

Assessment of Various Entities

Some Key Points : Recent Amendments

(a) Concessional rate of tax on interest on borrowings in foreign currency by Indian companies [Section 115A]

- (i) Interest payable by an **Indian company** to a foreign company or a non-corporate non-resident in respect of borrowing made in foreign currency from sources outside India between 1.7.2012 and 30.6.2015 would be subject to tax at a concessional rate of 5% on gross interest (as against the rate of 20% of gross interest applicable in respect of other interest received by a non-corporate non-resident or foreign company from Government or an Indian concern on money borrowed or debt incurred by it in foreign currency).
- (ii) To avail this concessional rate, the borrowing should be from a source outside India under a loan agreement or by way of issue of long-term infrastructure bonds approved by the Central Government.
- (iii) The interest to the extent the same does not exceed the interest calculated at the rate approved by the Central Government, taking into consideration the terms of the loan or the bond and its repayment, will be subject to tax at a concessional rate of 5%.
- (iv) Such interest paid by an Indian company to a non-corporate non-resident or a foreign company would be subject to TDS@5% under section 194LC.
- (v) Accordingly, section 195 would include, within its scope, interest payments to foreign companies and non-corporate non-residents, other than interest covered under section 194LB and section 194LC.

(b) Income received or receivable by a non-resident entertainer, from performance in India included within the scope of Section 115BBA and rate of tax thereunder increased from 10% to 20%

Therefore, the following income shall be charged to tax at the rate of 20% as per the provisions of section 115BBA w.e.f. A.Y. 2013-14:

- (1) the income of a non-resident sportsman (including an athlete) who is not a citizen of India, by way of participation in any game (other than a game the winnings from which are taxable under section 115BB) or sport in India or advertisement or any contribution of article in relation to any game or sport in India;

- (2) any amount guaranteed to be paid or payable to any non-resident sports association or institution in relation to any game (other than a game the winnings from which are taxable under section 115BB) or sport played in India; or
- (3) income of a non-resident entertainer who is not a citizen of India, received or receivable from his performance in India

Consequently, section 194E has been amended w.e.f. 1st July, 2012 to provide that tax shall be deducted at source on the income referred to in section 115BBA at the rate of 20%.

(c) Dividends received by Indian companies from specified foreign companies to be entitled to concessional rate of tax for one more year [Section 115BBD]

Dividends received by Indian companies from **specified foreign companies** are subject to a concessional tax rate of 15% on gross dividend as against the normal tax rate of 30% on net dividend. This amendment, effected by the Finance Act, 2011, to be applicable for A.Y.2012-13 has now been made applicable for A.Y.2013-14 also.

(d) Net profit as per profit and loss account prepared in accordance with the respective Act governing insurance companies, banking companies, electricity companies etc. to form the basis for computation of book profit for levy of MAT in case of such companies [Section 115JB]

In order to align section 115JB(2) with the proviso to section 211(2) of the Companies Act, 1956, sub-section (2) of section 115JB has been substituted to require such companies to prepare their profit and loss account for the relevant previous year in accordance with the provisions of the Act governing such company. Companies, other than companies referred to in the proviso to section 211(2) of the Companies Act, 1956, shall continue to prepare their profit and loss account for the relevant previous year in accordance with the provisions of Part II of Schedule VI to the Companies Act, 1956. Reference to Part III has been omitted since Revised Schedule VI applicable in respect of financial periods commencing from 1st April, 2011 does not contain Part III.

Also, it has been provided that any income accruing or arising to a company from life insurance business referred to in section 115B would not be subject to MAT. [Sub-section (5A) of section 115JB]

(e) Amount standing in the revaluation reserve relating to a retired or disposed asset, to be subject to minimum alternate tax, if the same is not credited to profit and loss account [Explanation 1 to section 115JB]

(f) Levy of Alternate Minimum Tax (AMT) extended to all persons claiming profit-linked deductions, other than companies [Chapter XII-BA-Sections 115JC to 115JF]

- (i) Last year, the Finance Act, 2011 introduced the concept of AMT in relation to LLPs and accordingly the LLPs were subject to AMT @ 18.5% of adjusted total income.

(ii) Though the concept of Alternate Minimum Tax (AMT) was similar to MAT in case of corporates, however, the tax base in the case of LLPs was the adjusted total income computed as per the Income-tax Act, 1961 and not the book profit computed after making the specified adjustments to the profit as per the profit and loss account prepared in accordance with Schedule VI to the Companies Act, 1956.

(iii) The Finance Act, 2012 has now extended the levy of AMT to certain persons other than companies, in order to widen the tax base vis-à-vis profit-linked deductions. Accordingly, any person other than a company, who has claimed deduction under any section (other than section 80P) included in Chapter VI-A under the heading "C – Deductions in respect of certain incomes" or under section 10AA would be subject to AMT with effect from A.Y.2013-14. [Section 115JEE]

The provisions of AMT would, however, not be applicable to an individual, HUF, AOP, BOI, whether incorporated or not, or artificial juridical person, if the adjusted total income of such person does not exceed ₹ 20 lakh. [Section 115JEE]

(iv) Accordingly, where the regular income-tax payable by a person, other than a company, for a previous year computed as per the provisions of the Income-tax Act, 1961 (other than Chapter XII-BA) is less than the AMT payable for such previous year, the adjusted total income shall be deemed to be the total income of the person. Such person shall be liable to pay income-tax on the adjusted total income @ 18.5% [Section 115JC].

(g) Removal of cascading effect of DDT in multi-tier corporate structure [Section 115-O]

(i) Dividend Distribution Tax (DDT)@15% is leviable on dividends declared, distributed or paid by a domestic company. Such dividend is exempt in the hands of the shareholder.

(ii) In order to provide a partial relief from double taxation of dividends, sub-section (1A) was inserted in section 115-O by the Finance Act, 2008. Accordingly, a holding company receiving dividend from its subsidiary company can reduce such dividend received from dividends declared, distributed or paid by it. For this purpose, a holding company is one which holds more than 50% of the nominal value of equity shares of the subsidiary.

(iii) There are certain conditions to be fulfilled to avail this benefit. They are -

- (1) the subsidiary company should have actually paid the dividend distribution tax on the dividend declared, distributed or paid by it;
- (2) the holding company should be a domestic company; and

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(3) the holding company should not be a subsidiary of any other company.

- (iv) However, the above provision removed the cascading effect of DDT only in a two-tier corporate structure.
- (v) In order to remove the cascading effect of DDT in a multi-tier corporate structure also, section 115-O has been amended to remove the condition mentioned in (iii)(3) above and modify the condition in (iii)(1) above. Therefore, in case any domestic company receives any dividend during the year from any subsidiary company and such subsidiary company has paid the DDT as **payable on such dividend**, then, dividend distributed by the holding company in the same year, to the extent of dividend received from the subsidiary, shall not be subject to DDT under section 115-O, irrespective of whether the holding company is a subsidiary of any other company.

(h) Increase in presumptive rate of daily tonnage income [Section 115VG]

Qualifying ship having net tonnage	Amount of daily tonnage income	
	Upto A.Y.2012-13	From A.Y.2013-14
≤ 1,000	₹ 46 for each 100 tons	₹ 70 for each 100 tons
> 1,000 ≤ 10,000	₹ 460 + ₹ 35 for each 100 tons exceeding 1,000 tons	₹ 700 + ₹ 53 for each 100 tons exceeding 1,000 tons
> 10,000 ≤ 25,000	₹ 3,610 + ₹ 28 for each 100 tons exceeding 10,000 tons	₹ 5,470 + ₹ 42 for each 100 tons exceeding 10,000 tons
> 25,000	₹ 7,810 + ₹ 19 for each 100 tons exceeding 25,000 tons	₹ 11,770 + ₹ 29 for each 100 tons exceeding 25,000 tons

Assessment of Individuals

Question 1

Ajay, a non-resident Indian, has the following sources of income in India during the previous year 2012-13:

	Particulars	₹	₹
(i)	Income from house property located in India (computed)		1,80,000
(ii)	Dividend from Indian Companies		75,000
(iii)	Interest on debentures of Indian company (Subscribed in convertible foreign exchange)	1,00,000	
	Less: Interest on loan taken for purchase of debentures	<u>20,000</u>	80,000

(iv)	Long-term capital gains on sale of debentures subscribed in US \$:		
	Cost in 2002-03	4,00,000	
	Sale in 2012-13	<u>6,00,000</u>	
		2,00,000	
	Less: Commission to brokers	<u>6,000</u>	1,94,000
	Cost Inflation Index: F.Y. 2002-03 - 447; F.Y.2012-13 – 852.		

Compute the tax payable by Ajay for Assessment Year 2013-14, if he opts for the provisions of Chapter XII-A of the Income-tax Act, 1961.

Answer

Computation of tax liability of Mr. Ajay for the A.Y. 2013-14 as per provisions of Chapter XII-A

Particulars	₹	₹
Tax on long term capital gain (₹ 1,94,000 × 10%) [See Notes 1 & 2]	19,400	
Tax on interest on debentures being investment income (₹ 1,00,000 × 20%) [See Notes 1 & 3]	20,000	
Tax on balance income of ₹ 1,80,000	<u>Nil</u>	39,400
Add: Education cess @ 2%		788
Add: Secondary and higher education cess @ 1%		394
Total tax liability		40,582
Total tax liability (rounded off)		40,580

Notes:

(1) **Computation of total income of Mr. Ajay for the A.Y. 2013-14 as per provisions of Chapter XII-A**

Particulars	₹	₹
Income from house property (computed)		1,80,000
Capital Gains on sale of debentures		
Sale consideration	6,00,000	
Less: Commission to brokers	<u>6,000</u>	
Net sale consideration	5,94,000	
Cost of acquisition (Refer Note 2)	<u>4,00,000</u>	

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Long term capital gain	1,94,000
Dividend income received from Indian companies [exempt under section 10(34)]	Nil
Interest on debentures of Indian company (Refer Note 3)	1,00,000
Total Income	4,74,000

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

Note - If a non-resident purchases shares in, or debentures of, an Indian company by utilising foreign currency, capital gain shall be calculated under first proviso to section 48 in the same foreign currency which was initially utilised in purchase of shares and debentures. Capital gains so computed in foreign currency shall be reconverted into Indian currency. Since the telegraphic transfer buying rates and telegraphic transfer selling rates of US \$ on the date of acquisition, date of sale and 31st March, 2013 are not given in the question, effect has not been given to the first proviso to section 48 in the above solution.

Question 2

Who can be treated as an agent of a non-resident foreign collaborator for the purpose of proceedings and/or any other matters under the Income-tax Act, 1961?

Answer

Section 2(7) defining the term 'assessee', includes within its scope, a representative assessee as well. The Assessing Officer is statutorily empowered to issue notice under section 163 to any person to deem him as the agent of the non-resident foreign collaborator.

The term 'agent' in relation to a non-resident includes:-

- (i) any person in India who is employed by or on behalf of the non-resident; or
- (ii) any person in India who has any business connection with the non-resident; or

- (iii) any person in India from or through whom the non-resident is in receipt of any income, whether directly or indirectly; or
- (iv) any person in India who is the trustee of the non-resident; or
- (v) any other person who, whether a resident or non-resident, has acquired by means of a transfer, a capital asset in India.

However, a broker in India who in respect of any transaction does not deal directly with or on behalf of a non-resident principal but deals with or through a non-resident broker will not be deemed to be an agent under section 163 in respect of such transactions, provided both the following conditions are fulfilled:

- (a) the transactions must be carried on in the ordinary course of business through the first mentioned broker; and
- (b) the non-resident broker must be one who carries on such transactions in the ordinary course of his business and not as a principal.

Question 3

Mr. Harsh, aged 66 years, running business as a proprietor furnishes the particulars of his income for the year ended 31.3.2013 as under:

- (a) Net Profit of ₹ 3,35,500 from the wholesale business of textiles and fabrics arrived at after charge of following expenses in the Profit & Loss Account:
 - (i) Personal travelling expenses of ₹ 12,750.
 - (ii) Purchase of furniture items for shop on 13.6.2012 of ₹ 25,000 but charged in shop expenses.
- (b) He owns a house of two storeys constructed with financial assistance of HDFC out of which ground floor is used by him for self use and first floor was on rent for ₹ 8,500 p.m. from April, 2012. The municipal tax paid for the whole house was of ₹ 2,500 and interest paid on housing loan taken for the construction was ₹ 52,000. Both the floors of the house are identical.
- (c) He had deposited insurance premium on the life of self of ₹ 12,500, wife ₹ 13,500, son and daughter of ₹ 28,000, made investment of ₹ 50,000 in the bonds issued by NABARD and paid ₹ 22,500 by credit card for his mediclaim insurance.

Compute taxable income and the amount of tax payable by Mr. Harsh on such income for the Assessment Year 2013-14.

Answer

Computation of total income of Mr. Harsh for the A.Y.2013-14

Particulars	₹	₹
<u>Income from house property</u>		
Self-occupied portion (50%)		

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Annual Value under section 23(2)	Nil	
Less: Deduction under section 24(b)		
Interest on housing loan [$\text{₹ } 52,000 \times 50\%$]	<u>26,000</u>	(26,000)
Let-out portion (50%)		
Income of rented out portion being rent of ₹ 8,500 p.m. received for 12 months (Rent received has been taken as the GAV in the absence of other information).		
Gross Annual Value under section 23(1) ($\text{₹ } 8,500 \times 12$)	1,02,000	
Less: 50% of municipal taxes paid allowable in respect of rented out portion (i.e., 50% of ₹ 2,500)	<u>1,250</u>	
Net Annual Value (NAV)	1,00,750	
Less: Deduction under section 24		
30% of NAV under section 24(a)	30,225	
Interest on housing loan under section 24(b)	<u>26,000</u>	<u>44,525</u>
		18,525
<u>Profits and gains of business or profession</u>		
Net profit as per profit and loss account of wholesale business of textiles and fabrics	3,35,500	
Add: Expenses charged in profit and loss account either not allowable or to be considered separately -		
Personal travelling expenses of proprietor	12,750	
Purchase of furniture wrongly debited to shop expenses	<u>25,000</u>	
	3,73,250	
Less: Depreciation on furniture @ 10% on ₹ 25,000	<u>2,500</u>	<u>3,70,750</u>
Gross Total Income		3,89,275
Less: Deduction under Chapter VI-A		
Under section 80C		
- Life insurance premium		
Self	12,500	
Wife	13,500	
Son and daughter	28,000	
- Bonds issued by NABARD	<u>50,000</u>	
	<u>1,04,000</u>	
Maximum allowable upto ₹ 1 lakh (section 80CCE)	1,00,000	
Under section 80D [Medical insurance premium]		
Mediclaime insurance premium of ₹ 22,500, restricted to ₹ 20,000 being maximum allowable for a Senior Citizen	<u>20,000</u>	<u>1,20,000</u>
Total Income		<u>2,69,275</u>

Total Income (rounded off)		2,69,280
Tax on total income of ₹ 2,69,280 [10% of ₹ 19,280, being the excess of ₹ 2,69,280 over the basic exemption limit of ₹ 2,50,000]		1,928
Education cess @ 2%		39
Secondary and higher education cess @ 1%		19
Total tax payable		<u>1,986</u>

Question 4

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

(1)	Dividend from Indian company ₹ 50,000	
(2)	Interest on debentures of an Indian company invested out of remittances in convertible foreign exchange	₹ 75,000
	Less: Interest paid on money borrowed in India for investment in the debentures	₹ 25,000
	Net	₹ 50,000
(3)	Long-term capital gains on sale of shares subscribed in convertible foreign exchange:	
	Cost in 2006-07 ₹ 2,00,000	
	Sale in 2012-13 ₹ <u>3,00,000</u>	
		₹ 1,00,000
	Less: Brokerage ₹ <u>10,000</u>	₹ 90,000
	Cost Inflation index 2006-07 519	
	2012-13 852	
(4)	Property income in India (Net)	₹ 3,00,000
	T.D.S	₹ 30,000

The property was acquired partly out of a loan from HDFC. The repayment of loan made during the year amounted to ₹ 20,000. The assessee also claims deduction of ₹ 10,000 by way of donation to the Prime Minister's Relief Fund and of ₹ 20,000 towards interest on loan taken for higher education in India in 2006 before his migration.

Answer

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

According to section 115C –

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

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

- (i) No deduction in respect of any expenditure or allowance under any provision of the Income-tax Act, 1961 is allowable in computing such investment income;
- (ii) No deduction under Chapter VI-A shall be allowed in respect of both investment income and long term capital gains; and
- (iii) No indexation will be applicable in respect of long term capital gains.

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

Computation of total income for A.Y. 2013-14

Particulars		₹
1. Dividend income – Exempt under section 10(34)		Nil
2. Debenture Interest [interest on loans borrowed for investment not allowable as deduction as per section 115D(1)]		75,000
3. Long-term capital gains - Assuming it was subjected to Securities Transaction Tax, the entire long term capital gain from sale of shares is exempt under section 10(38)		NIL
4. Property Income (Net) [assuming net of all deductions]		3,00,000
Gross Total Income		3,75,000
Less: Deduction under section 80C in respect of housing loan repaid	20,000	
Deduction under section 80E allowable in respect of interest paid on loan taken for higher education	20,000	
Deduction under section 80G in respect of donation to Prime Minister's Relief fund (50%)	<u>10,000</u>	50,000
Total income		3,25,000

Computation of tax payable

Particulars	₹	₹
Tax at 20% on debenture interest of ₹ 75,000		15,000
Total Income (as reduced by investment income) i.e. ₹ 3,25,000 minus ₹ 75,000	2,50,000	
Tax thereon		5,000
		20,000
Add: Education cess & secondary and higher education cess @ 3%		600
		20,600
Less: Tax Deducted at Source		30,000
Balance tax refundable		9,400

Assessment of HUFs**Question 5**

Krishan Kanhaiya HUF, running Kanha Departmental Stores consists of Karta, his wife, two sons and daughter. Both the sons who are having professional/technical qualifications as a Chartered Accountant and as an Automobile Engineer started in partnership, a garage for the repairing of motor cars, with a clear understanding that the technical side of the business be looked after by the Engineer while the general administration and finance part be taken care by the Chartered Accountant. They had taken an interest-free loan of ₹ 5,00,000 from the HUF for starting the venture. The business of garage resulted in a net profit of ₹ 15,00,000 for the year ended 31.03.2013. The Assessing Officer proposes to assess the income from the business of motor garage in the hands of HUF. What do you say about the validity of the proposition of the Assessing Officer?

Answer

The Delhi High Court, in *CIT v. Charan Dass Khanna & Sons* (1980) 123 ITR 194, observed that if the investment made by the HUF in the business started by the coparceners plays a minor role and it is primarily the personal efforts, specialized skill and enterprise of the individual coparceners which resulted in setting up of a new business and earning of goods profits, then it may not essentially be said that the income belongs to the HUF.

In the case on hand, the good profits were earned primarily because of the specialized skills acquired by both the partners in their respective fields and used in the business of motor garage. The initial capital taken from the HUF as interest free loan, of course, has its role but it is nevertheless a minor one. Therefore, the income from the business set up by the brothers is assessable in their individual hands and not as the income of the family.

The Supreme Court has also supported this view in the case of *K.S. Subbiah Pillai v. CIT* (1999) 237 ITR 11. In that case, it was held that where the remuneration and commission earned by the

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Karta were on account of the personal qualifications and exertions and not on account of the investment of the family funds, such income cannot be treated as income of the HUF.

The proposition of the Assessing Officer to tax the profits of the business of motor garage earned by the two sons in the hands of the HUF is, thus, not valid.

Question 6

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

Answer

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

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

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

Assessment of Firms/LLPs

Question 7

- (i) *Who shall sign and verify the return of income of a limited liability partnership?*
- (ii) *XYZ LLP is liquidated. What is the liability of partners of XYZ LLP in respect of its tax dues?*
- (iii) *PQR LLP has a profit of ₹ 500 lacs after charging interest on capital for P amounting to ₹ 10 lacs calculated at 15% p.a. as per the agreement, but before considering remuneration to partners. What is the maximum admissible amount of remuneration to partners assuming all the partners are working partners and remuneration is authorized by the LLP instrument?*

Answer

- (i) Under section 140, the return of income shall be signed and verified, in the case of a limited liability partnership (LLP), by the designated partner thereof.

Where for any unavoidable reason, such designated partner is not able to sign and verify the return, or where there is no designated partner as such, the return can be signed by any partner of the LLP.

- (ii) Section 167C provides for the liability of partners of LLP in liquidation. In case of liquidation of an LLP, where tax due from the LLP cannot be recovered, every person who was a partner of the LLP at any time during the relevant previous year will be jointly and severally liable for payment of tax unless he proves that non-recovery cannot be attributed to any gross neglect, misfeasance or breach of duty on his part in relation to the affairs of the LLP. This provision would also apply where tax is due from any other person in respect of any income of any previous year during which such other person was a LLP.

(iii) **Computation of maximum admissible remuneration to working partners**

Particulars	₹(in lacs)
Net profit before considering partners' remuneration	500
Add: Interest to Partner, P, in excess of 12% p.a. $\left(₹ 10 \text{ lacs} \times \frac{3}{15} \right)$	<u>2</u>
Book profit under section 40(b)	<u>502</u>
Maximum amount admissible as remuneration to working partners under section 40(b) :	
On first ₹ 3 lacs of book profit, 90%	2.70
On balance of book profit i.e. ₹ 499 lacs at 60%	<u>299.40</u>
Maximum admissible remuneration	<u>302.10</u>

Question 8

M/s. Harilal Industries, a partnership firm, submits the following profit and loss account for computation of its business income for the assessment year 2013-14.

Profit and loss account for the year ending 31.03.2013

Expenses	₹	Income	₹
To Salaries	4,23,000	By gross profit	7,47,300
" Rent	32,000	Dividend from UTI	8,000
" Printing & Stationery	5,600		
" Telephone	3,700		
" Conveyance	21,000		
" Travelling	14,000		

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" Interest	72,000		
" Depreciation	27,000		
" Legal fees	15,000		
" Auditor's fees	18,000		
" PF contribution	24,000		
" Net profit	1,00,000		
Total	7,55,300	Total	7,55,300

Additional information:

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

Answer

Computation of business income of M/s. Harilal Industries for the A.Y 2013-14

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

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

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

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

Question 9

X, Y and HUF of Z (represented by Z) are partners with equal shares in profits and losses of a firm, M/s Popular Cine Vision, which is engaged in the production of TV serials and telefilms. In the previous year 2011-12, one partner 'A' retired, but his dues have been settled in the previous year 2012-13.

The earlier partnership deed did not authorise payment of remuneration or interest to partners. The partnership deed was revised by the partners on 1st June, 2012 to authorise payment of remuneration of ₹ 1 lac per month to each working partner and simple interest at 15% per annum to X and Y on their capital. X, Y and Z are actively associated with the affairs of the firm.

The Profit & Loss Account of the firm for the year ended 31st March, 2013 shows a net profit of ₹ 10 lacs after debiting/crediting the following:

- Interest amounting to ₹ 7.5 lacs each was paid to partners X and Y on the balances standing to their capital accounts from 1st April, 2012 to 31st March, 2013.*
- Remuneration to the partners including partner in representative capacity ₹ 30 lacs.*
- Interest amounting to ₹ 2 lacs paid to Z on loan provided by him in his individual capacity at 16% interest.*
- Royalty of ₹ 5 lacs paid to partner X, who is litterateur and a professional script writer, for use of his scripts as per an agreement between the firm and X.*
- Two separate payments of ₹ 18,000 and ₹ 15,000 made in cash on 1st February, 2013 to Altaf, a hairdresser, against his bill for services rendered in January, 2013 and two payments of ₹ 19,000 and ₹ 10,000 made in cash on 1st February and 2nd February, 2013, respectively, to Priyam, an assistant cameraman, against her bill for services provided in January, 2013.*
- Amount of ₹ 5 lacs provided in the books on 31st March 2013 as liability for remuneration to Shreyashi, a film artist and a non-resident. Tax deducted at source under section 195 from the amount so credited was paid on 3rd June, 2013.*
- Amount of ₹ 6 lacs provided as gratuity for the year on the basis of actuarial valuation. Gratuity paid to retired employees is ₹ 1.50 lacs.*

13.16 Direct Tax Laws

- (h) Interest of ₹ 1.20 lacs received on income-tax refund under section 244(1A) in respect of assessment year 2011-12.

The firm has also provided the following additional information:

The amount due to A, the former partner, was ₹ 15 lacs. The dues were settled on 30th September, 2012 by transferring a plot of land purchased two years back having a book value of ₹ 10 lacs. The difference of ₹ 5 lacs was credited to partners' capital accounts in their profit sharing ratio. The fair market value of the plot on the date of transfer was ₹ 16 lacs.

Compute the total income of the firm for the assessment year 2013-14 stating the reasons for treatment of each item.

Answer

Computation of Total Income of M/s. Popular Cine Vision for the A.Y.2013-14

Particulars	₹	₹
Profits and Gains from Business or Profession		
Net Profit as per Profit & Loss A/c		10,00,000
Add: Expenses disallowed or considered separately:		
Interest to partners in excess of 12% (Note 1)	5,00,000	
Disallowance under section 40A(3) for aggregate cash payment exceeding ₹ 20,000 in a single day (Note 5)	33,000	
Remuneration to non-resident film artist to be disallowed under section 40(a)(i) as the TDS payment was made in June 2013 (Note 6)	5,00,000	
Provision for gratuity (Note 7)	4,50,000	
Partners' Remuneration	30,00,000	
Royalty paid to Partner X (Note 4)	5,00,000	49,83,000
		59,83,000
Less: Interest on income-tax refund (Note 8)		1,20,000
Book Profit		58,63,000
Less: Partners' remuneration allowable under section 40(b)(v)		
(i) As per limit prescribed in section 40(b)		
On first ₹ 3,00,000 90%	2,70,000	
On the balance ₹ 55,63,000 60%	33,37,800	
	36,07,800	
(ii) Remuneration actually paid or payable (₹ 1,00,000 × 10 months × 3 partners) + (Royalty ₹ 5 Lacs)	35,00,000	
(i) or (ii) whichever is less, is deductible		35,00,000
		23,63,000

Capital Gain		
Short-term capital gain on transfer of land (Note 9)		6,00,000
Income from other sources		
Interest on income-tax refund		1,20,000
Gross Total Income		30,83,000
Deductions under Chapter VI-A		Nil
Total Income		30,83,000

Notes:

- As per section 40(b), simple interest at 12% p.a. to partners relating to the period after the date of partnership deed is allowable. Therefore, interest to partners from 1st April to 31st May, 2012 should be disallowed. Further, the excess interest @ 3% paid from 1st June, 2012 to 31st March, 2013 should also be disallowed.

		₹
Interest for April and May, 2012	₹ 15,00,000 x 2/12	2,50,000
Excess interest from June'12 to March'13	(₹15,00,000 x 3/15) x 10/12	2,50,000
		5,00,000

- Even though Z is a partner in a representative capacity, he is still a partner. Therefore, remuneration to Z should also be subject to the limits prescribed in section 40(b). This view finds support from the decision of the Supreme Court in the case of *Rashik Lal & Co. vs CIT (1998) 229 ITR 458 (SC)*.
- As per *Explanation 1* to section 40(b), where an individual is a partner in a firm in a representative capacity, the provisions of section 40(b) shall not apply to any interest payable by the firm to such individual in his personal capacity. Z represents his HUF in the firm. However, Z gave the loan in his individual capacity. Hence, assuming that the provisions of section 40A(2) do not get attracted in this case, such interest shall be allowed as deduction in full even though the interest rate is more than 12% p.a.
- It may be noted that the limits specified under section 40(b)(v) are applicable in case of payment of salary, bonus, commission, or remuneration, by whatever name called, to a working partner. From a plain reading of the section, it is clear that any remuneration, by whatever name called, paid to a working partner, is subject to the limits laid down in section 40(b)(v). Therefore, the royalty of ₹ 5 Lacs paid to partner X would also be subject to the limits laid down in section 40(b)(v). Hence, the same has to be added back for computing book profits.
- Section 40A(3) provides for disallowance of any expenditure in respect of which aggregate of payments made otherwise than by an account payee cheque or account payee bank draft in a single day to a person exceeds a sum of ₹ 20,000. Hence, the payments of ₹ 18,000 and ₹ 15,000 in cash on 1.2.2013 to Altaf, a hairdresser, shall be disallowed, since the aggregate payment of ₹ 33,000 exceeds the limit of ₹ 20,000.

13.18 Direct Tax Laws

In case of payment of bill of the assistant cameraman of ₹ 19,000 and ₹ 10,000 respectively on 1st February and 2nd February is not liable for disallowance under section 40A(3) since the aggregate payment in cash on a single day has not exceeded ₹ 20,000.

6. As per section 40(a)(i), any sum payable to a non-resident shall not be allowed as deduction, if tax has not been deducted at source or after deduction, has not been paid within the time limit prescribed in section 200(1). Tax deducted from the amount of remuneration credited to payee's account on 31st March 2013 has to be deposited latest by 30th April, 2013. The firm has paid the tax on 3rd June, 2013 and hence, the remuneration shall not be allowed.
7. As per section 40A(7), any provision made for payment of gratuity to employees on their retirement or on termination of employment for any reason is disallowed. However, any provision made for the purpose of payment of a sum by way of any contribution to an approved gratuity fund or for the purpose of payment of gratuity which has become payable during the previous year shall be allowed as deduction. The question does not mention any approved gratuity fund. However, gratuity of ₹ 1.50 lacs paid to retired employees is allowable as deduction. Hence, the balance provision of ₹ 4.50 lacs (i.e., ₹ 6 lacs – ₹ 1.50 lacs) is to be disallowed.
8. Interest on income-tax refund is assessable under the head "Income from other sources".
9. Distribution of a capital asset by a firm to its partner on dissolution or otherwise attracts capital gains tax liability as per the provisions of section 45(4) and the fair market value of the asset on the date of transfer is deemed to be the full value of consideration received or accruing as a result of the transfer. The words "or otherwise" includes within its scope, cases of distribution of capital assets on retirement of a partner also. [*CIT vs. A. N .Naik Associates 265 ITR 346 (Bom.)*]. Therefore, distribution of a plot of land on retirement of a partner would attract section 45(4).

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

Question 10

HSP, a partnership firm engaged in the business of running a heritage hotel approved by the competent authority provides the following information relating to the year ended on 31.3.2013:

- (a) *Net profit as per P & L account of ₹ 200 lacs was arrived at after charge of the following:*
 - (i) *Depreciation on hotel building having W.D.V. on 1.4.2012 of ₹ 500 lacs was charged by treating the same as plant and machinery.*
 - (ii) *Expenses of ₹ 1,00,000 incurred for the purpose of promoting family planning among its employees.*

- (iii) Payment of ₹ 50,000 for an advertisement published in the souvenir released on 15th August by Bhartiya Janta Party.
- (iv) Compensation of ₹ 1,00,000 paid to the suppliers of automatic kitchen appliances because of termination of the contract after receipt of 50% of appliances.
- (v) Wines and liquor imported in F.Y. 2011-12 for ₹ 20 lacs and were available in the stock on 1.4.2012 cost ₹ 5 lacs were confiscated by the Govt. authority and therefore were written off.
- (vi) Expenses of ₹ 20 lacs incurred on replacement of carpets in the foyer, lounge and bar.
- (b) Amount of ₹ 4 lacs equal to U.K. £5000 was remitted and paid to a travel agent resident of U.K. as commission for the booking of international tourists in the hotel. Tax at source was not deducted out of such payment. The said commission is charged to profit & loss account.
- (c) Amount of ₹ 40,000 each was paid in cash to the suppliers of vegetables, milk products and eggs on 05.09.2012 because of suspension of banking operations due to strike of bank employees. The expenditure was debited to profit & loss account.
- (d) Amount of ₹ 5 lacs written off in the F.Y. 2010-11 as irrecoverable from a travel agent; an amount of ₹ 2 lacs out of it was recovered on 13.3.2013 and credited to a reserve account.

Compute the Gross Total Income for A.Y. 2013-14 and give reasons in brief for treatment given to each of the items.

Answer

Computation of gross total income of M/s. HSP for the A.Y.2013-14

Particulars	₹	
Income from business and profession		
Net profit as per profit and loss account		2,00,00,000
Add : Items charged in profit and loss account which are not allowable		
Excess depreciation on building @ 5%(i.e. 15% - 10%) on ₹ 500 Lacs	25,00,000	
Expenses on promoting family planning amongst the employees	1,00,000	
Advertisement in souvenir of a political party	50,000	
Compensation to a supplier of kitchen appliances	1,00,000	27,50,000
Add : Recovery of bad debts credited in reserve but chargeable under section 41(4)		2,00,000
Gross Total Income		2,29,50,000

Notes:-

- (1) Hotel building does not constitute plant and machinery and therefore, depreciation chargeable thereon is 10%. However, depreciation has been charged in the profit and loss account at the rate applicable to plant and machinery i.e. @ 15%. Accordingly, the excess depreciation charged in the profit and loss account @ 5% (15%-10%) has to be added to income.
- (2) Expenses on promoting family planning amongst employees is allowable under section 36(1)(ix) only to a company assessee. In this case, since the assessee is a firm, such expenses are not allowable and therefore, the same has to be added back.
- (3) Advertisement of any nature given in a magazine / souvenir published by a political party is not allowable as per section 37(2B).
- (4) Compensation paid for breach of a contract for supply of a capital asset is in the nature of capital expenditure as held by the Supreme Court in case of *Swadeshi Cotton Mills Co. Ltd. vs. CIT (1967) 63 ITR 65*. Accordingly, the same will be disallowed and added back to income.
- (5) The Apex Court in case of *Dr. T.A. Quereshi vs CIT (2006) 287 ITR 547* observed that loss of stock-in-trade has to be considered as a trading loss. *Explanation* to section 37(1) is not relevant here since it is not a case of business expenditure but one of business loss. Business loss is allowable on ordinary commercial principles.
Therefore, since wine and liquor formed part of stock-in-trade of the firm, confiscation of the same has to be allowed as a business loss.
- (6) The expenditure incurred on replacement of carpets by a hotel are in the nature of expenses incurred for the purposes of business and are allowable as revenue expenses under section 37(1).
- (7) The payment to a non-resident outside India without deduction of tax at source is an allowable expense notwithstanding the withdrawal of *CBDT Circular No.786 dated 7.2.2000* by means of *Circular No.7 of 2009 dated 22.10.2009* as there is no income accruing or arising to the non-resident in India.
- (8) The cash payments made totaling ₹ 1,20,000 on the day when bank employees were on strike is an exception as per rule 6DD(k) and clarification of CBDT as per *letter No.142(14)/70 dated 28/9/1970*. Therefore, disallowance under section 40A(3) is not attracted.
- (9) The recovery of a debt which was earlier written off under section 36(1)(vii) and was allowed as deduction is chargeable to tax under section 41(4) in the year of such recovery. Accordingly, such amount has to be added to income despite the fact that the same was credited by the firm in a reserve account.

Question 11

M/s. HIG, a firm, consisting of three partners namely, H, I and G, carried on the business of purchase and sale of television sets in wholesale and manufacture and sale of pens under a deed of partnership executed on 1.4.2008. H, I and G were partners in their individual capacity.

The deed of partnership provided for payment of salary amounting to ₹ 1,25,000 each to H and G, who were the working partners. A new deed of partnership was executed on 1.10.2012 which, apart from providing for payment of salary to the two working partners as mentioned in the deed of partnership executed on 1.4.2008, for the first time provided for payment of simple interest @ 12% per annum on the balances standing to the credit of the Capital accounts of partners from 1.4.2012.

The firm was dissolved on 31.3.2013 and the Capital assets of the firm were distributed among the partners on 20.4.2013. The net profit of the firm for the year ending 31.3.2013 after payment of salary to the working partners and debit/credit of the following items to the Profit and Loss Account was ₹ 1,50,000:

- (i) Interest amounting to ₹ 1,00,000 paid to the partners on the balances standing to the credit of their capital accounts from 1.4.2012 to 31.3.2013.
- (ii) Interest amounting to ₹ 50,000 paid to the partners on the balances standing to the credit of their Current accounts from 1.4.2012 to 31.3.2013.
- (iii) Interest amounting to ₹ 20,000 paid to the Hindu undivided family of partner H @ 18% per annum.
- (iv) Payment of ₹ 25,000 towards purchase of television sets made by crossed cheque on 1.11.2012.
- (v) ₹ 30,000 being the value of gold jewellery received as gift from a manufacturer for achieving sales target.
- (vi) Depreciation amounting to ₹ 15,000 on motor car bought and used exclusively for business purposes, but not registered in the name of the firm.
- (vii) Depreciation under section 32(1)(ii) amounting to ₹ 37,500 of new machinery bought and installed for manufacture of pens on 1.11.2012 at a cost of ₹ 5,00,000. There was no increase in the installed capacity as a result of the installation of the new machinery.
- (viii) Interest amounting to ₹ 25,000 received from bank on fixed deposits made out of surplus funds.

The firm furnishes the following information relating to it:

- (a) Closing stock-in-trade was valued at ₹ 60,000 as per the method of lower of cost or market rate consistently followed by it. The market value of the closing stock-in-trade was ₹ 65,000.
- (b) Brought forward business loss relating to the assessment year 2012-13 was ₹ 50,000.

13.22 Direct Tax Laws

(c) The fair market value of the capital assets as on 31.3.2013 was ₹ 20,00,000 and the cost of their acquisition was ₹ 15,00,000.

Compute the total income of M/s. HIG for the assessment year 2013-14.

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

Answer

Computation of total income of M/s. HIG for the A.Y. 2013-14

Particulars	₹	₹
Net profit as per profit & loss account		1,50,000
Add: Interest to partners on capital accounts for the period from 1.4.2012 to 30.9.2012 (₹ 1,00,000 but deduction limited to 6 months only hence 50% thereof is deductible and the balance is added)	50,000	
Interest to partners on current accounts from 1.4.2012 to 31.3.2013 – not authorized by the deed, hence disallowed.	50,000	
100% of ₹ 25,000 paid towards purchase of television sets otherwise than by way of account payee cheque (being stock in trade, hence disallowed)	25,000	
Difference on account of valuation of closing stock-in-trade at market value (₹ 65,000 less ₹ 60,000)	5,000	
Salary paid to working partners considered separately	2,50,000	
		3,80,000
		5,30,000
Less: Additional depreciation on new machinery (₹ 5,00,000 × 20%) = ₹ 1,00,000. Only 50% is allowable as deduction.		50,000
		4,80,000
Less: Interest received from bank on fixed deposits considered separately		25,000
		4,55,000
Less: Salary to working partners -		
(i) As per limit in section 40(b)		
On first ₹ 3,00,000 @ 90%	2,70,000	
On the balance of ₹ 1,55,000 @ 60%	93,000	
	3,63,000	
(ii) Salary actually paid	2,50,000	
Deduction allowed being (i) or (ii) whichever is less		2,50,000
		2,05,000

Less: Business loss relating to assessment year 2012-13 set off	50,000
Income from business	1,55,000
Income from other sources	
Interest received from bank on fixed deposits	25,000
Total Income	1,80,000

Explanation for the treatment of various items

- (i) Interest to partners authorised by the partnership deed will be allowed as deduction only for the period beginning with the date of the partnership deed and not for any earlier period as per section 40(b)(iv). Therefore, interest paid to the partners on the balances standing to the credit of their capital accounts from 1.10.2012 alone is eligible for deduction, since the partnership deed was executed only on 1.10.2012. Interest for the period prior to 1.10.2012 is not allowed.
- (ii) The partnership deed of 1.10.2012 provides for payment of interest on balances in capital accounts of partners only. As such, the interest paid on the balances standing to the credit of the current accounts of partners is not allowable under section 40(b). The Kerala High Court has, in *Novel Distributing Enterprises v. DCIT (2001) 251 ITR 704 (Ker)*, on identical facts, held that interest paid to the partners on their current account balances is not allowable.
- (iii) Since H is a partner in his individual capacity, interest paid to the Hindu Undivided Family of partner H does not attract disallowance under section 40(b)(iv).
- (iv) Section 40A(3) provides for disallowances @ 100% of the expenditure incurred otherwise than by an account payee cheque / account payee bank draft. Since the firm has made payment of ₹ 25,000 towards purchase of television sets by a crossed cheque and not by an account payee cheque, 100% of such expenditure would be disallowed.
- (v) Gold jewellery valued at ₹ 30,000 received as gift from a manufacturer for achieving sales target is taxable under section 28(iv), being a benefit arising from business.
- (vi) Depreciation on motor car bought and used exclusively for the purposes of business is allowable though not registered in the name of the firm in view of the ratio of the decision of the Supreme Court in *Mysore Minerals Ltd. v. CIT (1999) 239 ITR 775*.
- (vii) The firm is entitled to additional depreciation @ 20% under section 32(1)(ia) in respect of the new machinery installed for manufacture of pens. Since the new machinery is put to use for less than 180 days during the relevant previous year, the additional depreciation is restricted to 50% of the prescribed rate of 20% i.e. it is restricted to 10%.
- (viii) Interest received from bank on fixed deposits made out of surplus funds is assessable under the head 'Income from other sources'. Hence, it is not taken into account for the purpose of computing book-profit.

13.24 Direct Tax Laws

- (ix) The Supreme Court has, in *A.L.A Firm v. CIT* (1991) 189 ITR 285, held that the closing stock has to be valued at market rate in the case of a dissolved firm. As such, the closing stock-in-trade of the firm has to be valued at the market rate.
- (x) Net profit shown in the profit and loss account computed in the manner laid down in Chapter IV-D as increased by the aggregate amount of the remuneration paid or payable to all the partners constitutes book profit as per *Explanation 3* to section 40(b). Carry forward and set off of business loss is covered under Chapter VI. Hence, brought forward business loss relating to the assessment year 2012-13 is not considered for calculation of book-profit.
- (xi) Section 45(4) is not applicable to the firm for the assessment year 2013-14, though the dissolution of the firm took place on 31.3.2013, there was no transfer by way of distribution of capital assets during the relevant previous year. The distribution of the capital assets took place on 20.4.2013. The capital gains will be assessable in the assessment year 2014-15.

Question 12

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

Answer

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

In *Sakthi Trading Company v. CIT* (2007) 250 ITR 871 the Supreme Court reviewed all the cases relating to valuation and held that in *ALA Firm's* case, there was not only a dissolution but also a discontinuance thereof and the stocks had therefore to be valued at market value for settling the accounts of the partners. Where there is no discontinuance of the business, the stocks have to be valued at cost or market value, whichever is lower. This is the established rule of commercial practice and accountancy.

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

Question 13

Vijay Agencies, a partnership firm constituted by three partners with equal shares was dissolved on 1-04-2012 after a search. The liability to tax finally decided against the firm outstanding to be paid was ₹ 15 Lacs. Out of three partners, one was declared insolvent on 18-03-2013 by the Court. The Assessing Officer, for recovering the demand, attached the Bank Accounts of other two partners and could recover an amount of ₹ 6 Lacs from the Account of one such partner. You are asked by the partners of dissolved firm:

- (i) *About the liability of each of them to pay outstanding demand.*
- (ii) *Whether the action of Assessing Officer to attach the Bank Account of partners against demand of dissolved firm is justified?*

Answer

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

Question 14

- (a) *Ravi Traders, a partnership firm consisting of three partners. 'A', 'B' and 'C' is assessed to income-tax as partnership firm assessed as such. 'B' and 'C' retired from the partnership with effect from 31st December 2012 'A' took over the business and continued as a proprietor. The stock in trade as at 31st December, 2012 was valued at average purchase price for settlement of accounts, which was the system consistently followed. On these facts, you are consulted on the following issues:*

Under which provisions of the Income-tax Act, 1961 M/s. Ravi Traders for the period 1.4.2012 to 31.3.2013 shall be assessed for the assessment year 2013-14? Can the Assessing Officer dispute the stock valuation in the assessment of the firm?

- (b) *'A' desires to admit three partners from 1st April, 2012. Amongst the partners, it is agreed that two partners, shall be the working partners and be paid remuneration, your advice is sought as to the requirements to see that the remuneration to the working partners is allowable in the hands of the firm under the Income-tax Act, 1961.*

Answer

- (a) M/s. Ravi Traders was a partnership firm and it became a proprietary concern thereafter. Therefore there was a discontinuance of the firm. Section 189 provides for the

assessment in the case of a discontinuance or dissolution of the firm to safeguard the interests of the Revenue for the assessment of the firm and levy of tax. The section proceeds on the premise that the firm is deemed to be a continuing firm for purposes of assessment in that assessment year. The section provides that (a) the assessment shall be made as if no discontinuance has taken place (b) every person who was a partner at the time of discontinuance of the firm and the legal representative of any such partner who is deceased, shall be jointly and severally liable for the tax and penalty and or other sums payable and (c) all the other provisions of the Act so far as may be, shall apply to any such assessment or imposition of penalty or other sum. Penalty proceedings can be initiated and penalty may be imposed on such firm even after the discontinuance and/or dissolution. Therefore the firm M/s. Ravi Traders shall be assessed as partnership firm assessed as such as per the provisions of section 189.

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

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

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

Assessment of Companies**Question 15**

S. Ltd., engaged in the business of manufacturing, shows a net profit of ₹ 5 crores for the financial year ended 31-3-2013, after debiting/crediting the following items:

- (i) On EPABX and mobile phones (exclusively used for the business purpose) purchased during the year, depreciation amounting to ₹ 18 lacs was claimed at higher rate of 60% treating them at par with computer.*
- (ii) ₹ 50 lacs paid to N. Ltd, towards feasibility study conducted for examining proposals for technological advancement relating to the existing business, where the project was abandoned without creating a new asset.*
- (iii) ₹ 35 lacs paid for the higher studies of the director's son abroad, with a stipulation that he would be appointed as a trainee in the company under "apprentice training scheme" where there is no evidence of existence of such scheme.*
- (iv) Payment of ₹ 29 lacs (without deducting tax at source) towards purchase of software from a non-resident, meant for subsequent resale in the Indian market, was ultimately sold at a profit during F.Y. 2012-13.*
- (v) Dividend of ₹ 10 lacs received from a foreign company in which this company holds 28% in nominal value of the equity share capital of the company. ₹ 0.25 lac expended on earning this income.*
- (vi) A machine in use since past 7 financial years having WDV amounting to ₹ 1.50 lacs on 01-04-2011 was discarded on 3rd September, 2011. The depreciation on the block at 15% has been provided and charged to profit and loss account for the previous year ended 31st March, 2013. The entire block is used for the purpose of business.*
- (vii) ₹ 45 lacs were paid on 3rd June, 2012 to a National Laboratory with a stipulation that the said contribution shall be used for the purpose of an approved scientific research programme only.*
- (viii) Secret commission of ₹ 13 lacs was paid and debited under commission account.*
- (ix) Purchased a brand new bus for ₹ 15 lacs and donated to a school where the employees' children were studying and debited the same to the Workmen and Staff Welfare Account.*

Additional Information:

- (x) A debt of ₹ 10 lacs was claimed as bad debt in the previous year 2011-12. However, the Assessing Officer allowed only a sum of ₹ 5 lacs as bad debts. In the previous year 2012-13, a sum of ₹ 4 lacs is recovered ultimately in respect of the debt.*

Compute total income of S. Ltd. for the Assessment Year 2013-14 and work out the amount of tax payable on such income, indicating reasons for treatment of each item. Ignore provision relating to minimum alternate tax.

Answer

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

Particulars	₹	₹
Profits and gains of business or profession		
Net profit as per profit and loss account		5,00,00,000
Add: Excess depreciation provided on EPABX & Mobile phones not allowable as deduction [Note (i)]	13,50,000	
Payment for higher studies of director's son abroad not allowable as deduction [Note (iii)]	35,00,000	
Payment towards purchase of software from a non-resident made without deducting tax at source, not allowable as deduction [Note (iv)]	29,00,000	
Expenditure on earning dividend from foreign company not deductible [Note (v)]	25,000	
Secret commission paid not allowable [Note (viii)]	<u>13,00,000</u>	<u>90,75,000</u>
		5,90,75,000
Less: Dividend received from foreign company to be considered under the head "Income from other sources" [Note (v)]	10,00,000	
Payment to National Laboratory eligible for weighted deduction@ 200% under section 35(2AA) [Note (vii)]	45,00,000	
Bad debts allowable as deduction [Note (x)]	<u>1,00,000</u>	<u>56,00,000</u>
		5,34,75,000
Income from Other Sources		
Dividend from foreign company [Note (v)]		<u>10,00,000</u>
Total Income		<u>5,44,75,000</u>

Computation of tax liability of S Ltd. for the A.Y.2013-14

Particulars	₹
Tax @15% on dividend from specified foreign company ₹ 10,00,000 [Note (v)]	1,50,000
Tax @30% on the balance total income of ₹ 5,34,75,000	<u>1,60,42,500</u>
	1,61,92,500
Add: Surcharge@5% (since total income exceeds ₹ 1,00,00,000)	<u>8,09,625</u>
	1,70,02,125
Add: Education cess@2%	3,40,043
Secondary and higher education cess@1%	<u>1,70,021</u>
Total tax liability	<u>1,75,12,189</u>

Notes:

- (i) EPABX and mobile phones are not computers and therefore, are not entitled to higher depreciation@60%. It was so held by the Kerala High Court in *Federal Bank Ltd. v. ACIT (2011) 332 ITR 319*. Therefore, EPABX and mobile phones would be entitled to depreciation of ₹ 4,50,000, calculated by applying the rate of 15%, being the general rate applicable to plant and machinery, on the cost of ₹ 30,00,000 ($₹ 18,00,000 \times 100/60$). The excess depreciation of ₹ 13,50,000 (being ₹ 18,00,000 – ₹ 4,50,000), debited to profit and loss account, should be added back.
- (ii) The issue is whether payment of ₹ 50 lakhs to N Ltd. towards feasibility study conducted for examining proposals for technological advancement relating to the existing business, where the project was abandoned without creating a new asset, is allowable as revenue expenditure.

On this issue, the Delhi High Court, in *CIT v. Priya Village Roadshows Ltd. (2011) 332 ITR 594*, observed that in such cases, whether or not a new business/asset comes into existence would become the relevant factor. If there is no creation of a new asset, then the expenditure incurred would be of revenue nature. In this case, since the feasibility study was conducted by S Ltd. for the existing business and the study was abandoned without creating a new asset, the expenses were of revenue nature.

Since the expenditure of ₹ 50 lakhs has already been debited to profit and loss account, no further adjustment is required.

- (iii) In this case, since there is no evidence of existence of any “apprentice training scheme”, the expenditure of ₹ 35 lakhs incurred in respect of higher studies abroad for the director’s son is not allowable as deduction as there is no nexus between the education expenditure incurred abroad for the director’s son and the business of S Ltd. It was so held by the Bombay High Court in *Echjay Forgings Ltd. v. ACIT (2010) 328 ITR 286*.
- (iv) The Finance Act, 2012 has inserted *Explanation 4* to section 9(1)(vi) retrospectively with effect from 1st June, 1976, to clarify that consideration for use or right to use of computer software is royalty and consequently, tax has to be deducted at source under section 195 in respect of such payments. Since, S Ltd. has not deducted tax at source on payment of ₹ 29 lakhs, it would be disallowed under section 40(a)(i). Therefore, the payment of ₹ 29 lakhs already debited to the profit and loss account, has been added back.
- (v) Under section 115BBD, dividend received by an Indian company from a foreign company in which it holds 26% or more in nominal value of the equity share capital of the company, would be subject to a concessional tax rate of 15% as against the tax rate of 30% applicable to other income of a domestic company. This rate of 15% would be applied on gross dividend, in the sense, that no expenditure would be allowable in respect of such dividend.

Therefore, dividend of ₹ 10 lakhs received by S Ltd. from a foreign company, in which it holds 28% in nominal value of equity share capital of the company, would be subject to

tax@15% under section 115BBD. Such dividend would be taxable under the head "Income from other sources". No deduction is allowable in respect of ₹ 0.25 lakhs expended on earning this income.

Since such dividend has been credited to the profit and loss account, the same has to be reduced for computing income under the head "Profits and gains of business or profession. Likewise, ₹ 0.25 lakhs, representing expenditure for earning dividend income, which has been debited to profit and loss account, should be added back for computing business income.

- (vi) The issue under consideration is whether depreciation is allowable on the written down value of the entire block, even though the block includes some machinery which has already been discarded and hence, cannot be put to use during the relevant previous year.

The expression "used for the purposes of the business" in section 32, when used with respect to discarded machinery, would mean the use in the business, not in the relevant financial year, but in the earlier financial years. Therefore, the condition for claiming depreciation in respect of the discarded machine would be satisfied if it is used in the earlier previous years for the business. It was so held by the Delhi High Court in *CIT vs. Yamaha Motor India Pvt. Ltd. (2010) 328 ITR 297*.

Since the depreciation, in this case, has been debited to profit and loss account, no further adjustment is required.

- (vii) Under section 35(2AA), weighted deduction@200% is allowable in respect of amount paid to a National Laboratory with a specific direction that such sum shall be used for the purpose of an approved scientific research programme. Therefore, in this case, deduction of ₹ 90 lakhs (i.e., 200% of ₹ 45 lakhs) is allowable to S Ltd under section 35(2AA). Since only the actual payment of ₹ 45 lakhs has been debited to profit and loss account, the balance of ₹ 45 lakhs has to be deducted.
- (viii) As per *Explanation* to section 37(1), any expenditure incurred by an assessee for any purpose which is an offence or which is prohibited by law, shall not be deemed to have been incurred for the purpose of business and no deduction or allowance shall be made in respect of such expenditure. Therefore, payment of secret commission, if it is established as a payment for any purpose which is an offence or which is prohibited by law, cannot be allowed as deduction. It was so held in *Tarini Tarpauline Productions v. CIT (2002) 254 ITR 495 (Ori.)*. Even in cases where it cannot be so established, it would be disallowed under section 40(a)(ia) for non-deduction of tax at source under section 194H.
- (ix) The expenditure incurred for acquiring a new bus and donating it to the school is for the welfare of the children of staff/workmen of the company. Such expenditure is a part of employees' welfare expenses incurred for the purpose of securing healthy services for staff members. Therefore, such expenses were incurred wholly and exclusively for the purpose of the business. Since the bus had been donated to the school, no benefit of enduring nature was derived by S Ltd. as the right of ownership was transferred to

school. Hence, it is not a capital expenditure. Since such expenditure is incurred wholly and exclusively for the purpose of business and is not capital in nature, S Ltd. is entitled to claim deduction in full under section 37(1). It was so held by the Rajasthan High Court in *CIT v. Rajasthan Spinning and Weaving Mills Ltd. (2006) 281 ITR 408*.

- (x) In a case where the debt ultimately recovered is less than the difference between the amount of debt and bad debt allowed as deduction, such deficiency will be deductible in the previous year in which the ultimate recovery is made. Therefore, in this case, since the ultimate recovery of ₹ 4 lakhs is less than ₹ 5 lakhs (being the difference between the debt of ₹ 10 lakhs and the amount of ₹ 5 lakhs allowed as bad debts in the previous year 2011-12), the deficiency of ₹ 1 lakh will be deductible in the P.Y.2012-13, being the year in which the ultimate recovery of ₹ 4 lakhs is made. It may be noted that in a case where the net result is a deficiency, the amount recovered will not be taxable in the year of recovery. Since ₹ 4 lakhs is not credited to profit and loss account, no further adjustment is necessary.

Note - It appears that bad debts recovery of ₹ 4 lakhs is not credited to the profit and loss account since it is given under "Additional Information" in the question. The above solution has been worked out on this basis. However, if it is assumed that the bad debts recovery of ₹ 4 lakhs is credited to profit and loss account as per the correct accounting treatment, then, the same has to be reduced to compute the income chargeable under the head "Profits and gains of business or profession". In addition, the deficiency of ₹ 1 lakh will be deductible in the P.Y.2012-13, being the year in which the ultimate recovery of ₹ 4 lakhs is made. The computation of total income and tax liability, will accordingly change. The total income would be ₹ 5,40,75,000 and tax liability would be ₹ 1,73,82,409.

Question 16

XYZ Private Limited is engaged in manufacturing and selling ceramic tiles. The net profit of the company as per its profit and loss account for the year ended 31st March, 2013 is ₹ 150 lakh after debiting or crediting the following items:

- (i) One-time license fee of ₹ 20 lakh paid to a foreign company for obtaining franchise on 1st June, 2012.
- (ii) ₹ 29,000 paid to A & Co., a goods transport operator, in cash on 31st January, 2013 for distribution of the company's products to its warehouse.
- (iii) Rent of ₹ 6 lakh received from letting out a part of its office premises. Municipal tax in respect of the said part of the building amounting to ₹ 15,000 remains unpaid.
- (iv) ₹ 2 lakh, being contribution to a University approved and notified under section 35(1)(ii).
- (v) ₹ 3 lakh, being loss due to destruction of a machinery caused by a fire due to short circuit. The Insurance Company did not admit the claim of the company.

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- (iv) ₹ 4 lakh and ₹ 1 lakh, being amounts waived by a bank out of principal and arrear interest, respectively, in an one-time settlement. The loan was obtained for meeting working capital requirement four years back.
- (vii) ₹ 1 lakh, being amount payable to a contractor (who does not have Permanent Account Number) for repair work at the company's factory. Tax of ₹ 2,000 was deducted and paid in time.
- (viii) Dividend of ₹ 0.10 lakh from P. Limited on 1000 equity shares of ₹ 10 each purchased at ₹ 100 per share on 10th October, 2012. The rate of dividend declared is 100%, the record date being 1st December, 2012. The shares were sold on 1st March, 2013 at ₹ 80 per share. Loss of ₹ 0.20 lakh has been debited to Profit & Loss Account.
- (ix) Depreciation on tangible fixed assets ₹ 1 lakh.

Additional Information:

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

Compute total income of XYZ Private Limited for the Assessment Year 2013-14 indicating reasons for treatment of each item. Ignore the provisions relating to minimum alternate tax.

Answer

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

Particulars	₹	₹
Income from House Property (Note 1)		
Gross Annual Value (GAV) (Rental income has been taken as GAV in the absence of other information)	6,00,000	
Less: Municipal Taxes (not deductible since it has not been paid)	<u>Nil</u>	
Net Annual Value (NAV)	6,00,000	
Less: Deduction under section 24 (30% of NAV)	<u>1,80,000</u>	4,20,000
Profits and gains of business or profession		
Net profit as per profit and loss account	1,50,00,000	
Add: Licence fee for obtaining franchise (Note 2)	20,00,000	
Municipal taxes in respect of let-out part of office premises (Note 1)	15,000	
Contribution to approved and notified university (treated separately) (Note 4)	2,00,000	

Loss due to destruction of machinery by fire (Note 5)	3,00,000	
Amount payable to contractor not having PAN (Note 6)	1,00,000	
Short-term capital loss on sale of shares of P. Ltd. (Note 7)	20,000	
Depreciation on tangible fixed assets (Note 8)	<u>1,00,000</u>	
	1,77,35,000	
Less: Depreciation under section 32 (Note 8)		
Tangible fixed assets (Note 8)	1,75,000	
Intangible asset (Franchise)		
25% of ₹ 20,00,000 (Note 2)	<u>5,00,000</u>	6,75,000
Weighted deduction under section 35(1)(ii) (Note 4)		
₹ 2,00,000 x 175% (Contribution of University)	3,50,000	
Rental income to be taxed under "Income from house property" (Note 1)	6,00,000	
Dividend credited to profit and loss account to be excluded (Note 7)	10,000	
Waiver of interest on bank loan credited to profit and loss account but not taxable (Note 9)	<u>1,00,000</u>	
		1,60,00,000
Capital Gains (Note 7)		
Short-term capital loss (₹ 20 x 1000 shares)	20,000	
Less: Dividend exempt under section 10(34)	<u>10,000</u>	
Short-term capital loss to be carried forward to A.Y. 2014-15	<u>10,000</u>	
Income from Other Sources (Note 10)		
Deemed dividend under section 2(22)(e)		<u>50,000</u>
Total Income		<u>1,64,70,000</u>

Notes:

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

Note - There is an alternate view that rental income from letting out part of the excess premises by an assessee who is engaged in business is only exploitation of the commercial asset by an assessee who is engaged in business and hence, the same constitutes business income only. In such a case also, municipal taxes is not allowable

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as deduction since the same has not been paid on or before the due date of filing of return of income as required under section 43B.

- (2) Franchise is an intangible asset eligible for depreciation @ 25%. Since one-time licence fees of ₹ 20 lakh paid to a foreign company for obtaining franchise has been debited to profit and loss account, the same has to be added back. Depreciation @ 25% has to be provided in respect of the intangible asset since it has been used for more than 180 days during the year.
- (3) ₹ 29,000 paid to A & Co., a goods transport operator in cash is deductible while computing business income, since the limit above which disallowance under section 40A(3) would be attracted in case of payment to a transport contractor engaged in the business of plying, leasing goods carriages is ₹ 35,000. Since it is already debited to profit and loss account, no further adjustment is required.
- (4) Contribution to a university approved and notified under section 35(1)(ii) is eligible for a weighted deduction of 175%. Therefore, the contribution of ₹ 2,00,000 debited to profit and loss account has been added back and ₹ 3,50,000 (being 175% of ₹ 2,00,000) has been deducted while computing business income.
- (5) Loss of ₹ 3 lakh due to destruction of machinery caused by fire is not deductible since it is capital in nature.
- (6) Non-furnishing of PAN to deductor results in attracting provisions of section 206AA, which require tax to be deducted at a higher rate of 20%. Since the company has deducted tax @ 2% and not @20% as per the requirement under section 206AA, disallowance under section 40(a)(ia) would be attracted in respect of payment of ₹ 1 lakh made to contractor.

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

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

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

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

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

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

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

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

Question 17

ABC Limited has claimed exemption on the income from long-term capital gains under section 54EC by investing in bonds of National Highway Authority of India within the prescribed time. In the computation of "book profit" under section 115JB, the company claimed exclusion of long-term capital gains because of exemption available on it by virtue of section 54EC. The Assessing Officer reckoned the book profit including long-term capital gains for the purpose of levy of minimum alternate tax payable under section 115JB.

Is the action of the Assessing Officer justified in law?

Answer

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

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It may be noted that minimum alternate tax (MAT) is attracted under section 115JB, on account of tax on total income being less than 18.5% of book profit. Chapter XII-B is a self-contained code for computation of book profit. The net profit as per the profit and loss account for the relevant previous year prepared in accordance with the provisions of Parts II and III of Schedule VI to the Companies Act, 1956, as increased/reduced by the specified adjustments provided for in *Explanation 1* to section 115JB would be the book profit for levy of MAT under section 115JB.

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

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

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

Question 18

Aditya, Avirup and Avigyan carried on business of running hotels in partnership from 1st April, 2002 to 31st March, 2011. In order to increase its scale of operation and meet its fund requirement, the firm decided to carry on its business through corporate route. For that purpose, a company under the name and style "Triple A Hospitality Private Limited" was formed on 1st April, 2011 and the business of the partnership firm as a whole was succeeded to by the company with effect from 1st June, 2011.

The company's profit and loss account for the year ended 31st March, 2013 shows a net profit of ₹ 450 lacs after debit/credit of the following items:

- (a) *Interest of ₹ 3 lacs paid to Allahabad Bank on a term loan taken for the purpose of acquiring a land at Bhubaneswar for a new hotel to be set up.*
- (b) *Depreciation charged ₹ 40 lacs.*
- (c) *₹ 2 lacs credited on account of waiver of dues obtained from a supplier of the erstwhile firm against supply of certain materials.*
- (d) *₹ 1.18 lacs being the aggregate of amounts paid in cash to Rajaram, a transport contractor as follows:*

Date of Payment	₹ (In lacs)
5 th June, 2012	0.15
20 th July, 2012	0.21
20 th September, 2012	0.22

3 rd November, 2012	0.26
5 th November, 2012	0.36

Tax was not deducted at source from the above payments.

- (e) ₹ 0.50 lac, being proportionate part of the cost of animals (purchased and kept for entertainment of the guests of hotel) amortised as per the accounting policy of the company.
- (f) ₹ 0.10 lacs credited on account of sale proceeds of carcass of animal which died during the year.
- (g) Provision for bad and doubtful debts ₹ 12 lacs.
- (h) Payment of ₹ 25 lacs to some employees as compensation for voluntary retirement, as per scheme.
- (i) Foreign exchange fluctuation loss (net) amounting to ₹ 30 lacs arising from restatement of the year-end liabilities to foreign suppliers of provisions and beverages as per the requirement of Accounting Standard 11 of the Institute of Chartered Accountants of India.

Other Information:

- (i) Depreciation as per the Income-tax Act, 1961 ₹ 65 lacs.
- (ii) Cost of animal died as referred to in (f) above was ₹ 2 lacs.
- (iii) Debt of ₹ 4 lacs due from one corporate customer for three months has been written off during the year after giving few reminders by debiting provision for bad and doubtful debts account.
- (iv) The erstwhile firm was allowed exemption of ₹ 50 lacs under section 47(xiii) in respect of long-term capital assets transferred to the company.
- (v) The company's voting rights till 31st March, 2012 were held as follows:

Aditya	40%
Avirup	30%
Avigyan	15%
Others	15%

During the year, shares constituting 36% voting rights were sold by Aditya to his son-in-law, Avishek.

- (vi) Unabsorbed business loss and unabsorbed depreciation of ₹ 10 lacs each have been carried forward from Assessment Year 2011-12.
- (vii) The company has a subsidiary company, Tours & Travels Private Limited (a closely held company). During the year, the company obtained a temporary loan of ₹ 12 lacs from its subsidiary company. Accumulated profit of the subsidiary company was ₹ 30 lacs at the time of payment of the loan. The loan was repaid by the company before the end of the year.

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Compute total income of Triple A Hospitality Private Limited for the Assessment Year 2013-14 indicating reason for treatment of each of the items. Ignore the provisions relating to minimum alternate tax.

Answer

Computation of Total Income of Triple A Hospitality (P) Ltd. for the A.Y.2013-14

Particulars		₹
A. Profits and Gains from Business and Profession		
Net Profit as per Profit & Loss Account		4,50,00,000
Add: Items debited but to be considered separately or to be disallowed		
Interest on loan taken for acquiring land (Note 1)	3,00,000	
Depreciation debited in accounts	40,00,000	
Disallowance for payment exceeding the limit prescribed in section 40A(3) (Note 3)	36,000	
Amortisation of cost of animals (Note 4)	50,000	
Provisions for bad and doubtful debts (Note 5)	12,00,000	
Compensation for voluntary retirement (Note 6)	<u>20,00,000</u>	<u>75,86,000</u>
		5,25,86,000
Less: Items credited but to be considered separately or to be allowed		
Sale proceeds of carcass of animal treated separately (Note 4)	10,000	
Depreciation allowable under the Income-tax Act, 1961	65,00,000	
Deduction under section 36(1)(vi) in respect of dead animal (Note 4)	1,90,000	
Bad debts written off under section 36(1)(vii) (Note 5)	<u>4,00,000</u>	<u>71,00,000</u>
Business Income		4,54,86,000
B. Capital Gains		
Deemed long-term capital gain under section 47A(3) (Note 8)		50,00,000
C. Income from other sources		
Deemed dividend under section 2(22)(e) (Note 9)		<u>12,00,000</u>
Gross Total Income		5,16,86,000
Deduction under Chapter VI-A		<u>Nil</u>
Total Income		<u>5,16,86,000</u>

Notes:

- (1) Interest on term loan taken from bank for acquiring land for new hotel to be set up is not allowable under section 36(1)(iii). As per the proviso to section 36(1)(iii), interest paid in respect of capital borrowed for acquisition of an asset for extension of existing business or profession (whether capitalized in the books of account or not) for the period from the date on which the borrowing was made till the date on which such asset is first put to use shall not be allowed as deduction. Setting up of a new hotel is an extension of the existing business of the assessee and as the land is yet to be put to use, deduction for interest is not allowable.
- (2) Under section 41(1), where any expenditure or loss or a trading liability was allowed as deduction to the predecessor-firm and the successor in business has obtained (in cash or in any other manner), any amount in respect of which loss or expenditure was incurred by the predecessor-firm or some benefit by way of remission or cessation of such trading liability, the amount obtained by the successor in business (the company, in this case) or the value of benefit accruing to the successor shall be deemed to be profits and gains of business or profession and would be chargeable to tax in the year in which the amount is so obtained or the benefit accrued. In view of this provision, the amount of waiver i.e. ₹ 2,00,000 obtained from the supplier of the predecessor firm is deemed as business income of the assessee company. Since the amount is already credited to profit & loss account, no adjustment is necessary.
- (3) Section 40A(3) provides that where the assessee incurs any expenditure for which a payment or aggregate of payments made to a person in a single day, otherwise than by account payee cheque or account payee bank draft exceeds ₹ 20,000, the whole of such expenditure shall be disallowed. However, for payment to transport operators for plying, hiring or leasing goods carriage, the limit for attracting disallowance under section 40A(3) is ₹ 35,000. Therefore, payment or aggregate payments up to ₹ 35,000 in a day can be made to a transport operator otherwise than by way of account payee cheque or account payee bank draft without attracting disallowance under section 40A(3). Therefore, the amount to be disallowed is ₹ 36,000 being the payment made on 5th November, 2012.

Note – Disallowance under section 40(a)(ia) for non deduction of tax at source under section 194C is not attracted, presuming that Rajaram has furnished his PAN to the company.

- (4) Under section 36(1)(vi), deduction is allowable in computing business income in respect of animals which have been used for the purpose of business, otherwise than as stock-in-trade and have died or become permanently useless for such purpose. The amount to be allowed is the difference between the actual cost of the animals to the assessee and the amount realized in respect of the carcasses.

Therefore, ₹ 50,000 debited to profit and loss account has to be added back and ₹ 10,000 credited to profit and loss account has to be deducted. The difference between

the cost of animal died (₹ 2 lacs) and the sale proceeds of carcasses (₹ 0.10 lac) is allowable as deduction under section 36(1)(vi). Therefore, ₹ 1,90,000, is allowable as deduction under section 36(1)(vi).

- (5) Provision for bad and doubtful debts is allowable as deduction under section 36(1)(viia) only in the case of specified banks and financial institutions. Therefore, a company engaged in hotel business is not eligible for deduction in respect of provision for bad and doubtful debts and accordingly, ₹ 12 lacs, debited to profit and loss account has to be added back.

A bad debt written off is allowed as deduction under section 36(1)(vii) if such debt is written off as irrecoverable in the books of account. Bad debts may be written off by debiting profit & loss account or provision for bad and doubtful debts account.

Therefore, the amount of ₹ 4 lacs written off during the year by debiting provision for bad and doubtful debts is allowable as deduction under section 36(1)(vii).

- (6) As per section 35DDA, where in any previous year, any expenditure is incurred by way of payment of any sum to an employee in connection with voluntary retirement, one-fifth of the amount so paid shall be deducted in computing profits and gains of business for that previous year, and the balance shall be deducted in four equal instalments in the immediately succeeding four previous years. Therefore, out of ₹ 25,00,000, an amount of ₹ 5,00,000 is deductible in assessment year 2013-14 and the balance shall be disallowed in this assessment year. Therefore, ₹ 20 lacs has to be added back.
- (7) Where the assessee regularly follows accrual system of accounting and the assessee provides loss suffered on account of foreign exchange difference according to accepted Accounting Standard and not with a view to reduce incidence of taxation, such loss is an item of expenditure under section 37(1).

This was the decision of the Supreme Court in the case of *CIT v. Woodward Governor India Pvt. Limited* (2009) 312 ITR 254 (SC). In this case, as the exchange loss has already been debited to profit & loss account, no adjustment is required.

- (8) It is stated that the erstwhile firm was allowed exemption under section 47(xiii) in respect of long-term capital gain from transfer of capital assets to the assessee company. One of the conditions as per the proviso to clause (xiii) of section 47 is that the aggregate of the shareholding in the company of the partners of the firm is at least 50% of the total voting power in the company and their shareholding continues to be as such for 5 years from the date of succession.

According to section 47A(3), where any of the conditions laid down in the proviso to clause (xiii) of section 47 are not complied with, the capital gain which was not charged to tax under section 45 shall be chargeable to tax in the hands of the successor company for the previous year in which the requirements of the proviso to clause (xiii) of section 47 are not complied with.

In the instant case, on sale of shares carrying 36% voting rights by Aditya to his son-in-law, the aggregate of shareholding of the partners in the company has become less than

50% of the total voting power in the company and such change has taken place before expiry of 5 years from the date of succession. Therefore, the long-term capital gain which was not charged to tax in the hands of the firm in the year of succession shall be deemed to be long-term capital gain of the assessee company in the assessment year 2013-14.

- (9) Section 2(22)(e) provides that dividend includes any payment to the extent of accumulated profits by a company, in which the public are not substantially interested, of any sum by way of loan or advance to a shareholder who holds the beneficial ownership of equity shares carrying not less than 10% of the voting power.

In the instant case, the assessee company having more than 10% voting power in Tours & Travel Private Limited (a closely held company) received loan of ₹ 12 lacs from the latter which had an accumulated profit of ₹ 30 lacs. Therefore, the amount of loan shall be deemed to be dividend in the hands of the assessee company. The fact that the loan was repaid before end of the previous year is not relevant.

The amount deemed to be dividend under section 2(22)(e) is not exempt under section 10(34).

- (10) Since the unabsorbed business loss and unabsorbed depreciation relate to P.Y.2010-11, which is prior to incorporation of the company on 1.4.2011, such loss and depreciation would relate to the predecessor firm, and consequently, the provisions of section 72A(6) would be attracted.

As per section 72A(6), accumulated loss and depreciation of the predecessor firm would become the loss and depreciation of the successor company of the previous year in which the conversion takes place (i.e., P.Y.2011-12, in this case), provided the conditions laid down in section 47(xiii) are fulfilled. In this case, the conditions are fulfilled in the P.Y.2011-12. It appears that the assessee-company did not have sufficient profits during the P.Y.2011-12, against which the brought forward loss and unabsorbed depreciation can be set-off and for this reason, the same has been carried forward to the P.Y.2012-13 (A.Y.2013-14).

However, in the P.Y.2012-13, one of the conditions as per the proviso to clause (xiii) of section 47 is not satisfied, namely, the condition requiring the aggregate of the shareholding in the company of the partners of the firm to be at least 50% of the voting power in the company and to continue to remain as such for 5 years from the date of succession. Therefore, since in the P.Y.2012-13, this condition is not satisfied on account of sale of shares by Aditya to Avishek, and consequent reduction in the holding from 85% to 49%, the business loss and unabsorbed depreciation cannot be set-off.

Question 19

Examine the following statements in the context of the provisions contained in the various Chapters of the Income-tax Act, 1961:

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

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- (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)".

Answer

- (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 18.5% of its book profit exceeds the tax payable on the total income computed under the normal provisions of the Act. Therefore, the provisions of section 115JB would be attracted both in the case of a domestic as well as a foreign company, if the tax payable on its total income is less than 18.5% 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 correct.

The Finance Act, 2011 has introduced a sunset clause to remove the exemption in respect of dividend distribution tax in case of an undertaking or an enterprise engaged in developing, operating and maintaining an SEZ for dividends declared, distributed or paid on or after 1st June, 2011. Therefore, the statement given in the question is correct in respect of dividend declared, distributed or paid on or after 1st June, 2011.

Question 20

The net profit of ABP Ltd. as per Profit & Loss Account for the previous year 2012-13 is ₹ 100 lacs after debiting/crediting the following items:

- (i) Provision for income-tax : ₹ 15 lacs
- (ii) Provision for deferred tax : ₹ 8 lacs
- (iii) Proposed Dividend : ₹ 20 lacs
- (iv) Depreciation debited to Profit & Loss Account is ₹ 12 lacs. This includes depreciation on revaluation of asset to the tune of ₹ 2 lacs.
- (v) Profit from unit established in Special Economic Zone : ₹ 30 lacs
- (vi) Provision for permanent diminution in value of investments : ₹ 2 lacs

Brought forward losses and unabsorbed depreciation as per books of the company are as follows:

Previous year	Brought forward loss (₹ in lacs)	Unabsorbed Depreciation (₹ in lacs)
2009-10	2	5

2010-11	-	3
2011-12	10	2

Compute book profit of the company under section 115JB for Assessment Year 2013-14.

Answer

Computation of book profit of ABP Ltd. under section 115JB for A.Y. 2013-14

Particulars	₹ (in lacs)	
Net profit as per profit and loss account		100
Add: Net profit to be increased by the following amounts as per Explanation 1 to section 115JB		
Provision for income tax	15	
Provision for deferred tax	8	
Proposed dividend	20	
Depreciation	12	
Provision for diminution in value of investment	<u>2</u>	<u>57</u>
		157
Less: Net profit to be reduced by the following amounts as per Explanation 1 to section 115JB		
Depreciation (excluding depreciation on revaluation of assets)	10	
Lower of brought forward loss or unabsorbed depreciation, as per books (on overall basis)	<u>10</u>	<u>20</u>
Book Profit		<u>137</u>

Note- A sunset clause has been inserted by the Finance Act, 2011 to remove MAT exemption to SEZ units and developers with effect from A.Y. 2012-13. Therefore, profit from unit established in SEZ cannot be excluded for computation of book profit.

Question 21

ABC (P) Ltd. made a provision of ₹ 30 lacs for doubtful debts by debit to profit and loss account. The Assessing Officer, while computing book profit under section 115JB, wants to add back the provision. Is the Assessing Officer justified in making such addition for computing book profit?

Answer

Explanation 1 below section 115JB(2) has been amended to provide that the net profit should also be increased by, inter alia, the amount set aside as provision for diminution in the value of any asset, if the same has been debited to profit and loss account, for computing the book profit.

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Therefore, the Assessing Officer is justified in adding back the provision of ₹ 30 lacs for doubtful debts while computing book profit.

Question 22

Yaman Limited is a company in which 60% shares are held by Piloo Limited. Yaman Limited declared a dividend amounting to ₹ 35 lacs to its shareholders for the financial year 2011-12 in its Annual General Meeting held on 10th May, 2012. Dividend distribution tax was paid by Yaman Limited on 15th May, 2012. Piloo Limited declared an interim dividend amounting to ₹ 50 lacs on 15th October, 2012 for the year ended 31st March, 2013.

Compute the amount of tax on dividend payable by Piloo Limited.

What would be your answer, if 58% shares of Piloo Limited are held by Kafi Limited, an Indian company?

Answer

As per section 115-O, dividend distribution tax at the rate of 16.2225% (i.e., 15% plus surcharge@5%, education cess@2% and secondary and higher education cess@1%) is leviable on dividend declared, distributed or paid by a domestic company. As per section 115-O(1A), a holding company receiving dividend from its subsidiary company can reduce the same from dividend declared, distributed or paid by it. For this purpose, the matching principle does not apply. This means that even if the dividend received from the subsidiary company and dividend distributed by the holding company relate to different periods, the same can be adjusted for the purpose of computing dividend distribution tax of the holding company. However, the dividend from its subsidiary company should be received in the same financial year in which the holding company declares, distributes or pays the dividend. Further, the dividend shall not be considered for reduction more than once.

The conditions to be fulfilled for this purpose are as follows:

- (1) The subsidiary company should paid the dividend distribution tax which is payable on such dividend;
- (2) The holding company should be a domestic company;

For this purpose, a holding company is a company which holds more than 50% of the nominal value of equity shares of another company.

On the basis of the aforesaid provision, dividend distribution tax payable by Piloo Limited shall be 16.2225% of ₹ 29 lacs [₹ 50 lacs – (₹ 35 lacs x 60%)] i.e. ₹ 4.70 lacs.

If 58% of shares of Piloo Ltd. are held by Kafi Ltd., then Piloo Ltd is a subsidiary company of Kafi Ltd. Section 115-O(1A) has been amended by the Finance Act, 2012 to remove the condition that the holding company should not be a subsidiary of any other company for claiming reduction of dividend received from the subsidiary company from the dividend declared, paid or distributed by the holding company. Therefore, in spite of the fact that Piloo Ltd. is a subsidiary of Kafi Ltd., it can reduce the amount of dividend received from Yaman Ltd.

for computation of dividend distribution tax. Therefore, dividend distribution tax payable by Piloo Ltd. shall be 16.2225% of ₹ 29 lacs i.e. ₹ 4.70 lacs.

Question 23

ABC Ltd., engaged in diversified activities, earned a net profit of ₹ 42,50,000 after debit/credit of the following items to its profit and loss account for the year ended on 31.3.2013:

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

The company provides the following additional information:

Brought forward Business Loss/Unabsorbed Depreciation:

Assessment Year	Amount as per books	
	Loss	Depreciation
2008-09	5,00,000	4,00,000
2009-10	3,00,000	Nil
2010-11	1,00,000	2,50,000

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You are required to examine the applicability of section 115JB of the Income-tax Act, 1961, and compute book profit and the tax credit to be carried forward, assuming that the total income computed as per the provisions of the Income-tax Act, 1961 is ₹ 25,00,000.

Answer

Computation of Book Profit under section 115JB

Particulars	₹	₹
Net Profit as per Profit & Loss Account		42,50,000
Add: Net Profit to be increased by the following amounts as per Explanation 1 to section 115JB		
Income-tax paid or payable or provision therefor		
- Provision for income-tax ₹ 8,64,000		
- Dividend distribution tax ₹ 1,00,000	9,64,000	
Provision for deferred tax	70,000	
Transfer to General Reserve	1,50,000	
Provision for losses of subsidiary company	1,40,000	
Dividend paid or proposed		
- Proposed dividend ₹ 1,60,000		
- Preference dividend ₹ 1,30,000	2,90,000	
Expenditure to earn income exempt under section 10 [except section 10(38)]		
- Expenditure to earn agricultural income [exempt under section 10(1)] ₹ 50,000		
- Expenditure to earn dividend income [exempt under section 10(34)] ₹ 20,000	70,000	
Depreciation	3,50,000	20,34,000
		62,84,000
Less: Net Profit to be reduced by the following amounts as per Explanation 1 to section 115JB		
Amount credited to P&L A/c from Special Reserve	1,00,000	
Depreciation (excluding depreciation on account of revaluation of fixed assets) (i.e. ₹ 3,50,000 – ₹ 1,50,000)	2,00,000	
Amount credited to P&L A/c from Revaluation Reserve (to the extent of depreciation on revaluation)	1,50,000	
Brought forward business loss or unabsorbed depreciation as per books of account, whichever is less taken on cumulative basis	6,50,000	
Income exempt under section 10 [except section 10(38)]		
Agricultural Income [since it is exempt under section 10(1)]	2,50,000	

Dividend income [since it is an income exempt under section 10(34)]	1,20,000	14,70,000
Book Profit		48,14,000
18.50% of book profit		8,90,590
Add: Education cess @ 2%	17,812	
Secondary and higher education cess @ 1%	8,906	26,718
Tax liability under section 115JB		9,17,308
Total income computed as per the provisions of the Income-tax Act, 1961	25,00,000	
Tax payable @ 30%		7,50,000
Add: Education cess @ 2%	15,000	
Secondary and higher education cess @ 1%	7,500	22,500
Tax Payable as per the Income-tax Act, 1961		7,72,500

In case of a company, it has been provided that where income-tax payable on total income computed as per the provisions of the Act is less than 18.50% of book profit, the book profit shall be deemed as the total income and the tax payable on such total income shall be 18.50% thereof plus education cess @ 2% and secondary and higher education cess @ 1%. Accordingly, in this case, since income-tax payable on total income computed as per the provisions of the Act is less than 18.50% of book profit, the book profit of ₹ 48,14,000 is deemed to be the total income and income-tax is payable @ 18.50% thereof plus education cess @ 2% and secondary and higher education cess @ 1%. The tax liability, therefore, works out to ₹ 9,17,308.

Section 115JAA provides that where tax is paid in any assessment year in relation to the deemed income under section 115JB(1), the excess of tax so paid, over and above the tax payable under the other provisions of the Income-tax Act, 1961, will be allowed as tax credit in the subsequent years. The tax credit is, therefore, the difference between the tax paid under section 115JB(1) and the tax payable on the total income computed in accordance with the other provisions of the Act. This tax credit is allowed to be carried forward for ten assessment years succeeding the assessment year in which the credit became allowable. Such credit is allowed to be set off against the tax payable on the total income in an assessment year in which the tax is computed in accordance with the provisions of the Act, other than section 115JB, to the extent of excess of such tax payable over the tax payable on book profits in that year.

Particulars	₹
Tax on book profit under section 115JB	9,17,308
Less: Tax on total income computed as per the other provisions of the Act	7,72,500
Tax credit to be carried forward	1,44,808

Notes:

1. Wealth-tax and securities transaction tax do not form part of income-tax and hence, should not be added back to net profit for computing book profit.
2. Provision for gratuity based on actuarial valuation is a provision for meeting an ascertained liability. Therefore, it should not be added back for computing book profit.
3. Long-term capital gains on sale of equity shares through a recognized stock exchange on which securities transaction tax (STT) is paid is exempt under section 10(38). One of the adjustments to the book profit is that exempt income under section 10, which is credited to profit and loss account, would be deducted in arriving at the book profit.

However, deduction of such long-term capital gains is not allowed for computing book profit. Consequently, expenditure to earn such income should not be added back to arrive at the book profit. Section 10(38) also provides that such long term capital gain of a company shall be taken into account in computing the book profit and income-tax payable under section 115JB.

Question 24

The net profit of ABC Ltd. for the year ending 31.03.2013 amounted to ₹ 7,22,000 after debiting/crediting following items:

- (i) *Payment of interest on money borrowed from bank for purchase of land and building ₹ 2,22,000.*
- (ii) *Commission ₹ 1,00,000 paid in the month of February, 2013 and ₹ 1,25,000 paid in March, 2013. Tax deducted at source from the payments was deposited to the Government on 20.09.2013.*
- (iii) *Travelling expenses of ₹ 90,000 on a foreign tour of a director for negotiating collaboration with a foreign manufacturer for initiation of new line of business.*
- (iv) *Securities transaction tax paid ₹ 10,000. Income from trading in shares already credited to profit and loss account ₹ 3,82,000.*
- (v) *As part of the restructuring of its debt, the company has converted arrears of interest of ₹ 3,00,000 on term loan into a new term loan with a revised repayment schedule.*

The company has paid ₹ 50,000 towards such funded interest during the year. Entire ₹ 3,00,000 has been debited to profit and loss account. However, out of this, a further sum of ₹ 50,000 was paid before the due date of filing of return.

- (vi) *₹ 5,00,000, being contribution to S Ltd. (wholly owned subsidiary company) for construction of a school for the benefit of its employees.*
- (vii) *Provision for gratuity based on actuarial valuation ₹ 6,00,000. Actual gratuity paid ₹ 1,50,000 was debited to provision for gratuity account.*

Other information:

- (1) Provision for bonus for the year 2011-12 paid on 15.11.2012 ₹ 98,000. It is inclusive of payment by bearer cheque of ₹ 34,000.
- (2) The company has purchased and put to use a commercial vehicle of ₹ 8,00,000 for the purpose of business on 21.03.2013 and calculated depreciation@15% for the full year. Depreciation debited to the profit and loss account is calculated on all other assets as per the rates prescribed in the Income-tax Act, 1961.
- (3) The company collected ₹ 3,00,000 from its customers towards sales tax in the year 2008-09 and remitted it to the State Government in due time. On the levy being challenged in the High Court, the Court held the levy as illegal and the State Government refunded the amount to the company in February, 2013. The company refunded ₹ 2,00,000 to the customers and the remaining amount of ₹ 1,00,000 was shown under the head "current liabilities".

Compute the income chargeable to tax in assessment year 2013-14 and work out the amount of tax payable on such income, ignoring the provisions of section 115JB.

Answer**Computation of total income and tax liability of ABC Ltd. for A.Y.2013-14**

Particulars	₹	₹
Profits & Gains of Business of Profession		
Net Profit as per Profit & Loss Account		7,22,000
Add: Items debited but to be considered separately or to be disallowed		
Commission paid in February, 2013 and March 2013, but TDS from such payment before the due date for filing the return of income. Hence, allowed (Note 2)	Nil	
Travelling expenses on foreign tour in connection with new line of business (Note 3)	90,000	
Interest on term loan converted into new term loan (Note 5)	2,00,000	
Provision for gratuity ₹ 6,00,000		
Less: Gratuity paid ₹ 1,50,000 (Note 7)	4,50,000	
Depreciation on commercial vehicle (Note 9)	60,000	
Sales tax refund not returned to the customers (Note 10)	<u>1,00,000</u>	<u>9,00,000</u>
		16,22,000
Less: Items credited but to be considered separately and those not charged but to be allowed		
Bonus paid on 15.11.2012 in respect of previous year 2011-12 disallowed last year but allowable now (Note 8)		<u>64,000</u>

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Business Income	15,58,000
Deduction under Chapter VI-A	Nil
Total Income	15,58,000
Tax payable @ 30%	4,67,400
Education cess @ 2%	9,348
Secondary and higher education cess@1%	4,674
Total tax payable	4,81,422
Total tax payable (rounded off)	4,81,420

Notes:

- (1) As per section 36(1)(iii), interest on borrowed capital is allowed as deduction, if the borrowed capital is used for the purpose of business of the assessee. The section does not distinguish between borrowed capital used for financing capital expenditure and borrowed capital used for the financing revenue expenditure. Assuming that land and building was acquired for business purpose, interest on money borrowed is allowable under section 36(1)(iii). It is presumed that the interest liability pertains to a period after the asset is put to use.
- (2) As per section 40(a)(ia), tax deducted and remitted in respect of commission paid in the months of February and March 2013 is deductible since the TDS was remitted on 20.09.2013 being the date before the due date meant for filing return of income.
- (3) Travelling expenses incurred on foreign tour of a director for initiating a new line of business is a capital expenditure. The same is, therefore, not deductible under section 37(1).
- (4) Securities transaction tax is allowable as deduction under section 36(1)(xv) if the income arising from taxable securities transaction is included in computing the income under the head "Profits and gains of business or profession". As income from trading in shares is included in computation of business income, securities transaction tax of ₹ 10,000 is allowable as deduction.
- (5) As per section 43B, any sum payable by the assessee as interest on any loan or borrowing from, *inter alia*, any public financial institution or scheduled bank shall be allowed only in computing the income of that previous year in which sum is actually paid. In respect of the previous year in which the liability to pay such sum was incurred, deduction will also be allowed in relation to the sum or part thereof which is paid on or before the due date of filing of return for that year. As per *Explanations 3C and 3D* below section 43B, a deduction of any sum, being interest payable on any loan or borrowing from a public financial institution or scheduled bank shall be allowed, if such interest has been actually paid and such interest which has been converted into a loan or borrowing shall not be deemed to have been actually paid.

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

Accordingly, out of ₹ 3 lacs, only ₹ 1 lac (₹ 50,000 + ₹ 50,000), being the funded interest actually paid, is allowable as deduction while computing business income of P.Y.2012-13. It is presumed that the installment of ₹ 50,000 paid before the due date of filling the return relates to P.Y.2012-13. Since the entire amount of ₹ 3 lacs, representing arrears of interest converted into term loan, has been debited to the profit and loss account, the balance ₹ 2 lacs (i.e., ₹ 3 lacs – ₹ 1 lac) has to be added back.

- (6) Contribution to a wholly owned subsidiary company for construction of a school for the benefit of its employees is allowable under section 37(1).
- (7) Under section 40A(7), no deduction is allowed in respect of any provision made for the payment of gratuity to the employees on retirement or termination of employment for any reason. However, gratuity actually paid is admissible as deduction. Therefore, provision for gratuity of ₹ 6,00,000 is to be disallowed. Actual gratuity paid ₹ 1,50,000 debited to provision for gratuity account is allowable. Hence, only the net sum of ₹ 4,50,000 has to be added back.
- (8) As per section 40A(3), expenditure in respect of which payment is made in a day in a sum exceeding ₹ 20,000 otherwise than by account payee cheque or account payee bank draft is disallowed. In this case, provision for bonus for the previous year 2011-12 would have been disallowed under section 43B for non-payment by due date for filing of return of income for assessment year 2012-13. Payment of bonus made after the said date is allowed in the year of actual payment. However, such deduction allowable in the year of payment is subject to the provisions of section 40A(3). Hence, the sum of ₹ 34,000 being bonus paid by bearer cheque shall not be allowed as deduction in the year of payment. Assuming that the balance amount of ₹ 64,000 (i.e., ₹ 98,000 – ₹ 34,000) is paid by account payee cheque or account payee bank draft, it is admissible as deduction in the A.Y.2013-14.
- (9) Depreciation on commercial vehicle has been calculated @15% and, consequently, ₹ 1,20,000 has been debited to profit and loss account. Since it was acquired in March 2013 only, 50% of normal depreciation is allowable. The excess depreciation of ₹ 60,000 is hence disallowed.
- (10) Sales tax collected by the assessee is to be treated as a trading receipt of the assessee as held by the Supreme Court in the case of *Chowringhee Sales Bureau Private Limited v. CIT (1973) 87 ITR 542 (SC)*. Sales tax paid by the assessee is to be deducted from its profits. If any deduction is so allowed and subsequently the sales tax is refunded by the Government, the refund so made has the character of a revenue receipt. Therefore, the

amount is taxable as deemed income under section 41(1). However, the assessee is entitled to claim deduction of the amount of refund of sales tax as and when the same is refunded by the assessee to the purchaser. This view finds support from *CIT v. Thirumalaiswamy Naidu and Sons v. CIT* (1998) 230 ITR 534 (SC). In view of this, the amount not yet refunded to the customers is taxable. Accordingly, the sum of ₹ 1,00,000, being sales tax not refunded to the customers, is added back.

Question 25

Laxmi Tea Limited is engaged in growing and manufacturing tea in Assam and West Bengal. The company's profit and loss account for the year ended 31st March, 2013 shows a net profit of ₹ 550 lacs after debiting or crediting the following amounts:

- (a) Depreciation ₹ 40 lacs.
- (b) Interest amounting to ₹ 2 lacs on term loan from a bank for purchase of machinery for one of its tea factories.
- (c) Repairs to factory building amounting to ₹ 15 lacs for which a sum of ₹ 10 lacs was withdrawn from Tea Deposit account maintained with National Bank for Agricultural and Rural Development (NABARD) as per section 33AB of the Income-tax Act, 1961.
- (d) Profit from sale of green tea leaves plucked in own gardens ₹ 20 lacs.
- (e) ₹ 5 lacs on account of stamp duty and registration fees for the issue of bonus shares.
- (f) ₹ 10 lacs, being sales tax dues of earlier years determined during the year on disposal of appeals by the appellate authority, for which the company has furnished a bank guarantee to the Commercial Tax Authority.
- (g) ₹ 5 lacs written off as bad in respect of a trade debt transferred from Saraswati Tea Limited in previous year 2010-11 pursuant to a scheme of amalgamation approved by the jurisdictional High Court.
- (h) ₹ 2 lacs contributed to Employees' Welfare Trust.
- (i) Interest on inter-corporate deposit ₹ 1 lac and ₹ 1.50 lacs for February, 2013 and March, 2013, respectively, for which tax deducted at source was paid to the Central Government in June, 2013.

Following additional information are furnished by the management:

- (i) Depreciation as per Tax Audit Report under section 44AB ₹ 55 lacs.
- (ii) One financial institution converted arrear interest of ₹ 10 lacs into a new loan in financial year 2008-09, which is repayable in five annual instalments. The company has paid ₹ 2 lacs towards the instalment due for the financial year 2012-13 in February, 2013.
- (iii) A sum of ₹ 250 lacs deposited in NABARD on 15th June, 2013 as per the provision of Section 33AB.

Compute total income of the company for the Assessment Year 2013-14 stating the reasons for each item. Ignore provision relating to Minimum Alternate Tax.

Answer

Computation of total income of Laxmi Tea Ltd. for the A.Y.2013-14

Particulars	₹	
Profit and Gain from Business and Profession		
Net profit as per Profit & Loss Account		5,50,00,000
Add: Items debited but to be considered separately or to be disallowed		
Depreciation as per accounts	40,00,000	
Repairs to factory building to the extent of amount spent by withdrawal from Tea Deposit Account (Note 2)	10,00,000	
Sales tax not paid (Note 4)	10,00,000	
Contribution to Employees' Welfare Trust disallowed under section 40A(9) (Note 6)	2,00,000	
Interest on inter-corporate deposit for February, 2013 and March 2013 for which tax deducted at source was deducted and deposited in June 2013 allowed under section 40(a)(ia) (Note 7)	<u>NIL</u>	<u>62,00,000</u>
		6,12,00,000
Less: Amount credited to profit & loss account but not chargeable to tax		
Profit on sale of green tea leaves plucked in own gardens is agricultural income and the same is exempt under section 10(1)		<u>20,00,000</u>
		5,92,00,000
Less: Deductions allowable while computing business income		
Depreciation as per Income-tax Rules	55,00,000	
Payment of new loan converted from arrear interest (Note 8)	<u>2,00,000</u>	<u>57,00,000</u>
		5,35,00,000
Deduction under section 33AB for making deposit in an account with NABARD as per scheme approved by the Tea Board, being lower of the following two amounts:		
Amount deposited	2,50,00,000	
40% of the profit from business of growing and manufacturing tea computed under the head "profits and gains from business and profession" before making this deduction (₹ 5,35,00,000 x 40%)	<u>2,14,00,000</u>	<u>2,14,00,000</u>
		3,21,00,000

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Less : 60% of above, being agricultural income as per Rule 8	<u>1,92,60,000</u>
Business income	<u>1,28,40,000</u>
Gross Total Income	1,28,40,000
Less : Deduction under Chapter VIA	<u>Nil</u>
Total Income	<u>1,28,40,000</u>

Notes:

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

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

5. Under section 36(1)(vii) read with section 36(2), an assessee can claim deduction in respect of bad debt, provided the amount of such debt has been taken into account in computing total income of the assessee and it is written off in the books of account of the assessee. In the case of *CIT vs. T.Veerabhadra Rao, K.Koteswara Rao & Co. (1985) 155 ITR 152 (SC)*, the Apex Court held that the successor of a business is entitled to write off the predecessor's debt as a bad debt and claim deduction if the other conditions are fulfilled. This is so because the benefit of deduction in respect of bad debt is not accrued to the assessee by way of personal relief but relates to the business. Therefore, the assessee company is entitled to deduction under section 36(1)(vii) read with section 36(2) in respect of debt transferred from the amalgamating company, Saraswati Tea Limited.
6. As per section 40A(9), any contribution made by the assessee as an employer to any fund, trust, company, association of persons, body of individuals, society registered under the Societies Registration Act or other institution for any purpose shall be disallowed, except where such contribution is paid to a recognised provident fund or approved superannuation fund or approved gratuity fund. Therefore, contribution to the Employees' Welfare Trust is to be disallowed.
7. Section 40(a)(ia) seeks to disallow interest paid to any resident, if tax is not deducted at source or, after deduction, tax is not deposited to the Central Government on or before the due date prescribed under section 139(1) of the Act.
In this case, tax has been deducted and paid before the due date prescribed under section 139(1). Hence, the expenditure shall be allowed.
8. As per *Explanation 3C* below section 43B, a deduction of any sum, being interest payable on any loan or borrowing from a public financial institution shall be allowed, if such interest has been actually paid and such interest which has been converted into a loan or borrowing shall not be deemed to have been actually paid.

The manner in which the converted interest will be allowed as deduction has been clarified vide *Circular No.7/2006 dated 17.7.2006*. The unpaid interest, whenever actually paid to the financial institution, will be in the nature of revenue expenditure deserving deduction in the computation of income. Therefore, irrespective of the nomenclature, the deduction will be allowed in the previous year in which the converted interest is actually paid. Accordingly, the sum of ₹ 2 lacs, being installment paid in February, 2013 shall be allowed as deduction while computing business income of P.Y.2012-13.

Question 26

The net profit as per the profit and loss account of XYZ Ltd., a resident company, for the year ended 31.3.2013 is ₹190 lacs arrived at after making the following adjustments:

	Particulars	₹(in lacs)
(i)	Depreciation on assets	100

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(ii)	Reserve for currency exchange fluctuation	50
(iii)	Provision for tax	40
(iv)	Proposed dividend	120

Following further information are also provided by company:

- Net profit includes ₹10 lacs, being dividend received from a subsidiary company.
- Provision for tax includes ₹16 lacs of tax payable on distribution of profit and of ₹2 lacs of interest payable on income-tax.
- Depreciation includes ₹40 lacs towards revaluation of assets.
- Amount of ₹50 lacs credited to P & L account was drawn from revaluation reserve.
- Balance of profit and loss account shown in balance sheet at the asset side as at 31.3.2012 was ₹30 lacs representing unabsorbed depreciation.

Compute the income of the company for the year ended 31.3.2013 liable to tax under MAT.

Answer

Computation of income of XYZ Ltd. liable to tax under MAT for the year ended 31.3.2013

Particulars	₹	₹
Net Profit as per Profit & Loss Account		1,90,00,000
Add : Net profit to be increased by the following amounts as per Explanation 1 to section 115JB		
Depreciation	1,00,00,000	
Reserve for currency exchange fluctuation, since the amount carried to any reserve, by whatever name called, has to be added back	50,00,000	
Provision for tax (See Note below)	40,00,000	
Proposed dividend	<u>1,20,00,000</u>	<u>3,10,00,000</u>
		5,00,00,000
Less : Net profit to be decreased by the following amounts as per Explanation 1 to section 115JB		
Depreciation other than depreciation on revaluation of assets (₹ 100 lacs - ₹ 40 lacs)	60,00,000	
Withdrawal from revaluation reserve restricted to the extent of depreciation on account of revaluation of assets (₹ 50 lacs or ₹ 40 lacs, whichever is less)	40,00,000	
Unabsorbed depreciation or brought forward business loss, whichever is less, as per the books of account (₹ 30 lacs or Nil)	NIL	

Dividend income [since the same is exempt under section 10(34)]	<u>10,00,000</u>	<u>1,10,00,000</u>
Income liable to tax under MAT		<u>3,90,00,000</u>

Note – For the purpose of section 115JB, book profit means the net profit as per the profit and loss account prepared in accordance with Parts II of Schedule VI to the Companies Act, 1956, as adjusted by certain additions/deductions as specified. One of the adjustments is to add back income-tax paid or payable, and the provision therefor. *Explanation 2* after sub-section (2) of section 115JB clarifies that income-tax includes, inter alia, dividend distribution tax / tax on distributed income and interest. Therefore, the entire provision of ₹ 40 lacs for income-tax has to be added back for computing book profit for levy of MAT.

Question 27

Hyper Ltd., engaged in diversified activities, earned a net profit of ₹ 14,25,000 after debit/credit of the following items to its profit and loss account for the year ended on 31.3.2013:

(a) Items debited to Profit and Loss Account	₹
Provision for loss of subsidiary	70,000
Provision for sales tax demand (paid before due date)	75,000
Provision for wealth-tax demand	90,000
Provision for income-tax demand	1,05,000
Expenses on purchase/sale of equity shares	15,000
Depreciation	3,60,000
Interest on deposit credited to buyers on 31.3.2013 for advance received from them, on which TDS was deposited on 31.7.2013	90,000
(b) Items credited to Profit and Loss Account	
Long term capital gain on sale of equity shares on which securities transaction tax was paid	3,60,000
Income from units of UTI	75,000

The company provides the following additional information:

- Depreciation includes ₹ 1,50,000 on account of revaluation of fixed assets.
- Depreciation allowable as per Income-tax Rules is ₹ 2,80,000.
- Brought forward Business Loss/Unabsorbed Depreciation:

F.Y.	Amount as per books		Amount as per Income-tax	
	Loss	Depreciation	Loss	Depreciation
2008-2009	2,50,000	3,00,000	2,00,000	2,50,000
2009-2010	Nil	2,70,000	1,00,000	1,80,000
2010-2011	3,50,000	3,15,000	1,20,000	2,10,000

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You are required to:

- compute the total income of the company for the assessment year 2013-14 giving the reasons for treatment of items and
- examine the applicability of section 115JB of the Income-tax Act, 1961, and compute book profit and the tax credit to be carried forward.

Answer

Computation of total income of M/s Hyper Ltd. for the A.Y. 2013-14

Particulars	₹	₹
Net profit as per Profit & Loss Account		14,25,000
Add: Items disallowed /considered separately		
Provision for loss of subsidiary [since it is not wholly and exclusively for the purpose of business of the assessee]	70,000	
Provision for wealth-tax [disallowed under section 40(a)(ia)]	90,000	
Provision for sales tax [is fully allowable since the sales tax has been paid before the due date]	-	
Provision for income-tax [disallowed under section 40(a)(ii)]	1,05,000	
Expenses on transfer of shares [not deductible from business income. It is to be deducted from gross sale consideration while computing capital gains]	15,000	
Interest on deposit credited on 31.3.2013 and tax deposited on 31.7.2013 [allowed under section 40(a)(ia) as paid before due date of filing return of income under section 139(1)]	Nil	
Depreciation debited to profit and loss account [only depreciation calculated as per the Income-tax Rules, 1962 is allowable as deduction]	3,60,000	6,40,000
Less: Items credited but not includible under business income or are exempt under the provisions of the Act		20,65,000
Long-term capital gain on sale of equity shares on which securities transaction tax was paid, since it is not a business income.	3,60,000	
Income from UTI, since it is not a business income.	75,000	4,35,000
Less: Depreciation (allowable as per the Income-tax Rules, 1962)		16,30,000
		2,80,000
		13,50,000
Less: Set-off of brought forward business loss and unabsorbed depreciation		
Brought forward business loss under section 72	4,20,000	
Brought forward depreciation under section 32	6,40,000	10,60,000
Income from business		2,90,000

Capital Gains		
Long term capital gain on sale of equity shares on which securities transaction tax was paid	3,60,000	
Less: Exempt under section 10(38)	3,60,000	Nil
Income from Other Sources		
Income from units of UTI	75,000	
Less: Exempt under section 10(35)	75,000	Nil
Total Income		2,90,000
Tax payable @ 30%		87,000
Add: Education cess @ 2%	1,740	
Secondary and higher education cess @ 1%	870	2,610
Tax Payable as per the Income-tax Act, 1961		89,610

Computation of Book Profit under section 115JB

Particulars	₹	₹
Net Profit as per Profit & Loss Account		14,25,000
Add: Net Profit to be increased by the following amounts as per Explanation 1 to section 115JB		
Provision for loss of subsidiary	70,000	
Provision for income-tax	1,05,000	
Depreciation debited to profit and loss account	3,60,000	5,35,000
		19,60,000
Less: Net Profit to be reduced by the following amounts as per Explanation 1 to section 115JB		
Depreciation debited to profit and loss account (excluding depreciation on account of revaluation of fixed assets) (i.e. ₹ 3,60,000 – ₹ 1,50,000)	2,10,000	
Income from UTI [since it is an income exempt under section 10(35)]	75,000	
Brought forward business loss or unabsorbed depreciation as per books of account, whichever is less, taken on cumulative basis	6,00,000	8,85,000
Book Profit		10,75,000
18.50% of book profit		1,98,875
Add: Education cess @ 2%	3,978	
Secondary and higher education cess @ 1%	1,989	5,967
		2,04,842

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In case of a company, it has been provided that where income-tax payable on total income computed as per the provisions of the Act is less than 18.50% of book profit, the book profit shall be deemed as the total income and the tax payable on such total income shall be 18.50% thereof plus education cess @ 2% and secondary and higher education cess @ 1%.

Accordingly, in this case, since income-tax payable on total income computed as per the provisions of the Act is less than 18.50% of book profit, the book profit of ₹ 10,75,000 is deemed to be the total income and income-tax is payable @ 18.50% thereof plus education cess @ 2% and secondary and higher education cess @ 1%. The tax liability, therefore, works out to be ₹ 2,04,842.

Section 115JAA provides that where tax is paid in any assessment year in relation to the deemed income under section 115JB(1), the excess of tax so paid, over and above the tax payable under the other provisions of the Income-tax Act, 1961, will be allowed as tax credit in the subsequent years.

The tax credit is, therefore, the difference between the tax paid under section 115JB(1) and the tax payable on the total income computed in accordance with the other provisions of the Act. This tax credit is allowed to be carried forward for ten assessment years succeeding the assessment year in which the credit became allowable.

Such credit is allowed to be set off against the tax payable on the total income in an assessment year in which the tax is computed in accordance with the provisions of the Act, other than section 115JB, to the extent of excess of such tax payable over the tax payable on book profits in that year.

Particulars	₹
Tax on book profit under section 115JB	2,04,842
Less: Tax on total income computed as per the other provisions of the Act	89,610
Tax credit to be carried forward under section 115JAA	1,15,232

Note: Long-term capital gains on sale of equity shares through a recognized stock exchange on which securities transaction tax (STT) is paid is exempt under section 10(38). One of the adjustments to the book profit is that exempt income under section 10, which is credited to profit and loss account, would be deducted in arriving at the book profit. However, deduction of such long-term capital gains is not allowed for computing book profit. Consequently, expenditure to earn such income should not be added back to arrive at the book profit.

Question 28

The net profit for the year ended on 31.3.2013 of India Biotech Ltd. engaged in the business of bio-technology works out to ₹ 45 lacs after debit/credit of the following items:

- (i) *Profit of ₹ 2,50,000 from a hedging contract entered into for meeting out the loss in foreign currency payments towards an imported machinery of ₹ 80 lacs installed on 1.2.2013.*

- (ii) Incidental charges of ₹ 20 lacs paid to a financial institution for taking short-term loan of ₹ 25 crores repayable in 18 months.
- (iii) Commission of ₹ 25,000 paid to a recovery agent for getting realisation of an old outstanding. Tax deducted and remitted as per Chapter XVII-B of the Act.
- (iv) Registration fees of ₹ 20,000 and listing fees of ₹ 30,000 paid to the Registrar of Companies and the Stock Exchange respectively on the issue of bonus shares.
- (v) Amount of ₹ 1,00,000 towards carry forward losses for Asst. year 2000-01 of X Ltd., which got merged with the company during the financial year 2005-06.
- (vi) Interest received from banks of ₹ 90,000 net of TDS of ₹ 10,000.
- (vii) Amount of ₹ 1,50,000 incurred towards reconditioning of generator.
- (viii) Employer's share to the EPF for the month of March, 2013 of ₹ 40,000. The amount was deposited with the PF Commissioner on 22.4.2013.

Compute the total income of the company for Asst. year 2013-14 and give brief reasons for the treatment given to each of the items, ignoring the provisions of section 115JB.

Answer

Computation of Total Income of India Biotech Ltd. for A.Y. 2013-14

Particulars	₹	₹
Income from business		
Net Profit as per profit and loss account		45,00,000
Less: Items credited but to be considered separately		
Profit from hedging contract	2,50,000	
Interest from banks	<u>90,000</u>	<u>3,40,000</u>
		41,60,000
Add: Employer's share already charged in Profit & Loss Account is allowable under section 43B since it is deposited before the due date of filing return under section 139(1) i.e. 30.09.2013.		NIL
		41,60,000
Add: Depreciation on plant and machinery on account of hedging profit (7.5% on ₹ 2,50,000)	18,750	
Additional depreciation (10% on ₹ 2,50,000)	<u>25,000</u>	<u>43,750</u>
		42,03,750
Income from other sources		
Interest received from banks (gross)		<u>1,00,000</u>
Total Income		<u>43,03,750</u>

Notes -

1. Hedging contract is entered into for safeguarding against any loss that may arise due to currency fluctuation. The profit from such contract entered into for meeting loss in foreign currency payments towards imported machinery has to be adjusted against the cost of plant and machinery. Consequently, the same will have an impact on depreciation and additional depreciation on imported plant and machinery. It is presumed that the conditions for claim of additional depreciation are satisfied and accordingly, the additional depreciation has been charged to profit and loss account. Since there is a reduction in the cost of plant and machinery on account of the hedging profit of ₹ 2,50,000, the excess depreciation and additional depreciation debited to the profit and loss account have to be added back to the profits.
2. Incidental charges incurred for raising short term loan from financial institutions is allowable as deduction, since, as per *CBDT letter F.No.32/6/62-IT(A-1) dated 16.1.1963*,–
 - (i) it is in respect of a short term loan of a duration of not more than 2 years; and
 - (ii) it does not exceed 1% of ₹ 25 crores, being the amount of loan raised.
3. Commission of ₹ 25,000 paid to a recovery agent for realisation of old outstanding is an allowable expense under section 37 as per *DCIT v. Super Tannery (India) Ltd. (2005) 274 ITR 338 (All)*.
4. The Supreme Court has, in *CIT v. General Insurance Corporation (2006) 286 ITR 232*, observed that the issue of bonus shares does not result in expansion of the capital base of the company. Therefore, the expenditure incurred by the company on account of registration fees and listing fees for the issue of bonus shares is allowable as revenue expenditure.
5. As per section 72A, the unabsorbed business loss of the amalgamating company shall be deemed to be the loss of the amalgamated company for the previous year in which the amalgamation took place. Therefore, such loss can be set-off against the income of the amalgamated company in the year of amalgamation and the balance, if any, can be carried forward and set-off against the business income of the amalgamated company in the subsequent years. Such loss can be carried forward by the amalgamated company for a maximum period of 8 years from the year of amalgamation. In this case, the amalgamation took place in the financial year 2005-06 and therefore, the 8 year period has not expired in the financial year 2012-13. Therefore, the set-off of losses of ₹ 1 Lac relating to X Ltd. is in order. It is assumed that the conditions specified in section 72A are satisfied.
6. Interest received from banks is chargeable to tax under the head "Income from other sources", assuming that there is no nexus between the interest income and the business of the assessee. For this purpose, the net amount of interest has to be grossed up by adding the amount of TDS of ₹ 10,000. Since the net interest of ₹ 90,000 is credited to profit and loss account, the same has to be reduced to compute the business income.
7. Expenditure on reconditioning of the generator is in the nature of normal repairs and is eligible for deduction under section 31.

Question 29

RST Ltd. is engaged in the manufacture and sale of drugs and pharmaceuticals. Its net profit for the year ending 31-3-2013 after debit/credit of the following items to the Profit and Loss Account was ₹ 28,00,000.

- (i) Income-tax paid on non-monetary perquisites provided to the employees ₹ 1,00,000.
- (ii) Legal fees incurred in defending title to factory premises ₹ 2,00,000.
- (iii) Expenditure on scientific research (not in respect of cost of land or building) on in-house research and development facility approved by the prescribed authority ₹ 10,00,000.
- (iv) Interest paid on arrears of sales tax ₹ 1,00,000.
- (v) Cash payment of ₹ 20,000 made on 10.10.2012 to a supplier towards purchase of raw material.
- (vi) Rent received from letting out vacant land ₹ 1,00,000.
- (vii) Arrears of rent received in respect of a house property, which was let out in the earlier years and which was not charged to tax in any earlier year ₹ 2,00,000. The said property was sold during the year ending 31.3.2011.

The company had paid royalty in India to a foreign company amounting to ₹ 3,00,000 on 1.5.2011, which was disallowed by the Assessing Officer for the assessment year 2012-13 since tax was not deducted thereon. The company deducted and paid tax at source on the said amount of royalty on 1.1.2013.

The company has brought forward loss from property relating to the assessment year 2011-12 amounting to ₹ 40,000.

Compute the total income of RST Ltd. for the assessment year 2013-14, ignoring MAT.

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

Answer**Computation of total income of RST Ltd for the assessment year 2013-14**

Particulars	₹	₹
Profits and gains of business or profession		
Net profit as per profit and loss account		28,00,000
Add: Income-tax paid on non-monetary perquisites provided to employees not allowable [Section 40(a)(v)]		1,00,000
		29,00,000
Less: Deduction / Additional deduction allowable		
Additional sum allowable towards scientific research expenditure [Section 35(2AB)(1) @ 200%].	10,00,000	

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Royalty paid during the year 2011-12, without deduction of tax, disallowed in A.Y. 2012-13, now allowable as tax thereon is deducted and paid	<u>3,00,000</u>	13,00,000
		16,00,000
Less: Income credited in the profit and loss account to be considered under other heads of income		
Rent received from letting out vacant land	1,00,000	
Arrears of rent received in respect of property let out in the earlier years	<u>2,00,000</u>	3,00,000
		13,00,000
Income from house property		
Arrears of rent received in respect of property let out in earlier years	2,00,000	
Less: 30% of ₹ 2,00,000	<u>60,000</u>	
	1,40,000	
Less: Brought forward loss from property relating to A.Y.2011-12 set off	<u>40,000</u>	1,00,000
Income from other sources		
Rent received from letting out vacant land		1,00,000
Total Income		15,00,000

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

- Income-tax paid by an employer on non-monetary perquisites provided to the employees is not deductible as per section 40(a)(v).
- Legal fees incurred in defending title to factory premises is an expenditure incurred wholly and exclusively for the purpose of business and is, therefore, allowable under section 37(1). This was held by the Supreme Court in *Dalmia Jain & Co. Ltd. v. CIT* (1971) 81 ITR 754.
- Expenditure on scientific research incurred by the company is entitled to deduction at the rate of 200% as per section 35(2AB). Since the company has debited ₹ 10,00,000 in the profit and loss account, the additional deduction of ₹ 10,00,000 is claimed while computing its total income.
- Interest paid on arrears of sales tax is not penal in nature but is compensatory in character and is an allowable deduction under section 37(1) as held by the Supreme Court in *Lachmandas Mathurdas v. CIT* (2002) 254 ITR 799.
- Disallowance under section 40A(3) is attracted where cash payment in excess of ₹ 20,000 is made in respect of any expenditure. In such a case, 100% of the expenditure

is disallowed. Since the cash payment made by the company is ₹ 20,000, that is, not exceeding ₹ 20,000, the expenditure does not attract disallowance under section 40A(3).

- (vi) Rent received from letting out vacant land is assessable under the head "Income from other sources".
- (vii) Arrears of rent received in respect of the house property let out in earlier years is deemed to be income from house property in the year of receipt. Such arrears of rent, after deduction of 30% thereof, is assessable as income from house property even though the assessee is not the owner of the property in the year of its receipt as provided in section 25B.
- (viii) Royalty paid during the year 2011-12 in respect of which tax was deducted and paid during the previous year ending 31.3.2013 is allowable as deduction for the assessment year 2013-14 as per the proviso to section 40(a)(i).
- (ix) Brought forward loss from house property relating to the assessment year 2011-12 is set off against the deemed income from house property for the assessment year 2013-14 in accordance with the provisions of section 71B.

Question 30

Betki Limited is a company in which 70% shares are held by Ruhu Limited. Betki Limited, in its annual general meeting held on 18th May, 2012, declared a dividend amounting to ₹ 40 lacs to its shareholders for the year ended 31st March, 2012 and it paid dividend distribution tax on 28th May, 2012. Ruhu Limited did not declare any dividend for the year ended 31st March, 2012. It, however, declared an interim dividend amounting to ₹ 60 lacs on 1st December, 2012 for the year ended 31st March, 2013.

What is the amount of tax on dividend payable by Ruhu Limited?

What would be your answer, if 60% of shares in Ruhu Limited are held by Hilsha Limited, a domestic company?

Answer

As per section 115-O, dividend distribution tax at the rate of 15% (plus surcharge@5%, education cess @ 2% and secondary and higher education cess @ 1%) is levied on dividend, declared, distributed or paid by a domestic company. As per sub-section (1A), inserted to section 115-O a holding company receiving dividend from its subsidiary company can reduce the same from dividends declared, distributed or paid by it. For this purpose, the matching principle does not apply. This means that even if the dividend received and dividend distributed relate to different periods, the same can be adjusted for the purpose of computing dividend distribution tax of the holding company. The only condition to be satisfied is that the dividend received from subsidiary company and dividend declared, distributed or paid by the holding company should be in the same financial year. However, the dividend shall not be considered for reduction more than once.

The conditions to be fulfilled for this purpose are as follows:

- (1) The subsidiary company should have paid the dividend distribution tax as payable on such dividend;
- (2) The holding company should be a domestic company;

For this purpose, a holding company is a company which holds more than 50% of the nominal value of equity shares of another company.

On the basis of the above

- (a) Dividend distribution tax payable by Ruhu Limited shall be 16.2225% of [(₹ 60,00,000 - (₹ 40,00,000 x 70%)] i.e. ₹ 5,19,120.
- (b) If 60% of shares of Ruhu Limited are held by Hilsha Limited, then Ruhu Limited is a subsidiary company of Hilsha Limited. Section 115-O(1A) has been amended by the Finance Act, 2012 to remove the condition that the holding company should not be a subsidiary of any other company for claiming reduction of dividend received from the subsidiary company from the dividend declared, distributed or paid by the holding company. Therefore, even if Ruhu Ltd. is a subsidiary of Hilsha Ltd., it can reduce the amount of dividend received from Betki Limited for computation of dividend distribution tax. Hence, dividend distribution tax payable by Ruhu Limited shall be 16.2225% of ₹ 32,00,000 i.e. ₹ 5,19,120.

Question 31

ABC Ltd. is engaged in the manufacture and sale of textiles. Its net profit for the year ending 31.3.2013 after debit/credit of the following items to the Profit and Loss Account was ₹75,00,000:

- (i) *Payment to two employees of ₹ 2,50,000 each in connection with their voluntary retirement.*
- (ii) *Income-tax paid ₹1,00,000.*
- (iii) *Charges of ₹ 2,00,000 paid for the advertisement in souvenir published by a Political Party registered with the Election Commission of India.*
- (iv) *Retrenchment compensation paid to employees of one of the units closed down during the year ₹10,00,000.*
- (v) *Capital expenditure incurred for the purpose of promoting family planning amongst its employees ₹3,00,000.*
- (vi) *Interest paid under section 234B for short payment of advance tax pertaining to the assessment year 2012-13 ₹1,10,000.*
- (vii) *Loss incurred in transactions of purchase and sale of shares of various companies ₹3,00,000.*
- (viii) *Compensation received from supplier for delay in supply of raw materials ₹1,00,000.*
- (ix) *Dividend received from a foreign company ₹2,00,000.*

Compute the total income of ABC Ltd. for the assessment year 2013-14, ignoring MAT.

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

Answer

Computation of total income of ABC Ltd. for the Assessment Year 2013-14

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

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

- Section 35DDA provides for amortisation of expenditure incurred under voluntary retirement scheme over a period of five years in equal instalments. The company is, therefore, entitled to deduction of ₹ 1,00,000, being one-fifth of the total sum of ₹ 5,00,000 paid to the two employees in connection with their voluntary retirement for the relevant assessment year.
- Income tax paid is not allowable as deduction from business profits as per section 40(a).
- Section 37(2B) prohibits allowance of any expenditure incurred by an assessee on advertisement in any souvenir, brochure, pamphlet or the like published by a political

party. As such, advertisement charges paid in respect of souvenir published by a political party is not allowable as deduction from business profits of the company.

However, under section 80GGB, expenditure incurred by an Indian company on advertisement in any publication, including a souvenir, by a political party is deemed to be a contribution of such amount to the political party and is, therefore, allowable as deduction in the hands of the company. It is logical to presume that ABC Ltd. is an Indian company.

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

Question 32

A domestic company is liable to pay minimum alternate tax under section 115JB for the Assessment Year 2013-14. While computing book profit under section 115JB the company claims provision for deferred tax charged to Profit & Loss account in accordance with Accounting Standard-22 of the Institute of Chartered Accountants of India, which is sought to be disallowed by the Assessing Officer. Is the action of the Assessing Officer valid in law?

Answer

Clause (h) to the *Explanation 1* to section 115JB provides that the amount of deferred tax and any provision therefor, is to be added to the net profit of the company. Similarly, any amount credited to profit and loss account being the amount of deferred tax is to be reduced /

deducted for computing the book profit under section 115JB. Therefore, the action of the Assessing Officer is valid in law.

Question 33

Netherlands Oil Corporation is a Foreign Company engaged in the exploration of oil and gas in all countries including India. In respect of its Indian business, the company has prepared the Profit and Loss Account in accordance with Part II of Schedule VI to the Companies Act, 1956 and such Profit and Loss Account for the previous year ended 31.03.2013 shows a Net Profit of ₹ 65 Lacs. The Net Profit from activities in all other countries stands at ₹ 550 Lacs. The company informs that while arriving at the Net Profit as indicated above in respect of Indian business, the following debits/credits have been made in its Profit and Loss Account.

Credits to the Profit and Loss Account	₹ (in Lacs)
(i) Net agricultural income in India	16
(ii) Share of profits from a firm engaged in business in India	15
(iii) Amount withdrawn from Reserve created during 2009-10 (Book Profit was increased by the amount transferred to such reserve in the A.Y 2010-11)	3
(iv) Profits from an Industrial Undertaking covered and qualified for deduction under Section 80-IC of Income-tax Act, 1961.	6
Debits to the Profit and Loss Account	₹ (in Lacs)
(i) Depreciation for current year under the Companies Act, 1956	24
(ii) Interest to Financial Institutions not paid upto the date of filing the return	6
(iii) Penalty for infraction of law	1
(iv) Proposed Dividend	3
(v) Provision for Taxation (Income-tax)	2
(vi) Transfer to General Reserve	5
(vii) Provision for Unascertained Liabilities	2
(viii) Expenditure relating to 80-IC undertaking	5

The following additional information is also provided:

	₹ (in Lacs)
Brought forward loss (As per books of account)	12
Depreciation allowable under Income-tax Rules, 1962.	30
Brought forward business loss and unabsorbed depreciation as per Income-tax law.	18
(Loss ₹ 8 Lacs and Depreciation ₹ 10 Lacs)	

You are requested to compute the total tax liability of the company for the Assessment Year 2013-14.

Answer

Computation of Book Profit under section 115JB

Particulars	₹ (in Lacs)	₹ (in Lacs)
Net Profit as per Profit & Loss Account		65
Add: Transfer to General Reserve	5	
Proposed dividend	3	
Provision for taxation	2	
Provision for unascertained liabilities	2	
Depreciation	24	36
		101
Less: Amount transferred from reserve and credited to profit and loss account to be excluded since it was already subjected to adjustment in the assessment year 2010-11	3	
Depreciation	24	
Net Agricultural Income [exempt under section 10(1)]	16	
Share of Profit from a firm [exempt under section 10(2A)]	15	
Business loss brought forward or unabsorbed depreciation, whichever is lower.	Nil	58
Book Profit (A)		43

Computation of Total Income as per the Income-tax Act, 1961

Particulars	₹(in Lacs)	₹(in Lacs)
Net Profit as per Profit & Loss Account		65
Add: Transfer to General Reserve	5	
Proposed Dividend	3	
Provision for taxation	2	
Provision for unascertained liabilities	2	
Expenditure relating to an undertaking eligible for deduction under section 80-IC	5	
Depreciation as per books of account	24	
Interest to financial institutions disallowed under section 43B	6	
Penalty for infraction of law	1	48
		113
Less: Net agricultural Income [Exempt under section 10(1)]	16	
Amount withdrawn from General Reserve	3	
Share of profit from a firm [Exempt under section 10(2A)]	15	
Profits from Undertaking eligible for deduction under section 80-IC	6	

Depreciation as per Income-tax Rules, 1962	30	70
Profits from business for the year		43
Less: Brought forward loss under section 72	8	
Unabsorbed Depreciation under section 32(2)	10	18
Total Income (B)		25

Computation of tax liability for the assessment year 2013-14

Particulars	₹	₹
1. Book profit as per (A)	43,00,000	
Tax thereon @ 18.50%		7,95,500
2. Total income as per (B)	25,00,000	
Tax on total income @ 40%		10,00,000

Since the income-tax payable on the total income of the company computed under the Income-tax Act, 1961 is not less than 18.50% of its book profit, section 115JB will not apply for A.Y.2013-14. So, the company's total income is ₹ 25 Lacs and the tax liability therefore works out to be ₹ 10,00,000 plus education cess @ 2% and secondary and higher education cess @ 1% i.e. ₹ 10,30,000.

Notes:

1. Amount withdrawn from reserve is to be excluded while computing "Book Profit" as the said amount was added and increased the book profit of the earlier assessment year. Also, such amount would be excluded for computing total income as net profit of ₹ 65 Lacs stands increased by the said credit of ₹ 3 Lacs to the profit and loss account.
2. As per section 115JB, the amount of loss brought forward or unabsorbed depreciation as per books, whichever is less, has to be reduced from net profit. As only brought forward loss is indicated at ₹ 12 Lacs in the question, it has been assumed that there is no unabsorbed depreciation as per books of account. Therefore, no adjustment has been made in this respect for computing the "Book Profit".
3. Since the company is a foreign company, it is not liable to be taxed in respect of its profits attributable to its activities outside India.
4. Section 115JB does not provide for the increase of net profit by the amount of expenditure relatable to any income to which section 80-IC applies. Accordingly, no adjustment in respect of both expenditure and income pertaining to an undertaking covered under section 80-IC has been made while computing book profit.
5. Expenditure of the eligible undertaking covered by section 80-IC is not to be adjusted for the purpose of computing Book Profit under section 115JB.

Question 34

"NEPTUNE" is a ship liner, used in carrying passengers and cargo, owned by M/s Thomas & Thomas of U.K. The ship carried the passengers and cargo in June, 2012 from Singapore to

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Mumbai and vice versa and collected charges thereof amounting to ₹ 200 lacs. It left Mumbai port on 15.6.2012 for its journey to Korea. No other journey to India was undertaken by any of the vessels of the company during the year ended on 31.3.2013. The non-resident company had authorized its Indian agent to comply with the income tax provisions.

You are consulted by the company to explain about the procedure as to return of income to be filed and the period within which the assessment thereof will be completed by the Assessing Officer.

Answer

M/s. Thomas & Thomas of U.K shall be required to file the return of income in India for the journey of its ship before it leaves for onward journey to Korea.

However, as per the proviso to section 172(3), where the Assessing Officer is satisfied that it is not possible for the master of the ship to furnish the return before the departure of the ship from the port, and if satisfactory arrangements have been made for filing of return and payment of tax by the authorised agent in India, he may permit filing of return within 30 days of departure of the ship.

Section 172(4A) provides a time limit of 9 months for completion of assessment in such cases. The period of 9 months is reckoned from the end of the financial year in which the return under section 172(3) is furnished.

Question 35

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

Answer

Section 179 contains the provisions relating to the liability of directors of a private company in liquidation in respect of tax due from the company. Where any tax due from a private company in respect of income of any previous year or from any other company in respect of any income of any previous year during which such other company was a private company cannot be recovered, then, every person who was a director of such company at any time during the relevant previous year shall be jointly and severally liable for the payment of such tax. However, the director shall not be so liable if he proves that the non-recovery cannot be attributed to any gross neglect, misfeasance or breach of duty on his part in relation to the affairs of the company.

Question 36

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

Answer

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

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

Question 37

The net profits of XYZ Ltd. for the year ended 31st March, 2013, after debiting/crediting the following items, were ₹ 9 Lacs:

- (a) The company had taken on lease an old building for the purposes of locating its business. Due to old age of the building, it was demolished and a new building put up, which was used for purposes of XYZ's business from September, 2012. The cost of the new building ₹ 10 Lacs was written off as revenue expenditure. The lessor permitted the company to have an extension of the lease by another twenty years.*
- (b) ₹ 1 Lac was paid as an annual fee for technical services to a foreign collaborator under an agreement approved by the Government.*
- (c) The company collected ₹ 3 Lacs from its customers by way of sales tax in the year 2008-09 and had remitted it to the State Government in due time. On the levy being challenged in the High Court, the Court held the collection as illegal and the State Government in February, 2013 refunded the amount to the company.*
- (d) Land development charges of ₹ 1.5 Lacs were paid to the State Industrial Development Corporation on allotment of a commercial plot.*
- (e) A criminal case was filed against a Director of the company, in his official capacity. The company spent legal expenses of ₹ 50,000 defending him in the proceedings. The Director was acquitted of the charges at the end.*
- (f) The company issued in the year bonus shares to its shareholders and for that purpose fees of ₹ 1.5 Lacs were paid to the Registrar of Companies. These have been written off in the accounts as revenue expenses.*
- (g) The company paid ₹ 70,000 as interest on deposits to some of the non-resident buyers on advances received from them. No tax at source was deducted on the payment.*

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- (h) Overdraft interest of ₹ 40,000 was paid to the company's bank to enable the company to pay its income tax dues.
- (i) The opening and closing stocks of the year were ₹ 90,000 and ₹ 1,17,000 respectively and were undervalued by 10% on cost.
- (j) Some investments were held by the company (not as stock in trade), which had to be depreciated by ₹ 4.8 Lacs due to a directive from the Government.

The balance on 1st April, 2012 to the Profit and Loss Account, shown separately in the Balance Sheet, was a debit of ₹ 2 Lacs.

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

Business losses relating to	
Assessment year 2004-05	₹ 8 Lacs
Assessment year 2010-11	₹ 4 Lacs
Long-term losses under the head capital gains -	
Assessment year 2011-12	₹ 3 Lacs
Unabsorbed depreciation	
(Both as per income-tax records and books of account of the company)	₹ 12.50 Lacs

You are required to :

- (a) Calculate the total income of XYZ Ltd. for the assessment year 2013-14 [Your answer should clearly indicate the reasons for the treatment of the individual items given above.]
- (b) Examine the applicability of section 115JB of the Income-tax Act, 1961 to the company for the same assessment year.

Answer

(a) Computation of total income of XYZ Ltd. for the A.Y.2013-14

Particulars	₹	₹
Net profit as per profit and loss account		9,00,000
Add: Cost of the new building – written off is a capital expenditure – disallowed	10,00,000	
Land development charges paid to State Industrial Development Corporation is a capital expenditure – hence disallowed	1,50,000	
Fees paid to ROC for issuing bonus shares is revenue expenditure – hence allowed. [CIT v. General Insurance Corpn (2006) 156 Taxman 96 (SC)]	Nil	
Interest on deposit to non-resident buyers without deduction of tax at source – disallowed under section 40(a)(i)	70,000	

Interest to bank on overdraft for payment of income-tax dues – disallowed as per Supreme Court's decision in <i>East India Pharmaceutical Works Ltd. v. CIT</i> (1997) 224 ITR 627	40,000	
Depreciation on investments not held as stock-in-trade	4,80,000	
Under valuation of stock (₹ 1,17,000 - ₹ 90,000) x 10/90	<u>3,000</u>	<u>17,43,000</u>
		26,43,000
Less: Depreciation on building @10% on ₹ 10 Lacs (See Notes 1 & 2)		<u>1,00,000</u>
Business Income		25,43,000
Less: Set-off of business loss and unabsorbed depreciation		
Business loss of A.Y.2004-05 cannot be set-off against business income of the current year, since business loss can be carried forward for a maximum period of 8 years only.	-	
Business loss of A.Y.2010-11	4,00,000	
Long-term capital loss of A.Y.2011-12 cannot be set-off against business income since as per section 74, long-term capital loss can be set-off only against long-term capital gains.	-	
Unabsorbed depreciation	<u>12,50,000</u>	<u>16,50,000</u>
Total Income		<u>8,93,000</u>

(b) Tax on total income as computed under the Income-tax Act, 1961

Particulars	₹
Tax on total income of ₹ 8.93 Lacs	2,67,900
Add: Education cess and SHEC @ 3%	<u>8,037</u>
Tax on total income	<u>2,75,937</u>

(c) Computation of tax as per section 115JB

Particulars	₹
Net profit as per profit and loss account	9,00,000
Add: Decrease in value of investment not eligible for deduction if the amount is set aside by way of provision for diminution in value of asset	<u>4,80,000</u>
	13,80,000
Less: Business loss of ₹ 2 Lacs (as per books of account as on 01.04.2012), since it is lower than the unabsorbed depreciation of ₹ 12.50 Lacs	<u>2,00,000</u>
Book Profit	<u>11,80,000</u>

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18.50% of book profit	2,18,300
Add: Education cess and SHEC @ 3%	<u>6,549</u>
	<u>2,24,849</u>

Since the income-tax payable on the total income of the company computed under the Income-tax Act, 1961 is not less than 18.50% of its book profit, section 115JB will not apply for A.Y.2013-14.

Notes:

1. As per *Explanation 1* to section 32(1), where an assessee carries on business or profession in a building which is not owned by him but in respect of which he holds a lease or other right of occupancy, depreciation is to be allowed on account of any capital expenditure incurred by the assessee on construction of any structure for improvement/ renovation of the building as if the structure is a building owned by the assessee. Therefore, depreciation is allowable on the capital expenditure of ₹ 10 Lacs incurred by XYZ Ltd. towards the cost of the new building put up after demolition of the old building.
2. The rate of depreciation on buildings is 10%. Since it is put to use for more than 180 days during the previous year 2012-13, full depreciation is allowable.
3. Payment of annual fees for technical services to a foreign collaborator is an allowable business expense and has been correctly charged to profit and loss account. Therefore, no adjustment is required.
4. Sales tax refund from the Government has to be treated as a revenue receipt. Since it has been correctly credited to profit and loss account, no adjustment is required.
5. Land development charges paid to SIDC on allotment of a commercial plot is a capital expenditure [*Jaswant Trading Co. v. CIT (1995) 212 ITR 293 (Raj)*]
6. Section 37(1) does not make any distinction between expenditure incurred in civil litigation and that incurred in criminal litigation. If the expenditure is *bona fide* incurred wholly and exclusively for the purpose of the business, it is allowable as deduction [*CIT v. Birla Cotton Spinning & Weaving Mills Ltd. (1971) 82 ITR 166 (SC)*]. Therefore, in this case, since legal expenses were incurred by the company for defending the Director in a criminal case filed against him in his official capacity, it is allowable as deduction.
7. Fees paid to Registrar of Companies for enhancement of authorised capital to issue bonus shares is deductible since it is related to issue of bonus shares. Alternatively, if it is a mere increase in authorized capital then such expenditure is a capital expenditure and not deductible under section 37(1)[*Punjab State Industrial Development Corporation Ltd. v. CIT (1997) 225 ITR 792 (SC)*].

8. Since no tax has been deducted at source on payment of interest to non-residents, interest paid will not be allowed as a deduction as per section 40(a)(i).
9. Interest paid to bank on overdraft for payment of income-tax dues is not an expenditure incurred wholly and exclusively for the purpose of business and is hence, not deductible under section 37(1) as per the Supreme Court's decision in *East India Pharmaceutical Works Ltd. v. CIT* (1997) 224 ITR 627.
10. The under valuation of both opening and closing stocks will have an impact on the profits for the year and accordingly, the difference in valuation of stock has to be credited to profit and loss account to the extent of 10% of cost.
11. Value of investment written down is on capital account and hence not allowed, even if such write down was on a directive from the Government. Clause (i) of *Explanation 1* to section 115JB provides for increasing the net profit if any amount is set side as provision for diminution in the value of any asset. Though it is stated as written off in the question, it is assumed that the charge to profit and loss account is by way of provision to meet possible loss in future and accordingly adjusted in the solution while computing book profit.

Question 38

Tarun Shipping Co. Ltd., having its registered office in Mumbai, plies two ocean-going vessels which it owns. The registered tonnage of the two vessels are 47,549 tonnes and 800 kgs and 25,759 tonnes and 400 kgs respectively. In the accounting year 2012-13, the first vessel was operated for 360 days and the second for 200 days.

The accounts of the company reveal the following results:

- | | |
|--|--------------|
| (i) Profit from core shipping activity | ₹ 90.50 Lacs |
| (ii) Profit from incidental activity | ₹ 15,000 |

Compute the tax payable by the company for the assessment year 2013-14, taking note of the provisions of the law relating to taxation of income of shipping companies. Also indicate the specified conditions for the applicability of the procedure.

Answer**Computation of tax payable by Tarun Shipping Company Ltd. for the A.Y.2013-14**

Particulars	₹
Tonnage income (See Working Note below)	89,86,600
Tax @ 30%	26,95,980
Add: Surcharge (Not applicable as the income is below ₹ 100 Lacs)	Nil
	26,95,980
Add: Education cess and SHEC @ 3%	80,879
Total tax payable	27,76,859

Working Note

Since the income under tonnage tax scheme is lower than the normal income of ₹ 90.50 Lacs, the tonnage tax scheme is taken for computing tax payable.

Computation of Tonnage Income [Section 115VG]

Particulars	Ship 1 ₹	Ship 2 ₹
First 1,000 tons (1000 x 70/100)	700	700
Next 9,000 tons (9,000 x 53/100)	4,770	4,770
Next 15,000 tons (15,000 x 42/100)	6,300	6,300
Balance [(22,500/800) x 29/100]	6,525	232
	18,295	12,002

Tonnage income	₹
Ship 1 (18,295 × 360)	65,86,200
Ship 2 (12,002 × 200)	24,00,400
	89,86,600

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

As per section 115VF, the tonnage income computed under section 115VG would be deemed to be the profits chargeable under the head "Profits and gains of business or profession". This is, however, subject to fulfillment of the conditions mentioned below in the next paragraph. Then, the relevant shipping income referred to in section 115-VI(1), which includes the profit from core shipping activity (i.e. ₹ 90.50 Lacs) and the profit from incidental activity (₹ 15,000), shall not be chargeable to tax.

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

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

Question 39

A Ltd., engaged in the business of manufacturing, shows a net profit of ₹ 65.00 lacs for the financial year ended 31-3-2013. A scrutiny of the profit and loss account revealed the following:

- (i) Rent of ₹ 2.40 Lacs from a commercial property owned by the company and let to a bank was included in the profit.
- (ii) Loss of ₹ 5 Lacs due to non-realisation of advances given to a wholly owned subsidiary Company engaged in the business of hire-purchase financing charged to Profit & Loss Account.
- (iii) The Company used to include interest cost in valuation of its finished stock upto the financial year 2011-12. During the financial year 2012-13 the Company changed its accounting policy and excluded interest cost in valuation of finished stock. This has resulted in a decrease in the year's profit by ₹ 15.40 lacs.
- (iv) Municipal taxes on commercial property debited ₹ 0.22 lacs, which were ultimately paid on 1-12-2013.
- (v) The Company has received equity shares of AB Ltd. valued at ₹ 1.25 lacs in exchange of equity shares of CD Ltd. in a scheme of amalgamation during the year. The shares in CD Ltd. were acquired in 2007-08 at a cost of ₹ 0.40 lacs. The surplus has been credited to Profit & Loss account. Both AB Ltd. and CD Ltd. are Indian companies.
- (vi) An executive, while on business trip abroad, died and gratuity paid voluntarily amounted to ₹ 6.00 lacs.
- (vii) As restructuring of its debt, the company has converted arrears of interest of ₹ 5.00 Lacs on term loan into a new term loan with a revised repayment schedule. The company has paid ₹ 0.50 lac towards such funded interest during the year.
- (viii) Legal charges in connection with alteration of the Articles of Association ₹ 1.50 lacs and for issue of bonus shares ₹ 5.00 lacs.
- (ix) The company has purchased scrap materials amounting to ₹ 0.60 lacs, the payment for which was made in cash on 15th August, 2012.
- (x) The profit, as shown above, includes ₹ 5.00 lacs received from a Foreign Government for use of company's product. This was, however, not brought into India.

Compute the net income of the company for the assessment year 2013-14 (ignoring MAT) clearly indicating the basis of treatment of each item.

Answer

Computation of net income of A Ltd. for the A.Y. 2013-14

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

Working Note 1: Computation of income from house property

Particulars	₹(in lacs)
Gross annual value (See Note 2 below)	2.40
Less: Municipal taxes are not allowable as deduction since they were not paid in the previous year.	-
Net Annual Value (NAV)	2.40
Less: 30% of NAV	<u>0.72</u>
Income from house property	<u>1.68</u>

Working Note 2: Computation of income under the head "Profits and gains of business or profession"

Particulars	₹(in lacs)	₹(in lacs)
Net profit as per profit and loss account		65.00
Add: Inadmissible expenditure		
(i) Loss on non-realization of advance to wholly owned subsidiary company does not arise in the normal course of business, since the assessee is engaged in the business of manufacturing and not financing. Hence, loss is to be disallowed.	5.00	
(ii) Municipal tax on commercial property is not allowable as a deduction under this head of income.	0.22	
(iii) Arrears of interest converted into funded interest term loan not allowed. However, amount of funded interest term loan paid allowed as deduction. (Assuming whole ₹ 5 Lacs was debited in profit and loss account)	4.50	
(iv) Legal expenses of ₹ 1.50 lacs for amendment of Articles of Association is deductible. [Allahabad High Court in <i>CIT vs Modi Spinning & Weaving Mills Co Ltd. (1973) 89 ITR 304</i>].	--	
(v) Legal expenses in connection with the issue of bonus shares is a revenue expenditure and hence allowable. [Warner Hindustan Ltd v. CIT 171 ITR 224 (AP) and CIT v. General Insurance Corpn.(2006) 156 Taxman 96 (SC)]	--	9.72
		74.72
Less: Income not taxable/considered separately		
(i) Rent of commercial property let out on rent to a bank. This is taxable under the head "Income from House Property" and has been considered separately.	2.40	
(ii) Surplus on exchange of shares on amalgamation of companies – (See Note 1 below)	0.85	3.25
Income under the head "Profits and gains from business or profession"		71.47

Note:-

1. Under section 47(vii), any transfer by a shareholder, in a scheme of amalgamation, of a capital asset, being shares held by him in the amalgamating company does not attract capital gains tax, if the transfer is made in consideration of the allotment of any shares in the amalgamated company (except where the shareholder itself is the amalgamated company) and the amalgamated company is an Indian company. Since the surplus is credited to profit and loss account, it is excluded by way of deduction.
2. Rent of commercial property has been taken as its gross annual value in the absence of other information.
3. A company can change its method of valuation of stock provided the change is made for *bona fide* reason and is followed consistently in future. The assessee changed its method of valuation of stock in line with the Accounting Standard – 2, Valuation of inventories issued by ICAI, being a pronouncement of a professional body. Therefore, the genuineness of the change in method of valuation of stock cannot be questioned. Hence, even though the profit is lower by ₹ 15.40 lacs, it would not have any impact on the computation of income.
4. Payment of gratuity ₹ 6.00 lacs on account of death of an executive while on business trip is allowable as deduction. [*CIT vs. Laxmi Cement Distributors (P) Ltd. (1976) 104 ITR 711 (Gujarat)*]. Since it has already been debited to the profit and loss account, no further adjustment is required.
5. Payment for scrap materials was made on 15th August being the "Independence Day" on which banks are closed. Such payment is covered by Rule 6DD(j) of the Income-tax Rules, 1962. Therefore, the expenditure cannot be disallowed under section 40A(3).
6. ₹ 5 lacs received from a foreign Government for use of company's product though not brought into India, it is taxable as the assessee is assumed as domestic company and resident in India.

Question 40

A domestic company, ABC Ltd., furnishes the following particulars in respect of Assessment Year 2013-14 and seeks your opinion on the application of section 115JB. You are also required to compute the total income and tax payable.

(1) Net profits as per profit and loss account as per schedule VI	₹ 200 Lacs
(2) Profit and Loss A/c includes:	
(a) Credits: Dividend income	₹ 20 Lacs
Excess realized on sale of land held as investment	₹ 30 Lacs
(b) Debits: Depreciation on straight line method basis	₹ 100 Lacs
Provision for loss of subsidiary company	₹ 60 Lacs

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- (3) Depreciation allowable as per the Income-tax Rules, 1962 ₹ 150 Lacs
- (4) Capital gains on sale of land mentioned above as computed under Income-tax Act, 1961 ₹ 40 Lacs
- (5) Losses brought forward as per books of account and as per Income-tax Act, 1961:
- | | |
|-------------------------|-----------|
| Business loss | ₹ 50 Lacs |
| Unabsorbed depreciation | ₹ 60 Lacs |

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

Answer

In the case of a company, it has been provided that where tax on 18.50% of book profit exceeds tax on total income computed as per normal provisions, the book profit shall be deemed to be the total income for tax purposes.

It is therefore necessary to compute total income as per Income-tax Act, 1961 as well as book profits.

I. Computation of Total income as per the Income-tax Act, 1961

Particulars	₹ (in Lacs)	
Net profit as per profit and loss account		200
Add: Depreciation debited to profit and loss account	100	
Provision for losses of subsidiary company	<u>60</u>	<u>160</u>
		360
Less: Dividend income – exempt under section 10(34)	20	
Excess realized on sale of land (considered separately)	30	
Depreciation allowable as per Income-tax Rules, 1962	<u>150</u>	<u>200</u>
Business Income		160
Less: Set-off of brought forward business loss (See Note below)		<u>50</u>
		110
Capital gains		<u>40</u>
		150
Less: Set-off of unabsorbed depreciation (See Note below)		<u>60</u>
Total Income as per Income-tax Act, 1961		<u>90</u>

II. Computation of book profit under section 115JB

Particulars	(₹ in Lacs)	
Net profit as per profit and loss account		200
Add: Provision for loss of subsidiary		60

Depreciation		100
		360
Less: Dividend income exempt under section 10(34)	20	
Depreciation	100	
Business loss which is less than unabsorbed depreciation	50	170
" Book Profit"		190

- I. Total income as per the Income-tax Act, 1961 is ₹ 90 Lacs, the tax payable is ₹ 27 Lacs (₹ 90 Lacs x 30%).
- II. 18.50% of book profit of ₹ 190 Lacs is ₹ 35.15 Lacs.

Note : Since 18.50% of book profit exceeds the tax payable as per the Income-tax Act, 1961, the book profit of ₹ 190 Lacs shall be deemed to be the total income and the tax payable on such total income shall be 18.50% thereof i.e. ₹ 35,15,000 plus surcharge @ 5% of ₹ 1,75,750 plus education cess @ 3% [of tax and surcharge] being ₹ 1,10,723. Total tax liability would be ₹ 38,01,473.

With regard to the company's representation, in respect of long term capital gain whether liable for book profit tax under section 115JB, it may be noted that as per Schedule VI, profits or losses in respect of transactions of an exceptional or non-recurring nature, if material in amount, are to be disclosed. Since the excess realized on sale of land has been included in net profit computed under Schedule VI, it will form part of book profit [*Bombay High Court judgment in CIT v. Veekay Lal Investment Co. Pvt. Ltd. (2001) 249 ITR 597*].

Question 41

The accounts of a public company have been prepared in accordance with provisions of Part II of Schedule VI to the Companies Act, 1956 and its Profit and Loss Account laid before the Annual General Meeting for the previous year ending 31st March, 2013 shows a net profit of ₹ 15 Lacs. The following information relevant for the purpose of computing its assessable income has been extracted from a scrutiny of the profit and loss account:

Credits In Profit and Loss A/c		₹
(1)	Profit from a new industrial undertaking qualifying for deduction under section 80-IA (Net)	17,00,000
(2)	Long-term capital gains	3,00,000
Debits in Profit and Loss A/c		
(1)	Depreciation relating to 2009-10 brought forward	10,00,000
(2)	Business loss relating to 2009-10 brought forward	12,00,000
(3)	Current year depreciation	10,00,000
(4)	Penalty for infraction of law	1,00,000
(5)	Provision for sales-tax	3,00,000
(6)	Dividend proposed	2,00,000

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Depreciation admissible under the Income-tax Rules, 1962 for the previous year is ₹ 19,50,000. The capital gain has been invested in specified assets under section 54EC. Sales tax provided in the accounts has been remitted before the due date. There is no loss or unabsorbed depreciation to be carried forward and adjusted as per IT assessment.

You are required to compute the total tax liability of the company for the assessment year 2013-14.

Answer

The impact of the provisions of section 115JB has to be ascertained and for this purpose the income-tax on the total income as computed under the Income-tax Act, 1961 has to be compared with 18.50% of the book profits ascertained under section 115JB.

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

Particulars	₹	₹
Net Profit as per profit and loss account		15,00,000
Add : Expenses not allowable:		
Unabsorbed Depreciation	10,00,000	
Business Loss brought forward	12,00,000	
Depreciation as per the Companies Act, 1956	10,00,000	
Penalty – not an admissible deduction	1,00,000	
Proposed dividend	2,00,000	35,00,000
		50,00,000
Less : Expenses deductible :		
Depreciation as per Income-tax Rules, 1962		19,50,000
		30,50,000
Less : LTCG to be considered under the respective head		3,00,000
Profit and Gains from business		27,50,000
Capital Gains	3,00,000	
Less : Exemption under section 54EC (See Note 5)	3,00,000	Nil
		27,50,000
Less : Deduction under section 80-IA		17,00,000
Total Income		10,50,000
Tax payable @ 30.9% = ₹ 3,24,450		

Computation of Book Profit under section 115JB

Particulars	₹	₹
Net Profit (See Note 6)		37,00,000
Add: Proposed dividend		2,00,000
Depreciation		10,00,000
		49,00,000

Less: Unabsorbed depreciation, since, it is lower than brought forward business loss (See Note 4)	10,00,000	
Depreciation	10,00,000	20,00,000
Book profit under section 115JB		29,00,000
Tax at 18.50% of ₹ 29,00,000 = ₹ 5,36,500 plus education cess & SHEC @ 3%. The tax liability is ₹ 5,52,595.		

Since tax payable on income computed as per the provisions of the Income-tax Act, 1961 is less than 18.50% of the book profit, the book profit of ₹ 29 Lacs would be deemed to be the total income and tax is payable @18.50% thereon plus 2% education cess and 1% secondary and higher education. The total tax liability would be ₹ 5,52,595.

Notes:

- (1) Income from new industrial undertaking qualifying for deduction under section 80-IA will not be reduced in computing book profit under section 115JB.
- (2) Provision for sales-tax is an ascertained liability. Hence it is not to be added.
- (3) Book profit includes capital gains (*CIT v. Veekely Investment Co Ltd. (2001) 249 ITR 597*)
- (4) Brought forward depreciation or business loss, whichever is less is deductible while computing book profit under section 115JB.
- (5) Capital gains are not chargeable to tax as the assessee has invested the gain in specified assets mentioned in section 54EC.
- (6) Students may note that the debit entries pertaining to unabsorbed depreciation and brought forward business loss are not in consonance with Parts II of Schedule VI to the Companies Act, 1956. These items are part of the balance sheet under "Reserves and Surplus" on the liabilities side or "Profit & Loss Account" (as the case may be) on the assets side. In order to rectify the treatment in the books of account, the following adjustments should be made:

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

Question 42

Xtra Ltd. gives the following information for the year ended 31.3.2013:

- Net Profit as per Profit and Loss Account for the financial year 2011-12 ₹ 33,00,000 was included in General Reserve.

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- On 1.8.2012, the company redeemed its redeemable bonus shares for ₹ 9,09,000.
- A shareholder holding 10% equity shares of the company borrowed ₹ 3,00,000 from the company @ 18% per annum on 31.8.2012.
- The company declared dividend of ₹ 14,00,000 at its annual general meeting held on 30.9.2012. But the dividend remained unpaid up to 31.3.2013.

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

Also give reasons for treatment of each item.

Answer

Computation of tax liability of Xtra Ltd. under section 115-O for the A.Y. 2013-14

Particulars	₹
Redemption of Bonus Shares [See Note 1 below]	9,09,000
Dividend declared at AGM [See Note 3 below]	<u>14,00,000</u>
Taxable Dividend	<u>23,09,000</u>
Tax payable on distributed profits under section 115-O [₹ 23,09,000×16.2225%] [See Note 4 below]	3,74,578

Notes –

- (1) It is assumed that the bonus shares are in the form of redeemable preference shares, since only then such redemption is possible. If such bonus shares are issued to equity shareholders, it does not amount to distribution of dividend at the time of issue of bonus shares, as there is no release of assets. However, when bonus shares are redeemed, there will be release of assets and in that event it would constitute dividend under section 2(22)(a).
- (2) Borrowing by a shareholder holding 10% equity shares of the company is deemed dividend under section 2(22)(e), taxable in the hands of shareholder. Therefore, the company is not liable to pay any tax on it.
- (3) The tax on distributed profits shall be paid within 14 days from the date of declaration or distribution or payment of any dividend, whichever is earliest. Therefore, in this case, the dividend distribution tax is payable within 14 days of the declaration though dividend is not actually paid up to end of the previous year.
- (4) The rate of tax on distributed profits as per section 115-O is 15% plus surcharge 5% plus education cess 2% plus secondary and higher secondary education cess of 1% i.e. 16.2225%

Question 43

X Co Ltd., a domestic company, holds 50% of the share capital of Y Co Ltd. which is another domestic company. Y Co Ltd. paid total dividend for the year ended on 31-03-2012 of ₹ 50

Lacs in the F.Y. 2012-13. Out of the dividend received from Y Co Ltd., the X Co Ltd. distributed dividend of ₹ 15 Lacs in the year 2012-13. Explain with reasons the amount of dividend chargeable to tax and dividend distribution tax payable by X Co Ltd. Would your answer be different if X Co Ltd. had distributed dividend of ₹ 60 Lacs?

Answer

The dividend received by X Co Ltd. from Y Co Ltd. is exempt from tax under section 10(34) if such dividend is covered by section 115-O.

X Co Ltd., while paying dividend distribution tax under section 115-O, is eligible to reduce the dividend received from its subsidiary company from the dividend paid / declared by it in the same financial year. Since, the dividend paid by X Co Ltd. is less than the dividend received from its subsidiary, i.e. Y Co Ltd., the tax liability under section 115-O would be Nil.

In case X Co. Ltd. had distributed dividend of ₹ 60 Lacs, the dividend distribution tax of ₹ 5.68 Lacs @ 16.2225% of ₹ 35 Lacs only (i.e. dividend declared ₹ 60 Lacs less ₹ 25 Lacs being the dividend received from subsidiary domestic company which has paid dividend distribution tax on the dividend declared by it) is payable.

Question 44

Fun India Limited has a carried forward credit of ₹ 2 lacs under section 115JAA(3A) of the Income-tax Act, 1961 from assessment year 2012-13. In the A.Y. 2013-14, the company's total income and book profit under section 115JB are ₹ 5 lacs and ₹ 7 lacs, respectively. Compute the tax payable by the company for assessment year 2013-14 and the amount to be carried forward under section 115JAA.

Answer

According to section 115JAA, the tax credit to be allowed under the section is the difference between the minimum alternate tax paid under section 115JB and the tax payable by the assessee on his total income computed as per the other provisions of the Income-tax Act, 1961.

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

Computation of tax payable by Fun India Limited for A.Y. 2013-14 and MAT credit to be carried forward to A.Y.2014-15

	Particulars	₹
A.	Total income	5,00,000
B.	Book profit	7,00,000
C.	Tax on A (30.9% of ₹ 5,00,000)	1,54,500
D.	Tax on B (19.055% of ₹ 7,00,000)	1,33,385
E.	Difference between C and D	21,115

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F.	Tax credit brought forward from assessment year 2012-13	2,00,000
G.	MAT credit set-off (Being lower of E and F)	21,115
H.	Tax payable for A.Y.2013-14 (C - G)	1,33,385
I.	MAT credit to be carried forward to A.Y.2014-15 (F - G)	1,78,885

Question 45

Intelysis Limited charged depreciation on its fixed assets at the rates prescribed in the Income-tax Rules, 1962 in its accounts consistently. The Assessing Officer disallowed the same and considered depreciation computed at the rates prescribed in the Companies Act, 1956, for the purpose of computation of 'book profit' under section 115JB of the Income-tax Act, 1961 for the assessment year 2013-14. Examine the correctness of the action of the Assessing Officer.

Answer

This issue was settled by the Supreme Court in *Malayala Manorama Co. Ltd. v. CIT (2008) 300 ITR 251*. The Apex Court observed that for the purpose of computation of book profit under section 115JB, the Assessing Officer's power is restricted to examining whether the books of account are certified by the authorities under the Companies Act, 1956 as having been properly maintained in accordance with the Companies Act, 1956. Thereafter, he only has the limited power of making additions and deductions as provided for in *Explanation 1* below section 115JB. The Assessing Officer does not have the jurisdiction to go behind the net profit shown in the profit and loss account except to the extent provided in *Explanation 1* below section 115JB.

Where an assessee is consistently charging depreciation in its books of account at the rates prescribed in Income-tax Rules, 1962 and the accounts of the assessee have been prepared and certified as per the provisions of the Companies Act, 1956, the Assessing Officer does not have any jurisdiction under section 115JB to rework the net profit of the assessee by substituting the rates of depreciation prescribed under the Companies Act, 1956.

Applying the ratio of the Supreme Court decision to this case, it may be concluded that the action of the Assessing Officer is not correct.

Note - The rates of depreciation prescribed in Schedule XIV to the Companies Act, 1956 are the minimum rates at which depreciation is to be charged in the profit & loss account. The rates prescribed in the Income-tax Rules, 1962 are higher than those prescribed in the Companies Act, 1956. A company is, therefore, not precluded from adopting higher rates of depreciation, if the circumstances justify. Thus, even if a company adopts the higher rates of depreciation prescribed in the Income-tax Rules, 1962, it can be said that the company has prepared the accounts in the manner provided under the Companies Act, 1956.

Assessment of AOPs & BOIs**Question 46**

JK Associates is an Association of Persons (AOP) consisting of two members, J and K. Shares of the members are: 60%(J) and 40%(K). Income of the AOP for the previous year 2012-13 is ₹ 2 lacs.

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

- (i) *J and K have their income, other than income from AOP, amounting to ₹ 1 lac and ₹ 2.2 lacs, respectively.*
- (ii) *J and K's income, other than income from AOP, amount to ₹ 1 lac and ₹ 1.20 lacs, respectively.*

Answer

Computation of tax of AOP is governed by section 167B of the Income-tax Act, 1961. Tax on total income of AOP is computed as follows:

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

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

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

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

Tax Liability of J K Associates, AOP

- (i) As K's income, other than that from the AOP, exceeds the basic exemption limit, the AOP shall pay tax at maximum marginal rate of 30.90% (i.e. 30% plus education cess@2% plus secondary and higher education cess@1%). Thus the tax payable by AOP = ₹ 6,00,000 x 30.90% = ₹ 1,85,400.
- (ii) Since none of the members have income, other than income from the AOP, exceeding the basic exemption limit, the AOP would be taxed at the rates applicable to an individual. Therefore, the AOP's tax liability = ₹ 50,000 + ₹ 1,500 = ₹ 51,500.

Tax Liability of J and K

	Particulars	J ₹	K ₹
(i)	Share of profit from AOP	Exempt	Exempt
	Income from other sources	<u>1,00,000</u>	<u>2,20,000</u>
	Total Income	<u>1,00,000</u>	<u>2,20,000</u>
	Tax liability	NIL	2,000
	Education cess@2% + SHEC@1%	—	<u>60</u>
	Total tax payable	<u>NIL</u>	<u>2,060</u>
(ii)	Share of profit from AOP	3,60,000	2,40,000
	Income from other sources	<u>1,00,000</u>	<u>1,20,000</u>
	(A)	<u>4,60,000</u>	<u>3,60,000</u>
	Tax liability	26,000	16,000
	Education cess@2% + SHEC@1%	<u>780</u>	<u>480</u>
	Total tax payable (B)	<u>26,780</u>	<u>16,480</u>
	Average rate of tax [B/A x 100]	5.82%	4.58%
	Total tax liability	26,780	16,480
	Less: Rebate under section 86 in respect of share of profit from AOP (share in AOP x Average rate of tax)	<u>20,958</u>	<u>10,987</u>
	Tax liability of members	<u>5,822</u>	<u>5,493</u>

Question 47

Prakash, a member in two AOPs, namely, "AOP & Co." and "Prakash & Akash", provides the following details of his income for the year ended on 31.3.2013:

- (a) "AOP & Co.", assessed at normal rates of tax, had credited in his account, amount of ₹ 96,000 as interest on capital, ₹ 96,000 as salary and ₹ 20,000 as share of profit.
- (b) A house property located at Jaipur was purchased on 1.7.2006 with the borrowed capital in "Prakash & Akash" jointly shared equally and occupied by both of them for self residential purposes. Total interest paid for the year 2012-13 on the borrowed capital was ₹ 1,60,000.

Compute the income and the tax liability thereon for the A.Y. 2013-14 and support your answer with brief reasons and the provisions of the Act.

Answer

Mr. Prakash is a member in two AOPs, namely, AOP & Co. and Prakash & Akash. Though Prakash & Akash is an AOP, the income from the house property will not be assessed as

income of the AOP, but will be included in the hands of the individual members as per section 26, since the share of each member is definite and ascertainable. Hence, Prakash's share of income from house property would be assessed in his individual hands.

Since AOP & Co., has been taxed at normal rates of tax, Mr. Prakash's share income from the AOP (i.e. salary, interest on capital and his share of profit) would be included in his total income. Mr. Prakash, however, would be entitled to a relief under section 86 in respect of this income which has been included in his total income but on which tax has already been paid by the AOP. As per section 110, the relief shall be allowed at the average rate of tax calculated on the total income inclusive of such income.

Hence, the tax liability in the hands of Mr. Prakash would be as under:-

Particulars	₹	₹
Annual Value ($\frac{1}{2}$ share in house property used for own residence)	Nil	
Less: Interest on loan [$\frac{1}{2}$ share in ₹ 1,60,000] – Since the loan is borrowed on or after 1.4.1999 and is used for acquiring property within 3 years, deduction would be available upto a maximum of ₹ 1,50,000. This limit of ₹ 1,50,000 applies for each member separately.	80,000	
Loss from house property		(-) 80,000
Share income from AOP & Co.		
- Interest on capital	96,000	
- Salary	96,000	
- Share of profit	20,000	2,12,000
Total Income		1,32,000
Tax on total income		NIL

Question 48

T and Q are individuals, who constitute an Association of Persons, sharing profit and losses in the ratio of 2:1. For the accounting year ended 31st March, 2013, the Profit and Loss account of the business was as under:

		Figures are in ₹ '000s	
Cost of goods sold	4,250	Sales	4,900
Remuneration to:		Dividend from Indian companies	25
T	130	Capital gains-Long term (computed)	640
Q	170		
Employees	256		

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Interest to:		
T	48.3	
Q	35.7	
Other expenses	111.7	
Sales-tax penalty due	39	
Net profit	524.3	
	5,565	5,565

Additional information furnished:

- (i) Other expenses included:
- wristwatches costing ₹ 2,500 each were given to 12 dealers, who had exceeded the sales quota prescribed under a sales promotion scheme;
 - employer's contribution of ₹ 6,000 to the Provident Fund was paid on 14th January, 2013.
 - ₹ 30,000 was paid in cash to an advertising agency for publicity.
- (ii) Outstanding sales tax penalty was paid on 15th October, 2013. The penalty was imposed by the Sales-tax Officer for non-filing of returns and statements by the due dates.

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

Required to :

- Compute the total income of the AOP for the assessment year 2013-14;
- Ascertain the tax liability of the association for that year; and
- Discuss the tax implication for that year in the hands of the individual members.

Answer

- (i) **Computation of total income of the AOP for A.Y.2013-14**

Particulars	₹
Profit & gains of business (See Working Note below)	3,12,300
Long term capital gain	6,40,000
Income from other sources [Dividend is exempt under section 10(34)]	-
Total income	9,52,300

Working Note - Computation of profits and gains of business

Particulars	₹	₹
Net profit as per profit & loss account		5,24,300

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

(ii) **Computation of tax liability of the AOP for A.Y.2013-14**

Particulars	₹	₹
Long-term capital gain (₹ 6,40,000 @ 20%)		1,28,000
Other income (₹ 3,12,300 @ 30%)		93,690
Tax on total income		2,21,690
Add: Education cess @3%		6,651
Total tax due		2,28,341

Notes –

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

(iii) **Tax implication in the hands of members T & Q for the A.Y.2013-14**

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

Assessment of Other Entities

Question 49

The assessee, Pandey Co-operative Housing Society, is a registered co-operative housing society, formed with the objective of maintaining the property owned by it, to effect repairs and maintenance of the common property of the members, and to confer to the members, the usual rights and privileges. For the assessment year 2013-14, the assessee has received ₹ 3 lacs as transfer fees from the transferor members and like amount from the transferees, who at the time of transfer, were not members of the society. Discuss the exigibility to tax the aforesaid receipts in the hands of the assessee.

Answer

Transfer fees received by a co-operative housing society, whether from outgoing or from incoming members, is not liable to tax on the ground of principle of mutuality where the predominant activity of such co-operative society is maintenance of property of the society. It was so held by the Bombay High Court in *Sind Co-op Housing Society v. ITO (2009) 317 ITR 47*.

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.

Therefore, ₹ 3 lacs received as transfer fees by Pandey Co-operative Housing Society from its transferor members and its transferees, is not chargeable to tax.

Question 50

Explain the incidence of taxation on mutual concerns.

Answer

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

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

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

- (i) Where a mutual concern carries on the business of insurance, the profits therefrom are chargeable to tax. Section 44 provides that the profits for this purpose have to be computed in accordance with the method prescribed in the Rules contained in the First Schedule.
- (ii) In the case of trade, professional or similar associations, the income derived from specific services performed for its members is chargeable to tax u/s 28(iii). However, if there is a loss on account of expenditure exceeding the subscription etc. from members, such shortfall shall be absorbed by the income chargeable to tax u/s 28(iii). This set off as per section 44A cannot exceed 50% of the total income of such associations as computed before allowing the set off.
- (iii) In the case of a mutual concern, if income is derived both from mutual activity as well as from non-mutual activity, the exemption applies only to the income from the mutual activity. The income attributable to the non-mutual activity will be liable to tax as was held by the Gujarat High Court in *Sports Club of Gujarat Ltd. vs CIT* (1988) 171 ITR 504.

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

Self-examination Questions

1. Discuss briefly the concept of HUF.
2. What are the schools of Hindu Law? Discuss.
3. What are the two types of partition of HUF? What is the effect of such partitions?
4. What are the circumstances under which the income of public charitable and religious trust will be subjected to income-tax at maximum marginal rate?
5. What is meant by an oral trust under the Income-tax Act? Is the income of such a trust chargeable to tax?
6. Chapter XII-G of the Income-tax Act, 1961 contains a special scheme for taxation of the income of shipping companies. With reference to this scheme, explain the meaning of the following terms -
 - (a) Operating ship;
 - (b) Qualifying company;
 - (c) Relevant shipping income.

7. Chapter XII-G of the Income-tax Act, 1961 contains special provisions relating to taxation of the income of shipping companies. What are the provisions contained therein relating to amalgamation and demerger of shipping companies?
8. Kanpur club was a private club which provided entertainment to its members by offering accommodation, library, reading room etc. The club also earned income by letting out its marriage hall to non-members by making them as temporary members. It contended that the “doctrine of mutuality” would apply in such a case and hence, its income would not be taxable. Discuss the correctness or otherwise of the contention of the assessee-club.

Answer

8. The concept of mutuality means that the contributors and the beneficiaries are identical. Since one cannot make a profit by dealing with oneself, there is no taxable profit involved wherever such concept applies. In this case, however, the principle of mutuality does not apply since non-members are made temporary members only for the purpose of letting out the marriage hall. This issue came up before the Kerala High Court, in *CIT v. Trivandrum Club* (2006) 153 Taxman 481. The High Court observed that the marriage hall was being rented out to non-members by making them temporary members only for the purpose of letting out the marriage hall and the amounts received from the non-members formed part of the income of the assessee-club. The principle of mutuality, therefore, would not apply in such a case. Thus, the contention of the assessee-club is incorrect.