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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) Tani purchased a land at a cost of ₹ 10 lakhs in the financial year 1982-83 and held the same as her capital asset till 31st March, 2010. Tani started her real estate business on 1st April, 2010 and converted the said land into stock-in-trade of her business on the said date, when the fair market value of the land was ₹ 150 lakhs.

She constructed 20 flats of equal size, quality and dimension. Cost of construction of each flat is ₹ 8 lakhs. Construction was completed in December, 2012. She sold 15 flats at ₹ 20 lakhs per flat between January, 2013 and March, 2013. Remaining 5 flats were held in stock as on 31st March, 2013.

She invested ₹ 50 lakhs in bonds issued by Rural Electrification Corporation Ltd. on 31st March, 2013.

Compute the amount of chargeable capital gain and business income in the hands of Tani arising from the above transactions for Assessment Year 2013-14 indicating clearly the reasons for treatment for each item.

Cost Inflation Index: FY 1982-83: 109; FY 2010-11 : 711; FY 2012-13: 852. (10 Marks)

- (b) ABC Ltd. owns the following assets as on 31st March, 2013. State whether the assets are chargeable to wealth-tax indicating reasons in brief.

(i) Land at Delhi purchased in 2010 on which a residential complex consisting of 12 flats, to be sold on ownership basis, is under construction for last one year.

(ii) Three office flats at Mumbai purchased in the financial year 2005-06 for resale.

(iii) Shares of group companies, break up value of which is ₹ 7.50 lakhs.

(iv) Cash at construction site ₹ 2.50 lakhs, not recorded in the books of account.

(v) Residential flat in occupation of company's whole time director drawing a salary of ₹ 9 lakhs per annum. (5 Marks)

- (c) Anil has a house property in Delhi. He constructed the said property in 1985 at a cost of ₹ 40 lakhs. He has let out the property at ₹ 25,000 per month for a period of three years from 1st October, 2012. The half yearly municipal tax is ₹ 12,500 which is borne by him. The house was constructed on freehold land measuring 10,000 sq. ft. The built up area of the house is 2,000 sq. ft. Compute the value of the house property for wealth tax purpose as on the valuation date 31st March, 2013. (5 Marks)

The Suggested Answers for Paper 7:- Direct Tax Laws are based on the provisions applicable for A.Y.2013-14, which is the assessment year relevant for May, 2013 examination.

Answer**(a) Computation of capital gains and business income of Tani for A.Y.2013-14**

Particulars	₹
Capital Gains	
Fair market value of land on the date of conversion deemed as the full value of consideration for the purposes of section 45(2)	1,50,00,000
Less: Indexed cost of acquisition [$₹ 10,00,000 \times 711/109$]	65,22,936
	84,77,064
Proportionate capital gains arising during A.Y.2013-14 [$₹ 84,77,064 \times \frac{3}{4}$]	63,57,798
Less: Exemption under section 54EC	50,00,000
Capital gains chargeable to tax for A.Y.2013-14	13,57,798
Business Income	
Sale price of flats [$15 \times ₹ 20$ lakhs]	3,00,00,000
Less: Cost of flats	
Fair market value of land on the date of conversion [$₹ 150$ lacs $\times \frac{3}{4}$]	1,12,50,000
Cost of construction of flats [$15 \times ₹ 8$ lakhs]	1,20,00,000
Business income chargeable to tax for A.Y.2013-14	67,50,000

Alternate presentation for computation of capital gains

	₹
Proportionate Fair Market Value as on 1 st April 2010 - the date of conversion – to be taken as deemed consideration ($₹ 150$ lakhs $\times 15/20$)	1,12,50,000
Less: Proportionate Indexed Cost of Acquisition of Land (Note1) ($₹ 10,00,000 \times 711/109 \times 15/20$)	48,92,202
Long term capital gain	63,57,798
Less: Exemption under section 54EC	
Investment in bonds issued by Rural Electrification Corporation Ltd	50,00,000
Taxable long-term capital gain	13,57,798

Notes:

- (1) The conversion of a capital asset into stock-in-trade is treated as a transfer under section 2(47). It would be treated as a transfer in the year in which the capital asset is converted into stock-in-trade.

- (2) However, as per section 45(2), the capital gains arising from the transfer by way of conversion of capital assets into stock-in-trade will be chargeable to tax only in the year in which the stock-in-trade is sold.
- (3) The indexation benefit for computing indexed cost of acquisition would, however, be available only up to the year of conversion of capital asset to stock-in-trade and not up to the year of sale of stock-in-trade.
- (4) For the purpose of computing capital gains in such cases, the fair market value of the capital asset on the date on which it was converted into stock-in-trade shall be deemed to be the full value of consideration received or accruing as a result of the transfer of the capital asset.

In this case, since only 75% of the stock-in-trade (15 flats out of 20 flats) is sold in the P.Y.2012-13, only proportionate capital gains (i.e., 75%) would be chargeable in the A.Y.2013-14.

- (5) On sale of such stock-in-trade, business income would arise. The business income chargeable to tax would be the difference between the price at which the stock-in-trade is sold and the fair market value on the date of conversion of the capital asset into stock-in-trade.
- (6) In case of conversion of capital asset into stock-in-trade and subsequent sale of stock-in-trade, the period of 6 months is to be reckoned from the date of sale of stock-in-trade for the purpose of exemption under section 54EC [*CBDT Circular No.791 dated 2.6.2000*]. In this case, since the investment in bonds of RECL has been made within 6 months of sale of flats, the same qualifies for exemption under section 54EC.

(b) (i) Land, on which a residential complex consisting of flats are under construction

There are three alternative views on the basis of which this question can be answered. Each view is based on a decided case law. The question can, therefore, be answered on the basis of taxability of –

- (i) urban land, on which building is under construction; **or**
- (ii) urban land, on which the building under construction is to be held as stock-in-trade; **or**
- (iii) the incomplete building.

First view (based on taxability of urban land, on which building is under construction)

One view is that urban land excludes only land occupied by any completed building which has been constructed with the approval of the appropriate authority. Therefore, value of land on which construction is in progress as on the valuation

date would not be excluded from the definition of urban land. Hence, it is an asset chargeable to wealth-tax on the valuation date 31.3.2013. This view was taken by the Karnataka High Court in *CWT v. Giridhar G. Yadalam (2010) 325 ITR 223*.

Second view (based on taxability of urban land, on which the building under construction is to be held as stock-in-trade)

Once construction activity starts on urban land, it loses its character of urban land and is outside the purview of definition of “assets”. Further, once a non-productive asset like urban land is converted to a productive asset like a building which qualifies for exemption, then, the assessee can start availing exemption even during the period of conversion of such non-productive asset to productive asset.

This view was upheld by the Kerala High Court in *Apollo Tyres Ltd. v. CIT (2010) 325 ITR 528*.

Therefore, once the residential complex, consisting of 12 flats is constructed, to be sold on ownership basis, it would become the stock-in-trade of ABC Ltd., thereby qualifying for exemption under the Wealth-tax Act, 1957 and the company can start availing such exemption during the construction period itself.

Hence, the land at Delhi on which a residential complex is under construction is not an asset as on the valuation date 31.3.2013.

Third view (based on taxability of an incomplete building)

A building under construction is not a completed building. An incomplete building would neither fall within the meaning of a building nor within the purview of “urban land” under section 2(ea) and hence, it is not an asset chargeable to wealth-tax. Thus, as on the valuation date 31.3.2013, wealth-tax liability does not arise in respect of the building under construction.

This view was upheld by the Punjab and Haryana High Court in *CIT v. Smt. Neena Jain (2011) 330 ITR 157 (P & H)*.

(ii) Office flats purchased for resale – Not chargeable to wealth-tax

Though building or land appurtenant thereto is an asset under section 2(ea), **any house for residential or commercial purposes which forms part of stock-in-trade** is specifically excluded from the scope of “building”. Hence, office flats purchased for resale do not fall within the meaning of “asset” under section 2(ea).

(iii) Shares of group companies, break up value of which is ₹ 7.50 lakhs – Not chargeable to wealth-tax

Shares are not included in the definition of “asset” under section 2(ea). Hence, the value of shares of group companies is not chargeable to wealth-tax.

(iv) Cash at construction site, not recorded in the books of account – Chargeable to wealth-tax

In case of persons other than individuals and HUFs, any amount not recorded in the books of account is an asset under section 2(ea). Hence, ₹ 2.50 lakhs, representing cash at construction site, not recorded in the books of account, constitutes an asset under section 2(ea).

(v) Residential flat in occupation of company's whole time director drawing a salary of ₹ 9 lakhs per annum – Not chargeable to wealth-tax

Building and land appurtenant thereto is an asset chargeable to wealth-tax. However, a house meant exclusively for residential purposes, allotted by a company to, *inter alia*, a director who is in whole-time employment having a gross annual salary of less than ₹ 10 lakhs, is not chargeable to wealth-tax in the hands of the company.

Therefore, the residential flat in occupation of company's whole time director drawing a salary of ₹ 9 lakhs per annum is not chargeable to wealth-tax in the hands of ABC Ltd.

(c) Computation of value of the house property of Mr. Anil as on valuation date 31.03.2013

Particulars	₹	₹
Gross Maintainable Rent (Annual rent) ¹ (₹ 25,000 × 12)		3,00,000
Less: Corporation tax (₹ 12,500 × 2)	25,000	
15% of Gross Maintainable Rent	45,000	
		70,000
Net Maintainable Rent (NMR)		2,30,000
Value of the house property		
Capitalised value of NMR (NMR × 12.5) (₹ 2,30,000 × 12.5)	28,75,000	
Cost of acquisition	40,00,000	
Value arrived at under Rule 3 – Higher of Capitalised value of NMR and Cost of acquisition (to be further adjusted for unbuilt area of plot of land)		40,00,000
Add: Adjustment for unbuilt area of plot of land		
(i) Aggregate Area	10,000 sq.ft.	
(ii) Specified Area (60%, since the house is in Delhi)	6,000 sq.ft.	
(iii) Built up area	2,000 sq.ft.	

¹ Since Annual Value assessed by the local authority is not given in the question, the annual rent has been taken as the Gross Maintainable Rent.

(iv) Unbuilt Area	8,000 sq.ft.		
(v) Excess of unbuilt area over specified area	2,000 sq.ft.		
% of such excess area on aggregate area (2,000 / 10,000) × 100	20%		
(vi) Premium to be added when (v) is 20% (40% of value arrived at under Rule 3 i.e., 40% of ₹ 40 Lacs)			16,00,000
Value of house property as on valuation date 31.3.2013			56,00,000

Question 2

The Profit & Loss Account of ST Private Limited for the year ended 31st March, 2013 shows a profit of ₹ 75 lakhs after debiting the following items:

- (i) ₹ 2 lakhs contributed to Employees' Welfare Trust.
- (ii) ₹ 12 lakhs paid towards course fee and hostel expenses for MBA course of a close relative of a director. The relative is not in employment with the company.
- (iii) ₹ 3.50 lakhs, being expenses incurred on installation of a traffic signal, so as to facilitate its employees coming to office to overcome traffic jam and save office time.
- (iv) ₹ 3 lakhs spent on gift items distributed to various dealers under the company's sales incentive scheme.
- (v) ₹ 6 lakhs, being expenses incurred on the travelling of the wife of MD, who accompanied him on tour to Singapore on invitation of Trade and Commerce Chamber, Singapore.
- (vi) ₹ 3 lakhs, being amount paid in March 2013 consequent upon change in currency rate due to exchange fluctuation in excess of the amount due to the supplier of machinery.
- (vii) ₹ 18,000 and ₹ 9,000 paid in cash on 25th October, 2012 by two separate vouchers to a contractor who carried out certain repair work in the office premises.
- (viii) Interest of ₹ 2 lakhs was paid in March, 2013 to a company on a loan taken from a company. Tax deducted at source from such interest was deposited in July, 2013.

Additional Information:

- (a) Provision for audit fee of ₹ 6 lakhs was made in the books for the year ended 31st March, 2012 without deducting tax at source. Such fee was paid to the auditors in September, 2012 after deducting tax under section 194J and the tax so deducted was deposited on 7th October, 2012.
- (b) During the year, the company purchased 10,000 shares of VK Private Limited at ₹ 40 per share. The fair market value of such shares on the date of transaction was ₹ 60 per share.

Compute total income of ST Private Limited for Assessment Year 2013-14 and tax payable on such income indicating reasons for treatment of each item. Ignore the provisions relating to minimum alternate tax. (16 Marks)

Answer

Computation of total income of ST Private Ltd. for the A.Y.2013-14

Particulars	₹
Profits and gains of business or profession	
Net profit for the year as per profit and loss account	75,00,000
Add: Expenses debited to profit and loss account but not allowable	
(i) Contribution to Employees Welfare Trust disallowed under section 40A(9)	2,00,000
(ii) Expenses on course fee and hostel expenses for MBA course of a close relative of a director, who is not in employment of ST Private Ltd., is not deductible under section 37 [Enkay (India) Rubber Co. Pvt. Ltd v. CIT (2003) 263 ITR 521 (Del)]. Such expenditure is not incurred wholly and exclusively for the purposes of business. Hence, it should be added back to compute business income.	12,00,000
(iii) Expenses on installation of traffic signal, to facilitate its employees to overcome traffic jam and be on time, is in the interest of the business so that the work gets completed on time, and is hence, an allowable expense under section 37(1).	--
(iv) Expenses on distribution of gift items to dealers under sales incentive scheme would promote goodwill and is made in the interest of business. Such gifts are prompted by commercial expediency and hence, the expenditure is allowable under section 37(1) [CIT v. Avery Cycle Industries Ltd. (2008) 298 ITR 239 / 296 ITR 393 (Punjab & Haryana)].	--
(v) Expenses on travelling to Singapore of the wife of Managing Director on the invitation of Trade and Commerce Chamber, Singapore, is an allowable expense on the grounds of commercial expediency and business considerations.	--
(vi) Increase in liability due to change in currency rate and paid to the suppliers of machinery is to be added to cost of the asset irrespective of the method of accounting as per section 43A. Hence, it should be added back to compute business income.	3,00,000
(vii) Payments to a contractor for repair work in a day by two separate vouchers in cash, is not an allowable expense as per section 40A(3), since the aggregate payment in a day exceeds the limit of ₹ 20,000.	27,000

(viii) Interest of ₹ 2 lakhs paid in March, 2013, on which tax deducted at source was remitted to the Government before the due date of filing of return (i.e., before 30 th September, 2013), is allowable as per section 40(a)(ia).		-
		92,27,000
Less: Expenditure allowable as deduction but not debited to profit and loss account		
Provision for audit fees for the year ended 31.3.2012 for which tax was not deducted in the F.Y. 2011-12 but was deducted and paid in F.Y. 2012-13 is allowable as deduction in the A.Y.2013-14, as per the proviso to section 40(a)(ia).	6,00,000	
Depreciation on the amount of ₹ 3 lakhs added in cost of machinery @ 15% for the year, assuming that the machinery was put to use for more than 180 days (See Note below)	<u>45,000</u>	6,45,000
		85,82,000
Income from other sources		
Difference between the aggregate fair market value of shares of a closely held company and the consideration paid for purchase of such shares is deemed as income in the hands of the purchasing company under section 56(2)(viiia). Since the difference exceeds ₹ 50,000, the entire sum is taxable.		2,00,000
Total income		87,82,000

Computation of tax liability of ST Private Ltd. for A.Y.2013-14

Particulars	₹
Tax on ₹ 87,82,000 @ 30%	26,34,600
Add: Education cess @ 2%	52,692
Secondary and higher education cess @ 1%	<u>26,346</u>
Total Tax Payable	<u>27,13,638</u>

Note :

It has been assumed that the machinery in respect of which payment of ₹ 3 lakhs is made in March, 2013 towards exchange rate fluctuation has been put to use for more than 180 days in the P.Y.2012-13, and hence, depreciation@15% of ₹ 3 lakhs (i.e. ₹ 45,000) has been allowed to compute the business income.

Alternatively, since the question states that the payment of ₹ 3 lakhs for exchange fluctuation is made in March, 2013, it is possible to assume that the machinery has been put to use for less than 180 days and accordingly, restrict the depreciation to 7.5% of ₹ 3 lakhs (i.e., ₹ 22,500). In such a case, the business income would be ₹ 86,04,500 and total income would be ₹ 88,04,500. The tax liability would be ₹ 27,20,591 (i.e., 30.9% of ₹ 88,04,500).

Question 3

- (a) Mr. Shakti purchased a residential house in June, 2001 for ₹ 22 lakhs. He sold the house on 1st December, 2012 for ₹ 100 lakhs. He paid brokerage at 2% on sale price. He invested ₹ 80 lakhs in April, 2013 in equity shares of Shakti Manufacturing Private Limited, a newly formed manufacturing company which qualifies to be a medium enterprise under the Micro, Small and Medium Enterprises Development Act, 2006. Mr. Shakti holds 80% of share capital of the company.

The company utilised the sum of ₹ 80 lakhs in the following manner:

- (i) Purchase of new machinery during April, 2013 ₹ 70 lakhs (including ₹ 10 lakhs for purchase of computers).
- (ii) Deposit in specified bank on 25th September, 2013 ₹ 10 lakhs.

The due date for filing return of income for Mr. Shakti for Assessment Year 2013-14 is 30th September, 2013. Assume that he files the return on 28th September, 2013.

Compute the taxable capital gain arising from the above transaction for Assessment Year 2013-14. Cost Inflation Index: FY 2001-02: 426; FY 2012-13: 852. (6 Marks)

- (b) Discuss the taxability or otherwise of the following transactions under section 56(2) of the Income-tax Act, 1961:

- (i) Bharat is the Karta of Bharat HUF. Sujata, daughter of Bharat is a member of the HUF. She transferred a house property to the HUF without any consideration. The value of the house property for stamp duty purpose is ₹ 10 lakhs.
- (ii) JD Private Limited issued 50,000 equity shares of face value of ₹ 10 per share at a premium of ₹ 60 per share. The fair market value of the share as per prescribed rule is ₹ 50 per share. (4 Marks)

- (c) What are the "specified domestic transactions" which are subject to transfer pricing provisions? (6 Marks)

Answer

- (a) **Computation of taxable capital gains of Mr. Shakti for A.Y.2013-14**

Particulars	₹
Gross sale consideration	1,00,00,000
Less: Expenses on transfer (2% of the gross sale consideration)	<u>2,00,000</u>
Net sale consideration	98,00,000
Less: Indexed cost of acquisition (₹ 22,00,000 × 852/426)	<u>44,00,000</u>
Long term capital gains	54,00,000
Less: Exemption under section 54GB (See Note below) (₹ 54,00,000 × ₹ 70,00,000 / ₹ 98,00,000)	<u>38,57,143</u>
Taxable capital gains	<u>15,42,857</u>

Deemed cost of new plant and machinery for exemption under section 54GB

	Particulars	₹
(1)	Purchase cost of new plant and machinery acquired in April, 2013	70,00,000
	Less: Cost of office appliances, i.e., computers (which have been specifically excluded from the meaning of new plant and machinery)	<u>10,00,000</u>
		60,00,000
(2)	Amount deposited in the specified bank before the due date of filing of return	<u>10,00,000</u>
	Deemed cost of new plant and machinery for exemption u/s 54GB	<u>70,00,000</u>

Note:

Exemption under section 54GB can be availed on long-term capital gains on transfer of a residential house, since all the conditions given below are fulfilled by Mr. Shakti :

- (i) *The sale proceeds are used for subscription in the equity shares of an eligible company, being a newly incorporated manufacturing company which qualifies to be a small or medium enterprise under the Micro, Small and Medium Enterprises Act, 2006.*
 - (ii) *Mr. Shakti holds more than 50% of the share capital in the said company.*
 - (iii) *Further, the amount of subscription as share capital has been utilized by the eligible company for purchase of new plant and machinery within a period of one year from the date of subscription.*
- (b) (i)** Immovable property, being land or building or both, received without consideration by a HUF from its relative is not taxable under section 56(2)(vii).
- Since Sujata is a member of Bharat HUF, she is a “relative” of the HUF. Therefore, if Bharat HUF receives a house property from its member, Sujata, without consideration, the stamp duty value of such property will **not** be chargeable to tax in the hands of the HUF, since such receipt from a “relative” is excluded from the scope of section 56(2)(vii).
- (ii)** The provisions of section 56(2)(viib) are attracted in this case since the shares of a closely held company are issued at a premium (i.e., the issue price of ₹ 70 per share exceeds the face value of ₹ 10 per share).
- The consideration received by the company in excess of the fair market value of the shares would be taxable under section 56(2)(viib).
- Therefore, ₹ 10,00,000 {i.e., (₹ 70 – ₹ 50) x 50,000 shares} shall be the income chargeable under the head “Income from other sources” in the hands of JD Private Limited.
- (c)** The specified domestic transactions, which are subject to transfer pricing provisions, means any of the following transactions, not being an international transaction, namely-

- (1) Any expenditure in respect of which payment has been made or is to be made to a related person referred to in section 40A(2)(b);
- (2) Any transaction referred to in section 80A i.e., inter-unit transfer of goods and services by an undertaking or unit or enterprise or eligible business to other business carried on by the assessee or vice versa, for consideration not corresponding to the market value on the date of transfer;
- (3) Any transfer of goods or services referred to in section 80-IA(8) i.e., inter-unit transfer of goods or services between eligible business and other business, where the consideration for transfer does not correspond with the market value of goods and services;
- (4) Any business transacted between the assessee carrying on eligible business and other person as referred to section 80-IA(10);
- (5) Any transaction, referred to in any other section under Chapter VI-A or section 10AA, to which provisions of section 80-IA(8) or section 80-IA(10) are applicable; or
- (6) Any other transaction as may be prescribed.

However, the above mentioned transactions shall not be treated as specified domestic transaction in case the aggregate of such transactions entered into by the assessee in the previous year does not exceed a sum of ₹ 5 crore.

Question 4

- (a) *Discuss the liability for deduction of tax at source in the Financial Year 2012-13 in the following cases:*
 - (i) *Mr. A has been running a sole proprietary business whose accounts are audited under section 44AB of the Income-tax Act, 1961 every year. He pays a monthly rent of ₹ 15,000 for the office premises to Mr. X, the landlord. Besides, he also pays service charge of ₹ 10,000 per month to Mr. X towards the use of furniture and fixtures.*
 - (ii) *By virtue of an agreement with a catering organization, a nationalized bank pays ₹ 50,000 per month towards supply of food, snacks, etc. during the office hours to the employees of the bank.*
 - (iii) *A notified infrastructure debt fund eligible for exemption under section 10(47) of the Income-tax Act, 1961 pays interest of ₹ 5 lakhs to a company incorporated in USA. The US Company incurred expenditure of ₹ 12,000 for earning such interest. The fund also pays interest of ₹ 3 lakhs to Mr. X, who is a resident of a notified jurisdictional area.* (8 Marks)
- (b) *XYZ Limited's Profit & Loss Account for the year ended 31st March, 2013 shows a net profit of ₹ 75 lakhs after debiting / crediting the following items:*
 - (i) *Depreciation ₹ 24 lakhs (including ₹ 4 lakhs on revaluation).*

- (ii) Interest to financial institution not paid before due date of filing return of income ₹ 6 lakhs.
- (iii) Provision for doubtful debts ₹ 1 lakh.
- (iv) Provision for unascertained liabilities ₹ 2 lakhs.
- (v) Transfer to General Reserve ₹ 5 lakhs.
- (vi) Net Agricultural Income ₹ 16 lakhs
- (vii) Amount withdrawn from Reserve created during 2009-10 ₹ 3 lakhs.

(Book profit was increased by the amount transferred to such reserve in Assessment Year 2010-11)

Other Information:

Brought forward loss and unabsorbed depreciation as per books are ₹ 12 lakhs and ₹ 10 lakhs, respectively.

Compute minimum alternate tax under section 115JB for A.Y.2013-14. (8 Marks)

Answer

- (a) (i) Mr. A, being an individual whose accounts are required to be audited under section 44AB for the immediately preceding financial year in which the rent is credited or paid, shall be liable to deduct tax at source under section 194-I in respect of rental payments made during the financial year 2012-13, if it exceeds the threshold of ₹ 1,80,000 p.a.

As per clause (i) of *Explanation to section 194-I*, rent means any payment, by whatever name called, for the use of (either separately or together), building, furniture, fittings etc. Therefore, the rent of ₹ 15,000 p.m. for office premises as well as the service charges of ₹ 10,000 p.m. for use of furniture and fixtures, paid to Mr. X, would fall within the meaning of "rent" under section 194-I.

Since the aggregate rental payments (for both premises and furniture and fittings) made to Mr. X during the financial year 2012-13 exceeds ₹ 1,80,000, Mr. A is liable to deduct tax at source @10% on ₹ 3,00,000 (i.e., ₹ 1,80,000 for office premises and ₹ 1,20,000 for furniture and fixtures). The tax to be deducted under section 194-I would, therefore, be ₹ 30,000.

- (ii) As per section 194C, the definition of "work" shall include catering.

Therefore, TDS@2% under section 194C will get attracted in respect of payments of ₹ 6,00,000 to the catering organization, since each individual payment exceeds ₹ 30,000. The tax to be deducted, in this case, would be ₹ 12,000 (i.e. 2% of ₹ 6,00,000).

If the catering organization is run by an individual or HUF, tax is to be deducted @1% under section 194C, amounting to ₹ 6,000, being 1% of ₹ 6,00,000.

- (iii) As per section 194LB, tax would be deductible @ 5% on gross interest paid/credited by a notified infrastructure debt fund, eligible for exemption under section 10(47), to a foreign company.

In the first case, since the payment is to a foreign company, education cess @ 2% and secondary higher education cess @1% have to be added to the applicable rate of TDS. Therefore, the tax deductible under section 194LB would be ₹ 25,750 (i.e., 5.15% of ₹ 5 lakhs).

However, in case the notified infrastructure debt fund pays interest to a person who is a resident of a notified jurisdictional area, section 94A will apply. Accordingly, tax would be deductible @30% (plus education cess@2% and secondary and higher education cess@1%) under section 94A, even though section 194LB provides for deduction of tax at a concessional rate of 5%. Therefore, the tax deductible in respect of payment of ₹ 3 lakh to Mr. X, who is a resident of a notified jurisdictional area, would be ₹ 92,700, being 30.9% of ₹ 3,00,000.

(b) **Computation of Book Profit of XYZ Limited under section 115JB**

Particulars	₹	₹
Net Profit as per profit and loss account		75,00,000
Add: Net Profit to be increased by the following amounts as per Explanation 1 to section 115JB		
Transfer to General Reserve	5,00,000	
Provision for unascertained liabilities	2,00,000	
Provision for doubtful debts	1,00,000	
Depreciation	<u>24,00,000</u>	<u>32,00,000</u>
		1,07,00,000
Less: Net Profit to be reduced by the following amounts as per Explanation 1 to section 115JB		
Amount transferred from reserve and credited to profit and loss account [since the book profit was increased by the amount transferred to such reserve in the assessment year 2010-11]	3,00,000	
Depreciation (excluding revaluation)	20,00,000	
Net Agricultural Income [Exempt under section 10(1)]	16,00,000	
Loss brought forward (₹ 12 lakhs) or unabsorbed depreciation (₹ 10 lakhs) as per books, whichever is less	<u>10,00,000</u>	<u>49,00,000</u>
Book Profit for computation of MAT under section 115JB		<u>58,00,000</u>

Computation of minimum alternate tax (MAT) under section 115JB		
Particulars	₹	₹
18.50% of book profit (18.5% of ₹ 58 lakh)		10,73,000
Add: Education cess @ 2%	21,460	
Secondary and higher education cess @ 1%	10,730	32,190
Minimum Alternate Tax payable under section 115JB		<u>11,05,190</u>
Note - Explanation 1 to section 115JB does not require adjustment of interest not paid before due date of filing return of income, while computing book profit.		

Question 5

Attempt any **four** questions out of the following questions :

- (a) The partnership deed of a firm does not specify the remuneration payable to each individual working partner but lays down the manner of fixing the remuneration as follows:

In case the book profits of the firm are up to ₹ 3 lakhs, then the partners would be entitled to remuneration up to ₹ 1.50 lakhs or 90% of book profits, whichever is more. In respect of balance book profits, it is 60%. "Book profits" shall be computed as defined in section 40(b) of the Income-tax Act, 1961. In case there is a loss in a particular year, the partners shall not be entitled to any remuneration. Remuneration payable to the working partners should be credited to the respective accounts at the time of closing of the accounting year and the working partners shall be entitled to equal remuneration.

Can the firm claim deduction in respect of remuneration paid to the working partners?

(4 Marks)

- (b) Transfer fees are received by a cooperative housing society from its incoming and outgoing members. Are such transfer fees liable to tax in the hands of the cooperative society?

(4 Marks)

- (c) The Assessing Officer accepted the returned income filed by RL Ltd. for a particular assessment year. However, the Assessing Officer initiated reassessment proceeding under section 147 as he had reason to believe that the income had escaped assessment due to claim and allowance of club fees, gifts and presents and provision for leave encashment and accordingly, he issued notice under section 148. However, after sufficient enquiries made by him, he came to the conclusion that no additions were required on account of these expenses. But instead he made additions on account of disallowances under section 14A and section 40(a)(ia) in respect of other expenses which were not the original "reason to believe" and passed his reassessment order under section 147. The Assessing Officer is of the opinion that Explanation 3 to section 147

permits him to assess the income which has escaped assessment and which comes to his notice subsequently in the course of proceeding under section 147, even though the said issues were not part of the reasons recorded in the notice under section 148. Is the action of the Assessing Officer valid ? (4 Marks)

- (d) *Y. Ltd. was amalgamated with X. Ltd. in accordance with a scheme of amalgamation. Assets and liabilities were transferred and vested with X. Ltd. X. Ltd. is of the view that excess consideration paid by it over the value of net assets acquired from Y. Ltd. should be considered as goodwill arising on amalgamation. X. Ltd. claimed depreciation on such goodwill, but the claim was rejected by the Assessing Officer on the ground that goodwill is not an asset falling under Explanation 3 to section 32(1) of the Income-tax Act, 1961. Is the action of the Assessing Officer valid?* (4 Marks)
- (e) *R. Ltd. was engaged in the business of manufacturing and trading activities. The company was declared a sick industrial company and as a part of a restructuring programme, a part of the term loan for purchase of machinery and cash credit and interest was waived. The Assessing Officer was of the view that the waiver of loans and interest amounted to remission or cessation of liability and was taxable under section 41(1) of the Income-tax Act, 1961. Give your views on the correctness of the action of the Assessing Officer.* (4 Marks)

Answer

- (a) As per section 40(b), payment of remuneration to a working partner which is authorized by and is in accordance with the terms of the partnership deed is allowable as a deduction to the extent it does not exceed the limits specified in section 40(b)(v).

The issue under consideration is whether, in a case where the partnership deed does not specify the amount of remuneration payable to each partner, but lays down the manner of fixing the remuneration, can payment of such remuneration be allowed as deduction.

In this regard, the CBDT had, vide *Circular No. 739 dated 25.3.1996*, clarified that no deduction under section 40(b)(v) will be admissible unless the partnership deed either specifies the amount of remuneration payable to each individual working partner or lays down the manner of quantifying such remuneration.

The High Court, in *CIT v. Anil Hardware Store (2010) 323 ITR 368 (HP)*, held that where the manner of fixing the remuneration of the working partners has been specified in the partnership deed, the assessee-firm would be entitled to deduct the remuneration paid to such partners, subject to the limits specified under section 40(b)(v).

Therefore, in this case, since the partnership deed lays down the manner of quantifying the remuneration payable to working partners, the firm is entitled to claim deduction of remuneration paid to working partners, subject to the limits specified in section 40(b)(v).

- (b) The issue under consideration is whether the transfer fees received by a co-operative housing society from its incoming and outgoing members is taxable or exempt on the principle of mutuality.

On this issue, the High Court, in *Sind Co-operative Housing Society v. ITO (2009) 317 ITR 47*, observed that under the bye-laws of the society, charging of transfer fees had no element of trading or commerciality. Both the incoming and outgoing members have to contribute to the common fund of the assessee. The amount paid was to be exclusively used for the benefit of the members as a class.

The High Court, therefore, held that transfer fees received by a co-operative housing society, whether from outgoing or from incoming members, is not liable to tax on account of the principle of mutuality, since the predominant activity of such co-operative society is maintenance of property of the society and there is no taint of commerciality, trade or business.

Further, section 28(iii), which provides that income derived by a trade, professional or similar association from specific services performed for its members shall be treated as business income, can have no application since the co-operative housing society is not a trade or professional association.

Applying the rationale of the above ruling, transfer fees received by a co-operative housing society from its incoming and outgoing members would not be liable to tax in the hands of the co-operative society.

- (c) The issue under consideration is whether the Assessing Officer can make an assessment on the basis of an issue which came to his notice during the course of assessment, when the issues, which originally formed the basis of issue of notice under section 148, were dropped in its entirety.

As per section 147, the Assessing Officer may assess or reassess such income and also any other income chargeable to tax which has escaped assessment and which comes to his notice in the course of proceedings under that section. The High Court, in *Ranbaxy Laboratories Ltd. v. CIT (2011) 336 ITR 136 (Delhi)*, observed that the words “and also” used in section 147 are of wide amplitude.

The language of the section is indicative of the position that the assessment or reassessment must be of the income, in respect of which the Assessing Officer has formed a ‘reason to believe’ for the issue of notice under section 148 **and also** in respect of any other income which comes to his notice subsequently during the course of the proceedings as having escaped assessment. The correct interpretation, therefore, would be to regard the words ‘**and also**’ as being “conjunctive and cumulative with” and not “in alternative to” the first part of the sentence, namely, “the Assessing Officer may assess and reassess such income”.

If the income, the escapement of which was the basis of the formation of the “reason to believe”, is not assessed or reassessed, it would not be open to the Assessing Officer to

independently assess only that income which comes to his notice subsequently in the course of the proceedings under the section as having escaped assessment. If he intends to do so, a fresh notice under section 148 would be necessary.

Applying the rationale of the above court ruling, the action of the Assessing Officer in passing a reassessment order under section 147 by making additions on account of disallowances under section 14A and section 40(a)(ia) in respect of other expenses, when the original "reasons to believe" ceased to exist, is not valid.

- (d) The issue under consideration is whether X Ltd. can claim depreciation on the excess consideration paid by it over the value of net assets acquired from Y Ltd. in a scheme of amalgamation, by treating the same as goodwill, and considering it as an intangible asset within the meaning of *Explanation 3* to section 32(1).

This issue came up before the Supreme Court, in *CIT v. Smifs Securities Ltd. (2012) 348 ITR 302*, wherein it was observed that *Explanation 3(b)* to section 32(1) states that the expression 'asset' shall mean an intangible asset, being know-how, patents, copyrights, trademarks, licences, franchises or 'any other business or commercial rights of similar nature'.

A reading of the words 'any other business or commercial rights of similar nature' in *Explanation 3* indicates that "goodwill" would fall under the said expression, applying the principle of *ejusdem generis*. In the process of amalgamation, the amalgamated company had acquired a capital right in the form of goodwill because of which the market worth of the amalgamated company stood increased.

Therefore, it was held that the excess consideration paid by X Ltd. over the value of net assets acquired from Y Ltd. in the scheme of amalgamation constitutes goodwill, which is an intangible asset under *Explanation 3(b)* to section 32(1), thereby qualifying for depreciation under that section.

The action of the Assessing Officer in rejecting the claim of depreciation made by X Ltd. is, therefore, not valid.

- (e) The term loan for purchase of machinery is not a trading liability. Therefore, on writing off of the loans, no benefit or perquisite arose to R Ltd. in the revenue field. Therefore, the provisions of section 41(1) are not attracted in this case since the waiver is in respect of a term loan taken for a capital asset and hence, cannot be treated as remission or cessation of a trading liability. Thus, the waiver of such term loans cannot be treated as income of R Ltd.

However, where the loan is written off in the cash credit account, the benefit is in the revenue field as the money had been borrowed for day-to-day affairs and not for the purchase of capital asset. Therefore, the writing off of these loans on the cash credit account which was received for carrying out the day-to-day operations of the assessee amounted to remission of a trading liability and hence, has to be treated as income in the hands of R Ltd. by virtue of section 41(1). This is the crux of the Delhi High Court decision in *Rollatainers Ltd. v. CIT (2011) 339 ITR 54*.

In effect, the provisions of section 41(1) are attracted in respect of waiver of the working capital loan utilized for day-to-day business operations, since it amounted to remission of a trading liability. However, in the case of waiver of term loan for purchasing capital assets, the provisions of section 41(1) are not attracted since it cannot be treated as remission or cessation of a trading liability.

Waiver of interest on term loan is not taxable under section 41(1), since interest due but not paid would not have been allowed as deduction in the earlier years or current year, on account of the provisions of section 43B. Therefore, the question of taxability of interest waived does not arise.

Therefore, the action of the Assessing Officer in invoking the provisions of section 41(1) in respect of waiver of cash credit is correct. However, as regards invoking the provisions of section 41(1) in respect of waiver of term loan and interest, the action of the Assessing Officer is not correct.

Question 6

- (a) Z, a resident Indian aged 21 years, earned a sum of ₹ 10 lakhs during the previous year 2012-13 from playing badminton matches in a country with which India does not have double taxation avoidance agreement. Tax of ₹ 2 lakhs was levied on such income in the source country. In India, he earned ₹ 15 lakhs during the previous year 2012-13 from playing badminton matches. He has deposited ₹ 1 lakh in public provident fund and ₹ 50,000 in IDFC Infrastructure Bonds during the year. Compute his income tax liability for Assessment Year 2013-14. (8 Marks)
- (b) Discuss, with reasons, whether the following statements are correct:
- Mahesh, a resident and ordinarily resident in India and having a house property and a bank account outside India, is not required to file return of income for Assessment Year 2013-14, if his total income is below the maximum amount not liable to tax.
 - Rectification of an assessment order under section 154 due to subsequent change of law on retrospective basis is valid in law. (4 Marks)
- (c) Discuss how an appeal before Income Tax Appellate Tribunal can be dealt with when there is a difference of opinion amongst the members of bench. (4 Marks)

Answer

(a) Computation of income-tax liability of Z for A.Y. 2013-14

Particulars	₹
Indian Income	15,00,000
Foreign Income	<u>10,00,000</u>
Gross Total Income	25,00,000
Less: <u>Deduction under section 80C</u>	
Deposit in public provident fund	<u>1,00,000</u>
Total Income	<u>24,00,000</u>

Tax on total income (30% of ₹ 14 lakh + ₹ 1,30,000)		5,50,000
Add: Education cess @ 2%		11,000
Secondary and higher education cess @ 1%		<u>5,500</u>
Total tax liability		5,66,500
Average rate of tax in India [i.e. ₹ 5,66,500 / ₹ 24,00,000 x 100]	23.60%	
Average rate of tax in foreign country [i.e., ₹ 2,00,000 / ₹ 10,00,000 x 100]	20%	
Doubly taxed income	₹ 10,00,000	
Less: Deduction under section 91 @ 20%, being lower of the two rates, on doubly taxed income (₹ 10,00,000 x 20%) [See Note 1 below]		<u>2,00,000</u>
Tax payable in India after deduction u/s 91 [₹ 5,66,500 – ₹ 2,00,000]		<u>3,66,500</u>

Notes:

- (1) Mr. Z shall be allowed deduction under section 91 since all the following conditions are fulfilled :-
- He is a resident in India during the P.Y.2012-13.
 - Income of ₹ 10 lakhs accrues or arises to him outside India during that previous year.
 - Such income is not deemed to accrue or arise in India during the previous year.
 - The income in question has been subjected to income-tax in the foreign country in the hands of Mr. Z and he has paid tax on such income in the foreign country.
 - There is no agreement under section 90 for the relief or avoidance of double taxation between India and the other country where the income has accrued or arisen.
- (2) No deduction is allowable for investment in IDFC Infrastructure Bonds for A.Y.2013-14.
- (b) (i)** The statement is incorrect.
- As per section 139(1), every resident and ordinarily resident having any asset located outside India or signing authority in any account located outside India is required to file a return of income in the prescribed form compulsorily, whether or not he has income chargeable to tax.
- Therefore, Mahesh has to file a return of income in the prescribed form compulsorily for A.Y.2013-14, even if his total income is below the maximum amount not liable to tax, since he is a resident and ordinarily resident in India and has a house property and a bank account outside India.
- (ii)** The statement is correct.

If the assessment order is plainly and obviously inconsistent with the specific and clear provision as amended retrospectively, there is a mistake apparent from record. In light of the retrospective amendment, the assessment order can be rectified under section 154 [CIT v. E. Sefton and Co. (P) Ltd. (1989) 179 ITR 435]

- (c) As per section 255(4), if the members of a Bench differ in opinion on any point, the point shall be decided according to the opinion of the majority, if there is a majority.

However, if the members are equally divided, they should state the point or points on which they differ.

The case shall then be referred by the President of the Appellate Tribunal for hearing on such point or points by one or more of the other members of the Appellate Tribunal.

Thereafter, such point or points shall be decided according to the opinion of the majority of the members of the Appellate Tribunal who have heard the case, including those who first heard it.

Question 7

- (a) In the course of scrutiny assessment of Mr. X, the Assessing Officer, on the basis of information available with him, sought an explanation for the source of the expenditure of ₹ 20 lakhs incurred on the wedding of his daughter. The said expenditure was neither recorded in the books of account maintained nor was the explanation offered by Mr. X satisfactory. What are the consequences? (6 Marks)

- (b) Mr. A has gifted a house property valued at ₹ 50 lakhs to his wife, Mrs. B, who in turn has gifted the same to Mrs. C, their daughter-in-law. The house was let out at ₹ 25,000 per month throughout the year. Compute the total income of Mr. A and Mrs. C.

Will your answer be different if the said property was gifted to his son, husband of Mrs. C?

(4 Marks)

- (c) Mr. K, who has attained 63 years, has the following income during the previous year 2012-13:

- Salary Income ₹ 6,80,000
- Interest on savings bank account with Allahabad Bank ₹ 16,000

Other particulars given by Mr. K are as under:

- (i) Insurance premium paid to Max Life Insurance Ltd. amounting to ₹ 25,000 under a policy taken on life of his son. The policy was taken on 20th July, 2011 and the sum assured is ₹ 1,80,000.
- (ii) Insurance premium paid to Life Insurance Corporation of India amounting to ₹ 22,000 under a policy taken on his life on 20th April, 2012 and the sum assured is ₹ 2,00,000.
- (iii) Premium of ₹ 18,000 paid by cheque on health insurance for self to National Insurance Corporation Ltd. and payment in cash of ₹ 5,000 to a hospital for preventive health check-up for self.

Compute the total income of Mr. K for Assessment Year 2013-14 on the basis of the above particulars. (6 Marks)

Answer

- (a) If any expenditure is incurred by an assessee in any financial year in respect of which he is not able to offer explanation about the source of such expenditure or the explanation offered by him is not satisfactory in the opinion of the Assessing Officer, then the amount of such unexplained expenditure may be deemed as income of the assessee for such financial year as per section 69C.

Therefore, in this case, the expenditure of ₹ 20 lakhs incurred by Mr.X on the wedding of his daughter may be deemed as income of Mr.X as per section 69C.

Further, such unexplained expenditure which is deemed as the income of Mr.X shall not be allowed as deduction under any head of income.

Where the total income of Mr.X includes such unexplained expenditure of ₹ 20 lakhs, which is deemed as his income under section 69C, such deemed income would be taxed at the maximum marginal rate of 30% as per section 115BBE (plus education cess@2% and secondary and higher education cess@1%).

Further, no basic exemption or allowance or expenditure shall be allowed to Mr.X under any provision of the Income-tax Act, 1961 in computing such deemed income.

Penalty under section 271(1)(c) shall be levied for concealment of income.

- (b) As per section 27(i), an individual who transfers otherwise than for adequate consideration any house property to his spouse, not being a transfer in connection with an agreement to live apart, shall be deemed to be the owner of the house property so transferred.

Therefore, in this case, Mr. A would be the deemed owner of the house property transferred to his wife Mrs. B without consideration.

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

Income from let-out property is ₹ 2,10,000 [i.e., ₹ 3,00,000, being the actual rent calculated at ₹ 25,000 per month less ₹ 90,000, being deduction under section 24@30% of ₹ 3,00,000]

In this case, income of ₹ 2,10,000 from let-out property arising to Mrs. C, being Mr. A's son's wife, would be included in the income of Mr. A, applying the provisions of section 27(i) and section 64(1)(vi). Such income would, therefore, not be taxable in the hands of Mrs. C.

In case the property was gifted to Mr. A's son, the clubbing provisions under section 64 would not apply, since the son is not a minor child. Therefore, the income of ₹ 2,10,000 from letting out of property gifted to the son would be taxable in the hands of the son.

It may be noted that the provisions of section 56(2)(vii) would not be attracted in the hands of the recipient of house property, since the receipt of property in each case was

from a “relative” of such individual. Therefore, the stamp duty value of house property would not be chargeable to tax in the hands of the recipient of immovable property, even though the house property was received by her or him without consideration.

Note - The first part of the question can also be answered by applying the provisions of section 64(1)(vi) directly to include the income of ₹ 2,10,000 arising to Mrs. C in the hands of Mr. A. [without first applying the provisions of section 27(i) to deem Mr. A as the owner of the house property transferred to his wife Mrs. B without consideration], since section 64(1)(vi) speaks of clubbing of income arising to son's wife from indirect transfer of assets to her by her husband's parent, without consideration. Gift of house property by Mr. A to Mrs. C, via Mrs.B, can be viewed as an indirect transfer by Mr.A to Mrs. C.

(c) **Computation of total income of Mr.K for the A.Y.2013-14**

Particulars	₹	₹
Income from salaries		6,80,000
Income from Other Sources (Interest on savings bank account)		16,000
Gross Total Income		6,96,000
Less: Deductions under Chapter VI-A		
<u>Under section 80C (Life insurance premium paid)</u>		
Premium paid in respect of policy taken on life of son (See Note 1 below) 25,000		
Premium paid in respect of policy taken on own life (See Note 2 below) 20,000	45,000	
<u>Under section 80D (Medical insurance premium paid)</u>		
(See Note 3 below)	20,000	
<u>Under section 80TTA (Interest on savings bank account)</u>		
(See Note 4 below)	10,000	75,000
Total Income		6,21,000

Notes:

- (1) Mr.K can claim deduction under section 80C in respect of insurance premium paid by him in respect of a policy taken on the life of his son. Since the policy was issued before 1.4.2012, the premium paid shall be allowed as deduction upto 20% of sum assured (i.e., upto ₹ 36,000, being 20% of ₹ 1,80,000). Since the insurance premium of ₹ 25,000 paid is within this limit, the same is fully allowable as deduction under section 80C.
- (2) In respect of premium of ₹ 22,000 paid by Mr.K to LIC under an insurance policy taken on his own life, the deduction under section 80C would be restricted to 10% of sum assured, since the premium is paid in respect of a life insurance policy taken on or after 1.4.2012. Therefore, the deduction under section 80C in respect of this policy would be restricted to ₹ 20,000, being 10% of ₹ 2,00,000.

- (3) Deduction under section 80D is allowable in respect of health insurance premium paid by any mode other than cash and expenses on preventive health check-up (upto ₹ 5,000) paid by any mode, including cash. Therefore, both the premium of ₹ 18,000 paid by cheque and preventive health check-up of ₹ 5,000 paid by cash qualifies for deduction under section 80D. However, the deduction would be restricted to ₹ 20,000, which is the overall limit under section 80D in respect of an individual, who is of the age of 60 years or more at any time during the previous year.
- (4) As per section 80TTA, deduction shall be allowed from the gross total income of an individual in respect of income by way of deposit in the savings bank account included in the assessee's gross total income, subject to a maximum of ₹ 10,000. Therefore, a deduction of ₹ 10,000 is allowable from the gross total income of Mr.K, even though his interest from savings bank account is ₹ 16,000.