

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.

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) Which of the following income is agricultural income —
 - (a) Rent received from agricultural land
 - (b) Income from dairy farm
 - (c) Income from poultry farm
 - (d) Dividend from a company engaged in agriculture.
 - (ii) The term 'income' includes the following types of incomes —
 - (a) Legal
 - (b) Illegal
 - (c) Legal and illegal both
 - (d) None of the above.
 - (iii) Every year, the residential status of an assessee —
 - (a) May change
 - (b) Will certainly change
 - (c) Will not change
 - (d) None of the above.
 - (iv) Sneha is an employee in a private company. In the previous year she received salary Rs.1,80,000 and entertainment allowance Rs.12,000. She spent Rs.6,000 on entertainment. Under section 16(ii), she is entitled to deduction of —
 - (a) Rs.12,000
 - (b) Rs.6,000
 - (c) Rs.5,000
 - (d) Nil.
 - (v) In whose total income, the income of a minor child is included —
 - (a) Father
 - (b) Mother
 - (c) Father and mother both
 - (d) Parent whose total income is greater. (1 mark each)
- (b) State, with reasons in brief, whether the following statements are correct or

incorrect :

- (i) *An Indian company is always resident in India no matter where and to what extent its control and management is situated.*
 - (ii) *Rent from house property let-out by an assessee to his employees when such letting is incidental to his main business, will be chargeable to tax under the head 'income from house property'.*
 - (iii) *Income by way of winnings from lotteries in the hands of a dealer as a regular business activity is not chargeable to tax under the head 'profits and gains of business or profession'.*
 - (iv) *Income from transfer of self-generated goodwill of a profession is not chargeable to tax under the head 'capital gains'.*
 - (v) *Literary awards instituted by the Central Government are exempted from income-tax. (1 mark each)*
- (c) *Particulars of income received by Mrs. Sarita for the year ended 31st March, 2010 are as follows :*
- (i) *Family pension received from the Government of Madhya Pradesh Rs.15,000.*
 - (ii) *Royalty received from a publisher Rs.42,700. She spent Rs.2,700 on books, stationery, typing, etc.*
 - (iii) *Winnings from lotteries (gross) Rs.90,000.*
 - (iv) *Winnings from horse race (net) Rs.35,000.*
 - (v) *Interest from tax-free debentures of a public company (listed) Rs.18,000.*
 - (vi) *Interest on tax-free notified government bonds Rs.10,000.*
 - (vii) *Dividend received from a foreign company (net) Rs.8,000. Nothing has been paid to the Government of India out of tax deducted at source.*
- From the above information, compute income from other sources of Mrs.Sarita for the assessment year 2010-11. (5 marks)*

Answer 1(a)

- (i) (a) Rent received from agricultural land
- (ii) (c) Legal and illegal both
- (iii) (a) May change
- (iv) (d) Nil
- (v) (d) Parent whose total income is greater.

Answer 1(b)

- (i) **Correct:** According to Section 6(3) of the Income-tax Act, 1961, an Indian company is always resident in India no matter where and to what extent its control and management is situated.

- (ii) **Incorrect:** The residential quarters let out by the assessee to his employees for the purpose of his business shall not be chargeable under section 22 of the Act as 'Income from house property' same judgment given in *CIT v. Delhi Cloth and General Mills Ltd.* [1966] 59 ITR 152.
- (iii) **Incorrect:** Income by way of winnings from lotteries in hands of a dealer as regular business activity shall be chargeable under the head Income from "Profits and gains of business or Profession" as decided in *Director of State Lotteries v. Asstt.* (IT (2000) 108 Taxmann (Gauhati)
- (iv) **Correct:** When it is not possible to ascertain the cost of acquisition and improvement which is required to be deducted from the full value of consideration while computing income from capital gains, then income from transfer of such asset is not taxable. This has been so held by the Supreme Court in *CIT v. B C Srinivasa Setty* [1981] 5 Taxmann. However, as per the Amendments made in the Act by the Government, this judgment is not applicable in the case of certain other self-generated assets.
- (v) **Correct:** Under Section 10(17A) of the Act, any payments made in cash or kind in pursuance of any award instituted in the public interest by the Government or instituted by any other body and approved by the Central Government is exempt from tax.

Answer 1(c)

Computation of Income from other sources for the Assessment Year 2010-11

	Rs.	Rs.
(i) Family pension received from Government of M.P.	15,000	
Less : 1/3 rd exempt u/s 57	<u>5,000</u>	10,000
(ii) Royalty	42,700	
Less : Expenses	<u>2,700</u>	40,000
(iii) Winning from lottery		90,000
(iv) Winning from Horse Races		
Grossed up $(35,000 \times 100)/70$		50,000
(v) Interest from tax free debentures of a Public Company		20,000
Grossed up $(18,000 \times 100)/90$		
(vi) Interest from tax free notified Govt. Bonds		Exempt
(vii) Dividend from a Foreign Company		<u>8,000</u>
Income from Other Sources		<u>2,18,000</u>

Question 2

- (a) Re-write the following sentences after filling-in the blank spaces with appropriate word(s)/figure(s) :
- (i) The maximum exemption limit under the Income-tax Act, 1961 in case of a woman who is less than 65 years of age and who is non-resident in India is Rs._____.
- (ii) The time limit for filing an appeal before the appellate tribunal on receipt

of an appeal order from the commissioner is _____ days.

- (iii) Wealth-tax is charged at the rate of _____ % on net wealth in excess of Rs. _____ lakh under the Wealth-tax Act, 1957.
 - (iv) Business loss relating to illegal business is _____ as deduction.
 - (v) Marriage gift from a non-relative is _____ to tax. (1 mark each)
- (b) Write short notes on **any two** of the following :
- (i) Belated return
 - (ii) Taxation of zero coupon bonds
 - (iii) Profit in lieu of salary. (3 marks each)
- (c) Discuss the procedure for rectification of mistakes under the Income-tax Act, 1961. (4 marks)

Answer 2(a)

- (i) Rs.1,60,000
- (ii) 60 days
- (iii) One percent, 30 lakh
- (iv) Not allowable
- (v) Not chargeable

Answer 2(b)(i)

Belated return

Any person who has not furnished a return of Income within the time allowed to him under Section 139(1) or within the time allowed under a notice issued under Section 142(1) may furnish the return for any previous year at any time before the expiry of one year from the end of relevant assessment year or before the completion of the assessment whichever is earlier. In case of belated return, the assessee will be liable to pay interest under section 234A, capital gain loss or business loss can not be carry forward, and no deduction under section 10A, 10B, 80-IA, 80-IB etc. will be allowed.

Answer 2(b)(ii)

Taxation of zero coupon bonds

The profits arising on the transfer of zero coupon bonds shall be chargeable under the head capital gains. Further Section 2(42A) has been amended to provide that if such zero coupon bonds are held for not more than 12 months such capital asset shall be treated as short-term capital asset and hence shall be subject to short-term capital gain. On the other hand where these bonds are held for more than 12 months such capital gain shall be treated as long-term capital gain.

As per section 112(1) where the tax payable in respect of any income arising from the transfer of a long-term capital assets being zero coupon bonds exceed 10% of the amount of capital gain before giving effect to the provisions of the second proviso to Section 48 (i.e. before giving effect to indexed cost) such excess shall be

ignored for the purpose of computing the tax payable by the assessee. In other words long-term capital gain shall be chargeable to tax at 10% of LTCG before indexation of cost of such bonds.

Answer 2(b)(iii)

Profit in lieu of salary

Under section 17(3) of the Income Tax Act the following are deemed to be the profits in lieu of or in addition to salary and are taxable in the hands of employee:

1. **Terminal compensation:** The amount of any compensation due to or received by an assessee from his employer or former employer at or in connection with the termination of his employment or the modification of the terms and conditions.
2. **Payment from an unrecognized provident fund or an unrecognized superannuation fund:** Payment due to or received by an assessee from an unrecognized provident fund or an unrecognized superannuation fund to the extent of employer's contribution till date and interest thereon.
3. **Payment under Keyman Insurance Policy:** Any payment due to or received by an employee, under a Keyman Insurance Policy including the sum allocated by way of bonus on such policy, will also be regarded as profit in lieu of salary.
4. **Any amount due or received before joining or after cessation of employment:** Any amounts due to or received, whether in lump sum or otherwise by any assessee from any person :
 - (a) Before his joining any employment with that person; or
 - (b) After cessation of his employment with that person.

Answer 2(c)

Rectification of Mistakes

Under section 154 of the Income Tax Act with a view to rectify any mistake apparent from the records the Income tax Authorities referred in Section 116 may amend any order passed by it under provisions of this Act and also amend any intimation/deemed intimation under section 143(1) or enhance or reduce the amount of refund granted by it under that sub-section. This power of rectification can be exercised by the authorities either on their own motion or on application made by the assessee.

The mistake sought to be rectified may be a mistake of facts or of law. But the mistake must be one which is glaring, obvious or apparent from the records and should not be one to discover with a long drawn process of reasoning, arguments etc. are needed or for which there may be conceivably two opinions.

The power of rectification of mistake lies with the authority who passed the order which is sought to be rectified.

Where an order of rectification of assessment has the effect of enhancing the

amount of income assessed or reducing a refund granted to the assessee or in any way otherwise increasing the liability of the assessee a notice of demand and an opportunity of being heard must be given to the assessee.

The time limit for rectification of mistakes is a period of four years from the end of financial year in which the order sought to be amended was passed.

Question 3

- (a) *An asset is transferred by a person to another person under a partly revocable transfer whereby a part of the asset will revert back to the transferor. Who shall be liable to pay tax in respect of income from the asset transferred as per section 61 ?* (2 marks)
- (b) *Distinguish between **any three** of the following :*
- 'Mercantile system of accounting' and 'cash system of accounting'.*
 - 'Free trade zone' and 'special economic zone'.*
 - 'Exemption to capital gains under section 54G' and 'exemption to capital gains under section 54GA'.*
 - 'Intra-head adjustment' and 'inter-head adjustment'.* (2 marks each)
- (c) *Ram and Shyam are partners in Mozart Co., a partnership firm, which is engaged in manufacturing carpets. They share profits and losses in the ratio of 2:3. The profit and loss account of the firm for the year ended 31st March, 2010 is as follows :*

Liabilities		Rs.
Cost of goods sold		10,00,000
Depreciation		50,000
Salary to staff		1,00,000
Remuneration to partners :		
Ram	Rs. 2,50,000	
Shyam	<u>Rs. 1,20,000</u>	3,70,000
Interest on capital @15% :		
Ram	Rs. 45,000	
Shyam	<u>Rs. 67,500</u>	1,12,500
Sundry expenses		1,00,500
Net profit		<u>7,35,200</u>
		<u>24,68,200</u>
Assets		
Sales		23,00,000
Dividends		28,200
Winnings from lotteries (Rs.2,00,000)		<u>1,40,000</u>
		<u>24,68,200</u>

Additional information :

- (i) *The firm donated Rs.30,000 to National Defence Fund and this amount is*

included in sundry expenses.

(ii) Depreciation admissible under the income-tax rules is Rs.68,000.

(iii) The firm is evidenced by partnership deed.

Compute the taxable income and amount of tax liability of the firm for the assessment year 2010-11. (7 marks)

Answer 3(a)

By virtue of section 61, if an asset is transferred under a 'revocable transfer', income from such asset is taxable in the hands of the transferor as and when the power to revoke arises, 'Transfer' for this purpose includes any settlement, trust, covenant, agreement or arrangement. The section does not speak of an absolute or unqualified power of revocation. The transferor will be taxable even if the power to revoke has not been exercised so far.

Answer 3(b)(i)

Mercantile system of accounting and cash system of accounting

Under the mercantile method of accounting, income and expenditure are recorded at the time of their occurrence during the previous year while under the cash method, revenue and expenses are recorded only when actually received or paid. Under the mercantile method, income accrued during the previous year is recorded whether it is received during the previous year or during any other year while under the cash system, income received during the previous year is included in taxable income whether it is earned during the previous year or during any other year. Under the mercantile method, expenditure is recorded when it becomes due during the previous year irrespective of the fact whether it is paid during the previous year or not while under the cash system, expenditure is deductible from the taxable income only if it is paid during the previous year irrespective of the fact whether it relates to the previous year or not under the mercantile method, profit is the amount which represents the amount of earnings accrued during the previous year though not necessarily released in cash while under the cash system income is represented by excess of receipts over disbursements during the previous year.

Answer 3(b)(ii)

Free trade zone and special economic zone

Provisions relating to free trade zone are given under section 10A while provisions relating to 'special economic zone', are given under section 10AA of the Act. In order to get benefit under section 10A, an undertaking must begin manufacture or production during the financial year 1980-81 or any subsequent year while under section 10AA the entrepreneur must begin to manufacture or produce articles or things or provide services during the financial year 2005-06 or any subsequent year. If a unit is eligible to get deduction under section 10AA, it cannot get the benefit of deduction under section 10A. The maximum period of availability of deduction under section 10A is 10 years while the period of availability of deduction under section 10AA is 15 years. The requirement of debiting 50% of the amount of profit to 'Special Economic Zone Re-investment Reserve Account' under section 10A

starts from the eighth year from the previous year in which the undertaking begins to manufacture or produce articles or things while under section 10AA this requirement of debiting 50% of the profits to 'Special Economic Zone Re-investment Reserve Account' starts from the eleventh year from the previous year in which the unit begins to manufacture or produce articles or things or provide services.

Answer 3(b)(iii)

Exemption under section 54G is available in respect of transfer of asset in the case of shifting of industrial undertaking from urban area to any area other than urban area while exemption under section 54GA is available in case of shifting of an industrial undertaking from urban area to a special economic zone which may be situated in urban area.

Answer 3(b)(iv)

Intra-head adjustment and inter-head adjustment

The provisions relating to inter-source adjustment have been given under section 70 while the provisions relating to inter-head adjustment are given under section 71 of the Act. In case of Intra head adjustment, loss from a source is allowed to be adjusted against income from another source within the same head of income. In case of inter head adjustment, loss under one head of income can be adjusted against income under another sources. As per section 70, long-term capital loss cannot be set-off from short-term capital gains, while as per section 71, neither long-term capital loss nor short-term capital loss can be set off from income under other heads of income. As per section 71, loss from business or profession cannot be set off against income under the head "salaries". There is no parallel restriction under section 70.

Answer 3(c)

Computation of Taxable Income of Mozart Co. a firm for the Assessment Year 2010-11.

Particulars	Amount (Rs.)
Computation of book Profits :	
Net Profit as per Profit & Loss A/c	7,35,200
Add : Inadmissible expenses :	
Donations	30,000
Interest on capital in excess of 12%	
Ram	9,000
Shyam	<u>13,500</u>
Remuneration to partners	3,70,000
	<u>4,22,500</u>
	11,57,700
Less: Non-business incomes credited to P&L A/c :	
Dividends	28,200
Winnings from lotteries	<u>1,40,000</u>
	1,68,200
	9,89,500
Less : Depreciation under charged	<u>18,000</u>
Book Profits	<u>9,71,500</u>

Computation of remuneration allowable to Partners :

On first Rs.3,00,000 @ 90% or Rs.1,50,000	2,70,000
On balance Rs.6,21,500 @ 60%	3,72,900
Maximum permissible amount	6,42,900

Actual amount of remuneration is Rs.3,70,000

Therefore, amount allowable as remuneration to partners will be Rs.3,70,000

Income under head PGBP:

Book Profits	9,71,500
Less: Remuneration to partners	3,70,000
	6,01,500

Income from other Sources :

Winnings from lotteries	2,00,000
Dividends	Exempt
	2,00,000
GTI	8,01,500

Less: Deduction under Chapter VI

Under section 80G (100%)	30,000
Total Income	7,71,500

Computation of amount of Tax

On winnings from lotteries [30% on Rs.2,00,000]	60,000
On balance of income @ 30%	
[Rs.7,71,500 – Rs.2,00,000]	1,71,450

	2,31,450
Add: EC & SHEC (3%)	6,944
	2,38,394

Less: TDS on winnings from lotteries [30% on Rs.2,00,000]

Tax Payable	1,78,394
Tax payable rounded off	1,78,390

Question 4

- (a) Raman has following assets and liabilities as on 31st March, 2010. Compute his net wealth and wealth-tax liability for the assessment year 2010-11 :

	Market Value (Rs.)
(i) Cash in hand	75,000
(ii) Cash at bank	10,00,000
(iii) Residential house (Loan taken to purchase this house Rs.5,00,000)	45,00,000
(iv) Land in rural area (it is within 5 kms. from Delhi)	48,00,000
(v) Land in urban area (construction not permitted under the law, loan taken to purchase this land Rs.3,00,000)	28,00,000
(vi) Motor car for personal use	14,00,000

- | | |
|--|-------------|
| (vii) Jewellery | 6,00,000 |
| (viii) Aircraft for personal use (Loan taken to purchase aircraft Rs.20,00,000) | 1,00,00,000 |
| (ix) Farm house situated within 20 kms. from local limits of municipality | 24,00,000 |
| (x) One let-out residential house given on rent throughout the year (Loan taken to construct this house Rs.2,00,000) | 20,00,000 |
| | (5 marks) |
- (b) State the provisions regarding deduction of tax at source in respect of the following incomes :
- Winnings from horse races.
 - Payment by way of fees or royalty for professional or technical services.
 - Payment of compensation on acquisition of immovable property.
- (2 marks each)
- (c) Discuss the cases in which payment by way of loan/advance to the extent of accumulated profits by a closely held company is treated as dividend under section 2(22)(e). (4 marks)

Answer 4(a)

**Computation of net wealth of Mr. Raman
for the Assessment Year 2010-11.**

Particulars	Amount (Rs.)
(i) Cash in hand (in excess of Rs.50,000)	25,000
(ii) Cash at bank (not an asset)	---
(iii) Residential house (exempt under section 5(vi))	---
(iv) Land in rural area (being within 5 kms. from municipal limits of Delhi)	48,00,000
(v) Land in urban area (not taxable because construction is not permitted)	---
(vi) Motor Car for personal use	14,00,000
(vii) Jewellery	6,00,000
(viii) Aircraft for personal use	1,00,00,000
(ix) Farm house (being situated within 25 kms. from local limits of municipality)	24,00,000
(x) Let out residential house (not an asset because given On rent throughout the year)	
Gross Wealth	1,92,25,000
Less: Loan on Aircraft	20,00,000
Net Wealth	1,72,25,000
Amount of Wealth Tax Payable by Mr. Raman	
1% of [Rs.1,72,25,000 – 30,00,000]	1,42,250

Note: The amount of loan borrowed in respect of non-taxable assets will not be taken into consideration.

Answer 4(b)

(i) Winnings from horse races:

Tax is deductible at source from any income by way of winnings from horse races under section 194BB @ 30% (from 1st Oct. 2009 surcharge and education cess shall not be applicable). TDS is applicable only when income by way of such winnings paid to a person exceeds Rs.2,500.

(ii) Payment by way of Fees or Royalty for professionals or technical services:

TDS on fees for professional or technical services or royalty is payable under section 194J. TDS in such a case is generally deductible by a person other than an individual or HUF who is responsible for paying to a resident person any sum by way of fees for professional services, or fees for technical services or royalty. Tax shall be deducted @10% (from 1st Oct. 2009 surcharge and education cess shall not be applicable). TDS does not apply when amount of such sum or aggregate of the amount of sums credited or paid or likely to be credited or paid during the financial year to the account of the payee does not exceed Rs.20,000 individually for payments for professional services, technical service for royalty or receipts in the nature of non-compete fees and exclusivity rights.

(iii) Payment of compensation on acquisition of immovable property:

TDS in respect of payment of compensation on acquisition of immovable property is covered under section 194LA. Any person who is responsible for paying to a resident any compensation/consideration on account of compulsory acquisition of any immovable property other than agricultural land is responsible for deducting TDS, Tax is deductible at the time of payment of the sum in cash or by issue of a cheque or draft or by any other mode, whichever is earlier. Tax is deductible @10% (from 1st Oct. 2009 surcharge and education cess shall not be applicable) However, tax is not deductible if the aggregate amount during a financial year does not exceed Rs.1 lac.

Answer 4(c)

Payment by way of loan/advance to the extent of accumulated profits by a closely-held company is treated as dividend under section 2(22)(e) in the following cases:

Loan or advance is given by a closely held company to a registered shareholder directly or it may be given for the benefit of shareholder or on behalf of shareholder. The shareholder getting the loan beneficially holds 10% or more of equity shares in the company which gives the loan. Such loan or advance is treated as dividend in the hands of the shareholder.

Loan or advance is given by a closely-held company to a concern which may be a HUF, sole proprietor, firm, AOP, BOI or a company; one of the shareholders, beneficially holding at least 10% equity share capital in loan giving company, has a substantial interest in the concern. A person shall be deemed to have a substantial interest in an concern, if he is at any time during the previous year, beneficially,

entitled to at least 20% of income of such concern; if such concern is a company then he should beneficially hold at least 20% equity share capital of the company. Such loan or advance is treated as dividend in the hands of the concern.

Loan or advances given to any person on behalf or for the benefit of the shareholder holding 10% share in the loan giving company.

Question 5

- (a) Amit is a cloth merchant in Ghaziabad. From the following profit and loss account for the year ended 31st March, 2010, compute his taxable income and tax payable for the assessment year 2010-11 :

	Rs.		Rs.
Opening stock	1,00,000	Sales	40,00,000
Purchases	25,00,000	Closing stock	3,00,000
Reserve for bad debts	10,000	Gift from friend	70,000
Household expenses	20,000	Gift from brother	80,000
Advertisement	40,000		
Depreciation	20,000		
Salaries and wages	1,20,000		
Reserve for future losses	20,000		
Travelling expenses	15,000		
Expenditure on scientific research	50,000		
Net profit	<u>15,55,000</u>		
	<u>44,50,000</u>		<u>44,50,000</u>

Additional information :

- (i) Household expenses include an amount of Rs.5,000 paid for premium on life insurance policy of Amit.
 - (ii) Depreciation admissible as per the income-tax rules is Rs.30,000.
 - (iii) Advertisement costing Rs.10,000 appeared in a newspaper owned by a political party is included in the total amount spent on advertisement.
 - (iv) Expenditure on air fare from Delhi to Bangalore and from Bangalore to Delhi of a sales manager costing Rs.10,000 is included in travelling expenses. The sales manager is otherwise entitled for a second class AC train where the expenditure would be Rs.4,000.
 - (v) Expenditure on scientific research relates to the money spent by Amit on conducting research relating to the business of cement which he proposes to undertake in future. (7 marks)
- (b) Explain with the help of suitable illustration how capital gains are computed under section 45(2) in case of conversion of capital asset into stock-in-trade. (4 marks)
- (c) Describe the powers of Central Board of Direct Taxes (CBDT) under the Income-tax Act, 1961. (4 marks)

Answer 5(a)

**Computation of total Income of Mr. Amit
for the Assessment Year 2010-11**

<i>Particulars</i>	<i>Amount(Rs.)</i>
Income from business:	
Net profit as per Profit & Loss A/c	15,55,000
Add: Inadmissible expenses	
Household expenses	20,000
Advertisement	10,000
Expenditure on scientific research	50,000
Reserve for bad debts	10,000
Reserve for future losses	<u>20,000</u>
	1,10,000
Less: Non-business incomes credited to Profit & Loss A/c	
Gift from friend	70,000
Gift from brother	<u>80,000</u>
	1,50,000
	15,15,000
Less: Depreciation undercharged	<u>10,000</u>
Income from business	15,05,000
Income from other sources:	
Gift from friend	<u>70,000</u>
Gross Total Income	15,75,000
Less: Deduction under section 80-C	
Life Insurance premium	<u>5,000</u>
Total Income	<u>15,70,000</u>

Answer 5(b)

Conversion of investment into stock-in-trade of a business carried on under section 2(47) with effect from the Assessment Year 1985-86 will be treated as 'transfer' in the year in which capital asset is converted into stock-in-trade. The notional profit arising from transfer by way of conversion of capital asset into stock-in-trade is chargeable to tax in the year in which stock-in-trade is sold. If stock-in-trade is sold in parts in different years, tax on capital gains on conversion of capital asset into stock-in-trade as per Section 45(2), can be said to arise in parts in different years and not in one year in which last of stock-in-trade is sold. For the purposes of computing capital gains in such cases, the fair market value of the capital asset on the date on which it was converted or treated as stock-in-trade shall be deemed to be the full value of consideration received or accruing as a result of the transfer of the capital asset.

Suppose Mr. X converts his capital asset into stock-in-trade on February, 28, 1985. Fair market value on the date of conversion is Rs.4,00,000. He acquired the asset on August 16, 1970 for Rs.50,000; fair market value on April 1, 1981 is Rs.70,000. he sells the asset on September 10, 2008 for Rs.8,00,000, what will be the amount of long-term capital gains and assessable business profits chargeable to tax taking the CII for 1984-85 to be 125 and for 2008-09 to be 582?

Solution: By virtue of section 45(2), long-term capital gains will be taxable for the

Assessment Year 2009-10 – the year of transfer of the asset.

	Rs.
Full value of consideration (FMV on date of conversion)	4,00,000
Less: Indexed cost of acquisition	
[70,000 x 125/100]	<u>87,500</u>
LTCG	<u>3,12,500</u>

Business Profits chargeable to tax for the Assessment Year 2009-10 will be:

Sales consideration	8,00,000
Less: FMV on the date of conversion	<u>4,00,000</u>
Business Profits	<u>4,00,000</u>

Answer 5(c)

The CBDT has been vested with a wide variety of powers important among which are as follows :

- (i) CBDT has the power to make rules for carrying out the purpose of the Act.
- (ii) It may issue, orders, instructions and direction to all officers and persons employed in the executions of the Act. However, it cannot interfere with the discretion of the Commissioner (Appeals) in the exercise of appellate functions and it cannot direct the Assessing Officer to make a particular assessment in a particular manner.
- (iii) It may declare any organization as a company.
- (iv) It may direct that income from property held under trust should not form part of the total income of the recipient.
- (v) It may notify any profession under which it will be compulsory to maintain accounts and to make rules regarding maintenance of accounts.
- (vi) It may specify the Income Tax authorities who are empowered to issue summons for search and seizures.
- (vii) To require any authority under any law to disclose information regarding any assessee.
- (viii) It may condone the delay in obtaining approval of the Board, wherever such approval is required.
- (ix) It may prescribe educational qualifications for a person to qualify to be an authorised representative.
- (x) It may give directions to Income Tax Authorities regarding the exercise of their powers and functions.

Question 6

- (a) Naveen owns a house at Indore. Its municipal valuation is Rs.24,000. He incurred the following expenses in respect of the house property :

Municipal tax @ 20%, fire insurance premium Rs.2,000 and land revenue Rs.2,400. He took a loan of Rs.25,000 @16% per annum on 1st April, 2006.

The whole amount is still unpaid. The house was completed on 1st April 2009. Find out the income from house property for the assessment year 2010-11 in respect of the following options :

- (i) If the house is used by the assessee throughout the previous year for his residential purpose; and
- (ii) If the house is let-out for residential purposes on monthly rent of Rs.2,000 from 1st April, 2009 to 31st January, 2010 and self-occupied for the remaining period. (6 marks)
- (b) What are the due dates of payment of advance tax in the case of corporate and non-corporate assesseees ? (3 marks)
- (c) How is the liability to advance tax computed as per provisions of section 210? (3 marks)
- (d) Explain the deductions which are available to an assessee under section 57 while computing taxable income chargeable under the head 'income from other sources'. (3 marks)

Answer 6(a)

**Computation of Income from House Property
for the Assessment Year 2010-11.**

- (a) If the house is used by the assessee throughout the previous year for his residential purpose:

	Rs.
Annual Value	Nil
Less: Interest on Loan	<u>6,400</u>
As per point (ii) + (iii) below	
Loss from House Property	<u>6,400</u>

OR

- (B) If the house is let out for some period:

Annual Rental value of whole house :		Rs.
Municipal Valuation	24,000	
OR		
Rent received for 10 months 2000 x 10	<u>20,000</u>	24,000
Less : Municipal Tax 20%		<u>4,800</u>
Net Annual Value		19,200
Less: Deduction under section 24		
(i) SD 30% of NAV 19,200 x 30% =	5,760	
(ii) Interest on Loan (2008-09) =	4,000	
(iii) 1/5 of Interest on Loan (3 years)		
Construction period :		
25,000 x 16% x 3 x 1/5 =	<u>2,400</u>	<u>12,160</u>
Income from HP		<u>7,040</u>

Answer 6(b)**Due date and instalments (Section 211):****(i) In case of companies:**

<i>Due Date</i>	<i>Amount Payable</i>
On or before 15th June	Not less than 15% of Advance Tax liability
On or before 15th September	Not less than 45% of Advance Tax liability reduced by the amount already paid
On or before 15th December	Not less than 75% of Advance Tax liability reduced by the amount already paid
On or before 15th March	Not less than 100% of Advance Tax liability reduced by the amount already paid

(ii) In case of other assesseees:

<i>Due Date</i>	<i>Amount Payable</i>
On or before 15th September	Not less than 30% of Advance Tax liability
On or before 15th December	Not less than 60% of Advance Tax liability reduced by the amount already paid
On or before 15th March	100% of Advance Tax liability reduced by the amount already paid.

Answer 6(c)**Liability for payment of Advance Tax:**

Advance tax shall be payable during a financial year in every case where the tax payable by the assessee during the year is Rs.10,000 or more. As per provisions under section 210, an assessee who is liable to pay advance tax is required to estimate his current income and pay advance tax thereon without having to submit any estimate or statement of income to the assessing authorities. After making payment of first/second installment of advance tax, an assessee can revise the remaining instalments of advance tax in accordance with his revised estimate of advance tax. Tax can be computed on the current income as estimated by the taxpayer at the rates in force during the financial year. From out of the amount of tax so computed tax deductible or collectible at source will be deducted.

As regards computation of tax by Assessing Officer, first of all he will have to find out income of the current year on the following basis:

- (i) Total income of the latest previous year in respect of which the assessee has been assessed by way of regular assessment; or
- (ii) The total income computed by the assessee in the return for any subsequent year; which is higher

Tax liability on the income of the current year would be calculated according to the rate applicable TDS/TCS will be deducted. Calculation can be made on the

similar lines when the assessee wants to make upward/downward revision of current income.

As regards payment of advance tax in pursuance of revised order of Assessing Officer, the total income declared in the return furnished by the assessee for the later previous year or total income in respect of which the regular assessment is made after passing an order by the Assessing Officer but before March 1, shall be taken and income-tax thereon shall be calculated at the rates in force in the financial year. From the tax so determined, TDS or TCS will be deducted.

Answer 6(d)

The income chargeable to tax under the head 'income from other sources' is computed after making the following deductions available under section 57:

- (i) In the case of dividend or interest on securities :
 - (a) Any reasonable sum paid by way of commission or remuneration to a banker or any other person for the purpose of realizing dividend or interest on securities on behalf of the assessee. Dividend under section 115-O is not chargeable to tax in the hands of shareholders.
 - (b) Any other expenses expended wholly and exclusively for the purpose of earning such income during the previous year. However, the expenditure must not be in the nature of capital expenditure and personal expenditure.
- (ii) In respect of employee's contribution towards staff welfare schemes—Deduction in respect of any sum received by a taxpayer as contribution from his employees towards any welfare fund of such employees is allowable only if such sum is credited by the taxpayer to the account of the employee in the relevant fund before the due date. Due date is the date by which the assessee is required, as employer, to credit such contribution to the account of the employee in the relevant fund under the provisions of any law or terms of contract of service or otherwise.
- (iii) In respect of plant, machinery furniture and building which are let out :
 - (a) current repairs in respect of building;
 - (b) insurance premium in respect of insurance against risk of damage or destruction of premises;
 - (c) repairs and insurance of machinery plant or furniture; and
 - (d) depreciation
- (vi) In respect of family pension, the amount deductible is Rs.15,000 or one-third of such income, whichever is less.

PART—B

Question 7

Attempt **any four** of the following :

- (a) As per rule 2(1)(d) of the Service Tax Rules, 1994, who is the person

specified to be liable for paying service tax in respect of the following services —

- (i) Telecommunication services.*
- (ii) Services in relation to general insurance business.*
- (iii) Services in relation to any taxable service or service to be provided by any person from a foreign country to any person in India.*
- (iv) Business auxiliary service of distribution of mutual fund by a mutual fund distributor or an agent, as the case may be.*
- (v) Sponsorship services provided to any body corporate or firm located in India. (1 mark each)*
- (b) (i) Which category of persons must mandatorily obtain registration under Chapter V of the Finance Act, 1994 ? (3 marks)*
- (ii) What are the time limits for making application for registration and granting registration for service tax under Chapter V of the Finance Act, 1994 ? (2 marks)*
- (c) (i) When is an assessee registered under service tax required to surrender the registration certificate ?*
- (ii) On which amount — amount of bill raised on the client or amount actually received from the client, service tax is payable ?*
- (iii) If an assessee pays service tax on the billed amount but he gets less amount from his customers, can he get refund from the government ?*
- (iv) If the service provider fails to recover service tax on a bill of Rs.12,000 where service tax is not shown separately in the invoice, what will be the amount of service tax ?*
- (v) When will the small service provider claiming exemption from paying service tax apply for registration under service tax ? (1 mark each)*
- (d) Comment on the following statements —*
 - (i) "Service tax is payable as soon as advance is received even if the service is provided later." (2 marks)*
 - (ii) "Excess service tax collected is to be paid to the Central Government." (3 marks)*
- (e) Discuss the exemption available to small service providers from paying service tax. (5 marks)*

Answer 7(a)

- (i) The Director General of Post and Telegraph, Chairman cum managing director of MTNL, any person who has been granted a license by the Government under Indian Telegraph Act.*
- (ii) Insurer or reinsurer providing such service.*
- (iii) Recipient of such service*

- (iv) Mutual fund or asset Management Company, as the case may be, receiving such service.
- (v) Person providing such sponsorship services.

Answer 7(b)(i)

The following categories of persons must mandatorily obtain registration:

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

Answer 7(b)(ii)

The time limit for making application for registration under the Service Tax in respect of different categories of persons is as follows:

- (a) For persons who are liable to pay services tax—As per Rule 4(1), the application for registration is required to be made within 30 days from the date of the commencement of business.
- (b) For input service distributors—an input service distributor must make the application in Form No. ST—1 within a period of 30 days of the commencement of business.
- (c) For small service providers—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.

Time limit for granting registration –The department is required to issue the registration certificate within 7 days from the receipt 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. Of course, the service provider is required to mention his registration number in his service.

Answer 7(c)

- (i) A registered assessee as per Rule 4(7) is required to surrender the registration certificate when he ceases to provide the taxable service in respect of which registration has been obtained, to the designated Central Excise Officer/Superintendent of Central Excise.
- (ii) Service tax is payable to the Government on the amount actually received towards value of taxable services and not on amount charged in the bills/invoice.
- (iii) If the assessee pays service tax on the billed amount while he gets less amount from his customers, he is entitled to a refund. In such a case, the service provider should amend the bill by rectifying the bill or by issuing a revised bill by endorsing the changes in the amount of the bill.

- (iv) The amount of the service tax would be :

(Gross amount x Rate of Tax)/100 + Rate of Tax

$(12,000 \times 10.3)/110.3 = \text{Rs.}1121$

- (v) 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.

Answer 7(d)(i)

As per Section 67(3), gross amount charged for taxable service shall include payment for services received before, during or after the provision of taxable service. Therefore, service tax is payable as soon as advance is received even if the service is provided later.

Answer 7(d)(ii)

As per Section 73A(1), if any person who is liable to pay service tax has collected any amount in excess of the service tax assessed or determined and paid on any taxable service, from the service receiver in any manner as representing service tax, he shall pay the amount so collected to the credit of the Central Government. Also, if any person has collected any amount of service tax from any person which is not required to be collected, such person shall also pay the amount so collected to the credit of the Central Government. The Central Excise Officer is responsible for collecting such amount by serving notice on the person in question.

Answer 7(e)

Service tax is a tax imposed by the Central Government on taxable services. Taxable services means which is included in the list of taxable services under Section 65. But in the Act small services providers are exempted from paying service tax. 100% exemption from service tax has been granted to a provider of taxable service when aggregate value of taxable service rendered by him from one or more premises, does not exceed Rs.10 lakhs in the preceding Financial Year 2009-10.

In the Union Budget 2008 the exemption limit increased from 8 to 9 lakh. Therefore, w.e.f. 1.4.2008 such service providers whose annual taxable service is not more than Rs.10 lakh shall not be covered under service tax i.e., they shall not pay service tax on services provided by them.

PART—C

Question 8

Attempt **any four** of the following :

- (i) "As a result of introduction of value added tax (VAT), the central sales tax will be phased out." Explain the statement.
- (ii) Discuss in what respects VAT system as adopted in India is deficient in the direction of getting maximum benefits of VAT.
- (iii) "VAT liability of a dealer is calculated by deducting input tax credit from tax collected on sales during the payment period." Discuss with the help of a

suitable illustration.

- (iv) *Discuss the cases of purchases in respect of which generally no input tax credit is available.*
- (v) *Explain the various methods of computation of VAT liability. (5 marks each)*

Answer 8(i)

As a result of introduction of VAT the CST is to be phased out. The provisions regarding Central Sales Tax are summarized as below :

- (a) Present CST will continue for some time. CST may go after decision in respect of loss of revenue to states is taken and comprehensive taxation information system is put in place.
- (b) As a result of introduction of VAT CST has been reduced to 3% w.e.f. 1.4.2007. Further from 1.06.2008 the CST rate reduced to 2%.
- (c) There will be no credit of CST paid on inter-state purchases.
- (d) If goods are sent on stock transfer outside the state input tax paid in excess of 2% will be allowed as credit. In other words input tax credit to the extent of 2% will not be allowed as credit if goods are sent inter-state.

Answer 8(ii)

The system of VAT as adopted by states in India though possesses several advantages but still it is deficient on several counts as given below:

- (i) The general rate of VAT is too high. The general rate of VAT is 12.5% which is very high. This high rate has been fixed to compensate for revenue loss on a large number of commodities and industrial inputs which have been included in 4% rate category and many commodities are covered under the 'exempt' category.
- (ii) Non-inclusion of services—A serious short-coming of the VAT system is the non-inclusion of services up till now though the Central Government may delegate the powers to tax some services to the states.
- (iii) Exemptions—under continuous pressure from various quarters the number of commodities exempted from VAT is still large.
- (iv) Floor Rate – The states in India have two basic rates; general rate of 12.5% and a reduced rate of 4%; for precious metals including gold and silver the rate is 1%. These are supposed to be applied uniformly in all states and so these rates are described as floor rates but the states have no power to fix higher or lower rates than these rates. So, this acts as a contradiction in terms in which floor rate is meant. Also, no rebate is given for taxes paid on purchases of goods belonging to the exempted category.
- (v) Classification of goods –classification of goods under different lists is in many cases, arbitrary and leaves wide room for doubts and disputes as to whether a particular item comes within the lower rate category or not. This is bound to give rise to distortions and inequities in the application of the Tax.
- (vi) Concessional rate for inputs—In no country in general, there is concessional

rate for inputs as in India. This goes against the basic idea behind VAT that the end use of a product by the customer should not affect the VAT to be charged and paid by a seller, the system of 'set-off' takes care in the event when it is used as business input. Also reduced rate of tax on inputs also increases revenue loss from undeclared rates of finished products.

- (vii) The application of VAT on maximum retail price at first point is a misconceived idea as is being implemented in the case of drugs in West Bengal and Maharashtra. It defeats the purpose of VAT which is to tax sales at all stages with credits for input/purchase taxes so that there is an audit trail at each stage. It also results in diverting investment from the consuming states to the producing states where the first-point sellers are located.

Answer 8(iii)

The essence of VAT lies in providing set-off for the tax paid earlier through the concept of input tax credit/rebate. This concept means setting off the amount of input tax by a registered dealer against the amount of his output tax. The VAT is based on the value addition to the goods, and the related VAT liability of the dealer is calculated by deducting input tax credit from tax collected on sales during the payment period.

Supposing Mr. X purchases raw materials worth Rs.10,00,000 and records sales in the month of January 2009 of Rs.15,00,000. The rate of input tax is 4% and rate of output tax is 12.5%. The computation of input tax credit shall be calculated as follows:

	Rs.
Input purchased in January, 2008	10,00,000
Value of Output sold in January	15,00,000
Input tax paid @ 4% on Rs.10 lac	40,000
Output tax collected during January @ 12.5% on Rs.15 lac	1,87,500
VAT payable for January 2009 after input tax credit [Rs.1,87,500 – Rs.40,000]	1,47,500

Answer 8(iv)

Generally, no credit is available in respect of the following purchases:

- (i) Goods purchased from unregistered dealers;
- (ii) Goods purchased from other States/Countries;
- (iii) Purchase of Goods which are used in manufacture of exempted goods.
- (iv) Purchase of Capital Goods.
- (v) Purchase of Goods used as fuel in power generation.
- (vi) Purchase of Goods to be dispatched as branch transfers outside states.
- (vii) Purchase of Goods used in manufacture of goods to be dispatched outside any state as branch transfer/consignments;
- (viii) Purchase of Goods in cases where the dealer does not have invoices showing amounts of tax charged separately by the selling dealer.

- (ix) Purchase of non-creditable goods.
- (x) Purchase from a dealer who has opted for composition scheme.

Answer 8(v)

There are three different methods of computation of VAT. These are:

- (a) **Addition method:** Under this method identification of Value Added is estimated by adding values of all the elements of production, wages, profits rent and interest. Under this method the incidence of tax evasion is greater because it does not require matching of invoices.
 - (b) **Subtraction method:** In this method value addition is computed by means of difference between output and input. This method is also known as the product approach and has further variants, i.e., Direct Subtraction, Intermediate Subtraction and Indirect Subtraction method.
 - (c) **Tax Credit method:** Under this method VAT payable by a dealer is arrived at by deducting tax on inputs from the tax on sales. This method is known as the invoice method. This method is universally used because of advantages of computing tax liability under this method. As rate of tax is different in respect of inputs and outputs the addition method and the subtraction method are not practicable in case of a manufacturer.
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