

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) PQR Limited has two units - one engaged in manufacture of computer hardware and the other involved in developing software. As a restructuring drive, the company has decided to sell its software unit as a going concern by way of slump sale for Rs.385 lakh to a new company called S Limited, in which it holds 74% equity shares.

The balance sheet of PQR limited as on 31st March 2011, being the date on which software unit has been transferred, is given hereunder –

Balance Sheet as on 31.3.2011

Liabilities	Rs. in lakh	Assets	Rs. in lakh
Paid up Share Capital	300	<u>Fixed Assets</u>	
General Reserve	150	Hardware unit	170
Share Premium	50	Software unit	200
Revaluation Reserve	120	<u>Debtors</u>	
<u>Current Liabilities</u>		Hardware unit	140
Hardware unit	40	Software unit	110
Software unit	90	<u>Inventories</u>	
		Hardware unit	95
		Software unit	35
	<u>750</u>		<u>750</u>

Following additional information are furnished by the management:

- The Software unit is in existence since May, 2007.
- Fixed assets of software unit includes land which was purchased at Rs.40 lakh in the year 2004 and revalued at Rs.60 lakh as on March 31, 2011.
- Fixed assets of software unit mirrored at Rs.140 lakh (Rs.200 lakh minus land value Rs.60 lakh) is written down value of depreciable assets as per books of account. However, the written down value of these assets under section 43(6) of the Income-tax Act is Rs.90 lakh.

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 May, 2011 examination.

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- (a) Ascertain the tax liability, which would arise from slump sale to PQR Limited.
 (b) What would be your advice as a tax-consultant to make the restructuring plan of the company more tax-savvy, without changing the amount of sale consideration?

(10 Marks)

- (B) How shall the assets retained pursuant to an order passed as per section 37A(5A) of the Wealth-tax Act, 1957 be dealt with? (3 Marks)
- (C) Can summons enforcing attendance and to take evidence on oath be issued by a Valuation Officer to the seller of the building for which a reference under section 16A has been made by the Wealth-tax Officer? (3 Marks)
- (D) Mr. 'W' gifted a gold chain worth Rs.1,00,000 to the adopted minor child of his son. On 31st March, 2011, the net wealth of Mr. 'W' is worth Rs.50 lakh whereas the net wealth of W's wife is Rs.60 lakh. Besides, the net wealth of W's son is worth Rs.30 lakh while the net wealth of his daughter-in-law is worth Rs.40 lakh. State with reason, in whose net wealth the value of gifted chain will be included.

Will it make any change in your answer if the marriage of the parents of adopted minor child does not subsist and the child is maintained by his father? (4 Marks)

Answer

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

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

Ascertainment of tax liability of PQR Limited from slump sale of software unit

Particulars	(Rs. in lakh)
Sale consideration for slump sale of Software Unit	385
Less: Cost of acquisition being the net worth of Software Unit	<u>185</u>
Long term capital gains arising on slump sale	<u>200</u>
(The capital gains is long-term as the Software Unit is held for more than 36 months)	
<u>Tax liability on LTCG</u>	
Under section 112 @ 20% on Rs. 200 lakhs	40.00

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Add: Surcharge 7½%	<u>3.00</u>
	43.00
Add: Education cess @ 2% and SHEC @ 1% i.e., totalling 3%	<u>1.29</u>
	<u>44.29</u>

Working Note	(Rs.
Computation of net worth of Software Unit	in lakh)
(1) Book value of non-depreciable assets	
(i) Land (Revaluation not to be considered)	40
(ii) Debtors	110
(iii) Inventories	35
(2) Written down value of depreciable assets under section 43(6) (Note 1)	<u>90</u>
Aggregate value of total assets	275
Less: Current liabilities of software unit	<u>90</u>
Net worth of software unit	<u>185</u>

Note 1: For computing net worth, the aggregate value of total assets in the case of depreciable assets shall be the written down value of the block of assets as per section 43(6).

(b) Tax-advice

- (i) Transfer of any capital asset by a holding company to its 100% Indian subsidiary company is exempt from capital gains under section 47(iv). Hence, PQR Limited should try to acquire the remaining 26% equity shares in S Limited then make the slump sale in the above said manner, in which case the slump sale shall be exempt from tax. For this exemption, PQR Limited will have to keep such 100% holding in S Limited for a period of 8 years from the date of slump sale, otherwise the amount exempt would be deemed to be income chargeable under the head "Capital Gains" of the previous year in which such transfer took place.
- (ii) Alternatively, if acquisition of 26% share is not feasible, PQR Limited may think about demerger plan of Software Unit to get benefit of section 47(vib) of the Income-tax Act, 1961.

(B) The assets retained pursuant to an order passed under section 37A(5A) of Wealth-tax Act, 1957 may be dealt with in the manner as specified under section 37C as under: -

- (i) the amount of the existing liability and the amount of liability determined on completion of the regular assessment or reassessment including the amount of any

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penalty or interest in respect of which the assessee is in default or is deemed to be in default may be recovered out of such assets.

- (ii) where the assets consist solely of money or partly of money and partly of other assets, the money may be applied in discharge of such liabilities and the assessee shall be treated as discharged to the same extent.
 - (iii) assets other than money may also be applied for discharge of such liabilities as remains undischarged. The Assessing Officer may recover the amount of such liabilities by sale of such assets effected in the manner laid down in Third Schedule to the Income-tax Act, 1961 as made applicable to the Wealth-tax Act, 1957 by section 32.
- (C) Section 38A(1) empowers the Valuation Officer to enter any land, building or other place belonging to or occupied by any person in connection with whose assessment a reference has been made under section 16A or inspect any asset in respect of which a reference under that section has been made and require any person in charge of or in occupation or possession of such land, building to afford him necessary facility to survey or inspect the building or estimate its value or inspect any books of account etc. which may be relevant for valuation of such building or gather other particulars relating to such building. If any person who is required to afford any facility to the Valuation Officer, either refuses or evades to afford such facility, the Valuation Officer, by virtue of section 38A(2), is empowered to invoke powers under section 37(1) and issue summons enforcing the attendance of any person and examining him on oath.
- (D) As per section 4(1)(a)(ii), the assets held by a minor child (including step child/adopted child, not being a married daughter) will be included in the net wealth of that parent whose net wealth [excluding the assets of minor child so includible under section 4(1)] is greater.

In the given problem, the value of gold chain of adopted minor grandson of W, which was transferred to him by W, shall be included in the net wealth of the mother of the adopted minor child, because the net wealth of the mother of the minor child exceeds that of the father of the minor child.

Where, however, the marriage of parents does not subsist, the assets of the minor child shall be included in the net wealth of that parent who maintains the minor child during the previous year ending on the valuation date.

If the marriage of the parents of the adopted minor child does not subsist and the child is maintained by his father, then it will be included in the net wealth of his father.

Question 2

- (A) *The procedure relating to the recovery of tax due or the arrears of taxes from a non-resident is different than the resident assessee. Comment and state how such recovery is to be made along with its limitation.* (6 Marks)

- (B) Explain in the context of provisions of the Act:
- (i) The underlying idea behind DTAA.
 - (ii) Rate of tax in other country. (4 Marks)
- (C) "Any transfer of a capital asset or intangible asset by a private company or unlisted public company to a LLP or any transfer of share or shares held in a company by a shareholder on conversion of a company into a LLP in accordance with section 56 and section 57 of the Limited Liability Partnership Act, 2008, shall not be regarded as a transfer for the purposes of levy of capital gains tax under section 45 subject to fulfillment of certain conditions". Explain in the context of the provisions contained in the Act. (6 Marks)

Answer

- (A) The provisions for recovery of tax in respect of non-residents are contained in section 173. According to this section, the tax chargeable on the income, which is deemed to accrue or arise in India under section 9(1)(i), in the name of the non-resident or his agent who is liable as a representative assessee, maybe recovered by deduction of tax at source under any of the provisions of Chapter XVII-B.

Any arrears of tax may be recovered also in accordance with the provisions of the Income-tax Act, 1961. However, the limitation contained in section 173 is that such recovery can be made only from any assets of the non-resident which are within India or which may at any time come within India.

Note

The provisions for recovery of tax in respect of non-residents and the limitation thereto required for in the question can be answered on the basis of the provisions of section 173.

However, students may note that in a case where the Central Government has entered into an agreement for recovery of tax with the Government of the country where the non-resident resides, the provisions of section 228A provide for an exception to the limitation contained in section 173.

Under section 90A(1), the Central Government may enter into an agreement with the Government of any country outside India or specified territory outside India for, inter alia, recovery of income-tax under the Income-tax Act, 1961 and under the corresponding law in force in that country or specified territory.

Section 228A provides for the procedure of recovery of tax in pursuance of an agreement entered into by the Central Government with the Government of any country outside India. Sub-section (2) thereof provides that where an assessee is in default or is deemed to be in default in making a payment of tax, the Tax Recovery Officer may, if the assessee has property in a country outside India, forward to the Board a certificate drawn up by him under section 222 and the Board may take such action thereon as it may deem appropriate having regard to the terms of the agreement with such country.

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- (B) (i) The underlying idea behind Double Taxation Avoidance Agreement entered between two countries is to promote mutual economic relations by relieving the tax payers from the burden of paying tax twice on the same income in two different countries.
- (ii) Rate of tax in the other country means income tax and super tax actually paid in that country in accordance with the corresponding laws in force in that country after deduction of all relief due, but before deduction of any relief due in the said country on account of double taxation, divided by the whole amount of income assessed in that country.
- (C) Any transfer of a capital asset or intangible asset by a private company or unlisted public company to a LLP or any transfer of a share or shares held in a company by a shareholder on conversion of a company into a LLP shall not be regarded as a transfer for a purpose of levy of capital gains tax under section 45 on fulfillment of the following conditions:-
- (1) the total sales, turnover or gross receipts in business of the company should not exceed Rs.60 lakh in any of the three preceding previous years;
 - (2) all the shareholders of the company become partners of the LLP and their capital contribution and profit sharing ratio in the LLP are also in the same proportion as their shareholding in the company on the date of conversion;
 - (3) no consideration other than share in profit and capital contribution in the LLP arises to the shareholders of the company;
 - (4) the erstwhile shareholders of the company continue to be entitled to receive at least 50% of the profits of the LLP for a period of 5 years from the date of conversion;
 - (5) all assets and liabilities of the company immediately before the conversion become the assets and liabilities of the LLP; and
 - (6) no amount is paid, either directly or indirectly, to any partner out of the accumulated profit of the company for a period of 3 years from the date of conversion.

Question 3 (Answer any four out of five)

- (A) *Mr. Ramanand, after putting 25 years of service, opted for voluntary retirement and under approved scheme received an amount of Rs.20 lakhs as VRS compensation on 01.01.2011. He was advised by his tax consultant to claim exemption to the extent as specified in section 10(10C) and also the relief under section 89. He, in order to have an expert opinion, consults you and asks whether such a treatment of VRS compensation is permissible under the Act.*
- (B) *“Save Wild Life” an institution having its main object as ‘preservation of wildlife’, used the entire income derived from an activity in the nature of trade for its main object during the previous year ended on 31.03.2011. The institution seeks your opinion to know whether such utilization of its income be treated for “charitable purpose”? Would your*

answer be different, if the main object of the institution is "advancement of object of general public utility"?

- (C) Which are the conditions to be satisfied by an electoral trust for claiming the benefit of exemption of its income? Is this benefit available in respect of all the income earned by an electoral trust?
- (D) Mr. Divyam avails the benefit of LTC and went by air (economy class) on a holiday in India on 25.01.2011 along with his wife and three children consisting of son aged 4 years and twin daughters of 1 year age. Total cost of tickets reimbursed by his employer was Rs.90,000 (Rs.60,000 for 2 adults and Rs.30,000 for the three children). State with reasons the amount which can be claimed by Mr. Divyam out of the reimbursement as not subject to tax. Will your answer be different where among his three children the twins were of 4 years of age and the age of the son was of 1 year ?
- (E) Mr. M is working with MNO Limited for the last 10 years. He was granted an option on 1.7.2008 by the company to purchase 800 equity shares at a price of Rs.250 per share. The period during which the option can be exercised to purchase 800 shares at a pre-determined price of Rs.250 per share commencing on 1.7.2008 and ending on 31.3.2011. Mr. M exercised the option on 15.3.2010 to purchase 500 shares. Fair market value on the said date was Rs.6490 on the Bombay Stock Exchange and Rs.6500 on the National Stock Exchange. The NSE has recorded the higher volume of trading in that share.
- The company has allotted him 500 shares on 24th April, 2010. The fair market value on the date of allotment was Rs.7100 per share on NSE and Rs.7110 on the BSE, that has recorded the higher volume of trading in that share. The option was granted for making available rights in the nature of intellectual property rights.
- Determine the taxability of perquisite. Does it make any difference if the option was granted for providing technical know-how? (4 × 4 = 16 Marks)

Answer

- (A) Where any relief was allowed under section 89 for any assessment year in respect of any amount received or receivable on voluntary retirement, no exemption under section 10(10C) shall be allowed in respect of the said sum in that assessment year or any other assessment year.
- Similarly, relief under section 89 cannot be claimed if benefit of exemption has been claimed under section 10(10C).
- Mr. Ramanand can, therefore, opt to claim exemption of Rs.5 lakh under section 10(10C) or relief under section 89(1) in respect of compensation received on voluntary retirement, but not both. Accordingly, the advice given by his tax consultant is not correct.
- (B) Section 2(15) defines "charitable purpose" to include relief of the poor, education, medical relief, preservation of environment (including watersheds, forests and wildlife) and preservation of monuments or places or objects of artistic or historic interest and the

advancement of any other object of general public utility. However, the “advancement of any other object of general public utility” shall not be a charitable purpose, if the institution is carrying on any activity in the nature of trade, commerce or business, or any activity of rendering any service in relation to any trade, commerce or business, for a cess or fee or any other consideration, irrespective of the nature of use or application, or retention, of the income derived from such activity.

Therefore, preservation of wildlife is included in the definition of “charitable purpose” under section 2(15). Further, an institution having the preservation of wildlife as its main object would not be subject to the restrictions which are applicable to the “advancement of any other object of general public utility”. Such institution would continue to retain its “charitable” status, even if it derives income from an activity in the nature of trade.

However, if an institution having its main object as “advancement of any other object of general public utility”, derives income from an activity in the nature of trade during a financial year, it would lose its “charitable” status for that year, even if it applies such income for its main objects.

It may be noted that if the receipts from such activity does not exceed Rs.10 lakh in that year, then, the institution would not lose its “charitable” status.

- (C) An approved electoral trust is eligible for exemption under section 13B in respect of voluntary contributions received by it.

The voluntary contributions received by such electoral trust shall be treated as its income under section 2(24), but shall be exempt under section 13B, if the trust distributes to a registered political party during the year, 95% of the aggregate donations received by it during the year along with the surplus, if any, brought forward from any earlier previous year.

Another condition for availing the benefit under this section is that the electoral trust should function in accordance with the rules made by the Central Government.

The benefit under section 13B is available only in respect of voluntary contribution received by an electoral trust and not in respect of its other income

- (D) Mr. Divyam can avail exemption as per section 10(5) on the entire amount of Rs. 90,000 reimbursed by the employer for the LTC as the same was availed for himself, his wife and the three children in India and the journey was also undertaken by economy class airfare. The restriction imposed for two children is not applicable to the multiple births which take place after the first child.

However, if the age of the twin daughters is more than the age of the son, the restriction imposed for two children under the section would be applicable and therefore, Mr. Divyam cannot avail exemption in this case for all the three children. The exemption of LTC can be availed in respect of only two children. Therefore, the fare of Rs.10,000 (i.e., $\text{Rs. } 30,000 \times 1/3$) reimbursed for one child will form part of taxable salary and balance amount of LTC of Rs. 80,000 (90,000 - 10,000) will be exempt under section 10(5).

- (E) The perquisite of sweat equity shares shall be taxable in the previous year 2010-11 (assessment year 2011-12), being the previous year of allotment of such shares. The value of sweat equity shares shall be the fair market value of such shares on the date on which the option is exercised by the assessee, as reduced by any amount actually paid by, or recovered from, the assessee in respect of such shares.

As per Rule 3(8) of the Income-tax Rules, 1962, the fair market value of a share on the date of exercising the option shall be the price of the share on the recognized stock exchange which records the highest volume of trading in such shares.

Hence, the value of taxable perquisite for sweat equity shares

$$\begin{aligned}
 &= \text{FMV on the date of exercising the option on the NSE (since it recorded higher volume than BSE)} \quad (-) \quad \text{Amount recovered from the employee} \\
 &= 500 \times \text{Rs.6500} \quad (-) \quad 500 \times \text{Rs.250} \\
 &= \text{Rs. 32,50,000} \quad (-) \quad \text{Rs. 1,25,000} \\
 &= \text{Rs.31,25,000}
 \end{aligned}$$

As per section 17(2)(vi), "sweat equity shares" means equity shares issued by a company to its employees or directors at a discount or for consideration other than cash for providing technical knowhow or making available rights in the nature of intellectual property rights or value additions, by whatever name called.

Therefore, this provision is equally applicable whether the sweat equity shares option was granted for making available rights in the nature of intellectual property rights or for providing technical know-how.

Question 4

- (A) *Examine the following statements in the context of the provisions contained in the various Chapters of the Act:*
- (i) *"The provisions of section 115JB are not applicable in case of foreign companies".*
 - (ii) *"The provisions of dividend distribution tax are also applicable to an undertaking or enterprise engaged in developing, operating and maintaining a Special Economic Zone (SEZ)".*
 - (iii) *"A penalty for concealment can be imposed even in the case where the claim of the assessee is debatable or arguable".* (3 × 3 = 9 Marks)
- (B) *Can the brought forward losses and unabsorbed depreciation be set off against the profit determined under section 44B?* (4 Marks)
- (C) *Mr. Balram is a non-resident. The appeal pertaining to the assessment year 2010-11 is pending before the Income-tax Appellate Tribunal, the issue involved being computation of export profit and tax thereon. The same issue persists for the assessment year 2011-*

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12 as well. Mr. Balram's brother Mr. Krishna has obtained an advance ruling under Chapter XIX - B of Income-tax Act, 1961 from the Authority for Advance Ruling on an identical issue. Mr. Balram proposes to use the said ruling for his assessment pertaining to the assessment year 2011-12. Can he do so? (3 Marks)

Answer

(A) (i) "The provisions of section 115JB are not applicable in case of foreign companies" -

The statement is not correct since there is no provision in section 115JB restricting its applicability to only domestic companies and therefore, section 115JB is applicable to both domestic and foreign companies. The provisions of section 115JB are applicable in the case of an assessee, being a company, where 18% of its book profit exceeds the tax payable on the total income computed under the provisions of the Act. Therefore, the provisions of section 115JB would be attracted in the case of a domestic and foreign company, if the tax payable on its total income is less than 18% of its book profit.

However, section 115JB will not be applicable to a foreign company which has no presence or permanent establishment in India - *Timken Company., In re. (2010) 326 ITR 193 / 193 Taxman 20 (AAR- New Delhi)*.

(ii) The statement is not correct.

As per section 115-O(6), no tax on distributed profits shall be chargeable in respect of the total income of an undertaking or enterprise engaged in developing or developing and operating or developing, operating and maintaining a Special Economic Zone for any assessment year on any amount declared, distributed or paid by such Developer or enterprise, by way of dividends (whether interim or otherwise) on or after 1.4.2005 out of its current income either in the hands of the Developer or enterprise or the person receiving such dividend.

Note - The Finance Act, 2011 has introduced a sunset clause to remove the above exemption in respect of dividend distribution tax for dividends declared, distributed or paid on or after 1st June, 2011. However, the amendments made by the Finance Act, 2011 are not applicable for May 2011 examination. Therefore, the question has been answered on the basis of the position prior to amendment by the Finance Act, 2011.

(iii) The Rajasthan High Court in the case of *CIT vs. Harshvardhan Chemicals & Minerals Ltd. (2003) 259 ITR 212* has held that if the claim of a deduction or an expenditure is either debatable or controversial or even arguable, in such cases, it cannot be said that the assessee has concealed any income or has furnished inaccurate particulars of its income with the intention of evasion of tax and hence, penalty cannot be levied under section 271(1)(c).

Note – This question may also be answered on the basis of the Apex Court ruling in *CIT v. Reliance Petro Products Pvt. Ltd. (2010) 322 ITR 158*, where it was held that

a mere making of a claim, which is not sustainable in law, would not, by itself, tantamount to furnishing inaccurate particulars and hence, penalty provisions under section 271(1)(c) would not be attracted.

Therefore, since an incorrect claim itself will not attract penal provisions under section 271(1)(c), there is no question of imposition of penalty in respect of a claim which is debatable or arguable.

- (B) The provisions of section 44B, introduced w.e.f. 1.4.1976, requiring computation of income of a non-resident from shipping business on a presumptive basis are mandatory and not optional. Therefore, there is no possibility of having a business loss where income is computed on presumptive basis under section 44B. In case the brought forward losses mentioned in the question are taken to be business losses, there is an inbuilt presumption that such losses and depreciation relate to another business of the non-resident and not the shipping business. In such a case, both business loss and unabsorbed depreciation of another business can be set-off against the profits determined under section 44B in respect of shipping business.

Even though the provisions of section 44B are applicable “notwithstanding anything to the contrary contained in sections 28 to 43A”, it is possible to take a view since the *non obstante* clause is relevant only for computation of income from shipping business under section 44B, it does not bar set-off of unabsorbed depreciation relating to some other business.

- (C) As per section 245S(1), the advance ruling pronounced under section 245R by the Authority for Advance Ruling shall be binding only on the applicant who had sought it and in respect of the specific transaction in relation to which advance ruling was sought.

In view of the above provision, Mr. Balram cannot use the advance ruling, obtained on an identical issue by his brother, for his assessment.

Question 5

- (A) *Examine the taxability or allowability or otherwise in the following cases while computing income under the head “Profits and gains from business or profession” to be declared in the return of income for the financial year ended on 31.3.2011:*
- (i) *Amount received towards power subsidy with a stipulation that the same is to be adjusted in the electricity bills.*
 - (ii) *Donations received by a person in the course of carrying on vocation from his followers.*
 - (iii) *Profit derived by an assessee engaged in carrying the business as dealers in shares on exchange of the shares held as stock in trade of one Company with the shares of other Company.*
 - (iv) *Interest received by a contractor on the amount of compensation awarded by an arbitrator resolving the dispute relating to the work done.*

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- (v) *The amount of margin money forfeited by a bank on the failure of its constituents of not taking the delivery of the shares purchased by such bank on their behalf.*
- (vi) *Depreciation on the “decoders” given on loan to the cable operators but owned by the assessee who is engaged in the business of distributing satellite channels.*

(2 × 6 = 12 Marks)

- (B) *X Co. Ltd. was amalgamated with Y Co. Ltd. on 30.04.2010. X Co. Ltd. was engaged in real estate and whereas Y Co. Ltd. was engaged in manufacture of textile articles. Y Co. Ltd. after amalgamation altered its objects clause of Memorandum of Association, to carry on real estate business.*

The stock in trade of X Co. Ltd. (being vacant lands) was taken over at Rs.110 lakhs by Y Co. Ltd. as against their original cost of Rs.125 lakhs to X Co. Ltd. for the purpose of amalgamation. Y Co. Ltd incurred Rs.25 lakhs towards development of those lands obtained on amalgamation. It sold the entire land for Rs.160 lakhs during the year ended 31.03.2011.

Determine the tax implication of the transaction in the hands of Y Co. Ltd. for the assessment year 2011-12. (4 Marks)

Answer

- (A) (i) Power subsidy received by the assessee is revenue in nature as it goes towards reduction of the electricity bills. Therefore, the subsidy is taxable as business income. It was so held by the Supreme Court in *CIT vs. Rajaram Maize Products (2001) 251 ITR 427*.
- (ii) Donations received by a person from his followers in the course of carrying on vocation for the furtherance of the objects of his vocation were receipts arising from the carrying on of his vocation and not casual or non-recurring receipts. The Supreme Court, in *Dr. K. George vs. CIT (1985) 156 ITR 412*, held that such donations are taxable as a business income as there is a direct nexus between the vocation carried on by the assessee and the receipt of such donation.
- (iii) The difference between the cost/book value of shares of the first company and the market value of shares of the new company on the date of such exchange has to be treated as profit derived by the dealer in shares (on exchange of shares held as stock-in-trade of first company with the shares of the new company) in the normal course of his business, and hence such profit is taxable as business income. It was so held by the Supreme Court in *Orient Trading Co. Ltd. vs. CIT (1997) 224 ITR 371*.
- (iv) Interest received by a contractor on the amount of compensation awarded by an arbitrator resolving the dispute relating to the work done is in the nature of receipt relating to the business of the contractor and shall be, thus, assessable as business income. This view was upheld by the Supreme Court, in *CIT vs. B. N. Agarwal and Co. (2003) 259 ITR 754*.

- (v) Since the bank is purchasing shares on behalf of the constituents, the forfeiture of margin money by the bank from the constituents for not paying the balance amount of purchase price and taking delivery of shares purchased by the bank on their behalf is in the normal course of its banking business and hence, the forfeited amount is assessable as business income of the bank. The forfeited amount being revenue in nature cannot be adjusted against the purchase price of the shares. The Supreme Court, in the case of *CIT vs. Lakshmi Vilas Bank Ltd. (1996) 220 ITR 305*, has confirmed this view.
- (vi) Loan of decoders to cable operators is in the normal course of the assessee's business of distribution of satellite channels, and hence the same can be treated as use of asset for business purposes. Since the assessee is the owner of decoders used for business purposes, therefore, he is entitled to depreciation under section 32. The Delhi High Court, in *CIT vs. Turner International (P) Ltd. (2008) 297 ITR 373*, has also confirmed this view.
- (B) The provisions of section 43C would be attracted in this case. Where an asset which becomes the property of an amalgamated company under a scheme of amalgamation is sold by the amalgamated company as its stock in trade, then, the cost of acquisition of the said asset to the amalgamated company in computing the profits and gains derived from sale of such asset would be the cost of acquisition of such asset to the amalgamating company plus the cost of any improvement incurred thereto and the expenditure incurred wholly and exclusively in connection with such transfer by the amalgamating company.

In this case, since the stock-in-trade of X Co. Ltd. is taken over by Y Co. Ltd. on amalgamation, the provisions of section 43C are attracted and the cost of acquisition of vacant lands to Y Co. Ltd. (the amalgamated company) will be Rs.125 lakhs, being the original cost of such lands to X Co. Ltd., the amalgamating company. Since the stock in trade of X Co. Ltd (being vacant land) is taken over by Y Co Ltd., which has altered its object clause immediately after amalgamation to include real estate business, a view can be taken that the provisions of section 45(2) are not attracted in this case.

The business income of Y Co. Ltd. on sale of such lands would be calculated as under -

Particulars	(Rs in lakhs)	
Sale price (in the hands of Y Co Ltd)	160	
Less:		
Cost of acquisition under section 43C, being the original cost to the amalgamating company, X Co. Ltd	125	
Cost of improvement (incurred by Y Co. Ltd)	25	150
Taxable business income chargeable in the hands of Y Co. Ltd		<u>10</u>

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Question 6

- (A) Nandita, an individual resident retired employee of the Prasar Bharati aged 60 years, is a well-known dramatist deriving income of Rs.1,10,000 from theatrical works played abroad. Tax of Rs.11,000 was deducted in the country where the plays were performed. India does not have any Double Tax Avoidance Agreement under section 90 of the Income-tax Act, 1961, with that country. Her income in India amounted to Rs.5,10,000. In view of tax planning, she has deposited Rs.70,000 in Public Provident Fund and paid contribution to approved Pension Fund of LIC Rs.32,000 along with subscription to notified long-term infrastructure bonds Rs.25,000. She also contributed Rs.18,000 to Central Government Health Scheme during the previous year and gave payment of medical insurance premium of Rs.21,000 to insure the health of her father, a non-resident aged 76 years, who is not dependent on her. Compute the tax liability of Nandita for the Assessment year 2011-12. (8 Marks)
- (B) Is it valid in law to rectify an assessment order under section 154 due to subsequent change of law on retrospective basis? Also state, whether a Supreme Court judgement would warrant a rectification under section 154 in respect of an order passed earlier by the Assessing Officer. (4 Marks)
- (C) Maya Bank credited Rs.73,50,000 towards interest due on the deposits in a separate account for macro-monitoring only by using Core-branch Banking Solutions (CBS) software. No tax was deducted at source in respect of interest on deposits so credited even where the interest payable in respect of some deposits exceeded the limit of Rs.10,000.

The Assessing Officer disallowed the entire interest expenditure where the interest due on time deposits credited exceeded the limit of Rs.10,000 and also levied penalty under section 271C.

Decide the correctness of action of the Assessing Officer. (4 Marks)

Answer

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

Particulars	(Amount in Rs.)
Indian Income	5,10,000
Foreign Income	<u>1,10,000</u>
Gross Total Income	6,20,000
Less: <u>Deduction under section 80C</u>	
Deposit in PPF	70,000
<u>Under section 80CCC</u>	
Contribution to approved Pension Fund of LIC	<u>32,000</u>
	1,02,000

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Under section 80CCE

The aggregate deduction under section 80C, 80CCC and 80CCD has to be restricted to Rs. 1,00,000

1,00,000

Under section 80CCF

Subscription to notified long-term infrastructure bonds, Rs.25,000, restricted to Rs.20,000, being the maximum deduction allowable under section 80CCF

20,000

Under section 80D

Contribution to Central Government Health Scheme Rs.18,000. As per the Finance Act, 2010, this contribution is also allowable as deduction under section 80D, but restricted to Rs.15,000

15,000

Medical insurance premium of Rs. 21,000 paid for father aged 76 years. Since the father is a non-resident in India, he will not be entitled for the higher deduction of Rs. 20,000 eligible for a senior citizen, who is resident in India. Hence, the deduction will be restricted to maximum of Rs.15,000.

15,000

1,50,000

Total Income 4,70,000

Tax on Total Income

Income-tax	28,000	
Add : Education cess @ 2%	560	
Add: SHEC @ 1%	280	
	280	28,840

Average rate of tax in India
(i.e. $28,840 / 4,70,000 \times 100$)

6.14%

Average rate of tax in foreign country
(i.e. $11,000 / 1,10,000 \times 100$)

10%

Rebate under section 91 on Rs.1,10,000 @ 6.14%
(lower of average Indian-tax rate or average foreign tax rate)

6,754

Tax payable in India (Rs.28,840 - Rs.6,754)	22,086	
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- (B) The Calcutta High Court, in *CIT v. E.Sefton & Co. (P.) Ltd. (1989) 179 ITR 435*, observed that if the assessment order is plainly and obviously inconsistent with the specific and clear provision as amended retrospectively, undisputably there is a mistake apparent

from record. In the light of the retrospective amendment, the assessment order had to be revised.

In view of this, it can be said that the Assessing Officer can, under section 154 of the Income-tax Act, 1961, rectify the order of assessment in the light of the later amendment of the law with retrospective effect.

The Gujarat High Court, in *CIT v. Subodhchandra S Patel (2004) 265 ITR 445*, held that non-consideration of a judgment of the jurisdictional High Court or the Apex Court would always constitute a mistake apparent from the record, regardless of the judgment being rendered prior to or subsequent to the order proposed to be rectified.

Note – The Calcutta High Court, however, expressed a different view in *Geo Miller & Co. v. DCIT [2003] 262 ITR 0237* holding that a subsequent exposition of law by Supreme Court does not render assessment order as made on mistake.

- (C) The *Explanation below* section 194A(1) provides that where any income by way of interest other than interest on securities is credited to any account, whether called 'interest payable account' or 'suspense account' or by any other name, in the books of account of the person liable to pay such income, such crediting shall be deemed to be credit of such income to the account of the payee and provisions of section 194A shall apply accordingly.

The *CBDT Circular No.3/2010 dated 02.03.2010* has clarified that *Explanation* to section 194A will not apply in cases of banks where credit is made to provisioning account on daily/monthly basis for the purpose of macro monitoring only by the use of CBS software.

Since no constructive credit to the depositor's / payee's account takes place while calculating interest on daily / monthly basis in the CBS software used by banks, tax need not be deducted at source on such provisioning of interest by banks for the purposes of macro monitoring only.

In such cases, tax shall be deducted at source on accrual of interest at the end of the financial year or at periodic intervals as per practice of the bank or as per the depositor's or payee's requirement or on maturity or on encashment of time deposit, whichever event takes place earlier, whenever the aggregate amounts of interest income credited or paid or likely to be credited or paid during the financial year by the banks exceeds the limits specified in section 194A.

In view of the above, the action of the Assessing Officer in disallowing the interest expenditure credited in a separate account for macro monitoring purpose is not valid and consequent penalty proceedings are also not tenable in law.

Note:

In the question, it has been stated that no tax was deducted at source in respect of interest on deposits credited to a separate account for macro monitoring only using CBS software, even where the interest payable in respect of some deposits exceeded the limit

of Rs.10,000. Further, it has been given that the Assessing Officer disallowed the entire interest expenditure where the interest due on time deposits credited exceeded the limit of Rs.10,000.

The use of the words "payable" and "due" in the question may lead to an inference that TDS provisions under section 194A are attracted in such a case, since it is the interest due which has exceeded Rs.10,000 and not just the interest credited to the provisioning account for macro monitoring.

The CBDT Circular exempting deduction of tax at source would apply where interest has been credited to provisioning account for macro monitoring only by the use of CBS software. However, if such interest has already fallen due and the amount exceeds the threshold limit of Rs.10,000 in any case or cases, the provisions of section 194A would be attracted, since such interest would have been credited to the account of the payee when it fell due.

On the basis of the above reasoning, it is possible to answer that the provisions of section 194A would be attracted in this case, since the interest due has exceeded the limit of Rs.10,000. Therefore, the action of the Assessing Officer in disallowing the interest under section 40(a)(ia) and levying penalty under section 271C is correct. It is presumed that the Assessing Officer is a Joint Commissioner.

Question 7

- (A) *Seizures were made from Mr. Sunder pursuant to a search conducted in his premises. He filed an application for settlement by claiming to have received the amount by way of loans from several persons. The Settlement Commission accepted his statement and made an order. The CBI, however, conducted enquiry at the instance of the Revenue regarding the claimed amount of loans and opined that the alleged lenders had no means or financial capacity to advance such huge loans to Mr. Sunder and were mere name lenders only. The Commissioner filed an application under section 245D(6) praying for the order to be declared void and for withdrawal of benefit granted. Mr. Sunder, however, contended that the order of the Settlement Commission was final and any fresh analysis would amount to sitting in judgement over an earlier decision, for which the Settlement Commission was not empowered. Discuss the correctness of Mr. Sunder's contention.* (6 Marks)
- (B) *Mayur gifted amount of Rs.5,00,000 to the wife of his brother which was used by her for the purchase of a house and simultaneously, on the same day, Mayur's brother gifted shares owned by him in a foreign company worth Rs.5,00,000 to the minor son of Mayur. What will be the impact of such transfers in the hands of both the transferors and the transferees?* (5 Marks)
- (C) *State whether the following assesseees have to file return of income and if so, the due date for the assessment year 2011-12:*

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- (i) A public charitable trust registered under the Act is running an educational institution with aggregate annual receipt of Rs.65,00,000 and total income of Rs.3,20,000. Is the accounts of the trust liable for audit under section 44AB of the Act?
- (ii) A registered trade union having income from let out property of Rs.1,00,000.
- (iii) A public trust hospital having an aggregate annual receipt of Rs.200 lakhs and availing exemption under section 10(23C)(via) with total income of Rs.1,10,000.

(5 Marks)

Answer

- (A) The Apex Court, in *CIT vs. Om Prakash Mittal* (2005) 273 ITR 326, observed that a plain reading of section 245D(6) shows that every order passed under sub-section (4) has to provide for:-

- (i) the terms of settlement; and
- (ii) that the settlement would become void, if it is subsequently found by the Settlement Commission that it has been obtained by fraud or misrepresentation of facts.

The decision that the order has been obtained by fraud or misrepresentation is that of the Settlement Commission. However, there is no requirement that the action be initiated by the Settlement Commission *suo moto*. The Revenue can move the Settlement Commission for decision on an issue if it has material to show that the order was obtained by fraud or misrepresentation of facts.

The Supreme Court observed that the foundation for settlement is an application which an assessee can file at any stage of a case relating to him in such form and manner as may be prescribed. The fundamental requirement of the application under section 245C is that there must be full and true disclosure of the income along with the manner in which it has been derived. If an order is obtained by fraud or misrepresentation of facts, it cannot be said that there is a full and true disclosure and therefore, the Legislature has prescribed the condition relating to declaration of the order void when it is obtained by fraud or misrepresentation of facts.

The Supreme Court held that merely because section 245-I provides that the order of settlement is conclusive, it does not take away the power of the Settlement Commission to decide whether the settlement order has been obtained by fraud or misrepresentation of facts. If the Commissioner is able to establish that the earlier decision was void because of misrepresentation of facts, then it is open for the Settlement Commission to decide the issue. It cannot be called by any stretch of imagination to be a review of the earlier judgment or the subsequent Bench sitting in appeal over the earlier Bench's decision.

Mr. Sunder's contention is, therefore, not correct.

- (B) In the given case, Mayur is making a gift of Rs.5,00,000 to the wife of his brother for the purchase of a house by her and simultaneously, his brother is making a gift to the minor son of Mayur, shares owned by him in a foreign company worth Rs.5,00,000. These transfers are in the nature of cross transfers. Accordingly, the income from the assets transferred would be assessed in the hands of the deemed transferor because the transfers are so intimately connected to form part of a single transaction and each transfer constitutes consideration for the other by being mutual or otherwise.

The Supreme Court has, in *CIT vs. Keshavji Morarji (1967) 66 ITR 142*, held that if two transactions are inter-connected and are part of the same transaction in such a way that it can be said that the circuitous method was adopted as a device to evade tax, the implication of clubbing provisions would be attracted.

Accordingly, the income arising to the wife of Mayur's brother from the house property would be included in the total income of his brother and the dividend from shares transferred to Mayur's minor son would be taxable in the hands of Mayur. This is because both Mayur and his brother are the indirect transferors of the income yielding assets to their minor child and spouse, respectively, with an intention to reduce their burden of taxation.

- (C) (i) Since the total income of Rs.3,20,000 exceeds the basic exemption limit of Rs.1,60,000, the mandatory requirement of filing return under section 139(4C) will apply.

The accounts of the charitable trust running an educational institution with an aggregate annual receipt of less than 100 lakhs is eligible for exemption under section 10(23C)(iiiad) and therefore, the accounts of such trust need not be audited under section 44AB.

Therefore, the due date of filing of return of income of the public charitable trust running an educational institution eligible for exemption under section 10(23C)(iiiad) is 31st July 2011.

- (ii) A registered trade union is having income from property, which is exempt under section 10(24).

Section 139(4C) mandates filing of return only when the total income exceeds the maximum amount which is not chargeable to tax without giving effect to the provisions of section 10. Even without giving effect to section 10(24), the total income is below basic exemption limit and therefore, there is no mandatory requirement to file the return of income.

- (iii) Since the total income of the public trust hospital, without giving effect to the exemption under section 10(23C)(via), is less than the basic exemption limit of Rs.1,60,000, the trust need not file its return of income.