

The Suggested Answers for Paper 7: - Direct Taxes are based on the provisions applicable for A.Y. 2008-09, which is the assessment year relevant for November, 2008 examination.

PAPER – 7 : DIRECT TAXES

Answer all questions

Question 1

Hyper Ltd., engaged in diversified activities, earned a net profit of Rs.14,25,000 after debit/credit of the following items to its profit and loss account for the year ended on 31.3.2008:

(a) Items debited to Profit and Loss Account	Rs.
Expenses on Industrial Unit exempt under section 10A	2,10,000
Provision for Loss of Subsidiary	70,000
Provision for Sales Tax Demand (paid before due date)	75,000
Provision for Wealth Tax Demand	90,000
Provision for Income Tax Demand	1,05,000
Expenses on purchase/sale of equity shares	15,000
Depreciation	3,60,000
Interest on deposit credited to buyers on 31.3.2008 for advance received from them, on which TDS was deposited on 31.7.2008	90,000
 (b) Items credited to Profit and Loss Account	
Income on Industrial Unit exempt under section 10A	2,70,000
Profit from 100% EOU under section 10B	60,000
Long term capital gain on sale of equity shares on which securities transaction tax was paid	3,60,000
Income from units of UTI	75,000

The company provides the following additional information:

- (i) Depreciation includes Rs.1,50,000 on account of revaluation of fixed assets.
- (ii) Depreciation allowable as per Income-tax Rules is Rs.2,80,000.
- (iii) Brought forward Business Loss/Unabsorbed Depreciation:

F.Y.	Amount as per books		Amount as per Income-tax	
	Loss	Depreciation	Loss	Depreciation
1999-2000	2,50,000	3,00,000	2,00,000	2,50,000

2004-2005	Nil	2,70,000	1,00,000	1,80,000
2005-2006	3,50,000	3,15,000	1,20,000	2,10,000

You are required to:

- compute the total income of the company for the assessment year 2008-09 giving the reasons for treatment of items and
- examine the applicability of section 115JB of the Income-tax Act, and compute book profit and the tax credit to be carried forward. (16 Marks)

Answer

Computation of total income of M/s Hyper Ltd. for the A.Y. 2008-09

Particulars	Rs.	Rs.
Net profit as per Profit & Loss Account		14,25,000
Add: Items disallowed /considered separately		
Expenses on industrial unit exempt under section 10A [expenses in relation to exempt income are not be allowed]	2,10,000	
Provision for loss of subsidiary [since it is not wholly and exclusively for the purpose of business of the assessee]	70,000	
Provision for wealth-tax [disallowed under section 40(a)(ia)]	90,000	
Provision for sales tax [is fully allowable since the sales tax has been paid before the due date]	-	
Provision for income-tax [disallowed under section 40(a)(ii)]	1,05,000	
Expenses on transfer of shares [not deductible from business income. It is to be deducted from gross sale consideration while computing capital gains]	15,000	
Interest on deposit credited to buyers on 31.3.2008, but tax deposited after 2 months i.e. after 31.5.2008 [disallowed under section 40(a)(ia)]	90,000	
Depreciation debited to profit and loss account [only depreciation calculated as per Income-tax Rules is allowable as deduction]	3,60,000	9,40,000
		23,65,000
Less: Items credited but not includible under business income or are exempt under the provisions of the Act		
Income of industrial unit under section 10A, since it is an exempt income	2,70,000	
Profit from 100% EOU under section 10B, being an exempt income	60,000	

Long-term capital gain on sale of equity shares on which securities transaction tax was paid, since it is not a business income.	3,60,000	
Income from UTI, since it is not a business income.	75,000	
		7,65,000
		16,00,000
Less: Depreciation (allowable as per Income-tax rules)		2,80,000
		13,20,000
Less: Set-off of brought forward business loss and unabsorbed depreciation		
Brought forward business loss under section 72	4,20,000	
Brought forward depreciation under section 32	6,40,000	10,60,000
Income from business		2,60,000
Capital Gains		
Long term capital gain on sale of equity shares on which securities transaction tax was paid	3,60,000	
Less: Exempt under section 10(38)	3,60,000	Nil
Income from Other Sources		
Income from units of UTI	75,000	
Less: Exempt under section 10(35)	75,000	Nil
Total Income		2,60,000
Tax payable @ 30%		78,000
Add: Education cess @ 2%	1,560	
Secondary and higher education cess @ 1%	780	2,340
Tax Payable as per the Income-tax Act		80,340

Computation of Book Profit under section 115JB

Particulars	Rs.	Rs.
Net Profit as per Profit & Loss Account		14,25,000
Add: Net Profit to be increased by the following amounts as per Explanation 1 to section 115JB		
Provision for loss of subsidiary	70,000	

Provision for income-tax	1,05,000	
Depreciation	3,60,000	5,35,000
		19,60,000
Less: Net Profit to be reduced by the following amounts as per Explanation 1 to section 115JB		
Depreciation debited to profit and loss account (excluding depreciation on account of revaluation of fixed assets) (i.e. Rs.3,60,000 – Rs.1,50,000)	2,10,000	
Income from UTI [since it is an income exempt under section 10(35)]	75,000	
Brought forward business loss or unabsorbed depreciation as per books of account, whichever is less, taken on cumulative basis	6,00,000	8,85,000
Book Profit		10,75,000
10% of book profit		1,07,500
Add: Education cess @ 2%	2,150	
Secondary and higher education cess @ 1%	1,075	3,225
		1,10,725

In case of a company, it has been provided that where income-tax payable on total income computed as per the provisions of the Act is less than 10% of book profit, the book profit shall be deemed as the total income and the tax payable on such total income shall be 10% thereof plus education cess @2% and secondary and higher education cess @ 1%. Accordingly, in this case, since income-tax payable on total income computed as per the provisions of the Act is less than 10% of book profit, the book profit of Rs.10,75,000 is deemed to be the total income and income-tax is payable @ 10% thereof plus education cess @2% and secondary and higher education cess @ 1%. The tax liability, therefore, works out to be Rs.1,10,725.

Section 115JAA provides that where tax is paid in any assessment year in relation to the deemed income under section 115JB(1), the excess of tax so paid, over and above the tax payable under the other provisions of the Income-tax Act, will be allowed as tax credit in the subsequent years. The tax credit is, therefore, the difference between the tax paid under section 115JB(1) and the tax payable on the total income computed in accordance with the other provisions of the Act. This tax credit is allowed to be carried forward for seven assessment years succeeding the assessment year in which the credit became allowable. Such credit is allowed to be set off against the tax payable on the total income in an assessment year in which the tax is computed in accordance with the provisions of the Act, other than section 115JB, to the extent of excess of such tax payable over the tax payable on book profits in that year.

Particulars	Rs.
Tax on book profit under section 115JB	1,10,725
Less: Tax on total income computed as per the other provisions of the Act	80,340
Tax credit to be carried forward	<u>30,385</u>

Notes:

1. Income from industrial unit under section 10A and profit from 100% E.O.U. under section 10B are exempt from income-tax. However, w.e.f. A.Y.2008-09, MAT is leviable on income eligible for exemption under section 10A and 10B. Hence, such income should not be reduced while computing book profits and consequently, expenses relating to such units should not be added back while computing book profits.
2. Long-term capital gains on sale of equity shares through a recognized stock exchange on which securities transaction tax (STT) is paid is exempt under section 10(38). One of the adjustments to the book profit is that exempt income under section 10, which is credited to profit and loss account, would be deducted in arriving at the book profit. However, w.e.f. A.Y.2007-08, deduction of such long-term capital gains is not allowed for computing book profit. Consequently, expenditure to earn such income should not be added back to arrive at the book profit. Section 10(38) also provides that such long term capital gain of a company shall be taken into account in computing the book profit and income-tax payable under section 115JB.

Question 2

- (a) Ayush, an employee with M/s Isomer Solutions Ltd., provides the following information relating to his income for financial year 2007-08:
- (i) He received salary Rs.25,000 per month including conveyance allowance @ Rs. 2,500 per month for official purposes.
 - (ii) He deposited Rs.2,500 per month in his account under a pension scheme notified by the Central Government.
 - (iii) He paid a sum of Rs.60,000 during the year as interest on loan taken in April, 2006 from bank for higher studies of his daughter.
 - (iv) He paid health insurance premium for himself and for his family members Rs.8,500 in cash and Rs.9,000 by credit card.
 - (v) He invested Rs.40,000 in notified bonds under section 80C issued by NABARD in July, 2007.

- (vi) Equity shares having fair market price of Rs.1,00,000 were allotted to him by the company at a concessional price of Rs. 20,000 on 30.5.2007, which were sold by him for Rs.1,80,000 on 28.2.2008.

Compute the total income of Ayush for assessment year 2008-09 and give reasons for treatment to each of the items. (6 Marks)

- (b) 'X' Ltd., transferred its fertilizer business to a new company 'Y' Ltd., by way of demerger with effect from appointed date of 1.4.2007 after satisfying the conditions of demerger. Further information given:
- (a) WDV of the entire block of plant and machinery held by 'X' Ltd. as on 1.4.2007 is Rs. 100 crores;
 - (b) Out of the above, WDV of block of plant and machinery of fertilizer division is 70 crores;
 - (c) 'X' Ltd. has unabsorbed depreciation of Rs.50 lakhs as at 31.3.2007;

On the above facts:

- (i) You are required to explain the provisions of the income-tax as to the allowability of depreciation, post-merger, in the hands of 'X' Ltd. and 'Y' Ltd. as at 31.3.2008 duly calculating the depreciation. (4 Marks)
- (ii) State how the unabsorbed depreciation has to be dealt with for the assessment year 2008-09. (3 Marks)

Answer

- (a) Computation of total income of Mr. Ayush for the Assessment Year 2008-09

Particulars	Rs.	Rs.
Salaries		
Gross salary received	3,00,000	
Less: Conveyance allowance exempt under section 10(14)	<u>30,000</u>	2,70,000
Capital gains		
Sale consideration of equity shares sold on 28.02.2008	1,80,000	
Less: Fair Market Price of shares on 30.5.2007	<u>1,00,000</u>	
Short-term Capital Gains		<u>80,000</u>
Gross Total Income		3,50,000
Less: Deduction under Chapter VIA		
Under section 80C		
For investment in notified bonds issued by NABARD	40,000	

Under section 80CCD

For deposit in pension scheme notified by Central Government
[Rs.30,000 but restricted to 10% of salary i.e. 10% of Rs.2,70,000] 27,000

Under section 80D

For payment of health insurance premium by credit card 9,000

Under section 80E

For payment of interest on loan taken from bank for higher studies of daughter 60,000 1,36,000

Total Income 2,14,000

Notes:

- (i) Conveyance allowance received for official duties is fully exempt under section 10(14).
- (ii) Section 80CCD provides for deduction of employee's and employer's contribution to pension scheme notified by the Central Government. The Finance Act, 2007 has extended this deduction also to individuals employed by any other employer on or after 1.1.2004. However, if the amount contributed exceeds 10% of salary, then the deduction would be restricted to 10% of salary.
- (iii) The deduction under section 80E available to an individual in respect of interest on loan taken for his higher education has now been extended by the Finance Act, 2007, to also include interest on such loan taken for higher education of his relative i.e. his or her spouse and children. Hence, interest on loan taken by Mr. Ayush from bank for the higher studies of his daughter is eligible for deduction under section 80E.
- (iv) The maximum permissible deduction under section 80D in respect of medical insurance premium has been increased from Rs.10,000 to Rs.15,000 by the Finance Act, 2007, and such payment can be made by any mode other than cash. Hence, payment of Rs.8,500 made in cash will not qualify for deduction under section 80D.
- (v) Subscription to notified bonds of NABARD will qualify for deduction under section 80C with effect from A.Y.2008-09.
- (vi) The Finance Act, 2007 has widened the fringe benefit tax net. Fringe benefit tax would be leviable on the employer to the extent of concession given to the employee while allotting any specified security or sweat equity shares. The value of fringe benefits would be the fair market value of the specified security or sweat equity shares on the date on which the option vests with employee as reduced by the amount actually paid by, or recovered from the employee in respect of such security or shares. Consequently, it has been provided that for the purpose of computing capital gains in the hands of the employee at the time of sale of such securities/shares by the employee, the cost of acquisition shall be the fair market

value which has been taken into account for the purpose of computing the value of fringe benefits in the hands of the employer.

- (b) (i) In the case of a demerger, satisfying the conditions as laid down in section 2(19AA), the depreciation claim is governed by the provisions as under:
- (1) As per the Explanation 7A of section 43(1), where in a scheme of demerger, if the demerged company transfers any capital asset to the resulting company, being an Indian company, the actual cost of the capital asset transferred shall be taken to be the same as it would have been if the demerged company had continued to hold the capital asset for the purpose of its own business.
 - (2) The resulting company will be entitled to depreciation on the written down value of the block of assets transferred to it, which will be the written down value of the transferred assets of the demerged company immediately before the demerger [Explanation 2B to section 43(6)].
 - (3) Explanation 2A to section 43(6) provides that the written down value of the block of assets in the hands of the demerged company shall be the written down value of the block of assets of the demerged company for the immediately preceding previous year as reduced by the written down value of the assets transferred to the resulting company pursuant to the demerger.
 - (4) As per the above provisions, the calculation of depreciation on plant and machinery in the hands of 'X' Ltd. and 'Y' Ltd. is as under:

WDV of plant and machinery	'X' Ltd.	'Y' Ltd.
	Amt. in crores	
As at 1 st April, 2007	30.00	70.00
Less: Depreciation @ 15%	4.50	10.50
WDV as at 31 st March, 2008	25.50	59.50

Note – It is presumed that Y Ltd. is an Indian company

- (ii) Set-off of unabsorbed depreciation:
- (i) As per section 72A(4), on demerger, the unabsorbed depreciation directly relatable to the undertakings transferred to the resulting company is allowed to be carried forward and set off in the hands of the resulting company.
 - (ii) Where such unabsorbed depreciation is not directly relatable to the undertaking transferred to the resulting company, it has to be apportioned between the demerged company and the resulting company in the same proportion in which the assets of the undertakings have been retained by the demerged company and transferred to the resulting company.
 - (iii) The demerged company and the resulting company would be allowed to carry forward and set-off their respective portion of unabsorbed depreciation, as calculated above, for an unlimited period as per section 32(2).

Question 3

- (a) Bharat Charitable Trust created on 1.1.2003 applied for registration of trust under section 12A of the Income-tax Act before the Commissioner of Income-tax on 1.7.2007 and requested for condonation of delay.
- (i) Explain with reasons the period for which the trust is eligible to get exemption under section 11 and 12 of the Income-tax Act.
 - (ii) Can the exemption under sections 11 and 12 for assessment year 2008-09 be denied if the trust is holding investments in equity shares of a public sector company since 1.4.2005.
 - (iii) The Trust has also applied for granting exemption under section 80G of the Income-tax Act. But the approval for the same has been rejected by the Commissioner of Income-tax under section 80G(5)(vi) of the Income-tax Act on 30.9.2007. The Trust seeks your advice on whether it can file an appeal against the said rejection before the higher authorities. (6 Marks)
- (b) Xtra Ltd. gives the following information for the year ended 31.3.2008:
- Net Profit as per Profit and Loss Account for the financial year 2006-07 Rs.33,00,000 was included in General Reserve.
 - On 1.8.2007, the company redeemed its redeemable bonus shares for Rs.9,09,000.
 - A shareholder holding 10% equity shares of the company borrowed Rs.3,00,000 from the company @ 18% per annum on 31.8.2008.
 - The company declared dividend of Rs.14,00,000 at its annual general meeting held on 30.9.2007. But the dividend remained unpaid up to 31.3.2008.

Compute the tax liability of the company under section 115-O (tax on distributed profits) for the A.Y. 2008-09.

Also give reasons for treatment of each item.

(4 marks)

Answer

- (a) (i) The Finance Act, 2007 has inserted a new sub-section (2) in section 12A providing that in respect of applications filed on or after 1st June, 2007, the provisions of section 11 and 12 shall apply in relation to the income of the trust from the assessment year relevant to the financial year in which the application is made i.e. the exemption would be available only with effect from the assessment year relevant to the previous year in which the application is filed. It would not be available in respect of any earlier assessment year. Further, the power of the Commissioner to grant registration for past years, by condoning the delay in filing such application, has also been removed.
- Hence, Bharat Charitable Trust shall be eligible to get exemption under section 11 and 12 with effect from the financial year 2007-08 only.

- (ii) The exemption under section 11 and 12 for A.Y. 2008-09 cannot be denied to the trust for holding investments in equity shares of a public sector company in accordance with the amendment by the Finance Act, 2007 in section 13(1)(d)(iii) denying exemption to a trust holding any shares in a company, other than, inter alia, shares in a public sector company. Therefore, a trust cannot be denied exemption for holding shares in a public sector company.
- (iii) Section 253 has been amended by the Finance Act, 2007 to allow an appeal to be filed before the Appellate Tribunal against an order passed by the Commissioner under section 80G(5)(vi) rejecting the application of such trusts for the purpose of recognition under section 80G.
- (b) Computation of tax liability of Xtra Ltd. under section 115-O for the A.Y. 2008-09

Particulars	Rs.
Redemption of Bonus Shares [See Note 1 below]	9,09,000
Dividend declared at AGM [See Note 3 below]	<u>14,00,000</u>
Taxable Dividend	<u>23,09,000</u>
Tax payable on distributed profits under section 115-O [Rs.23,09,000×16.995%] [See Note 4 below]	3,92,415

Notes –

- (1) It is assumed that the bonus shares are in the form of redeemable preference shares, since only then would redemption be possible. If such bonus shares are issued to equity shareholders, it does not amount to distribution of dividend at the time of issue of bonus shares, as there is no release of assets. However, when bonus shares are redeemed, there will be release of assets and in that event it would constitute dividend under section 2(22)(a).
- (2) Borrowing by a shareholder holding 10% equity shares of the company is deemed dividend under section 2(22)(e), taxable in the hands of shareholder during the P.Y.2008-09. Therefore, the company is not liable to pay any tax on it.
- (3) The tax on distributed profits shall be paid within 14 days from the date of declaration or distribution or payment of any dividend, whichever is earliest. Therefore, in this case, the dividend distribution tax is payable within 14 days of the declaration though dividend is not actually paid up to 31.03.2008.
- (4) The Finance Act, 2007 has raised the rate of tax on distributed profits to 15% in respect of any amount declared, distributed or paid by a domestic company by way of dividends [Section 115-O]. The effective rate of tax (including surcharge@10%, education cess@2% and secondary and higher education cess@1%) is 16.995%.

Question 4

Discuss the correctness or otherwise of the following propositions in the context of the Income-tax Act, 1961:

- (a) A fresh claim before the Assessing Officer can be made only by filing a revised return and not otherwise.
- (b) The powers of the Commissioner of Income-tax (Appeals) to enhance the assessment are plenary and quite wide.
- (c) At the time of hearing of rectification application, the Income-tax Appellate Tribunal can re-appreciate the evidence produced during the proceedings of the appeal hearing.
- (d) The High Court cannot interfere with the factual finding recorded by the lower authorities and the tribunal, without any valid reasons. (4 × 4 = 16 Marks)

Answer

- (a) This proposition is correct. A return of income filed within the due date may be revised by filing a revised return under section 139(5) where the assessee finds any omission or wrong statement in the original return subject to satisfying other conditions. There is no provision in the Income-tax Act to make changes or modification in the return of income by filing a letter. In a case where a return of income has been filed within the due date, the only option available to the assessee to make an amendment to such return is by way of filing a revised return under section 139(5). Therefore, a fresh claim can be made before the Assessing Officer only by filing a revised return and not otherwise. The Supreme Court in *Goetze (India) Ltd. vs. CIT* (2006) 284 ITR 323 has held that there was no provision in the Income-tax Act to allow an amendment in the return of income filed except by way of filing a revised return.
- (b) The proposition is correct in law. The Supreme Court has, in *CIT vs. McMillan & Co.* (1958) 33 ITR 182 and *CIT vs. Kanpur Industrial Syndicate* (1964) 53 ITR 225, held that in disposing of an appeal before him, the appellate authority can travel over a whole range of the assessment order. The scope of his powers is co-terminus with that of the Assessing Officer. He can do what the Assessing Officer can do and can also direct him to do what he has failed to do. He can assess income from sources which have been considered by the Assessing Officer but not brought to tax. He can consider every aspect of the assessment order and give appropriate reliefs. The Allahabad High Court has, in *CIT v. Kashi Nath Chandiwalla* (2006) 280 ITR 318, held that the appellate authority is empowered to consider and decide any matter arising out of the proceedings in which the order appealed against was passed notwithstanding the fact that such matter was not raised before him by the assessee. The Commissioner (Appeals) is entitled to direct additions in respect of items of income not considered by the Assessing Officer.

Further, the Apex Court has, in the case of Jute Corporation of India Ltd. vs. CIT (1991) 187 ITR 688, held that the appellate authority is vested with all the plenary powers which the subordinate authority may have in the matter. He also has the jurisdiction to permit the appellant to raise an additional ground, if the ground became available subsequently because of change in law or because of change in circumstances and such ground could not have been raised at the time of filing the return or at the time of making an assessment. He must be satisfied that the ground raised is bona fide and that the same could not have been raised earlier for good reasons.

Thus, the powers of the appellate authority in enhancing the assessment are very wide and plenary.

- (c) The proposition is not correct as per law. This is because section 254(2) specifically empowers the Appellate Tribunal to amend any order passed by it, either suo-moto or on an application made by the assessee or Assessing Officer, with a view to rectifying any mistake apparent from record, at any time within 4 years from the date of the order sought to be amended.

The powers of the tribunal under section 254(2) relating to rectification of its order are very limited. Such powers are confined to rectifying any mistake apparent from the record. The mistake has to be such that for which no elaborate reasons or inquiry is necessary. Accordingly, the re-appreciation of evidence placed before the Tribunal during the course of the appeal hearing is not permitted. It cannot re-adjudicate the issue afresh under the garb of rectification. This issue came up for consideration before the Punjab & Haryana High Court in the case of CIT vs. Vardhman Spinning (1997) 226 ITR 296. The Court observed that the jurisdiction to review or modify orders passed by the authorities under the Act cannot be inferred on the basis of a supposed inherent right.

- (d) The proposition is correct in law. A finding of fact cannot be disturbed by the High Court in exercise of its powers under section 260A. The Income-tax Appellate Tribunal is a fact finding authority and the findings of fact recorded by the Tribunal can be interfered with by the High Court under section 260A only on the ground that the same were without evidence or material, or if the finding is contrary to the evidence, or is perverse or there is no direct nexus between conclusion of fact and the primary fact upon which that conclusion is based.

In CIT vs. P. Mohanakala (2007) 291 ITR 278 and Commissioner of Agricultural income-tax vs. M.N.Moni (2007) 291 ITR 387, the Apex Court observed that the High Court had set aside the factual findings of the lower authorities and the Tribunal without any valid reason. The Apex Court held that the findings of fact could not be interfered with by the High Court without carefully considering the facts on record, the surrounding circumstances and the material evidence. There is no scope for interference with the factual findings, unless the findings are per se without reason or basis, perverse and/or contrary to the material on record.

Question 5

- (a) The Commissioner of Income-tax issued notice to revise the order passed by an Assessing Officer under section 143. During the pendency of proceedings before the Commissioner, on the basis of material gathered during survey under section 133A, the Commissioner of Income-tax issued a second notice, the contents of which were different from the contents of the first notice. State with reasoning whether the action of the Commissioner is justified as to the second notice. (3 Marks)
- (b) State the circumstances where the appellant shall be entitled to produce additional evidence, oral or documentary, before the Commissioner of Income-tax (Appeals) other than the evidence produced during the proceedings before the Assessing Officer. (3 Marks)
- (c) In the context of transfer pricing provisions, read with rules, what are the factors to be considered while selecting the most appropriate method? (6 Marks)

Answer

- (a) The action of the Commissioner in issuing the second notice is not justified. The term "record" has been defined in clause (b) of Explanation to section 263(1). According to this definition "record" shall include and shall be deemed always to have included all records relating to any proceeding under the Act available at the time of examination by the Commissioner. In other words, the information, material, report etc. which were not in existence at the time the assessment was made and came into existence afterwards can be taken into consideration by the Commissioner for the purpose of invoking his jurisdiction under section 263(1). However, at the same time, in view of the express provisions contained in clause (b) of the Explanation to section 263(1), such information, material, report etc. can be relied upon by the Commissioner only if the same forms part of record when the action under section 263 is taken by the Commissioner,
- Issuance of a notice under section 263 succeeds the examination of record by Commissioner. In the present case, the Commissioner initially issued a notice under section 263, after the examination of the record available before him. The subsequent second notice was on the basis of material collected under section 133A, which was totally unrelated and irrelevant to the issues sought to be revised in the first notice. Accordingly, the material on the basis of which the second notice was issued could not be said to be "record" available at the time of examination as emphasised in Explanation (b) to section 263(1).
- (b) As per Rule 46A(1) of the Income-tax Rules 1962, an appellant shall be entitled to produce before the Commissioner (Appeals), evidence, either oral or documentary, other than the evidence produced by him during the course of proceedings before the Assessing Officer, only in the following circumstances -

- (a) where the Assessing Officer has refused to admit evidence which ought to have been admitted; or
 - (b) where the appellant was prevented by sufficient cause from producing the evidence which he was called upon to produce by the Assessing Officer; or
 - (c) where the appellant was prevented by sufficient cause from producing before the Assessing Officer any evidence which is relevant to any ground of appeal; or
 - (d) where the Assessing Officer has made the order appealed against without giving sufficient opportunity to the appellant to adduce evidence relevant to any ground of appeal.
- (c) Rule 10C deals with the determination of the most appropriate method. Under this Rule, the method which is best suited to the facts and circumstances of each particular international transaction, and which provides the most reliable measure of an arm's length price in relation to the international transaction will be considered as the most appropriate method.

For the purpose of selecting the most appropriate method, the following factors should be taken into account -

- (i) the nature and class of the international transaction;
- (ii) the class or classes of associated enterprises entering into the transaction and the functions performed by them taking into account assets employed or to be employed and risks assumed by such enterprises;
- (iii) the availability, coverage and reliability of data necessary for application of the method;
- (iv) the degree of comparability existing between the international transaction and the uncontrolled transaction and between the enterprises entering into such transactions;
- (v) the extent to which reliable and accurate adjustments can be made to account for differences, if any, between the international transaction and the comparable uncontrolled transaction or between the enterprises entering into such transactions;
- (vi) the nature, extent and reliability of assumptions required to be made in application of a method.

Question 6

- (a) P Ltd. is engaged in manufacture of a product. It paid a lump-sum deposit and obtained 50 mobile phone services so that the employees of the assessee can be contacted immediately. The company paid Rs.45,000 every month towards the service and call charges to the mobile phone franchise. On these facts:
- (i) Whether P Ltd. has to deduct tax at source on the payment?
 - (ii) If so, under which provisions of the Act?

(3 Marks)

- (b) R Ltd. paid Rs.5 lakhs as sales commission to Mr. Francis (non-resident), who acted as its agent for booking orders from various customers who are outside India. The assessee has not deducted tax at source on the commission payment for the year ended 31.3.2008. On these facts:
- (i) Decide whether the commission is chargeable to tax in the hands of Mr. Francis in India.
 - (ii) Decide about the deductibility of the commission payment in the assessment of R Ltd. (4 Marks)

Answer

- (a) In this case, the assessee pays the service and call charges every month to a mobile phone franchise. Explanation 2 to section 9(1)(vii) provides that "fees for technical services" means any consideration (including any lump sum consideration) for the rendering of any managerial, technical or consultancy services (including the provision of services of technical or other personnel). Therefore, mere collection of fee by the mobile phone franchise from the customers for use of mobile phone services will not amount to receipt of fees towards technical services. When a subscriber pays money to the mobile phone franchise, it is towards the benefit of availing the services to communicate with others and not for any technical services. The payment made is for the use of airtime. Installation of technical equipment to ensure connectivity to the subscriber cannot make it technical services. Therefore, P Ltd. does not have to deduct tax at source under section 194J on the payments made to the mobile phone franchisee towards the service and call charges. This view was upheld by the Madras High Court in Skycell Communications Ltd. v. Dy. CIT (2001) 251 ITR 53.
- (b) (i) A foreign agent of an Indian exporter operates in his own country and no part of his income arises in India. His commission is usually remitted directly to him and is, therefore, not received by him or on his behalf in India. Such an agent is not liable to income-tax in India on the commission. This has been clarified in Circular No.23, dated 23.7.1969. In view of the specific circular, the commission paid to the non-resident agent of the Indian exporter for services rendered outside India is not chargeable to tax in India for the A.Y. 2008-09.
- (ii) Section 40(a)(i) requires deduction of tax at source in respect of any interest, royalty, fees for technical services or other sum chargeable under this Act, which is payable outside India or in India to a non-resident. However, in this case, the commission payable to the non-resident agent is not chargeable to income-tax in view of the clarification given by Circular No.23 dated 23.7.1969 explained in (i) above. Further, Circular No.786 dated 7.2.2000 clarifies that, in such a case, no tax is required to be deducted at source under section 195. Hence, disallowance under section 40(a)(i) would not be attracted, and the commission payment would be deductible in the assessment of R Ltd.

Question 7

(a) Zeta (India) Ltd., a non-resident company dealing in consumer products and having their employee base in India, has furnished the following information for the year ended on 31.3.2008:

- (i) Expenditure on foreign travelling Rs.1,80,000.
- (ii) Expenditure on display of its products Rs.3,60,000.
- (iii) Expenditure on distribution of free samples Rs.2,40,000.
- (iv) Expenditure on providing transport facility for movement of offshore employees from their residence in home countries (outside India) to place of work (rigs in India) and back Rs.6,30,000.
- (v) The company granted to its 300 employees, options to buy 200 sweat equity shares of the company over a period of two years at Rs.100 per share on 1.6.2007. Out of which 250 employees exercised their option to buy 50% shares by 31.12.2007 and balance 50% shares after 1.6.2008. The Fair Market Price of shares as on 1.6.2007 was Rs.200 per share.

Calculate the fringe benefit tax liability of the company for Assessment Year 2008-09 along with due dates and amount of advance fringe benefit tax payable under section 115WJ of the Income-tax Act. Reasons for treatment of each of the above items should form part of your answer. (8 Marks)

(b) Explain as to what the term 'Advance Ruling' means under the Income-tax Act 1961.

(4 Marks)

(c) State the circumstances under which a certificate can be issued by the Assessing Officer to the Tax Recovery Officer. (4 Marks)

Answer

(a) Computation of fringe benefit tax liability of M/s Zeta (India) Ltd. for the A.Y. 2008-09.

	Amount (Rs.)	% of expenditure to be treated as value of fringe benefit	Value of fringe benefit (Rs.)
(i) Expenditure of foreign traveling	1,80,000	5%	9,000
(ii) Expenditure on display of products	3,60,000	-	-
(iii) Expenditure on distribution of free samples	2,40,000	-	-

(iv) Expenditure on providing transport facility for movement of offshore employees from their residence in home countries (outside India) to place of work (rigs in India) and back	6,30,000	-	-
(v) Sweat equity shares transferred to employees during the year at a concessional price	25,00,000	100%	25,00,000
Total value of fringe benefits			<u>25,09,000</u>
FBT payable @ 30%			7,52,700
Add: Surcharge @ 2.5%			<u>18,818</u>
			7,71,518
Add: Education cess@ 2%		15,430	
Secondary and higher education cess@1%		<u>7,715</u>	<u>23,145</u>
Total FBT payable			<u>7,94,663</u>
Total FBT payable (rounded off)			7,94,660

Advance FBT payable under section 115WJ

Due date of installment	Installments payable	Advance FBT payable	Rs.
On or before 15 th June, 2007	Not less than 15% of such advance tax.	15% of Rs.7,94,660 =	1,19,200
On or before 15 th September, 2007	Not less than 45% of such advance tax, as reduced by the amount, if any, paid in the earlier installment.	45% of Rs.7,94,660 - Rs.1,19,200 = Rs.3,57,600 - Rs.1,19,200 =	2,38,400
On or before 15 th December, 2007	Not less than 75% of such advance tax, as reduced by the amount or amounts, if any, paid in the earlier installment or installments.	75% of Rs.7,94,660 - (Rs.1,19,200+Rs.2,38,400) =Rs.5,96,000 – Rs.3,57,600 =	2,38,400

On or before the 15th March, 2008 The whole amount of such advance tax as reduced by the amount or amounts, if any, paid in the earlier installment or installments. Rs.7,94,660 – (Rs.1,19,200 +Rs.2,38,400+Rs.2,38,400) = Rs.7,94,660 – Rs.5,96,000 = 1,98,660

Notes:

- (i) Expenditure on tour and travel including foreign travel is liable for FBT @ 5% .
- (ii) Expenditure on display of products has been excluded from 'Sales promotion including publicity' by the Finance Act, 2007 and hence, is exempt from FBT from A.Y.2008-09.
- (iii) Expenditure on distribution of free samples has now been excluded from 'Sales promotion including publicity' by the Finance Act, 2007 and hence, such expenditure is exempt from FBT for A.Y. 2008-09.
- (iv) The expenditure incurred by the company on providing free or subsidised transport facility for movement of offshore employees from their residence in home countries (outside India) to their place of work (rigs in India) does not attract FBT. This has been held by the Supreme Court in R & B Falcon (A)(P.) Ltd. v. CIT (2008) 301 ITR 309.
- (v) FBT liability has also been extended to sweat equity shares allotted or transferred, directly or indirectly, by the employer, free of cost or at a concessional rate, to his employees, including former employees, by insertion of a new clause (d) in section 115WB(1) by the Finance Act, 2007. The value of fringe benefit is the fair market value on the date on which the option vests with the employee as reduced by the amount actually paid by, or recovered from, the employee in respect of such shares. Hence, the taxable fringe benefit in respect of options exercised during the financial year 2007-08 is calculated as under:

		Rs.
Fair market value of 100 shares as on 1.6.2007		
i.e. the date of vesting of option	= 250×100×200 =	50,00,000
Less: Amount recovered from employees	= 250×100×100 =	25,00,000
Taxable value of fringe benefit for A.Y. 2008-09		<u>25,00,000</u>

- (b) The term 'advance ruling' has been defined in section 245N(a) to mean :-
 - (a) a determination by the Authority in relation to a transaction which has been undertaken or is proposed to be undertaken by a non-resident applicant; or

- (b) a determination by the Authority in relation to the tax liability of a non-resident arising out of a transaction which has been undertaken or is proposed to be undertaken by a resident applicant with such non-resident,
and such determination shall include the determination of any question of law or of fact specified in the application;
- (c) a determination or decision by the Authority in respect of an issue relating to computation of total income which is pending before any income-tax authority or the Appellate Tribunal and such determination or decision shall include the determination or decision on any question of law or of fact relating to such computation of total income specified in the application.
- (c) The assessee is required to pay the tax due as per the notice of demand issued under section 156 within 30 days of the service of notice. If the amount is not paid within 30 days, then it could be recovered as per the provisions of sections 222 to 227, 229 and 232 of the Income-tax Act. Where the assessee has not paid the tax due within the specified period, the Assessing Officer may issue a certificate to the Tax Recovery Officer for initiating recovery proceedings in the following circumstance –
 - (a) where the assessee has not filed an appeal before Commissioner (Appeals) or Appellate Tribunal; and
 - (b) has also not made any request for extension of time for payment of tax.

As per the provisions of section 222, when an assessee is in default or is deemed to be in default in making a payment of tax, the Tax Recovery Officer may draw up under his signature a statement in the prescribed form specifying the amount of arrears due from the assessee. Such statement is referred to as “certificate”. He shall proceed to recover from such assessee the amount specified in the certificate by one or more of the modes mentioned below, in accordance with the rules laid down in the Second Schedule -

- (a) attachment and sale of the assessee's movable property;
- (b) attachment and sale of the assessee's immovable property;
- (c) arrest of the assessee and his detention in person;
- (d) appointing a receiver for the management of assessee's movable and immovable properties.

The Tax Recovery Officer may have recourse to any of the above measures notwithstanding that proceedings for recovery of the arrears by any other mode have already been taken.

Question 8

- (a) Matisha Constructions Ltd. furnishes the following particulars of its wealth for the valuation date as on 31.3.2008:

	Rs.in lacs
(i) Land in urban area (held as stock in trade since 1996).	81
(ii) Motor cars (including one imported car, worth Rs.18 lacs used for hiring)	38
(iii) 250 acres agricultural land acquired at Greater Noida Township on 27.8.2007 for construction of residential flats/commercial complex. However, Greater Noida Authority has reserved 25 acres land as green belt.	250
(iv) Residential flats of 1500 sq feet each provided to 3 employees (salary of one employee exceeded Rs.5 lacs per annum)	36
(v) Farm house of 5 acre at a remote village	9
(vi) Cash in hand as per cash book	3

Liabilities:

(i) Loan for purchase of land at Urban area	30
(ii) Loan for purchase of land at Greater Noida	120
(iii) Wealth-tax liability for Assessment year 2007-08	12
(iv) Loan for construction of residential flats	9

Compute the net wealth of the company for assessment year 2008-09. (8 Marks)

- (b) Mr. X, a member of co-operative housing society, was allotted a plot as per the bylaws of the society. He constructed a house on plot and substituted the name of his wife in the records of the society in his place. The society executed the registered sale deed in respect of said plot in favour of his wife. The Assessing Officer included the value of the said property in the hands of Mr. X. Examine the validity of the action of the Assessing Officer. (2 Marks)

Answer

- (a) Computation of Net Wealth of M/s Matisha Constructions Ltd. for A.Y. 2008-09

Particulars	Rs. in lacs
Assets [as per the definition of assets under section 2(ea)]	
(i) Land in urban area (held as stock in trade since 1996) – taxable since it is held as stock-in-trade for more than 10 years	81
(ii) Motor cars (excluding imported car not being an asset since it is used for hiring) [38 lac – 18 lac]	20

(iii)	Agricultural land acquired for construction of residential and commercial complex (is a stock-in-trade in the hands of a construction company – hence, not an asset)	Nil
(iv)	(a) Residential flats provided to 2 employees drawing salary less than Rs.5 lacs per annum – not an asset	Nil
	(b) Residential flat provided to one employee drawing salary exceeding Rs.5 lacs per annum is an asset $[36 \times 1/3]$	12
(v)	Farm house at a remote village is not an asset (assuming that it is not situated within 25 km from the local limits of any municipality)	Nil
(vi)	Cash in hand as per cash book is not an asset since it represents cash recorded in the books	Nil
		113

Less: Liabilities

(i)	Loan for purchase of land in urban area – deductible, since it is incurred in relation to land in urban area, which is an asset chargeable to wealth-tax.	30
(ii)	Loan for purchase of agricultural land - not deductible, since land is not an asset	Nil
(iii)	Wealth Tax liability for Assessment year 2007-08 – wealth tax liability is not deductible	Nil
(iv)	Loan for construction of residential flats - the portion relating to taxable asset (1/3) is deductible i.e. $\frac{1}{3} \times 9$ lacs	
		3 33
Net Wealth		80

- (b) The Allahabad High Court has, in the case of Ram Saran Das Tandon v. CWT (2007) 292 ITR 546, held that when the assessee has ceased to be a member of the society, he could not be treated as the owner of the house property. Therefore, the value of the property is not assessable in his hands.

In this case, assuming that Mr.X has received adequate consideration from his wife Mrs.X for the transfer, the action of the Assessing Officer in including the value of said property in the hands of Mr. X is not valid.