

The Suggested Answers for Paper – 7 : Direct Taxes are based on the provisions applicable for A.Y. 2007-08, which is the assessment year relevant for November, 2007 examination.

PAPER – 7 : DIRECT TAXES

Answer all questions

Question 1

HSP, a partnership firm engaged in the business of running a heritage hotel approved by the competent authority provides the following information relating to the year ended on 31.3.2007:

- (a) Net profit as per P & L account of Rs.200 lacs was arrived at after charge of the following:
 - (i) Depreciation on hotel building having W.D.V. on 1.4.2006 of Rs.500 lacs was charged by treating the same as plant and machinery.
 - (ii) Expenses of Rs.1,00,000 incurred for the purpose of promoting family planning among its employees.
 - (iii) Payment of Rs.50,000 for an advertisement published in the souvenir released on 15th August by Bhartiya Janta Party.
 - (iv) Compensation of Rs.1,00,000 paid to the suppliers of automatic kitchen appliances because of termination of the contract after receipt of 50% of appliances.
 - (v) Wines and liquor imported in F.Y. 2005-06 for Rs.20 lacs and were available in the stock on 1.4.2006 for Rs.5 lacs were confiscated by the Govt. authority and therefore were written off.
 - (vi) Expenses of Rs.20 lacs incurred on replacement of carpets in the foyer, lounge and bar.
- (b) Out of amount credited to the reserve created under section 80HHD(1) in the F.Y. 2001-02, an amount of Rs.15 lacs could not be utilised for the purposes as per section 80HHD(4) till 31.3.2007.
- (c) Amount of Rs.4 lacs equal to U.K. £5000 was remitted and paid to a travel agent resident of U.K. as commission for the booking of international tourists in the hotel. Tax at source was not deducted out of such payment.
- (d) Amount of Rs.40,000 each was paid in cash to the suppliers of vegetables, milk products and eggs on 11.2.07 because of suspension of banking operations due to strike of bank employees.
- (e) Amount of Rs.5 lacs written off in the F.Y. 2004-05 as irrecoverable from a travel agent; an amount of Rs.2 lacs out of it was recovered on 13.3.07 and credited to a reserve account.

Compute the income chargeable to tax for A.Y. 2007-08 and give reasons in brief for treatment given to each of the items. (14 Marks)

Answer

Computation of taxable income of M/s. HSP for the A.Y.2007-08

Particulars	Amount in Rs.
Income from business and profession	
Net profit as per profit and loss account	2,00,00,000
Add : Items charged in profit and loss account which are not allowable	
Excess depreciation on building @ 5%(i.e. 15% - 10%) on Rs.500 lakh	25,00,000
Expenses on promoting family planning amongst the employees	1,00,000
Advertisement in souvenir of a political party	50,000
Compensation to a supplier of kitchen appliances	1,00,000
	27,50,000
Add : Recovery of bad debts credited in reserve but chargeable under section 41 (4)	2,00,000
Total Income	
	2,29,50,000

Reasons for treatment given to each of the items specified :-

- (1) Hotel building does not constitute plant and machinery and therefore, depreciation chargeable thereon is 10%. However, depreciation has been charged in the profit and loss account at the rate applicable to plant and machinery i.e. @ 15%. Accordingly, the excess depreciation charged in the profit and loss account @ 5% (15%-10%) has to be added to income.
- (2) Expenses on promoting family planning amongst employees is allowable under section 36(1)(ix) only to a company assessee. In this case, since the assessee is a firm, such expenses are not allowable and therefore, the same has to be added back.
- (3) Advertisement of any nature given in a magazine / souvenir published by a political party is not allowable as per section 37(2B).
- (4) Compensation paid for breach of a contract for supply of a capital asset is in the nature of capital expenditure as held by the Supreme Court in case of Swadeshi Cotton Mills Co. Ltd. vs. CIT (1967) 63 ITR 65. Accordingly, the same will be disallowed and added back to income.
- (5) The Apex Court in case of Dr. T.A. Quereshi vs CIT (2006) 287 ITR 0547 observed that loss of stock-in-trade has to be considered as a trading loss. Explanation to section 37(1) is not relevant here since it is not a case of business expenditure but one of business loss. Business loss is allowable on ordinary commercial principles.

Therefore, since wine and liquor formed part of stock-in-trade of the firm, confiscation of the same has to be allowed as a business loss.

- (6) The expenditure incurred on replacement of carpets by a hotel are in the nature of expenses incurred for the purposes of business and are allowable as revenue expenses under section 37(1).
- (7) The amount credited in a reserve under section 80HHD(1) is to be utilized for the purposes as specified in section 80HHD(4) within a period of 5 years next following the previous year in which the amount was credited to the reserve i.e. by 31.3.2007. The assessee had failed to utilize the same in 5 years and therefore as per the provisions of section 80HHD(5)(b) the same is deemed to be the profits of the year immediately following the period of 5 years i.e. P.Y.2007-08 and shall be chargeable to tax in the A.Y. 2008-09. Therefore, for the current assessment year (i.e. A.Y.2007-08), there would be no adjustment.
- (8) The payment to a non-resident outside India without deduction of tax at source is an allowable expense as per CBDT Circular No.786 dated 7.2.2000, as there is no income accruing or arising to the non-resident in India.
- (9) The cash payments made totaling Rs.1,20,000 on the day when bank employees were on strike is an exception as per rule 6DD(k) and clarification of CBDT as per letter No.142(14)/70 dated 28/9/1970. Therefore, disallowance under section 40A(3) is not attracted.
- (10) The recovery of a debt which was earlier written off under section 36(1)(vii) and was allowed as deduction is chargeable to tax under section 41(4) in the year of such recovery. Accordingly, such amount has to be added to income despite the fact that the same was credited by the firm in a reserve account.

Question 2

- (a) Anush Motors Ltd., an Indian company declared income of Rs.300 crores computed in accordance with Chapter IV-D but before making any adjustments in respect of the following transactions for the year ended on 31.3.2007:
 - (i) 10,000 cars sold to Rida Ltd. which holds 30% shares in Anush Motors Ltd. at a price which is less by \$ 200 each car than the price charged from Shingto Ltd.
 - (ii) Royalty of \$ 1,20,00,000 was paid to Kyoto Ltd. for use of technical know-how in the manufacturing of car. However, Kyoto Ltd. had provided the same know-how to another Indian company for \$ 90,00,000.
 - (iii) Loan of Euro 1000 crores carrying interest @ 10% p.a. advanced by Dorf Ltd., a German company, was outstanding on 31.3.2007. The total book value of assets of Anush Motors Ltd. on the date was Rs.90,000 crores. The said German company had also advanced a loan of similar amount to another Indian company @ 9% p.a. Total interest paid for the year was EURO 100 crores.

Explain in brief the provisions of the Act affecting all these transactions and compute the income of the company chargeable to tax for A.Y.2007-08 keeping in mind that the value of 1\$ and of 1 EURO was Rs.50 and Rs.55, respectively, throughout the year. (7 Marks)

- (b) Simran Pharma Ltd., a manufacturer of drugs and pharma products, provides the following information relating to payments made to its marketing manager in the year 2006-07:

- Salary @ Rs. 20,000 p.m.
- Motor-cycle purchased for Rs.45,000 in June, 2006 was given free of cost.
- Conveyance allowance of Rs.5,000 p.m. which was allowed to him as exempt under section 10(14).
- Tickets worth Rs.4,000 for a cricket match between India and England.
- Reimbursement of medical expenses actually incurred by him of Rs.17,500.

The company asks you to compute the amount of:

- (a) income chargeable to tax in the hands of marketing manager; and
- (b) payments covered under fringe benefits, amount chargeable to FBT and the amount of such tax thereon. (6 Marks)

Answer

- (a) Any income arising from an international transaction, where two or more "associated enterprises" enter into a mutual agreement or arrangement, shall be computed having regard to arm's length price as per the provisions of Chapter X of the Act.

Section 92A defines an "associated enterprise" and sub-section (2) of this section speaks of the situations when the two enterprises shall be deemed to associated enterprises. Applying the provisions of section 92A(2)(a) to (m) to the given facts, it is clear that "Anush Motors Ltd." is associated with :-

- (i) Rida Ltd. as per section 92A(2)(a), because this company holds shares carrying more than 26% of the voting power in Anush Motors Ltd.;
- (ii) Kyoto Ltd. as per section 92A(2)(g), since this company is the sole owner of the technology used by Anush Motors Ltd. in its manufacturing process;
- (iii) Dorf Ltd. as per section 92A(2)(c), since this company has financed an amount which is more than 51% of the book value of total assets of Anush Motors Ltd.

The transactions entered into by Anush Motors Ltd. with different companies are, therefore, to be adjusted accordingly to work out the income chargeable to tax for the A.Y. 2007-08.

Income of Anush Motors Ltd. as computed under Chapter IV-D, Rs.300 crore
prior to adjustments as per Chapter – X

Add: Difference on account of adjustment in the value of international transactions:

(i)	Difference in price of car @ \$ 200 each for 10,000 cars (\$ 200 x 10,000 x 50)	Rs.10 crore
(ii)	Difference for excess payment of royalty of \$ 30,00,000 (\$ 30,00,000 x 50) [See Note below]	Rs.15 crore
(iii)	Difference for excess interest paid on loan of EURO 1000 crores (55*1000*1/100)	<u>Rs.550 crore</u>
	Total Income	<u>Rs.875 crore</u>

Note – The difference for excess payment of royalty has been added back presuming that the manufacture of cars by Anush Motors Ltd. is wholly dependent on the use of know-how owned by Kyoto Ltd.

- (b) Simran Pharma Ltd., a manufacturer of drugs and pharma products, is an employer as per section 115W(a)(i) for the charge of tax on fringe benefits provided to its employees. The total income chargeable to tax in the hands of the employee and fringe benefits chargeable to tax in the hands of the company are calculated as follows -

Particulars	Income of Marketing Manager (Rs.)	Value of Fringe Benefits (Rs.)
- Salary	2,40,000	-
- Free Motor cycle	45,000	-
- Conveyance allowance exempt under section 10(14) for employee	-	60,000
- Free ticket of a cricket match	-	4,000
- Reimbursement of medical expenses	2,500	15,000
(Reimbursement up to Rs.15,000 is exempt in the hands of the employee. Such amount is chargeable as fringe benefit in the hands of the employer).		
Total	<u>2,87,500</u>	<u>79,000</u>

- (a) Income chargeable to tax in the hands of Marketing Manager is Rs.2,87,500

- (b) The fringe benefits chargeable to tax in the hands of the company are -

(i)	Conveyance @ 5% (5% of 60,000)	Rs.3,000
(ii)	Others @20% [20% of 19,000 (4,000 + 15,000)]	<u>Rs.3,800</u>
	Total	<u>Rs.6,800</u>
	Tax on FBT @30% of 6,800/-	Rs.2,040
	Surcharge @ 10%	<u>Rs. 204</u>

	Rs.2,244
Education cess @ 2%	<u>45</u>
FBT payable by the company	<u>Rs.2,289</u>

Question 3

- (a) XYZ Ltd., engaged in the business of manufacturing of industrial cables, imported a car on 26.2.2001 from Japan which costed in total of Rs.53,00,000. The car was used from 1.3.01 continuously for the purposes of its business by the company. The Assessing Officer, in the month of June 2007, while completing assessment under section 143(3) of the Act for A.Y. 2005-06, noted that the company had claimed depreciation @ 25% since assessment year 2001-02 on this car in the block of assets. Therefore, he issued notices under section 148 read with section 147 for A.Y. 2001-02 to 2005-06.

Examine the validity of the action of the Assessing Officer in the context of the provisions of the Act. (4 Marks)

- (b) "Easy Call Ltd.", to provide telecom services in Mumbai, obtained a licence on 11.4.2004 for a period of 10 years ending on 31.3.2014 against a fee of Rs.27 lacs to be paid in 3 installments of Rs.10 lacs, 9 lacs and 8 lacs by April, 2004, April, 2005 and April, 2006 respectively. Explain, how the payment made for licence fee shall be dealt with under the Income-tax Act, 1961 and work out the amount, if any, deductible in this respect out of income chargeable to tax for A.Y. 2007-08 and subsequent years. (5 Marks)
- (c) Smt. Kanti engaged in the business of growing, curing, roasting and grounding of coffee after mixing chicory had a total income of Rs.3,25,000 from this business which was her only source of income during the year ended on 31.3.07. She consults you to have an opinion whether she is required to file return of income for the Asst. Year 2007-08 as per provisions of section 139(1) of the Act. (3 Marks)
- (d) An amount of Rs.5 lacs was paid on 17.3.07 to the parents of Amit by the Government of Maharashtra as a compensation to the aggrieved family whose only son Amit lost his life in Mumbai local train serial bomb blasts.

Explain with reasons, is the amount of compensation received chargeable to tax in A.Y. 2007-08? (3 Marks)

Answer

- (a) Depreciation is not admissible under section 32 on imported car acquired between 1.3.75 and 31.3.01. The car, imported by the company on 26.2.01 and used for the purposes of its business with effect from 1.3.01, was a vehicle acquired before the period ended on 31.3.01, thereby not qualifying for the claim of depreciation. Therefore, the depreciation charged by the company on this car for the assessment year 2001-02 and subsequent assessment years is not allowable.

The wrong claim of depreciation is a valid reason for taking action under section 148 read with section 147 for the assessment years 2001-02 to 2005-06, because income to

that extent chargeable to tax has escaped assessment as per Explanation 2(c)(iv) of section 147.

The issuance of notice under section 148 for five assessment years is also valid, since as per the requirement of section 149(1)(b), the income chargeable to tax which has escaped assessment amounts to more than Rs.1 lakh during each of these assessment years on account of depreciation charged on the imported car being in excess of Rs.1 lakh for each of these assessment years.

- (b) The payment made for acquiring the licence to operate telecom services in Mumbai shall be subject to deduction as per the scheme in section 35ABB. As per section 35ABB, any amount actually paid for obtaining licence to operate telecommunication services shall be allowed as deduction in equal installments during the number of years for which the license is in force. If the payment is made before the commencement of business, the deduction shall be allowed beginning with the year of commencement of business. In any other case, it will be allowed commencing from the year of payment. Deduction shall be allowed up to the year in which the license shall cease to be in force.

The amount of deduction available for A.Y. 2007-08 is Rs.3 lakh as worked out below:-

(1)	(2)	(3)	(4) = (3)/(2)
Previous year of payment	Unexpired period of license	Installment paid (Rs.)	Deduction in respect of each installment (Rs.)
2004-05	10 years	10,00,000	1,00,000
2005-06	9 years	9,00,000	1,00,000
2006-07	8 years	<u>8,00,000</u>	<u>1,00,000</u>
		<u>27,00,000</u>	<u>3,00,000</u>

The deduction under section 35ABB for assessment year 2007-08 onwards till A.Y. 2014-15 will be Rs.3 lakh each year.

Note – It is assumed that the company has commenced business during the P.Y.2004-05.

- (c) The clarification regarding filing of return of income by the coffee growers being individuals covered by Rule 7B of the Income tax Rules, 1962 is given in Circular No.10/2006 dated 16.10.06. According to this Circular, an individual deriving income from growing, curing, roasting and grounding of coffee with or without mixing chicory, would not be required to file the return of income if the aggregate of 40% of his or her income from growing, curing, roasting and grounding of coffee with or without mixing chicory and income under all other sources liable to tax in accordance with the provisions of this Act, is equal to or less than the basic exemption limit prescribed in the First Schedule of the Finance Act of the relevant year.

In this case, Smt. Kanti has a total income of Rs.3,25,000 from this business, which was her only source of income for P.Y.2006-07. 40% of her total income works out to Rs.1,30,000, which is less than the basic exemption limit of Rs.1,35,000 in respect of

resident women assesses. Therefore, Smt. Kanti is not required to file a return of income for the A.Y.2007-08 as per the provisions of section 139(1).

- (d) Section 10(10BC) defines disaster to mean a catastrophe, mishap, calamity or grave occurrence in any area, arising from natural or man made causes, or by accident or negligence. It should have the effect of causing substantial loss of life or human suffering or damage to, and destruction of, property, or damage to, or degradation of, environment. It should be of such a nature or magnitude as to be beyond the coping capacity of the community of the affected area. If, for this reason, a compensation is paid by the Central Government or by a State Government or by a local authority, then the same will be exempt from tax. Accordingly, the amount of Rs.5 lakh received by the parents of deceased Amit from the Government of Maharashtra for the disaster because of Mumbai local train serial bomb blasts, is exempt under section 10(10BC).

Question 4

- (a) A piece of land owned by Mr. Mishra located on Jaipur-Delhi highway was acquired by NHAI in the F.Y.2003-04, but the award ordered in F.Y. 2004-05 was paid in the F.Y. 2006-07. This land was purchased by him on 2.4.1977 for Rs.1,000. The fair market value of the land as on 1.4.1981 was Rs.900. Compensation paid was Rs.5 lacs.

The other piece of land located in Chennai purchased in April, 2003 for Rs.25 lacs was also sold by him in February, 2007 for Rs.35 lacs, but sale deed thereof could not be executed by 31.3.2007. The value for the purpose of stamp duty applied by the stamp valuation authority was Rs.38 lacs.

Compute the income chargeable to tax arising as a result of these transactions in the A.Y.2007-08. The CII's for the F.Y.2003-04, 2004-05 and 2006-07 are 463, 480 and 519 respectively. (6 Marks)

- (b) "NEPTUNE" is a shipliner, used in carrying passengers and cargo, owned by M/s Thomas & Thomas of U.K. The ship carried the passengers and cargo in June, 2006 from Singapore to Mumbai and vice versa and collected charges thereof amounting to Rs.200 lacs. It left Mumbai port on 15.6.06 for its journey to Korea. No other journey to India was undertaken by any of the vessels of the company during the year ended on 31.3.07. The non-resident company had authorized its Indian agent to comply with the income tax provisions.

You are consulted by the company to explain about the procedure as to return of income to be filed and the period within which the assessment thereof will be completed by the Assessing Officer. (4 Marks)

- (c) Raja Ltd., made a provision on 31.3.02 of Rs.85,500 against a bill of supplier of raw material by charging the amount to profit and loss account and claimed deduction thereof while computing the income chargeable to tax for A.Y. 2002-03. The amount of Rs.40,000 not paid to the party till 31.3.06 was paid in cash on 11.6.06. The Assessing Officer issued show cause notice to the company to rectify the computation of income for the A.Y. 2002-03 on account of payment made in cash on 11.6.06.

Can the Assessing Officer do so?

(4 Marks)

Answer

(a) Computation of taxable income of Mr. Mishra for A.Y.2007-08

Particulars	Rs.
Capital Gains	
(A) Long-term capital gain derived from transfer of land on Jaipur-Delhi highway acquired by NHAI in F.Y. 2003-04 for which award was paid in F.Y. 2006-07 is chargeable to tax in A.Y.2007-08 [See Note (i) below]	
Sale consideration i.e. compensation paid	5,00,000
Less: Indexed cost of acquisition [See Note (ii) below]	
$\frac{(1000 \times 463)}{100}$	4,630
	4,95,370
(B) Sale of land at Chennai in February 2007 [See Note (iii) below]	
Full value of consideration as per section 50C [See Note (iv) below]	38,00,000
Less: Indexed cost of acquisition	
$\frac{(25,00,000 \times 519)}{463}$	28,02,376
	9,97,624

Total income chargeable to tax arising as a result of these transactions in the A.Y.2007-08 is = Rs.14,92,994 (i.e. Rs.4,95,370 +Rs.9,97,624).

Notes:

- The capital gains arising on compulsory acquisition shall be charged to tax in the year in which the compensation is first received as per section 45(5)(a).
- The option of fair market value as on 1.4.81 is not exercised by the assessee since the fair market value is lower than the cost.
463 is the cost inflation index of F.Y.2003-04 i.e. the year in which the property was compulsorily acquired.
- The execution of sale deed is not compulsory for the purpose of charge of capital gain because the transfer of right enabling enjoyment of immovable property gives rise to charge of capital gains as held by the Kerala High Court in the case of CIT v. C.F. Thomas (2006) 284 ITR 557.

- (iv) As per section 50C, the value applied by the stamp valuation authority is deemed to be the full value of consideration received or accruing as a result of such transfer, since such value is higher than the sale consideration of Rs.35 lakh.
- (b) M/s. Thomas & Thomas of U.K shall be required to file the return of income in India for the journey of its ship before it leaves for onward journey to Korea.

However, as per the proviso to section 172(3), where the Assessing Officer is satisfied that it is not possible for the master of the ship to furnish the return before the departure of the ship from the port, and if satisfactory arrangements have been made for filing of return and payment of tax by the authorised agent in India, he may permit filing of return within 30 days of departure of the ship i.e. before 15.7.2006.

Section 172(4A) provides a time limit of 9 months for completion of assessment in such cases. The period of 9 months is reckoned from the end of the financial year in which the return under section 172(3) is furnished. However, in respect of returns filed on or before 1.4.2007, assessments are required to be completed on or before 31.12.2008.

- (c) The proviso to section 40A(3) provides that where an allowance has been made in the assessment for any year in respect of any liability for any expenditure incurred by the assessee and subsequently, during any previous year, the assessee makes any payment in respect of such liability in a sum exceeding Rs.20,000 otherwise than by an account payee cheque drawn on a bank or by an account payee bank draft, the allowance originally made shall be deemed to have been wrongly made and the Assessing Officer may recompute the total income of the assessee for the previous year in which such liability was incurred by making necessary amendment.

The proviso to section 40A(3) is attracted in this case since the company has made a cash payment of Rs.40,000 in respect of a liability incurred and allowed in A.Y.2002-03. Accordingly, Rs.8000/-, being 20% of Rs.40,000, will be added in the computation of income for the A.Y.2002-03.

The action of the Assessing Officer to issue show cause notice to rectify the computation of income for the A.Y.2002-03 is, therefore, correct.

Question 5

- (a) The business premises of Ram Bharose Ltd. and the residence of two of its directors at Delhi were searched under section 132 of the Act by the DDI, Delhi. The search was concluded on 9.8.2007 and following were also seized besides other papers and records:
- (i) Papers found in the drawer of an accountant relating to Shri Krishna Ltd., Mumbai indicating details of various business transactions. However, Ram Bharose Ltd. is not having any direct or indirect connection of any nature with these transactions and Shri Krishna Ltd., Mumbai and its directors.
 - (ii) Jewellery worth Rs. 5 lacs from the bed room of one of the director, which was claimed by him to be of his married daughter.

- (iii) Papers recording certain transactions of income and expenses having direct nexus with the business of the company for the period from 16.4.04 to date of search. It was admitted by the director that the transactions recorded in such papers have not been incorporated in the books.

You are required to answer on the basis of aforesaid and the provisions of Act, following questions:

- (a) What action the DDI shall be taking in respect of the seized papers relating to Shri Krishna Ltd., Mumbai?
 - (b) Whether the contention raised by the director as to jewellery found from his bed-room will be acceptable?
 - (c) What presumption shall be drawn in respect of the papers which indicate transactions not recorded in the books?
 - (d) Proceedings for how many years shall now be taken up and within which time limit the assessment thereof be completed by the Assessing Officer?
 - (e) Can the company move an application for settlement of case as per Chapter XIX-A of the Act? (11 Marks)
- (b) An individual resident in India, having income earned outside India in a country with which no agreement under section 90 exists, asks you to explain whether the credit of the tax paid on the income in that country will be allowed to him in India. (4 Marks)

Answer

- (a) (a) The authorised officer being DDI, Delhi is not having any jurisdiction over Shri Krishna Ltd., Mumbai, and therefore as per section 132(9A), the papers seized relating to this company shall be handed over by him to the Assessing Officer having jurisdiction over Shri Krishna Ltd., Mumbai within a period of 60 days from the date on which the last of the authorisations for search was executed for taking further necessary action thereon.
- (b) The contention raised by the Director will not be acceptable because as per the provisions of sub-section (4A)(i) of section 132, where any books of account, other documents, money, bullion, jewellery or other valuables are found in the possession or control of any person in the course of search, then, in respect thereof, it may be presumed that the same belong or belongs to that person.
- (c) As per section 132(4A), the presumptions in respect of the papers, indicating transactions not recorded in the books but having direct nexus with the business of the company, are that the same belong to the company, contents of such papers are true and the handwriting in which the same are written is/are of the persons(s) whose premises have been searched.
- (d) The search was conducted after 31.05.2003 and therefore, as per provisions of section 153A, the Assessing Officer will issue notices to the company to furnish the return of income in respect of each assessment year falling within six assessment

years immediately preceding the assessment year relevant to the previous year in which the search is conducted. Therefore, notices for A.Y. 2002-03 to 2007-08 shall be issued by the Assessing Officer.

The assessment for six assessment years shall be completed (as per provisions of section 153B(1)(a) read with proviso) within a period of 21 months from the end of the financial year in which the last of the authorisation for search was executed. Therefore, the assessment for the six assessment years shall be required to be completed by the Assessing Officer by 31.12.2009 as the search was concluded on 9.08.2007.

- (e) With effect from 1.6.2007, the definition of a case as per section 245A(b) has been amended to restrict the cases eligible to appear before the Settlement Commission. Accordingly, no proceedings, except the original assessment proceedings should be pending at the time of making an application to Settlement Commission. Therefore, an application cannot be made to the Settlement Commission where search has been initiated under section 132 followed by assessment under section 153A.
- (b) The assessee is a resident in India and accordingly, the income accruing or arising to him globally is chargeable to tax in India. However, section 91 specifies that if a person resident in India has paid tax in any country with which no agreement under section 90 exists, then, for the purpose of relief or avoidance of double taxation, a deduction is allowed from the Indian income-tax payable by him, of a sum calculated on such doubly taxed income at Indian rate of tax or the rate of tax of such country, whichever is lower, or at the Indian rate of tax if both rates are equal. Accordingly, the assessee shall not be given any credit of the tax paid on the income in other country, but shall be allowed a deduction from the Indian income-tax payable by him as per the scheme of section 91.

Question 6

- (a) Prakash, a member in two AOPs, namely, "AOP & Co." and "Prakash & Akash", provides the following details of his income for the year ended on 31.3.2007:
 - (a) "AOP & Co.", assessed at normal rates of tax, had credited in his account, amount of Rs.96,000 as interest on capital, Rs.96,000 as salary and Rs.20,000 as share of profit.
 - (b) A house property located at Jaipur was purchased on 1.7.2001 with the borrowed capital in "Prakash & Akash" jointly shared equally and occupied by both of them for self residential purposes. Total interest paid for the year 2006-07 on the borrowed capital was Rs.1,60,000.

Compute the income and the tax liability thereon for the A.Y. 2007-08 and support your answer with brief reasons and the provisions of the Act. (6 Marks)

- (b) What is the quantum of penalty that could be levied in each of the following cases:
 - (i) Failure to get books of accounts audited as required under section 44AB of the Income-tax Act within the time prescribed under the Act.

- (ii) Failure to get books of accounts audited in response to the notice issued under section 142(2A) of the Income-tax Act.
- (iii) Failure to furnish audit report as required under section 92E of the Income-tax Act.

(3 Marks)

Answer

- (a) Mr. Prakash is a member in two AOPs, namely, AOP & Co. and Prakash & Akash. Though Prakash & Akash is an AOP, the income from the house property will not be assessed as income of the AOP, but will be included in the hands of the individual members as per section 26, since the share of each member is definite and ascertainable. Hence, Prakash's share of income from house property would be assessed in his individual hands.

Since AOP & Co., has been taxed at normal rates of tax, Mr. Prakash's share income from the AOP (i.e. salary, interest on capital and his share of profit) would be included in his total income. Mr. Prakash, however, would be entitled to a relief under section 86 in respect of this income which has been included in his total income but on which tax has already been paid by the AOP. As per section 110, the relief shall be allowed at the average rate of tax calculated on the total income inclusive of such income.

Hence, the tax liability in the hands of Mr. Prakash would be as under:-

Particulars	Rs.	Rs.
Annual Value ($\frac{1}{2}$ share in house property used for own residence)	Nil	
Less: Interest on loan [$\frac{1}{2}$ share in Rs.1,60,000] – Since the loan is borrowed on or after 1.4.1999 and is used for acquiring property within 3 years, deduction would be available upto a maximum of Rs.1,50,000. This limit of Rs.1,50,000 applies for each member separately.	80,000	
Loss from house property		(-) 80,000
Share income from AOP & Co.		
- Interest on capital	96,000	
- Salary	96,000	
- Share of profit	20,000	
		2,12,000
Total Income		1,32,000

Tax on total income	3,200
Less: Rebate under section 86 read with section 110	
- Average rate of tax	
(Rs.3,200/Rs.1,32,000 x 100) = 2.424%	
- Rebate available	
(Rs.2,12,000 x 2.424%)	5,139
restricted to tax on total income	3,200
Tax liability	<u>Nil</u>

(b) The penalty that could be levied in each case is:-

- (i) Failure to get books of accounts audited as required under section 44AB of the Income-tax Act - a sum equal to $\frac{1}{2}\%$ of the total sales, turnover or gross receipts, as the case may be, in business, or of the gross receipts in profession, in such previous year or years, or a sum of Rs.1,00,000, whichever is less [Section 271B].
- (ii) Failure to get books of accounts audited in response to the notice issued under section 142(2A) – a sum of Rs.10,000 [Section 271(1)].
- (iii) Failure to furnish audit report under section 92E of the Income-tax Act - a sum of Rs.1,00,000 [Section 271BA].

Question 7

Examine and state, in the context of provisions of the Act, as to correctness of the following actions of the Income-tax authorities or of others:

- (i) A trust created for charitable purposes also derived income by letting out halls for functions. The Director of Income-tax (Exemptions) cancelled the registration on the ground that the trust was carrying on commercial activity. (3 Marks)
- (ii) The Assessing Officer 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. (3 Marks)
- (iii) Mr. Siddharth was a partner in a firm, representing his HUF, holding 25% of the share in the firm. His wife Vineeta, a house lady, was admitted in her individual capacity in the firm for 25% share. She was paid remuneration which has been proposed by the Assessing Officer to be clubbed in the hands of Siddharth-HUF by invoking section 64 of the Act. (4 Marks)

Answer

- (i) Section 12AA(3) empowers the Commissioner to cancel the registration if he is satisfied that the activities of such trust or institution are not genuine or are not being carried out in accordance with the objects of the trust or institution.

The Karnataka High Court, in *Sanjeevamma Hanumanthe Gowda Charitable Trust v. Director of Income-tax (Exemptions)*(2006) 285 ITR 327 (Karn.), observed, that for the purpose of registration under section 12AA, it is necessary for the authorities to satisfy themselves that the activities of the trust or institution are genuine and that the income derived from the trust property is applied to charitable or religious purpose. It is not necessary to go into the nature of the activity by which the income was derived by the trust.

In the case of a trust which derived income by letting out halls for functions, there is no evidence to show that the activity was not genuine or was not for the objects of the trust. The action of Director of Income-tax (Exemptions) is, thus, not correct.

- (ii) It is not necessary that any proceeding should be pending against the customer for the purpose of invoking section 133(6) of the Income-tax Act. It is with a view to collecting information that power is given to an Assessing Officer under section 133(6) to issue notice requiring a banking company to furnish information in respect of such points or matters as may be useful or relevant to any enquiry or proceeding under the Act. The second proviso to section 133(6) makes it clear that such information can be sought for even when no proceeding under the Act is pending; such power can be exercised even in case of an enquiry, the only safeguard being that before this power can be invoked by the Assessing Officer, the approval of the Director or the Commissioner, as the case may be, has to be obtained [*Karnataka Bank Ltd. vs. Secretary, Government of India* (2002) 255 ITR 508(SC)].

The action of the Assessing Officer in this case is, therefore, correct assuming that he has obtained the prior approval of the Director or the Commissioner, as the case may be.

- (iii) As per section 64(1)(ii) of the Income-tax Act, in computing the total income of any "individual", the remuneration paid to spouse by a firm in which the individual has substantial interest shall be liable for clubbing. In the present case, Mr. Siddharth is not a partner in his individual capacity, but a partner in representative capacity.

The Supreme Court has, in the case of *CIT vs. Om Prakash* (1996) 217 ITR 785, held that an individual can be a partner in a partnership firm in his individual capacity or in the capacity of the karta of a Hindu undivided family or, for that matter, in any other capacity, e.g., as a trustee. Where a person is a partner as the karta of a Hindu undivided family, the capacity in which he is a partner in the partnership firm is relevant as between him and the other members of the Hindu undivided family. The income the karta receives as a partner is not his individual income; it is the income of the Hindu undivided family and he receives it on behalf of the Hindu undivided family. It is for this reason that the income of the wife arising from her membership of the partnership firm, is held not includible in the income of the Hindu undivided family since the total income of the Hindu undivided

family is not the total income of the individual (husband). For section 64(1) to get attracted, it is necessary that the spouse should be a partner in a partnership firm in his individual capacity. It is not attracted where he is a partner as the karta of the Hindu undivided family to which his wife belongs.

The action of the Assessing Officer in this case is, therefore, not correct.

Question 8

- (a) Mr. Rajpal gives the particulars of various assets held by him on 31.3.2007 and requests you to compute his net wealth by explaining in brief that why the same was dealt with like that :
- (i) Jewellery gifted to wife from time to time in total of Rs.1 lac and were available with her on the valuation date having market value of Rs.5 lacs.
 - (ii) A flat in Mumbai purchased under instalment scheme in 1986 for Rs.6 lacs and used for own residence since then. The market value of it was Rs.20 lacs on 31.3.2007 and installment of Rs.1 lac was also outstanding.
 - (iii) He is a qualified engineer and was in possession of instruments used for his professional activity. The value of all such instruments was Rs.1 lac.
 - (iv) Urban land purchased for Rs.2 lacs in August 2004 located at Jaipur, in the name of his son who is suffering from a disability specified under section 80U. The age of his son on 31.3.2007 was 10 years and value of land was Rs.5 lacs.
 - (v) House located in NOIDA shown in his wealth-tax return for A.Y.2006-07 at Rs.40 lacs was sold on 20.3.07 for Rs.45 lacs, but the sale deed thereof was executed on 3.4.07. (5 Marks)
- (b) Examine the correctness of the statement that "All types of land held by an assessee on the valuation date are treated as 'Urban land' under the Wealth-tax Act." (5 Marks)

Answer

- (a) Computation of Net Wealth of Mr. Rajpal on 31.3.2007

Particulars of asset with reason for chargeability	Amount (Rs.)
1. Under section 4(1)(a)(i) read with Rule 18 of Schedule III, the fair market value of gifted jewellery on the valuation date will be included in the wealth of Mr. Rajpal.	5,00,000
2. The flat at Mumbai used by the assessee for his own residence is exempt under section 5(vi) and accordingly, the liability of outstanding installment is not deductible.	Nil
3. Professional instruments held on the valuation date used for the purpose of profession are not assets for the purpose of levy of wealth-tax.	Nil

4. Urban land is an asset by virtue of section 2(ea)(v). However, since the same is in the name of his minor son who suffers from a disability specified under section 80U, the clubbing provisions are not applicable as per section 4(1)(a)(ii).	Nil
5. The property at Noida was sold during the year and is, therefore, not an asset of the assessee but is an asset of the beneficial owner, since ownership of the property passes on sale of the property and execution of sale deed only confirms the act of the parties.	Nil
Net Wealth	<u>5,00,000</u>

- (b) Urban land is an “asset” as per section 2(ea)(v) of the Wealth Tax Act and it means (i) land situated in any area comprised within the jurisdiction of a municipality or cantonment board and which has a population of not less than 10,000 according to the last preceding census; (ii) land situated in any area not being more than 8 kms from the local limits of any municipality or cantonment board.

However, in spite of fulfilling the above conditions, the following are not treated as urban land:-

- (i) land on which construction of a building is not permissible under any law for the time being in force in the area in which such land is situated;
- (ii) land occupied by any building which has been constructed with the approval of the appropriate authority;
- (iii) unused land held by the assessee for industrial purposes for a period of 2 years from the date of its acquisition by him; and
- (iv) any land held by the assessee as stock-in-trade for a period of 10 years from the date of its acquisition by him.

Therefore, all types of land held by an assessee on the valuation date may not be treated as urban land under the Wealth-tax Act.

Hence, the statement is not correct.