmann 64 (Bom) 2012]**
Expenditure incurred by Airport Authority towards removal of illegal encroachments in and around Security Area of Airports and towards rehabilitation of encroachers would be allowed as Revenue Expenditure. **[Airport Authority of India Vs CIT 18 Taxmann 174 (2012)(Del.)]**
Keyman insurance policy premium allowable as business expenses. Merely because the policy was assigned after sometime would not mean that the expenditure incurred in the first instance would lose the flavour of it being "business expenditure". **[Rajan Nanda vs CIT 18 Taxmann 98 (2012)(Del.)]**
Assessing Officer cannot disregard method of accounting followed by assessee based on Guidance Note of ICAI. The Guidance Note reflects the best practices adopted by accountants the world over and has not attained any mandatory status. **[CIT Vs Virtual Soft Systems Ltd 18 Taxmann 119 (Del.)]**
Where a Company was assessed u/s 143(3), Sec.147 cannot be invoked merely by reason of a retrospective amendment to Section 115JB. **[Sun Investment (P.) Ltd. Vs ACIT 18 Taxmann 218 (2012)(Del.)]**

U/s 148, while disposing of objections of Assessee, AO stated that Assessee had filed only sketchy details in its return filed in Electronic Form. This is not a valid reason as relevant provisions u/s 139C and 139D expressly make it clear that no document or report can be filed with return of income in Electronic Form. Filing of Document or Report is possible only if a notice is issued u/s 143(2), which was not done in instant case. **[Indivest Pte Ltd., Singapore Vs ADIT (2012) (Bom) 19 Taxmann 216]**
Where an assessment is restored and original demand gets revived from inception, assessee is liable to pay interest u/s 220(2) from that date on unpaid amount. **[Girnar Investment Ltd. Vs CIT (2012) 17 Taxmann 69 (Del.)]**
Levy of penalty under section 271(1)(c) merely on basis of disallowance of expenses u/s 40(a)(i) not justified. **[AT&T Communication Services India Pvt Ltd. Vs. CIT (Del.)(2012) 18 Taxmann 144]**
Technical pleas of mistakes / defects / omissions in notices / summons do not invalidate Assessment Proceedings when no confusion or prejudice is caused by mistakes / defects / omissions. **[CIT Vs Jagat Novel Exhibitors 18 Taxmann 138 (Del.)]**
Sec 44BB(1) and 44BB(3) can be applied simultaneously. Even if a part of the Income falls under "Royalties" or "Fees for Technical Services", there is no scope to assess such receipts under these heads, once it is held that Income is from its Oil Exploration and production activities as envisaged u/s 44BB. **[Global Industries Asia Pacific Pte. Ltd Vs AAR 2012 18 Taxmann 243]**
A place of Business means all Tangible Assets (e.g. Premises, Facilities, Machinery or Equipment or Installations) used for carrying on the business, whether or not they are exclusively used for business purpose. Therefore, even existence of a Computer Server amounts to existence of a PE. **[Areva T&D India Ltd. 18 Taxmann 171 (AAR)]**
Where Non–resident agents rendered services abroad by soliciting export orders, the right to receive commission arises in India when order is executed by applicant in India. TDS u/s 195 shall apply. **[SKF Boilers and Driers Vs AAR 18 Taxmann 325 (Del.) 2012]**
Where employees of an Overseas Entity render services for their Employer in India by working for a specified period for a Subsidiary or Associate Enterprise of their Employer, it will give rise to a service PE. Reimbursement of Salary to overseas Company attracts TDS u/s 195. **[Centrica India Offshore Pvt Ltd (AAR) 2012 19 Taxmann 214]**
Payment for Inspection and Testing Services are Fees for Technical Services: Payment for Inspection, Verification, Testing and Certification (IVTC) services are Fees for Technical Services. Carrying out tests and certifying that goods imported/exported conformed to certain specifications are technical services. Inspection and survey of imported/exported cargo and certifying in relation to quality and price, laboratory testing, certification services for assuring quality, testing of samples, rendering technical assistance in preparation of project reports are Technical Services. **[XYZ Ltd. Vs AAR (Del.) 2012 19 Taxmann 231]**

Important Circulars and Notifications

1. **Grant of Refund of excess TDS – Circular No. 7, dated 23.10.2007 as amended by Circular No. 7, dated 27.09.2011. Addition to the Circumstances for grant of refund:** Where the tax is deducted at a higher rate relying on the relevant provisions of DTAA while a lower rate is prescribed under the Domestic Law.

2. **Notification GSR 848E dated 29.11.2011 –** Notification of National Savings Certificate (IX Issue) Rules, 2011.

3. **Interest Exempt Under The Head Other Sources [Section 10(15)]:**
   (a) Interest on Bonds or Debentures issued by Indian Railway Finance Corporation Ltd. **[Notfn No. 6/2012 dt 14.02.2012]**
   (b) Tax Free, Secured, Redeemable, Non–Convertible Bonds of Rural Electrification Corporation Limited **[Notfn. No. 7/2012 dt 14.02.2012]**

4. Issuance of TDS Certificates in Form 16A downloaded from TIN Website **[W.e.f. 01.04.2012] [C.No 01/2012 dt. 09.04.2012] –**

Nature	Person Involved	Authentication
Mandatory	All Deductors including Government Deductors	By using Digital Signature / Manual Signature