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PAPER – 7 : DIRECT TAX LAWS

Working notes should form part of the answer.

Question No.1 is compulsory.

Attempt any five questions from the remaining six questions.

Question 1

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

	Unit X ₹ (In lacs)	Unit Y ₹ (In lacs)
Total Sales:	180	120
Export Sales : (Inclusive of ₹ 10 lacs for onsite development of computer software outside India by Unit X)	120	10
Profit earned [After claim of bad debts under section 36(1)(vii) in Unit X]	63	36

Plant and machinery used in the business has been depreciated at 15% on straight line method (SLM) basis and depreciation of ₹ 9 lacs was charged to profit and loss account in the proportion of sales during the previous year.

₹ 100 lacs were realized out of export sales in time and balance of ₹ 20 lacs becomes irrecoverable due to bankruptcy of one of the foreign buyers in Unit-X.

Compute the deduction under section 10AA of the Income-tax Act, 1961 and taxable income of Siddarth Ltd. for the Assessment Year 2012-13. (10 Marks)

- (b) The net wealth of a firm consisting of two partners S & K having 3 : 1 share and a capital contribution of ₹ 7,50,000 and ₹ 2,50,000 respectively is as under:

- (i) Value of assets located outside India ₹ 15 lacs.
- (ii) Value of assets located in India ₹ 40 lacs.
- (iii) Debts incurred in relation to assets in India ₹ 5 lacs

Determine the value of interest of the partners in the firm under the Wealth-tax Act, 1957. (4 Marks)

- (c) (i) What are the cases where it is deemed that net wealth chargeable to tax has escaped assessment under section 17 of the Wealth-tax Act, 1957?

The Suggested Answers for Paper 7: Direct Tax Laws are based on the provisions applicable for A.Y. 2012-13, which is the assessment year relevant for May, 2012 examination.

- (ii) Can the Assessing Officer under section 16A of Wealth-tax Act, 1957 refer valuation of assets to the Departmental Valuation Officer for the purpose of making an assessment in a case where no return of wealth has been filed by the assessee? (3 Marks)
- (d) State the circumstances in which Schedule III shall not apply for valuation of immovable property. (3 Marks)

Answer

- (a) Computation of total income of Siddarth Ltd. for A.Y.2012-13

Particulars	₹	₹
Profits and gains of business or profession		
Unit X (See Note 4)	63,81,000	
Less: Deduction under section 10AA (See Working below)	<u>35,45,000</u>	
		28,36,000
Unit Y (See Note 4)		<u>36,54,000</u>
Total Income		<u>64,90,000</u>

Deduction under section 10AA in respect of Unit X (See Notes 1, 2 & 3)

$$\begin{aligned}
 &= \text{Profits of the business of the undertaking, being the Unit in SEZ} \times \frac{\text{Export turnover of the undertaking (in respect of computer software)}}{\text{Total turnover of the business of the undertaking}} \\
 &= \text{Profits of Unit X} \times \frac{\text{Export turnover of Unit X}}{\text{Total turnover of Unit X}} \\
 &= ₹ 63,81,000 \times \frac{1,00,00,000}{1,80,00,000} \\
 &= ₹ 35,45,000
 \end{aligned}$$

Notes:

- (1) Deduction under section 10AA is available in respect of units established in Special Economic Zones which begin to manufacture or produce articles or things or provide any services during the previous year relevant to A.Y.2006-07 or thereafter. Under section 10AA(1), 100% of the profits and gains derived from export of such articles or things or from services is allowable as deduction for a period of five consecutive assessment years beginning with the assessment year relevant to the previous year in which the Unit begins to manufacture or produce such articles or things or provide services, as the case may be. Therefore, in this case, the profits from Unit X, located in

a SEZ, will be eligible for deduction of 100% of the profits and gains derived from export, since P.Y.2011-12 is the second year of its operations. It is assumed that Unit X has fulfilled all the specified conditions for claim of deduction. Unit Y is, however, not eligible for deduction under section 10AA in respect of the exports made by it since it is located in a Free Trade Zone.

- (2) Export turnover, for the purpose of section 10AA, means the consideration received in respect of export by the unit in SEZ. Therefore, in this case, the amount of ₹ 20,00,000 which has become irrecoverable due to bankruptcy of one of the foreign buyers in Unit X will not be included in its export turnover.

Therefore, export turnover of Unit X (in SEZ) = ₹ 1,20,00,000 – ₹ 20,00,000 = ₹ 1,00,00,000.

- (3) Profits and gains from on site development of computer software outside India shall be deemed to be the profits and gains derived from export of computer software outside India. Since the same has already been included in the figure of export sales, no further adjustment is required.

- (4) Computation of unit-wise profits of the business

Particulars	Unit X	Unit Y	Total
	(₹)	(₹)	(₹)
Profit earned [after claim of bad debts under section 36(1)(vii) in Unit X]	63,00,000	36,00,000	99,00,000
Add: Depreciation calculated on SLM basis and charged in the proportion of sales (3:2)	5,40,000	3,60,000	9,00,000
	68,40,000	39,60,000	1,08,00,000
Less: Depreciation calculated @15% on WDV basis and charged in the proportion of sales (3:2) (See Note 5)	4,59,000	3,06,000	7,65,000
Profits of the business	63,81,000	36,54,000	1,00,35,000

- (5) Depreciation as per the Income-tax Rules, 1962 for the A.Y.2012-13 has to be calculated as follows –

Particulars	Amount in ₹
Actual cost of plant and machinery (₹ 9,00,000 / 15%)	60,00,000
Less: Depreciation @15% for P.Y.2010-11 (being the first year of operations). It is logical to assume that the assets were put to use for more than 180 days during the year.	<u>9,00,000</u>
Written down value as on 1.4.2011	<u>51,00,000</u>
Depreciation@15% on WDV for P.Y.2011-12 (₹ 51,00,000 × 15%)	7,65,000

(b) Computation of net wealth of the firm

Particulars	₹	₹
Value of assets located outside India		15,00,000
Value of assets located in India	40,00,000	
Less: Debts incurred in relation to such assets located in India	<u>5,00,000</u>	
		<u>35,00,000</u>
Net wealth of the firm		<u>50,00,000</u>

Value of partner's interest in the assets of the firm

Particulars	S ₹	K ₹
Net assets of the firm to the extent of capital i.e., up to ₹ 10,00,000 – to be allocated in the proportion in which capital has been contributed by the partners	7,50,000	2,50,000
Balance ₹ 40,00,000, to be distributed in profit sharing ratio (3:1)	<u>30,00,000</u>	<u>10,00,000</u>
Value of interest of partners in the net wealth of the firm	<u>37,50,000</u>	<u>12,50,000</u>

Note - As per section 4(1)(b) of the Wealth-tax Act, 1957, in computing the net wealth of an assessee, who is a partner in a firm, the value of his interest in the assets of the firm determined in the manner laid down in Schedule III shall be included.

As per Rule 16 of Schedule III, the net wealth of the firm on the valuation date shall first be determined as if it were the assessee. Thereafter, that portion of the net wealth of the firm as is equal to the amount of its capital shall be allocated amongst the partners in the proportion in which capital has been contributed by them. The remaining portion of net wealth of the firm shall be allocated amongst the partners in accordance with the agreement of partnership or, in the absence of such agreement, in the proportion in which the partners are entitled to share the profits.

- (c) (i) The provisions of section 17 are attracted if the net wealth chargeable to tax has escaped assessment, whether by reason of under-assessment or assessment at too low a rate or otherwise.

The following are the cases where it would be deemed that net wealth chargeable to tax has escaped assessment under section 17 of the Wealth-tax Act, 1957 -

- (1) where no return of net wealth has been furnished by the assessee although his net wealth or the net wealth of any other person in respect of which he is assessable on the valuation date exceeds the maximum amount not chargeable to tax i.e. ₹ 30,00,000;

- (2) where a return of net wealth has been furnished by the assessee but no assessment has been made, and the Assessing Officer notices that the assessee has understated the net wealth or claimed excessive exemption or deduction in the return.
- (ii) Reference to Valuation Officer under section 16A is made for the purposes of making an assessment under the Wealth-tax Act, 1957 where the market value of any asset is to be taken into account in such assessment.

If a person has not filed his return of wealth within the due date of filing the return, the Assessing Officer can serve a notice requiring such person to furnish the return on a specified date. If the person fails to furnish the return, then the Assessing Officer can proceed to make a best judgment assessment and estimate the net wealth of the person after giving him an opportunity of being heard.

Therefore, even in a case where return of wealth is not furnished, the Assessing Officer can make a best judgment assessment, and if the market value of any asset is to be taken into account in such assessment, he may refer the valuation of such asset to the Valuation Officer under section 16A, if having regard to the nature of the asset and other relevant circumstances, the Assessing Officer is of the opinion that it is necessary to do so.

Note – In CWT v. Anil Tayal (HUF) (No.1) (2006) 285 ITR 243, the Punjab & Haryana High Court held that reference under section 16A(1) could be made even where no return had been filed by the assessee.

- (d) As per section 7(1) of the Wealth-tax Act, 1957, the value of any asset, other than cash, for the purposes of this Act, shall be its value as on the valuation date determined in the manner laid down in Schedule III. Therefore, except in the case of cash, all other assets have to be valued in the manner laid down in Schedule III.

Rule 8 of Schedule III only specifies the circumstances in which Rule 3 of Schedule III shall not apply for valuation of immovable property. Even in such circumstances, the value of the property shall be determined in the manner laid down in Rule 20 of Schedule III.

Therefore, immovable property has to be valued as per Schedule III and there is no such circumstance specified in the Wealth-tax Act, 1957 where the entire Schedule III would not apply for valuation of immovable property.

Question 2

S. Ltd., engaged in the business of manufacturing, shows a net profit of ₹ 5 crores for the financial year ended 31-3-2012, after debiting/crediting the following items:

- (i) *On EPABX and mobile phones (exclusively used for the business purpose) purchased during the year, depreciation amounting to ₹ 18 lacs was claimed at higher rate of 60% treating them at par with computer.*

- (ii) ₹ 50 lacs paid to N. Ltd, towards feasibility study conducted for examining proposals for technological advancement relating to the existing business, where the project was abandoned without creating a new asset.
- (iii) ₹ 35 lacs paid for the higher studies of the director's son abroad, with a stipulation that he would be appointed as a trainee in the company under "apprentice training scheme" where there is no evidence of existence of such scheme.
- (iv) Payment of ₹ 29 lacs towards purchase of software from a non-resident, meant for subsequent resale in the Indian market (no tax deducted at source), was ultimately sold at a profit during Financial Year 2011-12.
- (v) Dividend of ₹ 10 lacs received from a foreign company in which this company holds 28% in nominal value of the equity share capital of the company. ₹ 0.25 lac expended on earning this income.
- (vi) A machine in use since past 7 financial years having WDV amounting to ₹ 1.50 lacs on 01-04-2010 was discarded on 3rd September, 2010. The depreciation on the block at 15% has been provided and charged to profit and loss account for the previous year ended 31st March, 2012. The entire block is used for the purpose of business.
- (vii) ₹ 45 lacs were paid on 3rd June, 2011 to a National Laboratory with a stipulation that the said contribution shall be used for the purpose of an approved scientific research programme only.
- (viii) Secret commission of ₹ 13 lacs was paid and debited under commission account.
- (ix) Purchased a brand new bus and donated to a school where the employees' children were studying and debited the same to the Workmen and Staff Welfare Account.

Additional Information:

- (x) A debt of ₹ 10 lacs was claimed as bad debt in the previous year 2010-11. However, the Assessing Officer allowed only a sum of ₹ 5 lacs as bad debts. In the previous year 2011-12, a sum of ₹ 4 lacs is recovered ultimately in respect of the debt.

Compute total income of S. Ltd. for the Assessment Year 2012-13 and work out the amount of tax payable on such income, indicating reasons for treatment of each item. (16 Marks)

Answer

Computation of total income of S Ltd. for the A.Y. 2012-13

Particulars	₹	₹
Profits and gains of business or profession		
Net profit as per profit and loss account		5,00,00,000
Add: Excess depreciation provided on EPABX & Mobile phones not allowable as deduction [Note (i)]	13,50,000	
Payment for higher studies of director's son abroad not allowable as deduction [Note (iii)]	35,00,000	

Expenditure on earning dividend from foreign company not deductible [Note (v)]	25,000	
Secret commission paid not allowable [Note (viii)]	<u>13,00,000</u>	<u>61,75,000</u>
		5,61,75,000
Less Dividend received from foreign company to be considered under the head "Income from other sources" [Note (v)]	10,00,000	
Payment to National Laboratory eligible for weighted deduction@ 200% under section 35(2AA) [Note (vii)]	45,00,000	
Bad debts allowable as deduction [Note (x)]	<u>1,00,000</u>	<u>56,00,000</u>
		5,05,75,000
Income from Other Sources		
Dividend from foreign company [Note (v)]		<u>10,00,000</u>
Total Income		<u>5,15,75,000</u>

Computation of tax liability of S Ltd. for the A.Y.2012-13

Particulars	₹
Tax @15% on dividend from specified foreign company ₹ 10,00,000 [Note (v)]	1,50,000
Tax @30% on the balance total income of ₹ 5,05,75,000	<u>1,51,72,500</u>
	1,53,22,500
Add: Surcharge@5% (since total income exceeds ₹ 1,00,00,000)	<u>7,66,125</u>
	1,60,88,625
Add: Education cess@2%	3,21,773
Secondary and higher education cess@1%	<u>1,60,886</u>
Total tax liability	<u>1,65,71,284</u>

Notes:

- (i) EPABX and mobile phones are not computers and therefore, are not entitled to higher depreciation@60%. It was so held by the Kerala High Court in *Federal Bank Ltd. v. ACIT (2011) 332 ITR 319*. Therefore, EPABX and mobile phones would be entitled to depreciation of ₹ 4,50,000, calculated by applying the rate of 15%, being the general rate applicable to plant and machinery, on the cost of ₹ 30,00,000 (₹ 18,00,000 × 100/60). The excess depreciation of ₹ 13,50,000 (being ₹ 18,00,000 – ₹ 4,50,000), debited to profit and loss account, should be added back.
- (ii) The issue is whether payment of ₹ 50 lakhs to N Ltd. towards feasibility study conducted for examining proposals for technological advancement relating to the existing business, where the project was abandoned without creating a new asset, is allowable as revenue expenditure.

On this issue, the Delhi High Court, in *CIT v. Priya Village Roadshows Ltd. (2011) 332 ITR 594*, observed that in such cases, whether or not a new business/asset comes into

existence would become the relevant factor. If there is no creation of a new asset, then the expenditure incurred would be of revenue nature. In this case, since the feasibility study was conducted by S Ltd. for the existing business and the study was abandoned without creating a new asset, the expenses were of revenue nature.

Since the expenditure of ₹ 50 lakhs has already been debited to profit and loss account, no further adjustment is required.

- (iii) In this case, since there is no evidence of existence of any "apprentice training scheme", the expenditure of ₹ 35 lakhs incurred in respect of higher studies abroad for the director's son is not allowable as deduction as there is no nexus between the education expenditure incurred abroad for the director's son and the business of S Ltd. It was so held by the Bombay High Court in *Echjay Forgings Ltd. v. ACIT (2010) 328 ITR 286*.
- (iv) Since S Ltd. has purchased the software from a non-resident for subsequent resale in the Indian market, it had acted as a dealer and therefore the payment to the non-resident cannot be termed as royalty to attract the provisions of tax deduction at source. Therefore, section 40(a)(i) would have no application in this case and the payment made to the non-resident cannot be disallowed under section 40(a)(i) on the ground that no tax was deducted at source. It was so held by the Delhi High Court in *CIT vs. Dynamic Vertical Software India P. Ltd. (2011) 332 ITR 222*.

In this case, since the payment of ₹ 29 lakhs is already debited to profit and loss account, no further adjustment is required.

Note – The Finance Act, 2012 has amended section 9(1)(vi) retrospectively with effect from 1st June, 1976, to clarify that consideration for use or right to use of computer software is royalty and consequently, tax has to be deducted at source in respect of such payments. However, the amendments made by the Finance Act, 2012, including retrospective amendments, are not applicable for May, 2012 examination.

- (v) Under section 115BBD, dividend received by an Indian company from a foreign company in which it holds 26% or more in nominal value of the equity share capital of the company, would be subject to a concessional tax rate of 15% as against the tax rate of 30% applicable to other income of a domestic company. This rate of 15% would be applied on gross dividend, in the sense, that no expenditure would be allowable in respect of such dividend.

Therefore, dividend of ₹ 10 lakhs received by S Ltd. from a foreign company, in which it holds 28% in nominal value of equity share capital of the company, would be subject to tax@15% under section 115BBD. Such dividend would be taxable under the head "Income from other sources". No deduction is allowable in respect of ₹ 0.25 lakhs expended on earning this income.

Since such dividend has been credited to the profit and loss account, the same has to be reduced for computing income under the head "Profits and gains of business or profession. Likewise, ₹ 0.25 lakhs, representing expenditure for earning dividend

income, which has been debited to profit and loss account, should be added back for computing business income.

- (vi) The issue under consideration is whether depreciation is allowable on the written down value of the entire block, even though the block includes some machinery which has already been discarded and hence, cannot be put to use during the relevant previous year.

The expression "used for the purposes of the business" in section 32, when used with respect to discarded machinery, would mean the use in the business, not in the relevant financial year, but in the earlier financial years. Therefore, the condition for claiming depreciation in respect of the discarded machine would be satisfied if it is used in the earlier previous years for the business. It was so held by the Delhi High Court in *CIT vs. Yamaha Motor India Pvt. Ltd. (2010) 328 ITR 297*.

Since the depreciation, in this case, has been debited to profit and loss account, no further adjustment is required.

- (vii) Under section 35(2AA), weighted deduction@200% is allowable in respect of amount paid to a National Laboratory with a specific direction that such sum shall be used for the purpose of an approved scientific research programme. Therefore, in this case, deduction of ₹ 90 lakhs (i.e., 200% of ₹ 45 lakhs) is allowable to S Ltd under section 35(2AA). Since only the actual payment of ₹ 45 lakhs has been debited to profit and loss account, the balance of ₹ 45 lakhs has to be deducted.
- (viii) As per *Explanation* to section 37(1), any expenditure incurred by an assessee for any purpose which is an offence or which is prohibited by law, shall not be deemed to have been incurred for the purpose of business and no deduction or allowance shall be made in respect of such expenditure. Therefore, payment of secret commission, if it is established as a payment for any purpose which is an offence or which is prohibited by law, cannot be allowed as deduction. It was so held in *Tarini Tarpauline Productions v. CIT (2002) 254 ITR 495 (Ori.)*. Even in cases where it cannot be so established, it would be disallowed under section 40(a)(ia) for non-deduction of tax at source under section 194H.
- (ix) The expenditure incurred for acquiring a new bus and donating it to the school is for the welfare of the children of staff/workmen of the company. Such expenditure is a part of employees' welfare expenses incurred for the purpose of securing healthy services for staff members. Therefore, such expenses were incurred wholly and exclusively for the purpose of the business. Since the bus had been donated to the school, no benefit of enduring nature was derived by S Ltd. as the right of ownership was transferred to school. Hence, it is not a capital expenditure. Since such expenditure is incurred wholly and exclusively for the purpose of business and is not capital in nature, S Ltd. is entitled to claim deduction in full under section 37(1). It was so held by the Rajasthan High Court in *CIT v. Rajasthan Spinning and Weaving Mills Ltd. (2006) 281 ITR 408*.
- (x) In a case where the debt ultimately recovered is less than the difference between the amount of debt and bad debt allowed as deduction, such deficiency will be deductible in

the previous year in which the ultimate recovery is made. Therefore, in this case, since the ultimate recovery of ₹ 4 lakhs is less than ₹ 5 lakhs (being the difference between the debt of ₹ 10 lakhs and the amount of ₹ 5 lakhs allowed as bad debts in the previous year 2010-11), the deficiency of ₹ 1 lakh will be deductible in the P.Y.2011-12, being the year in which the ultimate recovery of ₹ 4 lakhs is made. It may be noted that in a case where the net result is a deficiency, the amount recovered will not be taxable in the year of recovery. Since ₹ 4 lakhs is not credited to profit and loss account, no further adjustment is necessary.

Note - It appears that bad debts recovery of ₹ 4 lakhs is not credited to the profit and loss account since it is given under "Additional Information" in the question. The above solution has been worked out on this basis. However, if it is assumed that the bad debts recovery of ₹ 4 lakhs is credited to profit and loss account as per the correct accounting treatment, then, the same has to be reduced to compute the income chargeable under the head "Profits and gains of business or profession". In addition, the deficiency of ₹ 1 lakh will be deductible in the P.Y.2011-12, being the year in which the ultimate recovery of ₹ 4 lakhs is made. The computation of total income and tax liability, will accordingly change. The total income would be ₹ 5,11,75,000 and tax liability would be ₹ 1,64,41,504.

Note - Since the question has not specifically required calculation of minimum alternate tax nor does it contain the relevant information for such calculation, the same has not been worked out.

Question 3

- (a) Mr. W has provided the following information regarding his income and expenditure of the previous year 2011-12.

Income from business (computed)	₹ 5,00,000
Dividend income from Money Market Mutual Funds	₹ 1,25,000
Share of profit from firm	₹ 85,000
Consultancy charges to Mutual Fund agent	₹ 15,000
Interest expenditure relating to both taxable and non-taxable income	₹ 2,25,000

Value of investments in mutual fund units as on first and last day of the previous year are ₹ 5,00,000 and ₹ 3,00,000.

Value of total assets as appearing in Balance Sheet as on first day and last day of the previous year are ₹ 50,00,000 and ₹ 70,00,000.

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

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

You are required to compute the amount of expenditure incurred in relation to exempt income and resultant total income, assuming that Mr. W has no other income. (6 Marks)

- (b) Often controversies arise between the assessee and the department on the issue of treatment of gain arising out of transactions of sale and purchase of shares and securities.

Based on the judicial decisions, narrate the significant points of distinction in order to judge the purpose and motive of the assessee for its different treatment as income from business or income from capital gain. (5 Marks)

- (c) On an application made by Mr. Pandey, an order was passed by the Settlement Commission on 03-01-2012 under Section 245D. The said order had a mistake apparent on record. The Settlement Commission passed an amended order dated 30-04-2012 which resulted in modifying the liability of Mr. Pandey.

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

You are required to examine the following:

- (i) Correctness of claim made by Mr. Pandey
(ii) Validity of the order amended by the Settlement Commission (5 Marks)

Answer

- (a) As per section 14A, expenditure incurred in relation to any exempt income is not allowed as deduction. However, if the Assessing Officer is not satisfied with the correctness of the claim of the assessee in respect of expenditure in relation to exempt income, or the claim made by the assessee that no expenditure has been incurred in relation to exempt income for such previous year, he shall determine the amount of expenditure in relation to such income in the manner provided in Rule 8D.

In this case, since the Assessing Officer is not satisfied with the correctness of claim of Mr. W, he shall determine the amount of expenditure in relation to exempt income in the manner provided in Rule 8D.

Dividend income of ₹ 1,25,000 from mutual fund is exempt under section 10(35). ₹ 85,000 representing Mr. W's share of profit from firm is exempt under section 10(2A). Therefore, both dividend and share of profit from firm represent exempt income of Mr. W. However, since the data for ascertaining average value of investment in firm has not been given in the question, the same has been ignored while computing the figures in (ii) and (iii) in the table below showing the computation of expenditure in relation to exempt income in the manner provided in Rule 8D.

	Particulars	₹
(i)	The amount of expenditure directly relating to exempt income Consultancy charges paid to Mutual Fund Agent	15,000

(ii)	Calculation of interest expenditure attributable to exempt income	
Interest expenditure incurred ×	$\frac{\text{Average value of investment in Mutual Fund Units as on the first and last day of the previous year}}{\text{Average of total assets of the assessee as appearing in the Balance Sheet, on the first day and last day of the previous year}}$	
= 2,25,000 ×	$\frac{[(5,00,000+3,00,000)/2]}{[(50,00,000+70,00,000)/2]}$	
= 2,25,000 ×	$\frac{4,00,000}{60,00,000}$	15,000
(iii)	Half per-cent of the average value of investment, income from which is exempt from tax i.e., ½% of the average value of investment in mutual funds $₹ 4,00,000 \times \frac{1}{2}\%$	$\underline{2,000}$
Amount of expenditure in relation to exempt income		<u>32,000</u>

Computation of total income of Mr. W for the A.Y. 2012-13

Particulars	Amount (₹)
Income from business (computed)	5,00,000
Add: Amount of expenditure in relation to exempt income (See Note below)	<u>32,000</u>
Income from business / Total Income	<u>5,32,000</u>

Note - Since it has been stated in the question that Mr. W claims that no expenditure was incurred by him for exempt income earned, it is logical to assume that the entire interest expenses of ₹ 2,25,000 has been deducted to arrive at the income from business of ₹ 5,00,000. Therefore, the amount of interest expenses in relation to exempt income has been added back to compute the resultant total income.

- (b) The profit arising to an assessee from the transaction of sale and purchase of shares and securities, can be treated either as business income or capital gains.

The profit would be treated as business income if shares and securities constitute a trading asset and the assessee is a trader of shares and securities. However, the profit

would be taxable under the head "Capital Gains", if the shares and securities are held as an investment i.e., a capital asset.

The original purpose or intention is crucial. If the original intention was to hold the shares as investment, the gains resulting from the sale of such shares will be capital gains. On the other hand, if the original intention was to carry on the activities of purchase and sale as a systematic activity and hold the shares as stock-in-trade, the gains resulting from the sale of such shares will be assessable as business income.

It is open to the assessee to maintain two portfolios, one for investments and another for dealing in shares. It was so observed by the Bombay High Court, in *Gopal Purohit vs. CIT (2011) 336 ITR 287*, where it was held that there should be uniformity in treatment and consistency in treating transactions in shares as investment or stock-in-trade, when facts and circumstances were identical. Further, the High Court also held that entries in the books of account alone are not conclusive in determining the nature of income.

In case the purchase and sale of the shares and securities is undertaken with a motive of earning profit out of the transaction, then the same would result in a trading transaction and will give rise to business income whereas if the motive of investment in the shares and securities is to earn income by way of dividend or interest, as the case may be, then the profit arising from the transaction of sale and purchase of such shares and securities will give rise to capital gain and not business income.

The magnitude of purchase and sale, the ratio between the purchase and sale of the shares and securities and holding period of the same can be considered for determining the purpose and the motive of the assessee for undertaking such transaction.

- (c) (i) Under section 245F(1), the Settlement Commission has been conferred all the powers which are vested in an income-tax authority under the Act. Under section 154, an income-tax authority has the power to amend any order passed by it in order to rectify any mistake apparent from the record. Therefore, the Settlement Commission's power to amend an order to rectify any mistake apparent from the record is embedded in section 245F(1).

Further, in order to reflect the correct intention of the legislature, sub-section (6B) has been inserted in section 245D to specifically provide that the Settlement Commission may, at any time within a period of six months from the date of the order, amend any order passed by it under section 245D(4) to rectify any mistake apparent from the record. In this case, the rectification order was passed by the Settlement Commission within six months of passing the original order.

Therefore, Mr. Pandey's view is not correct.

- (ii) In this case, the rectification has the effect of modifying the liability of Mr. Pandey. Therefore, as per the proviso to section 245D(6B), the Settlement Commission, before passing the amended order, should have –

- (1) given a notice to the applicant and the Commissioner of its intention to make such an amendment; and
- (2) allowed the applicant and the Commissioner an opportunity of being heard.

If these conditions are fulfilled, the order amended by the Settlement Commission would be a valid order, since the amended order is passed by the Settlement Commission within the permitted time limit i.e., within six months from the date of its original order.

However, if the Settlement Commission has not given notice of its intention to make such an amendment or has not allowed the applicant and the Commissioner an opportunity of being heard, then, the amended order passed by it will not be valid.

Question 4

Attempt any four questions out of the following questions:

- (a) *MNO Limited paid a sum of ₹15 Lakhs as salary to Mr. X for which no tax was deducted at source by the company. Mr. X filed his return of income and paid the tax due by way of self assessment. The Assessing Officer (AO) issued notice to Mr. X demanding interest under section 234B as no advance tax was paid by him. Your opinion is sought on the following aspects,*

- (a) *Is the action of AO valid?*
- (b) *If not, is there any other means available to AO to recover the interest? (4 Marks)*

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

Whether the contention raised by the Assessing Officer is tenable in law? Critically examine. (4 Marks)

- (c) *Teachwell Education is a trust approved under section 10(23C)(vi) which runs various educational institutions. During the course of assessment under section 143(3), the Assessing Officer (AO), finds that the trust has carried out its activities in contravention of the section under which it was approved for exemption. Hence, the AO wants to pass an order without giving exemption under section 10, which the assessee objects. You are required to examine the following with respect to the provisions of Income-tax Act, 1961.*

- (a) *Whether the AO can pass an order without giving exemption under section 10?*
- (b) *Can the AO get any additional time limit in completing this assessment? (4 Marks)*

- (d) *The Assessing Officer (AO) issued notices under section 133 to four banks requiring particulars relating to a customer in a specific format duly verified in a prescribed manner. One of the banks refused to part with the information on the ground that the letter did not specify about any proceeding pending against the said customer under the Income-tax Act, 1961. Discuss the correctness of action of the bank in refusing to furnish the particulars as required by the AO. (4 Marks)*
- (e) *Dhaval is in business of manufacturing customized kitchen equipments. He is also the Managing Director and held nearly 65% of the paid-up share capital of Aarav Ltd. A substantial part of the business of Dhaval is obtained through Aarav Ltd. For this purpose, Aarav Ltd. passed on the advance received from its customers to Dhaval to execute the job work entrusted to him.*

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

Examine whether the action of the Assessing Officer is tenable in law. (4 Marks)

Answer

- (a) Interest liability under section 234B is attracted only if an assessee, who is liable to pay advance tax under section 208, has failed to pay such advance tax or the tax paid by him is less than 90% of the "assessed tax".

As per section 208, an assessee shall be liable to pay advance tax in case the tax payable by him for the previous year is equal to or more than ₹ 10,000. Further, as per section 209, while computing the tax payable by the assessee for the purpose of determining his advance tax liability, the amount of income-tax which is deductible or collectible at source, during the said financial year under any provision of the Income-tax Act, 1961, shall be reduced.

The Uttarkhand High Court, in *DIT v. Maersk Co. Ltd. (2011) 334 ITR 79 (FB)*, has expressed a view that the use of the words "deductible" and "collectible" in section 209 indicates that the amount of "tax deductible at source" can be reduced from the total tax payable by the assessee, for assessing his liability to pay advance tax, even though such amount is not actually deducted at source by the deductor. In case the amount of tax payable by the assessee after reducing the amount of tax deductible at source is less than ₹ 10,000, he shall not be liable to pay advance tax and consequently, the liability to pay interest under section 234B, leviable in case of default in payment of advance tax, shall not arise.

- (a) In the present case, tax was liable to be deducted from the salary of ₹ 15 lakhs paid by MNO Ltd. to Mr. X, though the company did not deduct the same. In the view of the above opinion expressed by the High Court, Mr. X would not be liable to pay

advance tax in respect of salary income and therefore, interest under section 234B cannot be levied. Hence, the action of Assessing Officer is not valid. It is assumed that Mr. X is not liable to pay advance tax in respect of any other income.

- (b) There is no other provision under the Income-tax Act, 1961 which enables the Assessing Officer to recover the interest due under section 234B.

Though the Assessing Officer cannot levy the interest for default in payment of advance tax on the deductee, he can recover interest under section 201(1A) from the deductor for failure to deduct tax at source. Therefore, in this case, interest under section 201(1A) is leviable@1% per month or part of month till such tax is actually paid by way of self-assessment tax by the employee.

Such interest shall be paid before furnishing the statement in accordance with the provisions of section 200(3).

Note - The Finance Act, 2012 has amended section 209 retrospectively, with effect from 1st April, 2012, to provide that in case the payer has failed to deduct tax at source, then, the amount of tax so deductible shall not be reduced from the income-tax liability of the resident payee for determining his liability to pay advance tax. Therefore, the resident payee would be liable to pay advance tax if the tax deductible was not deducted at source, in which case the interest under section 234B for default in payment of advance tax would also be attracted.

Further, interest@1% per month or part of month would be leviable under section 201(1A) on the payer from the month in which tax was deductible till the date of furnishing of return of income by the resident payee.

This retrospective amendment by the Finance Act, 2012 is, however, not applicable for May 2012 examination.

- (b) As per the provisions of section 194H, a person is liable to deduct tax at source at the time of credit or payment, whichever is earlier, of income in the nature of commission to any resident.

In the present case, B. Airways Ltd. correctly deducted tax at source under section 194H from the commission@9% of the published price paid to the travel agents, who were allowed to sell the air tickets at any price higher than the minimum fixed commercial price subject to a maximum of published price. However, the Assessing Officer raised a contention that the airline company was required to deduct tax at source on the difference between the actual sale price and the minimum fixed commercial price by treating it as "additional special commission" in the hands of the agents.

The facts of the case are similar to the case of *CIT v. Qatar Airways (2011) 332 ITR 253*, where the Bombay High Court held that the difference between the published price and the minimum fixed commercial price of the tickets cannot be taken as "additional special commission" in the hands of the agents. This is because the published price was the maximum price and the airline company had granted permission to the agents to sell the

tickets at a price lower than the published price. Further, the airline company would have no information about the exact rate at which the tickets were ultimately sold by its agents. In order to deduct tax at source, the exact income in the hands of the agents must necessarily be ascertainable by the airline company. However, it is not so ascertainable in this case, since the agents had been given discretion to sell the tickets at any rate between the minimum fixed commercial price and the published price. It would be impracticable and unreasonable to expect the airline company to get a feedback from its numerous agents in respect of the price at which tickets were sold by them.

Applying the rationale of the above case to the case on hand, B. Airways Ltd. is not liable to deduct tax at source under section 194H on the difference between the actual sale price and the minimum fixed commercial price, even though the amount earned by the agent over and above minimum fixed commercial price would be taxable as income in the hands of the agent.

Therefore, the contention raised by the Assessing Officer is not tenable in law.

- (c) (a) As per the first proviso to section 143(3), in the case of an institution approved under, *inter alia*, section 10(23C)(vi), which is required to furnish the return of income under section 139(4C), the Assessing Officer shall not pass an order of assessment under section 143(3) without giving effect to the provisions of section 10, unless he is of the view that the activities of the institution are being carried on in contravention to the provisions of that section and :
- (1) he has intimated the Central Government or the prescribed authority, which had earlier approved the concerned institution, about the contravention of the relevant provisions by the institution; and
 - (2) the approval granted to such institution has been withdrawn or notification in that respect has been rescinded.

Therefore, in the aforesaid case, the Assessing Officer can pass an assessment order without giving exemption under section 10 to Teachwell Education, which is an educational institution approved under section 10(23C)(vi), only if he has intimated the contravention made by Teachwell Education to the Central Government or the prescribed authority, as the case may be, and its approval under section 10(23C)(vi) is withdrawn.

- (b) As per *Explanation 1* to section 153, in case the Assessing Officer intimates the contravention of provisions of section 10(23C)(vi) to the Central Government or the prescribed authority, the period commencing from the date of intimation of such contravention by the Assessing Officer and ending on the date on which the copy of the order of withdrawing the approval under section 10(23C)(vi) is received by the Assessing Officer, shall be excluded for computing the period of limitation for completing the assessment.

Further, in case the time limit available to the Assessing Officer for passing an assessment order, after such exclusion, is less than 60 days, such remaining period of assessment shall be deemed to have been extended to 60 days.

Therefore, the Assessing Officer will get the above mentioned additional time for completing the assessment of Teachwell Education.

- (d) As per section 133(6), power is given to an Assessing Officer to issue notice, for the purposes of the Act, requiring any person, including a banking company, to furnish information in respect of such points or matters or to furnish statement of accounts and affairs verified in the manner specified by the Assessing Officer, as may be useful for, or relevant to, any enquiry or proceeding under the Act. Therefore, the provisions of this section can be invoked even in case of any enquiry and it is not necessary that any proceeding should be pending against the customer for the same.

However, in respect of an enquiry, this power can be exercised by any income-tax authority below the rank of Director or Commissioner only after getting the prior approval of the Director or the Commissioner, as the case may be.

Therefore, the Assessing Officer can issue notice under section 133(6) asking for particulars relating to a customer in the specified format duly verified in the prescribed manner from the banking company, even if no proceeding is pending against such customer, provided he has obtained the prior approval of the Director or the Commissioner, as the case may be.

Hence, in such a case, the action of bank in refusing to provide the particulars relating to a customer as required by the Assessing Officer on the ground that no proceeding was pending against the customer, is not correct.

- (e) As per section 2(22)(e), in case a company, not being a company in which the public are substantially interested, makes payment of any sum by way of advance or loan to a shareholder holding not less than 10% of voting power/share capital of the company, then, the payment so made shall be deemed to be dividend in the hands of such shareholder to the extent to which the company possesses accumulated profits.

In the present case, Dhaval is holding 65% of the paid-up capital of Aarav Ltd. Aarav Ltd. has passed on advance received from its customers to Dhaval for execution of job work entrusted to Dhaval.

Assuming that Aarav Ltd. is not a company in which public are substantially interested, the applicability of the provisions of section 2(22)(e) in respect of such transaction has to be examined. In *CIT v. Rajkumar* (2011) 318 ITR 462 (Del.), it was held that trade advance given to the shareholder which is in the nature of money transacted to give effect to a commercial transaction, would not be deemed to be dividend in the hands of the shareholder under section 2(22)(e). The Delhi High Court ruling in *CIT v. Ambassador Travels (P) Ltd.* (2009) 318 ITR 376 also supports the above view.

In the present case, the payment is made to Dhaval by Aarav Ltd. for execution of work is in the course of commercial business transaction and therefore, it shall not be deemed as dividend in the hands of Dhaval under section 2(22)(e). Hence, the action of the Assessing Officer is not tenable in law.

Note - The above answer is based on the assumption that Aarav Ltd. is a company in which public are not substantially interested. In case it is assumed that Aarav Ltd., being a public limited company, is a company in which the public are substantially interested, then, the provisions of section 2(22)(e) shall not be applicable and the said amount paid to Dhaval shall not be treated as dividend under section 2(22)(e) in the hands of Dhaval.

Question 5

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

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

Assuming that permissible variation notified by Central Government for such class of international transactions is 6% of the transaction price, state the tax implications under section 94A in respect of the above transaction by RV Ltd. to DK Inc. (4 Marks)

- (b) "The existence of a website on Indian Soil constitutes a permanent establishment". Is this statement correct? Examine. (4 Marks)

- (c) State the powers of the Authority for Advance Ruling under the Income-tax Act, 1961.

(4 Marks)

- (d) In order to overcome a situation where the tax is deducted at a rate prescribed in the relevant Double Taxation Avoidance Agreement which is higher than the rate prescribed in the Income-tax Act, 1961, CBDT recently has clarified this issue, to avoid genuine hardship faced by the resident deductor. Explain, in brief, the contents of this CBDT circular. (4 Marks)

Answer

- (a) As per section 94A, in case an assessee enters into any transaction where one of the parties thereto is located in the Notified Jurisdictional Area (NJA) then the parties to the transaction shall be treated as associated enterprises and the transaction shall be deemed to be an international transaction. The transfer pricing provisions would, therefore, be attracted in such a case. However, the benefit of permissible variation between the transfer price and the arm's length price, as notified by the Central Government, shall not be available in such a case.

Since DK Inc. is located in a NJA, the transaction of export of grapes by the Indian company, RV Ltd., would be deemed to be an international transaction and DK Inc. and

RV Ltd. would be deemed to be associated enterprises. Therefore, the provisions of transfer pricing would be attracted in this case.

The prices of ₹ 38 lakhs and ₹ 40 lakhs charged for sale of similar goods to CC Inc. and MM Inc., respectively, being independent entities located in a non-NJA country, can be taken into consideration for determining the arm's length price (ALP) under Comparable Uncontrolled Price (CUP) Method.

Since more than one price is determined by the CUP Method, the ALP would be the arithmetical mean of such prices.

Therefore, $ALP = ₹ 39,00,000$ i.e., $[(₹ 38,00,000 + ₹ 40,00,000)/2]$

Transfer Price = ₹ 30,00,000

Since the ALP is more than the transfer price, the ALP of ₹ 39 lakhs would be considered for computing the income from the international transaction between RV Ltd. and DK Inc.

- (b) The term "permanent establishment" has not been defined in section 2 of the Income-tax Act, 1961. As per section 92F(iii), "permanent establishment" includes a fixed place of business through which the business of the enterprise is wholly or partly carried on.

The term "permanent establishment" includes (a) a place of management (b) a branch, (c) an office, (d) a factory, (e) a workshop, (f) mines, (g) warehouse, etc. In most of the DTAA's, an exhaustive definition of the term "permanent establishment" is given, wherein several more items are enumerated.

A website is a set of web documents belonging to a particular organization. It consists of data and programs in digital form, from which it is stored in a server which is accessible through internet.

A website does not normally imply "a fixed place of business", even though in the case of some entities, some business could be transacted through a website. Thus, the mere presence of a website in Indian soil, without anything more, will not amount to a permanent establishment.

If the website contains merely information about the concern, the website cannot be regarded as a permanent establishment. Where the website is being used as a virtual office for transacting orders of purchases or sales or for rendering services on a more than casual basis, then it could be regarded as a permanent establishment.

- (c) Under section 245U, the Authority of Advance Ruling will have all the powers vested in the Civil Court under the Code of Civil Procedure, 1908 as are referred to in section 131.

Accordingly, the Authority of Advance Ruling shall have the same powers as are vested in a court under the Code of Civil Procedure, 1908, when trying a suit in respect of the following matters, namely -

- (1) discovery and inspection;

- (2) enforcing the attendance of any person, including any officer of a banking company and examining him on oath;
 - (3) compelling the production of books of account and other documents; and
 - (4) issuing commissions.
- (d) The CBDT had issued *Circular No.7/2007, dated 23.10.2007* laying down the procedure for refund of tax deducted at source under section 195 to the person deducting tax at source from the payment to a non-resident. The Circular allowed refund of tax deducted at source to the person making payment to a non-resident in certain circumstances, for example, if the income does not accrue to the non-resident or if the income is accruing, no tax is due but tax has been deducted, or tax has been deducted at a higher rate specified in the Income-tax Act, 1961, whereas it is deductible at a lower rate under the relevant DTAA.

A similar situation arises in a case where tax is deducted at a rate prescribed in the relevant DTAA which is higher than the rate prescribed in the Income-tax Act, 1961. This situation is, however not included in the list of circumstances covered under the above Circular of the CBDT. Since the law requires deduction of tax at a rate prescribed in the relevant Double Taxation Avoidance Agreement (DTAA) or under the Income-tax Act, 1961, whichever is lower, there is a possibility that in such cases, excess tax is deducted relying on the provisions of relevant DTAA.

Accordingly, in order to remove the genuine hardship faced by the resident deductor, the CBDT has, vide *Circular No. 7/2011 dated 27-09-2011*, modified *Circular No.07/2007, dated 23.10.2007* to the effect that the beneficial provisions under the said Circular allowing refund of excess tax deducted at source under section 195 to the deductor shall also apply to those cases where tax has been deducted at source at a higher rate as mentioned in the relevant DTAA while a lower rate is prescribed under the domestic law.

Question 6

- (a) *What are the consequences if the amount deposited in Capital Gains Account Scheme to avail exemption from capital gains is not utilised within the stipulated time? Is there any difference in the tax treatment in the event of death of the assessee before the stipulated time?* (3 Marks)
- (b) *X carrying on a business as sole proprietor, died on 31st March, 2011. On his death, the same business was continued by his legal heirs, by forming a firm. As on 31st March 2011, a determined business loss of ₹ 5 lacs is to be carried forward under the Income-tax Act, 1961.*
- Does the firm consisting of all legal heirs of Mr. X, get a right to have this loss adjusted against its current income?* (3 Marks)
- (c) *State the cases where the benefit of indexation of cost is not available for determination of capital gains.* (7 Marks)

- (d) Mr. C borrowed on Hundi, a sum of ₹ 15,000 by way of bearer cheque on 11-09-2011 and repaid the same with interest amounting to ₹ 20,000 by account payee cheque on 12-10-2011.

The Assessing Officer (AO) wants to treat the amount borrowed as income during the previous year. Is the action of AO valid? (3 Marks)

Answer

- (a) Where the amount deposited in Capital Gains Accounts Scheme is not utilized for the specified purpose mentioned under the respective section providing for exemption (like say, section 54, 54B, 54G, etc.) within the specified period of two years or three years, as the case may be, mentioned therein, then the unutilized amount shall be charged under section 45 as capital gain of the previous year in which the specified period of two years or three years, as the case may be, expires.

The tax treatment will be different where before the stipulated time, the assessee expires and the amount is received by his legal heirs.

The CBDT has, in *Circular No.743 dated 6.5.1996*, clarified that in the event of death of an individual before the stipulated period, the unutilized amount would not be chargeable to tax in the hands of the legal heirs of the deceased individual, since such unutilized amount is not income but is a part of the estate devolving upon them.

- (b) Section 78(2) provides that where a person carrying on any business or profession has been succeeded in such capacity by another person, otherwise than by inheritance, then, the successor is not entitled to carry forward and set-off the loss of the predecessor against his income. This implies that generally, set-off of business losses should be claimed by the same person who suffered the loss and the only exception to this provision is when the business passes on to another person by inheritance.

The facts of case given in the question are similar to the case *CIT v. Madhukant M. Mehta (2001) 247 ITR 805*, where the Supreme Court has held that if the business is succeeded by inheritance, the legal heirs are entitled to the benefit of carry forward of the loss of the predecessor. Even if the legal heirs constitute themselves as a partnership firm, the benefit of carry forward and set off of the loss of the predecessor would be available to the firm.

In this case, the business of X was continued by his legal heirs after his death by constituting a firm. Hence, the exception contained in section 78(2) along with the decision of the Apex Court discussed above, would apply in this case. Therefore, the firm is entitled to carry forward the business loss of ₹ 5 lacs of X.

- (c) In the following cases, the benefit of indexation of cost is not available for determination of capital gains on transfer of capital assets –
1. Transfer of capital assets held for not more than 36 months (12 months in the case of listed securities, etc), since capital gains arising therefrom would be a short term capital gains.

2. Transfer of depreciable assets where computation is governed by section 50, since capital gains arising therefrom would always be short term capital gains, even if they are held for more than 36 months.
 3. Transfer of undertaking or division in a slump sale under section 50B.
 4. Transfer of bonds/debentures other than capital indexed bonds issued by the Government (*Third proviso to section 48*).
 5. Transfer of shares in or debentures of an Indian company, acquired by a non-resident in foreign currency (*First and second proviso to section 48*).
 6. Transfer of a foreign exchange asset by a non-resident Indian, who opts to be governed by the provisions of Chapter XII-A (*Section 115D*).
 7. Transfer of Global Depository Receipts purchased in foreign currency by an individual resident in India and employee of an Indian company or its subsidiary engaged in specified knowledge based industry or service (*Section 115ACA*).
 8. Transfer of units of Unit Trust of India or a Mutual Fund specified under section 10(23D) purchased in foreign currency by an overseas financial organisation referred to as Offshore Fund (*Section 115AB*).
 9. Transfer of securities by Foreign Institutional Investors (*Section 115AD*).
- (d) Section 69D provides that where any amount is borrowed on a hundi or any amount due thereon is repaid otherwise than by way of an account-payee cheque drawn on a bank, the amount so borrowed or repaid shall be deemed to be the income of the person borrowing or repaying the amount for the previous year in which the amount was so borrowed or repaid, as the case may be.

In this case, Mr. C has borrowed ₹ 15,000 on Hundi by way of bearer cheque. Therefore, it shall be deemed to be income of Mr. C for the previous year 2011-12. Since the repayment of the same along with interest was made by way of account payee cheque, the same would not be hit by the provisions of section 69D. Therefore, the action of the Assessing Officer treating the amount borrowed as income during the previous year is valid in law.

Question 7

- (a) What are the consequences of not collecting tax at source (TCS) in respect of sale of scrap by a manufacturing company? State the circumstances under which the TCS provisions are not applicable in the above case. (5 Marks)
- (b) State with reasons whether return of income is to be filed in the following cases for the Assessment Year 2012-13 :
 - (i) Mr. X, an individual, aged 80 years, has a gross total income of ₹ 6,50,000 and he is eligible for deduction of ₹ 1,60,000 under Chapter VI-A.
 - (ii) ABC, a partnership firm, has a loss of ₹ 10,000 during the previous year 2011-12.

- (iii) A registered association, eligible for exemption under section 10(23B), has income from house property of ₹ 2,10,000.
- (iv) Mr. Y, an employee of ABC (P) Ltd, draws a salary of ₹ 4,90,000 and has income from fixed deposits with bank of ₹ 10,000. (4 Marks)
- (c) Mr. X received the following gifts / amounts during the previous year 2011-12 :
- Gift of bullion worth ₹ 60,000 on his birthday from his friend.
 - Received a car from his cousin on payment of ₹ 1 lac, fair market value of which was ₹ 4 lacs.
 - Received cash gift of ₹ 18,000 each from three of his friends A, B & C on 24-09-2011.
 - Acquired an office building on 22-11-2011 from his friend Q for a consideration of ₹ 10 lacs, stamp value of which is ₹ 20 lacs.
 - In respect of land of Mr. X acquired by Railways in the year 2009, he received the following amount on 25-12-2011 as interest on enhanced compensation on the order of the court -

Relating to previous year	₹
2009-10	1,45,000
2010-11	1,75,000
2011-12	1,10,000

You are required to compute the income of Mr. X chargeable under the head "Income from other sources" for the Assessment Year 2012-13 assuming that he has no other income. (7 Marks)

Answer

- (a) As per section 206C, every person being a seller of, *inter alia*, scrap, shall, at the time of debiting of the amount payable by the buyer to the account of the buyer or at the time of receipt of such amount from the buyer, whichever is earlier, collect tax at source @ 1% of the said amount from the buyer. If the seller does not collect tax at source on sale of scrap, then, the following would be the consequences:
- He shall be deemed to be an assessee in default in respect of the tax not collected.
 - He shall be liable to pay the tax, which he ought to have collected, to the credit of the Central Government, even if he has not actually collected the tax.
 - He shall be liable to pay simple interest at the rate of 1% per month or part thereof on the amount of such tax from the date on which such tax was collectible to the date on which the tax was actually paid and such interest shall be paid before furnishing the quarterly statement for each quarter.
 - Penalty equal to the amount of tax which is not collected can be levied under section 271CA.

However, he would not be liable to collect tax at source in the following cases:

- (i) If the buyer is a resident and he furnishes to the person responsible for collecting tax, a declaration in the prescribed form to the effect that scrap is to be utilized for the purpose of manufacturing, processing or producing articles or things and not for trading purposes.
- (ii) If scrap is sold to a public sector company, the Central Government, a State Government, an embassy, a high commission, legation, commission, consulate and the trade representation of a foreign State or a club.
- (iii) If the buyer, in the retail sale of scrap, has purchased the scrap for his personal consumption.

(b)

S. No.	Is filing of return required?	Reason
(i)	Yes	As per the provisions of section 139(1), every person, whose total income without giving effect to the provisions of, <i>inter alia</i> , Chapter VI-A exceeds the maximum amount not chargeable to tax, is required to furnish the return of income for the relevant assessment year on or before the due date. The gross total income of Mr. X before deduction under section 80C is ₹ 6,50,000, which exceeds the basic exemption limit of ₹ 5,00,000 applicable to an individual aged 80 years or more. Therefore, Mr. X has to furnish his return of income for the A.Y.2012-13.
(ii)	Yes	As per section 139(1), it is mandatory for a firm to furnish its return of income or loss on or before the specified due date. Therefore, M/s ABC has to furnish its return of loss for the A.Y.2012-13 on or before the due date.
(iii)	Yes	As per section 139(4C), every institution referred to, <i>inter alia</i> , in section 10(23B), whose total income without giving effect to the provisions of section 10 exceeds the maximum amount not chargeable to tax, is required to furnish the return of income for the relevant assessment year on or before the due date. In the above case, the registered association has income from house property of ₹ 2,10,000 before exemption under section 10, which exceeds the basic exemption limit of ₹ 1,80,000. Therefore, it is under an obligation to furnish its return of income for the A.Y. 2012-13.
(iv)	Yes	As per the provisions of section 139(1), every person, whose gross total income exceeds the maximum amount not chargeable to tax, is

	required to furnish the return of income for the relevant assessment year on or before the due date. The gross total income of Mr. Y is ₹ 5,00,000 (₹ 4,90,000 + ₹ 10,000) which exceeds the basic exemption limit of ₹ 1,80,000 applicable to an individual. Therefore, Mr. Y has to furnish his return of income for the A.Y.2012-13. <i>Note – The CBDT has issued Notification No. 9/2012 dated 17.02.2012, in exercise of its powers under section 139(1C), providing for exemption from filing return of income to an individual whose total income does not exceed ₹ 5,00,000, in case the total income consists only of salary and/or interest from savings bank account (not exceeding ₹ 10,000), subject to fulfillment of certain conditions. Since Mr. Y has income from fixed deposits with bank, he is not eligible for the above exemption and is, therefore, required to furnish his return of income for the A.Y. 2012-13.</i> <i>This CBDT Notification was, however, not applicable for May 2012 examination, since it was issued after 31st October, 2011.</i>
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(c) Computation of “Income from other sources” of Mr. X for the A.Y.2012-13

	Particulars	₹
(i)	Since bullion is included in the definition of “property”, therefore, when bullion is received without consideration, the same is taxable under section 56(2)(vii), as the aggregate fair market value of bullion exceeds ₹ 50,000	60,000
(ii)	Since car is not included in the definition of property, therefore the difference of ₹ 3 lakh between fair market value and purchase price of car is not taxable under section 56(2)(vii)	Nil
(iii)	Cash gift received from friends is taxable under section 56(2)(vii), since its aggregate value exceeds ₹ 50,000 (₹ 18,000 × 3)	54,000
(iv)	Immovable property purchased for inadequate consideration is outside the scope of section 56(2)(vii). Therefore the difference of ₹ 10 lakh between stamp duty value and purchase price of building is not taxable under section 56(2)(vii).	Nil
(v)	Interest received during the year on enhanced compensation is taxable under section 145A in the year of receipt, irrespective of the method of accounting followed by Mr. X. The interest is taxable under section 56(2)(viii).	
	(₹ 1,45,000 + ₹ 1,75,000 + ₹ 1,10,000)	₹ 4,30,000
	Less: Deduction under section 57 @50% of ₹ 4,30,000	<u>₹ 2,15,000</u>
	Income from Other Sources	<u><u>3,29,000</u></u>