
PAPER 7: DIRECT TAXES
NOVEMBER 2005

Answer all questions.

Question 1

The net profits of XYZ Ltd. for the year ended 31st March, 2005, after debiting/crediting the following items, were Rs. 9 lakhs : **(16 Marks)**

- (a) The company had taken on lease an old building for the purposes 'of locating its business. Due to old age of the building, it was demolished and a new building Put up, which was used for purposes of XYZ's business from September, 2004. The cost of the new building Rs. 10 lakhs was written off as revenue expenditure. The lessor permitted the company to have an extension of the lease by another twenty years.
- (b) Rs. 1 lakh was' paid as an annual fee for technical services to a foreign collaborator under an agreement approved by the Government.
- (c) The company collected Rs. 3 lakhs from its customers by way of sales tax in the year 1986-87 and had remitted it to the State Government in due time. On the levy being challenged in the High Court, the Court held the collection as illegal and the State Government in February, 2005 refunded. the amount to the company.
- (d) Land development charges of Rs. 1.5 lakhs were paid to the State Industrial Development Corporation on allotment of a commercial plot.
- (e) A criminal case was filed against a Director of the company, in his official capacity. The company spent legal expenses of Rs. 50,000 defending him in . the proceedings. The Director was acquitted of the charges at the end.
- (f) The company issued in the year bonus shares to its shareholder and for that purpose and to enhance the authorized capita. Fees of Rs.1.5 lakhs were paid to the Registrar of Companies in this regard. These have been written off in the accounts as revenue expenses.
- (g) The company paid Rs. 70,000 as interest on deposits to some of the nonresident buyers on advances received from them. No tax at source was deducted on the payment.
- (h) Overdraft interest of Rs. 40,000 was paid to the company'~ bank to enable the company to pay its income tax dues.
- (i) The opening and closing stocks of the year were Rs. 90,000 and Rs. 1,17,000 respectively and were undervalued by 10% on cost.
- (j) Some investments were held by the company (not as stock in trade), which had to be depreciated by Rs. 4.8 lakhs due to a directive from the Government.

The balance on 1st April, 2004 to the Profit and Loss Account, shown separately in the Balance Sheet, was a debit of Rs. 2 lakhs.

The company had the following claims brought forward from the prior year :

Business losses relating to

Assessment Year 1994-95	Rs 8 lakhs
Assessment Year 2002-03	Rs.4 lakhs
Losses under the head capital gains--	
Long term Assessment Year 2003-04	Rs.3 lakhs
Unabsorbed depreciation (as per IT records as well as the books of the company)	12.50 lakhs

Required to :

- (a) Calculate the total income of XYZ Ltd. for the assessment year 2005-06 [Your answer should clearly indicate the reasons for the treatment of the individual items given above.]
- (b) Examine the applicability of Section 115JB of the income-tax Act to the company for the same assessment year.

Question 2

- (a) Can penalty under Section 271(1)(c) of the Income-tax Act for concealment of income or particulars thereof be imposed on "intangible" additions to income made by the Assessing officer:
Can these additions be utilized by the asses sees to explain investments made in the subsequent years ?
Is there any time limit for initiation of penalty proceedings in such cases ? Discuss. **(5 Marks)**

- (b) State the cases where the benefit of indexation of costs is not available for determination of capital gains. **(5 Marks)**

- (c) A charitable trust, whose income can be exempt under Section 11 of the Income-tax Act, was formed on 1st March, 2004. For the accounting year ended 31st March, 2005, it earned an income of Rs.60,000. It filed with the Commissioner of Income-tax its application for registration on 30th March, 2005 explaining that for good and sufficient reasons, it was prevented from filing the application by the due date. **(5 Marks)**

State:

- (i) by which date the application for registration should have been filed;
- (ii) whether such an application could have been filed before the formation of the trust;
- (iii) in, the absence of an order of registration from the Commissioner, can the trust be deemed to be registered;
- (iv) the steps to be taken by the trust to secure exemption from Income-tax;
- (v) whether a certificate of registration once granted can be cancelled and if so, the conditions therefore.

Question 3

- (a) Tarun Shipping Co. Ltd., having its registered office in Mumbai, plies two ocean-going vessels which it owns. The registered tonnage of two vessels are 47,549 tonnes and 800 kgs and 25,759 tonnes and 400 kgs respectively. The first vessel, in the accounting year 2004-05, the first vessel was operated for 360 days and the second for 199 days. **(6 Marks)**

The accounts of the company reveal the following results:

- | | |
|--|----------------|
| (i) Profit from core shipping activity | Rs.60.50 lakhs |
| (ii) Profit from incidental activity | Rs.15,000 |

Compute the tax payable by the company for the assessment year 2005-06, taking note of the new provisions of the law. relating to taxation of income of shipping companies. Also indicate the specified conditions for the applicability of the new procedure.

(b) M, an individual, was carrying on a business as sole proprietor. On his death, his legal heirs decide to continue the same business by forming a firm.

At the time of death, M had a determined business loss of Rs. 2 lakhs, under the provisions of the Income-tax Act, to be carried forward.

Does the firm, consisting of all the legal heirs of M, get a right to have this loss adjusted against its current income? Discuss. **(4 Marks)**

(c) X Ltd., is a company engaged in the business of growing, manufacturing and selling of Tea. For the accounting year ended 31st March, 2005, its composite business profits, before an adjustment under Section 33AB of the Income-tax Act, were Rs. 60 lakhs. In the year, it deposited Rs. 25 lakhs with NABARD.

The company has a business loss of Rs. 10 lakhs brought forward from the previous year. The company withdrew in February, 2005 Rs. 20 lakhs from the deposit account to buy a non-depreciable asset for Rs. 18 lakhs and could not use the balance before the end of the accounting year. The withdrawal and the purchase were under a scheme approved by the Tea Board.

The non-depreciable asset was sold in November, 2005 for Rs. 29 lakhs. Indicate clearly the tax consequences of the above transactions and the total income for the relevant years. **(5 Marks)**

Question 4

(a) T and Q are individuals, who constitute an Association of persons, sharing profit and losses in the ratio of 2 : 1. For the accounting year ended 31st March, 2005, the Profit and Loss account of the business was as under: **(8 Marks)**

		Figures are in Rs.'000s	
Cost of goods sold	4,250.00	Sales	4,900
Remuneration to :		Dividends from companies	25
T	130.00	Capital gains—	
Q	170.00	Long term	640
Employees	256.00		
Interest to:			
T	48.30		
Q	35.70		
Other expenses	111.70		
Sales tax penalty due	39.00		
Net profit	524.30		
	5,565		5,565

Additional information furnished :

- (i) Other expenses included :
- entertainment expenses of Rs. 35,000;
 - wristwatches costing Rs. 2,500 each were given to 12 dealers, who had exceeded the sales quota prescribed under a sales promotion scheme;
 - Employer's contribution of Rs. 6,000 to the Provident Fund was paid on 14th January, 2005.
 - Rs. 30,000 was paid in cash to an advertising agency for publicity.
- (ii) Outstanding sales tax penalty was paid on 15th October, 2005. The penalty was imposed by the Sales-tax Officer for non-filing of returns and statements by the due dates.

T and Q had, for this year, income from other sources of Rs. 94,000 and Rs. 32,000 respectively.

Required to :

- (i) Compute the total income of the AOP for the assessment year 2005-06;
- (ii) Ascertain the tax liability of the Association for that year; and
- (iii) Ascertain the tax liability for that year of the individual members.

(b) M, an individual, is 70 years of age. He is a sitting member of the State Assembly of Karnataka and for the financial year 2004-05 received the following amounts from the Assembly Secretariat: **(7 Marks)**

- (i) Basic pay Rs.3,000 p.m
- (ii) Constituency allowance Rs.8,000 p.m
- (iii) Telephone allowance Rs.4,000 p.m
- (iv) Electricity allowance Rs.3,000 p.m.[from June, 2004 onwards]

He owns a house in Delhi which has been let out at Rs. 5,000 p.m. He received rent for 10 months only, the house having remained vacant for two months. Municipal taxes of Rs. 1,200 were paid by the tenant. Interest of Rs. 14,000 was paid by M on amount borrowed by him to buy the house. M has an agricultural income of Rs. 55,000.

Compute his tax liability for the relevant assessment year.

Question 5

- (a) State whether the provisions of Section 41(1) of the Act can be applied to a case, where refund of excise duty has been obtained by the assessee on the basis of a decision of the CEGAT and where the matter has been taken up in further appeal to the Court by the Central Excise Department. **(4 Marks)**
- (b) Does the Settlement Commission have the power to reduce or waive interest levied under Sections 234A, 234B and 234C of the Income-tax Act? Discuss. **(6 Marks)**
- (c) In the course of search operations under Section 132, a tax payer makes a declaration under Section 132(4) on the earning of income not disclosed. Can that state save the tax payer from a levy of penalty under Section 271(1)(C)? **(4 Marks)**

Question 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 of the Act. Discuss. **(5Marks)**
- (b) In the course of an assessment proceeding, the assessing officer enhanced the value of the closing stock and added the difference to the total income. In the assessment year subsequent to this, the assessee wants the assessing officer to enhance, by the same amount, the value of the opening stock of that year. Discuss the validity of the claim. **(5 Marks)**
- (c) A foreign company, ST, has entered into an agreement with an Indian Company KN for supply of know-how and the agreement is within the Industrial Policy conditions laid down by the Central Government. In the year 2004-05, Rs. 50 lakhs is paid, under the agreement, to ST by KN. **(5 Marks)**

ST claims to have spent Rs. 14 lakhs as expenses in India to be recognized as a deduction.

In the following situations, what will be your decision on the tax liability of the parties:

- (i) The agreement having been entered into before 1st June, 2002 and approved by the Government, KN pays to the Indian Income-tax authorities the tax payable by ST;

(ii) There is no agreement as to KN bearing the tax liability; the royalty payable is decided to be Rs. 59 lakhs net of taxes.

Question 7

New Era Construction Ltd. furnishes the following particulars of its wealth for the valuation date of 31st March, 2005. Compute its net wealth and the wealth tax payable by it for the Assessment year 2005-06 :
(10Marks)

Land in rural area (within 5 km of Aligarh purchased, hi 1990 construction on which is permissible) (Rs. 90 lakhs)	90,00,000
Land in urban area (for construction of all)	20,00,000
Land in urban area (held as stock-in-trade since 1990)	50,00,000
motor car (including one imported car worth Rs. 6 lakhs)	11,00,000
Jewellery (held as stock-in-trade)	18,00,000
Aircraft for use of directors and auditors	1,58,00,000
Bank balance	5,00,000
Cash in hand as per Cash-book	2,70,000
Guest house and land appurtenant thereto in rural area	8,00,000
Residential flats of identical size provided to six employees for their use near factory in rural areas (salaries of two such employees exceeds Rs. 5,00,000 p.a.)	15,00,000
Residence provided to managing director (salary exceeds Rs. 5,00,000 p.a.)	10,00,000
Flats constructed remaining unsold (not held as stock)	30,00,000
Residence provided to whole time director (salary Rs. 15,000 p.m.)	17,00,000
The company has taken the following loans :	
(a) for purchase of jewellery	6,00,000
(b) for purchase of aircraft	7,00,000
c) for flats constructed remaining unsold	2,00,000
(d) for residence provided to whole time director	<u>90,000</u>