
PAPER 7: DIRECT TAXES
NOVEMBER 2006

Answer all questions

Question 1

RST Ltd is engaged in the manufacture and sale of drugs and pharmaceuticals. Its net profit for the year ending 31-3-2006 after debit/credit of the following items to the Profit and Loss Account was Rs.28, 00,000.

1. Income fees incurred in defending title to factory premises Rs.2, 00,000.
2. Income tax paid on non-monetary perquisites provided to the employees Rs.1, 00,000.
3. Expenditure on Scientific Research (not in respect of cost of land or building) on in-house research and development facility approved by the prescribed authority Rs.10, 00,000.
4. Interest paid on arrears of Sales Tax Rs.1, 00,000.
5. Cash payment of Rs. 20,000 made on 10.10.2005 to a supplier towards purchase of raw material.
6. Rent received from letting out vacant Rs. 1, 00,000.
7. Arrears of rent received in respect of a house property, which was let out in the earlier years and which was not charged to tax in any earlier year Rs.2, 00,000. The said property was sold during the year ending 31.3.2004.

The Company had paid royalty in India to a foreign company amounting to Rs.3,00,000 on 1.5.2004, which was disallowed by the Assessing Officer for the assessment year 2005-06 since tax was not deducted thereon. The company deducted and paid tax at source on the said amount of royalty on 1.1.2006.

The Company has brought forward loss from property relating to the assessment year 2004-05 amounting to Rs.40, 000.

Compute the total income of RST Ltd for the assessment year 2006-07.

Furnish explanations for the treatment of the various items given above

(16 marks)

Question 2

- (a) What is a zero coupon bond? State briefly the treatment of zero coupon bonds in the hands of the issuer and the investor under the Income tax Act, 1961. **(8 marks)**

- (b) A Hindu undivided family is carrying on the business of purchase and sale of foodgrains. The Karta of the family manages the business. Can the Hindu undivided family pay salary to the Karta and claim the payment made as a deduction from the profits of its business? If so, what are the conditions and limitations for such payment? **(4 marks)**

Question 3

- (a) ABC club, a member's club, registered as a society under Orissa state societies Registration Act, derived surplus from the sale of refreshments, beverages, etc. and letting out rooms to its members. The club provided these facilities and amenities to its members as part of advantage attached to the membership. The club claims that the said surplus accruing to it is not income at all for the purpose of Income tax Act, 1961. Examine the validity of the claim made by the club. Would your answer be different, if the club was incorporated as a company or if some members alone took advantage of the facilities and amenities it provided? (6 marks)
- (b) State whether the following persons have mandatory furnish their return of income for the assessment year 2006-07.
 - i. Mr. A, an individual, aged 50 years, whose gross total income before deduction under section 80C is Rs.1, 90,000 and total income after deduction under Section 80C is Rs.95, 000.
 - ii. M/s XYZ, a firm, which has incurred a loss **(4 marks)**

Question 4

- (a) S, an individual, purchased a site on 21.4.2000 for Rs.2, 00,000. He completed construction of a building thereon on 14.2.2003 at a cost of Rs.10, 00,000. He sold the property consisting of site and building on 7.12.2005 for Rs.20, 00,000. S seeks your opinion on the nature of capital gain arising to him from, the sale of the property for the assessment year 2006-07. Computation of capital gain is not necessary. **(5 marks)**
- (b) J, a citizen of India, is employed in the Indian Embassy at Tokyo, Japan. He received salary and allowance at Tokyo from the Government of India during the year ending 31.3.2006 for services rendered by him in Tokyo. Besides, he was allowed perquisites in the hands of J for the assessment year 2006-07. **(3 marks)**
- (c) Q, a non-resident, made an application to the Authority for Advance Rulings on 2.1.2006 in relation to a transaction proposed to be undertaken by him. On 31.3.2006, he decides to withdraw the said application. Can he withdraw the application on 31.3.2006? **(2 marks)**

Question 5

- (a) Can an order of assessment, which was in accordance with the law as it stood on the date, when it was passed, be rectified by the Assessing Officer under section 154 of the Income tax Act, 1961, on an account of a subsequent amendment of the law with retrospective effect? **(4 marks)**
- (b) An appeal was preferred by the assessee to the Commissioner (Appeals) against the order of the assessment made by the Assessing Officer. The appeal was allowed by the Commissioner (Appeals). The assessee later found that he was entitled to a certain deduction, which was neither claimed by him nor allowed by the Assessing Officer in the course of assessment. The issue of deduction was not raised by the assessee in the appeal before the Commissioner (Appeals). Examine the power of the commissioner to revive under Section 264 the order of assessment in order to allow such deduction on an application by the assessee. **(4 marks)**
- (c) M, an individual, had let out his building on a monthly rent of Rs.12, 000. The tenant deducted tax under section 194I from the rent paid to M, but did not remit such tax to the credit of the Central Government. M filed his return of income for the assessment year 2006-07 including therein the rental income from the said building and paid the balance tax on his total income after taking credit for the tax deducted at source by the tenant. The Assessing Officer has called upon M to pay the tax to the extent of tax deducted at source. Is the Assessing Officer justified in doing so? **(4 marks)**

Question 6

- (a) Write a brief note on filing of memorandum of cross-objections before the Income tax Appellate Tribunal. **(5 marks)**
- (b) C, an individual, resident in India, paid medical insurance premium amounting to Rs.20,000 by cash during the year ending 31.3.2006 out of his income chargeable to tax in respect of the policy taken on the health of his dependent father in accordance with the scheme framed by the General Insurance Corporation of India and approved Central Government. Besides, he paid Rs.90,000 during the year ending 31.3.2006 for the medical treatment of his dependent mother, aged 69 years, in respect of a disease specified in rule 11DD(1) of the Income tax rules, 1962. He received Rs.20, 000 from the insurance company for the said medical treatment of his mother. C seeks your advice on the deductions, if any, available in respect of these two payments. **(6 marks)**
- (c) An Assessing Officer entered a hotel run by a person, in respect of whom he exercise jurisdiction, at 8 pm for the purpose of collecting information, which may be useful for the purposes of the Act. The hotel is

kept open for business every day between 9am. And 9 pm. The hotelier claims that the Assessing Officer wants to take away with him after sunset. The Assessing Officer could not enter the hotel. Examine the validity of the claim made by the hotelier and the proposed action of the Assessing Officer with reference to the provisions of section 133B of the Income tax Act, 1961. **(4 marks)**

Question 7

- (a) What is an adventure in the nature of trade? State the factors which are relevant in deciding whether a transaction is an adventure in the nature of trade. **(7 marks)**
- (b) The assessment of B, an individual, for the assessment year 2004-05 was made under section 143(3) of the Income tax Act, 1961 on 18.3.2005. The assessment has become final and is not the subject-matter of an appeal or revision. The Assessing Officer issued a show cause notice for levy of penalty under section 271(1)(c) to B on 25.3.2005. B furnished a reply to the said notice on 30.3.2005. There was a change in incumbent and the Assessing Officer, who made the assessment and issued the show cause notice was succeeded by another. The successor-Assessing Officer suo motu issued a notice under section 129 to B on 20.9.2005. B did not respond to the said notice. The successor-Assessing Officer passed an order on 4.10.2005 levying penalty passed with reference to the aspect of limitation. **(8 marks)**

Question 8

D, an individual, has the following Assets and Liabilities as on 31.3.2006:

Rs. in lakhs

Assets

Plot of land at Bhopal comprising an area of 1,200 square meters on which building has been constructed without the approval of the appropriate authority	25
Building constructed on land at Bhopal without the approval of the appropriate authority and used for his business purposes	10
Motor car held as stock-in-trade	60
Gold jewellery brought into India from Singapore, where he was residing on his return to India on 1.11.2002 for permanently in India.	6
Jewellery made of Platinum	9
Interest in the coparcenary property of the Hindu undivided family of which he is a member	15
Cash in hand recorded in the books of account	5
Fixed deposit in a co-operative Bank	10
Liabilities:	
Loan borrowed for marriage of daughter	6
Loan borrowed for construction of building at Bhopal	5

The minor married daughter of D holds a plot of land at Indore valued at Rs.20 lahs.

The amounts stated against the assets, except cash in hand, are the values determined as per section 7 of the Wealth Tax Act, 1957 read with Schedule III thereto.

Compute the net worth of D for the assessment year 2006-07.

State reasons for inclusion or exclusion of the various items.

(8 marks)