
PAPER 7: DIRECT TAXES

MAY 2006

Answer all Questions

Question 1

ABC Ltd., is engaged in the manufacture and sale of textiles. 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.75,00,000:

(16 Marks)

- (i) Payment to two employees of Rs.2,50,000 each in connection with their voluntary retirement.
- (ii) Fringe benefit tax paid Rs.1,00,000.
- (iii) Changes of Rs.2,00,000 paid for advertisement in Souvenir published by a political party registered with the Election Commission of India.
- (iv) Retrenchment compensation paid to employees of one of the units closed down during the year Rs.10,00,000.
- (v) Capital expenditure incurred for the purpose of promoting Family Planning amongst its employees Rs.3,00,000.
- (vi) Banking Cash transaction tax paid Rs.10,000
- (vii) Interest paid U/s. 234B for short payment of advance tax pertaining to the assessment year 2005-06 Rs.1,10,000.
- (viii) Loss incurred in transactions of purchase and sale of shares of various companies Rs.3,00,000.
- (ix) Compensation received from supplier for delay in supply of raw materials Rs.1,00,000.
- (x) Dividend received from a foreign Company Rs.2,00,000.

The total sales of ABC Ltd., for the year was Rs.30 crores out of which Export sales amounted to Rs.10 crores.

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

Furnish explanations for the treatment of the various items given above.

Question 2

- (a) A charitable trust registered U/s. 12AA of the Income Tax Act, 1961 has out of its income of Rs.3,90,000 for the year ending 31.3.2006 and sale proceeds of a capital asset held by it for less than 36 months amounting to Rs.9,60,000 purchased a building during the year ending 31.3.2006 for Rs.13,50,000. The capital asset was sold during the year ending 31.3.2006. The building is held only for charitable purposes. The trust claims that the purchase of the building amounts to application of its income for charitable purposes and that the capital gain arising on the sale of the capital asset is deemed to have been applied to charitable purposes. Are the claims made by the charitable trust value in law?
- (b) R, an individual resident in India bought 1,000 equity shares of Rs.10 each of A Ltd., at Rs.50 per share on 30.5.2005. he sold 700 equity shares at Rs.35 per share on 30.9.2005 and the remaining 300 shares at Rs.25 per share on 20.12.2005. A Ltd., declared a Dividend of 50%, the record date being 10.8.2005. R sold on 1.2.2006 a house from which he derived a long term capital gain of Rs.75,000.
Compute the amount of capital gain arising to R for the assessment year 2006-07.

Question 3

- (a) Examine the obligation of the person responsible for paying the income to deduct tax at source and indicate the due date for payment of such tax wherever applicable in respect of the following items:

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- i. MNO Ltd., the employer credited salary due for the financial year 2005-06 amounting to Rs.2,40,000 to the account of Q, the employee in its books of account on 31.3.2006. Q has not furnished any information about his income/loss from any other head or proof of Investments / payments qualifying for deduction U/s. 80C.
- ii. T, an individual whose total sales in business during the year ending 31.3.2005 was Rs.1.20 crores paid Rs.9 lakhs by cheque on 1.1.2006 to a contractor for construction of his business premises in full and final settlement. No amount was credited earlier to the account of the contractor in the books of T.
- iii. BCD Ltd., credited Rs.18,000 towards fees for professional services and Rs.12,000 towards fees for technical services to the account of HG in its books of account on 6.10.2005. The total sum of Rs.30,000 was paid by cheque to HG on 18.12.2005.
- (b) H, a mentally retarded minor has a total income of Rs.1,20,000 for the assessment year 2006-07. The total income of his father L and his mother R for the relevant assessment year is Rs.2,40,000 and Rs.1,80,000 respectively. Discuss the treatment to be recorded to the total income of H for the relevant assessment year. **(3 Marks)**
- (c) M/s. PR and M/s. ST are firms with common partners carrying on different business. M/s. PR had taken a loan from M/s. ST for purposes of its business. Interest on the loan for the year ending 31.3.2006 worked out to Rs.20,000. M/s. PR deducted tax of Rs.2,244 on interest and paid the balance sum of Rs.17,756 in cash to M/s. ST on 31.3.2006. Tax deducted was remitted to the credit of the Central Government of Rs.30.4.2006. Tax deducted was remitted to the credit of the Central Government on 30.4.2006. How will you treat the interest paid while computing the total income of M/s. PR for the assessment year 2006-07? **(3 Marks)**

Question 4

- (a) M/s.JKLM, a firm consists of four partners namely, J,K,L and M. They shared profits and losses equally during the year ending 31.3.2005. The assessed business loss of the firm for the assessment year 2005-06 which it is entitled to carry forward amounts to Rs.3,60,000. A new deed of partnership was executed among J,K,L and M on 1.4.2005 in terms of which they agreed to share profits and losses in the ratio of 15:1520:50 respectively. **(3 Marks)**
- Compute the amount of business loss relating to the assessment year 2005-06, which the firm is entitled to set off against its business income for the assessment year 2006-07. The business income of the firm for the assessment year 2006-07. The business income of the firm for the assessment year 2006-07 is Rs.3,30,000. Your answer should be supported by reasons.
- (b) The Income Tax Act, 1961 provides for taxation of a certain income earned by X. The Double Taxation Avoidance Agreement, which applies to X excludes the income earned by X from the purview of tax. Is X liable to pay tax on the income earned by him? Discuss. **(4 Marks)**
- (c) A Co-operative Society engaged in the business of banking seeks your opinion in the matter of eligibility of deduction U/s. 80P on the following items of income earned by it during the year ending 31.3.2006:
- i. Interest on investment in Government securities made out of statutory reserves.
 - ii. Hire charges of safe deposit lockers.

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- (d) The Assessing Officer found during the course of assessment of a firm that it had paid rent in respect of its business premises amounting to Rs.60,000, which was not debited in the books of account for the year ending 31.3.2005. The firm did not explain the source for payment of rent. The Assessing Officer proposes to make an addition of Rs.60,000 in the hands of the firm for the assessment year 2005-06. The firm claims that even if the addition is made, the sum of Rs.60,000 should be allowed as deduction while computing its business income since it has been expended for purposes of its business. Examine the claim of the firm. **(2 Marks)**

Question 5

- (a) S, an individual filed his return of income for the assessment year 2005-06 erroneously offering for taxation interest received from notified Relief Bonds exempt U/s. 10(15) (iic) in the said return. The Assessing Officer completed the assessment U/s. 143(3) on 20.4.2006 accepting the income returned by S. S had furnished complete particulars relating to the interest income in the return of income. S approaches you for advice regarding the steps to be taken to secure exemption of the income. Advise S about the various remedies available under the Income Tax Act, 1961 for the redressal of his grievance.
- (b) D, a lady received the following gifts during the year ending 31.3.2006:
- Rs.30,000 from her elder sister.
 - Rs.50,000 from the daughter of her elder sister.
 - Rs.1,25,000 from various friends on the occasion of her marriage.
- Discuss the taxability or otherwise of these gifts in the hands of D.
- (c) What is the circumstance in which it is not necessary for a non-resident Indian, whose total income is above the taxable limit to file his return of income U/s. 139(1)?

Question 6

- (a) State whether the following persons are liable to pay fringe benefit tax in respect of the fringe benefits provided to their employees: **(3 Marks)**
- Hindu Undivided Family having 30 employees on its rolls in its textile business.
 - Charitable trust running a hospital registered U/s. 12AA.
- (b) Examine the liability to fringe benefit tax in respect of the following items of expenditure incurred by the Private Limited Company: **(3 Marks)**
- Transport allowance paid to employees exempt U/s. 10(14) read with rule 2BB.
 - Expenditure on conference of dealers.
 - Free medical samples distributed to doctors by its Pharmaceutical manufacturing unit.
- (c) X, an individual whose total sales in the business of food grains in the year ending 31.3.2005 was Rs.66 lakhs did not maintain books of account. The Assessing Officer levied penalties U/s. 271A for non-maintenance of books of account and section 271b for not getting the books audited as required by section 44AB. Is the Assessing Officer justified in levying penalty U/s. 271B? **(3 Marks)**
- (d) An assessee sustained a loss under the head "Income from House Property" in the previous year relevant to the assessment year 2005-06, which could not be set off against income from any other head in that assessment year. The assessee did not furnish the return of loss within the time allowed under section 139(1) in respect of the relevant assessment year. However, the assessee filed the return within the

time allowed U/s. 139(4). Can the assessee carry forward such loss for set off against income from house property of the assessment year 2006-07? **(3 Marks)**

Question 7

(a) 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 made an application to its Assessing Officer for determination of the rate of tax 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?

(8 Marks)

(b) Can an employee of a State Government claim exemption U/s. 10(10C) in respect of compensation received on voluntary retirement to the extent of Rs.5 lakhs and relief U/s. 89(1) in respect of the amount of compensation in excess of Rs.5 lakhs? **(4 Marks)**

(c) (i) J inherits a house property from his father, who had mortgaged it. J discharges the mortgage Debt. J later sells the property. Can he claim the amount paid to the mortgagee as cost of improvement in computing the capital gain? **(4 Marks)**

(ii) L mortgaged his house property and utilized the mortgage amount to perform the marriage of his son. He paid the amount to the mortgagee later. Upon sale of the said property thereafter, he claims the mortgage debt discharged as forming part of the cost of acquisition. Can capital gain be computed accepting his claim?

Question 8

G, an individual furnishes the following particulars of his Assets and Liabilities as on 31.3.2006: **(10 Marks)**

Assets	Rs. in lakhs
Residential house at New Delhi	25
Residential house at Agra	15
Plot of land comprising an area of 450 square meters at Mumbai	60
Houses at New Delhi exclusively used for carrying on his business	15
Commercial complex at Agra	20
Residential house at Chennai let out for 335 days during the relevant previous year	10
Motor cars used in business of running them on hire	20
Shares in Private Limited Companies	25
Cash in hand	3
Gold jewelry	12

Liabilities

Loan borrowed for purchase of land at Mumbai	20
Loan borrowed for purchase of shares in Private Limited Companies	10
Loan borrowed for purchase of Gold Jewellery	6

Amounts stated against 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 wealth of G for the Assessment Year 2006-07.

State the reasons for inclusion or exclusion of the various items.