

PAPER – 7 : DIRECT TAX LAWS

Question No.1 is compulsory.

Attempt any five questions from the remaining six questions.

Question 1

- (a) You are the auditor of Sigma Limited under section 44AB of the Income-tax Act, 1961. You have observed that during the previous year ended 31st March, 2010, the company has charged to Profit & Loss Account, a sum of Rs.20 lakhs, being loss due to fluctuation in foreign exchange rates arising on settlement of dues to a foreign company from whom one machine was imported in the previous year ended 31st March, 2009. The company's accounting policy of charging such exchange loss to Profit & Loss Account is in consonance with the Accounting Standard 11 notified by the Companies (Accounting Standards) Rules. State the particulars to be provided in respect of the exchange loss in the Form 3CD (Statement of Particulars) forming part of the tax audit report. (5 Marks)
- (b) Hari has acquired a residential house property in Delhi on 1st April, 2000 for Rs.10,00,000 and decided to sell the same on 3rd May, 2003 to Ms. Pari and an advance of Rs. 25,000 was taken from her. The balance money was not paid by Ms. Pari and Hari has forfeited the entire advance sum. On 3rd June, 2009, he has sold this house to Mr. Suri for Rs. 35,00,000. In the meantime, on 4th April, 2009, he had purchased a residential house in Delhi for Rs.8,00,000, where he was staying with his family on rent for the last 5 years and paid the full amount as per the purchase agreement. However, Hari does not possess any legal title till 31st March, 2010, as such transfer was not registered with the registration authority.
- Hari has purchased another old house in Chennai on 14th October, 2009 from Mr. X, an Indian resident, by paying Rs.5,00,000 and the purchase was registered with the appropriate authority.
- Determine the taxable capital gain arising from above transactions in the hands of Hari for Assessment Year 2010 -11. Cost inflation Index: 2000-01: 406; 2003-04: 463; 2009-10: 632. (5 Marks)
- (c) Chirag owns two residential flats, one in Mumbai and another in Chennai. Both the flats are meant to be used for residential purposes by Chirag and his family. The particulars of the flats are as follows:
- (i) The flat at Mumbai was purchased by him in January, 1980 for Rs.10 lakhs. The flat was occupied by his friend, Suvalaxmi, without rent for three months from 1st April, 2009 to 30th June, 2009. The value of the flat as per Schedule III to the Wealth-tax Act, 1957 on 31st March, 2010 is Rs.30 lakhs. Its value on the same basis as on 31st March, 1980 was Rs.12 lakhs.

The Suggested Answers for Paper 7: - Direct Tax Laws are based on the provisions applicable for A.Y. 2010-11, which is the assessment year relevant for November, 2010 examination.

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- (ii) The flat at Chennai was purchased in March, 2007 for Rs.6 lakhs. The values of the flat as per Schedule III to the Wealth-tax Act, 1957, on 31st March, 2007 and 31st March, 2010 are Rs 3 lakhs and Rs 5 lakhs, respectively.

You are required to fix the value of each flat for the purpose of computation of net wealth of Chirag for Assessment year 2010-11. (5 Marks)

- (d) Mrs. E, wife of Mr. F, is a partner in a firm. Her capital contribution to the firm as on 01-04-2009 was Rs.5 lakhs, out of which Rs.3 lakhs was contributed out of her own sources and Rs. 2 lakhs was contributed out of gift from her husband.

As further capital was needed by the firm, she further invested Rs.2 lakhs on 01-05-2009 out of the funds gifted by her husband. The firm paid interest on capital of Rs. 80,000 and share of profit of Rs. 60,000 for the financial year 2009-10.

Advise Mr. F as to the applicability of the provisions of section 64(1)(iv) and the manner thereof in respect of the above referred transactions. (5 Marks)

Answer

- (a) Exchange fluctuation loss arising from settlement of liability in respect of capital asset is charged to profit and loss account as per Accounting Standard-11. However, the treatment of such loss for income-tax purpose is governed by section 43A of the Income-tax Act, 1961. Section 43A requires adjustment of such exchange loss to the actual cost of the asset as defined in section 43(1).

Clause 17(a) of Form 3CD requires the tax auditor to state whether an expenditure of capital nature has been debited to profit and loss account. Exchange loss, in the instant case, being an expenditure of capital nature is to be shown by the tax auditor against clause 17(a) of Form No.3CD.

Further, the tax auditor should also indicate addition by way of adjustment in respect of each asset/block of assets on account of change in rate of exchange of currency. This fact is required to be indicated against clause 14(d)(ii) of Form 3CD.

- (b) Computation of taxable capital gain of Mr. Hari for the A.Y.2010-11

Particulars	Amount in Rs.
Sale proceeds	35,00,000
Less: Indexed cost of acquisition (See Note 1)	<u>15,17,734</u>
Long Term Capital Gain	19,82,266
Less: Exemption under section 54 in respect of investment in house at Delhi (See Note 2)	<u>8,00,000</u>
Taxable long-term capital gain	<u>11,82,266</u>

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Notes:

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|---|--|-----------------|
| 1 | Computation of indexed cost of acquisition | Rs. |
| | Cost of acquisition | 10,00,000 |
| | Less: Advance taken and forfeited | <u>25,000</u> |
| | Cost for the purpose of Indexation | <u>9,75,000</u> |
| | Indexed cost of acquisition (9,75,000 x 632/406) | 15,17,734 |
- 2 In order to avail exemption of capital gains under section 54, a new residential house should be purchased within 1 year before or 2 years after the date of transfer or constructed within a period of 3 years after the date of transfer. In this case, Hari has purchased the residential house in Delhi within one year before the date of transfer and paid the full amount as per the purchase agreement, though he does not possess any legal title till 31.3.2010 since the transfer was not registered with the registration authority. However, for the purpose of claiming exemption under section 54, holding of legal title is not necessary. If the taxpayer pays the full consideration in terms of the purchase agreement within the stipulated period, the exemption under section 54 would be available. It was so held in *Balraj v. CIT* (2002) 254 ITR 22 (Del.) and *CIT v. Shahzada Begum* (1988) 173 ITR 397 (A.P.).
- 3 Exemption under section 54 can be availed only in respect of one house. The Bombay High Court, in *K.C. Kanshik v. P.B. Rane, ITO* (1990) 185 ITR 499, held that where the assessee purchases more than one house, then the assessee can claim exemption in respect of only one house. It would be more beneficial for Mr. Hari to claim exemption in respect of the Delhi house since the cost of the same is higher than the cost of the Chennai house.

Note – The decision of the Karnataka High Court in *CIT v. D.Ananda Basappa* (2009) 309 ITR 0329 allowing exemption under section 54 in respect of investment in two houses was owing to the reason that the two flats were adjacent to each other and were suitably modified to be used as a single residential unit. However, in this case, one house is in Delhi and the other is in Chennai. Obviously, they cannot be used as a single residential unit. Therefore, the ruling of the Karnataka High Court would not apply in this case.

- (c) In the given case, Chirag is the owner of two residential flats for self-occupation, one at Mumbai and another at Chennai.

In respect of A.Y.2010-11, the value of any one flat can be claimed as exempt under section 5(vi) of the Wealth-tax Act, 1957. The assessee should first determine the value to be adopted for wealth-tax purpose and then should select the flat with the higher value for availing such exemption.

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As per section 7(2) of the Wealth-tax Act, 1957, the value of a house belonging to the assessee and exclusively used by him for residential purposes throughout the period of 12 months immediately preceding the valuation date, may, at the option of the assessee, be taken to be the value determined in the manner laid down in Schedule III as on the valuation date next following the date on which he became the owner of the house or the valuation date relevant to the assessment year commencing on 1st April, 1971, whichever valuation date is later.

This benefit of pegging down of value is available only if the house is self-occupied by the assessee throughout the period of 12 months immediately preceding the valuation date. Therefore, such benefit of pegging down of value cannot be availed for the flat situated at Mumbai since the flat was occupied by the assessee's friend for a part of the year. The Schedule III value of the flat at Mumbai as on the valuation date 31st March, 2010, being Rs.30 lakhs, or the cost of acquisition of Rs.10 lakhs, whichever is higher, is to be adopted as the value for wealth-tax purpose. Therefore, Rs.30 lakhs is the value of the Mumbai flat for wealth-tax purpose.

The benefit of pegging down of value can be opted for the flat situated at Chennai, as it was self-occupied by the assessee throughout the 12 months immediately preceding the valuation date of 31st March, 2010 for his residential purposes. In case of the flat at Chennai, the Schedule III value as on 31st March, 2007, being the first valuation date after he became the owner, i.e. Rs.3 lakh can be adopted, since its cost of acquisition does not exceed Rs.50 lakhs. Therefore, Rs.3 lakhs is the value of the Chennai house for wealth-tax purposes.

It would be more beneficial for the assessee to claim exemption under section 5(vi) in respect of the Mumbai house since the value of the Mumbai house (Rs.30 lakhs) is higher than the value of the Chennai house (Rs.3 lakhs) as on the valuation date 31st March, 2010.

- (d) As per section 64(1)(iv), in computing the total income of any individual, there shall be included all such income as arises, directly or indirectly, subject to the provisions of section 27(i), to the spouse of such individual from assets transferred directly or indirectly to the spouse by such individual otherwise than for adequate consideration or in connection with an agreement to live apart.

In this instant case, Mr. F has gifted money to his wife, Mrs. E. Mrs. E, in turn, invested such gifted money in the capital of a partnership firm, of which she is a partner. Mrs. E has also contributed a sum of Rs.3 lakhs out of her own resources to the capital of the firm.

As per Explanation 3 to section 64(1), for the purpose of clubbing under section 64(1)(iv), where the assets transferred, directly or indirectly, by an individual to his spouse are invested by the transferee in the nature of contribution of capital as a partner in a firm, proportionate interest on capital will be clubbed with the income of the transferor. Such proportion has to be computed by taking into account the value of the aforesaid

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investment as on the first day of the previous year to the total investment by way of capital contribution as a partner in the firm as on that day.

In view of the above provision, interest received by Mrs. E from the firm shall be included in total income of Mr. F to the extent of Rs.32,000 i.e., $\text{Rs.80,000} \times \text{Rs.2,00,000} / \text{Rs.5,00,000}$.

Share of profit amounting to Rs.60,000 is exempt from income-tax under the provisions of section 10(2A). The provisions of section 64 will not apply, if the income from the transferred asset itself is exempt from tax.

Note: It is assumed that rate of interest on capital contributed by Mrs. E does not exceed 12% per annum.

Question 2

- (a) ABC Limited was amalgamated with XYZ Limited on 01-04-2009. All the conditions of section 2(1B) were satisfied.

ABC Limited has the following carried forward losses as assessed till the Assessment Year 2009-10:

(i)	Speculative Loss	Rs. 4 lakhs
(ii)	Unabsorbed Depreciation	Rs. 18 lakhs
(iii)	Unabsorbed expenditure of capital nature on scientific research	Rs. 2 lakhs
(iv)	Business Loss	Rs.120 lakhs

XYZ Limited has computed a profit of Rs.140 lakhs for the financial year 2009-10 before setting off the eligible losses of ABC Limited but after providing depreciation at 15% per annum on Rs.150 lakhs, being the consideration at which plant and machinery were transferred to XYZ Limited. The written down value as per income-tax record of ABC Limited as on 31st March, 2009 was Rs. 100 lakhs.

The above profit of XYZ Limited includes speculative profit of Rs.10 lakhs.

Compute the total income of XYZ Limited for Assessment Year 2010-11 and indicate the losses/other allowances to be carried forward by it. (10 Marks)

- (b) R Limited transferred a building worth Rs.25 lakhs to the Chief Executive Officer, Mr. Mohan Lal, a resident individual on his retirement under an agreement for not carrying on any activity related to its business for a period of five years. In course of assessment under section 143(3), the Assessing Officer found that no tax had been deducted at source by R Limited and on that ground, he disallowed the expenditure by invoking the provision of section 40(a)(ia). Examine the correctness of the action of the Assessing Officer. (6 Marks)

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Answer

(a) Computation of total income of XYZ Limited for the A.Y. 2010-11

Particulars	Amount (Rs. in lakhs)
Business income before setting-off brought forward losses of ABC Ltd.	140
Add: Excess depreciation claimed in the scheme of amalgamation of ABC Limited with XYZ Limited.	
Value at which assets are transferred by ABC Ltd.	150
WDV in the books of ABC Ltd.	<u>100</u>
Excess accounted	50
Excess depreciation claimed in computing taxable income of XYZ Ltd. $[50 \times 15/100]$ [Explanation 2 to section 43(6)]	7.50
	147.50
Set-off of brought forward business loss of ABC Ltd. (See Notes 2 & 4)	(120.00)
Set-off of unabsorbed depreciation under section 32(2) read with section 72A (See Notes 2 & 4)	(18.00)
Set-off of unabsorbed capital expenditure under section 35(1)(iv) read with section 35(4) (See Note 5)	(2.00)
	7.50

Notes:

1. It is presumed that the amalgamation is within the meaning of section 72A of the Income-tax Act, 1961.
2. In the case of amalgamation of companies, the unabsorbed losses and unabsorbed depreciation of the amalgamating company shall be deemed to be the loss or unabsorbed depreciation of the amalgamated company for the previous year in which the amalgamation was effected and such business loss and unabsorbed depreciation shall be carried forward and set-off by the amalgamated company for a period of 8 years and indefinitely, respectively.
3. As per section 72A(7), the accumulated loss to be carried forward specifically excludes loss sustained in a speculative business. Therefore, speculative loss of Rs.4 lakhs of ABC Ltd. cannot be carried forward by XYZ Ltd.
4. Section 72(2) provides that where any allowance or part thereof unabsorbed under section 32(2) (i.e., unabsorbed depreciation) or section 35(4) (i.e., unabsorbed

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scientific research capital expenditure) is to be carried forward, effect has to be first given to brought forward business losses under section 72.

5. Section 35(4) provides that the provisions of section 32(2) relating to unabsorbed depreciation shall apply in relation to deduction allowable under section 35(1)(iv) in respect of capital expenditure on scientific research related to the business carried on by the assessee. Therefore, unabsorbed capital expenditure on scientific research can be set-off and carried forward in the same manner as unabsorbed depreciation.
6. The restriction contained in section 73 is only regarding set-off of loss computed in respect of speculative business. Such a loss can be set-off only against profits of another speculation business and not non-speculation business. However, there is no restriction under the Income-tax Act, 1961 regarding set-off of normal business losses against speculative income. Therefore, normal business losses can be set-off against profits of a speculative business.

Consequently, there is no loss or allowance to be carried forward by XYZ Ltd. to the A.Y.2011-12.

- (b) As per section 194J, any person, who is responsible for paying to a resident, any sum by way of fees for professional services, or fees for technical services or royalty or non-compete fees referred to in section 28(va) is required to deduct tax at source.

As per section 28(va), any sum received or receivable in cash or in kind under an agreement for not carrying out any activity in relation to any business is chargeable to income-tax under the head "Profits and gains of business or profession".

Therefore, the obligation to deduct tax under section 194J arises even if the non-compete fee is payable in kind. It is the responsibility of the payer to recover the amount of tax deductible from the recipient of the non-compete fee in kind.

Under section 40(a)(ia), non-deduction of tax at source in respect of the following amounts payable to a resident attracts disallowance –

1. Interest [Sections 193 & 194A];
2. Commission or Brokerage [Section 194H];
3. Rent [Section 194-I];
4. Royalty [Section 194J(1)(c)];
5. Fees for professional services [Section 194J(1)(a)];
6. Fees for technical services [Section 194J(1)(b)]; and
7. Amount payable to a contractor or sub-contractor [Section 194C].

Therefore, in respect of fees for professional services, fees for technical services and royalty, disallowance is attracted if tax is not deducted at source under section 194J. However, non-compete fee is classified separately under section 194J(1)(d), in respect of

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which there is no specific provision in section 40(a)(ia) for disallowance in case of non-deduction of tax at source.

Therefore, the action of the Assessing Officer is not correct since even though tax is required to be deducted at source under section 194J, disallowance under section 40(a)(ia) would not be attracted.

Question 3

- (a) A resident woman individual sold a house property on 16-01-2010. On the said transaction, she earned a long-term capital gain of Rs.1,01,50,000. She invested a sum of Rs.50,00,000 in capital gains bonds specified in section 54EC on 05-03-2010. She further invested a sum of Rs.50,00,000 in the same bonds on 05-05-2010. Her other income for the financial year 2009-10 was Rs.46,000. Compute the tax payable by her for the Assessment year 2010-11. (6 Marks)
- (b) ILT Limited is engaged in manufacturing pipes and tubes. The Profit & Loss Account of the company for the year ended 31st March, 2010 shows a net profit of Rs.405 lakhs. The following information and particulars are furnished to you. You are required to compute total income of the company for Assessment Year 2010-11 indicating reasons for treatment of each item.
- (i) A group Free Air Ticket was provided by a supplier for reaching a certain volume of purchase during the financial year 2009-10. The same is encashed by the company for Rs.10 lakhs in April 2010.
 - (ii) A regular supplier of raw materials agreed for settlement of Rs.8 lakhs instead of Rs.10 lakhs for poor quality of material supplied during the previous year which was not given effect in the running account of the supplier.
 - (iii) Andhra Bank sanctioned and disbursed a term loan in the financial year 2006-07 for a sum of Rs.50 lakhs. Interest of Rs.8 lakhs was in arrear. The bank has converted the arrear interest into a new loan repayable in ten equal instalments. During the year, the company has paid two instalments and the amount so paid has been reduced from Funded Interest in the Balance Sheet.
 - (iv) The company remitted Rs.5 lakhs as interest to a company incorporated in USA on a loan taken two years ago. Tax deducted under section 195 from such interest has been deposited by the company on 15th June, 2010.
 - (v) Liquidated damage of Rs.3 lakhs received from KS Limited for delay in supply of plant and machinery has been shown under the head "Other income" in Profit & Loss Account.
 - (vi) Sandeep, a sales executive stationed at HO at Delhi, was on official tour in Bangalore from 31st May, 2009 to 18th June, 2009 and 28th September, 2009 to 15th October, 2009 for the business development. The company has paid Sandeep's salary, in cash, from its local office at Bangalore for the month of May, 2009 (payable on 1st June) and September 2009 (payable on 1st October), amounting to

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Rs.25,000 and Rs.27,000 respectively (net of TDS and other deduction), as Sandeep has no bank account at Bangalore.

(vii) The company has taken up initiative to restructure its debt and paid Rs.20,000 to a finance company, M/s ABC Ltd., towards pre payment premium. As per the scheme, Rs.50,000 loan was waived against its loan and B Limited directly credited it to its reserve account, considering loan waiver amount as capital receipt.

(viii) The company has contributed Rs 50,000 to an electoral trust and the same stands included under the head "General Expenses". (10 Marks)

Answer

(a) Computation of taxable income for the A.Y. 2010-11

	Particulars	Rs.
A	Long term capital gains	1,01,50,000
	Less: Deduction under section 54EC [See Notes 1 & 2 below]	1,00,00,000
	Long term capital gain	1,50,000
B	Other income	46,000
	Total Income	1,96,000

As per section 112, in case of an individual, being a resident where her total income includes long-term capital gain and other income, the tax payable on the total income is the aggregate of the amount of income tax on long-term capital gains@ 20% and the amount of income tax on the total income as reduced by the amount of long term capital gain, had the total income so reduced been her total income.

However, the unexhausted basic exemption limit can be exhausted against long-term capital gains, and tax would be leviable on the balance long-term capital gains@20%. Therefore, the basic exemption limit of Rs.1,90,000 should be first adjusted against other income of Rs.46,000 and the unexhausted basic exemption limit of Rs.1,44,000 should be adjusted against the long-term capital gains of Rs.1,50,000. The balance long-term capital gains of Rs.6,000 would be taxable@20% plus education cess@2% and secondary and higher education cess@1%. Therefore, the tax payable by the assessee would be Rs.1,236.

Notes:

- (1) In order to claim exemption under section 54EC, the assessee has to invest in specified bonds of RECL or NHAI within a period of 6 months from the date of transfer of the asset.
- (2) However, investments made on or after 1.04.2007 in such bonds by an assessee during any financial year cannot exceed Rs. 50 lakhs.

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In this case, the assessee has invested Rs.50 lakhs in the F.Y.2009-10 and Rs.50 lakhs in the F.Y.2010-11, both within six months from the date of transfer. She has, therefore, fulfilled both the conditions and hence, she is eligible to claim exemption of Rs. 100 lakhs under section 54EC.

(b) Computation of total income of ILT Ltd. for the A.Y.2010-11

Particulars	Rs. in lacs
Profits and gains from business or profession	
Net profit as per profit and loss account	405
<i>Add :</i> Items debited to profit and loss account, but to be disallowed and items not considered in accounts but to be taxed [See Note 1 below]	
Value of group free air ticket provided by a supplier is taxable as business income under section 28(iv), as the value of any benefit, whether convertible into money or not, arising from business is taxable as business income.	10
Amount waived by the supplier of raw materials is a deemed income under section 41(1), as the expenditure was allowed as deduction in the last year and there is a benefit by way of remission or cessation of a trading liability. The fact that effect was not given in the running account of supplier is not relevant.	2
Contribution to electoral trust is not an allowable expenditure while computing business income. Hence, the same has to be added back, since it is included in general expenses.	0.50
	12.50
	417.50
<i>Less:</i> Amount of deduction allowable or amount credited to profit and loss account but not taxable [See Note 1 below]	
Under section 43B, interest on loan due to any scheduled bank, etc. is allowed as deduction, if such interest is actually paid irrespective of the method of accounting followed by the assessee. Conversion of arrear interest into a fresh loan by a bank cannot be considered as actual payment of interest. However, the amount of funded interest (i.e. converted loan) actually paid is allowable as deduction. Hence, Rs. 1,60,000, being two installments of Rs.80,000 each, actually paid is deductible.	1.60

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Liquidated damages have been received due to delay in supply of plant and machinery by the supplier. As the liquidated damages relates to delayed supply of a capital asset, it is in the nature of capital receipt and not revenue receipt. As the amount has been wrongly credited to the profit and loss account, the same should be deducted. 3.00

In respect of payment of salary to sales executive in cash, no disallowance under section 40A(3) is to be made as such payment falls within the scope of Rule 6DD(1). Salary paid to him in cash is allowable as the executive was temporarily posted for a continuous period of more than 15 days in Bangalore, not being the place of his normal duty, tax was deducted from such salary under section 192 and he does not maintain any bank account in Bangalore. Therefore, the salary of Rs.25,000 and Rs.27,000 are allowable as deduction. 0.52

In the case of *CIT v. Gujarat Guardian Ltd. (2009) 177 Taxman 434 (Del.)*, it was held that pre-payment premium represents interest as per section 2(28A). Section 2(28A) defines interest to include any other charge in respect of money borrowed or debt incurred. Section 36(1)(iii) provides for deduction of interest paid in respect of capital borrowed for the purposes of business or profession. Under section 43B, such interest is allowable as deduction on actual payment. From a combined reading of section 2(28A), 36(1)(iii) and 43B it can be inferred that pre-payment premium is deductible as business expenditure in one lump-sum on actual payment. 0.20 5.32

Business Income	412.18	
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Gross total income	412.18	
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Less: Deduction under Chapter VI-A

Deduction under section 80GGB in respect of contribution by the assessee company to an electoral trust.	0.50	
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Total Income	411.68	
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Notes

1. Since the question is silent as to whether the net profit of Rs.405 lakh is after taking into account the adjustments in (i) to (viii), the problem has been worked out on the assumption that except for items (v) and (viii) in respect of which there is a specific mention about inclusion, all other adjustments have not been given effect to in the profit and loss account.

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2. Interest payable outside India to a foreign company is not allowable since tax deducted by the assessee is not deposited during the previous year or in the subsequent year within the time prescribed under section 200(1) [Section 40(a)(i)]. In this case, the tax deducted was deposited after the prescribed date after the end of the previous year and therefore, the assessee can claim deduction only in the A.Y. 2011-12.
3. Remission of principal amount of loan does not amount to income under section 41(1) or under section 28(iv), where there is a waiver of loan taken from a bank or financial institution, unless the loan is taken for a trading activity. It is assumed that such loan is not taken for a trading activity and therefore, waiver of loan cannot be treated as income.

Question 4

- (a) Dishant received a notice under section 148 from the Assessing Officer for Assessment Year 2004-05 on the ground that depreciation on certain assets was allowed in excess. The Assessing Officer recorded the reason for reopening. The original assessment was completed under section 143(3). In course of reassessment proceeding, the Assessing Officer also disallowed certain sum under section 14A in respect of expenses purported to be in relation to dividend from companies and tax-free interest. However, the Assessing Officer did not record the reason for applying the provisions of section 147 in respect of the issue of disallowance under section 14A and passed the order disallowing the excess depreciation and also certain sum under section 14A. Is there any infirmity in the order passed by the Assessing Officer? (3 Marks)
- (b) (i) Who shall sign and verify the return of income of a limited liability partnership?
(ii) XYZ LLP is liquidated. What is the liability of partners of XYZ LLP in respect of its tax dues?
(iii) PQR LLP has a profit of Rs.500 lakhs after charging interest on capital for P amounting to Rs.10 lakhs calculated at 15% p.a. as per the agreement, but before considering remuneration to partners. What is the maximum admissible amount of remuneration to partners assuming all the partners are working partners and remuneration is authorized by the LLP instrument? (2 × 3 = 6 Marks)
- (c) Who can be a e-return intermediary, as notified by CBDT? (4 Marks)
- (d) ITP Limited is engaged in growing and manufacturing tea in India. It commenced its operation from 1st April, 2008. It acquired plant and machinery, factory building and furniture at cost of Rs.40 lakhs, Rs.25 lakhs and Rs.10 lakhs, respectively, in the previous year 2008-09. All the assets were put to use for more than 180 days during 2008-09. Compute the written down value of each block of assets as on 1st April, 2009. (3 Marks)

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Answer

- (a) The Assessing Officer may, in course of proceeding under section 147, assess or reassess any other income which has escaped assessment and which comes to his notice subsequently in the course of such proceeding.

Some Courts have ruled that the Assessing Officer should confine reassessment proceedings only to issues in respect of which the reasons have been recorded for reopening of the assessment. He cannot extend the proceedings to issues for which no reasons have been recorded. This interpretation, however, does not reflect the correct legislative intent.

In order to clarify the correct legislative intent, Explanation 3 has been inserted in section 147 by the Finance (No. 2) Act, 2009, with retrospective effect from A.Y. 1989-90, to provide that the Assessing Officer may assess or reassess the income in respect of any issue (which has escaped assessment) which comes to his notice subsequently in the course of proceedings under section 147, even though the reason for such issue does not form part of the reasons recorded under section 148(2).

Therefore, in the instant case, the Assessing Officer has the power to disallow expenses under section 14A in addition to disallowing excess depreciation for which notice under section 148 was issued even though the reason for issue relating to disallowance under section 14A was not recorded under section 148(2).

Hence, there is no deficiency in the order passed by the Assessing Officer.

Note – It is presumed that the notice under section 148 for A.Y.2004-05 was issued within the permissible time limit specified in section 149.

- (b) (i) Under section 140, the return of income shall be signed and verified, in the case of a limited liability partnership (LLP), by the designated partner thereof.

Where for any unavoidable reason, such designated partner is not able to sign and verify the return, or where there is no designated partner as such, the return can be signed by any partner of the LLP.

- (ii) Section 167C provides for the liability of partners of LLP in liquidation. In case of liquidation of an LLP, where tax due from the LLP cannot be recovered, every person who was a partner of the LLP at any time during the relevant previous year will be jointly and severally liable for payment of tax unless he proves that non-recovery cannot be attributed to any gross neglect, misfeasance or breach of duty on his part in relation to the affairs of the LLP. This provision would also apply where tax is due from any other person in respect of any income of any previous year during which such other person was a LLP.

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(iii) Computation of maximum admissible remuneration to working partners

Particulars	Rs. in lacs
Net profit before considering partners' remuneration	500
Add: Interest to Partner, P, in excess of 12% p.a. $\frac{Rs.10 \text{ lacs} \times \frac{3}{15} \times \frac{12}{100}}{1}$	2
Book profit under section 40(b)	<u>502</u>
Maximum amount admissible as remuneration to working partners under section 40(b) :	
On first Rs. 3 lacs of book profit, 90%	2.70
On balance of book profit i.e. Rs. 499 lacs at 60%	<u>299.40</u>
Maximum admissible remuneration	<u>302.10</u>

- (c) As per CBDT Notification No. 70/2009 dated 22.9.2009, following entities/persons are qualified to be an e-return intermediary -
- a public sector company as defined in section 2(36A) or any other company in which public are substantially interested within the meaning of section 2(18) and any subsidiary of those companies; or
 - a company incorporated in India, including a bank, having a net worth of rupees one crore or more ; or
 - a firm of Chartered Accountants or Company Secretaries or Advocates, if it has been allotted a permanent account number; or
 - Chartered Accountants or Company Secretaries or Advocates or Tax Return Preparers, if they have been allotted a permanent account number; or
 - a Drawing or Disbursing Officer (DDO) of a Government Department.
- (d) As per section 32, depreciation to be allowed has to be computed at the prescribed percentage on the written down value of any block of assets.

As per section 43(6), in the case of assets acquired before the previous year, the written down value means the actual cost to the assessee less all depreciation "actually allowed" to him under the Income-tax Act, 1961.

As per Rule 8 of the Income-tax Rules, 1962, only 40% of income from business of growing and manufacturing of tea in India is deemed to be income liable to tax. The balance 60% would be agricultural income, which is not chargeable to tax.

Explanation 7 inserted in section 43(6) by the Finance (No.2) Act, 2009 provides that in cases of composite income, for the purpose of computing written down value of assets

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acquired before the previous year, the total amount of depreciation shall be computed as if the entire composite income of the assessee is chargeable to tax under the head "Profits and gains of business or profession". The depreciation so computed shall be deemed to have been "actually allowed" to the assessee.

Therefore, even if only 40% of ITP Limited's income from sale of tea grown and manufactured in India is taxable, full depreciation (and not 40%) should be taken as "actually allowed" for the purpose of computing WDV. Accordingly, the WDV of each block as on 1st April 2009 will be as follows:

Plant & Machinery = Rs. 40 lakhs – Rs.6 lakhs (15% of 40 lakhs) = Rs.34 lakhs.

Building (Factory) = Rs. 25 lakhs – Rs.2.50 lakhs (10% of 25 lakhs)= Rs.22.50 lakhs.

Furniture = Rs. 10 lakhs – Rs.1 lakh (10% of 10 lakhs) = Rs. 9 lakhs.

Question 5

Attempt any four questions out of the following:

- (a) CG Ltd. is engaged in the business of conversion of jumbo rolls of films into saleable packets/rolls of standard size. Is the company entitled to claim deduction under section 80-IB ? (4 Marks)
- (b) SK Enterprises, an exporter of soft toys, filed its return of income disclosing a total income of Rs.8.50 lakhs after claiming deduction under Section 10B of the Income-tax Act, 1961 for Rs 4 lakhs. The return was processed under section 143(1) and income as per return of income was accepted. Later on, it was noticed by the Assessing Officer that the assessee had offered interest income on fixed deposit under the head "Profits and gains of business or profession", but it was required to be assessed under the head "Income from other sources". The Assessing Officer initiated rectification proceeding by issue of notice under section 154 and after hearing the assessee, passed order under section 154 including the interest income under the head "Income from other sources" and adjusting the claim of the assessee under Section 10B. Examine the correctness of the action of the Assessing Officer. (4 Marks)
- (c) A charitable institution registered under section 12A of the Income-tax Act, 1961 filled in Form No.10 for seeking permission to accumulate unapplied income under Section 11(2) of the Act for the objects of the institution and submitted it to the Assessing Officer along with the resolution for accumulation. The Assessing Officer found that the objects for which accumulation was sought were not particularised in as much as they covered the entire range of objects of the institution. Can the Assessing Officer deny the benefit of accumulation in such a case? (4 Marks)
- (d) The residential premises of Mr.X, an income tax practitioner was searched under section 132. During the search, certain incriminating documents were seized. From the documents seized, it was revealed that he had been claiming and receiving income tax refunds by filing bogus TDS certificates with returns of income prepared by him, even in

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the names of non-existing persons. Discuss whether the refund collected illegally by Mr. X by producing bogus TDS certificates constitute income chargeable to tax. (4 Marks)

- (e) *People Housing Ltd. is engaged in the business of constructing residential and commercial properties. One of the building properties was included in the closing stock in the Balance Sheet. The said building was let out for a monthly rent as suitable buyers could not be found. All other buildings had been sold by the company. State with reasons whether the income by way of rent from the unsold property is assessable as income from business or income from house property. (4 Marks)*

Answer

- (a) One of the conditions to be satisfied for the purpose of claiming deduction under section 80-IB is that the industrial undertaking should “manufacture” or produce any article or thing. The issue in this case is whether conversion of jumbo rolls of films into saleable packets/rolls of standard size would amount to manufacture or production of an article or thing.

As per section 2(29BA), inserted by the Finance (No.2) Act, 2009, “manufacture” with all its grammatical variations, means a change in a non-living physical object or article or thing :-

- (a) resulting in transformation of the object or article or thing into a new and distinct object or article or thing having a different name, character and use; or
(b) bringing into existence of a new and distinct object or article or thing with a different chemical composition or integral structure.

The conversion of Jumbo rolls of films into rolls of standard size/saleable packets would not amount to “manufacture”, as there is no transformation of the original article/thing i.e. jumbo rolls. Rolls of standard size will not have a different character or use. Therefore, the company CG LTD., would not be eligible for deduction under section 80-IB, since the activity of conversion of jumbo rolls of film into rolls of standard size does not amount to manufacture.

- (b) The facts of the case are similar to that in *CIT vs. A.G. Granites P. Ltd. (2009) 311 ITR 170 (Mad.)* Section 154 provides for rectification of mistakes, which are apparent from the record. The phraseology “mistake apparent from the record” has been the subject matter of consideration by various courts including the Apex Court. The Courts have uniformly held that an error, which is not self-evident, and has to be detected by a process of reasoning, cannot be said to be an error apparent on the face of the record. There is a clear distinction between an erroneous order and an error apparent on the face of the record. While the first can be corrected by the higher forum, the latter can be corrected by exercising the power of rectification. A debatable issue or an issue which can be resolved through a long drawn process does not fall within the expression “mistake apparent from the record”.

The issue as to the head under which interest income on fixed deposit has to be assessed is a debatable issue. Therefore, the interest income offered by the assessee

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for tax under the head “Profits and gains from business or profession” cannot be reassessed under the head “Income from other sources” by way of rectification under section 154. The action of the Assessing Officer in this case is, therefore, not correct.

- (c) Section 11(2) permits a charitable trust or institution to accumulate its unspent income where 85% of the income is not applied or is not deemed to have been applied to charitable or religious purposes in India during the previous year. The institution or trust has to specify, by notice in writing given to the Assessing Officer, the purpose for which the income is being accumulated or set apart and the period for which such income is to be accumulated or set apart.

In the given case, the assessee institution sought the permission of the Assessing Officer to accumulate unapplied income for the objects of the institution. The institution had not stated any objects in particular for which the unspent income was sought to be accumulated or set apart. In *Bharat Krishak Samaj vs. Deputy Director of Income-tax (Exemption)* (2008) 306 ITR 153 (Del.), it was held that it is not necessary for a charitable trust to particularise each and every object for which accumulation is sought. It is enough if the assessee seeks permission for accumulation for the objects of the trust. Therefore, the Assessing Officer cannot deny the benefit of accumulation in such a case.

- (d) The facts of the given case are similar to the facts of the case *CIT vs. K. Thangamani* (2009) 309 ITR 015 (Mad.).

On this issue, the Madras High Court observed that the income-tax authorities are not concerned about the manner or means of acquiring income, and allowing tainted income to escape the tax net would be nothing but a premium or reward to the person for doing illegal trade. The Income-tax Act, 1961, treats the income earned legally as well as illegal income alike. In the event of taxing the income of only those who acquire the same through legal manner, the tendency of those who acquire income by illegal means would increase. Therefore, even if the assessee has been prosecuted by the law enforcing authorities for commission of offence, the income earned by him would be an income liable for assessment. Illegality tainted with the earning has no bearing on its taxability.

Therefore, where the assessee has filed bogus TDS certificates and collected refund from the Income-tax Department, income received by the assessee by getting refund from the Income-tax Department constitutes income chargeable to tax.

- (e) Under section 22, the charging section for “Income from house property”, the only exception provided is the income derived from property used/occupied by the assessee for his own business. Therefore, income derived from letting out of house property will always be taxable under the head “Income from house property”. Even if the business of the assessee is to own and give houses on rent or to trade in houses, the annual value of the houses owned by him during the previous year would be taxable as “Income from house property”. It will be so taxable even if property is held by the assessee as stock-in-trade of his business.

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This view is supported by the Madras High Court in *CIT v. Chennai Properties and Investments Ltd.* (2004) 266 ITR 685.

Note – The Gujarat High Court has, however, expressed an alternate view in *CIT v. Neha Builders P. Ltd.* (2008) 296 ITR 661, where it was held that in the case of an assessee engaged in construction and sale of buildings, the same would constitute stock-in-trade of the assessee and any income derived from stock would be assessable as business income.

Question 6

(a) *Fearless General Finance & Investment Limited, a residuary non-banking company, accepts public deposits, issues deposit certificate and repays the same after some period of time alongwith interest, under different schemes run by it. Following transactions were noted from their books of account:*

- (i) *Mr. A, an individual, has deposited Rs.15,000 on 1st May, 2006 for 48 months by cheque and another Rs.15,000 on 30th June, 2009 in cash to purchase a new certificate of 48 months tenure.*
- (ii) *Mr. A has applied for premature withdrawal against both the certificates and the company has paid him Rs.16,500, by a bearer cheque, against principal and interest on 23rd March, 2010, due against his first certificate (purchased in 2006) and Rs.15,500 in cash on 25th March, 2010, against the second certificate.*

Discuss the violation of income tax provision, if any, and consequential penalty for each transaction. Will it make any difference if the certificates were held jointly with Mrs. A, wife of Mr. A, while repaying back in cash or bearer cheque? (7 Marks)

(b) *The net profit of ABP Ltd. as per Profit & Loss Account for the previous year 2009-10 is Rs.100 lakhs after debiting/crediting the following items:*

- (i) *Provision for income-tax : Rs.15 lakhs*
- (ii) *Provision for deferred tax : Rs.8 lakhs*
- (iii) *Proposed Dividend : Rs.20 lakhs*
- (iv) *Depreciation debited to Profit & Loss Account is Rs.12 lakhs. This includes depreciation on revaluation of asset to the tune of Rs.2 lakhs.*
- (v) *Profit from unit established in Special Economic Zone : Rs.30 lakhs*
- (vi) *Provision for permanent diminution in value of investments : Rs.2 lakhs*

Brought forward losses and unabsorbed depreciation as per books of the company are as follows:

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<i>Previous year</i>	<i>Brought forward loss (Rs. in lakhs)</i>	<i>Unabsorbed Depreciation (Rs. in lakhs)</i>
2006-07	2	5
2007-08	-	3
2008-09	10	2

Compute book profit of the company under section 115JB for Assessment Year 2010-11.

(9 Marks)

Answer

- (a) (i) There is no violation of section 269SS at the time of acceptance of the first deposit of Rs.15,000 on 1.5.2006, since it is not in excess of the threshold limit of Rs.20,000. However, violation under section 269SS is attracted at the time of acceptance of the second deposit in cash on 30th June, 2009, since as on that date, there is already an outstanding deposit of Rs.15,000 and another cash deposit of Rs.15,000 would take the aggregate to Rs.30,000, which exceeds the threshold limit of Rs.20,000. Therefore, penalty under section 271D of a sum equal to the amount of deposit taken from Mr. A is attracted for failure to comply with the provisions of section 269SS.

Note – It has been assumed that the first deposit is made by bearer cheque. However, since the question only mentions that the first deposit is made by cheque, without specifying whether the same is by bearer cheque or account payee cheque, it is possible to assume that the first deposit is made by account payee cheque, in which case, the provisions of section 269SS would not be attracted since the second deposit in cash does not exceed the threshold limit of Rs.20,000.

- (ii) In this case, there is a violation of the provisions of section 269T at the time of first repayment by bearer cheque on 23rd March, 2010, since on that date, the aggregate amount of deposits held by Mr.A with the non-banking company (together with interest payable on such deposits) is more than Rs.20,000. Therefore, penalty under section 271E equal to the amount of deposit so repaid will be attracted for failure to comply with the provisions of section 269T.

However, the second repayment of Rs.15,500 on 25th March, 2010 in cash cannot be considered as a violation of section 269T, since neither the amount of deposit with interest thereon nor the aggregate amount of deposits held by Mr.A on that date together with interest exceeds the threshold limit of Rs.20,000.

The provisions of section 269T will be attracted even if the certificate is being held by Mr. A in joint name with his wife.

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- (b) Computation of book profit of ABP Ltd. under section 115JB for A.Y. 2010-11

Particulars	Rs. in lakhs	
Net profit as per profit and loss account		100
Add: Net profit to be increased by the following amounts as per Explanation 1 to section 115JB		
Provision for income tax	15	
Provision for deferred tax	8	
Proposed dividend	20	
Depreciation	12	
Provision for diminution in value of investment	2	57
		157
Less: Net profit to be reduced by the following amounts as per Explanation 1 to section 115JB and sub-section (6) of section 115JB		
Depreciation (excluding depreciation on revaluation of assets)	10	
Profit from unit established in Special Economic Zone	30	
Lower of brought forward loss or unabsorbed depreciation, as per books (on overall basis)	10	50
		107
Book Profit		107

Question 7

- (a) *Ranjit has taken an interest-free loan of Rs.10 lakhs from his company. The amount is utilized by him for purchasing a house on 30-06-2008. The house is self-occupied. As per the scheme of the company, loan would be recovered in 40 equal monthly instalments recoverable immediately after the completion of 18th month from the date of purchase. The SBI lending rate of similar loan on 1-4-2009 was 9.75%. Calculate the perquisite value of such loan in the hands of Ranjit for the assessment year 2010-11. Is it possible to get deduction of perquisite value of interest under section 24(b)? Does it make any difference, if the house is given on rent? (5 Marks)*
- (b) *Mr. Ram, a resident individual following cash basis of accounting, has the following assets as on 31-03-2010. Compute his net wealth for the assessment year 2010-11:*

	Valuation as on 31-03-2010 (Rs. in lakhs)
(i) Self-occupied residential house	60

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- | | |
|---|-----|
| (ii) <i>Owning of a guest house situated 26 kms from the municipality</i> | 30 |
| (iii) <i>Property used for his business</i> | 50 |
| (iv) <i>One residential complex consisting of 10 dwelling units. He intended to sell 5 units which are kept vacant for want of prospective buyers for the whole year. 2 units are vacant from 05-01-2010. 3 units are let out fully for the whole year.</i> | 500 |

(5 Marks)

- (c) *What are the nature and value of transactions to be reported in Annual Information Return by the following entities?*

- (i) *A banking company;*
(ii) *Registrar or Sub-registrar appointed under the Registration Act.*

What is the time limit for filing such return?

(3 Marks)

- (d) *Can the Transfer Pricing Officer accept use of multiple-year data for determination of Arm's Length Price in an international transaction?*

(3 Marks)

Answer

- (a) First installment will be due on 1st January, 2010. Amount of Installment will be = Rs.10,00,000 ÷ 40 = Rs. 25,000.

Therefore, value for perquisite for interest-free loan will be calculated by applying the interest rate charged by the State Bank of India on the outstanding amount of loan. Therefore, the value of perquisite will be as follows:

		Amount (Rs.)
From April 09 to Dec. 09	$(10,00,000 \times 9.75\% \times 9/12)$	73,125
For the month of Jan. 10	$(9,75,000 \times 9.75\% \times 1/12)$	7,922
For the month of Feb. 10	$(9,50,000 \times 9.75\% \times 1/12)$	7,719
For the month of Mar. 10	$(9,25,000 \times 9.75\% \times 1/12)$	<u>7,516</u>
Total		<u>96,282</u>

Therefore, the perquisite value of interest-free loan will be Rs.96,282.

Interest on capital borrowed for the purchase, construction, re-construction, repair or renewals of house property is deductible under section 24(b). In this case, capital is borrowed from the employer without interest. There is no interest paid or payable in respect of the amount of loan of Rs.10 lacs. Consequently, no deduction under section 24(b) would be available, whether the house is self-occupied or let out.

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(b) Computation of net wealth of Mr. Ram for the A.Y.2010-11

S. No.	Particulars	Amount Rs. in lakhs
1	Self-occupied house property - Exempt under section 5(vi)	Nil
2	Guest house situated within 26 kms from municipality is an asset as per section 2(ea)(i)	30
3	Property used for business Not an asset as per section 2(ea)(i)(3)	Nil
4	Residential complex [Section 2(ea)(i)(4)]	
	5 units kept vacant are assets as they are not let out for a minimum period of 300 days in a year [Rs. 50 lacs × 5]	250
	2 units let out for less than 300 days are assets [Rs. 50 lacs × 2]	100
	3 units let out for more than 300 days are not assets	<u>Nil</u>
	Net Wealth	<u>380</u>

(c) Section 285BA read with Rule 114E prescribes the nature of transactions and the value thereof to be reported in Annual Information Return to be filed by any person specified in section 285BA.

- (i) A banking company has to furnish details of cash deposits aggregating to Rs.10 lakhs or more in a year in any savings account of a person maintained in that bank.

A bank has also to furnish the details of payments made by any person against bills raised in respect of a credit card issued to that person aggregating to Rs. 2 lakhs or more in the year.

- (ii) A Registrar or a Sub-registrar appointed under the Registration Act, 1908 has to report purchase or sale by any person of immovable property valued at Rs.30 lakh or more.

The Annual Information Return is required to be filed on or before 31st August immediately following the financial year in which transaction is registered or recorded.

(d) Rule 10B of the Income-tax Rules, 1962, has prescribed the methods of determining Arm's Length Price under section 92C.

As per Rule 10B(4), the data to be used in analyzing the comparability of an uncontrolled transaction with an international transaction shall be the data relating to the financial year in which the international transaction has been entered into. However, data relating to a period of maximum 2 years prior to such financial year may also be considered if such data reveals the facts which could have an influence on the determination of transfer prices in relation to the transactions being compared.