

TAX LAWS

Time allowed : 3 hours

Maximum marks : 100

NOTE : All references to sections mentioned in Part - A of the Question Paper relate to the Income-tax Act, 1961 and the relevant Assessment Year 2010-11 unless stated otherwise.

PART A

(Answer Question No. 1 which is **COMPULSORY**
and **ANY THREE** of the rest from this part)

Question 1

- (a) Choose the most appropriate answer from the given options in respect of the following having regard to the provisions of the relevant direct tax laws :
- (i) Income accruing from agriculture in a foreign country is taxable in the case of an assessee who is —
 - (a) Resident
 - (b) Not-ordinarily resident
 - (c) Non-resident
 - (d) None of the above.
 - (ii) Foreign income received in India during the previous year is taxable in the case of —
 - (a) Resident
 - (b) Not-ordinarily resident
 - (c) Non-resident
 - (d) All of the above.
 - (iii) Manav receives Rs.50,000 as basic salary from the government during the financial year 2009-10 and receives Rs.9,000 by way of entertainment allowance which he spends in full for official purposes. The amount deductible under section 16(ii) in respect of the allowance will be —
 - (a) Rs.5,000
 - (b) Rs.9,000
 - (c) Rs. 10,000
 - (d) None of the above.
 - (iv) Prakash obtained interest-free loan of Rs.20,000 from his employer company for purchasing a two-wheeler. The market rate of interest on such loan is 20% per annum. The lending rate of State Bank of India is 15.5% and that of the private sector banks is 16%. The taxable amount of this perquisite will be computed at the rate of —
 - (a) 20%

- (b) 16%
- (c) 15.5%
- (d) Nil rate.
- (v) Sushil, a non-resident, received Rs. 18,000 by way of dividend from a foreign company and the company deducted Rs.2,000 by way of tax at source, The amount includible in income of Sushil will be —
- (a) Rs.2,000
- (b) Rs.18,000
- (c) Rs.20,000
- (d) None of the above. (1 mark each)
- (b) Re-write the following sentences after filling-in the blank spaces with appropriate word(s)/figure(s) :
- (i) The tax payable or refund due to an assessee is to be rounded off to the nearest _____.
- (ii) The net annual value of house let-out is Rs.1,00,000 and actual amount spent by the assessee on repairs and insurance premium is Rs.20,000, the amount of deduction allowed under section 24(a) shall be Rs._____.
- (iii) The amount of additional depreciation in respect of new building constructed in financial year 2009-10 at a cost of Rs.25 lakh for manufacturing garments will be Rs. _____.
- (iv) No deduction of tax at source will be made by a banking company under section 194A with respect to aggregate amount of interest paid or payable on time deposits during the financial year 2009-10, if it does not exceed Rs. _____.
- (v) The amount of deduction under section 80DD in respect of maintenance including medical treatment of a dependent with 60% disability will be Rs. _____ when no amount is actually spent on treatment by the resident assessee and the handicapped person does not claim any deduction under section 80U. (1 mark each)
- (c) Atul is working as Accounts Officer with Badri Steels Ltd., Ghaziabad drawing a salary of Rs.40,000 per month. He gets D.A. @ 12% of salary and entertainment allowance @ Rs.800 per month. He spends 40% of entertainment allowance on entertaining the customers of the company. The company has provided him the facility of rent-free unfurnished house for which the company pays rent @ Rs.3,000 per month. The company has provided the services of a cook at the house of Atul for which the company pays Rs. 1,000 per month as salary. The facility of free refreshment and free meal for 300 days is provided to Atul costing Rs.25 per day and Rs.120 per day respectively during working hours in the office.
- Atul and the company both contribute 15% of basic pay and D.A. towards recognised provident fund; Rs. 10,000 is credited to provident fund account by way of interest @ 9% per annum.
- Compute taxable income from salary of Atul for the assessment year 2010-11. (5 marks)

Answer 1(a)(i)

- (a) Resident

Answer 1(a)(ii)

- (d) All of these

Answer 1(a)(iii)

- (a) Rs.5,000

Answer 1(a)(iv)

- (d) Nil rate

Answer 1(a)(v)

- (b) Rs.18,000

Answer 1(b)

- (i) The tax payable or refund due to an assessee is to be rounded off to the nearest **Multiple of Ten Rupees.**
- (ii) The net annual value of house let-out is Rs.1,00,000 and actual amount spent by the assessee on repairs and insurance premium is Rs.20,000, the amount of deduction allowed under section 24(a) shall be **Rs.30,000**.
- (iii) The amount of additional depreciation in respect of new building constructed in financial year 2009-10 at a cost of Rs.25 lakh for manufacturing garments will be Rs. **Nil**.
- (iv) No deduction of tax at source will be made by a banking company under section 194A with respect to aggregate amount of interest paid or payable on time deposits during the financial year 2009-10, if it does not exceed **Rs. 10,000.**
- (v) The amount of deduction under section 80DD in respect of maintenance including medical treatment of a dependent with 60% disability will be **Rs.50,000** when no amount is actually spent on treatment by the resident assessee and the handicapped person does not claim any deduction under section 80U.

Answer 1(c)

**Computation of Income from salary of Mr. Atul
for the Assessment Year 2010-11**

	<i>Rs.</i>
Salary (40,000 x 12)	4,80,000
D.A. (12%)	57,600
Entertainment allowance (800 x 12)	9,600
Salary of Cook (1,000 x 12)	12,000
Free refreshment	Exempt
Free meal	Exempt
Employer's contribution to RPF in excess of 12% [5,37,600 x 3/100]	16,128

Interest credited to PF Account (See W.N 1)	Exempt
Value of rent free unfurnished house (See W. N 2)	36,000
Gross Salary	6,11,328
Less : Deductions u/s 16	NIL
Taxable Salary	6,11,328

Working Notes :

- (1) Interest credited in PF Account shall be exempt upto 9.5%.
 (2) Computation of Value of rent free unfurnished house:

Basic Salary	4,80,000
D.A.	57,600
Entertainment allowance	9,600
	<u>5,47,200</u>
(i) 15% of salary	82,080
(ii) Rent paid by the company	
Whichever is less.	36,000

Therefore, value of rent free unfurnished house will be Rs. 36,000.

Question 2

- (a) State, with reasons in brief, whether the following statements are true or false :
- An income derived from land situated in India is agricultural income.
 - Allowances payable to Central Government employees for serving outside India is fully taxable as salary.
 - Telephone provided to an employee at his residence is a tax-free perquisite.
 - Net wealth computed under the Wealth-tax Act, 1957 shall be rounded off to the nearest multiple of Rs. 100.
 - Tax return preparers are employees of income-tax department.

(2 marks each)

- (b) Alok, aged 40 years, has following incomes for the previous year 2009-10. You are required to ascertain his taxable income and tax liability :

	Rs.
Income from salary	2,10,000
Profit from business	1,50,000
Actual rent of house property	1,80,000
Municipal tax paid being 10% of municipal value	20,000
Agricultural income	1,20,000
Long-term capital gain on sale of plot	15,000
Winning from lottery (gross)	5,00,000
LIC premium paid	20,000
Contribution to public provident fund	50,000
Interest on fixed deposit in a bank	30,000

(5 marks)

Answer 2(a)

- (i) **False** : Income derived from land situated in India and used for agricultural purposes is an agricultural income.
- (ii) **False** : Any allowance or perquisite paid or allowed outside India by the Government to a citizen of India, for rendering services outside India, are exempt.
- (iii) **True** : Expense on telephone, including mobile phone, actually incurred on behalf of the employee by the employers shall be exempt.
- (iv) **True** : Under Section 44C, net wealth computed under Wealth-tax Act, 1957 shall be rounded off to the nearest multiple of Rs.100.
- (v) **False** : Tax return preparers are not the employees of Income Tax Department. They are independent professionals.

Answer 2(b)

**Computation of taxable Income of Alok
for the Assessment Year 2010-11**

		<i>Rs.</i>
(i) Income from salary		2,10,000
(ii) Income from House Property		
Gross Annual Value (See W.N 1)	2,00,000	
Less Municipal Tax	<u>20,000</u>	
	1,80,000	
Less Standard Deduction 30%	<u>54,000</u>	1,26,000
(iii) Income from Business		1,50,000
(iv) Capital Gains		
– (Long-term)		15,000
(v) Income from other source		
Winning from Lottery	5,00,000	
Interest of Fixed Deposit	<u>30,000</u>	5,30,000
Gross Total Income		10,31,000
Deduction u/s 80C		<u>70,000</u>
Total Income		<u>9,61,000</u>

Tax Liability:

Non-Agriculture Income Rs.9,61,000	
+ Agriculture Income Rs.1,20,000	Rs. 10,81,000
Tax on winning from lottery of Rs.5,00,000 @ 30%	1,50,000
Tax on Long-term gain of Rs.15,000 @ 20%	3,000
Tax on remaining Income (10,81,000 – 5,00,000 – 15,000)	<u>73,800</u>
	<u>2,26,800</u>

Less : Tax on agricultural income + Exemption Limit (1,20,000 + 1,60,000)	12,000
	2,14,800
Add : Education Cess & SHEC @3%	6,444
Total Tax	2,21,244
Less TDS on Lottery @ 30%	1,50,000
Net Tax payable	71,244
Rounded off	Rs. 71,240

Working Notes:

1. Gross Annual Value shall higher of the following:
 - (i) Actual rent 1,80,000
 - (ii) Expected Rent:

Municipal value (20000 x 100/10)	2,00,000
Fair Rent	NIL
Higher of the above	2,00,000

Therefore, Gross Annual value shall be Rs.2,00,000.

Question 3

- (a) Sanjay furnishes following particulars of income from his business for the previous year 2009-10 :
 - (i) Net profit as per profit and loss account Rs.72,000 after charging the following:
 - (a) Depreciation on building Rs.31,000
 - (b) Provision for discount on debtors Rs.40,000
 - (c) Private household expenses Rs.50,000
 - (d) Charity (unapproved) Rs.7,000
 - (e) Computer for scientific research Rs.60,000
 - (f) Payment of expenses made through bearer cheque Rs.25,000
 - (g) Security deposit Rs. 16,000
 - (h) Audit fee paid in cash Rs.25,000
 - (i) Patent purchased during the year Rs.75,000
 - (j) Market survey feasibility report expenses Rs.50,000 on new project costing Rs.6,00,000.
 - (ii) Opening stock Rs.66,000 valued at 10% above cost and closing stock Rs.72,000 valued at 10% below cost.
 - (iii) Income credited to profit and loss account include —
 - (a) Bank interest on fixed deposits Rs. 9,000
 - (b) Refund of excise duty Rs. 18,000 earlier allowed as deduction
 - (c) Bad debts recovered Rs.5,000.

Compute total income of Sanjay and his tax liability if he is a senior citizen assuming depreciation on building as per the Income-tax Act, 1961 is Rs.50,000.
(7 marks)

(b) Write notes on any two of the following :

(i) 'Best judgment assessment' under section 144

(ii) 'Assessee' under section 2(7)

(iii) 'Deemed asset' under the Wealth-tax Act, 1957. (4 marks each)

Answer 3(a)

**Computation of Total Income and Tax liability of Mr. Sanjay (Senior Citizen)
for the Assessment Year 2010-11**

	Rs.	Rs.
Profits and Gains of Business and Profession:		
Net Profit:		72,000
Add: Expenses Inadmissible		
- Depreciation on Building	31,000	
- Provision for discount on debtors	40,000	
- Household expenses	50,000	
- Charity	7,000	
- Expenses paid through bearer cheque	25,000	
- Security deposit	16,000	
- Audit Fees		
(Paid in cash therefore not allowed)	25,000	
- Patent	75,000	
- Market Survey Expenses (See Note:1)	44,000	
- Opening stock over valued	6,000	
- Closing stock under valued	8,000	3,27,000
Less : Expenses allowed		
- Depreciation		
Building	50,000	
Patent	18,750	68,750
Less : Income of other heads		
- Bank Interest on Fixed Deposits		9,000
Profits and Gains from Business and profession		3,21,250

Income from other sources:

- Bank Interest	9,000	9,000
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Gross Total Income

3,30,250

Less : Deductions u/s 80C to 80U:

NIL

Total Income

3,30,250

Tax Liability:

Tax on Rs. 3,30,250

On Rs.2,40,000

Nil

2,40,000 to Rs.3,00,000 @10%

Rs. 6000

3,00,000 to Rs. 3,30,250 @20%

Rs. 6050

12,050

Plus: Education cess & SHEC @3%

362

Tax Payable

12,412

(Rounded off)

12,410

Working Note :

1. Least of the following shall be eligible as Market Survey Expenses:

(a) Actual Expenditure incurred Rs. 50,000

(b) 5% of project cost Rs. 30,000

Hence, Rs. 30,000 shall be allowed for deduction in 5 equal instalments i.e. Rs. 6,000 (1/5 of Rs.30,000).

Answer 3(b)(i)

Best Judgment Assessment

Section 144 provides that the Assessing Officer after taking into account all relevant material gathered by him, is under an obligation to make an assessment of the total income or loss to the best of his judgment in any of the following three cases.

- (i) where the person fails to make the voluntary return under section 139(1) and has not made a return under section 139(4) or a revised return under section 139(5); or
- (ii) where the person fails to comply with all the terms of a notice issued under section 142(1) or failed to get the accounts audited under section 142(2A); or
- (iii) where the return has been made by the person but he does not comply with the terms of the notice issued under section 143(2).

The assessing officer shall give an opportunity of being heard to the assessee before making the Best Judgment Assessment.

Answer 3(b)(ii)

Assessee [Section 2(7)]

Assessee means a person by whom any tax or any other sum of money is payable under the Act and includes:

- (a) every person in respect of whom any proceeding under this Act has been taken for the assessment of his income or assessment of fringe benefits or of the

income of any other person in respect of which he is assessable or to determine the loss sustained by him or by such other person or to determine the amount of refund due to him or to such other person.

- (b) every person who is deemed to be an assessee under any provision of this Act.
- (c) every person who is deemed to be an assessee in default under any provision of this Act.

Accordingly, assessee is a person by whom tax or any other sum is payable under the Act.

The expression “other sum of money” includes

- fine, interest, penalty and tax or
- person to whom any refund of tax etc. is due under the Act or
- if any proceeding under the Act has been taken against any person, he is also an assessee. Remember, the proceedings must be initiated under the provisions of the Act. In other words, a single enquiry letter issued by the Income-tax Department without reference to any specific provision of the Act does not constitute proceeding under the Act and, as such, till proceedings are initiated under the Act, the person may not become an assessee within the ambit of Section 2(7) of the Act.

Answer 3(b)(iii)

Deemed Asset under Wealth-tax Act, 1957

In computing the net wealth of an assessee, the following assets shall be included as deemed assets belonging to the assessee by virtue of Section 4:

- (i) Assets transferred to spouse [Section 4(1)(a)(i)];
- (ii) Assets held by a minor child [Section 4(1)(a)(ii)];
- (iii) Assets transferred to a person or Association of Person for the benefit of the individual, his/her spouse [Section 4(1)(a)(iii)];
- (iv) Assets transferred to a person or AOP under revocable transfer [Section 4(1)(a)(iv)];
- (v) Assets transferred to son's wife [Section 4(1)(a)(v)];
- (vi) Assets transferred to person or AOP for the benefit of son's wife [Section 4(1)(a)(vi)];
- (vii) Interest of a partner in the firm [Section 4(1)(b)]
- (viii) Conversion of self acquired property into joint family property of HUF [Section 4(1A)]
- (ix) Gifts made by book entries [Section 4(5A)]
- (x) Holder of an Impartible Estate [Section 4(6)]

Question 4

- (a) *The tax payable for the assessment year 2010-11 by an individual is Rs. 1,23,600. He has deposited the following amount as advance tax :*

<i>Date of Deposit</i>	<i>Amount Deposited (Rs.)</i>
14th September, 2009	20,000
15th December, 2009	60,000
15th March, 2010	30,000

Compute the interest payable under section 234C. (5 marks)

- (b) *Discuss the statutory obligations of an assessee to file the return of income and indicate the time-limits for filing the return. (5 marks)*
- (c) *Rupesh acquired a residential house on 1st September, 1978 for Rs. 1,00,000. He spent Rs.25,000 on 1st July, 1980 for improvement of this house property. A further amount of Rs.50,000 was spent by him on 15th November, 1985 on improvement of the house. Rupesh gifted the said property to his son Bhupesh on 12th October, 1994. Bhupesh also spent the following amounts on improvement of the house :*

<i>Date of Expenditure</i>	<i>Amount (Rs.)</i>
15th July, 1995	60,000
15th June, 2009	40,000

Bhupesh sold the above house on 30th November, 2009 for a sum of Rs. 15,00,000. Expenses on transfer were 2% of the sale consideration. Compute the capital gains for the assessment year 2010-11, assuming the fair market value of the house as on 1st April, 1981 to be Rs. 3,00,000.

Cost inflation index for various years is as under :

1985-86 — 133
1994-95 — 259
1995-96 — 281
2009-10 — 632.

(5 marks)

Answer 4(a)**Computation of Interest Payable under section 234C:**

Tax Payable for the assessment year 2010-11 is Rs.1,23,600

Rs.

1. First installment payable on 15-09-2009 (1,23,600 x 30%)	37,080
Less : Tax Paid	20,000
Shortfall	17,080
Interest payable @ 1% for 3 months (17,080 X 1% X 3)	512

2. Second Installment Payable on 15-12-2009 (1,23,600X60%) – 20,000	54,160	
Less : Tax Paid	<u>60,000</u>	
Shortfall	NIL	
Interest Payable		NIL
3. Third Installment Payable on 15-03-2010 (1,23,600X100%) – 80,000	43,600	
Less : Tax Paid	<u>30,000</u>	
Shortfall	13,600	
Interest Payable @ 1% for 1 month (13,600 X 1% X 1)		<u>136</u>
Total Interest Payable		648
Rounded off		650

Answer 4(b)

Section 139(1) of the Act contains the relevant provisions relating to the furnishing of a return of income. It is statutorily obligatory for every person

- being a company or a firm
- or being a person other than a company or firm to furnish a return of his total income or the total income of any other person in respect of which he is assessable under the Income-tax Act, during the previous year.
- exceeds the maximum amount which is not chargeable to income-tax. The return of income must be furnished by the assessee in the prescribed form and verified in the prescribed manner and setting forth such particulars as may be prescribed.

Further, in respect of individual, HUF, AOP, BOI, Artificial juridical Person, filing of return of income shall be compulsory if their gross total income before allowing deductions under Sections 10A, 10B or 10BA or Chapter VIA exceeds the maximum amount which is not chargeable to income tax.

Due date for filing return of income

- (a) where the assessee is—
- (i) a company,
 - (ii) a person, other than a company whose accounts are required to be audited under the Income-tax Act or any other law, for the time being in force,
 - (iii) a working partner of a firm whose accounts are required to be audited under this Act or under any law for the time being in force,
- the 30th day of September of the Assessment Year.
- (b) in the case of any other assessee, the 31st day of July of the Assessment Year.

Answer 4(c)

**Computation of Capital Gains
for the Assessment Year 2010-11**

	<i>Rs.</i>	<i>Rs.</i>
Sale consideration	15,00,000	
Less : 1. Expenses on transfer	30,000	
2. Indexed cost of acquisition 3,00,000 x 632/259	7,32,046	
3. Indexed cost of improvement		
(i) By the previous owner		
50,000 x 632/133		2,37,594
(ii) By the assessee		
60,000 x 632/281		1,34,947
40,000 x 632/632	40,000	11,74,587
Long-term capital gain		<u>3,25,413</u>

Question No. 5

- (a) Distinguish between any three of the following :
- (i) 'Long-term capital gains' and 'short-term capital gains'.
 - (ii) 'Defective return of income' and 'belated return of income'.
 - (iii) 'Normal depreciation' and 'additional depreciation'.
 - (iv) 'Capital expenditure' and 'revenue expenditure'. (4 marks each)
- (b) Discuss the provisions relating to 'carry forward and set-off of business losses'. (3 marks)

Answer 5(a)(i)**Long-term capital gains and short-term capital gains**

Long-term capital gains [Section 2(29A)] : If the asset is held by the assessee for more than 36 months or 12 months, as the case may be, such an asset will be treated as a long-term capital asset. Capital gain arising on the transfer of long-term capital asset is called Long term Capital Gain.

Short-term Capital Gains [Section 2(42A)] : A capital asset held by an assessee for not more than 36 months immediately preceding the date of its transfer is known as a short-term capital asset. Capital gain arising on the transfer of short-term capital asset is called Short term Capital Gain.

However, the following assets shall be treated as short-term capital assets if they

are held for not more than 12 months (instead of 36 months mentioned above) immediately preceding the date of its transfer :

- (a) Equity or preference shares held in a company;
- (b) Any other security listed in a recognized stock exchange in India;
- (c) Units of the Unit Trust of India or units of a Mutual Fund specified u/s 10(23D);
- (d) Zero coupon bond.

Answer 5(a)(ii)

Defective return of income and belated return of income

Defective return [Section 139(9)]

The Assessing Officer may intimate the defect to the assessee where he considers that the return of income furnished by the assessee is defective. The Assessing Officer may give the assessee an opportunity to rectify the defect within a period of 15 days from the date of such intimation. If the defect is not rectified by the assessee within the period of 15 days or such further extended period, then the Assessing Officer shall treat the return as a invalid return. A return of income is regarded as defective return in case the return form has not been dully filled.

Belated return [Section 139(4)]

If return is not furnished within the time allowed under section 139(1) or within the time allowed under notice issued under section 142(1), the person may, before the assessment is made, furnish the return of any previous year at any time before the end of one year from the end of relevant assessment year. If return is submitted after the due date of submission of return of income, the following consequences will be applicable.

- (i) the assessee will be liable for penal interest under section 234A.
- (ii) a penalty of Rs.5,000 may be imposed under section 271F if belated return is submitted after the end of assessment year;
- (iii) If return of loss is submitted after the due date a few losses cannot be carried forward;
- (iv) If return is submitted belated, deduction under sections 10A, 10B, 80-IA, 80-IAB, 80-IB, 80-IC, 80-ID and 80-IE will not be available.

Answer 5(a)(iii)

Normal depreciation and additional depreciation

- (a) Normal depreciation is available in respect of all tangible assets and intangible asset such as building, machinery, plant, furniture, patent etc. while additional depreciation is available only in the case Plant and Machinery.
- (b) Normal depreciation is available in respect of both types of assets—new and old while additional depreciation is available only in respect of new plant and machinery which is acquired and installed after March 31, 2005;
- (c) Normal depreciation is computed by applying different rates of depreciation

prescribed for a particular asset while additional depreciation is computed by applying a uniform rate of depreciation viz. 20% of the actual cost of new plant & machinery.

- (d) The system of “block of assets” is quite relevant for computing normal depreciation while it is not relevant for computing additional depreciation;
- (e) Any plant & machinery which is used in business of the assessee is eligible for normal depreciation while certain plant & machinery, even if new, are not eligible for additional depreciation like ships and aircrafts, plant & machinery which was already used by a person either in India or abroad, plant & machinery which is used in any office premises or any residential accommodation or in a guest house, any office appliances or road transport vehicles or plant & machinery the entire cost of which has already been allowed as deduction either by way of depreciation or otherwise.

Answer 5(a)(iv)

Capital Expenditure and Revenue Expenditure

- (a) Capital expenditure, even if incurred for the purpose of earning income, is not deductible while computing taxable income; unless the law expressly so provides. Revenue expenditure, on the other hand, is deductible while computing taxable income unless the law provides specifically to disallow such expenditures wholly or partly;
- (b) Capital expenditure is incurred in acquiring, extending or improving a fixed asset, whereas revenue expenditure is incurred in the normal course of business as a routine business expenditure;
- (c) Capital expenditure produces benefits for several previous years, whereas revenue expenditure is consumed within one previous year;
- (d) Capital expenditure makes improvements in earning capacity of a business; revenue expenditure maintains the profit making capacity of a business;
- (e) Capital expenditure, usually is a non-recurring outlay, whereas revenue expenditure is normally a recurring outlay.

Answer 5(b)

Carry forward and set-off of business losses (Section 72)

Where the loss under the head ‘profits and gains of business or profession’ other than loss referred to in section 35AD or from speculation business, could not be set-off in the same assessment year because either the assessee had no income under any other head or the income was less than the loss, such loss which could not be set-off in the same assessment year, can be carried forward to the following assessment years and it shall be set off against the profit and gains of business or profession subject to the following conditions :

- (i) *Business losses can be adjusted only against business income* : The loss can be carry forward to the subsequent assessment year and set off only against business income of the subsequent year.

- (ii) *Business in respect of which a loss is incurred may or may not be continued :*
The business loss can be carried forward and set-off in the subsequent assessment year(s) even if the business in respect of which the loss was originally computed is not carried on by him in the previous year in which such loss is sought to be carried forward and set off.
- (iii) *Losses can be set off only by the assessee who has incurred loss except in the case of Inheritance, amalgamation, succession of proprietary concern or a firm by a company and demerger.*

Period of carry forward: Each year's loss is a separate loss and no business loss shall be carried forward for more than eight assessment years immediately succeeding the assessment year for which the loss was first computed. But the following can be carry forward indefinitely:

- (i) unabsorbed depreciation;
- (ii) unabsorbed capital expenditure on scientific research;
- (iii) unabsorbed expenditure on family planning.

Question 6

(a) *Write short notes on any three of the following :*

- (i) *Taxability of income by virtue of business connection*
- (ii) *Capital gains in case of damage or destruction of capital asset*
- (iii) *Clubbing of income of a minor child*
- (iv) *Tax liability of an association of persons*
- (v) *Tax on income of foreign institutional investors from capital gains arising from transfer of their securities.* (3 marks each)

(b) *Rohit provides the following particulars and asks you to work out the amount of net wealth to be declared by him in the wealth-tax return for the assessment year 2010-11 :*

- (i) *Value of a motor car Rs.6,00,000.*
- (ii) *Value of a motor cycle Rs.60,000.*
- (iii) *A house of which ground floor is used by him for business purposes and first floor for self-residence having value of Rs.60,00,000 on 31st March, 2010.*
- (iv) *Jewellery worth Rs.12 lakh purchased on 30th March, 2010 by his wife out of funds given by him of Rs.5 lakh and by his son of Rs.5 lakh.*
- (v) *Shares of various companies worth Rs. 2,00,000 purchased by him in the name of his daughter-in-law.*
- (vi) *Cash in hand Rs.1,20,000.* (6 marks)

Answer 6(a)(i)

Taxability of income by virtue of business connection

Any income which arises, directly or indirectly, from any activity or a business connection in India is deemed to be earned in India. Business connections may be in

several forms e.g., a branch office in India or an agent or an organization of a non-resident in India. Formation of a subsidiary company in India to carry on the business of the non-resident parent company would also be a business connection in India. Any profit of the non-resident which can be reasonably attributable to such part of operations carried out in India through business connections in India are deemed to be earned in India. Some illustrative instances of a non-resident having business connection in India are given below:

- (a) Maintaining a branch office, for the purchase or sale of goods or transacting other business.
- (b) Appointing an agent in India, for the systematic and regular purchase of raw materials or other commodities, or for sale of the non-resident goods for other business purposes.
- (c) Erecting a factory in India where the raw produce purchased locally is worked into a form suitable for export abroad.
- (d) Forming a local subsidiary company to sell the products of the non-resident parent company.
- (e) Having financial association between a resident and a non-resident company.

Answer 6(a)(ii)

Capital gains in case of damage or destruction of capital asset

Where any person receives at any time during any previous year any money or other assets under an insurance from an insurer on account of damage to, or destruction of, any capital asset, as a result of :

- (i) flood, typhoon, hurricane, cyclone, earthquake or other convulsion of nature; or
- (ii) riot or civil disturbance; or
- (iii) accidental fire or explosion; or
- (iv) action by an enemy or action taken in combating an enemy (whether with or without a declaration of war).

Then, any profits or gains arising from receipt of such money or other assets shall be chargeable to income-tax under the head "Capital gains" and shall be deemed to be the income of such person of the previous year in which such money or other asset was received and for the purposes of section 48, value of any money or the fair market value of other assets on the date of such receipt shall be deemed to be the full value of the consideration received or accruing as a result of the transfer of such capital asset.

Answer 6(a)(iii)

Clubbing of income of a minor child

Under Section 64(1A) the income of a minor child shall be included in the total income of either of his parents. The income shall be clubbed in the hands of that parent (excluding the income of minor) whose total income is greater. If the marriage of his parents does not subsist, the income shall be clubbed in the hands of that parent who maintains the minor child in the previous year. However the following income of a minor shall not be clubbed and will be taxable in the hands of the minor himself:

- (i) Any Income of a minor child suffering from any disability of the nature specified in Section 80C.

- (ii) Such income which accrues or arises to the minor child on account of any manual work done by him.
- (iii) Such income of the minor child involving application of his skills, talent or specialized knowledge and experience.

Answer 6(a)(iv)

Tax liability of an association of persons

An AOP/BOI will be assessed in the following two manners :

- (a) where in case of AOP/BOI, the individual share of members are unknown;
- (b) where in case of AOP/BOI, the individual share of members are known

Where share of members are unknown

Where the individual share of the members of AOP/BOI in the whole or part of its income are indeterminate or unknown, tax shall be charged on the Total Income of the AOP/BOI at the maximum marginal rate i.e., 30% plus education cess @ 2% plus SHEC @ 1%.

However, if the income of any member of AOP is chargeable at a rate higher than 30%, the tax will be charged on the total income of the AOP also at such higher rate.

Thus, although the maximum tax rate in case of AOP is 30% plus education cess @ 2% plus SHEC @ 1% but in case the foreign company is a member of AOP/BOI, the tax rate of the AOP shall be 41.2% instead of 30.9%.

Where share of members are known

- (a) Where one of the members has total income exceeding maximum exemption limit: Where the total income of any member of AOP/BOI, without including his income from AOP/BOI exceeds the Maximum Exemption Limit, then such AOP/BOI will be charged to tax at maximum rate of 30% plus education cess plus SHEC as applicable on its Total Income. However, in this case, if the income of one or more member of AOP/BOI is chargeable at a rate higher than 30% plus tax shall be charged on that portion or portions of income of AOP/BOI which is relatable to the share of such member(s) at such higher rate and the balance of the income is taxable at the maximum marginal rate of tax.
- (b) Where none of the members has total income exceeding maximum exemption limit.

In this case two situations may emerge:

<i>Situation</i>	<i>Liability of tax</i>
<i>(1)</i>	<i>(2)</i>
1. None of the members have total income exceeding maximum exemption limit and none of the member's is taxable at a rate more than maximum marginal rate.	The AOP in this case will pay income-tax on its total income at the rates which are applicable to an individual and the benefit of basic exemption of Rs.1,60,000 shall be available to such AOP.

(1)	(2)
2. Although none of the member has total income exceeding the maximum exemption limit, but one or more member is liable to tax rate of more than the maximum limit (i.e., taxable at a rate higher than 30%) which is possible only if the foreign company is also a member.	On that portion of income of AOP which is relatable to the member i.e., foreign company, the tax rate applicable shall be rate of income-tax which is applicable to such member and the balance total income of AOP shall be charged at the maximum marginal rate.

Answer 6(a)(v)

Tax on income of Foreign Institutional Investors from capital gains arising from transfer of their securities [Section 115AD]

Where the total income of the above assessee includes:

- (a) income received in respect of securities (other than units of mutual funds covered under section 10(23D) or of Unit Trust of India); or
- (b) income by way of short-term or long-term capital gains arising from the transfer of such securities.

The Income-tax on the total income shall be chargeable as under:

- (i) On the income in respect of securities referred to in clause (a) above @ 20%
- (ii) On the income by way of short-term capital gains covered under section 111A @ 15%
- (iii) On the income by way of long-term capital gains referred to in Clause (b) above @ 10%
- (iv) On the balance income included in total income Special/normal rate as the case may be.

Answer 6(b)**Computation of net wealth of Mr. Rohit for the Assessment Year 2010-11**

<i>Particulars</i>	<i>Amount (Rs.)</i>
(i) Motor Car	6,00,000
(ii) Motor Cycle (not an asset)	—
(iii) House used for business and personal purpose (See W.N 1)	—
(iv) Jewellery (See W.N 2)	6,00,000
(v) Shares (Not an asset)	—
(vi) Cash in hand (in excess of Rs.50,000)	70,000
Gross Wealth	12,70,000
Less : Debt	NIL
Net Wealth	12,70,000

Working Notes

1. Part of the house which is used for residential purpose shall be exempt under section 5(vi) and part of the house which is used for business purpose shall not be treated as asset under section 2(ea).
2. 50% of the value of Jewellery shall be clubbed with the wealth of Rohit as half of the fund was provided by him.

PART B**Question 7**

Attempt any four of the following :

- (i) *How is the value of taxable services determined as per provisions contained in section 67 of the Finance Act, 1994 ?* (5 marks)
- (ii) *Briefly state the provisions relating to the procedure of registration under the service tax.* (5 marks)
- (iii) *What are the general exemptions which are available to service providers from payment of the whole amount of service tax ?* (5 marks)
- (iv) *Re-write the following sentences after filling-in the blank spaces with appropriate word(s)/figure(s) :*
 - (a) *The application for registration shall be made within a period of _____ of commencement of business by an input service provider.*
 - (b) *The registration certificate is issued to a service provider within 7 days by the _____.*
 - (c) *Return of service tax is required to be filed by every assessee in Form No _____.*
 - (d) *Due date for payment of service tax in the case of individual assessee is _____ immediately following the quarter of the financial year except in case of last quarter.*
 - (e) *Service tax is rounded off to the nearest multiple of _____.* (1 mark each)
- (v) *State, with reasons in brief, whether the following statements are true or false :*
 - (a) *Service tax has been imposed by amending Chapter-VI of the Finance Act, 1994.*
 - (b) *There are provisions of TDS in respect of service tax.*
 - (c) *Service tax is applicable on whole India excluding Jammu and Kashmir.*
 - (d) *Registration is mandatory under the service tax.*
 - (e) *No service tax is payable on free services.* (1 mark each)

Answer 7(i)

Under section 67 the value of taxable services shall be determined in the following manner:

1. When the consideration for a taxable service is in monetary terms: The value of such service shall be the gross amount charged by the service provider for such service provided or to be provided by him. The gross amount is “value of taxable service” plus service tax payable.
2. When the consideration for a taxable service is not received wholly or partly in money: the value of taxable service shall be the amount of money which after addition of service tax is equivalent to the consideration.
3. When consideration for a taxable service is not ascertainable, value of such service will be on the basis of Rules of valuation prescribed in this regard.

If the gross amount charged by service provider is inclusive of service tax payable, the value of taxable service will be equal to

$$\frac{\text{Gross amount charged} \times 100}{(100 + \text{Rate of Service Tax})}$$

The gross amount charged for the taxable service can be received before, during or after the provision of taxable service. The value of a taxable service shall be determined subject to these provisions in such manner as may be prescribed.

Money includes any currency, cheque, promissory note, letter of credit, draft, pay order, travelers cheque, money order, postal remittance and other similar instruments but does not include currency that is held for its numismatic value. Also, gross amount charged includes payment by cheque, credit card, deduction from account and any form of payment by issue of credit notes or debit notes and book adjustment.

Answer 7(ii)

Every person who is liable to pay service tax must mandatorily, as per Section 69(1), make an application for registration to the concerned superintendent of Central Excise within a period of 30 days of the commencement of business. The following persons must mandatorily obtain registration:

- (a) Every person liable to pay service tax;
- (b) An input service distributor; and
- (c) Every service provider whose aggregate value of taxable service in a financial year exceeds Rs.9 lac.

Every person providing taxable service himself is primarily, as per Section 68(1), liable to pay service tax. The Central Government as per Section 68(2), is empowered to notify any taxable service in respect of which rules may provide for a designated person who will be treated as being liable to pay service tax.

The application for registration is required to be made in duplicate in Form ST-1 prescribed under the Rules.

Time limit for making application : Under Rule 4(1), the application for registration in the case of persons who are liable to pay service tax is required to be made within 30 days from the date on which levy of service tax is brought into force in respect of the relevant services. An input service distributor must make the application in Form ST-1 within a period of 30 days of the commencement of business or Rule 16, 2005 whichever is later.

The small service providers must make the application in Form No.ST-1 within a period of 30 days of the date in the financial year on which the aggregate value of taxable services has exceeded Rs.9 lac.

Certificate of registration : The Department is required to issue the registration certificate within seven days of the application. In case of failure to issue registration certificate within 7 days, the registration applied for is deemed to have been granted and the assessee can carry on with his activities.

Centralised registration : Where an assessee is providing a taxable service from more than one premises and has centralized billing or accounting system in respect of such services which are located on one or more offices or premises, he may, at his option, register such premises or offices from where such centralized billing or accounting systems are located. If the same assessee provides more than one taxable service, then as per Rule 4(4), a single application will be sufficient.

When information is to be changed or added : When there is a change in any information or details furnished by an assessee in Form ST-1 at the time of obtaining registration or he wishes to furnish any additional information or detail, it should be intimated in writing to the jurisdictional Assistant Commissioner or Deputy Commissioner of Central Excise within a period of 30 days of such change.

Answer 7(iii)

As per Section 93, the Central Government is empowered to exempt taxable services from payment of service tax. The following general exemptions which are applicable to all services are available to service providers from payment of the whole amount of service tax :

- (i) *Services provided to United Nations or an International Organization* — As per Section 65, the Central Government has exempted all taxable services provided by any person to the UN or an International Organization from payment of whole amount of service tax leviable on it.
- (ii) *Services provided to a developer of SEZ or units of SEZ* — Full exemption is available to the service provider for providing taxable services to an approved developer of SEZ or approved units of SEZ for consumption of the services within such SEZ. The approved developer or approved unit of SEZ shall have to maintain proper account of receipt and utilization of the taxable services. It is essential that services rendered by the service provider should be consumed in the unit in order to avail the exemption.
- (iii) *Goods and materials sold by service providers to recipient of service* — with effect from September 10, 2004, this exemption shall apply in the cases where no credit of duty paid on such goods and materials sold had been taken under

the provisions of CENVAT Rules, 2004, or where such credit has been taken by the service provider on such goods and materials, such service provider has paid the amount equal to such case availed before the sale of such goods and materials.

The value of all taxable services is exempt from service taxes which are equal to the value of goods and materials sold by the service provider to the recipient of services if the service provider maintains documentary proof indicating separately the value of said goods and materials.

- (iv) *Exemption for small service providers* — service providers whose turnover of taxable services from one or more premises is less than 10 lac per annum in the preceding financial year are exempt from payment of service tax on turnover of Rs.10 lac during the next financial year.
- (v) *Services provided by RBI* — Taxable services provided by RBI are exempt from service tax.
- (vi) *Exemption to Technology Business Incubator, Science & Technology Entrepreneurship Park and Incubates* — with effect from April 1, 2007, 100% exemption is available from service tax to taxable services provided or to be provided by TBI or STEP provided they furnish information in the prescribed formats. Also 100% exemption is available in respect of taxable services provided by incubators. Incubators are entrepreneurs working with the incubator to develop their ideas into a commercially viable venture. The conditions to be fulfilled for availing this exemption are that incubate should be located within the premises of the incubator; total business turnover of the incubate entrepreneur does not exceed Rs.50 lac during the preceding financial year and the exemption is available for a period of 3 years from the date of signing the agreement with the incubator.
- (vii) *Services provided by a digital cinema service provider* — exemption is granted to taxable services provided or to be provided by any person to other person in relation to delivery of content of cinema in digital form after encryption electronically if the film is directly transmitted to a cinema theatre through satellite, microwave or terrestrial communication link and not through CD and DVD.
- (viii) *Services provided by Resident Welfare Associations* — In case the monthly contribution of members to their RWAs does not exceed Rs.3000 per month, exemption is available in respect of services provided by RWAs to their members.
- (ix) *Technical Testing and Analytical Services* — Exemption from service tax is granted to technical testing and analytical services provided for testing newly developed drugs including vaccines and herbal remedies on human participants by a clinical research organization approved by the Drug Controller General of India.

Answer 7(iv)

- (a) The application for registration shall be made within a period of **30 days** of commencement of business by an input service provider.
- (b) The registration certificate is issued to a service provider within 7 days by the **Superintendent Central Excise**.

- (c) Return of service tax is required to be filed by every assessee in Form No. **ST-3**.
- (d) Due date for payment of service tax in the case of individual assessee is **5th day** immediately following the quarter of the financial year except in case of last quarter.
- (e) Service tax is rounded off to the nearest multiple of **One rupee**.

Answer 7(v)

- (a) **False**, Service tax has been imposed by amending Chapter V of Finance Act, 1994 not by Chapter VI of the Finance Act, 1994.
- (b) **True**, Circular No. 4/2008 dated 28-04-2008 has been issued by CBDT in regard to TDS on service tax included in rent. According to this circular, no TDS shall be deducted on service tax included in the rent.
- (c) **True**, As per section 64 of the Chapter V of Finance Act, 1994, the provisions of service tax extends to the whole of India except the State of Jammu and Kashmir
- (d) **False**, Every person liable to pay service tax is liable to seek registration, however, section 69(2) empowered the Central Government to specify any person or class of person who are required to seek registration. Therefore it is not mandatory for every person providing services to get registration.
- (e) **True**, Service tax is payable on the consideration charged by the service provider from the service recipient. As no consideration will be received in case of free services therefore the same is not liable to service tax.

PART C

Question 8

Attempt any four of the following :

- (i) *How is the value added tax (VAT) structure an improvement over the sales tax system ?* (5 marks)
- (ii) *"Input tax credit is generally given for the entire VAT paid within the State on purchases of taxable goods meant for re-sale or manufacture of taxable goods." Explain.* (5 marks)
- (iii) *Discuss the provisions of registration under VAT.* (5 marks)
- (iv) *How would you take input tax credit when goods purchased are transferred by the dealer to his branch in any other State ?* (5 marks)
- (v) *State, with reasons in brief, whether the following statements are true or false :*
 - (a) *Value added tax (VAT) is levied by the Central Government.*
 - (b) *VAT is a multi-point tax.*
 - (c) *VAT system has six broad tax rates.*
 - (d) *VAT system is followed by all States in India.*
 - (e) *Registration of dealer is mandatory under VAT.* (1 mark each)

Answer 8(i)

VAT structure is an improvement over the sales tax system due to the following reasons:

- (a) *Simple and certain* — VAT is simply based on transactions and is thus easy to comprehend and has the merit of certainty. When it is applied to all sales in business on a broad base, there is less chance of differing interpretations. As against this the sale tax system were found to be complicated.
- (b) *Eliminates cascading effect* — It eliminates the multiple tax system by setting off the tax paid earlier at every stage of sale. A set off is given for input tax as well as tax paid on previous purchases.
- (c) *Reduction in tax evasion* — The chances of tax evasion are reduced due to better tax compliance. In VAT system businesses demand invoice from their suppliers to enable them to obtain credit for the tax paid by them on their purchases. Under the sales tax system, tax used to be levied at only one stage at the first point of sale, it resulted in reduction in tax liability due to shifting of the value added to subsequent stages. VAT counters this tendency by taxing the value added at all stages. VAT creates the audit trail which provides a built in mechanism to counter tax evasion. The application of the tax at each point of sale ensures that if the tax is evaded at one stage, the full tax will be realized at a subsequent stage. Evasion can only occur under VAT when all companies in a production and distribution chain act in collusion to conceal their sale.
- (d) *Transparency* — Under VAT, the total burden of tax on a particular commodity is clearly seen from the transactions. Thus, the analysis of tax structure becomes convenient. This also results in tax neutrality in the international trade. Under the sales tax system it is difficult to estimate the exact amount of refund relating to exports.
- (e) *Neutral as regards the choice of location of business as well as choice of form of business organization* — Under VAT there is no interference as regards the choice of location and form of business. Also, the tax liability does not depend on the number of times a product is traded before reaching the final consumer or how much of the value is added at what stage in the process of production and distribution. The allocation of resources is left to be decided by the free play of market forces and competition rather than by the tax considerations. Further, there is no incentive for companies to integrate vertically as against the sales tax system that makes no allowances for taxes paid at earlier stages.
- (f) *Helps in reducing prices* — VAT reduces tax burden which helps in reducing the prices of commodities.
- (g) *Uniformity* — The VAT has introduced uniformity in the tax system.
- (h) *Stable source of revenue* — VAT provides a stable and flexible source of revenue to the Government in view of the fact that consumption is less volatile than income.

The above considerations clearly make VAT an improvement over the sales tax structure.

Answer 8(ii)

Input tax credit means setting off the amount of input tax paid by a registered dealer against the amount of his output tax. VAT is based on the value addition to the goods and the VAT liability of a dealer is calculated by deducting input tax credit from tax collected on sales during the payment period.

Input tax credit is generally given for the entire VAT paid within the state on purchases of taxable goods meant for resale or manufacture of taxable goods. However, generally no credit is available in respect of purchases given below:

- (i) Goods purchased from unregistered dealers;
- (ii) Goods purchased from other states or countries;
- (iii) Purchases of goods used in manufacture of exempted goods;
- (iv) Purchases of goods used in manufacture of goods to be dispatched outside any state as branch transfer or consignments;
- (v) Purchases of goods in cases where the dealer does not have invoices showing amounts of tax charged separately by the selling dealer;
- (vi) Purchases from a dealer who has opted for composition scheme.
- (vii) Purchase of goods used for personal purposes/consumption or provided free of charge or gifts.
- (viii) Purchase of goods where the purchase invoice is not available with the claimant.
- (ix) On purchase of fuels used in generation of electricity including captive power

If the tax credit exceeds the tax payable on sales in a tax period it shall be carried over to the next tax period. Excess unadjusted input tax credit, if any, at the end of the financial year, shall be eligible for refund. If VAT collected in a tax period is lower than input tax credit in respect of local purchases and inter-state purchases, only the balancing amount is carried forward to the next tax period and it will be adjusted on the same basis. However, unadjusted tax credit at the end of the financial year is generally refunded.

Input tax credit on capital goods is also available for traders and manufacturers. Tax credit on capital goods may be adjusted over a maximum of 36 equal monthly instalments. The states may, in their option, reduce the number of instalments.

In respect of exports, VAT paid within the state is generally refunded in full within a stipulated period which is, generally, three months. Also, units located in SEZ and EOU are, generally, exempted from payment of input tax or refund of the input tax paid within this period. Tax paid on inputs procured from other states through inter-state sale and stock transfers are not eligible for credit.

Answer 8(iii)**Registration of Dealer under VAT**

Every dealer upto the retailer level is required to be registered with sales tax department if he wants to avail the credit of input tax. However, a dealer with turnover below the specified amount (say Rs.5 lac or 10 lac) need not to be registered compulsorily. He may opt not to register but pay a nominal tax under composition system. When VAT

was introduced by the states almost all the dealers under the old system of sales tax have been automatically registered under the VAT Act. If the turnover of a new dealer crosses the specified limit, he is allowed 30 day period for registration from the date of liability to get registered. If the annual turnover of the dealer reaches the specified prescribed limit of turnover, his registration is compulsory. There are provisions of voluntary registration also. A dealer having annual turnover less than prescribed limit may opt for voluntary registration.

Small dealer with annual turnover less than specified limit are not liable to pay VAT. Small dealers who are otherwise liable to pay VAT are allowed option of composition scheme. Such dealers pay tax at a small percentage of their annual turnover. However, such dealers are not entitled to input-tax credit.

Answer 8(iv)

Input tax credit means setting off the amount of Input tax by a registered dealer against the amount of his output tax.

Input Tax Credit is available even when goods purchased are transferred by the dealer to his branch in any other state. In such a case input tax paid in excess of 4% will only be eligible for tax credit. Further, where the goods are exported from a state, other than by way of a sale, to a branch of the registered dealer or to a consignment agent; the dealer shall reduce the amount of tax credit originally claimed by the prescribed proportion.

It is also to be noted that in some states partial Input tax credit is available in respect of Inputs used for manufacture of exempted goods.

Answer 8(v)

- (a) **False**, Value Added Tax is levied and collected by State Government.
 - (b) **True**, VAT is a multi stage tax levied as a proportion of the value added at each stage.
 - (c) **False**, VAT system has four broad tax rates instead of six broad tax rates. The broad rates are 1%, 4%, 20% and 12.5%
 - (d) **True**, now VAT is followed by all the states.
 - (e) **False**, a dealer with turnover below the specified amount (say Rs.5 lac or 10 lac) need not to be registered compulsorily.
-