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**PAPER – 7 : DIRECT TAX**  
**NOVEMBER 2004**

Answer all questions  
Wherever necessary, workings should form part of your answer.

**Question 1**

A & Co. Limited, engaged in the business of manufacturing, shows a net profit of Rs. 65.00 lacs for the financial year ended 31-3-2004. A scrutiny of the Profit & Loss Account revealed the following: **(16 Marks)**

- (i) Rent of Rs.2.40 lakhs from a commercial property owned by the company and let to a Bank was included as profit.
- (ii) Rent of Rs. 2.40 lakhs from a commercial property owned by the company and let to a bank was included as profit.
- (iii) Loss of Rs. 5 lakhs due to non-realization of advances given to a wholly owned subsidiary Company engaged in the business of hire-purchase financing charged to Profit & Loss Account.
- (iv) The Company used to include interest cost in valuation of its finished stock upto the financial year 2002-03. During the financial year 2003-04 the Company changed its accounting policy to adopt AS-2 (Valuation of Inventories) issued by the ICAI and excluded interest cost in valuation of finished stock. This has resulted in a decrease in the year's profit by Rs.15.40 lacs.
- (v) Municipal taxes on commercial property debited Rs. 0.22 lacs, which were ultimately paid on 1-12-2004.
- (vi) The company has received equity share of AB Ltd. valued at Rs.1.25 lacs in exchange of equity shares of CD Ltd. in a scheme of amalgamation during the year. The shares in CD ltd. were acquired in 1998-99 at a cost of Rs. 0.40 lac. The surplus has been credited to Profit & Loss account. Both AB and CD are Indian companies.
- (vii) An executive, while on business trip abroad, died and gratuity paid voluntarily amounted to Rs. 6.00 lacs
- (viii) As restructuring of its debt, the company has converted arrears of interest of Rs. 5.00 lakhs on term loan into a new term loan with a revised repayment schedule. The company has paid Rs.0.50 lac towards such funded interest during the year.
- (ix) Legal charges in connection with alteration of the Articles of Association Rs. 1.50 lacs and for issue of bonus shares Rs. 5.00 lacs.
- (x) The company has purchased scrap materials amounting to Rs. 0.60 lac, the payment for which was made in cash on 15th August, 2003.
- (xi) The profit, as shown above, includes Rs.5.00 lacs received from a Foreign Government for use of company's product. This was, however, not brought into India.

Compute the net income of the company for the assessment year 2004-05 clearly indicating the basis of treatment of each item.

**Question 2**

- (a) A private limited company has share capital in the form of equity share capital . The shares were held up till 31<sup>st</sup> March, 2002 by four members A, B, C and D equally. The company made losses/profits for the past three assessment years as follows: **( 9 marks)**

Asst.Year	Business Loss Rs.	Unabsorbed Depreciation Rs.	Total Rs.
2000-2001	Nil	15,00,000	15,00,000
2001-2002	Nil	12,00,000	12,00,000
2002-2003	9,00,000	9,00,000	18,00,000
Total	9,00,000	36,00,000	45,00,000

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The above figures have been accepted by the tax department.

During the previous year 31.3.2003 A sold his shares to Y and during the previous year 31.3.2004. B sold his shares to Z. The profits for the past two previous years are as follows:

31.3.2003 Rs.18, 00,000 (before charging depreciation Rs. 9, 00,000)

31.3.2004 Rs.45, 00,000 (before charging depreciation Rs. 7, 50,000)

Compute taxable income for A.Y. 2004-05. Workings must form part of your answer.

(b) Given below is the summarized Profit and Loss Account of Sun and Sand Limited, engaged in the business of hotel approved by the prescribed authority:

	Rs. (in lacs)
Income	
Realized from service rendered to foreign tourists	75.00
Other business receipts	10.60
Capital gains (short- term)	3.50
Total (A)	<u>89.10</u>
Expenses (Total)	37.50
Transfer to reserve U/s. 80HHD	15.00
Total (B)	<u>52.50</u>
Net profit	(A-B) <u>36.60</u>

Following further informations are given:

- Expenses includes Rs. 6.70 lacs being interest on term loan from bank. The amount remains unpaid as of date.
- Services rendered to foreign tourists include Rs. 8.00 lacs received in convertible exchange after 30.9.2004 and Rs. 1.00 lakh by sale of articles from shops belonging to the company.
- Other business receipts includes Rs. 4.00 lacs (INR) from an approved tour operator rendering services to the foreigner.

Compute the amount of deduction that can be claimed by the company under section 80 HHD.

### Question 3

- R purchased equity shares in P. Ltd., a constituent of BSE-500 index on Mumbai Stock Exchange on 1<sup>st</sup> March, 2003. He sold the shares on 4<sup>th</sup> March, 2004 at a loss of Rs. 10,000. He wants to set off the loss against other long-term capital gain during the year. Examine whether such set off is permissible. Both purchase and sale transactions were entered into on recognized stock exchange. **(4 Marks)**
- Dinesh, an individual engaged in the business of finance advances Rs.5 lacs to his HUF on interest at 12% p.a., which is the prevailing market rate. The HUF invest the amount in its business and earn profit of Rs. 2 lakhs from this money. Can the assessing officer add a sum of Rs. 1, 40,000 (i.e. Rs.2, 00,000 – Rs.60, 000) as income of Dinesh under section 64(2) of the Income-tax Act? Will the position remain the same, if Dinesh does not charge any interest? **(4 Marks)**
- A domestic company is liable to pay minimum alternate tax under section 115JB for the Assessment Year 2003-04. While computing book profit under section 115JB the company claims provision for deferred tax charged to Profit & Loss account in accordance with Accounting Standard – 22 of the Institute of Chartered Accountants of India, which is sought to be disallowed by the Assessing Officer. On what grounds you can contest such disallowance? **(4 Marks)**

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**Question 4**

- (a) J filed a return of income for the Assessment Year 1999-2000, in due time disclosing a total income of Rs. 4 lakhs. The taxes due on the income were covered by taxes deducted at source, advance tax and self-assessment tax. **(4 Marks)**  
The return was taken for scrutiny by the Assessing Officer, who made large additions to the income enclosed by J. On appeal, the High Court set aside the order of assessment and directed a fresh assessment to be made after hearing the parties. The court order had become final since neither party had performed an appeal against it.  
The assessing officer did not make any fresh assessment with the result that the assessment becomes based by time.  
J has filed a petition that since no assessment of his income had been made by the assessing officer the entire taxes paid, including the pre-assessment payments, must be refunded to him.  
Is he justified in making this claim? Discuss.
- (b) An assessment was completed by the Assessing Officer under Section 143(3) on the basis of return submitted and other information furnished by the assessee. The Assessing Officer accepted the cost of the land after waiting for a reasonable period for report of the valuation officer to whom a reference was made. Subsequent to receiving the report from the valuer, it revealed that there was a variation by about Rs. 3.00 lacs. On the basis of this valuation report, the Commissioner issued notice under section 263 to set aside the completed assessment. **(3 Marks)**  
Justify the action of the Commissioner.
- (c) M filed return of income for Assessment Year 2003-04 claiming a refund of Rs. 45,000. The said refund was granted and paid to the assessee on 1<sup>st</sup> March, 2004 after processing the return under section 143(1). Later on the case was taken up for regular assessment by issue of notice under section 143(2) and the said assessment was completed on 16<sup>th</sup> August, 2004 resulting in demand of Rs. 2500. Is the assessee liable to interest on the amount of refund already granted to him and if so, what is the amount of such interest? **(3 Marks)**
- (d) A search was initiated in the premises of an assessee on 11<sup>th</sup> November, 2003 and it was concluded on 14<sup>th</sup> November, 2003. What is the period of limitation for issue of notice for making assessment of preceding six assessment years? In case assessments under Section 143(3) for assessment year 2001-02 and appeal before CIT (A) for assessment year 1999-2000 are pending on 11<sup>th</sup> November, 2003, what would be the fate of such pending assessment and appeal? **(4 Marks)**

**Question 5**

- (a) Explain the incidence of taxation on mutual concerns. **(4 Marks)**
- (b) A company engaged in the manufacturing of pharmaceutical products, commenced its business on 1.4.2003. During the financial years 2000-01 to 2002-03 it had incurred Rs. 2.00 lacs annually as expenditure on salaries and purchase of raw materials for the purpose of research connected with its business. During the previous 2003-04, it incurred on scientific research, revenue expenditure of Rs. 2.00 lacs and a capital expenditure of Rs. 3.50 lacs on purchase of plant and machinery. Since the result of the research was unsuccessful, the company sold its plant and machinery on 31.12.2003 for Rs. 8.00 lacs and closed its research activity. Compute the admissible deduction under Section 35 for the assessment year 2004-05. **(4 Marks)**
- (c) A company engaged in textile manufacturing, debited to its Profit & Loss Account a sum of Rs. 60,000 being the interest on loan of Rs. 6,00,000 taken for financing its expansion scheme. The plant and machinery for the project purchased with the loan were not received during the year and those were still in transit at the end of the year. A sum of Rs. 6,000 was paid to a broker who arranged the loan. Discuss the admissibility or otherwise of the interest on borrowing. **(4 Marks)**

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**Question 6**

- (a) R & Co. is a partnership firm consisting of two partners R and S. The partners decide to dissolve the firm on 31.3.2004. The firm owns a land which was purchased 15 years back. One of the decisions taken in the scheme of dissolution was that the land, whose present market value was ascertained at Rs. 15, 00,000, would be given to S. A suggestion was made to the firm that instead of making an allotment at the time of dissolution, the firm can gift the land to S by making book entries. Discuss the pros and cons of the decision and advise the firm suitably in this context. **(6 Marks)**
- (b) Redemption of preference shares amounts to “transfer” within the meaning of Sec. 2(47) of the Income Tax Act, 1961 in the hands of the shareholder. Discuss. **(4 Marks)**

**Question 7**

- (a) S. Ltd. is engaged in export of goods manufactured by it and by others. During a year it has suffered loss in export of trading goods but earned good profit in export of manufactured goods. The company is of the view that it can claim deduction U/s. 80HHC in respect of entire profit from export of manufactured goods ignoring the loss from export of trading goods, as Section 80 HHC basically is an incentive provision. Discuss the correctness of the view. **(4 Marks)**
- (b) US Ltd., a US company has a subsidiary, IND Ltd. in India. US Ltd. sells computer monitors to IND Ltd., for resale in India. US Ltd. also sells computer monitors to CMI Ltd., another computer reseller. It sells 50,000 computer monitors to IND. Ltd. at Rs. 11,000 per unit. The price fixed for CMI Ltd. is Rs.10,000 per unit. The warranty in case of sale of monitors by IND. Ltd. is handled by IND. Ltd. However, for sale of monitors by CMI Ltd. US Ltd. is responsible for the warranty for 3 months. Both US Ltd. and IND Ltd. offer extended warranty at a standard rate of Rs. 1,000 per annum. On these facts, how the assessment of IND Ltd. is going to be affected? **(8 Marks)**

**Question 8**

- (a) X Limited is engaged in the construction of residential flats. For the valuation date 31.3.2004, it furnishes the following data and requests you to compute the taxable wealth: **(6 Marks)**
- (i) Land in urban area (Construction is not permitted as per Municipal Laws in force) Rs. 35, 00,000
  - (ii) Motor-cars (used on hire by the company) Rs. 7, 00,000
  - (iii) Jewellery (Investment) Rs. 15, 00,000. Loan taken for purchasing the same Rs. 10, 00,000
  - (iv) Cash Balance (as per books) Rs. 1,75,000
  - (v) Bank Balances Rs.2,50,000
  - (vi) Guest House (situated in a place which is 30 kms away from the local limits of the municipality Rs.6,00,000
  - (vii) Residential flats occupied by the Managing Director Rs. 10, 00,000. the managing director is on whole time appointment and is drawing remuneration of Rs. 2,00,000 per month.
  - (viii) Residential house were let out on hire for 200 days Rs.8,00,000

The computation should be supported with proper reasoning for inclusion or exclusion.

- (b) What are the various circumstances under which an assessee will be deemed to have concealed the particulars of his net wealth or furnished inaccurate particulars thereof? **(4 Marks)**