

PAPER – 4 : TAXATION

Question No.1 is compulsory.

Attempt any *five* questions from the remaining six questions.

Wherever required, suitable assumptions may be made by the candidates.

Working notes should form part of the answer.

Question 1

(a) Rao & Jain, a partnership firm consisting of two partners, reports a net profit of ₹ 7,00,000 before deduction of the following items:

- (1) Salary of ₹ 20,000 each per month payable to two working partners of the firm (as authorized by the deed of partnership).
- (2) Depreciation on plant and machinery under section 32 (computed) ₹ 1,50,000.
- (3) Interest on capital at 15% per annum (as per the deed of partnership). The amount of capital eligible for interest ₹ 5,00,000.

Compute:

- (i) Book-profit of the firm under section 40(b) of the Income-tax Act, 1961.
 - (ii) Allowable working partner salary for the assessment year 2011-12 as per section 40(b) of the Income-tax Act, 1961. (5 Marks)
- (b) Shri Madan (age 67 years) gifted a building owned by him to his son's wife Smt. Hema on 01-10-2010. The building fetched a rental income of ₹ 10,000 per month throughout the year. Municipal tax for the first half-year of ₹ 5,000 was paid in June 2010 and the municipal tax for the second half-year was not paid till 30-09-2011.

Incomes of Shri Madan and Smt. Hema other than income from house property are given below:

Name	Business income (₹)	Capital gain (₹)	Other sources (₹)
Shri Madan	1,00,000	50,000 (long term)	1,50,000
Smt. Hema	(75,000)	2,00,000 (short term)	50,000

Note: Capital gain does not relate to gain from shares and securities.

Compute the total income of Shri. Madan and Smt. Hema taking into account income from property given above and also compute their income-tax liability for the assessment year 2011-12. (5 Marks)

The Suggested Answers for Paper 4: Taxation are based on the provisions of law as amended by the Finance Act, 2010 and applicable for A.Y. 2011-12 (in the case of Income-tax), which is the assessment year relevant for November, 2011 examination.

- (c) Vikas Coaching Centre, engaged in commercial training and coaching service, furnishes you the following information and the amounts received by it for the half-year ended 31-03-2011:-

	₹
Coaching fee for Civil Service examinations	3,50,000
Postal coaching fee for University examinations	2,40,000
Sports coaching fee from a local college	1,10,000
Fee for management diploma of a foreign university (not recognized by law in force in India)	4,40,000
Coaching and training provided by sending staff to the residence of service receivers.	6,40,000

Determine the value of taxable service. Your answer must be with reasons. (5 Marks)

- (d) Laxman, a registered dealer submits the following information for the month of February, 2011:

Particulars	Amount (₹)	Rate of VAT
<u>Details of purchase</u>		
Raw material purchased from another State (CST @ 2%)	10,00,000	
Raw material X purchased within the State	15,00,000	1%
Raw material Y imported from Singapore (includes customs duty paid @ 10%)	11,00,000	
Raw material Z purchased within the State.	6,00,000	12.5%
<u>Details of Sales</u>		
Sale of goods produced from raw material X	27,00,000	4%
Sale of goods produced from inter-state purchase and imported raw materials	32,00,000	1%
Sale of goods produced from raw material Z	8,00,000	12.5%

Note: The purchase and sales figures given above do not include VAT / CST.

Assume that there was no opening or closing inventory. Compute the amount of Value Added Tax (VAT) payable by Laxman for the month of February, 2011. (5 Marks)

Answer

- (a) (i) As per the provisions of Explanation 3 to section 40(b), book profit shall mean the net profit as per the profit and loss account for the relevant previous year computed in the manner laid down in Chapter IV-D as increased by the aggregate amount of the

remuneration paid or payable to the partners of the firm if the same has been already deducted while computing the net profit.

In the present case, the net profit given is before deduction of depreciation on plant and machinery, interest on capital of partners and salary to the working partners. Therefore, the book profits shall be as follows:

**Computation of Book Profit of the firm under section 40(b) of the
Income-tax Act, 1961.**

Particulars	₹	₹
Net Profit (before deduction of depreciation, salary and interest)		7,00,000
Less: Depreciation under section 32	1,50,000	
Interest @ 12% p.a. [being the maximum allowable as per section 40(b)] (5,00,000 × 12%)	<u>60,000</u>	<u>2,10,000</u>
Book Profit		<u>4,90,000</u>

- (ii) Salary actually paid to working partners = 20,000 × 2 × 12 = ₹ 4,80,000.

As per the provisions of section 40(b)(v), the salary paid to the working partners is allowed subject to the following limits -

On the first ₹ 3,00,000 of book profit	₹ 1,50,000 or 90% of book profit, whichever is more
On the balance of book profit	60% of the balance book profit

Therefore, the maximum allowable working partners' salary for the A.Y. 2011-12 in this case would be:

Particulars	₹
On the first ₹ 3,00,000 of book profit [(₹ 1,50,000 or 90% of ₹ 3,00,000) whichever is more]	₹ 2,70,000
On the balance of book profit [60% of (₹ 4,90,000 - ₹ 3,00,000)]	<u>₹ 1,14,000</u>
Maximum allowable partners' salary	<u>₹ 3,84,000</u>

Hence, allowable working partners' salary for the A.Y. 2011-12 as per the provisions of section 40(b)(v) is ₹ 3,84,000.

(b) Computation of total income and tax liability of Shri Madan for A.Y. 2011-12

Particulars	₹	₹
Income from house property (Refer Note 1)		80,500
Business Income		1,00,000
Long-term Capital Gains		50,000
Income from Other Sources		<u>1,50,000</u>
Total Income		<u>3,80,500</u>
Computation of tax liability		
Long-term Capital Gain of ₹ 50,000 @ 20%		10,000
Other income of ₹ 3,30,500		
(₹ 3,30,500 – ₹ 2,40,000) × 10% (Refer Note 2)		<u>9,050</u>
		19,050
Add: Education Cess @ 2%	381	
Secondary and Higher Education Cess @ 1%	<u>191</u>	<u>572</u>
Tax liability		<u>19,622</u>
Tax liability (Rounded Off)		19,620

Computation of Total Income and Tax Liability of Smt. Hema for A.Y. 2011-12

Particulars	₹	₹
Short-term Capital Gains	2,00,000	
Less: Business loss	<u>75,000</u>	1,25,000
Income from Other Sources		<u>50,000</u>
Total Income		<u>1,75,000</u>
Tax liability (Since total income is less than basic exemption limit of ₹ 1,90,000)		Nil

Note:

- As per section 64(1)(vi), the income arising to the son's wife of an individual, directly or indirectly, from assets transferred to her, otherwise than for adequate consideration, by such individual, shall be included in the total income of the individual.

Therefore, the rental income from building transferred by Shri Madan to his son's wife Smt. Hema without consideration on 01.10.2010 is includible in the hands of Shri Madan.

Computation of Income from House Property

Particulars	Madan (₹)	Hema (₹)
	Period (01.04.2010- 30.09.2010)	Period (01.10.2010- 31.03.2011)
Gross Annual Value (₹ 10,000 × 6 months) (Rental income taken as GAV in the absence of information relating to Municipal Value, fair value and standard rent)	60,000	60,000
Less: Municipal taxes paid (paid in June for first half year only)	<u>5,000</u>	<u>Nil</u>
Net Annual Value (NAV)	55,000	60,000
Less: Deduction under section 24(a), 30% of NAV	<u>16,500</u>	<u>18,000</u>
Income from House Property	38,500	<u>42,000</u>
Income from House Property of Hema to be clubbed in the hands of Madan as per section 64(1)(vi)	<u>42,000</u>	
Income from house property	<u>80,500</u>	

2. The basic exemption limit for A.Y. 2011-12 in respect of an individual who is of the age of 65 years or more during the relevant previous year is ₹ 2,40,000. The same has been considered while calculating Madan's tax liability.

(c) Computation of value of taxable services of Vikas Coaching Centre for the half-year ended 31.03.2011

S. No.	Particulars	₹
(i)	Coaching fee for civil service examinations [Refer Note 1]	3,50,000
(ii)	Postal coaching fees for university examinations [Refer Note 1]	2,40,000
(iii)	Coaching and training provided by sending staff to the residence of service receivers [Refer Note 1]	6,40,000
(iv)	Sports coaching fee from a local college [Refer Note 2]	-
(v)	Fee for management diploma of a foreign university not recognized by law in force in India [Refer Note 3]	<u>4,40,000</u>
	Total taxable services including service tax @ 10.30%	<u>16,70,000</u>
	Value of taxable services	15,14,053
	Value of taxable services (rounded off)	15,14,050

Notes

1. The definition of commercial training or coaching centre specifically includes *inter alia* any institute or establishment providing coaching or tutorial classes and hence, items mentioned in point (i), (ii) and (iii) would be liable to service tax.

2. Sports coaching is not taxable as the same is specifically excluded from the definition of commercial training or coaching centre.
3. Fee for management diploma of a foreign university not recognized by law in force in India would be liable to service tax as only the institute or establishment issuing certificate/diploma/degree/educational qualification recognized by law for the time being in force in India are outside the purview of service tax.
4. As the details furnished are the amounts received, the same are taken to be inclusive of service tax and hence, the value of taxable service has been computed by making back calculations $\frac{16,70,000}{110.38} \times \frac{100}{100}$.
5. It has been presumed that Vikas Coaching Centre is not eligible for exemption available to small service providers.

(d) Computation of VAT payable by Laxman for the month of February, 2011:-

Particulars	₹	₹
Total Output VAT payable [A]		
Goods produced from raw material (27,00,000 × 4%)	1,08,000	
Goods produced from inter-State purchases and imported raw materials (32,00,000 × 1%)	32,000	
Goods produced from raw material Z (8,00,000 × 12.5%)	<u>1,00,000</u>	2,40,000
Input VAT [B]		
Raw material purchased from another State [Refer Note 1]	Nil	
Raw material Y imported from Singapore [Refer Note 2]	Nil	
Raw material X purchased within the State (15,00,000 × 1%)	15,000	
Raw material Z purchased within the State (6,00,000 × 12.5%)	<u>75,000</u>	<u>90,000</u>
Net VAT payable [A-B]		<u>1,50,000</u>

Notes:

1. Input tax credit is not available on purchases made from another State liable to central sales tax.
2. Purchases made from outside India liable to customs duty are not eligible for input tax credit.

Question 2

- (a) Mr. Balaji, employed as Production Manager in Beta Ltd., furnishes you the following information for the year ended 31-03-2011:
- (i) Basic salary upto 31-10-2010 ₹ 50,000 p.m.

Basic salary from 01-11-2010 ₹ 60,000 p.m.

Note: Salary is due and paid on the last day of every month.

- (ii) Dearness allowance @ 40% of basic salary.
- (iii) Bonus equal to one month salary. Paid in October 2010 on basic salary plus dearness allowance applicable for that month.
- (iv) Contribution of employer to recognized provident fund account of the employee @ 16% of basic salary.
- (v) Profession tax paid ₹ 3,000 of which ₹ 2,000 was paid by the employer.
- (vi) Facility of laptop and computer was provided to Balaji for both official and personal use. Cost of laptop ₹ 45,000 and computer ₹ 35,000 were acquired by the company on 01-12-2010.
- (vii) Motor car owned by the employer (cubic capacity of engine exceeds 1.60 litres) provided to the employee from 01-11-2010 meant for both official and personal use. Repair and running expenses of ₹ 45,000 from 01-11-2010 to 31-03-2011, were fully met by the employer. The motor car was self-driven by the employee.
- (viii) Leave travel concession given to employee, his wife and three children (one daughter aged 7 and twin sons aged 3). Cost of air tickets (economy class) reimbursed by the employer ₹ 30,000 for adults and ₹ 45,000 for three children. Balaji is eligible for availing exemption this year to the extent it is permissible in law.

Compute the salary income chargeable to tax in the hands of Mr. Balaji for the assessment year 2011-12. (8 Marks)

- (b) (i) When does e-payment of service tax become mandatory?
- (ii) State the 'due date' for e-payment of service tax by individuals and companies. (4 Marks)
- (c) Explain the role of Chartered Accountants in proper compliance of VAT. (Any 4 points.) (4 Marks)

Answer

- (a) Computation of Taxable Salary of Mr. Balaji for A.Y. 2011-12

Particulars	₹
Basic salary [(₹ 50,000 × 7) + (₹ 60,000 × 5)]	6,50,000
Dearness Allowance (40% of basic salary)	2,60,000
Bonus (₹ 50,000 + 40% of ₹ 50,000) (See Note 1)	70,000
Employers Contribution to Recognised Provident Fund in excess of 12% of salary = 4% of ₹ 6,50,000 (See Note 4)	26,000

Professional tax paid by employer	2,000
Perquisite of Motor Car (₹ 2,400 for 5 months) (See Note 5)	<u>12,000</u>
Gross Salary	10,20,000
Less: Deduction under section 16	
Professional tax (See Note 6)	<u>3,000</u>
Taxable Salary	<u>10,17,000</u>

Notes:

1. Since bonus was paid in the month of October, the basic salary of ₹ 50,000 for the month of October is considered for its calculation.
2. As per Rule 3(7)(vii), facility of use of laptop and computer is an exempt perquisite, whether used for official or personal purpose or both.
3. Mr. Balaji can avail exemption under section 10(5) on the entire amount of ₹ 75,000 reimbursed by the employer towards Leave Travel Concession since the same was availed for himself, his wife and three children and the journey was undertaken by economy class airfare. The restriction imposed for two children is not applicable in case of multiple births which take place after the first child.

It is assumed that the Leave Travel Concession was availed for journey within India.

4. It is assumed that dearness allowance does not form part of salary for computing retirement benefits.
5. As per the provisions of Rule 3(2), in case a motor car (engine cubic capacity exceeding 1.60 liters) owned by the employer is provided to the employee without chauffeur for personal as well as office use the value of perquisite shall be ₹ 2,400 per month. The car was provided to the employee from 01.11.2010 therefore, the perquisite value has been calculated for 5 months.
6. As per section 17(2)(iv), a "perquisite" includes any sum paid by the employer in respect of any obligation which, but for such payment, would have been payable by the assessee. Therefore, professional tax of ₹ 2,000 paid by the employer is taxable as a perquisite in the hands of Mr. Balaji. As per section 16(iii), a deduction from the salary is provided on account of tax on employment i.e. professional tax paid during the year.

Therefore, in the present case, the professional tax paid by the employer on behalf of the employee ₹ 2,000 is first included in the salary and deduction of the entire professional tax of ₹ 3,000 is provided from salary.

- (b) (i) E-payment of service tax becomes mandatory if the assessee has paid a total service tax of ₹ 10 lakh or more (including the amount of service tax paid by utilizing CENVAT credit) in the previous financial year.

(ii)

Assessee	Due date for e-payment of service tax
(i) Individuals	6 th day of the month immediately following the quarter in which the value of taxable services are received
(ii) Companies	6 th day of the month immediately following the month in which the value of taxable services are received

However, service tax on the value of taxable services received in the month of March is payable by 31st March by both, individuals and companies.

(c) A Chartered Accountant plays a key role in proper compliance of VAT:-

- (i) *Record keeping*: For effective utilization of input tax credit, systematic records of the same have to be maintained. Chartered Accountants are well-equipped to ensure compliance of such record keeping requirements prescribed under VAT laws of different States.
- (ii) *Handling audit by Departmental officers*: By maintaining proper records of the client, a Chartered Accountant is able to satisfy the Departmental auditors. His professional expertise helps him in effectively replying to audit queries and resolving audit objections.
- (iii) *Procedural requirements of VAT laws*: Chartered Accountants ensure compliance of various procedural requirements prescribed under VAT laws of different States like submission of periodical returns, statements etc. by utilizing their technical knowledge and analytical abilities.
- (iv) *External audit of VAT records*: Under VAT, assessee is required to self-assess the VAT liability and only a few returns would be scrutinized on a selective basis. Hence, a check on compliance gains paramount importance. Chartered Accountants help in ensuring tax compliance by audit of VAT accounts.

Question 3

- (a) Mr. Selvan, acquired a residential house in January, 2000 for ₹ 10,00,000 and made some improvements by way of additional construction to the house, incurring expenditure of ₹ 2,00,000 in October, 2004. He sold the house property in October, 2010 for ₹ 75,00,000. The value of property was adopted as ₹ 80,00,000 by the State stamp valuation authority for registration purpose. He acquired a residential house in January, 2010 for ₹ 25,00,000. He deposited ₹ 20,00,000 in capital gains bonds issued by National Highways Authority of India (NHAI) in June, 2011.

Compute the capital gain chargeable to tax for the assessment year 2011-12.

What would be the tax consequence and in which assessment year it would be taxable, if the house property acquired in January, 2010 is sold for ₹ 40,00,000 in March, 2012?

Cost inflation index :	F.Y. 1999-2000	= 389	
	F.Y. 2004-2005	= 480	
	F.Y. 2010-2011	= 711	
	F.Y. 2011-1012	= 785	(8 Marks)

- (b) ABC Private Ltd., is engaged in providing a taxable service. For the month of January 2011, its gross receipts were ₹ 18,00,000. The break-up of these receipts are as follows:

Month in which services are performed	Receipt (₹)
March, 2010 (includes ₹ 1,00,000 for the services rendered to an international organization)	4,00,000
April, 2010 (includes ₹ 1,25,000 for the services rendered within the Indian territorial waters)	3,00,000
January, 2011 (includes ₹ 1,75,000 for services rendered to its associated enterprise)	5,00,000
February, 2011 (includes ₹ 1,50,000 for services rendered in the State of Jammu & Kashmir)	6,00,000

In the financial year 2009-10, ABC Private Ltd., had paid ₹ 2,06,000 as service tax (@ 10.3%). State the amount of service tax payable; for the month of January, 2011.

(4 Marks)

- (c) State any two benefits and two drawbacks for a dealer who opts for composition scheme under VAT as per White Paper. (4 Marks)

Answer

- (a) (I) Computation of Capital Gains Chargeable to tax for A.Y. 2011-12

Particulars	₹	₹
Sale consideration (i.e. Stamp Duty Value) (Note-1)		80,00,000
Less: Indexed Cost of Acquisition		
10,00,000 × 711/389	18,27,763	
Indexed Cost of Improvement		
2,00,000 × 711/480	<u>2,96,250</u>	<u>21,24,013</u>
		58,75,987
Less: Capital Gains exemption under section 54 (Note-2)		<u>25,00,000</u>
Taxable Capital Gains		<u>33,75,987</u>

Notes -

- As per the provisions of section 50C, in case the stamp duty value adopted by the stamp valuation authority is higher than the actual sale consideration, the

stamp duty value shall be deemed as the full value of consideration.

2. Exemption under section 54 is available if a new residential house is purchased within one year before or two years after the date of transfer. Since the cost of new residential house is less than the capital gain, capital gain to the extent of cost of new asset is exempt under section 54.
 3. Exemption under section 54EC is available in respect of investment in bonds of National Highways Authority of India only if the investment is made within a period of six months after the date of such transfer. In this case, since the investment is made after six months, exemption under section 54EC would not be available.
- (II) If the new asset purchased by the assessee on the basis of which exemption under section 54 is claimed, is transferred within 3 years from the date of its acquisition, then for computing the taxable short-term capital gain on such transfer, the capital gain exempted earlier shall be reduced from the cost of acquisition of such asset.

Hence, in the present case, if the house property acquired in January, 2010 is sold for ₹ 40,00,000 in March, 2012 (i.e. before the expiry of 3 years from the date of acquisition), the capital gains exempted earlier (i.e. ₹ 25,00,000) would be reduced from the cost of acquisition (i.e. ₹ 25,00,000) to arrive at the short-term capital gains for A.Y. 2012-13.

Particulars	₹	₹
Sale consideration		40,00,000
Less: Cost of acquisition	25,00,000	
Capital gains exempted earlier	<u>(25,00,000)</u>	<u>Nil</u>
Short-term Capital Gains		<u>40,00,000</u>

- (b) Computation of service tax payable by ABC private Ltd. for the month of January, 2011

Particulars	₹
Services performed in March, 2010 [Refer Note 1]	3,00,000
Services performed in April, 2010 [Refer Note 2]	3,00,000
Services performed in January, 2011 [Refer Note 3]	5,00,000
Services performed in February, 2011 [Refer Note 4]	<u>4,50,000</u>
Total taxable services including service tax	<u>15,50,000</u>
Service tax (including 3% education cesses) payable on above, rounded off [Refer Note 5]	1,44,742

Notes:

1. Services rendered to an international organization have been exempted from payment of service tax by the Central Government.

2. Levy of service tax extends to whole of India excluding Jammu and Kashmir and India includes Indian territorial waters. Hence, services rendered within Indian territorial waters would be liable to service tax.
3. Services rendered to associated enterprise are liable to service tax.
4. Levy of service tax extends to whole of India excluding Jammu and Kashmir. Hence, services rendered in Jammu and Kashmir would not be liable to service tax.
5. As the particulars relate to gross receipts, the same are taken to be inclusive of service tax and hence service tax has been computed by making back calculations

$$\frac{₹15,50,000}{110.3} \times \frac{10.3}{100}$$

6. The aggregate value of taxable services of ABC Private Ltd. in the preceding financial year i.e., F.Y. 2009-10 is more than ₹10,00,000 as it has paid service tax of ₹ 2,06,000. Hence, it will not be entitled to exemption for small service providers in F.Y. 2010-11 and would be liable to service tax.

(c) Benefits of composition scheme for a dealer:-

- (i) VAT system requires detailed accounting and record keeping which increases the labour and the compliance cost. The composition scheme saves a lot of labour and efforts in keeping records thereby reducing the cost of doing business. Under this scheme, a very small amount of tax is payable.
- (ii) Composition scheme simplifies the calculation of tax liability of a dealer. Moreover, there is a simple return form to cover longer return period.

Drawbacks of composition scheme for a dealer:-

- (i) The dealer under a composition scheme cannot avail input tax credit and issue tax invoices in order to pass on tax credit. This adds to the cost of the goods sold by him.
- (ii) As the purchaser would not get any tax credit for the purchases made by him from the dealer operating under the composition scheme, the purchasers desirous of availing input tax credit on their purchases may not prefer to buy from composition dealers. Hence, the profitability of the dealer may get affected.

Question 4

- (a) *Ramji Ltd., engaged in manufacture of medicines (pharmaceuticals), furnishes the following information for the year ended 31-03-2011:*
 - (i) *Municipal tax relating to office building ₹51,000 not paid till 30-09-2011.*
 - (ii) *Patent acquired for ₹20,00,000 on 01-09-2010 and used from the same month.*
 - (iii) *Capital expenditure on scientific research ₹ 10,00,000 which includes cost of land ₹ 2,00,000.*

- (iv) Amount due from customer X outstanding for more than 3 years written off as bad debt in the books ₹ 5,00,000.
- (v) Income tax paid ₹ 90,000 by the company in respect of non-monetary perquisites provided to its employees.
- (vi) Provident fund contribution of employees ₹ 5,50,000 remitted in July, 2011.
- (vii) Expenditure towards advertisement in souvenir of a political party ₹ 1,50,000.
- (viii) Refund of sales tax ₹ 75,000 received during the year, which was claimed as expenditure in an earlier year.

State with reasons the taxability or deductibility of the items given above under the Income-tax Act, 1961.

Note: Computation of total income is not required. (8 Marks)

- (b) Explain optional composition scheme under service tax for distributor or selling agents of lotteries. (4 Marks)
- (c) State with reasons whether the following are true or false in the context of VAT as per White Paper:
 - (i) No declaration form is prescribed under VAT system.
 - (ii) Taxpayer's Identification Number (TIN) is a 10 digit alpha numeral.
 - (iii) Self assessment concept on deemed basis is one of the important features of VAT.
 - (iv) Set off of input tax credit on capital goods is available only to manufacturers and not to traders (4 Marks)

Answer

- (a) (i) As per section 43B, municipal tax is not deductible for A.Y. 2011-12 since it is not paid on or before 30.09.2011, being the due date of filing the return for A.Y. 2011-12.
- (ii) Patent is an intangible asset eligible for depreciation@25%. Since it has been acquired and put to use for more than 180 days during the previous year 2010-11, full depreciation of ₹ 5,00,000 (i.e. 25% of ₹ 20,00,000) is allowable as deduction under section 32.
- (iii) Weighted deduction@200% is available under section 35(2AB) in respect of expenditure incurred by a company on scientific research on in-house research and development facility as approved by the prescribed authority. However, cost of land is not eligible for deduction.

Deduction under section 35(2AB) = 200% of ₹ 8 lakhs = ₹ 16,00,000.

Note: It is presumed that the in-house research and development facility is approved by the prescribed authority and is hence, eligible for the weighted deducted@200% under section 35(2AB).

- (iv) Bad debts i.e. ₹ 5,00,000 written off in the books of account as irrecoverable is deductible under section 36(1)(vii), provided the debt has been taken into account in computing the income of the company in the current previous year or any of the earlier previous years.
- (v) As per section 40(a)(v), income-tax of ₹ 90,000 paid by the company in respect of non-monetary perquisites provided to its employees, exempt in the employee's hands under section 10(10CC), is not deductible while computing business income of the employer-company.
- (vi) The employees' contribution to provident fund is taxable in the hands of the company since it is included in the definition of income under section 2(24)(x).

As per section 36(1)(va), provident fund contribution of employees is deductible only if such sum is credited to the employee's provident fund account on or before the due date under the Employees' Provident Fund and Miscellaneous Provisions Act, 1952. In this case, since it is remitted after the due date under the said Act, it is not deductible.

Note: There is an alternate view that remittance of provident fund contribution of employees is deductible even though it is remitted beyond the due date under the Employees' Provident Fund and Miscellaneous Provisions Act, 1952, in case the same is remitted before the due date of filing return of income in view of the Delhi High Court decision in *CIT vs. Aimil Ltd.* (2010) 321 ITR 508.

- (vii) Expenditure towards advertisement in souvenir of a political party is disallowed under section 37(2B) while computing business income.

However, the same is deductible under section 80GGB from gross total income.

- (viii) Refund of a trading liability is taxable under section 41(1), if a deduction was allowed in respect of the same to the taxpayer in an earlier year.

Since sales tax was claimed as expenditure in an earlier year, refund of the same during the year would attract the provisions of section 41(1).

- (b) The distributor or selling agents promoting, marketing or organising/assisting in organising lottery have an option to pay service tax in the following manner instead of paying the same @10%:

<i>Guaranteed lottery prize payout</i>	<i>Amount of service tax payable on every ₹ 10 Lakh (or part of ₹ 10 Lakh) of aggregate face value of lottery tickets printed by the organising State for a draw</i>
More than 80%	₹ 6000/-
Less than 80%	₹ 9000/-

In case of online lottery, the aggregate face value of lottery tickets will be the aggregate value of tickets sold.

The distributor/selling agent will have to exercise such option within a period of one month of the beginning of each financial year. The new service provider can exercise such option within one month of providing the service. The option once exercised cannot be withdrawn during the remaining part of the financial year.

- (c) (i) The statement is true. In view of the fact that lot of time and energy is wasted by the dealer in getting the declaration forms from the Department, most of earlier forms have been dispensed with. There is no declaration form prescribed under VAT.
- (ii) The statement is false. Taxpayer's Identification Number (TIN) is a 11 digit numeral. The first two characters represent State Code as used by the Union Ministry of Home Affairs and the next nine characters will be different in different states.
- (iii) The statement is true. Under VAT, a dealer assesses the VAT liability on his own and submits the return. The dealer is deemed to be self-assessed on the basis of the return filed by him if he does not receive any notice proposing departmental audit of his books of account within the time-limit specified in the VAT Act of the respective State.
- (iv) The statement is false. As per the White Paper on VAT, set off of input tax credit on capital goods is available to both manufacturers and traders.

Question 5

- (a) *Mr. Chandran (aged 38) owned 6 heavy goods vehicles as on 01-04-2010. He acquired 2 more heavy goods vehicles on 1-7-2010. He is solely engaged in the business of plying goods vehicles on hire since financial year 2006-07.*

He did not opt for presumptive provision contained in section 44AE for the financial year 2009-10. His books were audited under section 44AB and the return of income was filed on 5-8-2010. He has unabsorbed depreciation of ₹ 70,000 and business loss of ₹ 1,00,000 for the financial year 2009-10.

Following further information is provided to you:

- (i) *Deposited ₹ 20,000 in Tax Saver Deposit with UCO Bank in the name of married son.*
- (ii) *Paid medical insurance premium of ₹ 23,000 for his parents (both aged above 70) by means of bank demand draft.*
- (iii) *Paid premium on life insurance policy of his married daughter ₹ 25,000.*
- (iv) *Repaid principal of ₹ 40,000 and interest of ₹ 15,000 to Canara Bank towards education loan of his daughter, who completed B.E. two years ago. She is employed after completion of her studies.*

Assuming that Mr. Chandran has opted for presumptive provision contained in section 44AE of the Income-tax Act, 1961, compute the total income of Mr. Chandran for the assessment year 2011-12. (8 Marks)

(b) State the contents of Service tax return. (any **eight** points). (4 Marks)

(c) Ashok, purchased raw material 'A' for ₹ 30,00,000 plus VAT @ 4%. Out of such raw material 60% was used for manufacture of taxable goods and the remaining for manufacture of goods which are exempt from VAT.

Another raw material 'B' was purchased for ₹ 15,00,000 on which VAT was paid at 1 %. Entire raw material 'B' was used for manufacture of taxable goods only.

The entire taxable goods were sold for ₹ 50,00,000 plus VAT @ 12.5%.

Compute VAT liability of Ashok on the assumption that there was no opening or closing inventory.

Note: Ashok is not a dealer who opted for Composition Scheme. (4 Marks)

Answer

(a) Computation of total income of Mr. Chandran for the A. Y. 2011-12

Particulars	₹	₹
Income from business of plying goods vehicle (Refer Note 1)		4,50,000
Less: Brought forward business loss of financial year 2009-10 (Refer Note 2 & 3)		<u>1,00,000</u>
Gross Total Income		3,50,000
Less: Deduction under Chapter VI-A		
Section 80C:-		
Life insurance premium paid for insurance of married daughter (Refer Note 5)	25,000	
Section 80D:-		
Medical insurance premium paid for insurance of parents (Refer Note 6)	20,000	
Section 80E:-		
Interest paid towards education loan taken for studies of his daughter (Refer Note 7)	<u>15,000</u>	<u>60,000</u>
Total Income		<u>2,90,000</u>

Working Notes:

(1) Computation of income from business of plying goods vehicles under section 44AE.

Particulars	₹
6 heavy goods vehicle held throughout the year (₹ 5,000×6×12)	3,60,000

2 heavy goods vehicle – held for 9 months (₹ 5,000×2×9)	<u>90,000</u>
Income under section 44AE	<u>4,50,000</u>

- (2) As per section 44AE, any deduction allowable under the provisions of sections 30 to 38 shall be deemed to have been already allowed. Therefore, the unabsorbed depreciation of ₹ 70,000 shall not be allowed as a deduction since it is covered by section 32.
 - (3) Brought forward business loss of ₹ 1,00,000 shall be allowed as deduction, by virtue of section 72, as it is allowed to be carried forward for 8 assessment years following the assessment year to which it relates, since the return for A.Y. 2010-11 was filed before the due date specified under section 139(1).
 - (4) Fixed deposit in the name of married son does not qualify for deduction under section 80C.
 - (5) Premium paid for insurance on the life of any child of the individual, whether married or not, qualifies for deduction under section 80C. Therefore, the life insurance premium paid for insurance policy of married daughter is allowed as deduction.
 - (6) Deduction is allowed under section 80D for payment made for medical insurance of parents. Medical insurance premium paid for insuring the health of a person who is a senior citizen i.e. of age 65 years or more, qualifies for deduction under section 80D, subject to a maximum of ₹ 20,000. Hence, deduction of ₹ 20,000 is provided to Mr. Chandran, as his parents are senior citizens.
 - (7) It is only the payment of interest on education loan which qualifies for deduction under section 80E. Deduction under section 80E is allowed in respect of interest on loan taken for education of children of the individual even if they are not dependent. Principal repayment of the education loan is not eligible for deduction under section 80E.
- (b) General details, like financial year, half year period (April-September or October-March), name of the assessee, registration number of the premises for which return is being filed, category of taxable services are required to be furnished. Apart from this, some significant month-wise details also need to be furnished. For instance:
- (i) amount received towards taxable service
 - (ii) amount received in advance towards taxable service to be provided
 - (iii) amount billed for exempted services and services exported without payment of tax
 - (iv) amount billed for services on which tax is to be paid
 - (v) abatement claimed - value
 - (vi) notification number of abatement and exemption
 - (vii) service tax payable

- (viii) education cess payable
- (ix) GAR-7 challan date and number
- (x) credit details for service tax provider/recipient

(c) Computation of VAT liability of Ashok

Particulars	₹	₹
Output VAT (50,00,000 × 12.5%) [A]		6,25,000
Input VAT [B]		
Raw material 'A' (30,00,000 × 60% × 4%) [Refer Note 1]	72,000	
Raw material 'B' (15,00,000 × 1%)	<u>15,000</u>	<u>87,000</u>
Net VAT payable by Ashok [A] – [B]		<u>5,38,000</u>

Note: Input tax credit is allowed only in respect of the raw material used in manufacture of taxable goods and hence, the same is restricted to the extent of 60%.

Question 6

- (a) (i) Brett Lee, an Australian cricket player visits India for 100 days in every financial year. This has been his practice for the past 10 financial years. Find out his residential status for the assessment year 2011-2012.
- (ii) On 10-10-2010, Mr. Govind (a bank employee) received ₹5,00,000 towards interest on enhanced compensation from State Government in respect of compulsory acquisition of his land effected during the financial year 2005-06.
- Out of this interest, ₹1,50,000 relates to the financial year 2007-08; ₹1,65,000 to the financial year 2008-09; and ₹1,85,000 to the financial year 2009-10. He incurred ₹50,000 by way of legal expenses to receive the interest on such enhanced compensation.
- How much of interest on enhanced compensation would be chargeable to tax for the assessment year 2011-12? (2 × 4 = 8 Marks)
- (b) Write short notes on Service Tax Code Number and the objective sought to be achieved thereunder. (4 Marks)
- (c) Briefly explain the benefits of the system of cross-checking under VAT as per White Paper. (4 Marks)

Answer

- (a) (i) Determination of Residential Status of Mr. Brett Lee for the A.Y. 2011-12:-
 Period of stay during previous year 2010-11 = 100 days.
 Calculation of period of stay during 4 preceding previous years (100 × 4=400 days)

2009-10	100 days
2008-09	100 days
2007-08	100 days
2006-07	<u>100 days</u>
Total	<u>400 days</u>

Since Mr. Brett Lee has been in India for a period more than 60 days during previous year 2010-11 and for a period of more than 365 days during the 4 immediately preceding previous years. Therefore, since he satisfies one of the basic conditions under section 6(1), he is a resident for the assessment year 2011-12.

Computation of period of stay during 7 preceding previous years = $100 \times 7 = 700$ days

2009-10	100 days
2008-09	100 days
2007-08	100 days
2006-07	100 days
2005-06	100 days
2004-05	100 days
2003-04	<u>100 days</u>
Total	<u>700 days</u>

Since his period of stay in India during the past 7 previous years is less than 730 days, he is a not-ordinarily resident during the assessment year 2011-12. (See Note below)

Therefore, Mr. Brett Lee is a resident but not ordinarily resident during the previous year 2010-11 relevant to the assessment year 2011-12.

Note: A not-ordinarily resident person is one who satisfies any one of the conditions specified under section 6(6), i.e.,

- (i) If such individual has been non-resident in India in any 9 out of the 10 previous years preceding the relevant previous year, or
- (ii) If such individual has during the 7 previous years preceding the relevant previous year been in India for a period of 729 days or less.

In this case, since Mr. Brett Lee satisfies condition (ii), he is a not-ordinary resident for A.Y. 2011-12.

- (ii) Section 145A provides that interest received by the assessee on enhanced compensation shall be deemed to be the income of the assessee of the year in which it is received, irrespective of the method of accounting followed by the assessee and irrespective of the financial year to which it relates.

Section 56(2)(viii) states that such income shall be taxable as 'Income from other sources'.

50% of such income shall be allowed as deduction by virtue of section 57(iv) and no other deduction shall be permissible from such Income.

Therefore, legal expenses incurred to receive the interest on enhanced compensation would not be allowed as deduction from such income.

Computation of interest on enhanced compensation taxable as "Income from other sources" for the A.Y 2011-12:

Particulars	₹
Interest on enhanced compensation taxable under section 56(2)(viii)	5,00,000
Less: Deduction under section 57(iv) (50% x 5,00,000)	<u>2,50,000</u>
Taxable interest on enhanced compensation	<u>2,50,000</u>

- (b) Service Tax Code Number is a 15-digit alphanumerical number allotted by the system to the assessee based on the PAN number or temporary number (if PAN is not submitted). The assessee applies for it in a prescribed form. This code is available in the registration certificate issued to the assessee by the Assistant Commissioner/Deputy Commissioner of the Division. It is also known as assessee code or registration number.

The first 10 digits of the STC code are 10 character PAN issued by Income tax authorities. Next two are 'ST'. Last three are numeric code 001, 002, 003 etc.

Objective sought to be achieved

- The objective is to identify the assessee, exporters or importers as also the concerned office where the person would be assessed or registered.
 - It helps in online processing of the information in relation to the assessee.
- (c) (i) A comprehensive cross-checking system is a pre-requisite for an efficient VAT system as VAT system requires the assessee to self-assess the VAT liability and only a few returns are scrutinized on a selective basis. The system of cross checking reduces tax evasion and ultimately leads to significant growth of tax revenue.
- (ii) The system of cross checking under VAT system protects the honest dealers and penalizes the fictitious or dishonest ones. Hence, it creates a level playing field and brings more equal competition in the sphere of trade and industry.

Question 7

- (a) Answer any *two* of the following *three* sub-divisions:
- State any four of the specified businesses eligible for deduction under section 35AD of the Income-tax Act, 1961.
 - State the applicability of TDS provisions and TDS amount in the following cases:

- (a) Rent paid for hire of machinery by B Ltd. to Mr. Raman ₹2,10,000.
- (b) Fee paid to Dr. Srivatsan by Sundar (HUF) ₹35,000 for surgery performed to a member of the family.
- (iii) State with reasons whether you agree or disagree with the following statements:
- (a) Return of income of Limited Liability Partnership (LLP) could be signed by any partner.
- (b) Time limit for filing return under section 139(1) in the case of Mr. A having total turnover of ₹45 lakhs for the year ended 31-03-2011, whether or not opting to offer presumptive income under section 44AD is 30th September 2011.

(2 × 4 = 8 Marks)

- (b) Vaibhav Cargo Ltd., is engaged in providing cargo handling service. In January 2011, it received ₹150 lakh for the service rendered.

The break-up of the total receipts are given below:

Nature of receipt	₹ (in lakh)
For export cargo and handling of passenger baggage	55
For storage and cleaning of empty containers of shipping lines.	13
For packing and transport of cargo	10
For handling cargo of agriculture produce	20
Other receipts for providing cargo handling service	52

Calculate the value of taxable service under "cargo handling services" for the month of January, 2011.

(4 Marks)

- (c) X Co. furnishes you the following information:

Raw material purchased ₹5,00,000 plus VAT @4%.

Manufacturing expenses (revenue nature) ₹2,00,000.

Sale price ₹8,00,000 plus VAT @ 4%.

Plant & machinery acquired ₹2,50,000 plus VAT @ 4% eligible for input tax credit in the year of acquisition itself.

Compute VAT liability under :

(i) gross product variant.

(ii) consumption variant.

State which variant is beneficial to the dealer?

(4 Marks)

Answer

- (a) (i) Following are the specified business eligible for deduction under section 35AD:-
- (1) setting up and operating cold chain facilities for specified products.
 - (2) setting up and operating warehousing facilities for storing agricultural produce.
 - (3) laying and operating a cross-country natural gas or crude or petroleum oil pipeline network for distribution, including storage facility being an integral part of such network.
 - (4) building and operating a new hotel of two star or above category, anywhere in India.
 - (5) building and operating a new hospital, anywhere in India, with atleast 100 beds for patients.
 - (6) developing and building a housing project under a scheme for slum redevelopment or rehabilitation framed by the Central Government or a State Government, as the case may be, and notified by the CBDT in accordance with the prescribed guidelines.

Note: Any four of the above mentioned points can be given in the answer.

- (ii) (a) Since the rent paid for hire of machinery by B. Ltd. to Mr. Raman exceeds ₹ 1,80,000, the provisions of section 194-I for deduction of tax at source are attracted.

The rate applicable for deduction of tax at source under Section 194-I on rent paid for hire of plant and machinery is 2% assuming that Mr. Raman had furnished his permanent account number to B Ltd.

Therefore, the amount of tax to be deducted at source:

$$= ₹ 2,10,000 \times 2\% = ₹ 4200.$$

Note: In case Mr. Raman does not furnish his permanent account number to B Ltd., tax shall be deducted @20% on ₹ 2,10,000, by virtue of provisions of section 206AA.

- (b) As per the provisions of section 194J, a Hindu Undivided Family is required to deduct tax at source on fees paid for professional services only if it is subject to tax audit under section 44AB in the financial year preceding the current financial year.

However, if such payment made for professional services is exclusively for the personal purpose of any member of Hindu Undivided Family, then, the liability to deduct tax is not attracted.

Therefore, in the given case, even if Sundar (HUF) is liable to tax audit in the

immediately preceding financial year, the liability to deduct tax at source is not attracted in this case since, the fees for professional service to Dr. Srivatsan is paid for a personal purpose i.e. the surgery of a member of the family.

(iii) (a) Disagree

The return of income of LLP should be signed by a designated partner.

Any other partner can sign the Return of Income of LLP only in the following cases:-

- (i) where for any unavoidable reason such designated partner is not able to sign and verify the return, or,
- (ii) where there is no designated partner.

(b) Disagree

In case Mr. A opts to offer his income as per the presumptive taxation provisions of section 44AD, then, the due date under section 139(1) for filing of return of income for the year ended 31.03.2011 shall be 31st July, 2011.

It is only in case Mr. A does not opt for presumptive taxation provisions under section 44AD and offers income to be lower than 8% of total turnover and his total income exceeds the basic exemption limit, he has to keep books of account as per section 44AA and get his accounts audited under section 44AB, in which case the due date for filing return would be 30th September, 2011.

(b) Value of taxable cargo handling services of Vaibhav Cargo Ltd. for the month of January, 2011

Particulars	₹	₹
Total collections for handling cargo (including service tax)		1,50,00,00
Less: Exclusions and exemptions		
(i) Export cargo and handling of passenger baggage [Refer Note 1]	55,00,000	
(ii) Storage and cleaning of empty containers of shipping lines [Refer Note 2]	13,00,000	
(iv) Handling cargo of agricultural produce [Refer Note 3]	20,00,000	<u>88,00,000</u>
Total taxable services including service tax		<u>62,00,000</u>
Value of taxable service (rounded off) [Refer Note 5]		56,21,034

Notes:

1. The definition of taxable cargo handling service specifically excludes handling of export cargo and passenger baggage.

2. Storage and cleaning of empty containers of shipping lines does not fall within the ambit of cargo handling service.
 3. Cargo handling service provided in relation to agricultural produce is exempt from service tax vide a notification issued by the Central Government in this regard.
 4. Packing and transport of cargo is covered by the definition of cargo handling service and hence liable to service tax.
 5. As the particulars relate to total *receipts*, the same are taken to be inclusive of service tax and hence value of taxable service has been computed by making back calculations $\frac{62,00,000 \times 100}{110.34}$
 6. It has been presumed that Vaibhav Cargo Ltd. is not eligible for exemption available to small service providers.
- (c) Under gross product variant of VAT, deduction for taxes on all purchases of raw materials and components is allowed. However, deduction for tax paid on capital goods is not allowed. Hence, the VAT liability under gross product variant would be calculated as under:

Computation of VAT liability under Gross Product Variant

Particulars	₹
VAT payable on sales (8,00,000 × 4%)	32,000
Less: Input VAT allowed on raw material (5,00,000 × 4%)	<u>20,000</u>
Net VAT payable	12,000

Under consumption variant of VAT, deduction for taxes paid on all business purchases including capital goods is allowed. Hence, VAT liability under consumption variant would be calculated as under:

Computation of VAT liability under Consumption Variant

Particulars	₹	₹
VAT payable on sales (8,00,000 × 4%)		32,000
Less: Input VAT allowed on raw material (5,00,000 × 4%)	20,000	
Input VAT allowed on capital goods (2,50,000 × 4%) (whole input tax credit is allowed in the year of acquisition itself)	<u>10,000</u>	<u>30,000</u>
Net VAT payable		<u>2,000</u>

Since, the net VAT liability under consumption variant is less than the VAT liability under gross product variant, consumption variant is beneficial to the dealer.