PAPER 7 :DIRECT TAXES
NOVEMBER 1999

Answer All Questions

Question 1

(a) A, an individual, was the sole [proprietor of a business. His net investment in the business, on 31st March, 1998, was Rs. 20 lakhs represented by:

		Rs.
Fixed Assets		18,00,000
Current Assets		10,00,000
		28,00,000
Current Liabilities	5,00,000	
Loans	3,00,000	8,00,000
Net Investment		**20,00,000**

Finding himself unable to carry on business by himself and also to attract additional capital, he formed a private limited company in April, 1998 with an authorized capital of Rs. 1 crore. At the time of formation of the company, A and his wife had subscribed to 100 equity shares each — fully paid in cahs.

On 10th June, 1998, A transfers his individual business in entirety, as a going concern, to the private limited company for Rs. 40 lakhs for issue of shares in the following manner:

Preference Shares: Wholly to Mrs. A and her sister Mrs. G (in joint names)	1,50,000 shares
Equity Shares:	
Mr. A	1,30,000 shares
Mr. C, major son of A	20,000 shares
Mr. D, a friend of A	30,000 shares
Mr. E, a married sister of A	20,000 shares
Mr. F, husband of Mrs. E	50,000 shares

The shares of the face value of Rs. 10 each are to be issued fully paid up. No other purchase consideration for the transfer of the business to the company was due.

Required:

(i) Ascertain whether in A's hands and tax liability will be due; if so, also indicate the assessment year relevant for this.

(ii) If, on 30th March 1999, A had sold 10,000 equity shares allotted to hi, at Rs. 50 per share, to a friend, what will be the consequences? **(10 Marks)**

(b) After having lost its appeal before the Tribunal the Income tax Department preferred an appeal to the High court. Subsequent to the assessee's appeal before the first appellate authority, the Assessing Officer had refunded the excess tax paid. Interest u/s 244(1A) is withheld by the Commissioner of Income tax on the ground that an appeal against the order of the Tribunal is pending before the High Court. The assessee earns good profits and has a large turnover. Is the withholding of interest on refund justified in law? **(5 Marks)**

Question 2

(a) X Co operative Society Ltd., markets agricultural produce supplied to it by its members. Its Profit and Loss Account for the year ended 31st March, 1998 showed a profit of Rs. 10 lakhs on sales of Rs. 100 lakhs. (It can be assumed that profits accrured uniformly on sales).
The society claim for exemption of income from tax was examined by the assessing officer who found that the sales composed of Rs. 70 lakhs of produce raised by the Society's own members in their agricultural fields; and Rs. 30 lakhs of produce bought by the members from the open market and supplied to the Society. The assessing officer wants to deny exemption u/s 80P(1) in regard to profits on bought out goods supplied by members to the Society. Is the assessing officer's view correct in law? Discuss. **(6 Marks)**

(b) A hospital for the reception and treatment of persons suffering from illoness, existing for philanthropic purposes and not run for purposes of profit, run by a charitable trust seeks exemption of its income and from income tax for the assessment year 1999 – 2000 . What will be the procedure to be adopted by it to secure this? Discuss. **(6 Marks)**

Question 3

(a) Mr. Ram had purchased 5,000 equity shares in M/s Kamat & Co., Ltd at the rate of Rs. 2 per share. M/s Kamat & Co. Ltd. Goes into liquidation on June 30, 1998. The Balance Sheet of the company as on the date of liquidation stood as under:

	Rs.		Rs.
50,000 equity shares	5,00,000	10,000 debentures in Patel & Co. Ltd (Cost Rs. 10,00,000)	30,00,000
Accumulated profits	30,00,000	Cash in hand	8,00,000
Provision for dividend tax	3,00,000		
	38,00,000		**38,00,000**

After retaining Rs. 3,00,000 for paying dividend tax, the remaining assets are distributed to the shareholders. In the process, on 30th June, 1998, Mr. Ram gets 1,000 debentures (market value Rs. 3,00,000) and Rs. 50,000 in cash. He transfers the entire debentures on 10th March, 1999 for Rs. 3,20,000. Indicate the tax consequences of these transactions. [Cost of inflation index to be adopted: 133 and 351]

Question 4

Patel & Co., is a partnership firm consisting of three partners, Mr. Patel, Mr. Malhotra and Mr. Anand, haring profit and losses in ratio of 3:2:3. The firm was doing business in manufacture of electrical appliances. The Profit and loss account of the firm for the year ending 31-03-1999 was as under:

		Rs.		Rs.
Purchases		7,50,000	Sales	16,70,000
Salary to Staff		3,00,000	Long Term Capital Gains	4,90,000
Interest to Partners: Patel Malhothra Anand	 30,000 2,20,000 70,000	 3,20,000	Debenture Interest	40,000
Depreciation		1,80,000	Miscellaneous Business receipts	4,000
Remuneration to partners: Patel	 1,02,000		Interest on drawings recovered from Mr. Patel	16,000

Malhothra	60,000			
Anand	72,000	2,34,000		
Miscellaneous Expenses		1,80,000		
Net Profit:				
Patel	96,000			
Malhothra	64,000			
Anand	96,000	2,56,000		
		22,20,000		**22,20,000**

The following further details are furnished:

1. The firm was assessed as a registered firm upto and inclusive of the assessment year 1992-93.
2. The firm has completed all the formalities to be considered as a partnership assessed as such.
3. The firm satisfies all the conditions of Section 80HH but is not found to be eligible for deduction U/s. 80-I or 80-IA.
4. The Partnership deed was amended on 1st April, 1998 providing remuneration and interest to partners as under:

	Remuneration	Interest on Capital
Mr.Patel (Working Partner)	Rs.8,500 p.m.	20% simple interest
Mr.Malhotra (Sleeping partner)	Rs.5,000 p.m	24% simple interest
Mr.Anand (Working Partner)	Rs.6,000 p.m.	20% simple interest

5. Depreciation eligible under the Income Tax Act works to Rs.96,000.
6. Under Miscellaneous expenses Rs.82,000 are inadmissible expenses, out of which rs.60,000 were donations given to an approved charitable trust.
7. For the assessment year 1997-98 and 1998-99, the firm was assessed on a business loss of Rs.40,000 and capital loss of Rs.10,000.

Compute the total income of the firm and the tax payable **(13 Marks)**

Question 5

(a) Ramalingam, a resident India, has derived the following incomes for the previous year relevant to the assessment year 1999-2000:

		(Rs.)
(1)	Income from profession	94,000
(2)	Share income from a partnership from in Country X (Tax paid in country X for this income in equivalent Indian rupees Rs.8,000)	40,000
(3)	Commission income from concern in Country Y(Tax paid in country Y at 20%) converted in Indian rupees.	30,000
(4)	Interest from scheduled banks	18,000

Ramalingam wishes to know whether he is eligible to any double taxation relief and if, so its quantum. India does not have any Double Taxation Avoidance Agreement with Countries X and Y. **(5 Marks)**

(b) The power of attorney holder of an assessee misappropriated a sum of rs.2.5 lacs from out of sale consideration received at the time of registration consequent to sale of a house owned by the assessee. The assessee claim the same as deductible in the computation of capital gain. Is the claim valid?**(5 Marks)**

(c) Varinder Charitable Trust, a charitable trust registered U/s. 12a of the Income Tax Act, 1961 has sold the plot acquired two years back. The purchase price was Rs.2,00,000. The sale consideration was Rs,360,000 Rs.10,000 was incurred in connection with the sale. The trust acquired English mortgage (worth Rs.3,10,000) of an immovable property utilizing the sale proceeds. Is the trust entitled to exemption U/s. 11(1A)? **(5 Marks)**

Question 6

(a) In an existing firm, a well-established one, Viswath is given an option of joining the partnership with 20% share. Either he can joint the firm himself or his wife can join as a partner. In either case, Viswath would be paid a remuneration of Rs.90,000 per annum. In addition Viswath is deriving a commission income (Own) of rs.10,00,000.. Mrs.Viswath has business (own income of Rs.80,000. Viswath seeks your advice as to whether he should join the firm as a partner or his wife should join. Advise Viswath suitably so that the total incidence of tax payable is the least. **(6 Marks)**

(b) Dr. Vijay Manvas purchased a house property on 1-12-1996 for Rs.10,00,000. Till 1-5-1998, the same was self-occupied as a residence. On this date, the said building was brought into use for the purpose of his medical profession. What would be the depreciation allowable for the assessment year 1999-2000 assuming that he owns n other building and the rate of depreciation is 10%. Will the answer be different if the house property had been gifted to him by his father, who had purchased the same on 1-5-1995 for Rs.9,00,000? **(4 Marks)**

Question 7

(a) State the conditions to be satisfied before a warrant of authorization U/s. 132 is issued for search of a premises. **(3 Marks)**

(b) When does a deemed seizure arise? **(3 Marks)**

(c) Can the seized accounts books and other documents be retained beyond 180 days? If so, under what conditions? **(2 Marks)**

Question 8

(a) Mr.Salgonkar owns a house property at Pune, which is let out at Rs.90,000 per annum. The annual value of the property as per Municipal records also is Rs.90,000. Municipal taxes are partly bone by the owner (Rs.3,000) and partly by the tenant (Rs.4,000). Repair expenses are borne entirely by the tenant (Rs.3,000), the difference between the un-built area and specified are does not exceed 5%. The property was acquired on May 10, 1988 for Rs.12,50,000.

Determine for purpose of Wealth Tax Act, the value of the property as on 31st March, 1999 on the following situations:

(a) The house is built on a freehold land

(b) It is built o a leasehold land, the unexpired period of lease of the land more than 50 years

(c) If the area of the plot on which the house is built is 800 sq. metres, FSI permissible is 1.4 and FSI utilized is 1088 sq. metres. (136 Meters × 8 storeys)

(d) The tenant had made interest free deposit of Rs.50,000 with the land lord. **(15 Marks)**