

MOCK TEST PAPER – 1
FINAL: GROUP – II
PAPER – 7: DIRECT TAX LAWS

Question 1 is compulsory.

*Answer any **five** questions from the remaining **six** questions.*

Time Allowed – 3 Hours

Maximum Marks – 100

1. (a) M/s. Popat 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	4,65,000	By gross profit	8,65,800
“ Rent	52,000	Dividend from UTI	15,000
“ Printing & Stationery	6,600		
“ Telephone	4,200		
“ Conveyance	18,500		
“ Travelling	16,500		
“ Interest	75,000		
“ Depreciation	33,000		
“ Legal fees	18,000		
“ Auditor's fees	20,000		
“ PF contribution	22,000		
“ Net profit	1,50,000		
Total	8,80,800	Total	8,80,800

Additional information:

- (i) Salaries include ₹ 1,50,000 paid to working partner Anand and ₹ 1,00,000 to working partner Bhola (authorized by the partnership deed)
 - (ii) Interest paid includes ₹ 54,000, being interest paid on loan given by partner Bhola at the rate of 18% simple interest authorised by the partnership deed.
 - (iii) Out of provident fund contribution debited to profit and loss account, ₹ 12,500 is outstanding beyond the due date of filing of return.
 - (iv) 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. (10 Marks)
- (b) Pitbull Constructions Ltd. furnishes the following particulars of its wealth for the valuation date as on 31.3.2013:

Assets	₹ (in lacs)
(i) Land in urban area (held as stock in trade since 2001)	59
(ii) Motor cars (including one imported car worth ₹ 23 lacs used for hiring)	34
(iii) 125 acres of land acquired at Ghaziabad township on	155

	15.5.2012 for construction of commercial complex	
(iv)	Residential flats of 950 sq feet each provided to 2 employees (salary of one employee exceeds ₹ 10 lacs per annum)	30
(v)	Farm house situated at a remote village	10
(vi)	Cash in hand as per cash book	5
Liabilities:		₹ (in lacs)
(i)	Loan for purchase of land at urban area	39
(ii)	Loan for purchase of land at Ghaziabad	85
(iii)	Wealth-tax liability for A.Y. 2012-13	12
(iv)	Loan for construction of residential flats	18

Compute the net wealth of the company as on valuation date 31.03.2013. (10 Marks)

2. Topaz Ltd., engaged in diversified activities, earned a net profit of ₹ 48,25,000 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 income-tax	7,45,000
	Dividend distribution tax	1,20,000
	Provision for deferred tax	65,000
	Wealth-tax	2,25,000
	Securities Transaction Tax	1,05,000
	Transfer to General Reserve	1,82,000
	Provision for gratuity based on actuarial valuation	1,50,000
	Provision for losses of subsidiary company	1,00,000
	Proposed dividend	1,90,000
	Preference dividend	1,30,500
	Expenditure to earn agricultural income	85,500
	Expenditure to earn LTCG exempt under section 10(38)	52,000
	Expenditure to earn dividend income	40,000
	Depreciation (including depreciation of ₹ 2,00,000 on revaluation)	4,50,000
(b)	Items credited to Profit and Loss Account	
	Amount credited to P & L A/c from Special Reserve	2,00,000
	Amount credited to P & L A/c from Revaluation Reserve	2,80,000
	Agricultural income	2,80,000
	LTCG exempt under section 10(38)	1,80,000
	Dividend income	2,20,000

The company provides the following additional information:

Brought forward Business Loss/Unabsorbed Depreciation:

Assessment Year	Amount as per books	
	Loss	Depreciation
2008-09	4,50,000	3,70,000
2009-10	2,50,000	Nil
2010-11	2,00,000	2,80,000

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 ₹ 27,50,000. (16 Marks)

3. (a) Prakash Motors Ltd., an Indian company declared income of ₹ 300 crores computed in accordance with Chapter IV-D but before making any adjustments in respect of the following transactions for the year ended on 31.3.2013:

- (i) 10,000 cars sold to Meena Ltd. which holds 27% shares in Prakash Motors Ltd. at a price which is less by ₹ 200 each car than the price charged from Yomo Ltd.
- (ii) Royalty of ₹ 1,20,00,000 was paid to Komo Ltd. for use of technical know-how in the manufacturing of car. However, Komo Ltd. had provided the same know-how to another Indian company for ₹ 90,00,000.
- (iii) Loan of Euro 1000 crores carrying interest @ 10% p.a. advanced by Henken Ltd., a German company, was outstanding on 31.3.2013. The total book value of assets of Prakash Motors Ltd. on the date was ₹ 1,80,000 crores. The said German company had also advanced a loan of similar amount to another Indian company @ 9% p.a. Total interest paid for the year was EURO 100 crores.

Explain in brief the provisions of the Act affecting all these transactions and compute the income of the company chargeable to tax for A.Y.2013-14 keeping in mind that the value of 1\$ and of 1 EURO was ₹ 65 and ₹ 92, respectively, throughout the year. (6 Marks)

- (b) M/s. Midair Atlantic, incorporated as a company in the USA, operated its flights to India and vice versa during the year 2012-13 (April, 2012 to March, 2013) and collected charges of ₹ 225 lacs for carriage of passengers out of which ₹ 145 lacs were received for the passenger fare booked from New York to Mumbai. The balance represents amount received for passenger fare from Mumbai to New York. The total expenses for the year on operation of such flights were ₹ 195 lacs. You are required to compute the income chargeable to tax in India of the foreign airlines, M/s. Midair Atlantic, if –

- (i) ₹ 145 lacs is received in India.
- (ii) ₹ 145 lacs is received in US dollars in New York. (4 Marks)

- (c) Microsoft Inc., a US company has a subsidiary, Nano Ltd. in India. Microsoft Inc. sells computer monitors to Nano Ltd. for resale in India. Microsoft Inc. also sells computer monitors to NET Ltd., another computer reseller. It sells 50,000 computer monitors to Nano Ltd. at ₹ 11,000 per unit. The price fixed for NET Ltd. is ₹ 10,000 per unit. The warranty in case of sale of monitors by Nano Ltd. is handled by Nano Ltd. However, for sale of monitors by NET Ltd., Microsoft Ltd. is responsible for the warranty for 3 months. Both Microsoft Ltd. and Nano Ltd. offer extended warranty at a standard rate of ₹ 1,000 per annum. On these facts, how is the assessment of Nano Ltd. going to be affected? (6 Marks)

4. (a) Mr. Gaba received the following gifts / amounts during the previous year 2012-13:
- (i) Gift of bullion worth ₹ 55,000 on his birthday from his friend.
 - (ii) Received a car from his cousin on payment of ₹ 2 lac, fair market value of which was ₹ 6 lacs.

- (iii) Received cash gift of ₹ 25,000 each from three of his friends Amar, Bittu & Chander on 3-11-2012.
- (iv) Acquired an office building on 15-1-2013 from his friend Quasim for a consideration of ₹ 12 lacs, stamp value of which is ₹ 22 lacs.
- (v) In respect of land of Mr. Gaba acquired by Railways in the year 2010, he received the following amount on 22-2-2013 as interest on enhanced compensation on the order of the court -

Relating to previous year	₹
2010-11	1,55,000
2011-12	1,98,000
2012-13	1,27,000

You are required to compute the income of Mr. Gaba chargeable under the head "Income from other sources" for the A.Y.2013-14 assuming that he has no other income. (8 Marks)

- (b) Angle Ltd. has two industrial undertakings. Unit-I is engaged in the production of washing machines and Unit-II is engaged in the production of air conditioners. The company has, as part of its restructuring program, decided to sell Unit-II as a going concern by way of slump sale for ₹ 305 lacs to a new company called Triangle Ltd., in which it holds 85% equity shares. The following is the extract of the balance sheet of Angle Ltd. as on 31st March, 2013:

	₹ (in lacs)	
	Unit – I	Unit – II
Fixed Assets	142	168
Debtors	65	57
Inventories	70	38
Liabilities	42	51

	₹ (in lacs)
Paid-up share capital	292
General Reserve	110
Share Premium	45

The company set up Unit-II on 1st April, 2008. The written down value of the block of assets for tax purpose as on 31st March, 2013 is ₹ 180 lacs of which ₹ 90 lacs are attributable to Unit-II.

- (i) Determine what would be the tax liability of Angle Ltd. on account of Slump sale;
- (ii) How can the restructuring plan of Angle Ltd. be modified, without changing the amount of consideration, in order to make it more tax efficient? (8 Marks)

5. Attempt any four questions out of the following questions:

- (a) Pirates Ltd. incurred expenditure on demolition and re-erection of a cell room, which is a part of a building, used for business purposes. It also purchased a pumping set, mono block pump and two transformers, which are part of a bigger plant.

Discuss whether the above expenditure are revenue or capital in nature.

- (b) On 1st May, 2012, Mr. Rakesh sold a building, purchased by him five years back for use for the purposes of his sole-proprietorship business, on which he has been claiming depreciation under section 32. He claimed benefit of exemption under section 54F in respect of capital gains arising on sale of the building, by investing the entire net consideration therefrom in purchase of a residential house in March, 2013. The Assessing Officer, however, contended that he would not be eligible for exemption under section 54F in this case since such exemption is available only in respect of capital gain arising from transfer of a long-term capital asset whereas the capital gain arising from transfer of a depreciable asset (namely, building, in this case) is deemed to be a capital gain arising from transfer of a short-term capital asset by virtue of the provisions of section 50. Discuss the correctness of contention of the Assessing Officer.
- (c) Whether prize money winnings on unsold lottery tickets held by the distributor can be assessed as business income in his hands and be subject to normal rates of tax. Discuss.
- (d) "Aryan Infra (P) Ltd." is an Indian company engaged in undertaking infrastructure projects. In April 2012, it undertook two projects in Tamil Nadu - a highway project in East Coast Road (ECR) which involves expansion of existing roads by constructing additional lanes and a roadway project in Old Mahabalipuram Road (OMR), which involves relaying of existing roads. The General Manager of the company seeks your advice as to whether deduction under section 80-IA can be availed in respect of profits from such projects.
- (e) Magic Hotels Ltd., engaged in the business of owning, operating and managing hotels, allowed the employees to receive tips from the customers, by virtue of their employment. The tips were also collected directly by the company from the customers, when payment was made by them through credit cards. The company thereafter disbursed the tips to the employees. Is the company liable to deduct tax under section 192 from the tips so disbursed to the employees, by treating the same as salary? Discuss. (4 × 4 = 16 Marks)
6. (a) Mr. Rajesh, purchased on 15.5.2002, house property for ₹ 22,25,000 which was sold to Mr. Arjun on 19.1.2013 for ₹ 35,00,000. The sub-registrar, at the time of registration of sale deed, charged stamp duty on ₹ 60,00,000, which was paid by the buyer.
- The Assessing Officer, while assessing for capital gain, referred the matter to the valuation officer as per the request of vendor. The Valuation Officer determined the value of property at ₹ 45,00,000 on the date of transfer. Mr. Rajesh seeks your advice on the following:
- (i) On what value the Assessing Officer could compute capital gain chargeable to tax?
- (ii) The amount of capital gain on which Mr. Rajesh is required to pay capital gains tax.
- (The CII for F.Y. 2002-03 is 447 and of F.Y. 2012-13 is 852) (8 Marks)
- (b) Discuss the correctness or otherwise of the following propositions in the context of the Income-tax Act, 1961:
- (i) The powers of the Commissioner of Income-tax (Appeals) to enhance the assessment are plenary and quite wide.

- (ii) At the time of hearing of rectification application, the Income-tax Appellate Tribunal can re-appreciate the evidence produced during the proceedings of the appeal hearing. (2 × 4 = 8 Marks)

- 7 (a) Kuhu purchased a residential flat from her friend Bela at ₹ 12 lacs in the city of Kanpur on 3rd October, 2012. The value determined by the Stamp Valuation Authority for stamp duty purpose amounted to ₹ 15 lacs. Bela had purchased the flat on 1st January, 2010 at a cost of ₹ 3.50 lacs. Kuhu sold the flat for ₹ 20 lacs on 30th March, 2013.

Determine the effect of the above transactions on the assessments of Bela and Kuhu for assessment year 2013-14, assuming that value for stamp duty purpose in case of the second sale was not more than the sale consideration. . (4 Marks)

- (b) Mr. Raghav was a partner in a firm, representing his HUF, holding 25% of the share in the firm. His wife Janaki, a house lady, was admitted in her individual capacity in the firm for 25% share. She was paid remuneration which has been proposed by the Assessing Officer to be clubbed in the hands of Raghav-HUF by invoking section 64. (6 Marks)

- (c) Explain the applicability of the provision relating to the deduction of tax at source in the following transactions:

- (i) Bhanu Limited pays ₹ 1 lac to Bhoomi Limited, a resident contractor who, under the contract dated 15th October, 2012, manufactures a product according to specification of Bhanu Limited by using materials purchased from Bhanu Limited.
- (ii) Max Inc., a foreign company, pays outside India, salary to its employee, Mr. Shashi, a foreign national and a non-resident, for services rendered in India.

(2 × 3 = 6 Marks)