

PAPER – 7: DIRECT TAX LAWS

MOCK TEST PAPER – 1

Question No. 1 is compulsory. Attempt any **five** questions from the remaining **six** questions.

Question 1

- (a) Instyle Exports Ltd., a resident company, engaged in the business of manufacturing, shows a net profit of ₹ 350 lakhs for the year ended 31.3.2012 arrived at after making the following adjustments:

(i)	Depreciation	₹ 170 lakhs
(ii)	Reserve for currency exchange fluctuation	₹ 90 lakhs
(iii)	Provision for tax	₹ 30 lakhs
(iv)	Proposed dividend	₹ 80 lakhs

Following further information are also provided by company:

- (a) Provision for tax includes ₹ 13 lakhs of tax payable on distribution of profit and of ₹ 5 lakhs of interest payable on income-tax.
- (b) Depreciation debited in profit and loss account includes ₹ 60 lakhs towards revaluation of assets.
- (c) Amount of ₹ 80 lakhs credited to profit and loss account was drawn from revaluation reserve.
- (d) Balance of profit and loss account shown in balance sheet at the asset side as at 31.3.2011 was ₹ 25 lakhs representing unabsorbed depreciation.

Compute book profit of the company under section 115JB for the Assessment Year 2012-13.

(10 Marks)

- (b) Dhan Laxmi Limited furnishes the following particulars of its wealth as on 31.03.2012:

	Particulars	₹
(i)	Land in urban area on which construction is not permitted as per Municipal Laws in force	25,00,000
(ii)	Motor-cars used in running them on hire	12,00,000
(iii)	Jewellery held as investment	24,00,000
(iv)	Cash in hand as per cash book	2,50,000
(v)	Bank Balances	11,00,000
(vi)	Guest House (situated in a place which is 30 kms away from the local limits of the municipality)	10,00,000
(vii)	Residential flat occupied by the Managing Director who is on whole	16,00,000.

	time appointment and is drawing remuneration of ₹ 5,00,000.	
(viii)	Residential house let out on hire for 260 days	18,00,000
	Liabilities	
(i)	Loan for purchase of jewellery	13,00,000
(ii)	Loan for purchase of Motor-cars	6,00,000

Compute the net wealth of Dhan Laxmi Limited as on valuation date 31.03.2012 and also support your computation with proper reasoning for inclusion or exclusion. (10 Marks)

Question 2

- (a) Following profit and loss account has been furnished by M/s. XYZ (a partnership firm) for the year ended 31.03.2012:

Expenses	₹	Income	₹
To Salaries	3,68,000	By Gross profit	6,47,000
“ Rent	46,000	Dividend from Indian company	8,000
“ Interest	80,000		
“ Depreciation	32,000		
“ Other Administrative expenses	60,000		
“ Contribution to provident fund	24,000		
“ Net profit	<u>45,000</u>		
Total	<u>6,55,000</u>	Total	<u>6,55,000</u>

Additional information:

- Salaries include ₹ 1,00,000 paid to working partner X and ₹ 1,50,000 to working partner Y. It also includes ₹ 50,000 paid to sleeping partner Z.
- Interest paid includes ₹ 45,000, being interest paid to partner Z on loan provided by him at 20% simple interest.
- Depreciation includes depreciation on motor car of ₹ 6,000 bought and used exclusively for business purposes, but not registered in the name of the firm. The depreciation calculation is as per the Income-tax Rules, 1962.
- Out of provident fund contribution debited to profit and loss account, ₹ 4,000 is outstanding till the date of filing of return of income.
- The firm purchased goods by issuing account payee drafts except in the case of one bill for ₹ 86,000 for which payment has been made by cash. This has been debited to trading account as part of purchases.

The salary and interest payments to partners are authorized by the partnership deed. You are required to compute the business income of M/s. XYZ for the assessment year 2012-13. (10 Marks)

- (b) An institution whose main object is “advancement of general public utility” received ₹ 30 lakhs in aggregate during the P.Y.2011-12 from an activity in the nature of trade. It applied its entire receipt from such activity during the same year for its main object i.e. advancement of general public utility.
- (i) What would be the tax consequence of such receipt and application thereof by the institution?
- (ii) Would your answer be different if the institution had received ₹ 25 lakhs (instead of ₹ 30 lakhs) in aggregate during the P.Y.2011-12 from an activity in the nature of trade?
- (iii) What would be your answer if the main object of the institution is “preservation of environment” and the institution receives ₹ 30 lakhs from a trading activity and applies 85% of the said receipts for its main object? (6 Marks)

Question 3

Discuss the following with the aid of recent case laws -

- (a) Can an assessee, who has not claimed deduction under section 80-IB in the initial years, claim deduction under the said section for the remaining years during the period of eligibility, if the conditions mentioned under section 80-IB are fulfilled? (4 Marks)
- (b) Under section 2(22), dividend does not include, *inter alia*, any advance or loan made to a shareholder by a company in the ordinary course of its business, where the lending of money is a “substantial part of the business” of the company. What can be the tests to determine “substantial part of the business” of lending company for the purpose of application of exclusion provision under section 2(22)? (4 Marks)
- (c) J.K. Cement Ltd., a cement manufacturing company, entered into an agreement with a supplier for purchase of additional cement plant. One of the conditions in the agreement was that if the supplier failed to supply the machinery within the stipulated time, the company would be compensated at 2% of the price of the respective portion of the machinery without proof of actual loss. The company received ₹ 5 lakhs from the supplier by way of liquidated damages on account of his failure to supply the machinery within the stipulated time. What is the nature of liquidated damages received by Bricks Ltd from the supplier of plant for failure to supply machinery to the company within the stipulated time – a capital receipt or a revenue receipt? (4 Marks)
- (d) An airline company pays landing and parking charges to the Airports Authority of India. Discuss whether the company is required to deduct tax at source on such payment. (4 Marks)

Question 4

Discuss the correctness or otherwise of the following statements:

- (a) "The Finance Act, 2011 has inserted clause (45) in section 10 to exempt all allowances and perquisites paid to Chairman or a retired Chairman or any member or retired member of the Union Public Service Commission". (6 Marks)
- (b) "Dividend received by Indian companies from specified foreign companies would be subject to a concessional tax treatment". (6 Marks)
- (c) "The Finance Act, 2011 has expanded the scope of powers of the Transfer Pricing Officer". (4 Marks)

Question 5

- (a) Neelima, an individual resident in India, bought 1,000 equity shares of ₹ 100 each of ABC Ltd. at ₹ 200 per share on 8.7.2011. She sold 750 equity shares at ₹ 150 per share on 22.9.2011 and the remaining 250 shares at ₹ 180 per share on 22.1.2012. ABC Ltd. declared a dividend of 8%, the record date being 8.8.2011. Neelima sold on 29.2.2012, a house from which she derived a long-term capital gain of ₹ 1,15,000.

Compute the amount of capital gain arising to Neelima for the assessment year 2012-13. (8 Marks)

- (b) An Income-tax authority did not file an appeal to the Income-tax Appellate Tribunal against an order of the Commissioner (Appeals) decided against the Income tax department on a particular issue in case of one assessee, Mr. Atharv for assessment year 2010-11 on the ground that the tax effect of such dispute was less than the monetary limit prescribed by CBDT. In assessment year 2011-12, similar issue arose in the assessments of Mr. Atharv and his brother Mr. Vikalp, which was decided by the Commissioner (Appeals) against the Department. Can the Income-tax department move an appeal to the Tribunal against the orders of the Commissioner (Appeals) for A.Y.2011-12 in respect of Mr. Atharv and his brother Mr. Vikalp? (4 Marks)
- (c) Can the Assessing Officer issue notice under section 148 to reopen the same assessment order on the same grounds for which the Commissioner had issued notice under section 263? Examine critically in the context of provisions of the Income-tax Act, 1961. (4 Marks)

Question 6

- (a) Soumya, a resident Indian and aged 60 years, is a well-known dramatist deriving income of ₹ 1,10,000 from theatrical works played abroad. Tax of ₹ 11,000 was deducted in the country where the plays were performed. India does not have any Double Tax Avoidance Agreement under section 90 of the Income-tax Act, 1961, with that country. Her income in India amounted to ₹ 5,10,000.

She has made the following investments / payments during the year ended 31.03.2012:

1. deposited ₹ 65,000 in Public Provident Fund.
2. paid contribution to approved Pension Fund of LIC ₹ 37,000.
3. subscription to notified long-term infrastructure bonds ₹ 30,000.
4. Contribution of ₹ 20,000 to Central Government Health Scheme.
5. payment of medical insurance premium of ₹ 25,000 to insure the health of her father, a non-resident aged 82 years, who is not dependent on her.

Compute the tax liability of Soumya for the Assessment year 2012-13. (8 Marks)

- (b) SSI Pvt. Ltd. has converted into an LLP on 1.4.2011 and at the time of conversion, all the conditions specified in section 47(xiii b) have been fulfilled. The unabsorbed business loss and depreciation of the company as on the date of conversion, were ₹ 30 lakhs and ₹ 27 lakhs, respectively. The business profits of the LLP for the previous year 2011-12 were ₹ 75 lakhs.

However, on 5.9.2012, two partners (who were erstwhile shareholders in SSI Pvt. Ltd.), holding in aggregate 51% of the profit-sharing in the LLP, resigned. Discuss the tax consequences of the conversion of company into LLP and subsequent resignation of partners. (5 Marks)

- (c) Mr. Albert, a non-resident, made an application to the Authority for Advance Rulings on 17.8.2011 in relation to a transaction proposed to be undertaken by him. On 15.10.2011, he decides to withdraw the said application. Can he do so? (3 Marks)

Question 7

- (a) Examine the correctness or otherwise of the following statements:
- (i) "The Appellate Tribunal can grant indefinite stay in any proceeding relating to an appeal".
 - (ii) "The order of the Settlement Commission is final and conclusive and hence, the same cannot be rectified". (5 x 2 = 10 Marks)
- (b) Sea Star Ltd. made a cash payment of ₹ 25,000 on 22.06.2011 to local fishermen, who regularly supply to them lobsters and crabs. Would the provisions of section 40A(3) be attracted in respect of such payment? What would be your answer if such cash payments are made to a trader who supplies lobsters and crabs? (6 Marks)