

Test Series: August, 2017

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. ABC Corporation, a partnership firm, has earned a gross total income of Rs. 300 lacs for the year ended 31-3-2017. The firm has not undertaken any international transaction or specified domestic transaction during the said year.

The above includes a profit of Rs. 220 lacs from an industrial undertaking having a turnover of Rs. 80 crores. This is the fourth year and deduction under section 80-IA of the Income-tax Act, 1961 is available to the extent of Rs. 200 lacs.

There are some grey areas in the taxation workings and hence, the assessee is contemplating to file the return of income on 10.11.2017, after seeking clarifications from tax experts.

Advise the assessee-firm by working out the total income and tax payable, where the return is filed on 30-09-2017 or when the same is filed on 10-11-2017.

What is the practical solution as regards obtaining clarifications, which might or might not have an impact on the total income? (10 Marks)

- (b) MNO trust, a business trust, registered under SEBI (Real Estate Investment Trusts) Regulations, 2014, gives particulars of its income for the P.Y.2016-17:

- (1) Interest income from High Ltd. – Rs. 4 crore;
- (2) Dividend income from High Ltd. – Rs. 2 crore (received on 1st October, 2016);
- (3) Short-term capital gains on sale of listed shares of High Ltd. – Rs. 1.5 crore;
- (4) Interest received from investments in unlisted debentures of real estate companies – Rs. 10 lakh;
- (5) Rental income from directly owned real estate assets – Rs. 3.50 crore

High Ltd. is an Indian company in which the MNO trust holds controlling interest. The MNO trust holds 100% of the shareholding of High Ltd.

Discuss the tax consequences of the above income earned by the MNO trust in its hands and in the hands of the unit holders, assuming that the MNO trust has distributed Rs. 10 crore to the unit holders in the P.Y.2016-17. (10 Marks)

2. Ram, Shyam and HUF of Mohan (represented by Mohan) are partners with equal shares in profits and losses of a firm, M/s Popular Tele films, which is engaged in the production of TV serials and telefilms. In the previous year 2015-16, one partner 'Sunder' retired, but his dues have been settled in the previous year 2016-17.

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, 2016 to authorise payment of remuneration of Rs. 1 lac per month to each working partner and simple interest at 15% per annum on partners' capital. Ram, Shyam and Mohan are actively associated with the affairs of the firm.

The Profit & Loss Account of the firm for the year ended 31st March, 2017 shows a net profit of Rs. 10 lacs after debiting/crediting the following:

- (a) Interest amounting to Rs.5 lacs each was paid to partners on the balances standing to their capital accounts from 1st June, 2016 to 31st March, 2017.
- (b) Remuneration to the partners including partner in representative capacity Rs. 30 lacs.
- (c) Interest amounting to Rs. 2 lacs paid to Mohan on loan provided by him in his individual capacity at 16% interest.
- (d) Royalty of Rs. 5 lacs paid to partner Ram, who is a professional script writer, for use of his scripts as per agreement between the firm and Ram. The same is authorized by partnership deed.
- (e) Two separate payments of Rs. 17,000 and Rs. 16,000 made in cash on 1st March, 2017 to Asif, a hairdresser, against his bill for services rendered in February, 2017 and two payments of Rs. 16,000 and Rs. 18,000 made in cash on 1st February and 2nd February, 2017, respectively, to Prakash, an assistant cameraman, against her bill for services provided in January, 2017.
- (f) Amount of Rs. 4.50 lacs provided in the books on 31st March 2017 as liability for remuneration to Shreya, a film artist and a non-resident. Tax deducted at source under section 195 from the amount so credited was paid on 5th July, 2017.
- (g) Amount of Rs. 7 lacs provided as gratuity for the year on the basis of actuarial valuation. Gratuity actually paid to one retired employee during the year is Rs. 2.50 lacs.
- (h) Interest of Rs. 1.20 lacs received on income-tax refund under section 244(1A) in respect of A.Y. 2014-15.

The firm has also provided the following additional information:

The amount due to Sunder, an ex-partner, was Rs. 15 lacs which was settled on 30th September, 2016 by transferring a plot of land purchased two years back having book value of Rs. 10 lacs. The difference of Rs. 5 lacs was credited to partners' capital accounts

in their profit sharing ratio. The value of plot for stamp duty valuation on the date of transfer was Rs. 16 lacs.

Compute the total income of the firm for the assessment year 2017-18 stating the reasons for treatment of each item. (16 Marks)

3. (a) Hyper Private Ltd. went into liquidation on 30.06.2016. The company was seized and possessed of the following funds prior to the distribution of assets to the shareholders:

	Rs.
Share Capital (issued on 01.04.2012)	5,00,000
Reserves prior to 30.6.2016	3,00,000
Excess realization in the course of liquidation	<u>5,00,000</u>
Total	<u>13,00,000</u>

There are 5 shareholders, each of whom received Rs. 2,60,000 from the liquidator in full settlement. The shareholders desire to invest the resultant element of capital gains in long-term specified assets as defined in section 54EC. You are required to examine the various issues and advice the shareholders about their liability to income tax. (6 Marks)

- (b) "Units set up in an International Financial Services Centre are entitled to special tax concessions". Discuss. (6 Marks)
- (c) Mr. Kashyap held 12% equity shares in MNO Ltd., a private limited company. He gifted all the shares held by him in MNO Ltd., to his wife Mrs. Kashyap on 23/7/2016. The transfer was made without adequate consideration. On 5/8/2016, Mrs. Kashyap obtained a loan of Rs. 75,000 from MNO Ltd., when the company's accumulated profit was Rs. 50,000. What are the tax implications of the above transactions? (4 Marks)
4. (a) Foodie 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 hotel-company from the customers, when payment was made by them through credit cards. The hotel-company thereafter disbursed the tips to the employees. The Assessing Officer treated the receipt of the tips as income under the head "Salary" in the hands of the various employees and held that the company was liable to deduct tax at source from such payments under section 192. Since the company had not deducted tax at source on such payments, the Assessing Officer treated the company as an assessee-in-default under section 201(1). Discuss the correctness of the action of the Assessing Officer. (4 Marks)
- (b) Vikram, an individual, owned two residential houses which were let out. Besides, he and his three brothers co-owned a residential house in equal shares. He sold one residential house owned by him during the previous year relevant to the assessment year 2017-18. Within two month from the date of such sale, the three brothers

executed a release deed in respect of their shares in the co-owned residential house in favour of Vikram for a monetary consideration.

Vikram utilised the entire long-term capital gain arising out of the sale of the residential house for payment of the said consideration to his three brothers. Vikram has let out the house, in respect of which his brothers executed a release deed, to another person, who is using it for his residential purposes.

Is Vikram eligible for exemption under section 54 of the Income-tax Act, 1961 for the assessment year 2017-18 in respect of the long-term capital gain arising from the sale of his residential house, which he utilised for acquiring the shares of his brothers in the co-owned residential house? Will the non-use of the new house for his own residential purposes disentitle him to exemption? (4 Marks)

- (c) Mr. Deepak is a distributor of lottery tickets. He won Rs. 7,00,000 as prize money on unsold lottery tickets. It was offered as business income. The Assessing Officer wants to tax the same as lottery winning at the rate prescribed under section 115BB. Is he justified? (4 Marks)
- (d) Explain the tax treatment of emergency spares (of plant and machinery) acquired during the year which, even though kept ready for use, have not actually been used during the relevant previous year. (4 Marks)
5. (a) Mr. Raj has commenced the business of manufacture of computers on 1.4.2016. He employed 350 new employees during the P.Y.2016-17, the details of whom are as follows -

	No. of employees	Date of employment	Regular/Casual	Total monthly emoluments per employee (Rs.)
(i)	75	1.4.2016	Regular	24,000
(ii)	125	1.5.2016	Regular	26,000
(iii)	50	1.8.2016	Casual	25,500
(iv)	100	1.9.2016	Regular	24,000

The regular employees participate in recognized provident fund while the casual employees do not.

Compute the deduction, if any, available to Mr. Raj for A.Y.2017-18, if the profits and gains derived from manufacture of computers that year is Rs. 75 lakhs and his total turnover is Rs. 2.16 crores.

What would be your answer if Mr. Raj has commenced the business of manufacture of apparel (and not computers) on 1.4.2017 and the above particulars are related to such business? (6 Marks)

- (b) Ms. Kavita, a resident individual, is a magician deriving income of Rs. 6,00,000 from a magic show performed outside India. Tax of Rs. 1,50,000 was deducted at source in the country where she had performed the show. India does not have any double tax avoidance agreement with that country. Her income in India amounted to Rs. 42,00,000. Compute her tax liability for the assessment year 2017-18 assuming she has deposited Rs. 1,50,000 in Public Provident Fund and paid medical insurance premium in respect of her mother, resident in India, aged 61 years, Rs. 35,000.
(6 Marks)
- (c) In an order of assessment for the A.Y. 2015-16, the assessee noticed a mistake for which application under section 154 was moved and the order was rectified. Subsequently, the assessee moved further application for rectification under section 154 which was rejected by the Assessing Officer on the ground that the order once rectified cannot be rectified again. Is the contention of the Assessing Officer correct?
(4 Marks)
6. (a) State whether the information regarding possession of unexplained assets and income received from the Central Bureau of Investigation, a Government agency, can constitute "information" for action under section 132. Discuss.
(4 Marks)
- (b) Swift Inc., a France company has a subsidiary, ABC Ltd. in India. Swift Inc. sells Laptops to ABC Ltd. for resale in India. Swift Inc. also sells Laptops to XYZ Ltd., another Laptop dealer for resale in India. It sells 30,000 Laptops to ABC Ltd. at Rs. 21,000 per unit. The price fixed for XYZ Ltd. is Rs. 18,000 per unit. The warranty in case of sale of Laptops by ABC Ltd. is handled by ABC Ltd. However, for sale of Laptops by XYZ Ltd., Swift Inc. is responsible for the warranty for 4 months. Both Swift Inc. and ABC Ltd. offer extended warranty at a standard rate of Rs. 2,400 per annum. On these facts, how is the assessment of ABC Ltd. going to be affected?
(4 Marks)
- (c) A foreign company entered into contracts with several Indian companies for installation of mobile telephone system and made an application to the Authority for Advance Rulings for advance ruling on the rate of withholding tax on receipts from Indian companies. One of the Indian companies had also made an application to the Assessing Officer for determination of the rate at which tax is deductible on payment to the said foreign company. The Authority for Advance Rulings rejected the application of the foreign company on the ground that the question raised in the application is already pending before an income tax authority. Is the rejection of the application of the foreign company justified in law?
(4 Marks)
- (d) The return for A.Y. 2015-16 was filed on 28.7.2015. Later on, the assessee, noticed certain omissions and therefore filed a revised return on 5.4.2017. The Assessing Officer ignoring the revised return so filed framed the order under section 143(3) on 7.5.2017. Is the action of Assessing Officer correct?
(4 Marks)

7. (a) (i) Safe Airways Ltd. sold tickets to the travel agents in India at a minimum fixed commercial price. The agents were permitted to sell the tickets at a higher price but not exceeding the maximum published price. Commission at the rate of 9% of minimum fixed commercial price was deducted under section 194H by the company. The Assessing Officer contended that the liability for tax deduction at source is attracted on the difference between the minimum fixed commercial price and the maximum published price by treating it as "additional special commission" in the hands of the agents.
- Is the contention of Assessing Officer tenable in law?
- (ii) Subhash, an individual, had let out his building on a monthly rent of Rs. 25,000. The tenant deducted tax under section 194-I from the rent paid to Subhash, but did not remit such tax to the credit of the Central Government. Subhash filed his return of income for the assessment year 2017-18 including therein the rental income from the said building and paid the balance tax on his total income after taking credit for tax deducted at source by the tenant. The Assessing Officer has called upon Subhash to pay the tax to the extent of tax deducted at source. Is the Assessing Officer justified in doing so? *(6 Marks)*
- (b) Discuss the powers of the Settlement Commission to amend its orders. *(4 Marks)*
- (c) Discuss the correctness or otherwise of the following statements with reference to the provisions of the Income-tax Act, 1961:
- (i) The Commissioner (Appeals) cannot admit an appeal filed beyond 30 days from the date of receipt of order by an assessee.
- (ii) The Appellate Tribunal is empowered to grant indefinite stay for the demand disputed in appeals before it. *(6 Marks)*