

The Suggested Answers for Paper 7: - Direct Tax Laws are based on the provisions applicable for A.Y. 2009-10, which is the assessment year relevant for June, 2009 examination.

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Answer all questions

Question 1

- (a) The Net Profit of "Simran Ltd." for the year ended 31.3.2009 is Rs.50 lacs after debit of the following:
- (i) Amount of Rs.1,50,000 contributed to Employees Welfare Trust.
 - (ii) Amount of Rs.15,00,000 paid towards college fee and hostel expense for the MBA course of a close relative of a director.
 - (iii) Amount of Rs.3,00,000 incurred on installation of a traffic signal, so as to facilitate its employees coming to office to overcome traffic jam and save office time.
 - (iv) Amount of Rs.5,00,000 on the gift articles distributed to various dealers under sales incentive scheme.
 - (v) Expenses of Rs.5,00,000 incurred on the travelling of the wife of Managing Director, who accompanied him on a tour to U.K. on the invitation of Trade and Commerce Chamber, London.
 - (vi) Amount of Rs.3,00,000 paid on 11.5.08 consequent upon change in currency rate due to exchange fluctuation in excess of the amount due to the suppliers of machinery.

Following further information are also provided by the company:

- (a) Both the employees and employers contribution towards PF amounting to Rs.2 lacs each for the month of March, 2009 were deposited on 1.7.2009.
- (b) Provision for audit fees of Rs.5 lacs made in the books for the year ended 31.03.2008 was paid to the auditors in September, 2008 after deducting tax under section 194J and the tax so deducted was remitted by 7.10.2008.
- (c) A contractor who carried out repairing work in the office was paid in cash on 25.9.2008 by two vouchers No. 175 of Rs.17,000 and No.180 of Rs. 8,000.
- (d) TDS, out of payment of interest of Rs.1 lac in February, 2009 and of Rs.2 lacs in March, 2009, was remitted to the Government in July, 2009.

Compute the income chargeable to tax in A.Y. 2009-10 and work out the amount of tax payable on such income. (13 Marks)

- (b) The net profit as per the profit and loss account of XYZ Ltd., a resident company, for the year ended 31.3.2009 is Rs.190 lacs arrived at after making the following adjustments:

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(i)	Depreciation on assets	Rs. 100 lacs
(ii)	Reserve for currency exchange fluctuation	Rs. 50 lacs
(iii)	Provision for tax	Rs. 40 lacs
(iv)	Proposed dividend	Rs.120 lacs

Following further information are also provided by company:

- (a) Net profit includes Rs.10 lacs received from a subsidiary company.
- (b) Provision for tax includes Rs.16 lacs of tax payable on distribution of profit and of Rs.2 lacs of interest payable on income-tax.
- (c) Depreciation includes Rs.40 lacs towards revaluation of assets.
- (d) Amount of Rs.50 lacs credited to P & L account was drawn from revaluation reserve.
- (e) Balance of profit and loss account shown in balance sheet at the asset side as at 31.3.2008 was Rs.30 lacs representing unabsorbed depreciation.

Compute the income of the company for the year ended 31.3.2009 liable to tax under MAT. (7 Marks)

Answer

- (a) Computation of total income of Simran Ltd. for the A.Y.2009-10

Particulars	Amount (Rs.)
Profits and gains of business or profession	
Net profit for the year as per P&L Account	50,00,000
Add: Expenses debited to Profit and Loss Account but not allowable	
(i) Contribution to Employees Welfare Trust can be regarded as labour welfare expenditure and hence, is allowable as deduction under section 37 as the payments were made on the ground of assessee's business exigencies [CIT v. Cheran Transport Corp. Ltd. (1999) 238 ITR 892 (Mad.)]	--
(ii) Expenses on the education of a relative of Director, who is not in employment of Simran Ltd., is not deductible under section 37 [Enkay (India) Rubber Co. Pvt. Ltd v. CIT (2003) 263 ITR 521 (Del)]. Hence, it should be added back to compute business income.	15,00,000
(iii) Expenses on installation of traffic signal, to facilitate its employees to overcome traffic jam and be on time, is an allowable expense under section 37(1) [Infosys Technologies Ltd. v. CIT (2007) 109 TTJ 631 (Bangalore)]	--

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(iv)	Expenses on distribution of gift articles to dealers under sales incentive scheme would promote goodwill and is made in the interest of business. Such gifts are prompted by commercial expediency and hence, the expenditure is allowable under section 37(1) [CIT v. Avery Cycle Industries Ltd. (2006) 157 Taxman 381/ 298 ITR 0239 / 296 ITR 0393 (Punjab & Haryana)]	--
(v)	Expenses on travelling to UK of the wife of Managing Director on the invitation of Trade and Commerce Chamber, London, is an allowable expense for the purposes of business [Hero Honda Motors Ltd. v. CIT (2005) 3 SOT 572 (Delhi)]	--
(vi)	Increase in liability due to change in currency rate and paid to the suppliers of machine is to be added to cost of the asset irrespective of the method of accounting as per section 43A. Hence, it should be added back to compute business income.	3,00,000
		68,00,000
Less: Expenditure allowable as deduction but not debited to profit and loss account (See Note below)		

(a)	Employers contribution towards PF paid before due date for filing of return is allowable as per section 43B	2,00,000
	Employees contribution to PF is not remitted before the due date under the PF Act (i.e. by 31.5.2009). Therefore, it is not allowable as deduction under section 36(1)(va).	-
(b)	Provision for audit fees for the year ended 31-3-2008 for which tax was not deducted in the F.Y. 2007-08 but was deducted and paid in F.Y. 2008-09 is allowable in the year of payment as per the proviso to section 40(a)(ia).	5,00,000
(c)	Payment to a contractor for repairing work in a day by two vouchers in cash, the aggregate exceeding the limit of Rs.20,000 is not an allowable expense as per section 40A(3).	-
(d)	TDS on interest for the month of Feb 2009 is not paid before the end of the financial year. Accordingly, such interest is not allowable in the A.Y.2009-10 as per section 40(a)(ia).	-
	Interest for the month of March, 2009, on which TDS was remitted to the Government before the due date of filing of return, is allowable as per section 40(a)(ia).	2,00,000

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(e) Depreciation on the amount of Rs.3 lacs added in cost of machine @ 15% for the year	<u>45,000</u>	<u>9,45,000</u>
Total income		<u>58,55,000</u>

Computation of tax liability for A.Y.2009-10	Rs.	Rs.
Tax on Rs.58,55,000 @ 30%		17,56,500
Add: Education cess @ 2%	35,130	
Secondary and higher education cess @ 1%	<u>17,565</u>	
		<u>52,695</u>
Total Tax Payable		<u>18,09,195</u>

Note – The first sentence of the question states that the net profit of the company has been arrived at after debit of the following expenditure, which implies that the items of expenditure in serial nos. (i) to (vi) (given below the first sentence) have been debited to profit and loss account. Thereafter, the question states that following further information are also provided by the company, after which items in serial nos. (a) to (d) are given. From a plain reading of the question, it is apparent that items of expenditure in serial nos. (a) to (d) have not been debited to profit and loss account. Therefore, the deductibility or otherwise of these items of expenditure have to be considered while computing the business income and dealt with accordingly. Accordingly, the items of expenditure in (a) to (d), which are allowable as per the provisions of the Act, have to be deducted while computing business income and no adjustment is required of items of expenditure disallowed since they have not been debited to profit and loss account.

- (b) Computation of income of XYZ Ltd. liable to tax under MAT for the year ended 31.3.2009

Particulars	Rs.	Rs.
Net Profit as per Profit & Loss Account		1,90,00,000
Add : Net profit to be increased by the following amounts as per Explanation 1 to section 115JB		
Depreciation	1,00,00,000	
Reserve for currency exchange fluctuation, since the amount carried to any reserve, by whatever name called, has to be added back	50,00,000	
Provision for tax (See Note 1 below)	40,00,000	
Proposed dividend	<u>1,20,00,000</u>	<u>3,10,00,000</u>
		5,00,00,000

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Less : Net profit to be decreased by the following amounts as per Explanation 1 to section 115JB

Depreciation other than depreciation on revaluation of assets (Rs.100 lacs - Rs.40 lacs)	60,00,000	
Withdrawal from revaluation reserve restricted to the extent of depreciation on account of revaluation of assets (Rs.50 lacs or Rs.40 lacs, whichever is less)	40,00,000	
Unabsorbed depreciation or brought forward business loss, whichever is less, as per the books of account (Rs.30 lacs or Nil)	NIL	
Dividend income [since the same is exempt under section 10(34)] (See Note 2 below)	10,00,000	1,10,00,000
Income liable to tax under MAT		<u>3,90,00,000</u>

Note – 1. For the purpose of section 115JB, book profit means the net profit as per the profit and loss account prepared in accordance with Parts II and III of Schedule VI to the Companies Act, as adjusted by certain additions/deductions as specified. One of the adjustments is to add back income-tax paid or payable, and the provision therefor. The Finance Act, 2008 has inserted Explanation 2 after sub-section (2) of section 115JB to clarify that income-tax includes, inter alia, dividend distribution tax / tax on distributed income and interest. Therefore, the entire provision of Rs.40 lacs for income-tax has to be added back for computing book profit for levy of MAT.

2. It is presumed that the amount of Rs.10 lacs received from subsidiary company represents dividend income.

Question 2

- (a) Explain in the context of provisions of the Act, whether the income derived during the year ended on 31.03.2009 in each of the following cases shall be subject to tax in the A.Y. 2009-10 :
- (i) Income of Rs.75,000 derived by Anand Nursery from the sale of seedlings grown without carrying out all the basic operations on land.
 - (ii) Mr. Gaitonde, born and brought up in the State of Sikkim, had a net profit of Rs.2,25,000 from the business located in Sikkim and interest of Rs.55,000 on the securities/ bonds issued by the Government of Rajasthan.
 - (iii) Mr. Ravi, an IAS Officer, was posted to USA by the Government of India on 11.07.08 for a period of three years. He was paid salary of Rs.3 lacs for the period 01.04.08 to 10.07.08 and of Rs.12 lacs for the period upto 31.03.09. He left India for USA in the night of 10.07.08 and did not come even for a day up till 31.03.09.
 - (iv) Chitra received gifts of Rs.1,00,000 from her father-in-law and of Rs.11,000 each from her 10 friends at the time of her marriage on 11.03.09.

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- (v) A political party, duly registered under section 29A of the Representation of the People Act, 1951, received rent of Rs.1,25,000 per month of one of its building let out to a bank from 01.06.07. (2 × 5 = 10 Marks)
- (b) Work out, from the following particulars, the amount of capital gain which shall be deemed to have been applied for charitable or religious purpose arising out of sale of a capital asset utilized for the purposes of trust to the extent of 60% :

	Amount (Rs.)
Cost of transferred asset	2,40,000
Sale consideration	3,60,000
Cost of new asset purchased	3,00,000
	(4 Marks)

Answer

- (a) (i) Explanation 3, added in section 2(1A) by the Finance Act, 2008 provides that the income derived from saplings or seedlings grown in a nursery shall be deemed to be agricultural income, whether or not the basic operations were carried out on land. Accordingly, the income of Rs.75,000 derived by Anand Nursery from the sale of seedlings grown without carrying out all the basic operations on land shall be treated as agricultural income and exempt from tax under section 10(1).
- (ii) Clause (26AAA), inserted in section 10 by the Finance Act, 2008, exempts the income which accrues or arises to a Sikkimese individual from any source in the State of Sikkim and the income by way of dividend or interest on securities. Therefore, the income of Mr. Gaitonde from a business located in Sikkim and interest income on the securities/bonds of Government of Rajasthan shall not be subject to tax.
- (iii) The salary drawn by an IAS Officer by virtue of his posting in USA, despite the fact that he was a non-resident in the previous year, shall be subject to tax in India as per section 9(1)(iii) which states that income chargeable under the head "Salaries" payable by the Government to a citizen of India for his services outside India shall be deemed to accrue or arise in India. Therefore, the total amount of salary of Rs.15 lakh received by the IAS Officer in and outside India shall be subject to tax in India in the A.Y 2009-10.
- (iv) The cash gifts received by Chitra at the time of her marriage shall not be subject to tax by virtue of clause (b) of the proviso to section 56(2)(vi). Therefore, gifts of Rs.1 lakh received from her father-in-law and Rs.1.10 lakh received @ Rs.11,000 each from her 10 friends shall not be taxable as all such gifts were received by her on the occasion of her marriage.
- (v) Rent received by the political party from the bank is an income chargeable under the head "Income from house property". According to the provisions of section 13A, this income shall not be subject to tax in the hands of a political party registered under section 29A of the Representation of the People Act, 1951, provided the political party fulfills the conditions as specified therein.

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- (b) In this case, since the asset which is transferred is utilized for the purposes of the trust only to the extent of 60%, only the proportionate amount (i.e. 60%) of the capital gain would be regarded as having been applied for charitable or religious purposes.

As per section 11(1A), where a capital asset held under trust is transferred, and only a part of the net consideration is utilized for acquiring a new capital asset, only so much of the capital gain as is equal to the amount, if any, by which the amount so utilized exceeds the cost of the transferred asset shall be considered to have been applied for the objects of the trust.

In this case, only a part of the net consideration of Rs.3,60,000 is utilized for acquiring the new capital asset costing Rs.3,00,000. The amount utilized in acquiring the new asset (i.e. Rs.3,00,000) exceeds the cost of the transferred asset (i.e. Rs.2,40,000) by Rs.60,000.

Therefore, only 60% of (Rs.3,00,000 – Rs.2,40,000) = 60% of Rs.60,000 = Rs.36,000 is deemed to be applied for the objects of the trust.

Question 3

- (a) Work out the taxable income for A.Y. 2009-10 of a partnership firm engaged in retail trade from the following particulars:
- (i) Net profit of Rs.3,65,000 arrived at after debit of interest on capital of partners of Rs.1,80,000 and salaries to working partners of Rs.4,80,000.
 - (ii) Total capital of the partners on which interest paid is debited in the profit and loss account was Rs.10,00,000. (5 Marks)
- (b) An assessee, on fulfillment of certain conditions, can claim relief in respect of the income arising in those countries with which India does not have any double taxation agreement. Do you agree? (5 Marks)
- (c) "The profits and gains of an industrial undertaking established in specified areas and engaged in carrying out certain activities are enjoying tax holiday." Specify such areas and the activities. (4 Marks)

Answer

- (a) Computation of taxable income of the partnership firm for A.Y.2009-10

Particulars	Amount (Rs.)	Amount (Rs.)
Net Profit as per profit and loss account		3,65,000
Add : Interest on Capital		1,80,000
Salaries to Partners		<u>4,80,000</u>
		10,25,000
Less : Interest on capital allowable @ 12% on Rs.10 lakh		<u>1,20,000</u>
Book Profits		9,05,000

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Less: Admissible amount of salary as a percentage of book profits or actual paid, whichever is less

90% of Rs.75,000	67,500	
60% of Rs.75,000	45,000	
40% of balance of Rs.7,55,000	<u>3,02,000</u>	
	<u>4,14,500</u>	<u>4,14,500</u>
Taxable Income		<u>4,90,500</u>

- (b) The assessee shall be allowed relief in respect of such income under section 91 provided all the following conditions are fulfilled :-
- (a) The assessee is a resident in India during the relevant previous year.
 - (b) The income accrues or arises to him outside India during that previous year.
 - (c) Such income is not deemed to accrue or arise in India during the previous year.
 - (d) The income in question has been subjected to income-tax in the foreign country in the hands of the assessee and the assessee has paid tax on such income in the foreign country.
 - (e) There is no agreement under section 90 for the relief or avoidance of double taxation between India and the other country where the income has accrued or arisen.
- (c) This question can be answered on the either on the basis of the provisions of section 10A or section 80-IB or section 80-IC.

Section 10A

This section provides tax holiday in respect of newly established industrial undertakings in free trade zones, electronic hardware technology parks and software technology parks set up in accordance with a scheme notified by the Central Government. The section exempts the profits and gains of such undertakings derived from the export of articles or things or computer software.

The benefit of exemption under this section is available to all categories of assesseees who derive any profits or gains from an undertaking engaged in export of articles or things or computer software. The profits and gains derived from on-site development of computer software (including services for development of software) outside India shall be deemed to be the profits and gains derived from the export of computer software outside India.

Section 80-IB

The tax holiday under section 80-IB is available in respect of the following industrial undertakings –

- (a) Small Scale Industrial undertakings

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- (b) Industrial undertakings set up in an industrially backward State specified in the Eighth Schedule. Industrial undertakings in the State of Jammu & Kashmir should not manufacture or produce cigarettes/cigar, distilled and brewed alcoholic drinks, aerated branded beverages and their concentrates.
- (c) Industrial undertakings, set up in notified backward districts, producing articles other than those given in the Eleventh Schedule.

Section 80-IC

The tax holiday under section 80-IC is available in respect of the industrial undertakings set up in Sikkim, Himachal Pradesh, Uttaranchal and North-Eastern States. If the undertaking is set up in the specified zone in the States of Sikkim, Himachal Pradesh and Uttaranchal, it should manufacture any article or thing other than those given in the Thirteenth Schedule. If the undertaking is set up in any other area in these States, it should manufacture any article given in the Fourteenth Schedule. Specified zones include export processing zone, integrated infrastructure development centre, industrial growth centre, industrial estate, industrial park, software technology park, industrial area or theme park.

Question 4

- (a) Meghna Film Distributors have acquired the rights of exhibition of a feature film 'Nasha' in the territory of Rajasthan from the producers under an agreement executed on 11.06.08 against a consideration of Rs.300 lacs. It thereafter executed a sub-agreement with a distributor to whom the rights of exhibition of the film in some of the areas of Rajasthan were assigned against an amount of Rs.100 lacs. The film was released for exhibition on commercial basis on 25.12.08. Collection from the exhibition of film of "Meghna Film Distributors" for 25.12.2008 to 10.01.2009 was Rs.50 lacs and thereafter up to 31.03.2009 was Rs.190 lacs.

It asks you to clarify as to how these transactions will be reflected in the Income-tax return for A.Y. 2009-10. Would your answer be different if the film was released for exhibition on 11.01.2009? (6 Marks)

- (b) State the circumstances, when notional income is charged to tax instead of real income under the head "Income from house property". (3 Marks)
- (c) What meaning has been assigned to "Speculative transaction"? Narrate those transactions which shall not be treated as speculative transactions under the Income-tax Act, 1961. (5 Marks)

Answer

- (a) Meghna Film Distributors is engaged in the business of exhibition of feature films after taking the rights from the producers. The profits and gains of such business are to be computed as per the provisions given in Rule 9B of the Income-tax Rules.

Accordingly, the profits shall be worked out after deducting the amount paid towards cost of acquisition of film by the film distributor to the producer from the amount recovered by giving the rights of exhibition of film to sub-distributors and the receipts from exhibition of

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the feature films on commercial basis by the distributor himself where the film was released for exhibition on commercial basis before 90 days from the end of the financial year. If the film is not so released at least 90 days before the end of such previous year, the cost of acquisition shall be allowed to the extent of the amount realized by the film distributor and the balance shall be carried forwarded to the next following previous year and allowed as deduction in that year.

In the present problem, the agreement was executed on 11.06.2008 and the film also stands released for exhibition on commercial basis before 90 days from the end of the financial year i.e., on 25.12.08. Accordingly, the profit of the assessee will be computed as under: -

Particulars	Rs.
Collection from exhibition of film (Rs.50 lacs + Rs.190 lacs)	240 lacs
Collection from sub-distributor	<u>100 lacs</u>
	340 lacs
Less : Cost of acquisition	
Amount paid to producer for exhibition rights of the film	<u>300 lacs</u>
Net income of film "Nasha"	<u>40 lacs</u>

Release of film for exhibition on commercial basis in the second case on 11.1.09 i.e., less than 90 days before the end of the previous year. In this case, the profits of the assessee will be as under :-

Particulars	Rs.
Collection from exhibition of film	190 lacs
Collection from sub-distributor	<u>100 lacs</u>
	290 lacs
Less : Cost of acquisition	
Amount paid to producer for exhibition rights of the film (Rs.300 lakh, but restricted to Rs.290 lakh)	<u>290 lacs</u>
Net income of film "Nasha"	<u>Nil</u>

The balance of Rs.10 lakh (i.e. Rs.300 lakh – Rs.290 lakh) has to be carried forward to the next following previous year and allowed as a deduction in that year i.e., P.Y.2009-10.

- (b) The circumstances when notional income is charged to tax instead of real income under the head "Income from house property" are as under -
- (i) Where the assessee owns more than one house property for the purpose of self-occupation, the annual value of any one of those properties, at the option of the assessee, will be Nil and the other properties are deemed to be let-out properties for which income has to be computed on notional basis by taking the Annual Letting Value (ALV) as the Gross Annual Value (GAV).

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- (ii) In the case of let-out property, where the ALV exceeds the actual rent, the ALV is taken as the GAV.

Note – Annual Letting Value is the higher of municipal valuation and fair rent, but restricted to standard rent.

- (c) According to section 43(5), the expression "speculative transaction" means a transaction in which a contract for the purchase or sale of any commodity, including stocks and shares, is periodically or ultimately settled otherwise than by the actual delivery or transfer of the commodity or scrips.

The following transactions shall not be deemed to be speculative transactions:

- (i) a contract in respect of raw materials or merchandise entered into by a person in the course of his manufacturing or merchanting business to guard against loss through future price fluctuations in respect of his contracts for the actual delivery of goods manufactured by him or merchandise sold by him; or
- (ii) a contract in respect of stocks and shares entered into by a dealer or investor therein to guard against loss in his holdings of stocks and shares through price fluctuations; or
- (iii) a contract entered into by a member of a forward market or a stock exchange in the course of any transaction in the nature of jobbing or arbitrage to guard against loss which may arise in the ordinary course of his business as such member; or
- (iv) an eligible transaction in respect of trading in derivatives carried out in a recognized stock exchange.

Question 5

Examine critically in the context of provisions contained in Income-tax Act, 1961 as to the correctness of the action or the treatment given in each of the following cases:

- (a) An amount of Rs.12,50,000 paid by XYZ Ltd., after approval by the board, to a hospital in UK for the heart surgery of its managing director was charged under medical expenses. The Assessing Officer, while completing the assessment of the company, taxed the amount so paid by the company as a perquisite in the hands of its Managing Director. (3 Marks)
- (b) Singhal Sons Mines, for acquiring rights for extracting minerals, had taken a mine on lease basis w.e.f. 01.09.08 for a period of 15 years from Mr. Naresh against an amount of Rs.30 lacs payable in three equal instalments on 31.08.08, 31.08.09 and 31.08.10. Amount of Rs.10 lacs paid on 31.08.08 was charged as an expense in the mining account. (4 Marks)
- (c) XYZ is engaged in the business of sale of Zinc Concentrate in India and in U.K. markets. The company valued its closing stock on 31.03.09 on the basis of the price prevailing in London Metallic Exchange instead of price in the domestic market, as the price in London Metallic Exchange was lesser than the Indian rate. (4 Marks)
- (d) M/s Soft Drinks Limited entered into an agreement for the warehousing of its products with XYZ Warehousing and deducted tax at source as per provisions of section 194C out

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of warehousing charges paid during the year ended on 31.03.2008. The Assessing Officer, while completing the assessment for A.Y. 2008-09 of Soft Drinks Limited, treated the warehousing charges as rent as defined in section 194-I and asked the company to make payment of difference amount of TDS with interest. It was submitted by the company that the recipient had already paid tax on the entire amount of warehousing charges and therefore, now the difference amount of TDS cannot be recovered. However, it will make the payment of due interest on the difference amount of TDS.

(3 Marks)

Answer

- (a) A Managing Director generally occupies the dual capacity of being a director as well as an employee of the company. In this case, assuming that the Managing Director is also an employee of XYZ Ltd., clause (vi) of the proviso to section 17(2) would get attracted. Clause (vi) of the proviso to section 17(2) provides that any expenditure incurred by the employer on medical treatment of the employee outside India shall be excluded from perquisite only to the extent permitted by RBI. Therefore, the expenditure on medical treatment of the Managing Director outside India shall be excluded from perquisite to the extent permitted by RBI as per clause (vi) of the proviso to section 17(2). If it is assumed that the entire amount is permitted by RBI, there would be no perquisite chargeable in the hands of the Managing Director. Therefore, in such a case, the action of the Assessing Officer in taxing the entire amount paid by the company as a perquisite in the hands of the Managing Director is incorrect.

This question can also be answered by applying the ratio of the Allahabad High Court ruling in CIT v. D.P. Kanodia (2008) 296 ITR 0616. In that case, the High Court observed that the reimbursement by the company of medical expenditure incurred outside India by the director cannot be considered as an amenity or benefit provided by the company to its director, and therefore the provisions of section 17(2)(iii)(a) would not be attracted. Therefore, such reimbursement was not a perquisite within the meaning of section 17(2)(iii)(a).

Hence, applying the ratio of the above case to the facts of this case, the action of the Assessing Officer in taxing the amount paid by the company as a perquisite in the hands of the Managing Director is incorrect.

- (b) The assessee had acquired the mining rights after entering into the lease agreement against the payment of lease money in 3 installments. The assessee firm had charged the payment of Rs.10 lacs made on 31.8.2008 in the previous year as revenue expenditure. The Apex Court, in the case of Enterprising Enterprises v. DCIT (2007) 293 ITR 437, on identical facts, had held that the payment of royalty or rent for the mining lease falls under revenue expenditure where it is paid on a year to year basis, but where the lease money is paid either one time or in installments then the same would be a capital expenditure. Accordingly, the amount of Rs.10 lacs charged by the assessee in the mining account will not be allowed as revenue expenditure but shall be treated as capital expenditure.

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- (c) The Supreme Court, in the case of Hindustan Zinc Limited v. CIT (2007) 295 ITR 453, observed that it was generally accepted as a rule of commercial practice and accountancy that the closing stock has to be valued on the basis of cost or market price, whichever is lower, and there should be no writing down in the value of goods except when there was an actual or anticipated loss. In that case, the assessee was engaged only in domestic business activities and no export had taken place during the relevant previous year. Accordingly, the Supreme Court held that writing down the value of Zinc Concentrate by adopting the price of London Metallic Exchange as its net realizable value is incorrect as the same does not correspond with the term “actual or anticipated loss” in any manner, because prices in the domestic market were higher.

Therefore, in the case on hand, the action of the assessee to value the closing stock on the basis of the prices prevailing in the London Metallic Exchange is not correct, assuming that in this case also, the assessee was engaged only in domestic business activities and no export had taken place during the relevant previous year. Hence, the assessee is required to adopt the net realizable value of the goods held in the closing stock, being the market price prevailing in the domestic market, when the same is less than the cost price, for valuation of its closing stock.

- (d) The facts given in the case are identical to the facts, which were before the Apex Court in the case of Hindustan Coca Cola Beverage P. Ltd v. CIT (2007) 293 ITR 226. The Court held that though the assessee was as an assessee-in-default, the difference of tax deducted cannot be recovered from him since the same had already been paid by the recipient of income. Therefore, the Supreme Court had, in view of the Circular No. 275/201/95-IT(B) dated 29.1.97 and considering the payment of interest under section 201(1A) by the assessee, held that the tax cannot once again be recovered from the assessee. Therefore, the action of Assessing Officer to recover the amount of difference along with interest from M/s Soft Drinks Ltd., when the tax has been paid by the recipient and the assessee is making the payment of interest, is incorrect in view of the decision of the Apex Court.

Question 6

- (a) The net result of the business carried on by a branch of foreign company in India for the year ended 31.03.2009 was a loss of Rs.100 lacs after charge of head office expenses of Rs.200 lacs allocated to the branch. Explain with reasons the income to be declared by the branch in its return for the assessment year 2009-10. (4 Marks)
- (b) Axel Ltd. has two industrial undertakings. Unit-I is engaged in the production of television sets and Unit-II is engaged in the production of refrigerators. The company has, as part of its restructuring program, decided to sell Unit-II as a going concern by way of slump sale for Rs.260 lacs to a new company called Gamma Ltd., in which it holds 85% equity shares. The following is the extract of the balance sheet of Axel Ltd. as on 31st March, 2009:

	Rs. in lacs	
	Unit – I	Unit – II
Fixed Assets	112	158

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Debtors	88	67
Inventories	60	23
Liabilities	33	45

Paid-up share capital	Rs.231 lacs
General Reserve	Rs.160 lacs
Share Premium	Rs.39 lacs
Revaluation Reserve	Rs.105 lacs

The company set up Unit-II on 1st April, 2005. The written down value of the block of assets for tax purpose as on 31st March, 2009 is Rs.150 lacs of which Rs.60 lacs are attributable to Unit-II.

- (i) Determine what would be the tax liability of Axel Ltd. on account of Slump sale;
- (ii) How can the restructuring plan of Axel Ltd. be modified, without changing the amount of consideration, in order to make it more tax efficient? (7 Marks)
- (c) Can an assessee, fulfilling all the prescribed conditions, having total income of Rs.1,84,000 and paying house-rent @ Rs.4,800 p.m. in respect of the residential accommodation occupied by him at Mumbai, claim the deduction for the house rent so paid while computing his taxable income? (3 Marks)

Answer

- (a) Section 44C restricts the allowability of the head office expenses to the extent of lower of an amount equal to 5% of the adjusted total income or the amount actually incurred as is attributable to the business of the assessee in India.

For the purpose of computing the adjusted total income, the head office expenses of Rs.200 lakh charged to the profit and loss account have to be added back.

The amount of income to be declared by the assessee for A.Y. 2009-10 will be as under:

Particulars	Rs.
Net loss for the year ended on 31.03.2009	(100 lacs)
Add: Amount of head office expenses to be considered separately as per section 44C	<u>200 lacs</u>
Adjusted total income	100 lacs
Less: Head Office expenses allowable under section 44C is the lower of	
(i) Rs.5 lacs, being 5% of Rs.100 lacs and	
(ii) Rs.200 lacs.	<u>5 lacs</u>
Income to be declared in return	<u>95 lacs</u>

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- (b) (i) As per section 50B, any profits or gains arising from the slump sale effected in the previous year shall be chargeable to income-tax as capital gains arising from the transfer of capital assets and shall be deemed to be the income of the previous year in which the transfer took place.

If the assessee owned and held the undertaking transferred under slump sale for more than 36 months before slump sale, the capital gain shall be deemed to be long-term capital gain. Indexation benefit is not available in case of slump sale as per section 50B(2).

Calculation of capital gains

Particulars	Rs.
Slump sale consideration	2,60,00,000
Less :Cost of acquisition (net worth) [see working note below]	<u>1,05,00,000</u>
Long-term capital gain	<u>1,55,00,000</u>

Calculation of tax liability

Income tax @ 20%	31,00,000
Surcharge @ 10%	<u>3,10,000</u>
	34,10,000
Education Cess @ 2% and Secondary and higher education cess@1%	<u>1,02,300</u>
Total tax liability	<u>35,12,300</u>

Working Note:

Net worth of Unit II

Particulars	Rs.
WDV of block of assets	60,00,000
Debtors	67,00,000
Inventories	<u>23,00,000</u>
	1,50,00,000
Less : Liabilities	<u>45,00,000</u>
Net worth	<u>1,05,00,000</u>

- (ii) Transfer of any capital asset by a holding company to its 100% Indian subsidiary company is exempted from tax under section 47(iv). Therefore, if it is possible for Axel Ltd. to acquire the entire shareholding of Gamma Ltd. and thereafter make a slump sale, then the resultant capital gain shall not attract tax liability. However, in such case also, Axel Ltd. should not transfer any shares in Gamma Ltd. for 8 years from the date of slump sale.

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- (c) An individual, who is not in receipt of house rent allowance and complying with all the conditions as specified in section 80GG, shall be entitled to claim deduction (in respect of rent paid by him for the residential accommodation) of an amount, equal to the least of the following limits, under section 80GG -

	Rs.	Rs.
(i) Actual rent less 10% of total income i.e., Rs.57,600 minus Rs.18,400, being 10% of Rs.1,84,000	39,200	
(ii) 25% of total income i.e., 25% of Rs.1,84,000	46,000	
(iii) Amount calculated at Rs.2,000 p.m.	24,000	
Deduction allowable (least of the above)		24,000

Note - It is assumed that Rs.1,84,000 is the total income before providing deduction under section 80GG.

Question 7

- (a) Mr. Neeraj provides the following particulars and asks you to work out the amount of net wealth to be declared by him in the wealth tax return for Assessment year 2009-10 :
- (i) Value of a Motor Car Rs.5,00,000
 - (ii) Value of a Motor Cycle Rs.50,000
 - (iii) A house of which ground floor is used by him for business purposes and first floor for self residence having value of Rs.50,00,000 on 31.3.09.
 - (iv) Jewellery worth Rs.12 lacs purchased on 30.3.09 by his wife out of funds given by him of Rs.5 lacs and by his son of Rs.5 lacs.
 - (v) Shares of various companies worth Rs.2,00,000 purchased by him in the name of his daughter-in-law. (4 Marks)
- (b) An assessee, being aggrieved by the order of Wealth-tax Officer, filed an appeal by taking for the first time a ground "that notice to complete the assessment was not served upon him but he had co-operated in completion of proceedings". Are you in agreement with the view taken by the assessee? (3 Marks)
- (c) Ram gifted a house property valued at Rs.100 lacs to his wife on 1.4.2009 in an agreement to live apart. In whose hands the said property will be assessed to wealth-tax in the A.Y. 2009-10? (3 Marks)

Answer

- (a) Computation of Net Wealth of Neeraj on valuation date 31.3.2009

Particulars	Amount (Rs.)
(i) Motor car is an asset as per section 2(ea)	5,00,000
(ii) Motor cycle is not an asset as per section 2(ea)	--

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(iii)	Exemption under section 5(vi) shall be allowed in respect of one house, irrespective of its use, that is to say, the building may be used either for self-residence or for business purposes or for both.	--
(iv)	Jewellery purchased by his wife out of funds given by him is a deemed asset to the extent of funds given by him. It is presumed that the value of jewellery given in the question also represents the fair market value as on the valuation date, determined as per Rule 18 of Schedule III.	5,00,000
(v)	Shares purchased by him in the name of his daughter-in-law is not a deemed asset because shares are not an asset under the Wealth-tax Act.	--
Net wealth		10,00,000

- (b) Section 42 provides that the assessee would be precluded from raising any objection in any proceeding or inquiry that the notice was not served upon him or was not served in time or was served in an improper manner, if he had appeared in any proceedings or co-operated in any inquiry relating to assessment or re-assessment. Therefore, if the assessee had appeared in any proceedings or co-operated in any enquiry, it shall be deemed that any notice required to be served on him has been duly served upon him in time in accordance with the provisions of the Act.

Such deeming provision would, however, not apply where the assessee has raised an objection (regarding non-service of notice or non-service of notice in time or improper service of notice) before the completion of such assessment or reassessment.

In this case, the assessee objected to the non-service of notice for the first time at the appellate level i.e., after completion of the wealth-tax assessment. Therefore, the claim of the assessee is not tenable.

- (c) The property, gifted by Ram to his wife in an agreement to live apart, is not an asset to be included as a deemed asset in his wealth and accordingly, should be taxed in the hands of his wife. However, the transfer had taken place by way of gift on 1.4.2009 and accordingly, on the valuation date 31.3.2009, the house property was owned by Ram and therefore, the same would be assessed to wealth-tax in the hands of Ram for A.Y.2009-10. Thereafter, the property would be assessable in the hands of his wife.