

PAPER – 7 : DIRECT TAX LAWS

Working notes should form part of the answer.

Question No.1 is compulsory.

Attempt any five questions from the remaining six questions.

Question 1

- (a) Jyoti Education Centre, a charitable institution registered under section 12AA of the Income-tax Act, 1961 runs schools for primary and secondary education. The following particulars pertaining to the previous year 2010-11 are furnished to you by the institution:

		₹ in lakhs
(i)	Gross Receipts from students towards admission fees, tuition fees, development fees, laboratory fees etc.	152.75
(ii)	Dividend received on units of mutual funds specified in section 10(23D)	16.00
(iii)	Donations received (including anonymous donation ₹ 2.50 lakh)	10.50
(iv)	Grant from State Government	7.25
(v)	Amount applied for purposes of schools	90.60
(vi)	Purchase of computers and laboratory equipments	21.40
(vii)	Included in (v) above, a sum of ₹ 3.50 lakh, being the amount applied for the benefit of the founder of the institution	
(viii)	The institution had accumulated ₹ 20 lakh under section 11(2) in the previous year 2007-08 for a period of two years for acquiring and developing a plot of land for construction of a new school. Land was purchased for ₹ 15 lakh and development was made at a cost of ₹ 2 lakh in the previous year 2010-11	
(ix)	Excess of expenditure over income in the previous year 2009-10.	35.00

Compute total income of the institution and tax payable by it for the Assessment Year 2011-12. (10 Marks)

- (b) A Limited engaged in manufacturing activity has the following immovable properties as on 31st March, 2011. State, with reasons, whether the assets are chargeable to wealth tax on the valuation date 31st March, 2011.
- (i) A plot of agricultural land in Chennai acquired on 1st January, 2009 for conversion into non-agricultural land to be used for opening a new factory. The approval of the Tamil Nadu State Government for conversion into industrial land was obtained on 1st November, 2010. The development activity for conversion was in progress on 31st March, 2011.

The Suggested Answers for Paper 7: Direct Tax Laws are based on the provisions applicable for A.Y. 2011-12, which is the assessment year relevant for November 2011 examination.

- (ii) A building is under construction at Coimbatore. The said building after construction will be used partly for accommodating senior executives each having annual salary exceeding ₹ 5 lakh and partly as guest house. (4 Marks)
- (c) Madhav, a child artist acting in laughter shows, accumulated income of ₹ 25 lakh over a short span of time. The same was put into securities by his mother, who is also the guardian. The securities were sold in the P.Y. 2010-11 resulting in capital gain of ₹ 10 lakh, which was invested in a plot of land in urban area. The Assessing Officer proposes to include the value of the land in computation of net wealth of the mother under section 4(1) on the valuation date. Is the proposition of the Assessing Officer justified in law? (3 Marks)
- (d) "The rules laid down in Schedule III to the Wealth-tax Act, 1957 are not binding on the Valuation Officer." Examine the correctness of the statement. (3 Marks)

Answer

- (a) Computation of total income of Jyoti Education Centre for the P.Y.2010-11

Particulars	₹	₹
Gross receipts from students towards admission fees, tuition fees, development fees, lab fees etc.	1,52,75,000	
Less: Amount applied for purposes of schools assumed as revenue expenditure incurred for earning income (Note 1)	87,10,000	
	65,65,000	
Donations (other than anonymous donations) (Note 4)	8,00,000	
	73,65,000	
Less: 15% eligible for exemption	11,04,750	
	62,60,250	
Less: Application for the purposes of the institution		
Purchase of computers and lab equipments (Note 6)	21,40,000	
Excess of expenditure over income in the P.Y.2009-10 (Note 7)	35,00,000	
		6,20,250
Add: Application for the benefit of founder chargeable u/s 12(2) (Note 8)		3,50,000
Amount accumulated for construction of a school but not spent deemed to be income under section 11(3) (₹ 20 lakh – ₹ 15 lakh – ₹ 2 lakh) (Note 9)		3,00,000
Anonymous donations taxable@30% under section 115BBC		2,50,000
Total Income		15,20,250

Computation of tax liability for A.Y.2011-12		
Particulars	₹	₹
Tax on anonymous donations of ₹ 1,50,000@30% (Note 5)		45,000
Tax on amount of ₹ 3,50,000 applied for the benefit of founder @30% (Note 8)		1,05,000
Tax on other income of ₹ 9,20,250 at normal rates		
Upto ₹ 1,60,000 Nil	Nil	
₹ 1,60,001 – ₹ 5,00,000 10%	34,000	
₹ 5,00,001 – ₹ 8,00,000 20%	60,000	
₹ 8,00,001 – ₹ 9,20,250 30%	<u>36,075</u>	<u>1,30,075</u>
		2,80,075
Add: Education cess@2%		5,602
Secondary and higher education cess@1%		<u>2,801</u>
		<u>2,88,478</u>

Notes:

- (1) The information relating to “gross receipts” is given in the problem, but there is no information relating to expenditure incurred. Therefore, the problem has been solved by taking the amount applied for the purposes of the schools (i.e., ₹ 87,10,000, being ₹ 90,60,000 – ₹ 3,50,000, applied for the benefit of the founder of the institution) as the expenditure incurred.

Note – The problem can also be solved taking the amount of ₹ 87,10,000 as application for the purposes of the schools.

- (2) Dividend received on units of mutual funds specified in section 10(23D) is exempt under section 10(35). Therefore, it need not be applied for charitable purposes.

Note – There is an alternate view that since the income as envisaged by section 11 is not “total income” computed in accordance with the provisions of the Income-tax Act, 1961, but income as understood in commercial sense, the charitable institution is required to apply such income also for charitable purposes in India.

- (3) Grant from State Government is assumed to be capital in nature (for acquisition of capital assets).

Note – The purpose of the grant would determine the nature of the grant, i.e., whether it is revenue or capital in nature. Since the purpose of the grant has not been given in the question, it is also possible to assume that the grant is revenue in nature and solve the problem accordingly.

- (4) It is assumed that donations are not corpus donations. Hence, they have to be considered as income. Section 13(7) provides that the exemption provisions contained in section 11 or section 12 shall not be applicable in respect of any

anonymous donations referred to in section 115BBC on which tax is payable in accordance with the provisions of that section.

- (5) Only the anonymous donations in excess of the exemption limit specified below would be subject to tax@30% under section 115BBC.

The exemption limit is the higher of the following –

- (1) 5% of the total donations received by the assessee [i.e., ₹ 52,500 (5% x 10,50,000)]; or
- (2) ₹ 1 lakh.

Therefore, in this case, the exemption would be ₹ 1 lakh.

The total tax payable by such institution would be –

- (i) tax@30% on the anonymous donations exceeding the exemption limit as calculated above [i.e., tax @30% on ₹ 1,50,000 (being ₹ 2,50,000 – ₹ 1,00,000)]; and
 - (ii) tax on the balance income i.e., total income as reduced by the aggregate of anonymous donations received.
- (6) The institution must utilise 85% of its income within the previous year for the objects of the institution. The institution can apply its income either for revenue expenditure or for capital expenditure provided the expenditure is incurred for promoting the objects of the institution. Purchase of computers and laboratory equipments is a capital expenditure incurred for promoting the objects of the institution and hence, eligible for deduction. The adjustment for depreciation has not been provided for since in the absence of separate values of computer and laboratory equipment, it is not possible to compute depreciation.

Note – The alternate view is that when capital expenditure is fully allowed as application of income, depreciation in respect of the same is not permissible.

- (7) ₹ 35 lakhs, being excess of expenditure over income in the P.Y.2009-10 can be treated as application of income of the current year.
- (8) ₹ 3,50,000 applied for the benefit of the founder of the institution is taxable under section 12(2) read with section 13(6). This amount is taxable at the maximum marginal rate of 30%.
- (9) Section 11(3) provides that if the income accumulated for certain purpose is not utilized for the said purpose within the period (not exceeding 5 years) for which it was accumulated, or in the year immediately following the expiry thereof, then the unutilised amount is deemed to be the income of the charitable institution for the previous year immediately following the expiry of the period of accumulation. In the instant case, the institution accumulated ₹ 20,00,000 in the previous year 2007-08 for acquiring and developing a land for construction of a new school for a period of 2

years. Period of accumulation thus expired on 31.3.2010. The assessee has spent ₹ 17,00,000 [out of accumulated sum of ₹ 20,00,000] in the P.Y. 2010-11. Therefore, the unutilised amount of ₹ 3,00,000 is deemed to be income of the previous year 2010-11 (A.Y. 2011-12).

Note – This problem has been solved on the basis of certain assumptions/views as mentioned under the respective adjustments. Alternate assumptions/views are possible, and accordingly, the computation of total income and tax liability would vary in each case, depending upon the assumption made for each item of adjustment.

- (b) (i) A plot of agricultural land in Chennai is chargeable to wealth-tax on valuation date 31.3.2011, since it is an urban land within the definition of 'asset' under section 2(ea) of the Wealth-tax Act, 1957. Although unused land held for industrial purposes for a period of two years is not included in the definition of urban land, this exception does not apply in this case since as on the valuation date 31.3.2011, the land in Chennai has been held for more than two years from the date of its acquisition (i.e. 1.1.2009). It may be noted that the time period of two years has to be reckoned from the date of acquisition and not date of approval for conversion. Therefore, the plot of land in Chennai is an asset on the valuation date 31.3.2011.
- (ii) Building under construction is an incomplete building which neither falls within the meaning of 'building' nor within the purview of urban land under section 2(ea), and hence, is not an asset chargeable to wealth-tax on the valuation date 31.3.2011. It was so held by the Punjab & Haryana High Court in *CIT v. Smt. Neena Jain (2011) 330 ITR 157*.

Under section 2(ea), a building used for residential or commercial purposes or for the purpose of maintaining a guest house is an asset. However, an incomplete building cannot be used for residential or commercial purposes or for the purpose of maintaining a guest house and is hence, not an asset under section 2(ea). Therefore, the word "building" has to be interpreted to mean a completely built structure having a roof, dwelling place, walls, doors, windows, electric and sanitary fittings etc.

In this case, the building is under construction as on the valuation date and the purposes for which it will be used after its completion is not relevant for determining the issue.

The said building will also not fall within the definition of "urban land", since Explanation 1(b) under section 2(ea) defining "urban land" for levy of wealth-tax, specifically excludes from its scope, the land occupied by any building which has been constructed with the approval of the appropriate authority. Therefore, the incomplete building of the assessee neither falls within the meaning of a "building" nor within the purview of "urban land" under section 2(ea). Consequently, the incomplete building is not an asset chargeable to wealth-tax.

Note – There is an alternate view that only an urban land, on which a completed building stood, is eligible for exemption. According to this view, the urban land, on which building was under construction, is taxable. This was the view of the Karnataka High Court in CWT v. Giridhar G. Yadalam (2010) 325 ITR 223.

- (c) The value of asset held by a minor child on the valuation date is includible in the net wealth of the parent under section 4(1)(ii). However, assets acquired by the minor child out of income from activity involving, *inter alia*, appreciation of his talent, being income referred to in the proviso to section 64(1A), would be taxable in the hands of minor and not included in the hands of the parent.

In this case, however, the above exception to the clubbing provision under section 4(1)(ii) does not apply to the plot of land in urban area, since the same has been purchased out of capital gains of ₹ 10 lakhs from sale of the original asset, namely, securities. It is only the securities which were purchased out of income earned from application of talent of the minor child.

Therefore, the value of urban land, which is an asset under section 2(ea), is includible in the net wealth of the mother as on valuation date. The proposition of the Assessing Officer is justified in law.

Note: It has been assumed that Madhav is a minor child, not suffering from any disability of the nature specified in section 80U. It is also assumed that net wealth of mother (excluding minor's wealth) is higher than the net wealth of father or that she is the only living parent or in case the parents are separated, it is the mother who maintains the child.

- (d) The statement is not correct.

As per section 2(r) of the Wealth-tax Act, 1957, "Valuation Officer" means a person appointed as a Valuation Officer under section 12A. The Valuation Officer is, therefore, a creation of the Statute. He is, therefore, bound by the provisions of the Statute and the rules made thereunder unless there is something in the Act or in the Rules to indicate otherwise.

As per section 16A(1), for the purpose of making an assessment under the Wealth-tax Act, 1957, where under the provisions of section 7 read with rules made under the Act or, as the case may be, the rules in Schedule III, the market value of any asset is to be taken into account in such assessment, the Assessing Officer may refer the valuation of any asset to a Valuation Officer.

Therefore, the Valuation Officer is bound to follow the rules of valuation under Schedule III.

Note: The Supreme Court has held that the rules of valuation are binding on the Valuation Officer in Bharat Hari Singhania v. CWT (1994) 207 ITR 001, on the basis of the above reasoning.

Question 2

XYZ Private Limited is engaged in manufacturing and selling ceramic tiles. The net profit of the company as per its profit and loss account for the year ended 31st March, 2011 is ₹ 150 lakh after debiting or crediting the following items:

- (i) One-time license fee of ₹ 20 lakh paid to a foreign company for obtaining franchise on 1st June, 2010.
- (ii) ₹ 29,000 paid to A & Co., a goods transport operator, in cash on 31st January, 2011 for distribution of the company's products to its warehouse.
- (iii) Rent of ₹ 6 lakh received from letting out a part of its office premises. Municipal tax in respect of the said part of the building amounting to ₹ 15,000 remains unpaid.
- (iv) ₹ 2 lakh, being contribution to a University approved and notified under section 35(1)(ii).
- (v) ₹ 3 lakh, being loss due to destruction of a machinery caused by a fire due to short circuit. The Insurance Company did not admit the claim of the company.
- (iv) ₹ 4 lakh and ₹ 1 lakh, being amounts waived by a bank out of principal and arrear interest, respectively, in an one-time settlement. The loan was obtained for meeting working capital requirement four years back.
- (vii) ₹ 1 lakh, being amount payable to a contractor (who does not have Permanent Account Number) for repair work at the company's factory. Tax of ₹ 2,000 was deducted and paid in time.
- (viii) Dividend of ₹ 0.10 lakh from P. Limited on 1000 equity shares of ₹ 10 each purchased at ₹ 100 per share on 10th October, 2010. The rate of dividend declared is 100%, the record date being 1st December, 2010. The shares were sold on 1st March, 2011 at ₹ 80 per share. Loss of ₹ 0.20 lakh has been debited to Profit & Loss Account.
- (ix) Depreciation on tangible fixed assets ₹ 1 lakh.

Additional Information:

- (i) Depreciation on tangible fixed assets as per Income-tax Rules ₹ 1.75 lakh.
- (ii) The company has obtained a loan of ₹ 2 lakh from ABC Private Limited in which it holds 16% voting rights. The accumulated profits of ABC Private Limited on the date of receipt of loan was ₹ 0.50 lakh.

Compute total income of XYZ Private Limited for the Assessment Year 2011-12 indicating reasons for treatment of each item. Ignore the provisions relating to minimum alternate tax.

(16 Marks)

Answer

Computation of total income of XYZ Private Ltd. for the A.Y. 2011-12

Particulars	₹	₹
Income from House Property (Note 1)		
Gross Annual Value (GAV) (Rental income has been taken as GAV in the absence of other information)	6,00,000	
Less: Municipal Taxes (not deductible since it has not been paid)	<u>Nil</u>	
Net Annual Value (NAV)	6,00,000	
Less: Deduction under section 24 (30% of NAV)	<u>1,80,000</u>	4,20,000
Profits and gains of business or profession		
Net profit as per profit and loss account	1,50,00,000	
Add: Licence fee for obtaining franchise (Note 2)	20,00,000	
Municipal taxes in respect of let-out part of office premises (Note 1)	15,000	
Contribution to approved and notified university (treated separately) (Note 4)	2,00,000	
Loss due to destruction of machinery by fire (Note 5)	3,00,000	
Amount payable to contractor not having PAN (Note 6)	1,00,000	
Short-term capital loss on sale of shares of P. Ltd. (Note 7)	20,000	
Depreciation on tangible fixed assets (Note 8)	<u>1,00,000</u>	
	1,77,35,000	
Less: <u>Depreciation under section 32 (Note 8)</u>		
:		
Tangible fixed assets (Note 8)	1,75,000	
Intangible asset (Franchise)		
25% of ₹ 20,00,000 (Note 2)	<u>5,00,000</u>	6,75,000
<u>Weighted deduction under section 35(1)(ii) (Note 4)</u>		
2,00,000 x 175% (Contribution of University)	3,50,000	
Rental income to be taxed under "Income from house property" (Note 1)	6,00,000	
Dividend credited to profit and loss account to be excluded (Note 7)	10,000	
Waiver of interest on bank loan credited to profit and loss account but not taxable (Note 9)	<u>1,00,000</u>	
		1,60,00,000

<u>Capital Gains (Note 7)</u>		
Short-term capital loss (₹ 20 x 1000 shares)	20,000	
Less: Dividend exempt under section 10(34)	<u>10,000</u>	
Short-term capital loss to be carried forward to A.Y. 2012-13	<u>10,000</u>	
<u>Income from Other Sources (Note 10)</u>		
Deemed dividend under section 2(22)(e)		<u>50,000</u>
Total Income		<u>1,64,70,000</u>

Notes:

- (1) Rental income from letting out a part of the office premises is taxable under "Income from house property". Therefore, it has to be deducted while calculating business income, since the income has been credited to profit and loss account. Likewise, municipal taxes due in respect of such property, debited to profit and loss account has to be added back to compute business income

Note - There is an alternate view that rental income from letting out part of the excess premises by an assessee who is engaged in business is only exploitation of the commercial asset by an assessee who is engaged in business and hence, the same constitutes business income only. In such a case also, municipal taxes is not allowable as deduction since the same has not been paid on or before the due date of filing of return of income as required under section 43B.

- (2) Franchise is an intangible asset eligible for depreciation @ 25%. Since one-time licence fees of ₹ 20 lakh paid to a foreign company for obtaining franchise has been debited to profit and loss account, the same has to be added back. Depreciation @ 25% has to be provided in respect of the intangible asset since it has been used for more than 180 days during the year.
- (3) ₹ 29,000 paid to A & Co., a goods transport operator in cash is deductible while computing business income, since the limit above which disallowance under section 40A(3) would be attracted in case of payment to a transport contractor engaged in the business of plying, leasing goods carriages is ₹ 35,000.
- (4) Contribution to a university approved and notified under section 35(1)(ii) is eligible for a weighted deduction of 175%. Therefore, the contribution of ₹ 2,00,000 debited to profit and loss account has been added back and ₹ 3,50,000 (being 175% of ₹ 2,00,000) has been deducted while computing business income.
- (5) Loss of ₹ 3 lakh due to destruction of machinery caused by fire is not deductible since it is capital in nature.
- (6) Non-furnishing of PAN to deductor results in attracting provisions of section 206AA, which require tax to be deducted at a higher rate of 20%. Since the company has deducted tax @ 2% and not @20% as per the requirement under section 206AA,

disallowance under section 40(a)(ia) would be attracted in respect of payment of ₹ 1 lakh made to contractor.

Note - There is a possibility of alternate views regarding the tax treatment of disallowance under section 40(a)(ia) for short-deduction of tax. It is possible to take a view that only proportional disallowance under section 40(a)(ia) would be attracted in such a case. Another view is that disallowance under section 40(a)(ia) is only for non-deduction of tax at source and not short-deduction of tax and therefore, no disallowance should be made in case of short-deduction of tax. The computation of total income would, accordingly, change.

- (7) As per section 94(7), where any person buys any shares within 3 months prior to the record date and sells such shares within 3 months after such date and the dividend received on such shares is exempt, then the loss arising out of such purchase and sale of shares shall be ignored to the extent of dividend income.

	₹
Loss on purchase and sale of shares (₹ 100 - ₹ 80) x 1000 shares	20,000
Less: Dividend exempt under section 10(34)	<u>10,000</u>
Short-term capital loss	<u>10,000</u>

Since short term capital loss can be set-off only against income under the head "Capital Gains", the short-term capital loss of ₹ 10,000 has to be carried forward to the next year. Dividend of ₹ 10,000 credited to profit and loss account has to be deducted and short-term capital loss of ₹ 20,000 debited to profit and loss account has to be added back.

- (8) Depreciation as per Income-tax Rules, 1962, is deductible while calculating business income. Therefore, ₹ 1.75 lakh depreciation on tangible fixed assets and ₹ 5 lakh on intangible assets is deducted. The amount of ₹ 1 lakh depreciation debited to profit and loss account has been added back.
- (9) Waiver of principal amount of loan taken for trading activity is a benefit in respect of a trading-liability by way of remission or cessation thereof and is, hence, taxable under section 41(1). It has been so held in *Solid Containers v. DCIT (2009) 308 ITR 417 (Bom.)*. Since the loan waiver has already been credited to profit and loss account, no adjustment is required.

Since the loan is for meeting working capital requirement, it is logical to assume that is taken for trading activity.

However, the treatment is different in respect of interest of loan. Since interest on such loan would have not been allowed as deduction in the earlier years as per section 43B due to non-payment of such interest, waiver of interest will not be taxable. Since ₹ 1,00,000 representing interest waiver has already been credited to profit and loss account, the same has to be deducted for computing business income.

- (10) As per section 2(22)(e), any payment by a company in which the public are not substantially interested by way of loan to a shareholder, who is the beneficial owner of shares holding not less than 10% of voting power, is deemed as dividend to the extent to which the company possesses accumulated profits. Accordingly, in this case, ₹ 50,000 would be deemed as dividend under section 2(22)(e).

Question 3

- (a) A partnership firm consisting of three partners X, Y and Z is engaged in the business of manufacturing and selling toys.

Turnover of the business for the year ended 31st March, 2011 amounts to ₹ 55 lakh. Bad debts written off in the books are ₹ 75,000. Interest at 12% is provided to partner Z on his capital of ₹ 6 lakh as authorized by the partnership deed.

The firm had business loss of ₹ 50,000 and unabsorbed depreciation of ₹ 1,50,000 carried forward from Assessment Year 2010-11. The firm did not pay tax under presumptive tax system in assessment year 2010-11. The firm opts for presumptive taxation under section 44AD for Assessment Year 2011-12.

- (i) Compute the income of the firm chargeable under the head "Profits and gains of business or profession."
 - (ii) What would be the liability for interest under section 234B and 234C, if the firm has not paid any advance tax? (7 Marks)
- (b) Mr. X transferred his residential house to Y for ₹ 10 lakh on 1st April, 2010. The value of the said house as per Stamp Valuation Authority was ₹ 16 lakh. Mr. Y is a childhood friend of Mr. X.
- Mr. X gifted a plot of land (purchased by him on 1st August, 2007) to Mr. Y on 1st July, 2010. The value as per Stamp Valuation Authority is ₹ 8 lakh. Mr. Y sold the land on 1st March, 2011 at ₹ 14 lakh.
- Cost Inflation Index - 2007-08:551; 2010-11:711.
- Compute the income of Mr. Y chargeable under the heads "Capital Gains" and "Income from other sources" for Assessment Year 2011-12. (5 Marks)
- (c) JJ Limited, a company incorporated in Australia has entered into an agreement with KK Limited, an Indian company for rendering technical services to the latter for setting up a fertilizer plant in Orissa. As per the agreement, JJ Limited rendered both off-shore services and on-shore services to KK Limited at fee of ₹ 1 crore and ₹ 1.5 crore, respectively. JJ Limited is of the view that it is not liable to tax in India in respect of fee of ₹ 1 crore as it is for rendering services outside India. Discuss the correctness of the view of JJ Limited. (4 Marks)

Answer

- (a) (i) Computation of income of the firm chargeable under the head "Profits and Gains of business or profession"

Particulars	₹
Presumptive income under section 44AD (8% of ₹ 55 lakh) [See Note 1]	4,40,000
Less: Interest @ 12% to Z (12% of ₹ 6 lakh) [See Note 3]	<u>72,000</u>
	3,68,000
Less: Brought forward business loss under section 72 [See Note 4]	<u>50,000</u>
	<u>3,18,000</u>

Notes: -

- (1) A partnership firm falls within the definition of "eligible assessee" under section 44AD. The threshold limit of turnover for applicability of presumptive taxation scheme under section 44AD is ₹ 60 lakh. In this case, since the turnover of the business of the firm is ₹ 55 lakh, it falls within the definition of "eligible business" and therefore, the firm is eligible to opt for presumptive taxation under section 44AD. 8% of the total turnover would be deemed to be the business income of the firm.
 - (2) As per section 44AD(2), all deductions allowable under sections 30 to 38 shall be deemed to have been allowed in full and no further deduction shall be allowed.
Accordingly, no deduction shall be allowed for bad debts since the same is deductible under section 36(1)(vii) and unabsorbed depreciation since the same is deductible under section 32(2).
 - (3) However, where the "eligible assessee" is a firm, salary and interest would be allowed as deduction subject to the conditions and limits prescribed under section 40(b). Therefore, interest@12% to partner Z, which is authorized by the partnership deed, is allowable as deduction.
 - (4) Further, business loss of previous year 2009-10 can be set-off against current year business income as per section 72.
- (ii) As per section 44AD(4), the provisions of Chapter XVII-C would not apply to an eligible assessee in so far as they relate to the eligible business. Therefore, an assessee opting for presumptive taxation scheme under section 44AD is relieved from the requirement of advance tax payments. It would be sufficient compliance if they pay their tax while filing their return of income before the due date.
- Therefore, in this case, the firm is not required to make advance tax payments. Accordingly, there would be no liability for interest under sections 234B and 234C.

- (b) Computation of income of Mr. Y chargeable under the heads “Capital Gains” and “Income from other sources” for A.Y. 2011-12

Particulars	₹
Income chargeable under the head “Capital Gains”	
Sale consideration	14,00,000
Less: Cost of acquisition (deemed to be the stamp value charged to tax under section 56(2)(vii) as per section 49(4) (See Note 3)	<u>8,00,000</u>
Short-term capital gains (See Note 4)	<u>6,00,000</u>
Income from other sources	
Stamp duty value of plot of land received without consideration (taxable under section 56(2)(vii) (See Note 2)	8,00,000

Notes:-

- (1) Transfer of immovable property for inadequate consideration is outside the scope of section 56(2)(vii). Therefore, the provisions of section 56(2)(vii) are not attracted in respect of transfer of residential house by Mr. X to Mr. Y for inadequate consideration.
 - (2) The provisions of section 56(2)(vii) are, however, attracted in respect of transfer of immovable property without consideration, if the stamp duty value of such property exceeds ₹ 50,000. In this case, since Mr. Y has received a plot of land from Mr. X, a non-relative, without consideration and the stamp duty value of ₹ 8 lakh exceeds ₹ 50,000, the entire stamp duty value of ₹ 8 lakh is chargeable to tax under section 56(2)(vii).
 - (3) Section 49(4) provides that where the capital gain arises from the transfer of such property which has been subject to tax under section 56(2)(vii), the cost of acquisition shall be deemed to be the value taken into account for the purpose of section 56(2)(vii). Therefore, ₹ 8 lakh would be the cost of acquisition in this case.
 - (4) The resultant capital gains will be short-term capital gains since for calculating the period of holding, in a case where cost is computed under section 49(4), the period of holding of the previous owner is not to be included. As per section 2(42A), the period of holding will include the period of holding of the previous owner only in the case of a capital asset which becomes the property of the assessee in the circumstances mentioned in section 49(1) [i.e., where cost to previous owner would be deemed as the cost of acquisition].
- (c) *Explanation* below section 9(2) has been substituted with retrospective effect from 1st June, 1976 to clarify that income by way of, *inter alia*, fees for technical services from services utilized in India would be deemed to accrue or arise in India under section 9(1)(vii) in case of a non-resident and be included in his total income, whether or not such services were rendered in India.

In this case, the technical services rendered by the foreign company, JJ Ltd., were for setting up a fertilizer plant in Orissa. Therefore, the services were utilized in India. Consequently, as per section 9(2), the fee of ₹ 2.5 crore for technical services rendered by JJ Ltd. (both off-shore and on-shore services) to KK Ltd. is deemed to accrue or arise in India and includible in the total income of JJ Ltd.

Therefore, the view of JJ Ltd. that it is not liable to tax in India in respect of fee of ₹ 1 crore (as it is for rendering services outside India) is not correct.

Question 4

Attempt any four questions out of the following questions:

- (a) *Rajesh regularly files his return of income electronically. While he was trying to upload his return of income for assessment year 2010-11 on 31st July, 2010, last date for filing the same, he found it extremely difficult to do the same due to network problems and ultimately he became successful in making e-filing of his return only at 1 A.M. on 1st August, 2010. The return contained a claim for carry forward of business loss of 1 lakh. This circumstance was recorded in a letter delivered to the office of the Deputy Commissioner of Income Tax on 1st August, 2010 during normal office hours. Rajesh made a request to the CBDT for condonation of delay in filing the return of income.*

Discuss whether the CBDT has the power to condone the delay in filing the return of income and permit carry forward of loss in the given circumstance.

- (b) *PQR Limited has written off certain debts as bad debts in the books of account and claimed deduction under section 36(1)(vii) in the return of income filed for Assessment Year 2011-12. The Assessing Officer made disallowance for deduction of bad debts on the ground that the debts have not been established to have become irrecoverable and bad in the previous year 2010-11.*

Examine the correctness of the action of the Assessing Officer.

- (c) *MNO Limited is engaged in manufacturing activities. It received liquidated damages of ₹ 10 lakh from supplier of machinery due to delay in supply of machinery. State, with reasons, whether or not the income by way of liquidated damages is assessable as income from business.*
- (d) *ABC JET Limited, an airline company, pays landing and parking charges to the Airports Authority of India. Discuss whether the company is required to deduct tax at source from such payment.*
- (e) *ABC Limited has claimed exemption on the income from long-term capital gains under section 54EC by investing in bonds of National Highway Authority of India within the prescribed time. In the computation of "book profit" under section 115JB, the company claimed exclusion of long-term capital gains because of exemption available on it by virtue of section 54EC. The Assessing Officer reckoned the book profit including long-*

term capital gains for the purpose of levy of minimum alternate tax payable under section 115JB.

Is the action of the Assessing Officer justified in law?

(4 × 4 = 16 Marks)

Answer

- (a) Section 119(2)(b) empowers the CBDT to authorise any income tax authority to admit an application or claim for any exemption, deduction, refund or any other relief under the Act after the expiry of the period specified under the Act, to avoid genuine hardship in any case or class of cases. The claim for carry forward of loss in case of late filing of a return is relatable to a claim arising under the category of “any other relief available under the Act”. Therefore, the CBDT has the power to condone delay in filing of such loss return due to genuine reasons.

The facts of the case are similar to the case of *Lodhi Property Company Ltd. v. Under Secretary, (ITA-II), Department of Revenue (2010) 323 ITR 0441*, where the Delhi High Court held that the Board has the power to condone the delay in case of a return which was filed late and where a claim for carry forward of losses was made. The delay was only one day and the assessee had shown justifiable reason for the delay of one day in filing the return of income. If the delay is not condoned, it would cause genuine hardship to the assessee. Therefore, the Court held that the delay of one day in filing of the return had to be condoned.

Applying the rationale of the above court ruling to the case on hand, the CBDT has the power to condone the delay in filing the return of income of Mr. Rajesh and permit carry forward of business loss of ₹ 1 lakh, since the delay of one hour was due to a genuine and justifiable reason i.e., network problem while e-filing the return.

- (b) As per section 36(1)(vii), the amount of any bad debts or part thereof which is written off as irrecoverable in the accounts of the assessee for the previous year is allowable as deduction, subject to the provisions of section 36(2).

Section 36(2), *inter alia*, provides that such debt should have been taken into account in computing the income of the assessee for the previous year in which it was written off or any earlier previous year or represents money lent in the ordinary course of the business of banking or money-lending which is carried on by the assessee.

Therefore, there is no requirement under section 36(1)(vii) to establish that the debt has become irrecoverable or bad. It is enough if the bad debts is written off as irrecoverable in the accounts of the assessee during the relevant previous year. It was so held by the Apex Court in the case of *T.R. F. Ltd. v. CIT (2010) 323 ITR 397*.

Applying the provisions of section 36(1)(vii), section 36(2) and the rationale of the Supreme Court decision, the action of the Assessing Officer in this case is incorrect, assuming PQR Ltd. had taken into account such debt in computing its income of this previous year or any earlier previous year.

- (c) The issue under consideration in this case is whether the liquidated damages received by a company from the supplier of machinery for delay in supply of machinery is revenue in nature i.e., whether the same can be assessed as business income.

On this issue, the Apex Court, in the case of *CIT v. Saurashtra Cement Ltd. (2010) 325 ITR 422*, held that such liquidated damages were directly and intimately linked with the procurement of a capital asset which lead to delay in coming into existence of the profit-making apparatus. It was not a receipt in the course of profit earning process. Therefore, the amount received by the assessee towards compensation for sterilization of the profit earning source, not in the ordinary course of business, is a capital receipt in the hands of the assessee.

Applying the rationale of the above Apex Court ruling in this case, the income by way of liquidated damages of ₹ 10 lakh received by MNO Ltd. from the supplier of machinery is a capital receipt and hence, not assessable as income from business.

- (d) This issue as to whether landing and parking charges could be deemed as rent to attract the provisions of section 194-I came up before the High Court in the cases of *CIT v. Japan Airlines Co. Ltd. (2010) 325 ITR 298* and *United Airlines v. CIT (2006) 287 ITR 281*.

The Court observed that rent as defined in section 194-I had a wider meaning than “rent” in common parlance. It included any payment under any agreement or arrangement for use of, *inter alia*, land. When the wheels of the aircraft coming into an airport touch the surface of the airfield, use of the land of the airport immediately begins. Similarly, for parking the aircraft in that airport, again, there is use of the land. Therefore, the landing and parking fee were “rent” within the meaning of the provisions of section 194-I as they were payments for the use of the land of the airport.

Applying the rationale of the above ruling to the case on hand, the payment of landing and parking charges by ABC JET Ltd., an airline company, to the Airports Authority of India is in the nature of rent, and accordingly, the provisions of tax deduction at source under section 194-I would be attracted, if the aggregate rental income during the year is ₹ 1,80,000 or more.

- (e) The issue under consideration in this case is whether long-term capital gain exempted by virtue of section 54EC can be included in the book profit computed under section 115JB for levy of minimum alternate tax.

It may be noted that minimum alternate tax (MAT) is attracted under section 115JB, on account of tax on total income being less than 18% of book profit. Chapter XII-B is a self-contained code for computation of book profit. The net profit as per the profit and loss account for the relevant previous year prepared in accordance with the provisions of Parts II and III of Schedule VI to the Companies Act, 1956, as increased/reduced by the specified adjustments provided for in *Explanation 1* to section 115JB would be the book profit for levy of MAT under section 115JB.

Therefore, if an assessee has claimed exemption under section 54EC by investing in bonds of National Highways Authority of India within the prescribed time, the long term capital gains so exempt would still be taken into account for computing book profit under section 115JB for levy of MAT, since *Explanation 1* to section 115JB does not provide for such deduction.

As long as long-term capital gains are part of the profits included in the profit and loss account prepared in accordance with the provisions of Parts II and III of Schedule VI to the Companies Act, 1956, capital gains cannot be excluded unless provided under *Explanation 1* to section 115JB. It was so held by the Kerala High Court in *N. J. Jose and Co. (P.) Ltd. v. ACIT (2010) 321 ITR 0132*.

Therefore, the action of the Assessing Officer is justified in law.

Question 5

- (a) Explain the term "Bilateral Relief" in the context of Double Taxation Avoidance Agreement. (4 Marks)
- (b) Ajay, a non-resident Indian, has the following sources of income in India during the previous year 2010-11:

	Particulars	₹	₹
(i)	Income from house property located in India (computed)		1,80,000
(ii)	Dividend from Indian Companies		75,000
(iii)	Interest on debentures of Indian company (Subscribed in convertible foreign exchange)	1,00,000	
	Less: Interest on loan taken for purchase of debentures	<u>20,000</u>	80,000
(iv)	Long-term capital gains on sale of debentures subscribed in US \$:		
	Cost in 2002-03	4,00,000	
	Sale in 2010-11	<u>6,00,000</u>	
		2,00,000	
	Less: Commission to brokers	<u>6,000</u>	1,94,000
	Cost Inflation Index: F.Y. 2002-03 - 447; F.Y.2010-11 – 711.		

Compute the tax payable by Ajay for Assessment Year 2011-12, if he opts for the provisions of Chapter XII-A of the Income-tax Act, 1961. (6 Marks)

- (c) State the consequences that would follow if the Assessing Officer makes adjustment to arm's length price in international transactions of the assessee resulting in increase in taxable income. What are the remedies available to the assessee to dispute such adjustment? (6 Marks)

Answer

- (a) Where a tax payer is resident in one country but has a source of income in another country, it gives rise to possible double taxation. The Governments of two countries can enter into a mutual agreement to provide relief to the tax payer against double taxation of the income by working out the basis on which the relief is to be granted. This is called bilateral relief.

Bilateral Relief may be granted by way of the following methods:

- (a) **Exemption method** :- Under this method, the relief is provided to the assessee by taxing a particular income in only one of the two countries, which would otherwise have been taxed in both the countries
- (b) **Tax relief method** :- Under this method, the income of the assessee is taxable in both countries in accordance with their respective tax laws/DTAAs. However, the country of which the tax payer is a resident, allows him credit for the tax charged on the doubly taxed income in the other country.

Note - In India, double taxation relief is provided for in sections 90 and 90A, either by way of granting relief in respect of income-tax paid in India and the other country or specified territory or by way of avoidance of double taxation of income in India and the other country or specified territory.

- (b) **Computation of tax liability of Mr. Ajay for the A.Y. 2011-12 as per provisions of Chapter XII-A**

Particulars	₹	₹
Tax on long term capital gain ($\text{₹ } 1,94,000 \times 10\%$) [See Notes 1 & 2]	19,400	
Tax on interest on debentures being investment income ($\text{₹ } 1,00,000 \times 20\%$) [See Notes 1 & 3]	20,000	
Tax on balance income of ₹ 1,80,000		
Upto ₹ 1,60,000	Nil	
₹ 1,60,000 – ₹ 1,80,000 @ 10%	<u>2,000</u>	41,400
Add: Education cess @ 2%		828
Add: Secondary and higher education cess @ 1%		414
Total tax liability		<u>42,642</u>
Total tax liability (rounded off)		42,640

Notes:

- (1) Computation of total income of Mr. Ajay for the A.Y. 2011-12 as per provisions of Chapter XII-A

Particulars	₹	₹
Income from house property (computed)		1,80,000
Capital Gains on sale of debentures		
Sale consideration	6,00,000	
Less: Commission to brokers	<u>6,000</u>	
Net sale consideration	5,94,000	
Cost of acquisition (Refer Note 2)	<u>4,00,000</u>	
Long term capital gain		1,94,000
Dividend income received from Indian companies [exempt under section 10(34)]		Nil
Interest on debentures of Indian company (Refer Note 3)		1,00,000
Total Income		<u>4,74,000</u>

- (2) As per section 115D, the indexation benefit would not be available for calculating cost of acquisition for computing long term capital gains under Chapter XII-A.
- (3) No expenditure is allowed to be deducted from the interest on debentures being the investment income as per the provisions of section 115D. Therefore, interest on loan taken for purchase of debentures is not deductible.
- (4) As per the provisions of section 115E, the tax rate applicable on investment income is 20% and on the long term capital gain the tax rate applicable shall be 10%. The balance income shall be chargeable to tax as per the normal tax rates.
- (5) It has been assumed that the debentures referred to in the question are issued by an Indian company which is not a private company and are hence, specified assets. Since the specified assets have been subscribed in convertible foreign exchange, they are foreign exchange assets.

Note - If a non-resident purchases shares in, or debentures of, an Indian company by utilising foreign currency, capital gain shall be calculated under first proviso to section 48 in the same foreign currency which was initially utilised in purchase of shares and debentures. Capital gains so computed in foreign currency shall be reconverted into Indian currency. Since the telegraphic transfer buying rates and telegraphic transfer selling rates of US \$ on the date of acquisition, date of sale and 31st March, 2011 are not given in the question, effect has not been given to the first proviso to section 48 in the above solution.

- (c) In case the Assessing Officer makes adjustment to Arm's Length Price in an international transaction which results in increase in taxable income of the assessee, the following consequences shall follow:-

- (1) No deduction under section 10A, section 10AA, section 10B or Chapter VI-A shall be allowed from the income so increased.
- (2) No corresponding adjustment would be made to the total income of the other associated enterprise (in respect of payment made by the assessee from which tax has been deducted or is deductible at source) on account of increase in the total income of the assessee on the basis of the arm's length price so recomputed.

The remedies available to the assessee to dispute such an adjustment are:-

- (1) In case the assessee is an eligible assessee under section 144C, he can file his objections to the variation made in the income within 30 days [of the receipt of draft order by him] to the Dispute Resolution Panel and Assessing Officer. Appeal against the order of the Dispute Resolution Panel can be made to the Income-tax Appellate Tribunal.
- (2) In any other case, he can file an appeal under section 246A to the Commissioner (Appeals) against the order of the Assessing Officer within 30 days of the date of service of notice of demand.
- (3) The assessee can opt to file an application for revision of order of the Assessing Officer under section 264 within one year from the date on which the order sought to be revised is communicated, provided the time limit for appeal to the Commissioner (Appeals) or the Income-tax Appellate Tribunal has expired or the assessee has waived the right of such an appeal. The eligibility conditions stipulated in section 264 should be fulfilled.

Question 6

- (a) *The Assessing Officer within his jurisdiction surveyed a popular Cyber Café at 12 o'clock in night for the purpose of collecting information which may be useful for the purposes of the Income-tax Act, 1961. The Cyber Café is kept open for business every day between 2 P.M. and 2 A.M. The owner of the Cyber Café claims that the Assessing Officer could not enter the café in late night. The Assessing Officer wanted to take away with him the books of account kept at the Cyber Café. Examine the validity of the claim made by the owner and the proposed action of the Assessing Officer.* (4 Marks)
- (b) *The Assessing Officer issued a notice under section 142(1) on the assessee on 24th December, 2010 calling upon him to file return of income for Assessment Year 2010-11. In response to the said notice, the assessee furnished a return of loss and claimed carry forward of business loss and unabsorbed depreciation. State whether the assessee would be entitled to carry forward as claimed in the return.* (4 Marks)

- (c) *The regular assessment of MNO Ltd. for the Assessment Year 2009-10 was completed under section 143(3) on 13th March, 2011. There was an audit objection by the Revenue Audit team that interest on loan should be disallowed partly as there was diversion of borrowed fund to sister concern without charge of interest.*

Based on the above facts:

- (i) *State, with reasons, whether the Assessing Officer can issue notice under section 148 on the basis of audit objection of the Revenue Audit team.*
 - (ii) *If the action stated in (i) above is not permitted, what is the option open to the Revenue Department to deal with the said audit objection? (5 Marks)*
- (d) *Discuss the correctness or otherwise of the following statements with reference to the provisions of the Income-tax Act, 1961:*
- (i) *An appeal before Income-tax Appellate Tribunal cannot be decided in the event of difference of opinion between the Judicial Member and the Accountant Member on a particular ground.*
 - (ii) *A High Court does not have an inherent power to review an earlier order passed by it on merits. (3 Marks)*

Answer

- (a) The Assessing Officer can exercise his power of survey under section 133A only after obtaining the approval of the Joint Commissioner or Joint Director, as the case may be. Assuming that he has obtained such approval in this case, he is empowered under section 133A to enter any place of business of the assessee within his jurisdiction only during the hours at which such place is open for the conduct of business.

In the case given, the cyber cafe is open from 2.00 p.m. to 2.00 a.m. for the conduct of business. The Assessing Officer entered the cyber cafe at 12 o'clock in the night which falls within the working hours of the cyber cafe. Therefore, the claim made by the owner to the effect that the Assessing Officer could not enter the cyber cafe at late night is not in accordance with law.

Further, as per section 133A(3)(ia), the Assessing Officer may, impound and retain in his custody for such period as he thinks fit, any books of account or other documents inspected by him. However, he shall not impound any books of account or other documents except after recording his reasons for doing so. He shall not retain in his custody any such books of account or other documents for a period exceeding ten days (exclusive of holidays) without obtaining the approval of the Chief Commissioner or Director General therefor, as the case may be.

- (b) As per the provisions of section 139(3), any person who has sustained loss under the head 'Profit and gains of business or profession' is allowed to carry forward such a loss under section 72(1) or section 73(2), only if he has filed the return of loss within the time allowed under section 139(1). Also, the provisions of section 80 specify that a loss which has not been determined as per the return filed under section 139(3) shall not be allowed to be carried

forward and set-off under, *inter alia*, section 72(1) (relating to business loss) or section 73(2) (losses in speculation business) or section 74(1) (loss under the head "Capital gains") or section 74A(3) (loss from the activity of owning and maintaining race horses). However, if the loss relates to a "specified business" to be carried forward under section 73A, no such condition is imposed either under section 139(3) or under section 80. Further, there is no such condition for carry forward of unabsorbed depreciation under section 32.

In the given case, the assessee has filed its return of loss in response to notice under section 142(1). As per the provisions stated above, the return filed by the assessee in response to notice under section 142(1) is a belated return and therefore, the benefit of carry forward of business loss under section 72(1) or section 73(2) shall not be available. However, if the loss relates to a "specified business" to be carried forward under section 73A, the same can be carried forward. The assessee shall also be entitled to carry forward the unabsorbed depreciation as per provisions of section 32(2).

- (c) (i) Section 147 states that, *inter alia*, if the Assessing Officer has reason to believe that any income chargeable to tax has escaped assessment for any assessment year, he may, assess or reassess such income and also any other income chargeable to tax which has escaped assessment and which comes to his notice subsequently in the course of the proceedings under this section.

The basic requirements are as follows:

- (1) The Assessing Officer should have reason to believe that income chargeable to tax has escaped assessment. The belief should be that of the Assessing Officer and not the audit party.
- (2) It is further well established that audit party cannot express opinion on legal issues or issues involving provisions of law [*Indian & Eastern Newspaper Society v. CIT (1979) 119 ITR 996 (SC)*]. Such opinion cannot be the basis upon which the Assessing Officer can initiate reassessment proceedings.
- (3) The Income-tax Act, 1961 does not confer jurisdiction on change of opinion on the interpretation of a particular provision earlier adopted by the assessing authority. It is assumed that this issue had already been considered earlier during the course of scrutiny assessment and the Assessing Officer had come to a conclusion that no disallowance of interest paid by the assessee is required, even though loans had been given to sister concern without any interest. Therefore, the same issue cannot be the basis of reassessment, merely because the revenue audit team takes a different view.

Therefore, the Assessing Officer cannot issue notice under section 148 on the basis of audit objection of the Revenue Audit team.

- (ii) The option open to the Revenue is initiation of proceedings under 263, by the jurisdictional Commissioner. He has the power to call for and examine the records,

if he is of the opinion that the order passed by the Assessing Officer under section 143(3) is erroneous in so far as it is prejudicial to the interests of the Revenue.

However, where the Assessing Officer has considered the issue in the original assessment and come to a conclusion that no disallowance of interest is called for, the Commissioner cannot initiate revisionary proceedings, merely because he holds a different view. Only where the view taken by the Assessing Officer is unsustainable in law, the Commissioner will be justified in initiating the revisionary proceedings under section 263. In *CIT v. Sohana Woollen Mills (2008) 296 ITR 238*, it has been held that mere audit objection and merely because a different view can be taken, are not enough to say that the order of the Assessing Officer is erroneous or prejudicial to the interest of revenue.

- (d) (i) The statement given is not correct. As per the provisions of section 255, in the event of difference in opinion between the members of the Bench of the Income-tax Appellate Tribunal, the matter shall be decided on the basis of the opinion of the majority of the members. In case the members are equally divided, they shall state the point or points of difference and the case shall be referred by the President of the Tribunal for hearing on such points by one or more of the other members of the Tribunal. Such point or points shall be decided according to the opinion of majority of the members of the Tribunal who heard the case, including those who had first heard it.
- (ii) The statement given is correct. As per the decision given by the High Court in the case of *Deepak Kumar Garg v. CIT (2010) 327 ITR 448*, the power to review the order passed is not an inherent power but need to be expressly provided in the statute by way of specific provisions or by way implication. It was observed that, by virtue of section 260A(7), the power of re-admission or restoration of the appeal is always enjoyed by the High Court. However, such power cannot be treated to be a power to review its earlier order on merits as it is not expressly provided for in the law.

Question 7

- (a) Ms. Madhvi, a resident individual and self-employed industrial designer, furnished the following particulars for the year ended 31-03-2011:

	Particulars	₹
i.	Gross total income	5,00,000
ii.	Housing loan principal repayment. The property is under construction at Jaipur as on 31-03-2011.	1,10,000
iii.	Principal repayment of housing loan from a relative. This property is self-occupied situated at Jodhpur.	50,000
iv.	Contribution to Public Provident Fund in the name of her mother.	70,000
v.	She deposited ₹ 5,000 per month in her account under a pension scheme notified by the Central Government.	

Compute total income of Ms. Madhvi for Assessment Year 2011-12 stating reasons for the deduction eligible under appropriate provisions of Chapter VI-A. (5 Marks)

- (b) A sum of ₹ 60,000 was paid to Mr. Dastur, an advocate, on 1st July, 2010 towards fees for his professional services without deducting tax at source. Later on, a further sum of ₹ 70,000 was due to him on 27th February, 2011 from which tax of ₹ 13,000 was deducted at source. The tax so deducted was deposited on 25th June, 2011. Compute interest payable by the deductor under section 201(1A). (5 Marks)
- (c) Explain whether there is conflict between accounting standards and provisions of the Income-tax Act, 1961 in respect of the following:
- Effect of fluctuation in foreign currency rates where a capital asset is imported by a company.
 - Permanent fall in value of long-term investments held by a company. (3×2=6 Marks)

Answer

- (a) Computation of total income of Ms. Madhvi for the A.Y. 2011-12

Particulars	₹	₹
Gross Total Income		5,00,000
Less: Deductions under Chapter VI-A		
<u>Section 80C</u>		
Principal repayment for housing loan taken for house property at Jaipur [See Note 1]	Nil	
Principal repayment for housing loan taken for house property at Jodhpur [See Note 2]	Nil	
Contribution to public provident fund in the name of mother [See Note 3]	Nil	
<u>Section 80CCD</u>		
Contribution to pension scheme notified by the Central Government [See Note 4]	50,000	50,000
Total income		<u>4,50,000</u>

Notes :

- As per the provisions of section 80C, the deduction for principal repayment of housing loan is provided only in respect of a house property whose income is chargeable to tax under the head 'Income from house property'. As the house property at Jaipur is still under construction, no income is chargeable to tax under the head "Income from house property". Hence, no deduction would be available under section 80C for principal repayment of the housing loan for property under construction at Jaipur.
- The deduction for principal repayment of housing loan under section 80C is provided only in respect of the loan taken from the institutions mentioned under

section 80C (like banks, Life Insurance Corporation of India, National Housing Bank, specified employer etc.) However, loan from a relative does not qualify for deduction under section 80C. Since, in the present case, the loan is taken from a relative, no deduction would be available under section 80C for the repayment of the principal in respect of self-occupied property at Jodhpur.

- (3) The contribution to public provident fund is allowed as deduction only if it is in the name of specified persons mentioned in section 80C, namely, self, spouse or any child of such individual. Since mother of the individual is not a specified person as per section 80C, no deduction would be available for the contribution to public provident fund in the name of the mother.
- (4) The deduction under section 80CCD shall be an amount not exceeding 10% of the gross total income of in case of a self-employed individual. Therefore, the deduction in respect of deposit by Ms. Madhvi to the pension scheme notified by the Central Government ₹ 60,000 shall be limited to ₹ 50,000, being 10% of ₹ 5,00,000.
- (b) In this case, tax is deductible@10% under section 194J in respect of fees for professional services. Since there has been a delay in deduction and deposit of tax, interest under section 201(1A) is attracted.

As per the provisions of section 201(1A), if a person who is liable to deduct tax at source fails to deduct tax at source or after deducting such tax, fails to pay the tax as required by the Act, then he is liable to pay interest as follows -

- (i) 1% for every month or part of month on the amount of such tax from the date on which such tax was deductible to the date on which such tax is actually deducted.
- (ii) 1½% for every month or part of month on the amount of such tax from the date on which such tax was deducted to the date on which tax is actually paid.

Therefore, in the given case, interest under section 201(1A) would be computed as follows –

	₹
1% on tax deductible but not deducted i.e., 1% on ₹ 6,000 for 8 months	480
1½% on tax deducted but not deposited i.e. 1½% on ₹ 13,000 for 4 months	780
Total interest payable under section 201(1A)	1,260

- (c) (i) As per AS-11 on “Accounting for the effects of changes in foreign exchange rates”, exchange differences relating to a liability incurred (i.e. loan taken to repaid in installments) for acquiring fixed assets, which are carried in terms of historical cost, cannot be adjusted in the carrying amount of the said fixed assets. The effect of fluctuation in foreign currency has to be charged to profit and loss account at the end of each year.

However, the provisions of section 43A of the Income-tax Act, 1961 requires such exchange differences to be adjusted against the actual cost of the imported asset in the year in which the actual payment is made irrespective of the method of accounting followed by the assessee.

Therefore, there is a difference regarding the treatment of the effect of fluctuation in foreign currency rates (where a loan is taken for purchase of capital asset imported by a company) as per the accounting standards and as per the provisions of the Income-tax Act, 1961.

Note - It may be noted that in the case of companies, the exchange difference relating to acquisition of a depreciable capital asset can be adjusted against the cost of the asset at the end of each year, at the option of the enterprise. This treatment can be done in respect of accounting periods between 7th December, 2006 and 31st March, 2012.

- (ii) As per AS-13 on "Accounting for Investments", long-term investments should be carried at cost and provision should be made to recognize a permanent decline in the value of long-term investments. Such reduction should be determined and made for each investment individually.

However, under the Income-tax Act, 1961 there is no provision to recognize any decline in the value of investments, whether permanent or temporary. Only if the investments are disposed of, the profit/loss on account of the same is recognized.

Therefore, there is a difference in the treatment of the permanent decline in the value of the long term investments held by a company under the accounting standards and the provisions of the Income-tax Act, 1961.