

MOCK TEST PAPER – 2
FINAL COURSE: GROUP – II
PAPER – 7: DIRECT TAX LAWS
SUGGESTED ANSWERS / HINTS

1. (a) Computation of taxable income of the trust for the A.Y. 2012-13

Particulars	₹	₹
Income from properties held by trust	15,00,000	
Income from business incidental to the main objects of the trust	14,00,000	
Voluntary Contribution other than corpus donation (Note 1)	<u>11,00,000</u>	40,00,000
Less: 15% of income accumulated or set apart under section 11(1)(a)		<u>6,00,000</u>
		34,00,000
Less: Amount applied for charitable purposes		
Activities and programmes for the benefit of physically challenged persons	18,00,000	
Repayment of loan taken for construction of training centre (Note 2)	<u>8,00,000</u>	<u>26,00,000</u>
Taxable Income		<u>8,00,000</u>
Tax Payable:		
Upto ₹ 1,80,000	Nil	
₹ 1,80,000 - ₹ 5,00,000	32,000	
₹ 5,00,000 – ₹ 8,00,000	<u>60,000</u>	
		92,000
Add: Education cess @ 2%		1,840
Add: Secondary and higher education cess @ 1%		<u>920</u>
Total tax liability		<u>94,760</u>

Notes:

- (1) Section 11(1)(d) excludes from the total income of the person, any income in the form of voluntary contributions made with a specific direction that they shall form part of the corpus of the trust or institution.

- (2) In *CIT vs. Janmabhumi Press Trust (2000) 242 ITR 457*, the Karnataka High Court held that where a debt is incurred for the purpose of the trust, the repayment of the debt would amount to an application of the income for the purpose of the trust. Therefore, repayment of loan taken for construction of training centre for physically challenged persons can also be considered as application for charitable purpose.

(b) **Computation of wealth-tax payable by Mrs. Vijaya for A.Y.2012-13**

Asset	₹	Reason
House Property 1	Nil	A house used exclusively for residential purpose is treated as an asset under section 2(ea), but the same is exempt under section 5(vi).
House Property 2	Nil	Building owned by a partner but used in firm's business is deemed to be used by the partner for his business purposes and is, hence, not an asset chargeable to tax under section 2(ea).
Value of interest in assets of the firm	14,25,000	Included in the net wealth of Mrs. Vijaya by virtue of section 4(1)(b). It has been assumed that the assets are those covered under section 2(ea).
Motor Cars	11,00,500	Motor cars, whether indigenous or imported, are assets chargeable to wealth-tax under section 2(ea).
Bank Deposit	Nil	Not an asset under section 2(ea) and hence, not chargeable to tax under the Wealth-tax Act.
House Property 3	20,50,000	Since the possession of the house property is taken, it is deemed as an asset and is chargeable to wealth-tax. It may be noted that only one house property is exempt under section 5(vi) and this exemption has already been availed in respect of House Property 1.
Cash balance	<u>75,000</u>	For an individual, cash in hand in excess of ₹ 50,000 shall be chargeable to wealth tax (₹ 1,25,000 – ₹ 50,000)
Gross Wealth	46,50,500	
Less: Loan borrowed from Bank	<u>16,00,000</u>	Money borrowed by the assessee for purchase of House Property 3 is deductible under section 2(m), since the value of House Property 3 is included in gross wealth.
Net Wealth	<u>30,50,500</u>	

Wealth-tax payable by Mrs. Vijaya will be ₹ 505 i.e. 1% of ₹ 50,500 (i.e., ₹ 30,50,500 – ₹ 30,00,000).

2. **Computation of taxable income of M/s. LMN for the A.Y.2012-13**

Particulars	Amount in ₹	
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 ₹ 450 lacs	22,50,000	
Expenses on promoting family planning amongst the employees	1,50,000	
Advertisement in souvenir of a political party	2,50,000	
Compensation to a supplier of kitchen appliances	<u>50,000</u>	27,00,000
Add : Recovery of bad debts credited in reserve but chargeable under section 41(4)		<u>3,00,000</u>
Gross Total Income		<u>2,30,00,000</u>

Reasons for treatment given to each of the items specified:-

- (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 0547* observed that loss of stock-in-trade has to be considered as a trading loss. Explanation to

section 37(1) is not relevant in case of confiscation of stock in trade by the Government, 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 ₹ 1,50,000 on the day when bank employees were on strike is an exception as per Rule 6DD 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.

3. (a) Deduction allowable under section 80D for the A.Y.2012-13

	Particulars	₹
(i)	Medical insurance premium paid for self, spouse and dependent children	14,000
(ii)	Contribution to CGHS	2,400
		16,400
	Deduction under (i) and (ii) above restricted to ₹ 15,000	15,000
(iii)	Mediclaime premium paid for mother, who is 65 years of age (₹ 30,000 but restricted to ₹ 20,000, being the maximum allowable in case of a senior citizen)	20,000
		35,000

Note – The total deduction under (i) and (ii) above should not exceed ₹ 15,000. The medical insurance premium paid for self, spouse and children (i.e., ₹ 14,000) and contribution to CGHS (i.e., ₹ 2,400) totaling to ₹ 16,400 (i.e., ₹ 14,000 + ₹ 2,400) under (i) and (ii) above has to be restricted to ₹ 15,000. Further, the maximum deduction allowable in respect of medical insurance premium paid in respect of a parent who is a senior citizen is ₹ 20,000. The deduction is allowable

even if the parent is not dependent on Mr. Suraj. Therefore, the total deduction allowable under section 80D would be ₹ 35,000 [i.e., ₹ 15,000 [(i) & (ii)] + ₹ 20,000 (iii)].

- (b) Sub-section (2A) has been inserted in section 260A with retrospective effect from 1.10.1998 to specifically provide that the High Court has and always had the power to condone the delay and admit an appeal after the expiry of the period of 120 days, if it is satisfied that there was sufficient cause for not filing the appeal within that period.

- (c) (i) The statement is correct.

Section 245A(b) defines the term “case” as any proceeding for assessment, of any person in respect of any assessment year or assessment years which may be pending before an Assessing Officer on the date on which an application is made to the Settlement Commission. However, proceedings for assessment or reassessment resulting from a search or as a result of requisition of books of account or other documents or any assets were specifically excluded from the definition of case.

This section has been amended by the Finance Act, 2010 to provide that the proceedings for assessment or reassessment resulting from search/requisition will now fall within the definition of a “case” which can be admitted by the Settlement Commission.

In the case of a person whose income is being assessed or reassessed as a result of search or as a result of requisition of books of account or other documents or any assets, the proceedings for assessment or reassessment shall be deemed to have commenced on the date of issue of notice initiating such proceedings and concluded on the date on which the assessment is made.

- (ii) As per section 245S(1), the advance ruling pronounced under section 245R by the Authority for Advance Ruling shall be binding only on the applicant who had sought it and in respect of the specific transaction in relation to which advance ruling was sought. It shall also be binding on the Commissioner and the income-tax authorities subordinate to him, in respect of the concerned applicant and the specific transaction.

In view of the above provision, Mr. Vivek cannot use the advance ruling, obtained on an identical issue by his brother, for his assessment pertaining to the assessment year 2012-13.

4. (a) (i) The issue under consideration is whether such freight subsidy arising out of the scheme of Central Government can be treated as a “profit derived from the business” for the purposes of section 80-IA. This issue was dealt with in *CIT v. Kiran Enterprises (2010) 327 ITR 520 (HP)*. The High Court held that the

transport subsidy received by the assessee was not a profit derived from business since it was not an operational profit. The source was not the business of the assessee but the scheme of Central Government. The words "derived from" are narrower in connotation as compared to the words "attributable to". Therefore, the freight subsidy cannot be treated as profits derived from the business for the purposes of section 80-IA.

- (ii) This issue was decided by the Supreme Court in *Liberty India v. CIT* (2009) 317 ITR 218. On this issue, the Supreme Court observed that DEPB / Duty drawback are incentives which flow from the schemes framed by the Central Government or from section 75 of the Customs Act, 1962. Section 80-IB provides for the allowing of deduction in respect of profits and gains derived from eligible business. However, incentive profits are not profits derived from eligible business under section 80-IB. They belong to the category of ancillary profits of such undertaking. Profits derived by way of incentives such as DEPB/Duty drawback cannot be credited against the cost of manufacture of goods debited in the profit and loss account and they do not fall within the expression "profits derived from industrial undertaking" under section 80-IB . Hence, duty drawback receipts and DEPB benefits do not form part of the profits derived from the eligible business for the purpose of the deduction under section 80-IB.

- (b) The issue under consideration is whether the time limit of 4 years as per section 154(7) would apply from the date of original assessment order or the order of the Appellate Authority.

On this issue, the Delhi High Court, in *CIT v. Tony Electronics Ltd.* (2010) 320 ITR 378, held that once an appeal against the order passed by an authority is preferred and is decided by the appellate authority, the order of the Assessing Officer merges with the order of the appellate authority. After merger, the order of the original authority ceases to exist and the order of the appellate authority prevails. Thus, the period of limitation of 4 years for the purpose of section 154(7) has to be counted from the date of the order of the Appellate Authority.

The Delhi High Court had followed the decision of the Supreme Court in the case of *Hind Wire Industries v. CIT* (1995) 212 ITR 639.

The contention of A Ltd. in this case is, therefore, not correct, since the four year period expires only on 31.3.2013.

- (c) The statement is not correct.

The Apex Court, in *GE India Technology Centre P. Ltd. v. CIT* (2010) 327 ITR 456, observed that the expression "chargeable under the provisions of the Act" in section 195(1) shows that the remittance has got to be a trading receipt, the whole or a part of which is liable to tax in India. If the tax is not so assessable, there is no question

of tax at source being deducted. A person paying interest or any other sum to a non-resident is not liable to deduct tax if such sum is not chargeable to tax under the Income-tax Act, 1961.

5. (a) An assessee shall be allowed deduction under section 91 provided all the following conditions are fulfilled :-

- (1) The assessee is a resident in India during the relevant previous year.
- (2) The income accrues or arises to him outside India during that previous year.
- (3) Such income is not deemed to accrue or arise in India during the previous year.
- (4) The income in question has been subjected to income-tax in the foreign country in the hands of the assessee and the assessee has paid tax on such income in the foreign country.
- (5) There is no agreement under section 90 for the relief or avoidance of double taxation between India and the other country where the income has accrued or arisen.

In view of the aforesaid provisions, deduction under section 91 will be calculated as follows:

Particulars	₹	₹
Indian Income		3,25,000
Foreign Income		<u>1,75,000</u>
Gross Total Income		5,00,000
Less: <u>Deduction under section 80C</u>		
PPF Contribution	50,000	
<u>Deduction under section 80D</u>		
Medical insurance premium of father (See Note 2 below)	<u>20,000</u>	<u>70,000</u>
Total Income		<u>4,30,000</u>
Tax on total income		25,000
Add: Surcharge		Nil
Add: Education cess @ 2%		500
Secondary and higher education cess @ 1%		<u>250</u>
		<u>25,750</u>
Average rate of tax in India [i.e. ₹ 25,750/4,30,000 x 100]		5.988%

Average rate of tax in foreign country [i.e. ₹ 35,000/ ₹ 1,75,000 x 100]		20%
Doubly taxed income		1,75,000
Rebate under section 91 on ₹ 1,75,000 @ 5.988% (lower of average Indian tax rate and foreign tax rate]		10,480
Tax payable in India [₹ 25,750 – ₹ 10,480]		15,270

Notes:

- (1) It has been assumed that Mr. Mano Vaidhya is a resident.
 - (2) In respect of medical insurance premium paid for father, ₹ 20,000 is allowed in full under section 80D, since his father is a senior citizen.
- (b) One of the methods for determination of arm's length price in an international transaction is Comparable Uncontrolled Price method (CUP). Under the CUP method, the price charged or paid for property transferred or services rendered in a comparable uncontrolled transaction, or a number of such transactions, is identified. Such price is adjusted to account for differences, if any, between the international transaction and the comparable uncontrolled transaction or between the enterprises entering into such transactions, which could materially affect the price in the open market. The adjusted price so arrived at is taken to be an arm's length price in respect of the property transferred or services provided in the international transaction.

Hel Inc., USA and Helsinki Limited, the Indian company shall be deemed to be associated enterprises since the former holds more than 26% voting power in the latter.

The arm's length rate of interest can be determined by using CUP method having regard to the rate of interest on external commercial borrowing permissible as per guidelines issued under Foreign Exchange Management Act. The interest rate permissible is LIBOR plus 250 basis points i.e., 5% + 2.5% = 7.5%, which can be taken as the arm's length rate. The interest rate applicable on the borrowing by Helsinki Limited, India from Hel Inc., USA, is LIBOR plus 200 basis points i.e., 5% + 2% = 7%. Since the rate of interest, i.e. 7% is less than the arm's length rate of 7.5%, the borrowing made by the Helsinki Ltd. is not at arm's length. However, in this case, the taxable income of Helsinki Ltd., India, would be lower if the arm's length rate is applied. Hence, no adjustment is required since the law of transfer pricing will not apply if there is a negative impact on the existing profits.

6. (a) The Supreme Court has, in *Goetze (India) Ltd. v. CIT (2006) 284 ITR 323*, ruled that the assessing authority has no power to entertain a claim for deduction made after filing of the return of income otherwise than by way of a revised return. In the instant case, Ganesh has claimed the deduction under section 80C, which he

omitted to claim in the original return of income, through a letter addressed to the Assessing Officer and not by filing a revised return under section 139(5). In view of the decision of the Supreme Court cited above, the Assessing Officer was justified in completing the assessment without allowing the deduction under section 80C.

- (b) (i) The fourth proviso to section 139(1) requires every person, whose total income without giving effect to the provisions of section 10A, 10B, 10BA and Chapter VIA exceeds the maximum amount not chargeable to tax, to compulsorily furnish the return of income for the relevant assessment year on or before the due date. The gross total income of Mr. Rakesh before deduction under section 80C exceeds the basic exemption limit of ₹ 2,50,000 being a senior citizen and therefore, Mr. Rakesh has to furnish his return of income for the A.Y.2012-13.
- (ii) It is compulsory for firms to furnish their returns of income and loss on or before the due date. Therefore, M/s ABC has to furnish its return of loss for the A.Y.2012-13 on or before the due date.
- (c) (i) Revision of orders by the Commissioner can be carried out under section 263 or section 264.

Revision of orders prejudicial to the interest of revenue [Section 263]

Section 263(1)(c) provides that if an order passed by the Assessing Officer has been the subject matter of any appeal, the same cannot be revised. However, at the same time, the power of the Commissioner under sub-section (1) of section 263 shall extend to such matters as had not been considered and decided in such appeal.

Revision of other orders [Section 264]

The Commissioner shall not revise any order under section 264, where an appeal against the order lies to the Commissioner (Appeals) or to the Appellate Tribunal, but it has not been made and the time within which such appeal may be made has not expired. However, if the assessee has waived his right of appeal, the Commissioner can revise the order under this section.

Therefore, CIT cannot revise an order under section 264 during the pendency of an appeal before the First Appellate Authority.

- (ii) The proposition is correct in law. A finding of fact cannot be disturbed by the High Court in exercise of its powers under section 260A. The Income-tax Appellate Tribunal is a fact finding authority and the findings of fact recorded by the Tribunal can be interfered with by the High Court under section 260A only on the ground that the same were without evidence or material, or if the finding is contrary to the evidence, or is perverse or there is no direct nexus between conclusion of fact and the primary fact upon which that conclusion is based.

In *CIT vs. P. Mohanakala* (2007) 291 ITR 278 and *Commissioner of Agricultural income-tax vs. M.N.Moni* (2007) 291 ITR 387, the Apex Court observed that the High Court had set aside the factual findings of the lower authorities and the Tribunal without any valid reason. The Apex Court held that the findings of fact could not be interfered with by the High Court without carefully considering the facts on record, the surrounding circumstances and the material evidence. There is no scope for interference with the factual findings, unless the findings are *per se* without reason or basis, perverse and/or contrary to the material on record.

7. (a) (i) Section 192 requires deduction of tax from salary at the time of payment. Thus, the employer is not required to deduct tax at source when salary has not been paid but is merely credited to the account of the employee in its books of account. X Ltd. therefore, is not required to deduct tax at source in respect of the salary merely credited to the account of employee, Mahesh, which is not paid.
- (ii) The definition of “work under Explanation to section 194-C includes catering services and therefore, TDS provisions under section 194C are attracted in respect of payments to a caterer. As the payment exceeds ₹ 30,000, the nationalized bank is required to deduct tax at source at 2% on the payments made to catering organization under 194C. If the catering organization is an individual or HUF, then the tax deduction shall be @ 1%.
- (iii) Under section 194G, the person responsible for paying to any person stocking, distributing, purchasing or selling lottery tickets shall at the time of credit of the commission or payment thereof, whichever is earlier, amounting to more than ₹ 1,000, deduct income-tax at 10%.
- (b) Mr. Mayank is a non-resident for the P.Y.2011-12, since his stay in India is only for 30 days during the P.Y.2011-12. As per section 5(2), the scope of total income in the case of a non-resident would include the following –
 - (i) income received or deemed to be received in India in the previous year; and
 - (ii) income which accrues or arises or is deemed to accrue or arise in India during the previous year.

As per section 9(1)(iii), income chargeable under the head ‘Salaries’ which is payable by the Government to a citizen of India for services rendered outside India is deemed to accrue or arise in India. Therefore, salary of ₹ 8 lakh would be taxable in the hands of Mr. Mayank even if he is a non-resident, assuming that he is a citizen of India. However, allowances and perquisites paid outside India by the Government to a citizen of India for rendering service outside India is exempt under section 10(7). Therefore, ₹ 4.5 lakh would be exempt under section 10(7)

- (c) (i) Failure to afford facility to the officer authorized as per section 132(1)(iib) is a case for which prosecution can be launched under section 275B and such person shall be punishable with rigorous imprisonment for a term which may extend to two years and shall also be liable to fine.
- (ii) Willful failure to produce books of account and documents as required under section 142(1) or willful failure to comply with a direction to get the accounts audited under section 142(2A) is a case for which prosecution can be launched under section 276D and such person shall be punishable with rigorous imprisonment for a term which may extend to one year or with a fine of ₹ 4 to ₹ 10 for every day during which the default continues or with both.
- (iii) Deliberate failure to deposit the tax collected under section 206C to the credit of the Central Government is a case for which prosecution can be launched under section 276BB and such person shall be punishable with rigorous imprisonment for a term which shall not be less than three months but which may extend to seven years and with fine.