

ASSESSMENT OF VARIOUS ENTITIES

Some Key Points : Recent Amendments

Increase in rate of MAT as well as its scope of coverage [Section 115JB]

- (i) Section 115JB provides that in the case of a company, where 15% of its book profit exceeds the tax on its total income, then the book profit shall be deemed to be the total income and the tax payable on such total income shall be 15% thereof.
- (ii) The rate of MAT has been increased from 15% to 18% of book profits.
- (iii) With effect from A.Y.2011-12, if tax on the total income of a company is less than 18% of its book profit, then MAT provisions are attracted and the book profit is deemed to be the total income and tax is payable @ 18% thereof.
- (iv) The effect of this amendment is that more companies would fall under the MAT net, since, those companies whose tax on total income is higher than 15% of book profit but lower than 18% of book profit would also be required to pay MAT. Further, their tax burden and cash outflow would be higher on account of the increase in rate of MAT from 15% to 18%

Question 1

M/s. Harilal Industries, a partnership firm, submits the following profit and loss account for computation of its business income for the assessment year 2011-12.

Profit and loss account for the year ending 31.03.2011

Expenses	Rs.	Income	Rs.
To Salaries	4,23,000	By gross profit	7,47,300
" Rent	32,000	Dividend from UTI	8,000
" Printing & Stationery	5,600		
" Telephone	3,700		
" Conveyance	21,000		
" Travelling	14,000		
" Interest	72,000		
" Depreciation	27,000		
" Legal fees	15,000		

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" Auditor's fees	18,000		
" PF contribution	24,000		
" Net profit	<u>1,00,000</u>		
Total	<u>7,55,300</u>	Total	<u>7,55,300</u>

Additional information:

- (i) Salaries include Rs.1,50,000 paid to working partner A and Rs.1,00,000 to working partner B. (authorized by the partnership deed)
- (ii) Interest paid includes Rs.54,000, being interest paid on loan given by partner B at the rate of 18% simple interest.
- (iii) Out of provident fund contribution debited to profit and loss account, Rs.10,000 is outstanding beyond the due date of filing of return.
- (iv) The firm purchased goods by issuing account payee drafts except in the case of one bill for Rs.80,000 for which payment has been made by cash. This has been debited to trading account as part of purchases.

Answer

Computation of business income of M/s. Harilal Industries for the A.Y 2011-12

Particulars	Rs.	Rs.
Net Profit as per Profit & Loss Account		1,00,000
Add : Remuneration to partners (considered separately)		<u>2,50,000</u>
		3,50,000
Add: Inadmissible expenses :		
Interest [54,000 – 36,000 (calculated@12%)]	18,000	
Provident fund payment outstanding as on due date of filing of return - disallowed under section 43B	10,000	
Cash purchases [disallowed under section 40A(3)]	<u>80,000</u>	<u>1,08,000</u>
		4,58,000
Less : Amount credited but exempt		
Dividend from UTI [exempt under section 10(35)]		<u>8,000</u>
Book Profit		4,50,000
Less : Remuneration to partners deductible (see note below)		<u>2,50,000</u>
Taxable business income		<u>2,00,000</u>

Note - Computation of remuneration allowable as deduction as per 40(b)(v)

Particulars	Percentage allowable	Rs.
On first 3,00,000 of book profit	90%	2,70,000
On the balance book profit of Rs.1,50,000	60%	<u>90,000</u>
Remuneration allowable as per 40(b)(v)		<u>3,60,000</u>

Since the actual remuneration of Rs.2,50,000 is less than the allowable limit of Rs.3,60,000, only Rs.2,50,000 is deductible.

Question 2

ABC Ltd., engaged in diversified activities, earned a net profit of Rs.42,50,000 after debit/credit of the following items to its profit and loss account for the year ended on 31.3.2011:

(a) Items debited to Profit and Loss Account	Rs.
Provision for income-tax	8,64,000
Dividend distribution tax	1,00,000
Provision for deferred tax	70,000
Wealth-tax	1,90,000
Securities Transaction Tax	1,35,000
Transfer to General Reserve	1,50,000
Provision for gratuity based on actuarial valuation	1,20,000
Provision for losses of subsidiary company	1,40,000
Proposed dividend	1,60,000
Preference dividend	1,30,000
Expenditure to earn agricultural income	50,000
Expenditure to earn LTCG exempt under section 10(38)	40,000
Expenditure to earn dividend income	20,000
Depreciation (including depreciation of Rs.1,50,000 on revaluation)	3,50,000
(b) Items credited to Profit and Loss Account	
Amount credited to P& L A/c from Special Reserve	1,00,000
Amount credited to P& L A/c from Revaluation Reserve	1,80,000
Agricultural income	2,50,000
LTCG exempt under section 10(38)	1,60,000
Dividend income	1,20,000

The company provides the following additional information:

Brought forward Business Loss/Unabsorbed Depreciation:

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Assessment Year	Amount as per books	
	Loss	Depreciation
2007-08	5,00,000	4,00,000
2008-09	3,00,000	Nil
2009-10	1,00,000	2,50,000

You are required to examine the applicability of section 115JB of the Income-tax Act, and compute book profit and the tax credit to be carried forward, assuming that the total income computed as per the provisions of the Income-tax Act is Rs.25,00,000.

Answer

Computation of Book Profit under section 115JB

Particulars	Rs.	Rs.
Net Profit as per Profit & Loss Account		42,50,000
<i>Add:</i> Net Profit to be increased by the following amounts as per Explanation 1 to section 115JB		
Income-tax paid or payable or provision therefor		
Provision for income-tax	8,64,000	
Dividend distribution tax	<u>1,00,000</u>	9,64,000
Provision for deferred tax		70,000
Transfer to General Reserve		1,50,000
Provision for losses of subsidiary company		1,40,000
Dividend paid or proposed		
Proposed dividend	1,60,000	
Preference dividend	<u>1,30,000</u>	2,90,000
Expenditure to earn income exempt u/s 10 [except section 10(38)]		
Expenditure to earn agricultural income [exempt u/s 10(1)]	50,000	
Expenditure to earn dividend income [exempt u/s 10(34)]	<u>20,000</u>	70,000
Depreciation		<u>3,50,000</u>
		62,84,000
<i>Less:</i> Net Profit to be reduced by the following amounts as per Explanation 1 to section 115JB		
Amount credited to P&L A/c from Special Reserve	1,00,000	

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Depreciation (excluding depreciation on account of revaluation of fixed assets) (i.e. Rs.3,50,000 – Rs.1,50,000)	2,00,000	
Amount credited to P& L A/c from Revaluation Reserve (to the extent of depreciation on revaluation)	1,50,000	
Brought forward business loss or unabsorbed depreciation as per books of account, whichever is less taken on cumulative basis	6,50,000	
Income exempt u/s 10 [except section 10(38)]		
Agricultural Income [since it is exempt under section 10(1)]	2,50,000	
Dividend income [since it is an income exempt under section 10(34)]	1,20,000	14,70,000
Book Profit		48,14,000
18% of book profit		8,66,520
Add: Education cess @ 2%	17,330	
Secondary and higher education cess @ 1%	8,665	25,995
Tax liability under section 115JB		8,92,515
Total income computed as per the provisions of the Income-tax Act	25,00,000	
Tax payable @ 30%		7,50,000
Add: Education cess @ 2%	15,000	
Secondary and higher education cess @ 1%	7,500	22,500
Tax Payable as per the Income-tax Act		7,72,500

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 18% of book profit, the book profit shall be deemed as the total income and the tax payable on such total income shall be 18% 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 18% of book profit, the book profit of Rs.48,14,000 is deemed to be the total income and income-tax is payable @ 18% thereof plus education cess @2% and secondary and higher education cess @1%. The tax liability, therefore, works out to Rs.8,92,515.

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 ten assessment years succeeding the assessment year in which the credit became allowable. Such credit is

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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	8,92,515
Less: Tax on total income computed as per the other provisions of the Act	7,72,500
Tax credit to be carried forward	1,20,015

Notes:

1. Wealth-tax and securities transaction tax do not form part of income-tax and hence, should not be added back to net profit for computing book profit.
2. Provision for gratuity based on actuarial valuation is a provision for meeting an ascertained liability. Therefore, it should not be added back for computing book profit.
3. 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, 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 3

JK Associates is an Association of Persons (AOP) consisting of two members, J and K. Shares of the members are: 60% (J) and 40%(K). Income of the AOP for the previous year 2010-11 is Rs.6 lakh.

Compute tax liability of the AOP and the members in the following situations:

- (i) *J and K have their income, other than income from AOP, amounting to Rs.1 lakh and Rs.1.70 lakh, respectively.*
- (ii) *J and K's income, other than income from AOP, amount to Rs.1 lakh and Rs.1.20 lakh, respectively.*

Answer

Computation of tax of AOP is governed by section 167B of the Income-tax Act. Tax on total income of AOP is computed as follows:

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- (i) If individual share of a member is known, and the total income of any member exceeds the basic exemption limit, then the AOP will pay tax at the maximum marginal rate.
- (ii) If individual share of a member is known and no member has total income exceeding the basic exemption limit, then the AOP will pay tax at the rates applicable to an individual.

Section 86 provides for assessment of share in the hands of members of AOP as follows:

A member's share in the total income of AOP will be treated as follows:-

- (i) If an AOP has paid tax at the maximum marginal rate or a higher rate, the member's share in the total income of AOP will not be included in his total income and will be exempt.
- (ii) If the AOP has paid tax at regular rates applicable to an individual, the member's share in the income of AOP will be included in his total income and he will be allowed rebate at the average rate of tax in respect of such share.

Tax Liability of J K Associates, AOP

- (i) As K's income, other than that from the AOP, exceeds the basic exemption limit, the AOP shall pay tax at maximum marginal rate of 30.90% (i.e. 30% plus education cess@2% plus secondary and higher education cess@1%). Thus the tax payable by AOP = Rs.6,00,000 x 30.90% = Rs.1,85,400.
- (ii) Since none of the members have income, other than income from the AOP, exceeding the basic exemption limit, the AOP would be taxed at the rates applicable to an individual. Therefore, the AOP's tax liability = Rs.54,000 + Rs.1,620 = Rs.55,620.

Tax Liability of J and K

Particulars		J Rs.	K Rs.
(i)	Share of profit from AOP	Exempt	Exempt
	Income from other sources	<u>1,00,000</u>	<u>1,70,000</u>
	Total Income	<u>1,00,000</u>	<u>1,70,000</u>
	Tax liability	NIL	1,000
	Education cess@2% + SHEC@1%	—	<u>30</u>
	Total tax payable	<u>NIL</u>	<u>1,030</u>
(ii)	Share of profit from AOP	3,60,000	2,40,000
	Income from other sources	<u>1,00,000</u>	<u>1,20,000</u>
		<u>4,60,000</u>	<u>3,60,000</u>

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Tax liability	30,000	20,000
Education cess@2% + SHEC@1%	<u>900</u>	<u>600</u>
Total tax payable	<u>30,900</u>	<u>20,600</u>
 Average rate of tax	 6.717%	 5.722%
 Total tax liability	 30,900	 20,600
Less: Rebate under section 86 in respect of share of profit from AOP	<u>24,181</u>	<u>13,733</u>
Tax liability of members	<u>6,719</u>	<u>6,867</u>

Question 4

The net profit of ABC Ltd. for the year ending 31.03.2011 amounted to Rs.7,22,000 after debiting/crediting following items:

- (i) Payment of interest on money borrowed from bank for purchase of land and building Rs.2,22,000.
- (ii) Commission Rs.1,00,000 paid in the month of February, 2011 and Rs.1,25,000 paid in March, 2011. Tax deducted at source from the payments was deposited to the Government on 20.09.2011.
- (iii) Travelling expenses of Rs.90,000 on a foreign tour of a director for negotiating collaboration with a foreign manufacturer for initiation of new line of business.
- (iv) Securities transaction tax paid Rs.10,000. Income from trading in shares already credited to profit and loss account Rs.3,82,000.
- (v) As part of the restructuring of its debt, the company has converted arrears of interest of Rs.3,00,000 on term loan into a new term loan with a revised repayment schedule.
The company has paid Rs.50,000 towards such funded interest during the year. Entire Rs.3,00,000 has been debited to profit and loss account. However, out of this, a further sum of Rs.50,000 was paid before the due date of filing of return.
- (vi) Rs.5,00,000, being contribution to S Ltd. (wholly owned subsidiary company) for construction of a school for the benefit of its employees.
- (vii) Provision for gratuity based on actuarial valuation Rs.6,00,000. Actual gratuity paid Rs.1,50,000 was debited to provision for gratuity account.

Other information:

- (1) Provision for bonus for the year 2009-10 paid on 15.11.2010 Rs.98,000. It is inclusive of payment by bearer cheque of Rs.34,000.

- (2) The company has purchased a commercial vehicle of Rs.8,00,000 for the purpose of business on 21.03.2011 and calculated depreciation@15% for the full year. Depreciation debited to the profit and loss account is calculated on all other assets as per the rates prescribed in the Income-tax Act.
- (3) The company collected Rs.3,00,000 from its customers towards sales tax in the year 2006-07 and remitted it to the State Government in due time. On the levy being challenged in the High Court, the Court held the levy as illegal and the State Government refunded the amount to the company in February, 2011. The company refunded Rs.2,00,000 to the customers and the remaining amount of Rs.1,00,000 was shown under the head "current liabilities".

Compute the income chargeable to tax in assessment year 2011-12 and work out the amount of tax payable on such income, ignoring the provisions of section 115JB.

Answer

(a) Computation of total income and tax liability of ABC Ltd. for A.Y.2011-12

Particulars	Rs.	Rs.
Profits & Gains of Business of Profession		
Net Profit as per Profit & Loss Account		7,22,000
Add: Items debited but to be considered separately or to be disallowed		
Commission paid in February, 2011 and March 2011, but TDS from such payment before the due date for filing the return of income. Hence allowed (Note 2)	Nil	
Travelling expenses on foreign tour in connection with new line of business (Note 3)	90,000	
Interest on term loan converted into new term loan (Note 5)	2,00,000	
Provision for gratuity	6,00,000	
Less: Gratuity paid	<u>1,50,000</u> (Note 7)	4,50,000
Depreciation on commercial vehicle (Note 9)	60,000	
Sales tax refund not returned to the customers (Note 10)	<u>1,00,000</u>	<u>9,00,000</u>
		16,22,000
Less: Items credited but to be considered separately and those not charged but to be allowed		
Bonus paid on 15.11.2010 in respect of previous year 2009-10 disallowed last year but allowable now (Note 8)		<u>64,000</u>
Business Income		15,58,000
Deduction under Chapter VI-A		NIL
Total Income		<u>15,58,000</u>

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Tax payable @ 30%	4,67,400
Education cess @ 2%	9,348
Secondary and higher education cess@1%	<u>4,674</u>
Total tax payable	<u>4,81,422</u>

Notes:

- (1) As per section 36(1)(iii), interest on borrowed capital is allowed as deduction, if the borrowed capital is used for the purpose of business of the assessee. The section does not distinguish between borrowed capital used for financing capital expenditure and borrowed capital used for the financing revenue expenditure. Assuming that land and building was acquired for business purpose, interest on money borrowed is allowable under section 36(1)(iii). It is presumed that the interest liability pertains to a period after the asset is put to use.
- (2) As per section 40(a)(ia), tax deducted and remitted in respect of commission paid in the months of February and March 2011 is deductible since the TDS was remitted on 20.09.2011 being the date before the due date meant for filing return of income.
- (3) Travelling expenses incurred on foreign tour of a director for initiating a new line of business is a capital expenditure. The same is, therefore, not deductible under section 37(1).
- (4) Securities transaction tax is allowable as deduction under section 36(1)(xv) if the income arising from taxable securities transaction is included in computing the income under the head "Profits and gains of business or profession". As income from trading in shares is included in computation of business income, securities transaction tax of Rs.10,000 is allowable as deduction.
- (5) As per section 43B, any sum payable by the assessee as interest on any loan or borrowing from, *inter alia*, any public financial institution or scheduled bank shall be allowed only in computing the income of that previous year in which sum is actually paid. In respect of the previous year in which the liability to pay such sum was incurred, deduction will also be allowed in relation to the sum or part thereof which is paid on or before the due date of filing of return for that year. As per Explanations 3C and 3D to section 43B, a deduction of any sum, being interest payable on any loan or borrowing from a public financial institution or scheduled bank shall be allowed, if such interest has been actually paid and such interest which has been converted into a loan or borrowing shall not be deemed to have been actually paid.

The manner in which the converted interest will be allowed as deduction has been clarified vide Circular No.7/2006 dated 17.7.2006. The unpaid interest, whenever actually paid to the financial institution or scheduled bank, will be in the nature of revenue expenditure deserving deduction in the computation of income. Therefore,

irrespective of the nomenclature, the deduction will be allowed in the previous year in which the converted interest is actually paid.

Accordingly, out of Rs.3 lakh, only Rs.1 lakh (Rs. 50,000 + Rs. 50,000), being the funded interest actually paid, is allowable as deduction while computing business income of P.Y.2010-11. It is presumed that the installment of Rs. 50,000 paid before the due date of filing the return relates to P.Y.2010-11. Since the entire amount of Rs.3 lakh, representing arrears of interest converted into term loan, has been debited to the profit and loss account, the balance Rs.2 lakh (i.e., Rs.3 lakh – Rs.1 lakh) has to be added back.

- (6) Contribution to a wholly owned subsidiary company for construction of a school for the benefit of its employees is allowable under section 37(1).
- (7) Under section 40A(7), no deduction is allowed in respect of any provision made for the payment of gratuity to the employees on retirement or termination of employment for any reason. However, gratuity actually paid is admissible as deduction. Therefore, provision for gratuity of Rs.6,00,000 is to be disallowed. Actual gratuity paid Rs.1,50,000 debited to provision for gratuity account is allowable. Hence, only the net sum of Rs.4,50,000 has to be added back.
- (8) As per section 40A(3), expenditure in respect of which payment is made in a day in a sum exceeding Rs.20,000 otherwise than by account payee cheque or account payee bank draft is disallowed. In this case, provision for bonus for the previous year 2009-10 would have been disallowed under section 43B for non-payment by due date for filing of return of income for assessment year 2010-11. Payment of bonus made after the said date is allowed in the year of actual payment. However, such deduction allowable in the year of payment is subject to the provisions of section 40A(3). Hence, the sum of Rs.34,000 being bonus paid by bearer cheque shall not be allowed as deduction in the year of payment. Assuming that the balance amount of Rs.64,000 (i.e., Rs.98,000 – Rs.34,000) is paid by account payee cheque or account payee bank draft, it is admissible as deduction in the A.Y.2011-12.
- (9) Depreciation on commercial vehicle has been calculated @15% and, consequently, Rs.1,20,000 has been debited to profit and loss account. Since it was acquired in March 2011 only, 50% of normal depreciation is allowable. The excess depreciation of Rs.50,000 is hence disallowed.
- (10) Sales tax collected by the assessee is to be treated as a trading receipt of the assessee as held by the Supreme Court in the case of *Chowringhee Sales Bureau Private Limited v. CIT* (1973) 87 ITR 542 (SC). Sales tax paid by the assessee is to be deducted from its profits. If any deduction is so allowed and subsequently the sales tax is refunded by the Government, the refund so made has the character of a revenue receipt. Therefore, the amount is taxable as deemed income under section 41(1). However, the assessee is entitled to claim deduction of the amount of refund

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of sales tax as and when the same is refunded by the assessee to the purchaser. This view finds support from *CIT v. Thirumalaiswamy Naidu and Sons v. CIT* 230 ITR 534 (SC). In view of this, the amount not yet refunded to the customers is taxable. Accordingly, the sum of Rs.1,00,000, being sales tax not refunded to the customers, is added back.

Question 5

Laxmi Tea Limited is engaged in growing and manufacturing tea in Assam and West Bengal. The company's profit and loss account for the year ended 31st March, 2011 shows a net profit of Rs.550 lacs after debiting or crediting the following amounts:

- (a) *Depreciation Rs.40 lacs.*
- (b) *Interest amounting to Rs.2 lacs on term loan from a bank for purchase of machinery for one of its tea factories.*
- (c) *Repairs to factory building amounting to Rs.15 lacs for which a sum of Rs.10 lacs was withdrawn from Tea Deposit account maintained with National Bank for Agricultural and Rural Development (NABARD) as per section 33AB of the Income-tax Act.*
- (d) *Profit from sale of green tea leaves plucked in own gardens Rs.20 lacs.*
- (e) *Rs.5 lacs on account of stamp duty and registration fees for the issue of bonus shares.*
- (f) *Rs.10 lacs, being sales tax dues of earlier years determined during the year on disposal of appeals by the appellate authority, for which the company has furnished a bank guarantee to the Commercial Tax Authority.*
- (g) *Rs.5 lacs written off as bad in respect of a trade debt transferred from Saraswati Tea Limited in previous year 2008-09 pursuant to a scheme of amalgamation approved by the jurisdictional High Court.*
- (h) *Rs.2 lacs contributed to Employees' Welfare Trust.*
- (i) *Interest on inter-corporate deposit Rs.1 lac and Rs.1.50 lacs for February, 2011 and March, 2011, respectively, for which tax deducted at source was paid to the Central Government in June, 2011.*

Following additional information are furnished by the management:

- (i) *Depreciation as per Tax Audit Report under section 44AB Rs.55 lacs.*
- (ii) *One financial institution converted arrear interest of Rs.10 lacs into a new loan in financial year 2007-08, which is repayable in five annual instalments. The company has paid Rs.2 lacs towards the instalment due for the financial year 2010-11 in February, 2011.*

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(iii) A sum of Rs.250 lacs deposited in NABARD on 15th June, 2011 as per the provision of Section 33AB.

Compute total income of the company for the Assessment Year 2011-12 stating the reasons for each item. Ignore provision relating to Minimum Alternate Tax.

Answer

Computation of total income of Laxmi Tea Ltd. for the A.Y.2011-12

Particulars	Amount in Rs.	
A. Profit and Gain from Business and Profession		
Net profit as per Profit & Loss Account		5,50,00,000
Add: Items debited but to be considered separately or to be disallowed		
Depreciation as per accounts	40,00,000	
Repairs to factory building to the extent of amount spent by withdrawal from Tea Deposit Account (Note 2)	10,00,000	
Sales tax not paid (Note 4)	10,00,000	
Contribution to Employees' Welfare Trust disallowed under section 40A(9) (Note 6)	2,00,000	
Interest on inter-corporate deposit for February, 2011 and March 2011 for which tax deducted at source was deducted and deposited in June 2011 allowed under section 40(a)(ia) (Note 7)	<u>NIL</u>	<u>62,00,000</u>
		6,12,00,000
Less: Amount credited to profit & loss account but not chargeable to tax		
Profit on sale of green tea leaves plucked in own gardens is agricultural income and the same is exempt under section 10(1)		<u>20,00,000</u>
		5,92,00,000
Less: Deductions allowable while computing business income		
Depreciation as per Income-tax Rules	55,00,000	
Payment of new loan converted from arrear interest (Note 8)	<u>2,00,000</u>	<u>57,00,000</u>
		5,35,00,000
Deduction under section 33AB for making deposit in an account with NABARD as per scheme approved by the Tea Board, being lower of the following two amounts:		

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Amount deposited	2,50,00,000	
40% of the profit from business of growing and manufacturing tea computed under the head "profits and gains from business and profession" before making this deduction (Rs.5,35,00,000 x 40%)	<u>2,14,00,000</u>	<u>2,14,00,000</u>
		3,21,00,000
Less : 60% of above, being agricultural income as per Rule 8		<u>1,92,60,000</u>
Business income		<u>1,28,40,000</u>
Gross Total Income		1,28,40,000
Less : Deduction under Chapter VIA		<u>Nil</u>
Total Income		<u>1,28,40,000</u>

Notes:

1. As per section 36(1)(iii), interest paid in respect of capital borrowed for the purpose of business or profession is allowed as deduction. The term loan was taken for purchasing machinery for use in a tea factory. Thus, the term loan was used for the purpose of business. Hence, interest on term loan is allowable as deduction. As interest has already been debited to the profit and loss account, no adjustment is required. It is assumed that—
 - (i) the new machinery was not acquired for extension of the business of the company; and
 - (ii) the interest has been actually paid.
2. As per section 33AB(6), where any amount standing to the credit of the assessee in the account maintained with NABARD is utilized by the assessee for the purpose of any expenditure in connection with such business in accordance with the scheme approved by the Tea Board, such expenditure shall not be allowed as deduction. Therefore, the amount of Rs.10 lacs withdrawn and utilized for incurring expenditure on repair to factory building is to be disallowed.
3. The Supreme Court, in the case of *CIT vs. General Insurance Corporation (2006) 286 ITR 232*, observed that there is no inflow of fresh funds or increase in capital employed on account of issue of bonus shares. There is only reallocation of company's fund on account of issue of bonus shares by capitalization of reserves. The company has not acquired any benefit of enduring nature. There is no increase in capital base of the company. Therefore, stamp duty and registration fee in connection with issue of bonus shares is allowable as revenue expenditure under section 37(1).
4. According to section 43B, any tax, duty, cess or fee (by whatever name called) is allowed as deduction if they are actually paid on or before the due date of filing return of income under section 139(1) irrespective of the method of accounting followed by the assessee.

In the case of *CIT vs. Udaipur Distillery Company Limited (2004) 268 ITR 305 (Raj)*, it was held that actual payment requires that amount must flow from the assessee to the public exchequer as specified in section 43B. Mere furnishing of bank guarantee by the assessee towards sales tax dues does not mean actual payment of sales tax dues. Therefore, sales tax liability determined on appeal shall be disallowed under section 43B for non-payment.

5. Under section 36(1)(vii) read with section 36(2), an assessee can claim deduction in respect of bad debt, provided the amount of such debt has been taken into account in computing total income of the assessee and it is written off in the books of account of the assessee. In the case of *CIT vs. T.Veerabhadra Rao, K.Koteswara Rao & Co. (1985) 155 ITR 152 (SC)*, the Apex Court held that the successor of a business is entitled to write off the predecessor's debt as a bad debt and claim deduction if the other conditions are fulfilled. This is so because the benefit of deduction in respect of bad debt is not accrued to the assessee by way of personal relief but relates to the business. Therefore, the assessee company is entitled to deduction under section 36(1)(vii) read with section 36(2) in respect of debt transferred from the amalgamating company, Saraswati Tea Limited.
6. As per section 40A(9), any contribution made by the assessee as an employer to any fund, trust, company, association of persons, body of individuals, society registered under the Societies Registration Act or other institution for any purpose shall be disallowed, except where such contribution is paid to a recognised provident fund or approved superannuation fund or approved gratuity fund. Therefore, contribution to the Employees' Welfare Trust is to be disallowed.
7. Section 40(a)(ia) seeks to disallow interest paid to any resident, if tax is not deducted at source or, after deduction, tax is not deposited to the Central Government on or before the due date prescribed under section 139(1) of the Act.

In this case, tax has been deducted and paid before the due date prescribed under section 139(1). Hence, the expenditure shall be allowed.

8. As per Explanation 3C to section 43B, a deduction of any sum, being interest payable on any loan or borrowing from a public financial institution shall be allowed, if such interest has been actually paid and such interest which has been converted into a loan or borrowing shall not be deemed to have been actually paid.

The manner in which the converted interest will be allowed as deduction has been clarified vide Circular No.7/2006 dated 17.7.2006. The unpaid interest, whenever actually paid to the financial institution, will be in the nature of revenue expenditure deserving deduction in the computation of income. Therefore, irrespective of the nomenclature, the deduction will be allowed in the previous year in which the converted interest is actually paid. Accordingly, the sum of Rs.2 lacs, being installment paid in February, 2011 shall be allowed as deduction while computing business income of P.Y.2010-11.

Direct Tax Laws

Question 6

The net profit as per the profit and loss account of XYZ Ltd., a resident company, for the year ended 31.3.2011 is Rs.190 lacs arrived at after making the following adjustments:

(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 by way of dividend.
- (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 debited in P&L account 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 31.3.2010 was Rs.30 lacs representing unabsorbed depreciation.

Compute the income of the company for the year ended 31.3.2011 liable to tax under MAT.

Answer

Computation of income of XYZ Ltd. liable to tax under MAT for the year ended 31.3.2011

Particulars	Rs.	Rs.
Net Profit as per Profit & Loss Account		1,90,00,000
<i>Add : Net profit to be increased by the following amounts as per Explanation 1 to section 115JB</i>		
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	40,00,000	
Proposed dividend	1,20,00,000	3,10,00,000
		<u>5,00,00,000</u>

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

Assessment of Various Entities

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 [exempt under section 10(34)]	10,00,000	1,10,00,000
Income liable to tax under MAT		3,90,00,000

Note –

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.

Question 7

X, Y and HUF of Z (represented by Z) are partners with equal shares in profits and losses of a firm, M/s Popular Cine Vision, which is engaged in the production of TV serials and telefilms. In the previous year 2009-10, one partner 'A' retired, but his dues have been settled in the previous year 2010-11.

The earlier partnership deed did not authorise payment of remuneration or interest to partners. The partnership deed was revised by the partners on 1st June, 2010 to authorise payment of remuneration of Rs.1 lac per month to each working partner and simple interest at 15% per annum to X and Y on their capital. X, Y and Z are actively associated with the affairs of the firm.

The Profit & Loss Account of the firm for the year ended 31st March, 2011 shows a net profit of Rs.10 lacs after debiting/crediting the following:

- (a) Interest amounting to Rs.7.5 lacs each was paid to partners X and Y on the balances standing to their capital accounts from 1st April, 2010 to 31st March, 2011.*
- (b) Remuneration to the partners including partner in representative capacity Rs.30 lacs.*
- (c) Interest amounting to Rs.2 lacs paid to Z on loan provided by him in his individual capacity at 16% interest.*

Direct Tax Laws

- (d) Royalty of Rs.5 lacs paid to partner X, who is litterateur and a professional script writer, for use of his scripts as per an agreement between the firm and X.
- (e) Two separate payments of Rs.18,000 and Rs.15,000 made in cash on 1st February, 2011 to Altaf, a hairdresser, against his bill for services rendered in January, 2011 and two payments of Rs.19,000 and Rs.10,000 made in cash on 1st February and 2nd February, 2011, respectively, to Priyam, an assistant cameraman, against her bill for services provided in January, 2011.
- (f) Amount of Rs.5 lacs provided in the books on 31st March 2011 as liability for remuneration to Shreyashi, a film artist and a non-resident. Tax deducted at source under section 195 from the amount so credited was paid on 3rd June, 2011.
- (g) Amount of Rs.6 lacs provided as gratuity for the year on the basis of actuarial valuation. Gratuity paid to retired employees is Rs.1.50 lacs.
- (h) Interest of Rs.1.20 lacs received on income-tax refund under section 244(1A) in respect of assessment year 2009-10.

The firm has also provided the following additional information:

The amount due to A, the former partner, was Rs.15 lacs. The dues were settled on 30th September, 2010 by transferring a plot of land purchased two years back having a book value of Rs.10 lacs. The difference of Rs.5 lacs was credited to partners' capital accounts in their profit sharing ratio. The fair market value of the plot on the date of transfer was Rs.16 lacs.

Compute the total income of the firm for the assessment year 2011-12 stating the reasons for treatment of each item.

Answer

Computation of Total Income of M/s. Popular Cine Vision for the A.Y.2011-12

	Rs.	Rs.
Profits and Gains from Business or Profession		
Net Profit as per Profit & Loss A/c		10,00,000
<i>Add:</i> Expenses disallowed or considered separately		
Interest to partners in excess of 12% (Note 1)	5,00,000	
Disallowance under section 40A(3) for aggregate cash payment exceeding Rs.20,000 in a single day (Note 5)	33,000	
Remuneration to non-resident film artist to be disallowed under section 40(a)(i) as the TDS payment was made in June 2011 (Note 6)	5,00,000	
Provision for gratuity (Note 7)	4,50,000	

13.18

Assessment of Various Entities

Partners' Remuneration	30,00,000	
Royalty paid to Partner X (Note 4)	5,00,000	49,83,000
		<u>59,83,000</u>
Less: Interest on income-tax refund (Note 8)		1,20,000
Book Profit		58,63,000
Less: Partners' remuneration allowable under section 40(b)(v)		
(i) As per limit prescribed in section 40(b)		
On first Rs.3,00,000 90%	2,70,000	
On the balance Rs.55,63,000 60%	33,37,800	
	<u>36,07,800</u>	
(ii) Remuneration actually paid or payable		
(Rs.1,00,000 × 10 months × 3 partners) + (Royalty Rs.5 lakh)	35,00,000	
(i) or (ii) whichever is less, is deductible		35,00,000
		<u>23,63,000</u>
Capital Gain		
Short-term capital gain on transfer of land (Note 9)		6,00,000
Income from other sources		
Interest on income-tax refund		1,20,000
Gross Total Income		30,83,000
Deductions under Chapter VI-A		Nil
Total Income		30,83,000

Notes:

- As per section 40(b) simple interest at 12% p.a. to partners relating to the period after the date of partnership deed is allowable. Therefore, interest to partners from 1st April to 31st May, 2010 should be disallowed. Further, the excess interest @ 3% paid from 1st June, 2010 to 31st March, 2011 should also be disallowed.

		Rs.
Interest for April and May, 2010	15,00,000 × 2/12	2,50,000
Excess interest from June'10 to March'11	(15,00,000 × 3/15) × 10/12	2,50,000
		<u>5,00,000</u>

- Even though Z is a partner in a representative capacity, he is still a partner. Therefore, remuneration to Z should also be subject to the limits prescribed in section 40(b). This

view finds support from the decision of the Supreme Court in the case of *Rashik Lal & Co. vs CIT (1998) 229 ITR 458 (SC)*.

3. As per Explanation 1 to section 40(b) where an individual is a partner in a firm in a representative capacity, the provisions of section 40(b) shall not apply to any interest payable by the firm to such individual in his personal capacity. Z represents his HUF in the firm. However, Z gave the loan in his individual capacity. Hence, assuming that the provisions of section 40A(2) do not get attracted in this case, such interest shall be allowed as deduction in full even though the interest rate is more than 12% p.a.
4. It may be noted that the limits specified under section 40(b)(v) are applicable in case of payment of salary, bonus, commission, or remuneration, by whatever name called, to a working partner. From a plain reading of the section, it is clear that any remuneration, by whatever name called, paid to a working partner, is subject to the limits laid down in section 40(b)(v). Therefore, the royalty of Rs.5 lakh paid to partner X would also be subject to the limits laid down in section 40(b)(v). Hence, the same has to be added back for computing book profits.
5. Section 40A(3) provides for disallowance of any expenditure in respect of which aggregate of payments made otherwise than by an account payee cheque or account payee bank draft in a single day to a person exceeds a sum of Rs.20,000. Hence, the payments of Rs.18,000 and Rs.15,000 in cash on 1.2.2011 to Altaf, a hairdresser, shall be disallowed, since the aggregate payment of Rs.33,000 exceeds the limit of Rs.20,000.

In case of payment of bill of the assistant cameraman of Rs.19,000 and Rs.10,000 respectively on 1st February and 2nd February is not liable for disallowance under section 40A(3) since the aggregate payment in cash on a single day has not exceeded Rs.20,000.
6. As per section 40(a)(i), any sum payable to a non-resident shall not be allowed as deduction, if tax has not been deducted at source or after deduction, has not been paid within the time limit prescribed in section 200(1). Tax deducted from the amount of remuneration credited to payee's account on 31st March 2011 has to be deposited latest by 31st May, 2011. The firm has paid the tax on 3rd June, 2011 and hence, the remuneration shall not be allowed.
7. As per section 40A(7), any provision made for payment of gratuity to employees on their retirement or on termination of employment for any reason is disallowed. However, any provision made for the purpose of payment of a sum by way of any contribution to an approved gratuity fund or for the purpose of payment of gratuity which has become payable during the previous year shall be allowed as deduction. The question does not mention any approved gratuity fund. However, gratuity of Rs.1.50 lacs paid to retired employees is allowable as deduction. Hence, the balance provision of Rs.4.50 lacs (i.e., Rs.6 lacs – Rs.1.50 lacs) is to be disallowed.

8. Interest on income-tax refund is assessable under the head "Income from other sources".
9. Distribution of a capital asset by a firm to its partner on dissolution or otherwise attracts capital gains tax liability as per the provisions of section 45(4) and the fair market value of the asset on the date of transfer is deemed to be the full value of consideration received or accruing as a result of the transfer. The words "or otherwise" includes within its scope, cases of distribution of capital assets on retirement of a partner also. [*CIT vs. A. N .Naik Associates 265 ITR 346 (Bom.)*]. Therefore, distribution of a plot of land on retirement of a partner would attract section 45(4).

Rs.16 lacs, being the fair market value of the plot on the date of transfer, is deemed to be the full value of consideration. Therefore, the capital gain would be Rs.6 lacs (i.e., Rs.16 lacs – Rs.10 lacs).

Question 8

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 31.3.2011:

<i>(a) Items debited to Profit and Loss Account</i>	Rs.
<i>Expenses on Industrial Unit exempt under section 10A</i>	2,10,000
<i>Provision for Loss of Subsidiary</i>	70,000
<i>Provision for Sales Tax Demand (paid before due date)</i>	75,000
<i>Provision for Wealth Tax Demand</i>	90,000
<i>Provision for Income Tax Demand</i>	1,05,000
<i>Expenses on purchase/sale of equity shares</i>	15,000
<i>Depreciation</i>	3,60,000
<i>Interest on deposit credited to buyers on 31.3.2011 for advance received from them, on which TDS was deposited on 31.7.2011</i>	90,000
<i>(b) Items credited to Profit and Loss Account</i>	
<i>Income on Industrial Unit exempt under section 10A</i>	2,70,000
<i>Profit from 100% EOU under section 10B</i>	60,000
<i>Long term capital gain on sale of equity shares on which securities transaction tax was paid</i>	3,60,000
<i>Income from units of UTI</i>	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:*

Direct Tax Laws

F.Y.	Amount as per books		Amount as per Income-tax	
	Loss	Depreciation	Loss	Depreciation
2007-2008	2,50,000	3,00,000	2,00,000	2,50,000
2008-2009	Nil	2,70,000	1,00,000	1,80,000
2009-2010	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 2011-12 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.

Answer

Computation of total income of M/s Hyper Ltd. for the A.Y. 2011-12

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 on 31.3.2011 and tax deposited on 31.7.2011 [allowed under section 40(a)(ia)]	Nil	
Depreciation debited to profit and loss account [only depreciation calculated as per Income-tax Rules is allowable as deduction]	3,60,000	8,50,000
		22,75,000
Less: Items credited but not includible under business income or are exempt under the provisions of the Act		

Assessment of Various Entities

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	
	<u>7,65,000</u>	
		15,10,000
Less: Depreciation (allowable as per Income-tax rules)		<u>2,80,000</u>
		12,30,000
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		<u>1,70,000</u>
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)	<u>3,60,000</u>	Nil
Income from Other Sources		
Income from units of UTI	75,000	
Less: Exempt under section 10(35)	<u>75,000</u>	Nil
Total Income		<u>1,70,000</u>
Tax payable @ 30%		51,000
Add: Education cess @ 2%	1,020	
Secondary and higher education cess @ 1%	510	1,530
Tax Payable as per the Income-tax Act		<u>52,530</u>

Computation of Book Profit under section 115JB

Particulars	Rs.	Rs.
Net Profit as per Profit & Loss Account		14,25,000

Direct Tax Laws

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 debited to profit and loss account	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

18% of book profit		1,93,500
Add: Education cess @ 2%	3,870	
Secondary and higher education cess @ 1%	1,935	5,805
		1,99,305

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 18% of book profit, the book profit shall be deemed as the total income and the tax payable on such total income shall be 18% 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 18% of book profit, the book profit of Rs.10,75,000 is deemed to be the total income and income-tax is payable @ 18% thereof plus education cess @ 2% and secondary and higher education cess @ 1%. The tax liability, therefore, works out to be Rs.1,99,305.

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 ten assessment years succeeding the assessment year in which the credit became allowable.

Assessment of Various Entities

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	1,99,305
Less: Tax on total income computed as per the other provisions of the Act	52,530
Tax credit to be carried forward under section 115JAA	1,46,775

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, 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, 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.

Question 9

The net profit for the year ended on 31.3.2011 of India Biotech Ltd. engaged in the business of bio-technology works out to Rs.45 lacs after debit/credit of the following items:

- (i) Profit of Rs.2,50,000 from a hedging contract entered into for meeting out the loss in foreign currency payments towards an imported machinery of Rs.80 lacs installed on 1.2.2011.
- (ii) Incidental charges of Rs.20 lacs paid to a financial institution for taking short-term loan of Rs.25 crores repayable in 18 months.
- (iii) Commission of Rs.25,000 paid to a recovery agent for getting realisation of an old outstanding. Tax deducted and remitted as per Chapter XVII-B of the Act.
- (iv) Registration fees of Rs.20,000 and listing fees of Rs.30,000 paid to the Registrar of Companies and the Stock Exchange respectively on the issue of bonus shares.
- (v) Amount of Rs.1,00,000 towards carry forward losses for Asst. year 1998-99 of X Ltd., which got merged with the company during the financial year 2003-04.
- (vi) Interest received from banks of Rs.90,000 net of TDS of Rs.10,000.

Direct Tax Laws

(vii) Amount of Rs.1,50,000 incurred towards reconditioning of generator.

(viii) Employer's share to the EPF for the month of March, 2011 of Rs.40,000. The amount was deposited with the PF Commissioner on 22.4.2011.

Compute the total income of the company for Asst. year 2011-12 and give brief reasons for the treatment given to each of the items.

Answer

Computation of Total Income of India Biotech Ltd. for A.Y. 2011-12

Particulars	Amount Rs.	Amount Rs.
Income from business		
Net Profit as per profit and loss account		45,00,000
Less: Items credited but to be considered separately		
Profit from hedging contract	2,50,000	
Interest from banks	<u>90,000</u>	<u>3,40,000</u>
		41,60,000
Add: Employee's share already charged in Profit & Loss Account is allowable under section 43B since it is deposited before the due date of filing return under section 139(1) i.e. 30.09.2011.		<u>NIL</u>
		41,60,000
Add: Depreciation on plant and machinery on account of hedging profit (7.5% on Rs.2,50,000)	18,750	
Additional depreciation (10% on Rs.2,50,000)	<u>25,000</u>	<u>43,750</u>
		42,03,750
Income from other sources		
Interest received from banks (gross)		<u>1,00,000</u>
Total Income		<u>43,03,750</u>

Notes -

1. Hedging contract is entered into for safeguarding against any loss that may arise due to currency fluctuation. The profit from such contract entered into for meeting loss in foreign currency payments towards imported machinery has to be adjusted against the cost of plant and machinery. Consequently, the same will have an impact on depreciation and additional depreciation on imported plant and machinery. It is presumed that the conditions for claim of additional depreciation are satisfied and accordingly, the additional depreciation has been charged to profit and loss account. Since there is a reduction in

the cost of plant and machinery on account of the hedging profit of Rs.2,50,000, the excess depreciation and additional depreciation debited to the profit and loss account have to be added back to the profits.

2. Incidental charges incurred for raising short term loan from financial institutions is allowable as deduction, since, as per CBDT letter F.No.32/6/62-IT(A-1) dated 16.1.1963,—
 - (i) it is in respect of a short term loan of a duration of not more than 2 years; and
 - (ii) it does not exceed 1% of Rs.25 crores, being the amount of loan raised.
3. Commission of Rs.25,000 paid to a recovery agent for realisation of old outstanding is an allowable expense under section 37 as per *DCIT v. Super Tannery (India) Ltd. (2005) 274 ITR 338 (All)*.
4. The Supreme Court has, in *CIT v. General Insurance Corporation (2006) 286 ITR 232*, observed that the issue of bonus shares does not result in expansion of the capital base of the company. Therefore, the expenditure incurred by the company on account of registration fees and listing fees for the issue of bonus shares is allowable as revenue expenditure.
5. As per section 72A, the unabsorbed business loss of the amalgamating company shall be deemed to be the loss of the amalgamated company for the previous year in which the amalgamation took place. Therefore, such loss can be set-off against the income of the amalgamated company in the year of amalgamation and the balance, if any, can be carried forward and set-off against the business income of the amalgamated company in the subsequent years. Such loss can be carried forward by the amalgamated company for a maximum period of 8 years from the year of amalgamation. In this case, the amalgamation took place in the financial year 2003-04 and therefore, the 8 year period has not expired in the financial year 2010-11. Therefore, the set-off of losses of Rs.1 lakh relating to X Ltd. is in order. It is assumed that the conditions specified in section 72A are satisfied.
6. Interest received from banks is chargeable to tax under the head "Income from other sources", assuming that there is no nexus between the interest income and the business of the assessee. For this purpose, the net amount of interest has to be grossed up by adding the amount of TDS of Rs.10,000. Since the net interest of Rs.90,000 is credited to profit and loss account, the same has to be reduced to compute the business income.
7. Expenditure on reconditioning of the generator is in the nature of normal repairs and is eligible for deduction under section 31.

Question 10

Prakash, a member in two AOPs, namely, "AOP & Co." and "Prakash & Akash", provides the following details of his income for the year ended on 31.3.2011:

- (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.

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- (b) A house property located at Jaipur was purchased on 1.7.2005 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 2010-11 on the borrowed capital was Rs.1,60,000.

Compute the income and the tax liability thereon for the A.Y. 2011-12 and support your answer with brief reasons and the provisions of the Act.

Answer

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		NIL

Question 11

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 31.3.2011:

- (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 1.4.2010 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. 2009-10 for Rs.20 lacs and were available in the stock on 1.4.2010 cost 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) 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.*
- (c) Amount of Rs.40,000 each was paid in cash to the suppliers of vegetables, milk products and eggs on 05.09.2010 because of suspension of banking operations due to strike of bank employees.*
- (d) Amount of Rs.5 lacs written off in the F.Y. 2008-09 as irrecoverable from a travel agent; an amount of Rs.2 lacs out of it was recovered on 13.3.11 and credited to a reserve account.*

Compute the income chargeable to tax for A.Y. 2011-12 and give reasons in brief for treatment given to each of the items.

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Answer

Computation of taxable income of M/s. HSP for the A.Y.2011-12

Particulars	Amount in Rs.
Income from business and profession	
Net profit as per profit and loss account	2,00,00,000
<i>Add : Items charged in profit and loss account which are not allowable</i>	
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
<i>Add : Recovery of bad debts credited in reserve but chargeable under section 41 (4)</i>	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 payment to a non-resident outside India without deduction of tax at source is an allowable expense notwithstanding the withdrawal of CBDT Circular No.786 dated 7.2.2000 by means of Circular No.7 of 2009 dated 22.10.2009 as there is no income accruing or arising to the non-resident in India.
- (8) 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.
- (9) 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 12

M/s. HIG, a firm, consisting of three partners namely, H, I and G, carried on the business of purchase and sale of television sets in wholesale and manufacture and sale of pens under a deed of partnership executed on 1.4.2006. H, I and G were partners in their individual capacity.

The deed of partnership provided for payment of salary amounting to Rs.1,25,000 each to H and G, who were the working partners. A new deed of partnership was executed on 1.10.2010 which, apart from providing for payment of salary to the two working partners as mentioned in the deed of partnership executed on 1.4.2006, for the first time provided for payment of simple interest @ 12% per annum on the balances standing to the credit of the Capital accounts of partners from 1.4.2010.

The firm was dissolved on 31.3.2011 and the Capital assets of the firm were distributed among the partners on 20.4.2011. The net profit of the firm for the year ending 31.3.2011 after payment of salary to the working partners and debit/credit of the following items to the Profit and Loss Account was Rs.1,50,000:

- (i) *Interest amounting to Rs.1,00,000 paid to the partners on the balances standing to the credit of their capital accounts from 1.4.2010 to 31.3.2011.*
- (ii) *Interest amounting to Rs.50,000 paid to the partners on the balances standing to the credit of their Current accounts from 1.4.2010 to 31.3.2011.*
- (iii) *Interest amounting to Rs.20,000 paid to the Hindu undivided family of partner H @ 18% per annum.*

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- (iv) *Payment of Rs.25,000 towards purchase of television sets made by crossed cheque on 1.11.2010.*
- (v) *Rs.30,000 being the value of gold jewellery received as gift from a manufacturer for achieving sales target.*
- (vi) *Depreciation amounting to Rs.15,000 on motor car bought and used exclusively for business purposes, but not registered in the name of the firm.*
- (vii) *Depreciation under section 32(1)(ii) amounting to Rs.37,500 of new machinery bought and installed for manufacture of pens on 1.11.2010 at a cost of Rs.5,00,000. There was no increase in the installed capacity as a result of the installation of the new machinery.*
- (viii) *Interest amounting to Rs.25,000 received from bank on fixed deposits made out of surplus funds.*

The firm furnishes the following information relating to it:

- (a) *Closing stock-in-trade was valued at Rs.60,000 as per the method of lower of cost or market rate consistently followed by it. The market value of the closing stock-in-trade was Rs.65,000.*
- (b) *Brought forward business loss relating to the assessment year 2010-11 was Rs.50,000.*
- (c) *The fair market value of the capital assets as on 31.3.2011 was Rs.20,00,000 and the cost of their acquisition was Rs.15,00,000.*

Compute the total income of M/s. HIG for the assessment year 2011-12.

You are required to furnish explanations for the treatment of the various items given above.

Answer

Computation of total income of M/s.HIG for the A.Y. 2011-12

Particulars	Rs.	Rs.
Net profit as per profit & loss account		1,50,000
Add: Interest to partners on capital accounts for the period from 1.4.2010 to 30.9.2010 (Rs.1,00,000 but deduction limited to 6 months only hence 50% thereof is deductible and the balance is added)	50,000	
Interest to partners on current accounts from 1.4.2010 to 31.3.2011 – not authorized by the deed, hence disallowed.	50,000	
100% of Rs.25,000 paid towards purchase of television sets (being stock in trade, hence disallowed)	25,000	
Difference on account of valuation of closing stock-in-trade at market value (Rs.65,000 less Rs.60,000)	5,000	

Assessment of Various Entities

Salary paid to working partners considered separately	2,50,000	
		3,80,000
		5,30,000
Less: Additional depreciation on new machinery (5,00,000 × 20%)= Rs.1,00,000. Only 50% is allowable as deduction.		50,000
		4,80,000
Less: Interest received from bank on fixed deposits considered separately		25,000
		4,55,000
Less: Salary to working partners -		
(i) As per limit in section 40(b)		
On first Rs.3,00,000 @ 90%	2,70,000	
On the balance of Rs.1,55,000 @ 60%	93,000	
	3,63,000	
(ii) Salary actually paid Rs.	2,50,000	
Deduction allowed being (i) or (ii) whichever is less		2,50,000
		2,05,000
Less: Business loss relating to assessment year 2008-09 set off		50,000
Income from business		1,55,000
Income from other sources		
Interest received from bank on fixed deposits		25,000
Total Income		1,80,000

Explanation for the treatment of various items

- (i) Interest to partners authorised by the partnership deed will be allowed as deduction only for the period beginning with the date of the partnership deed and not for any earlier period as per section 40(b)(iv). Therefore, interest paid to the partners on the balances standing to the credit of their capital accounts from 1.10.2010 alone is eligible for deduction, since the partnership deed was executed only on 1.10.2010. Interest for the period prior to 1.10.2010 is not allowed.
- (ii) The partnership deed of 1.10.2010 provides for payment of interest on balances in capital accounts of partners only. As such, the interest paid on the balances standing to the credit of the current accounts of partners is not allowable under section 40(b). The Kerala High Court has, in *Novel Distributing Enterprises v. DCIT & Anr. (2001) 251 ITR 704 (Ker)*, on identical facts, held that interest paid to the partners on their current account balances is not allowable.

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- (iii) Since H is a partner in his individual capacity, interest paid to the Hindu Undivided Family of partner H does not attract disallowance under section 40(b)(iv).
- (iv) Section 40A(3) provides for disallowances @ 100% of the expenditure incurred otherwise than by an account payee cheque / account payee bank draft. Since the firm has made payment of Rs.25,000 towards purchase of television sets after 13.7.2010 by a crossed cheque and not by an account payee cheque, 100% of such expenditure would be disallowed.
- (v) Gold jewellery valued at Rs.30,000 received as gift from a manufacturer for achieving sales target is taxable under section 28(iv), being a benefit arising from business.
- (vi) Depreciation on motor car bought and used exclusively for the purposes of business is allowable though not registered in the name of the firm in view of the ratio of the decision of the Supreme Court in *Mysore Minerals Ltd. v. CIT* (1999) 239 ITR 775.
- (vii) The firm is entitled to additional depreciation @ 20% under section 32(1)(ia) in respect of the new machinery installed for manufacture of pens. Since the new machinery is put to use for less than 180 days during the relevant previous year, the additional depreciation is restricted to 50% of the prescribed rate of 20% i.e. it is restricted to 10%.
- (viii) Interest received from bank on fixed deposits made out of surplus funds is assessable under the head 'Income from other sources'. Hence, it is not taken into account for the purpose of computing book-profit.
- (ix) The Supreme Court has, in *A.L.A Firm v. CIT* (1991) 189 ITR 285, held that the closing stock has to be valued at market rate in the case of a dissolved firm. As such, the closing stock-in-trade of the firm has to be valued at the market rate.
- (x) Net profit shown in the profit and loss account computed in the manner laid down in Chapter IV-D as increased by the aggregate amount of the remuneration paid or payable to all the partners constitutes book profit as per *Explanation 3* to section 40(b). Carry forward and set off of business loss is covered under Chapter VI. Hence, brought forward business loss relating to the assessment year 2010-11 is not considered for calculation of book-profit.
- (xi) Section 45(4) is not applicable to the firm for the assessment year 2011-12, though the dissolution of the firm took place on 31.3.2011, there was no transfer by way of distribution of capital assets during the relevant previous year. The distribution of the capital assets took place on 20.4.2011. The capital gains will be assessable in the assessment year 2012-13.

Question 13

RST Ltd. is engaged in the manufacture and sale of drugs and pharmaceuticals. Its net profit for the year ending 31-3-2011 after debit/credit of the following items to the Profit and Loss Account was Rs.28,00,000.

- (i) *Income-tax paid on non-monetary perquisites provided to the employees Rs.1,00,000.*

Assessment of Various Entities

- (ii) Legal fees incurred in defending title to factory premises Rs.2,00,000.
- (iii) Expenditure on scientific research (not in respect of cost of land or building) on in-house research and development facility approved by the prescribed authority Rs.10,00,000.
- (iv) Interest paid on arrears of sales tax Rs.1,00,000.
- (v) Cash payment of Rs.20,000 made on 10.10.2010 to a supplier towards purchase of raw material.
- (vi) Rent received from letting out vacant land Rs.1,00,000.
- (vii) Arrears of rent received in respect of a house property, which was let out in the earlier years and which was not charged to tax in any earlier year Rs.2,00,000. The said property was sold during the year ending 31.3.2009.

The company had paid royalty in India to a foreign company amounting to Rs.3,00,000 on 1.5.2009, which was disallowed by the Assessing Officer for the assessment year 2010-11 since tax was not deducted thereon. The company deducted and paid tax at source on the said amount of royalty on 1.1.2011.

The company has brought forward loss from property relating to the assessment year 2009-10 amounting to Rs.40,000.

Compute the total income of RST Ltd. for the assessment year 2011-12.

Furnish explanations for the treatment of the various items given above.

Answer

Computation of total income of RST Ltd for the assessment year 2011-12

Particulars	Rs.	Rs.
Profits and gains of business or profession		
Net profit as per profit and loss account		28,00,000
Add: Income-tax paid on non-monetary perquisites provided to employees not allowable [Section 40(a)(v)]		<u>1,00,000</u>
		29,00,000
Less: Deduction / Additional deduction allowable		
Additional sum allowable towards scientific research expenditure [Section 35(2AB)(1) @ 200%].	10,00,000	
Royalty paid during the year 2009-10, without deduction of tax, disallowed in A.Y. 2010-11, now allowable as tax thereon is deducted and paid	<u>3,00,000</u>	13,00,000
		<u>16,00,000</u>
Less: Income credited in the profit and loss account to be		

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considered under other heads of income

Rent received from letting out vacant land	1,00,000	
Arrears of rent received in respect of property let out in the earlier years	<u>2,00,000</u>	3,00,000
		<u>13,00,000</u>

Income from house property

Arrears of rent received in respect of property let out in earlier years	2,00,000	
Less: 30% of Rs.2,00,000	<u>60,000</u>	
	1,40,000	
Less: Brought forward loss from property relating to A.Y.2009-10 set off	<u>40,000</u>	1,00,000

Income from other sources

Rent received from letting out vacant land		<u>1,00,000</u>
Total Income		<u>15,00,000</u>

Explanations for the treatment of the various items are furnished herein below -

- (i) Income-tax paid by an employer on non-monetary perquisites provided to the employees is not deductible as per section 40(a)(v).
- (ii) Legal fees incurred in defending title to factory premises is an expenditure incurred wholly and exclusively for the purpose of business and is, therefore, allowable under section 37(1). This was held by the Supreme Court in *Dalmia Jain & Co. Ltd. v. CIT* (1971) 81 ITR 754.
- (iii) Expenditure on scientific research incurred by the company is entitled to deduction at 2 times as per section 35(2AB)(1). Since the company has debited Rs.10,00,000 in the profit and loss account, the additional deduction of Rs.10,00,000 is claimed while computing its total income.
- (iv) Interest paid on arrears of sales tax is not penal in nature but is compensatory in character and is an allowable deduction under section 37(1) as held by the Supreme Court in *Lachmandas Mathurdas v. CIT* (2002) 254 ITR 799.
- (v) Disallowance under section 40A(3) is attracted where cash payment in excess of Rs.20,000 is made in respect of any expenditure. In such a case, 100% of the expenditure is disallowed. Since the cash payment made by the company is Rs.20,000, that is, not exceeding Rs.20,000, the expenditure does not attract disallowance under section 40A(3).

- (vi) Rent received from letting out vacant land is assessable under the head "Income from other sources".
- (vii) Arrears of rent received in respect of the house property let out in earlier years is deemed to be income from house property in the year of receipt. Such arrears of rent, after deduction of 30% thereof, is assessable as income from house property even though the assessee is not the owner of the property in the year of its receipt as provided in section 25B.
- (viii) Royalty paid during the year 2009-10 in respect of which tax was deducted and paid during the previous year ending 31.3.2011 is allowable as deduction for the assessment year 2011-12 as per the proviso to section 40(a)(i).
- (ix) Brought forward loss from house property relating to the assessment year 2009-10 is set off against the deemed income from house property for the assessment year 2011-12 in accordance with the provisions of section 71B.

Question 14

ABC Ltd. is engaged in the manufacture and sale of textiles. Its net profit for the year ending 31.3.2011 after debit/credit of the following items to the Profit and Loss Account was Rs.75,00,000:

- (i) *Payment to two employees of Rs.2,50,000 each in connection with their voluntary retirement.*
- (ii) *Income- tax paid Rs.1,00,000.*
- (iii) *Charges of Rs.2,00,000 paid for the advertisement in souvenir published by a Political Party registered with the Election Commission of India.*
- (iv) *Retrenchment compensation paid to employees of one of the units closed down during the year Rs.10,00,000.*
- (v) *Capital expenditure incurred for the purpose of promoting family planning amongst its employees Rs.3,00,000.*
- (vi) *Interest paid under section 234B for short payment of advance tax pertaining to the assessment year 2010-11 Rs.1,10,000.*
- (vii) *Loss incurred in transactions of purchase and sale of shares of various companies Rs.3,00,000.*
- (viii) *Compensation received from supplier for delay in supply of raw materials Rs.1,00,000.*
- (ix) *Dividend received from a foreign company Rs.2,00,000.*

Compute the total income of ABC Ltd. for the assessment year 2011-12.

Furnish explanations for the treatment of the various items given above.

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Answer

Computation of total income of ABC Ltd. for the Assessment Year 2011-12

Particulars	Rs.
Net profit as per Profit and Loss Account	75,00,000
Add: Inadmissible expenditure	
4/5 th of Rs.5,00,000 paid to employees on voluntary retirement [1/5 th is allowable as deduction u/s 35DDA]	4,00,000
Income-tax paid – disallowed u/s 40(a)	1,00,000
Advertisement charges of souvenir of political party u/s 37(2B)	2,00,000
4/5 th of Rs.3,00,000, being capital expenditure incurred for promoting family planning amongst employees [1/5 th is allowable as deduction u/s 36(1)(ix)]	2,40,000
Interest paid u/s 234B	1,10,000
Loss incurred in transactions of purchase and sale of shares [assumed as speculation loss]	3,00,000
	88,50,000
Less: Dividend received from a foreign company considered under the head 'Income from other sources'	2,00,000
Business income	86,50,000
Income from other sources	
Dividend received from a foreign company	2,00,000
Gross total income	88,50,000
Less: Deduction u/s 80GGB – In respect of advertisement in souvenir published by a political party registered with Election Commission of India	2,00,000
Total income	86,50,000

Explanations for the treatment of the various items in computing the total income of the company are furnished below -

- (i) Section 35DDA provides for amortisation of expenditure incurred under voluntary retirement scheme over a period of five years in equal instalments. The company is, therefore, entitled to deduction of Rs.1,00,000, being one-fifth of the total sum of Rs.5,00,000 paid to the two employees in connection with their voluntary retirement for the relevant assessment year.
- (ii) Income tax paid is not allowable as deduction from business profits as per section 40(a).

- (iii) Section 37(2B) prohibits allowance of any expenditure incurred by an assessee on advertisement in any souvenir, brochure, pamphlet or the like published by a political party. As such, advertisement charges paid in respect of souvenir published by a political party is not allowable as deduction from business profits of the company.
- However, under section 80GGB, expenditure incurred by an Indian company on advertisement in any publication, including a souvenir, by a political party is deemed to be a contribution of such amount to the political party and is, therefore, allowable as deduction in the hands of the company. It is logical to presume that ABC Ltd. is an Indian company.
- (iv) Retrenchment compensation paid to employees at the time of closure of one of the units of the business is allowable as per the decision of the Allahabad High Court in *CIT V. JK Cotton Spinning & Weaving Co. Ltd. (2005) 145 Taxman 591*.
- (v) Capital expenditure incurred for the purpose of promoting family planning amongst employees is deductible over a period of 5 years as per the first proviso to section 36(1)(ix). Hence, only Rs.60,000 is deductible in the current year in respect of such expenditure incurred by the company.
- (vi) Interest paid for delayed payment of tax by the assessee is part and parcel of the liability to pay income-tax. When income-tax paid is itself not allowable as a deduction under section 40(a)(ii), the interest paid under section 234B cannot qualify for deduction. Thus, interest paid under section 234B is not deductible.
- (vii) Loss of Rs.3 lakhs incurred by the company in dealing of shares constitutes speculation loss in view of the Explanation to section 73. In the absence of any speculative profit for the year, speculation loss is to be carried forward under section 73(2) for set off against speculation profits of subsequent assessment years. It can be carried forward for a maximum of 4 assessment years
- (viii) Compensation received from supplier for delay in supplying the raw materials is a trading receipt.
- (ix) Dividend received from a foreign company is assessable under the head "Income from other sources".

Question 15

- (a) *T and Q are individuals, who constitute an Association of persons, sharing profit and losses in the ratio of 2:1. For the accounting year ended 31st March, 2011, the Profit and Loss account of the business was as under:*

Figures are in Rs. '000s			
Cost of goods sold	4,250	Sales	4,900
Remuneration to:		Dividend from Indian companies	25
T	130	Capital gains-Long term	640
Q	170		

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Employees	256	
Interest to:		
T	48.3	
Q	35.7	
Other expenses	111.7	
Sales-tax penalty due	39	
Net profit	524.3	
	<u>5,565</u>	<u>5,565</u>

Additional information furnished:

- (i) Other expenses included:
- (a) entertainment expenses of Rs.35,000;
 - (b) wristwatches costing Rs.2,500 each were given to 12 dealers, who had exceeded the sales quota prescribed under a sales promotion scheme;
 - (c) employer's contribution of Rs.6,000 to the Provident Fund was paid on 14th January, 2011.
 - (d) Rs.30,000 was paid in cash to an advertising agency for publicity.
- (ii) Outstanding sales tax penalty was paid on 15th October, 2011. The penalty was imposed by the Sales-tax Officer for non-filing of returns and statements by the due dates.

T and Q had, for this year, income from other sources of Rs.3,00,000 and Rs.1,32,000 respectively.

Required to :

- (i) Compute the total income of the AOP for the assessment year 2011-12;
- (ii) Ascertain the tax liability of the association for that year; and
- (iii) Ascertain the tax liability for that year of the individual members.

Answer

(i) **Computation of total income of the AOP for A.Y.2011-12**

Particulars	Rs.	Rs.
Profit & gains of business (See Working Note below)		3,12,300
Long term capital gain		6,40,000
Income from other sources [Dividend is exempt u/s 10(34)]		-
Total income		<u>9,52,300</u>

Working Note -

Computation of profits and gains of business

Net profit as per profit & loss account		5,24,300
Add: Inadmissible payments		
Interest to members T & Q (Rs.48,300 + Rs.35,700)	84,000	
Advertising [Disallowance u/s 40A(3) (100% of Rs.30,000 being a cash payment)]	30,000	
Remuneration to members T & Q (Rs.1,30,000 + Rs.1,70,000)	3,00,000	
Sales tax penalty (See Note 3 below)	39,000	4,53,000
		9,77,300
Less: Income not taxable under this head		
Dividend from Indian companies	25,000	
Long term capital gain	6,40,000	6,65,000
Profits and gains of business		3,12,300

(ii) Computation of tax liability of the AOP for A.Y.2011-12

<i>Particulars</i>	<i>Rs.</i>	<i>Rs.</i>
Long-term capital gain (Rs.6,40,000 @ 20%)		1,28,000
Other income (Rs.3,12,300 @ 30%)		93,690
Tax on total income		2,21,690
Add: Education cess @3%		6,650
Total tax due		2,28,340

Notes –

- Since one of the members has individual income more than the basic exemption limit, the AOP will be assessed at the maximum marginal rate. The maximum marginal rate includes the surcharge applicable in relation to the highest slab of income in case of an individual. As such surcharge shall not be chargeable as the total income does not exceed the prescribed limit.

Since the AOP is taxed at maximum marginal rate, the share income of members is not taxable in their hands individually.
- Since the employer's contribution to PF has been paid during the previous year itself, it is allowable as deduction.
- Penalty imposed for delay in filing sales tax return is not deductible since it is on account of infraction of the law requiring filing of the return within the specified period. – *CIT v. Ratanchand Bholanath (S.S) (1986) 160 ITR 500 (M.P.)*

(iii) Computation of tax liability of members T & Q for the A.Y.2011-12

Members of the AOP have to pay tax on their total income taking in to account savings/ investments etc. The share income from AOP is not taxable in their personal assessment.

Question 16

A domestic company is liable to pay minimum alternate tax under section 115JB for the Assessment Year 2011-12. While computing book profit under section 115JB the company claims provision for deferred tax charged to Profit & Loss account in accordance with Accounting Standard-22 of the Institute of Chartered Accountants of India, which is sought to be disallowed by the Assessing Officer. Is the action of the Assessing Officer valid in law?

Answer

Clause (h) to the Explanation to section 115JB provides that the amount of deferred tax and any provision therefor, is to be added to the net profit of the company. Similarly, any amount credited to profit and loss account being the amount of deferred tax is to be reduced / deducted for computing the book profit under section 115JB. Therefore, the action of the Assessing Officer is valid in law.

Question 17

Netherlands Oil Corporation is a Foreign Company engaged in the exploration of oil and gas in all countries including India. In respect of its Indian business, the company has prepared the Profit and Loss Account in accordance with Part II and III of Schedule VI to the Companies Act, 1956 and such Profit and Loss Account for the previous year ended 31.03.2011 shows a Net Profit of Rs.65 lakhs. The Net Profit from activities in all other countries stands at Rs.550 lakhs. The company informs that while arriving at the Net Profit as indicated above in respect of Indian business, the following debits/credits have been made in its Profit and Loss Account.

Credits to the Profit and Loss Account	Rs.(in Lakhs)
(i) Net agricultural income in India	16
(ii) Share of profits from a firm engaged in business in India	15
(iii) Amount withdrawn from Reserve created during 2007-08 (Book Profit was increased by the amount transferred to such reserve in the A.Y 2008-09)	3
(iv) Profits from an Industrial Undertaking covered and qualified for deduction under Section 10B of Income-tax Act, 1961.	30
(v) Profits from an Industrial Undertaking covered and qualified for deduction under Section 80-IC of Income-tax Act, 1961.	6

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Debits to the Profit and Loss Account	Rs.(in Lakhs)
(i) Expenditure relating to 10B undertaking	12
(ii) Depreciation for current year under Companies Act, 1956	24
(iii) Interest to Financial Institutions not paid upto the date of filing the return	6
(iv) Penalty for infraction of law	1
(v) Proposed Dividend	3
(vi) Provision for Taxation (Income-tax)	2
(vii) Transfer to General Reserve	5
(viii) Provision for Unascertained Liabilities	2
(ix) Expenditure relating to 80-IC undertaking	5

The following additional information is also provided:

	Rs.(in lakhs)
Brought forward loss (As per books of account)	12
Depreciation allowable under Income-tax rules.	30
Brought forward business loss and unabsorbed depreciation as per Income-tax law.	18

(Loss Rs.8 lakhs and Depreciation Rs. 10 lakhs)

You are requested to compute the total tax liability of the company for the Assessment Year 2011-12.

Answer

Computation of Book Profit in accordance with section 115JB of the Income-tax Act, 1961.

	Rs. in lakhs	Rs. in lakhs
Net Profit as per Profit & Loss Account		65
Add: Transfer to General Reserve	5	
Proposed dividend	3	
Provision for taxation	2	
Provision for unascertained liabilities	2	<u>12</u>
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Less: Amount transferred from reserve and credited to profit and loss account to be excluded since it was already subjected to adjustment in the assessment year 2008-09	3	
Net Agricultural Income {Section 10 (1)}	16	
Share of Profit from a firm {Section 10(2A)}	<u>15</u>	34
Business loss brought forward or unabsorbed depreciation, whichever is lower.		Nil
Book Profit	(A)	<u>43</u>

Computation of Total Income as per the Income Tax Act, 1961

	<i>Rs. in lakhs</i>	<i>Rs. in lakhs</i>
Net Profit as per Profit & Loss Account		65
Add: Transfer to General Reserve	5	
Proposed Dividend	3	
Provision for taxation	2	
Provision for unascertained liabilities	2	
Expenditure relating to an undertaking eligible for deduction under section 10B	12	
Expenditure relating to an undertaking eligible for deduction under section 80-IC	5	
Depreciation as per books of account	24	
Interest to financial institutions disallowed Under section 43B	6	
Penalty for infraction of law	<u>1</u>	<u>60</u>
		125
Less: Income exempt from tax		
Net agricultural Income under section 10(1) of the Act	16	
Amount withdrawn from General Reserve	3	
Share of profit from a firm under section 10(2A) of the Act	15	
Profits from Industrial Undertaking eligible for		

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Assessment of Various Entities

deduction under section 10B of the Act	30	
Profits from Undertaking eligible for deduction under section 80-IC of the Act	6	
Depreciation as per Income-tax Rules	<u>30</u>	<u>100</u>
Profits from business for the year		25
Less: Unabsorbed Depreciation under section 32(2)	10	
Brought forward loss under section 72	<u>8</u>	<u>18</u>
Total Income (B)		<u>7</u>

Computation of tax liability for the assessment year 2011-12

	Rs.	Rs.
1. Book profit as per (A)	43,00,000	
Tax thereon @ 18%		7,74,000
2. Total income as per (B)	7,00,000	
Tax on total income @ 40%		2,80,000

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 18% of book profit, the book profit shall be deemed as the total income and the tax payable on such total income shall be 18% 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 18% of book profit, the book profit of Rs.43,00,000 is deemed to be the total income and income-tax is payable @ 18% thereof plus education cess @2% and secondary and higher education cess @1%. The tax liability, therefore, works out to Rs.7,74,000.

Note:

1. Amount withdrawn from reserve is to be excluded while computing "Book Profit" as the said amount was added and increased the book profit of the earlier assessment year. Also, such amount would be excluded for computing total income as net profit of Rs.65 lakhs stands increased by the said credit of Rs.3 lakhs to the profit & loss account.
2. As per section 115JB of the Act, amount of loss brought forward or unabsorbed depreciation as per books, whichever is less, has to be reduced from net profit. As only brought forward loss is indicated at Rs.12 lakhs in the question, it has been assumed that there is no unabsorbed depreciation as per books of account. Therefore, no adjustment has been made in this respect for computing the "Book Profit".

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3. Since the company is a foreign company it is not liable to be taxed in respect of its profits attributable to its activities outside India.
4. Section 115JB of the Act does not provide for the increase of net profit by the amount of expenditure relatable to any income to which section 80-IC of the Act applies. It also does not provide for the exclusion of income relatable to industrial undertaking covered under section 10B of the Act. Accordingly, no adjustment in respect of both expenditure and income pertaining to an undertaking covered under sections 10B and 80-IC of the Act was made while computing book profit.
5. Profits from undertaking qualifying for deduction under section 10B of the Act is not eligible for exclusion from the assessment year 2008-09 onwards. Similarly, expenditure of the eligible undertaking covered by section 80-IC is not to be adjusted for the purpose of computing Book Profit under section 115JB

Note: It is possible to assume that the company, though a foreign company, has made prescribed arrangements for the declaration, distribution or payment of dividends in India, and accordingly calculate the tax at 30% plus education cess at 3% thereon treating it as a domestic company.

Question 18

A firm consisting of four partners was dissolved consequent to the death of one of the partners. The remaining partners reconstituted the firm immediately, without discontinuance of the business, and carried on the business as before. The inventory of stocks on the date of dissolution was valued at cost, which was lower than the market value and all other assets were valued at book value, for the purpose of transfer to the reconstituted firm. The Assessing Officer, while arriving at the total income of the firm was constituted prior to dissolution, valued the stocks as well as the other assets at market value. You are required to comment on the correctness of the Assessing Officer's action.

Answer

The position regarding the valuation of stocks and other assets on dissolution of a firm has been the subject matter of litigation for a long time. In *ALA Firm v. CIT 189 ITR 295*, the Supreme Court held that in taking accounts for the purposes of dissolution, the firm and partners would value the assets only on a realistic basis and not at cost or any other value appearing in the books of account.

In *Sakthi Trading Company v. CIT 250 ITR 871* the Supreme Court reviewed all the cases relating to valuation and held that in *ALA Firm's* case, there was not only a dissolution but also a discontinuance thereof and the stocks had therefore to be valued at market value for settling the accounts of the partners. Where there is no discontinuance of the business, the stocks have to be valued at cost or market value, whichever is lower. This is the established rule of commercial practice and accountancy.

In respect of other assets, section 45(4) will apply and hence other assets have to be valued at fair market value for the purpose of computing capital gains upon dissolution of firm due to death of a partner. Section 45(4) would be applicable only in the year where the distribution of assets takes place consequent to dissolution.

Question 19

“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, 2010 from Singapore to Mumbai and vice versa and collected charges thereof amounting to Rs.200 lacs. It left Mumbai port on 15.6.10 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 31.3.11. 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.

Answer

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.

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.

Question 20

The directors of a private company are personally liable to pay the income tax due from the company. Discuss.

Answer

Section 179 contains the provisions relating to the liability of directors of a private company in liquidation in respect of tax due from the company. Where any tax due from a private company in respect of income of any previous year or from any other company in respect of any income of any previous year during which such other company was a private company cannot be recovered, then, every person who was a director of such company at any time during the relevant previous year shall be jointly and severally liable for the payment of such

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tax. However, the director shall not be so liable if he proves that the non-recovery cannot be attributed to any gross neglect, misfeasance or breach of duty on his part in relation to the affairs of the company.

Question 21

In respect of the taxes due from a Private Limited company, which could not be recovered from it, the Tax Recovery Officer attached the properties of an erstwhile director for recovery thereof. It was contended by the director that a notice under section 156 had not been served on him and therefore, the proceedings for recovery were not valid. What is the correct legal position?

Answer

The liability of a director of a private limited company for arrears due from the company is provided in section 179. There is no necessity to issue a notice to a director, because the position of a person on whom liability is fastened is equated to that of an 'assessee' in default. For the purpose of section 220(4) of the Income-tax Act, the person held liable under section 179 would be deemed to be an assessee in default. This may be contrasted with the arrears of a partnership firm which may be recovered from the erstwhile partners only after issue of a notice under section 156 and a default is committed by them.

Under section 179 every person who was a director of a private limited company at any time during the relevant previous year shall be jointly and severally liable for the payment of taxes which cannot be recovered from the company, unless he proves that the non-recovery cannot be attributed to any gross negligence, misfeasance or breach of duty on his part in relation to the affairs of the company.

Question 22

The net profits of XYZ Ltd. for the year ended 31st March, 2011, after debiting/crediting the following items, were Rs.9 lakhs:

- (a) *The company had taken on lease an old building for the purposes of locating its business. Due to old age of the building, it was demolished and a new building put up, which was used for purposes of XYZ's business from September, 2010. The cost of the new building Rs.10 lakhs was written off as revenue expenditure. The lessor permitted the company to have an extension of the lease by another twenty years.*
- (b) *Rs.1 lakh was paid as an annual fee for technical services to a foreign collaborator under an agreement approved by the Government.*
- (c) *The company collected Rs.3 lakhs from its customers by way of sales tax in the year 2006-07 and had remitted it to the State Government in due time. On the levy being challenged in the High Court, the Court held the collection as illegal and the State Government in February, 2011 refunded the amount to the company.*

- (d) Land development charges of Rs.1.5 lakhs were paid to the State Industrial Development Corporation on allotment of a commercial plot.
- (e) A criminal case was filed against a Director of the company, in his official capacity. The company spent legal expenses of Rs.50,000 defending him in the proceedings. The Director was acquitted of the charges at the end.
- (f) The company issued in the year bonus shares to its shareholders and for that purpose had to enhance the authorised capital. Fees of Rs.1.5 lakhs were paid to the Registrar of Companies in this regard. These have been written off in the accounts as revenue expenses.
- (g) The company paid Rs.70,000 as interest on deposits to some of the non-resident buyers on advances received from them. No tax at source was deducted on the payment.
- (h) Overdraft interest of Rs.40,000 was paid to the company's bank to enable the company to pay its income tax dues.
- (i) The opening and closing stocks of the year were Rs.90,000 and Rs.1,17,000 respectively and were undervalued by 10% on cost.
- (j) Some investments were held by the company (not as stock in trade), which had to be depreciated by Rs.4.8 lakhs due to a directive from the Government.

The balance on 1st April, 2010 to the Profit and Loss Account, shown separately in the Balance Sheet, was a debit of Rs.2 lakhs.

The company had the following claims brought forward from the prior years:

Business losses relating to

Assessment year 2002-03	Rs.8 lakhs
Assessment year 2008-09	Rs.4 lakhs

Losses under the head capital gains -

Long-term

Assessment year 2009-10	Rs.3 lakhs
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Unabsorbed depreciation

(Both as per IT records and books of account of the company)	Rs.12.50 lakhs
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Required to :

- (a) Calculate the total income of XYZ Ltd. for the assessment year 2011-12 [Your answer should clearly indicate the reasons for the treatment of the individual items given above.]
- (b) Examine the applicability of section 115JB of the Income-tax Act to the company for the same assessment year.

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Answer

(a) Computation of total income of XYZ Ltd. for the A.Y.2011-12

Particulars	Rs.	Rs.
Net profit as per profit and loss account		9,00,000
Add: Cost of the new building – written off is a capital expenditure – disallowed.	10,00,000	
Land development charges paid to State Industrial Development Corporation is a capital expenditure – hence disallowed	1,50,000	
Fees paid to ROC for issuing bonus shares by increasing authorized capital is revenue expenditure – hence allowed. [<i>CIT v. General Insurance Corpn (2006) 156 Taxman 96 (SC)</i>]	Nil	
Interest on deposit to non-resident buyers without deduction of tax at source – disallowed under section 40(a)(i)	70,000	
Interest to bank on overdraft for payment of income-tax dues – disallowed as per Supreme Court's decision in <i>East India Pharmaceutical Works Ltd. v. CIT (1997) 224 ITR 627</i>	40,000	
Depreciation on investments not held as stock-in-trade	4,80,000	
Under valuation of stock $(1,17,000-90,000) \times 10/90$	3,000	<u>17,43,000</u>
		26,43,000
Less: Depreciation on building @10% on Rs.10 lakhs (See Notes 1 & 2)		<u>1,00,000</u>
Business Income		25,43,000
Less: Set-off of business loss and unabsorbed depreciation		
Business loss of A.Y.2002-03 cannot be set-off against business income of the current year, since business loss can be carried forward for a maximum period of 8 years only.	-	
Business loss of A.Y.2008-09	4,00,000	
Long-term capital loss of A.Y.2009-10 cannot be set-off against business income since as per section 74, long-term capital loss can be set-off only against long-term capital gains.		
Unabsorbed depreciation	<u>12,50,000</u>	<u>16,50,000</u>
Total Income		<u>8,93,000</u>

(b) Tax on total income as computed under the Income-tax Act

	Rs.
Tax on total income of Rs.8.93 lakhs	2,67,900
Add: Education cess and SHEC @ 3%	<u>8,040</u>
Tax on total income	<u>2,75,940</u>

(c) Computation of tax as per section 115JB

Net profit as per profit and loss account	9,00,000
Add: Decrease in value of investment not eligible for deduction if the amount is set aside by way of provision for diminution in value of asset	<u>4,80,000</u>
	13,80,000
Less: Business loss of Rs.2 lakhs (as per books of account as on 01.04.2010), since it is lower than the unabsorbed depreciation of Rs.12.50 lakhs	<u>2,00,000</u>
Book Profit	<u>11,80,000</u>
18% of book profit	2,12,400
Add: Education cess and SHEC @ 3%	<u>6,372</u>
	<u>2,18,772</u>

Since the income-tax payable on the total income of the company computed under the Income-tax Act is not less than 18% of its book profit, section 115JB will not apply for A.Y.2011-12.

Notes:

1. As per *Explanation 1* to section 32(1), where an assessee carries on business or profession in a building which is not owned by him but in respect of which he holds a lease or other right of occupancy, depreciation is to be allowed on account of any capital expenditure incurred by the assessee on construction of any structure for improvement/ renovation of the building as if the structure is a building owned by the assessee. Therefore, depreciation is allowable on the capital expenditure of Rs.10 lakhs incurred by XYZ Ltd. towards the cost of the new building put up after demolition of the old building.
2. The rate of depreciation on buildings is 10%. Since it is put to use for more than 182 days during the previous year 2010-11, full depreciation is allowable.
3. Payment of annual fees for technical services to a foreign collaborator is an allowable business expense and has been correctly charged to profit and loss account. Therefore, no adjustment is required.

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4. Sales tax refund from the Government has to be treated as a revenue receipt. Since it has been correctly credited to profit and loss account, no adjustment is required.
5. Land development charges paid to SIDC on allotment of a commercial plot is a capital expenditure [*Jaswant Trading Co. v. CIT (1995) 212 ITR 293 (Raj)*]
6. Section 37(1) does not make any distinction between expenditure incurred in civil litigation and that incurred in criminal litigation. If the expenditure is *bona fide* incurred wholly and exclusively for the purpose of the business, it is allowable as deduction [*CIT v. Birla Cotton Spinning & Weaving Mills Ltd. (1971) 82 ITR 166 (SC)*]. Therefore, in this case, since legal expenses were incurred by the company for defending the Director in a criminal case filed against him in his official capacity, it is allowable as deduction.
7. Fees paid to Registrar of Companies for enhancement of authorised capital to issue bonus shares is deductible since it is related to issue of bonus shares. Alternatively, if it is a mere increase in authorized capital then such expenditure is a capital expenditure and not deductible under section 37(1) [*Punjab State Industrial Development Corporation Ltd. v. CIT 225 ITR 792 (SC)*].
8. Since no tax has been deducted at source on payment of interest to non-residents, interest paid will not be allowed as a deduction as per section 40(a)(i).
9. Interest paid to bank on overdraft for payment of income-tax dues is not an expenditure incurred wholly and exclusively for the purpose of business and is hence, not deductible under section 37(1) as per the Supreme Court's decision in *East India Pharmaceutical Works Ltd. v. CIT (1997) 224 ITR 627*.
10. The under valuation of both opening and closing stocks will have an impact on the profits for the year and accordingly, the difference in valuation of stock has to be credited to profit and loss account to the extent of 10% of cost.
11. Value of investment written down is on capital account and hence not allowed, even if such write down was on a directive from the Government. Clause (i) of Explanation to section 115JB provides for increasing the net profit if any amount is set aside as provision for diminution in the value of any asset. Though it is stated as written off in the question, it is assumed that the charge to profit and loss account is by way of provision to meet possible loss in future and accordingly adjusted in the solution while computing book profit.

Question 23

Tarun Shipping Co. Ltd., having its registered office in Mumbai, plies two ocean-going vessels which it owns. The registered tonnage of the two vessels are 47,549 tonnes and 800 kgs and 25,759 tonnes and 400 kgs respectively. In the accounting year 2010-11, the first vessel was operated for 360 days and the second for 200 days.

The accounts of the company reveal the following results:

- | | |
|--|----------------|
| (i) Profit from core shipping activity | Rs.60.50 lakhs |
| (ii) Profit from incidental activity | Rs.15,000 |

Compute the tax payable by the company for the assessment year 2011-12, taking note of the provisions of the law relating to taxation of income of shipping companies. Also indicate the specified conditions for the applicability of the procedure.

Answer

Computation of tax payable by Tarun Shipping Company Ltd. for the A.Y.2011-12

Particulars	Rs.
Tonnage income (See Working Note below)	59,43,000
Tax @ 30%	17,82,900
Add: Surcharge (Not applicable as the income is below Rs.100 Lakhs)	Nil
	17,82,900
Add: Education cess @ 3%	53,487
	53,487
Total tax payable	18,36,387
Round Off	18,36,390

Working Note

Since the income under tonnage tax scheme is lower than the normal income of Rs. 60.50 lakh, the tonnage tax scheme is taken for computing tax payable.

Computation of Tonnage Income [Section 115VG]

Particulars	Ship 1 Rs.	Ship 2 Rs.
First 1,000 tons (1000 x 46/100)	460	460
Next 9,000 tons (9,000 x 35/100)	3,150	3,150
Next 15,000 tons (15,000 x 28/100)	4,200	4,200
Balance [(22,500/800) x 19/100]	4,275	152
	12,085	7,962

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Tonnage income -

Ship 1 (12,085 × 360)	43,50,600
Ship 2 (7,962 × 200)	15,92,400
	59,43,000

Note: Tonnage is to be rounded off to the nearest multiple of 100 tons. Hence, the first vessel will pay for 47,500 tons and the second for 25,800 tons.

As per section 115VF, the tonnage income computed under section 115VG would be deemed to be the profits chargeable under the head "Profits and gains of business or profession". This is, however, subject to fulfillment of the conditions mentioned below in the next paragraph. Then, the relevant shipping income referred to in section 115-VI(1), which includes the profit from core shipping activity (i.e. Rs.60.50 lakhs) and the profit from incidental activity (Rs.15,000), shall not be chargeable to tax.

The following are the conditions to be fulfilled by the company for applicability of the tonnage tax scheme -

- (i) An option to get assessed under Chapter XII-G has to be filed by the company.
- (ii) The company is required to credit to a reserve account called Tonnage Tax Reserve Account, at least 20% of the book profits derived from its core and incidental activities to be utilized before the expiry of a period of 8 years for acquisition of a new ship for the purposes of the business of the company. Until the acquisition of a new ship, the amount can be utilized for the purposes of the business of operating qualifying ships. However, the amount should not be used for distribution of dividends or profits or for remittance outside India as profit or for creation of assets outside India.

Question 24

SK Private Limited is engaged in the business of civil construction. The Profit and Loss account of the company for the year ended 31st March, 2011 is as under:

	Rs.		Rs.
Opening stock of building materials	40,000	Receipts from the business of Civil construction contracts	37,60,000
Salary to workers and Employees	4,10,000	Rent of godown	80,000
Purchase of building materials	24,00,000	Surplus from insurance compensation received for loss of plant and machinery by fire	2,00,000
Interest on loan	3,20,000	Interest on company deposits	25,000
Office administration		Dividend from companies	50,000
Expenses	2,60,000	Closing stock of building	

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Assessment of Various Entities

Travelling expenses	1,40,000	Materials	25,000
Municipal taxes on godown	12,000		
Insurance premium for godown	8,000		
Directors' remuneration	2,53,000		
Depreciation on plant and machinery	65,000		
Provision for tax:			
Current tax	1,00,000		
Deferred tax	<u>43,000</u>	1,43,000	
Net profit	89,000		
	<u>41,40,000</u>		<u>41,40,000</u>

The following additional information is also available :

- (i) Municipal tax of godown includes Rs.3,000 not paid by the company.
- (ii) The book value of the plant and machinery, which was insured against fire, was Rs.4,20,000. The written down value of plant and machinery block under section 43(6) as on 31st March, 2010 was Rs.1,85,000.
- (iii) The entire building materials were purchased from a firm in which the managing director of this company is a partner. The fair market value of the materials purchased is Rs.20,00,000.
- (iv) Interest on loan includes Rs.15,000 being interest on loan taken for investment in shares of various companies.
- (v) Office administration expenses include Rs.90,000 paid as a donation to a charitable organization recognized under Section 80G.
- (vi) The prescribed rate of depreciation under the Income-tax rules for plant and machinery is 15%.
- (vii) The company has decided to follow the presumptive tax provision in respect of its business income.

Compute the total income of SK Private Ltd. for the assessment year 2011-12. Your answer should include explanations of your treatment of various items. Ignore the provision of minimum alternate tax under Section 115JB.

Direct Tax Laws

Answer

Computation of total income of S.K. Private Limited for the A.Y. 2011-12

Particulars	Rs.	Rs.
A. Profits & gains of business		
Presumptive profit from the business of civil construction as per section 44AD (8% of Rs.37,60,000)		3,00,800
B. Capital Gains		
As per section 45(1A), where any money is received under an insurance from an insurer on account of damage to or destruction of any capital asset due to fire, any profit arising on receipt of such money is to be taxed as capital gains. For the purpose of section 48, the value of money received shall be deemed to be the full value of consideration received or accruing as a result of transfer of such capital asset.		
Amount received from insurance company (4,20,000 + 2,00,000)	6,20,000	
It is assumed that the surplus of Rs.2 lakhs credited to profit and loss account represents the surplus over the book value of plant and machinery.		
Less: WDV of the block as at 1 st April	1,85,000	
Short term capital gains		4,35,000
(Capital gains from transfer of a depreciable capital asset is deemed to be a short-term capital gain u/s 50)		
C. Income from house property		
Gross Annual Value	80,000	
(Rent from godown is taken to be the gross annual value in the absence of other information relating to municipal value, fair rent etc.)		
Less: Municipal tax actually paid (12,000-3,000)	9,000	
Net annual value	71,000	
Less: Deduction under section 24		
30% of net annual value u/s 24 (1)	21,300	
		49,700
D. Income from other sources		
Interest on company deposits	25,000	

Assessment of Various Entities

Dividend from companies [Exempt under section 10(34), assuming that dividend is from domestic companies]	-	25,000
Gross Total Income		8,10,500
Less: Deduction under Chapter VI-A		
Section 80G		
Donation to recognised charitable organisation		
Amount donated	90,000	
Qualifying Amount (restricted to 10% of Gross Total Income)	81,050	
Deduction under this section (50% of qualifying amount)		40,525
Total Income		7,69,975

Notes:

1. As per section 44AD, in the case of an assessee engaged in the business of civil construction or supply of labour for civil construction, an amount equal to 8% of gross receipts paid or payable to the assessee shall be deemed to be profits and gains from such business at the option of the assessee. The option is available if the gross receipt does not exceed Rs.60 lakhs in the relevant previous year. In this case, the company's gross receipt in the previous year on account of such business did not exceed Rs.60 lakhs. Thus, the company is entitled to exercise the option of paying tax under presumptive tax system.
2. Where the assessee opts for paying income tax under presumptive tax provisions of section 44AD, the deductions allowable under sections 30 to 38, including depreciation, shall be deemed to have been allowed. Therefore, separate deductions are not allowable for salary, purchase of materials, interest on loan, office administration expenses, travel expenses and directors' remuneration, since they are deemed to have been already allowed.
3. As deductions under sections 30 to 38 are deemed to have been allowed, the question of disallowance under section 40A(2) or any other provision does not arise. Therefore, even if the assessee company makes payment for purchase of materials to a firm, where the managing director is a partner, disallowance u/s 40A(2) is not attracted.
4. Similarly, WDV of assets used for such business shall be deemed to have been computed as if depreciation has been actually allowed.
5. Since dividend income is fully exempt under section 10(34), no deduction can be claimed in respect of any expenditure incurred to earn such income as per the provisions of section 14A. Therefore, interest on loan taken for investment in shares, dividend from which is exempt under section 10(34), is not allowable as deduction.

Question 25

A & Co. Limited, engaged in the business of manufacturing, shows a net profit of Rs.65.00 lacs for the financial year ended 31-3-2011. A scrutiny of the Profit & Loss Account revealed the following:

- (i) Rent of Rs.2.40 lakhs from a commercial property owned by the company and let to a bank was included in the profit.*
- (ii) Loss of Rs.5 lakhs due to non-realisation of advances given to a wholly owned subsidiary Company engaged in the business of hire-purchase financing charged to Profit & Loss Account.*
- (iii) The Company used to include interest cost in valuation of its finished stock upto the financial year 2009-10. During the financial year 2010-11 the Company changed its accounting policy and excluded interest cost in valuation of finished stock. This has resulted in a decrease in the year's profit by Rs.15.40 lacs.*
- (iv) Municipal taxes on commercial property debited Rs.0.22 lacs, which were ultimately paid on 1-12-2011.*
- (v) The Company has received equity shares of AB Ltd. valued at Rs.1.25 lacs in exchange of equity shares of CD Ltd. in a scheme of amalgamation during the year. The shares in CD Ltd. were acquired in 2005-06 at a cost of Rs.0.40 lacs. The surplus has been credited to Profit & Loss account. Both AB and CD are Indian companies.*
- (vi) An executive, while on business trip abroad, died and gratuity paid voluntarily amounted to Rs.6.00 lacs.*
- (vii) As restructuring of its debt, the company has converted arrears of interest of Rs.5.00 lakhs on term loan into a new term loan with a revised repayment schedule. The company has paid Rs.0.50 lac towards such funded interest during the year.*
- (viii) Legal charges in connection with alteration of the Articles of Association Rs.1.50 lacs and for issue of bonus shares Rs.5.00 lacs.*
- (ix) The company has purchased scrap materials amounting to Rs.0.60 lacs, the payment for which was made in cash on 15th August, 2010.*
- (x) The profit, as shown above, includes Rs.5.00 lacs received from a Foreign Government for use of company's product. This was, however, not brought into India.*

Compute the net income of the company for the assessment year 2011-12 clearly indicating the basis of treatment of each item.

Answer

Computation of net income of A & Co. Ltd. for the A.Y. 2011-2012

<i>Particulars</i>	<i>Rs. in lacs</i>
I. Income from House Property (Working Note 1)	1.68
II. Profits and gains of business or profession (Working Note 2)	71.47
Gross Total Income	73.15
Less: Deduction under Chapter VI-A	-
Total Income	73.15

Working Note 1

Computation of income from house property

Gross annual value (See Note 3 below)	2.40
Less: Municipal taxes are not allowable as deduction since they were not paid in the previous year.	-
Net Annual Value (NAV)	2.40
Less: 30% of NAV	<u>0.72</u>
Income from house property	<u>1.68</u>

Working Note 2

Computation of income under the head "Profits and gains of business or profession".

Net profit as per profit and loss account	65.00
Add: Inadmissible expenditure	
(i) Loss on non-realization of advance to wholly owned subsidiary company does not arise in the normal course of business, since the assessee is engaged in the business of manufacturing and not financing. Hence, loss is to be disallowed.	5.00
(ii) Municipal tax on commercial property is not allowable as a deduction under this head of income.	0.22
(iii) Arrears of interest converted into funded interest term loan not allowed. However, amount of funded interest term loan paid allowed as deduction.	4.50
(iv) Legal expenses of Rs 1.50 lacs for amendment of Articles of Association is deductible. [Allahabad High Court in <i>CIT vs Modi Spinning & Weaving Mills Co Ltd. (1973) 89 ITR 304</i>].	--

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(v)	Legal expenses in connection with the issue of bonus shares is a revenue expenditure and hence allowable. [<i>Warner Hindustan Ltd v. CIT</i> 171 ITR 224 (AP) and <i>CIT v. General Insurance Corpn.</i> (2006) 156 Taxman 96 (SC)]	--	9.72
			74.72

Less: Admissible deductions and income not taxable/considered separately

(i)	Rent of commercial property let out on rent to a bank. This is taxable under the head "Income from House Property" and has been considered separately.	2.40	
(ii)	Surplus on exchange of shares on amalgamation of companies – (See note 2 below)	0.85	3.25
Income under the head "Profits and gains from business or profession"			71.47

Note:-

1. Rs.5 lacs received from a foreign Government for use of company's product though not brought into India it is taxable as the assessee is assumed as domestic company and resident in India.
2. Under section 47(vii) any transfer by a shareholder, in a scheme of amalgamation, of a capital asset, being shares held by him in the amalgamating company does not attract capital gains tax, if the transfer is made in consideration of the allotment of any shares in the amalgamated company and the amalgamated company is an Indian company. Since the surplus is credited to profit and loss account, it is excluded by way of deduction.
3. Rent of commercial property has been taken as its gross annual value in the absence of other information.
4. A company can change its method of valuation of stock provided the change is made for *bona fide* reason and is followed consistently in future. The assessee changed its method of valuation of stock in line with the Accounting Standard – 2 Valuation of inventories issued by ICAI, being a pronouncement of a professional body. Therefore, the genuineness of the change in method of valuation of stock cannot be questioned. Hence, even though the profit is lower by Rs.15.40 lacs, it would not have any impact on the computation of income.
5. Payment of gratuity Rs.6.00 lacs on account of death of an executive while on business trip is allowable as deduction. [*CIT vs. Laxmi Cement Distributors (P) Ltd.* (1976) 104 ITR 711 (Gujarat)]. Since it has already been debited to the profit and loss account, no further adjustment is required.
6. Payment for scrap materials was made on 15th August being the "Independence Day" on which banks are closed. Such payment is covered by Rule 6DD(j) of the Income-tax Rules. Therefore, the expenditure cannot be disallowed under section 40A(3).

13.60

Question 26

A domestic company, ABC Ltd., has an undertaking newly established for export of Computer Software in a free trade zone, the profits of which have been merged in the net profit of the company as per Profit and Loss Account prepared in accordance with the provisions of Parts II and III of Schedule VI to the Companies Act. It furnishes the following particulars in respect of Assessment Year 2011-12 and seeks your opinion on the application of section 115JB. You are also required to compute the total income and tax payable.

(1) Net profits as per P and L A/c as per schedule VI	Rs.200 lakhs
(2) Profit and Loss A/c includes:	
(a) Credits	
Dividend income	Rs. 20 lakhs
Excess realized on sale of land held as investment	Rs. 30 lakhs
Net profit of the undertaking for export of computer software	Rs.100 lakhs
(b) Debits:	
Depreciation on straight line method basis	Rs.100 lakhs
Provision for loss of subsidiary company	Rs. 60 lakhs
(3) Depreciation allowable as per the Income-tax Act and Rules	Rs.150 lakhs
(4) Capital gains as computed under Income-tax Act	Rs. 40 lakhs
(5) Losses brought forward as per books of account and as per Income-tax Act, 1961:	
Business loss	Rs. 50 lakhs
Unabsorbed depreciation	Rs. 60 lakhs

The company has represented to you that the excess realized on sale of land cannot form part of the book profit for purposes of section 115JB. You will have to deal with this issue.

Answer

In the case of a company, it has been provided that where tax on 18% of book profit exceeds tax on total income computed as per normal provisions, the book profit shall be 'deemed to be the total income' for tax purposes.

It is therefore necessary to compute total income as per Income-tax Act as well as book profits.

I. Computation of Total income as per Income-tax Act	(Rs. in lakhs)
Net profit as per P & L A/c	200
Add: Depreciation debited to P&L account	100
Provision for losses of subsidiary company	<u>60</u>
	<u>160</u>
	360
Less: Dividend income – exempt under section 10(34)	20
Excess realized on sale of land (considered separately)	30

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Net profit of the undertaking in Free Trade Zone exempted under section 10A.	100	
Depreciation allowable as per Income-tax Rules	<u>150</u>	<u>300</u>
Business Income		60
Less: Set-off of brought forward business loss (See Note 1 below)		<u>50</u>
		10
Capital gains as per Income-tax Act		<u>40</u>
		50
Less: Set-off of unabsorbed depreciation (See Note 1 below)		<u>50</u>
Total Income as per Income-tax Act		<u>Nil</u>

Note:

1. It has been assumed that the figures of unabsorbed depreciation and business loss as per Income-tax Act and as per the books of account are same in the given problem.
2. Total unabsorbed depreciation b/f from P.Y. is Rs.60 lakhs against which Rs.50 lakhs is set-off in the current year. The balance of Rs.10 lakhs is to be carried forward to the next assessment year.

II. Computation of book profit under section 115JB	<i>(Rs. in lakhs)</i>
Net profit as per P & L A/c	200
Add: Provision for loss of subsidiary	<u>60</u>
	260
Less: Dividend income exempt under section 10(34)	20
Business loss which is less than unabsorbed depreciation	<u>50</u>
	<u>70</u>
“ Book Profit”	<u>190</u>

- I. Since total income is 'nil' as per the Income-tax Act, the tax payable is also 'nil'.
- II. 18% of book profit of Rs.190 lakhs is Rs.34.20 lakhs.

Note : Since 18% of book profit exceeds the total income, the book profit of Rs.190 lakhs shall be 'deemed to be the total income' and the tax payable on such total income shall be 18% thereof i.e. Rs.34,20,000 plus surcharge @ 7.5% of Rs.2,56,500 plus education cess @ 3% [of tax and surcharge] being Rs.1,10,295. Total tax liability Rs.37,86,795.

With regard to the company's representation, in respect of long term capital gain whether liable for book profit tax under section 115 JB, it may be noted that under item (xii)(b) of para 3 of Part II of Schedule VI, profits or losses in respect of transactions of an exceptional or non-recurring nature, if material in amount, are to be disclosed. Since the excess realized on sale of land has been included in net profit computed under Schedule

VI, it will form part of book profit [*Bombay High Court judgment in CIT v. Veekay Lal Investment Co. Pvt. Ltd.* 249 ITR 597].

Depreciation debited to profit and loss account excluding depreciation on account of revaluation of assets is to be allowed. Depreciation is debited on SLM basis and no revaluation of asset was involved. Hence, no adjustment is made in respect of depreciation while computing book profit under section 115JB.

Question 27

The accounts of a public company have been prepared in accordance with provisions of Parts II and III of Schedule VI to the Companies Act and its Profit and Loss Account laid before the Annual General Meeting for the previous year ending 31st March, 2011 shows a net profit of Rs.15 lakhs. The following information relevant for the purpose of computing its assessable income has been extracted from a scrutiny of the profit and loss account:

Credits in Profit and Loss A/c

(1) Profit from a new industrial undertaking qualifying for deduction under section 80-IA (Net)	17,00,000
(2) Profits from a new industrial undertaking qualifying for deduction under section 10A (Gross)	10,00,000
(3) Long-Term capital gains	3,00,000

Debits in Profit and Loss A/c

(1) Expenditure relating to industrial undertaking qualifying for deduction under section 10 A	7,00,000
(2) Depreciation relating to 2007-2008 brought forward	10,00,000
(3) Business loss relating to 2007-2008 brought forward	12,00,000
(4) Current year depreciation	10,00,000
(5) Penalty for infraction of law	1,00,000
(6) Provision for sales-tax	3,00,000
(7) Dividend proposed	2,00,000

Depreciation admissible under the Income-tax Act and Rules for the previous year is Rs.19,50,000. The capital gain has been invested in specified assets under section 54EC. Sales tax provided in the accounts has been remitted before the due date. There is no loss or unabsorbed depreciation to be carried forward and adjusted as per IT assessment.

You are required to compute the total tax liability of the company for the assessment year 2011-12.

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Answer

The impact of the provisions of section 115JB has to be ascertained and for this purpose the income-tax on the total income as computed under the Income-tax Act has to be compared with 18% of the book profits ascertained under section 115JB.

Computation of total income under the Income-tax Act, 1961

Net Profit as Profit and Loss account	15,00,000	
Add : Expenses not allowable:		
Unabsorbed Depreciation	10,00,000	
Business Loss	12,00,000	
Penalty – not an admissible deduction	1,00,000	
Proposed dividend	2,00,000	
		25,00,000
		40,00,000
Less : Expenses deductible :		
Depreciation for the year additionally allowable		9,50,000
(Rs.19,50,000 – 10,00,000 i.e. debited in P&L account)		
		30,50,000
Less : LTCG to be considered under the respective head		3,00,000
		27,50,000
Less : Exemption under section 10A profits		
(10,00,000 – 7,00,000)		3,00,000
Profit and Gains from business		24,50,000
Capital Gains	3,00,000	
Less :Exemption under section 54EC (Note 5)	3,00,000	Nil
		24,50,000
Less : Deduction under section 80-IA		17,00,000
Total Income		7,50,000
Tax payable @ 30.9% = Rs. 2,31,750		

Computation of Book Profit under section 115JB

Net Profit (see note 7)	37,00,000
Proposed dividend	2,00,000
	39,00,000
Less: Brought forward depreciation (see Note 4)	10,00,000

Book profit under section 115JB

29,00,000

Tax at 18% of 29,00,000 = Rs.5,22,000 plus education cess @ 3%.

The tax liability is Rs.5,37,660.

Since tax payable on income computed as per the provisions of the Income-tax Act, 1961 is less than 18% of the book profit, the book profit of Rs. 29 lakh would be deemed to be the total income and tax is payable @18% thereon plus 2% education cess and 1% secondary and higher education. The total tax liability would be Rs. 5,37,660.

Note:

1. Income from new industrial undertaking qualifying for deduction under section 80-IA will not be reduced in computing book profit under section 115 JB.
2. Provision for sales-tax is an ascertained liability. Hence it is not to be added [See clause (c) of Explanation].
3. Book profit includes capital gains (*CIT v. Veekely Investment Co Ltd* 249 ITR 597)
4. Brought forward depreciation or business loss, whichever is less is deductible while computing book profit under section 115JB.
5. Capital gains are not chargeable to tax as the assessee has invested the gain in specified assets mentioned in section 54EC.
6. Income from the units eligible for deduction under sections 10A / 10B is not to be to excluded while computing book profit.
7. Students may note that the debit entries pertaining to unabsorbed depreciation and brought forward business loss are not in consonance with Parts II and III of Schedule VI to the Companies Act, 1956. These items are part of the balance sheet under "Reserves and Surplus" on the liabilities side of "Profit & Loss Account" (as the case may be) on the assets side. In order to rectify the treatment in the books of account, the following adjustments should be made:

Net Profit	15,00,000
Add : Debits incorrectly made:	
Unabsorbed depreciation	10,00,000
B/f business loss	<u>12,00,000</u>
Net Profit as per Schedule VI	<u>37,00,000</u>

Question 28

Xtra Ltd. gives the following information for the year ended 31.3.2011:

- Net Profit as per Profit and Loss Account for the financial year 2009-10 Rs.33,00,000 was included in General Reserve.

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- On 1.8.2010, 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 31.8.2010.
- The company declared dividend of Rs.14,00,000 at its annual general meeting held on 30.9.2010. But the dividend remained unpaid up to 31.3.2011.

Compute the tax liability of the company under section 115-O (tax on distributed profits)

Also give reasons for treatment of each item.

Answer

Computation of tax liability of Xtra Ltd. under section 115-O [for the A.Y. 2011-12]

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.23,09,000×16.609%] [See Note 4 below]	3,83,496

Notes –

- (1) It is assumed that the bonus shares are in the form of redeemable preference shares, since only then such redemption is 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. 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 end of the previous year.

Question 29

Explain the incidence of taxation on mutual concerns.

Answer

The concept of “mutuality” means that the contributors and beneficiaries are identical. Since one cannot make profit by dealing with oneself, there is no taxable profit involved wherever such concept applies. A mutual concern or association stands on the same principle. All the contributors to the common fund are entitled to participate in the surplus and all the participants to the surplus are contributors in the case of a mutual concern. The excess of income over expenditure in a year shall supplement the common fund for future utilization to the benefit of the contributors and the excess of expenditure over income shall be absorbed by the common fund.

Generally the surplus derived by a mutual concern is not chargeable to tax. Therefore, a trade, professional or similar association which functions on the principle of mutuality concept is not chargeable to tax, if there is any surplus on account of subscriptions, membership fees, entrance fees etc., exceeding the expenditure incurred.

However, the following additional points need to be taken into consideration-

- (i) Where a mutual concern carries on the business of insurance, the profits therefrom are chargeable to tax. Section 44 provides that the profits for this purpose have to be computed in accordance with the method prescribed in the Rules contained in the First Schedule.
- (ii) In the case of trade, professional or similar associations, the income derived from specific services performed for its members is chargeable to tax u/s 28(iii). However, if there is a loss on account of expenditure exceeding the subscription etc. from members, such shortfall shall be absorbed by the income chargeable to tax u/s 28(iii). This set off as per section 44A cannot exceed 50% of the total income of such associations as computed before allowing the set off.
- (iii) In the case of a mutual concern, if income is derived both from mutual activity as well as from non-mutual activity, the exemption applies only to the income from the mutual activity. The income attributable to the non-mutual activity will be liable to tax as was held by the Gujarat High Court in *Sports Club of Gujarat Ltd. vs CIT* (1987) 171 ITR 504.

Note : Students may also refer to decisions such as *Canara Bank Golden Jubilee Staff Welfare Fund v. Dy.CIT* (2009) 308 ITR 202 (Karn); *CIT v. Trivandrum Club* (2006) 153 Taxman 481 (Ker); *CIT v. Willingdon Sports Club* (2008) 302 ITR 279 (Bom) and *Madras Gymkhana Club v. Dy.CIT* (2009) 183 Taxman 333 (Mad) to know the nuances of the principle of mutuality in various practical situations.

Question 30

X Co Ltd., a domestic company, holds 50% of the share capital of Y Co Ltd. which is another domestic company. Y Co Ltd. paid total dividend for the year ended on 31-03-10 of Rs.50 lakhs. Out of the dividend received from Y Co Ltd., the X Co Ltd. distributed dividend of Rs.15

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lakhs. Explain with reasons the amount of dividend chargeable to tax and dividend distribution tax payable by X Co Ltd.

Answer

The dividend received by X Co Ltd from Y Co Ltd is exempt from tax under section 10(34) if such dividend is covered by section 115-O. It is pertinent to note that the dividend covered by section 115-O is also not liable for 'book profit tax' under section 115JB in the assessment of recipient company i.e. X Co Ltd in this case.

It may be of interest to a note that X Co Ltd while paying dividend distribution tax under section 115-O is eligible to reduce the dividend received from the dividend paid / declared by it. Since the dividend paid by X Co Ltd is less than the dividend received from its subsidiary, i.e. Y Co Ltd the tax liability under section 115-O would be 'nil'.

If X Co Ltd had distributed dividend of Rs.60 lakhs the dividend distribution tax at 16.609% is payable on the net payout of Rs.35 lakhs only (i.e. dividend declared Rs.60 lakhs less Rs.25 lakhs being the dividend received from subsidiary domestic company which has paid DDT on the dividend declared by it).

Question 31

A non-resident Indian has the following sources of income in India. You are required to compute his total income and determine his tax liability. Details of your workings, with reasons, should form part of your answer:

- | | | | | |
|-----|---|--------------------|-----|------------------|
| (1) | Dividend from Indian company | Rs.50,000 | | |
| (2) | Interest on debentures of an Indian company invested out of remittances in convertible foreign exchange | | | Rs.75,000 |
| | Less: Interest paid on money borrowed in India for investment in the debentures | | | <u>Rs.25,000</u> |
| | | | Net | <u>Rs.50,000</u> |
| (3) | Long-term capital gains on sale of shares subscribed in convertible foreign exchange: | | | |
| | Cost in 2006-07 | Rs.2,00,000 | | |
| | Sale in 2010-11 | <u>Rs.3,00,000</u> | | |
| | | Rs.1,00,000 | | |
| | Less: Brokerage | <u>Rs. 10,000</u> | Net | Rs.90,000 |
| | Inflation index 2006-07 | 519 | | |
| | 2010-11 | 711 | | |
| (4) | Property income in India (Net) | | | Rs.3,00,000 |
| | T.D.S | | | <u>Rs.30,000</u> |

The property was acquired partly out of a loan from HDFC. The repayment of loan made during the year amounted to Rs.20,000. The assessee also claims deduction of Rs.10,000 by

way of donation to the Prime Minister's Relief Fund and of Rs.20,000 towards interest on loan taken for higher education in India in 2005 before his migration.

Answer

Chapter XII-A, comprising of sections 115C to 115-I, contains special provisions which provide concessional tax treatment in relation to certain incomes of non-residents (i.e. investment income and long term capital gains). Therefore, in this case, the income of the non-resident has to be computed applying the provisions of Chapter XII-A.

According to section 115-C –

- (a) The income derived by a non-resident Indian from any foreign exchange asset other than dividend referred to in section 115-O is called as “Investment income”
- (b) Foreign exchange asset includes debentures issued by an Indian public company acquired or purchased with or subscribed to in, convertible foreign exchange.

Section 115-D provides that in computing such “Investment income” or “Long-term capital gains” of a non-resident Indian –

- (i) No deduction in respect of any expenditure or allowance under any provision of the Income-tax Act is allowable in computing such investment income;
- (ii) No deduction under Chapter VI-A shall be allowed in respect of both investment income and long term capital gains; and
- (iii) No indexation will be applicable in respect of long term capital gains.

Section 115-E provides that the investment income and/or long-term capital gains in respect of foreign exchange asset will constitute a separate block of income and investment income will be charged to income-tax at a flat rate of 20% and long term capital gains at a flat rate of 10%. If the non-resident Indian has any other income in India, such other income will constitute altogether a separate block of income and will be charged to tax as if such other income is the total income. The aggregate of the income-tax so calculated in respect of the said two blocks of income will be the total tax payable.

Computation of total income for A.Y. 2011-12

	Rs.
1. Dividend income – Exempt under section 10(34)	Nil
2. Debenture Interest (interest on loans borrowed for investment not allowable as deduction as per section 115D(1))	75,000
3. Long-term capital gains : Assuming it was subjected to Securities Transaction Tax, the entire long term capital gain from sale of shares is exempt under section 10(38)	NIL

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4. Property Income (Net) [See Note below]	3,00,000	
Gross Total Income	3,75,000	
Less:		
Deduction under section 80C in respect of housing loan repaid	20,000	
Deduction under section 80E allowable in respect of interest paid on loan taken for higher education	20,000	
Deduction under section 80G in respect of donation to Prime Minister's Relief fund	<u>10,000</u>	50,000
Total income		<u>3,25,000</u>

Note: It has been assumed that Property Income (Net) implies the Income from house property is net of all deductions.

Computation of tax payable

Tax at 20% on debenture interest of Rs.75,000	15,000	
Total Income (as reduced by investment income) i.e. Rs.3,25,000 minus Rs.75,000	2,50,000	
Tax thereon	<u>9,000</u>	
	24,000	
Add: Education cess @ 3%	<u>720</u>	
	24,720	
Less: Tax Deducted at Source	<u>30,000</u>	
Balance tax refundable		<u>5,280</u>

Note - It may be noted that section 115-I enables the non-resident to opt out of the applicability of Chapter XII-A for any assessment year by furnishing his return of income for that assessment year under section 139 declaring therein that the provisions of the Chapter XII-A shall not apply to him for that assessment year and his total income shall be computed as per regular provisions of the Act and tax on such total income shall be charged accordingly.

Since the debenture interest is taxed at 20% as against the regular slab rate of 10% applicable for total income upto Rs.5 lakhs, the assessee by opting for normal provisions of the Act could minimize his tax liability as given below:

Debenture interest	75,000	
Rental income	<u>3,00,000</u>	
Gross total income		3,75,000
Less :Deduction U/s.80C	20,000	

Assessment of Various Entities

Deduction U/s.80E	20,000	
Deduction U/s.80G	10,000	
		50,000
Total income		3,25,000
Tax thereon		16,500
Add : Cess @ 3%		495
Total tax		16,995
TDS		30,000
Balance refundable		13,005

In this case, the assessee will gain by opting for regular provisions of the Income-tax Act, 1961 as the income liable for 20% rate of tax would be taxed at 10% as the total income is below Rs.5 lakhs.

Question 32

Raj & Family is a HUF in which Mrs. Raj has impressed upon a house property owned by her for the common hotchpot of the family. Examine whether the personal property of Mrs. Raj so blended by her can be treated as a property of HUF.

Answer

The Apex Court has, in the case of *Pushpa Devi v. CIT (1977) 109 ITR 730*, held that "to blend" means to share along with others and not to surrender one's interest in favour of others to the exclusion of oneself. If a Hindu female, who is a member of an undivided family, impresses her absolute, exclusive property with the character of joint family property, she creates new claimants to her property to the exclusion of herself because, not being coparcener, she has no right to demand a share in the joint family property by asking for a partition. The expression "blending" is inapposite in the case of a Hindu female who puts her separate property, be it the absolute property or limited estate, in the joint family stock.

Therefore, applying the decision of the above case to the case on hand, Mrs. Raj cannot blend her personal property with the character of joint family property because the right to blend is limited to coparceners as per principle laid down by the Apex Court.

Note – With effect from 9.9.2005, due to the amendment of the Hindu Succession Act, the daughter of a coparcener shall, by birth, become a coparcener in her own right in the same manner as a son. However, this amendment would not affect the answer, since in this case, Mrs. Raj is not the daughter of a coparcener of the HUF, Raj & Family, but is the wife of one of the coparceners.

Direct Tax Laws

Question 33

Fun India Limited has a carried forward credit of Rs.2 lacs under section 115JAA(3A) of the Income-tax Act from assessment year 2010-11. In the A.Y. 2011-12, the company's total income and book profit under section 115JB are Rs.5 lacs and Rs.7 lacs, respectively. Compute the tax payable by the company for assessment year 2011-12 and the amount to be carried forward under section 115JAA.

Answer

According to section 115JAA, the tax credit to be allowed under the section is the difference between the minimum alternate tax paid under section 115JB and the tax payable by the assessee on his total income computed as per the other provisions of the Income-tax Act.

The amount of tax credit determined as aforesaid can be carried forward for ten assessment years. The brought forward tax credit shall be allowed to be set off in any assessment year to the extent of the difference between the tax on total income and minimum alternate tax which would have been payable under section 115JB for that assessment year.

Computation of tax payable by Fun India Limited for A.Y. 2011-12 and MAT credit to be carried forward to A.Y.2012-13

	Particulars	Rs.
A.	Total income	5,00,000
B.	Book profit	8,00,000
C.	Tax on A (30.9% of Rs.5,00,000)	1,54,500
D.	Tax on B (18.54% of Rs.7,00,000)	1,29,780
E.	Difference between C and D	24,720
F.	Tax credit brought forward from assessment year 2010-11	2,00,000
G.	MAT credit set-off (Being lower of E and F)	24,720
H.	Tax payable for A.Y.2011-12 (C - G)	1,29,780
I.	MAT credit to be carried forward to A.Y.2012-13 (F - G)	1,75,280

Question 34

Vijay Agencies, a partnership firm constituted by three partners with equal shares was dissolved on 1-04-2010 after a search. The liability to tax finally decided against the firm outstanding to be paid was Rs.15 lakhs. Out of three partners, one was declared insolvent on 18-03-11 by the Court. The Assessing Officer, for recovering the demand, attached the Bank Accounts of other two partners and could recover an amount of Rs.6 lakhs from the Account of one such partner. You are asked by the partners of dissolved firm:

(i) *About the liability of each of them to pay outstanding demand.*

- (ii) *Whether the action of Assessing Officer to attach the Bank Account of partners against demand of dissolved firm is justified?*

Answer

- (i) As per section 189(3), every person who was at the time of dissolution, a partner of the firm, shall be jointly and severally liable for the amount of tax, penalty or other sum payable and all the provisions of the Act relating to assessment of such tax or imposition of such penalty or other sum, shall apply. Therefore, the three partners (till one was declared as insolvent by the Court) are jointly and severally liable for making the payment of outstanding dues of Rs.15 lakhs. After insolvency of one of the partners, the other two partners shall be jointly and severally liable to pay such demand.
- (ii) Accordingly, the action of the Assessing Officer to attach the bank accounts of the partners for recovery of outstanding demand is correct and the amount of Rs.6 lakhs recovered by attachment of the bank account of one of the partners is also in order.

Question 35

- (a) *Ravi Traders, a partnership firm consisting of three partners. 'A', 'B' and 'C' is assessed to Income-tax as partnership firm assessed as such. 'B' and 'C' retired from the partnership with effect from 31st December 2010 'A' took over the business and continued as a proprietor. The stock in trade as at 31st December, 2010 was valued at average purchase price for settlement of accounts, which was the system consistently followed. On these facts, you are consulted on the following issues:*

Under which provisions of the Income-tax Act, 1961 M/s. Ravi Traders for the period 1.4.2010 to 31.3.2011 shall be assessed for the assessment year 2011-12? Can the Assessing Officer dispute the stock valuation in the assessment of the firm?

- (b) *'A' desires to admit three partners from 1st April, 2010. Amongst the partners, it is agreed that two partners, shall be the working partners and be paid remuneration, your advice is sought as to the requirements to see that the remuneration to the working partners is allowable in the hands of the firm under the Income-tax Act.*

Answer

- (a) M/s. Ravi Traders was a partnership firm and it became a proprietary concern thereafter. Therefore there was a discontinuance of the firm. Section 189 of Income-tax Act provides for the assessment in the case of a discontinuance or dissolution of the firm to safeguard the interests of the Revenue for the assessment of the firm and levy of tax. The section proceeds on the premise that the firm is deemed to be a continuing firm for purposes of assessment in that assessment year. The section provides that (a) the assessment shall be made as if no discontinuation has taken

place (b) every person who was a partner at the time of discontinuance of the firm and the legal representative of any such partner who is deceased, shall be jointly and severally liable for the tax and penalty and or other sums payable and (c) all the other provisions of the Act so far as may be, shall apply to any such assessment or imposition of penalty or other sum. Penalty proceedings can be initiated and penalty may be imposed on such firm even after the discontinuance and/or dissolution. Therefore the firm M/s. Ravi Traders shall be assessed as partnership firm assessed as such as per the provisions of section 189.

On the issue whether the Assessing Officer can dispute the stock valuation at the time of conversion of firm into proprietary concern, the answer is “no”. The settled principle is that when the partnership firm is converted into a proprietary concern of one of the partners and the closing stock is taken over by him at the cost and there is no revaluation of stock, it cannot be said that any profit accrued to the firm. This is the principle laid down by Gujarat High Court in *Chunilal Khushaldas Patel v. CIT* (66 ITR 522 (Guj)).

Dissolution is different from discontinuance and in the present facts of the case the firm has become a proprietary concern because one of the partners took over the firm’s business and continued the business. Therefore the principle laid down by Supreme Court in the case of *ALA Firm v. CIT* 189 ITR 285 will not apply to the facts of the case. Hence the Assessing Officer cannot dispute the stock valuation.

- (b) Any payment of remuneration by whatever name called to a working partner shall be allowed as deduction under section 40(b)(v), provided the following conditions are satisfied.
- (i) The payment is to be authorized by the deed of partnership in writing.
 - (ii) It should be in accordance with the terms of the partnership.
 - (iii) The remuneration per month should be quantified. It cannot be left open to be determined by the partners as at the end of accounting period (vide Board Circular 739 dated 25th March, 1996)
 - (iv) The maximum amount of remuneration of all working partners put together should not exceed the limits prescribed in clause (v) of section 40(b) of the Act.
 - (v) On the first Rs. 3 lakh of book profit or in case of loss, the limit would be the higher of Rs. 1,50,000 or 90% of book profit and on the balance of book profit, the limit would be 60%.