

PAPER 7: DIRECT TAXES
MAY 2004

Answer all Questions.

Question 1

A domestic company, ABC Ltd., has an undertaking newly established for export of Computer Software in a free trade zone, the profits of which have been merged in the net profit of the company as per profit and loss account prepared in accordance with the provisions of Parts II and III of schedule VI to the Companies Act. It furnishes the following particulars in respect of Assessment Year 2004-05 and seeks your opinion on the application of Sec.115JB. You are also required to compute the total income and tax payable. **(16 Marks)**

(1) Net profit as P and L A/c as per Schedule VI	Rs. 200 lakhs
(2) Profit and Loss A/c. includes:	
(a) Credits : Dividend Income	Rs. 20 lakhs
Excess realized on sale of land held as investment	Rs. 30 lakhs
Net profit of the undertaking for export of computer software	Rs. 100 lakhs
(b) Debits : Depreciation on straight line method basis	Rs. 100 lakhs
Provision for losses of subsidiary company	Rs. 60 lakhs
(3) Depreciation allowable as per I.T. Act and Rules	Rs. 150 lakhs
(4) Capital gains as computed under I.T. Act	Rs. 40 lakhs
(5) Losses brought forward as per books of account:	
Business loss	Rs. 50 lakhs
Unabsorbed depreciation	Rs. 60 lakhs

The company has represented to you that the excess realized on sale of land cannot form part of the book profit for purposes of sec.115JB. You will have to deal with this issue.

Question 2

A non-resident Indian has the following sources of Income in India. You are required to compute his total income and determine his tax liability. Details of your working, with reasons, should form part of your answer: **(12 Marks)**

(1) Dividend from Indian Company	Rs. 50,000
(2) Interest on debentures of an Indian company invested out of remittances in convertible foreign exchange	Rs. 75,000
Less: Interest paid on money borrowed in India for investment in the debentures	Rs. 25,000
	Net Rs. <u>50,000</u>
(3) Long term capital gains on sale of shares subscribed in convertible foreign exchange:	
Cost in 2000-01	Rs. 2,00,000
Sales in 2003-04	Rs. <u>3,00,000</u>
	Rs. 1,00,000
Less : Brokerage	Rs. <u>10,000</u>
Inflation index 2000-01	406
2003-04	462
	Rs. 90,000
(4) Property income in India (Net)	Rs. 2,00,000
T.D.S.	Rs. 30,000

The property was acquired partly out of a loan from HDFC. The repayment of loan made during the year amounted to Rs.20,000. The assessee also claims deduction of Rs.10,000 by way of donation to the Prime Minister's Relief Fund and of Rs.50,000 towards repayment of loan taken for higher education in India in 1998 before his migration.

Question 3**(3×4=12 Marks)**

- (a) V.G. had placed a deposit of Rs.10 lakhs in a Bank on which he received interest of Rs.80,000. he had also borrowed Rs.5 lakhs from the same Bank on the security of the deposit and was liable to pay Rs.50,000 by way of interest to the Bank. He therefore, offered the difference between two amounts of Rs.30,000 as income from other sources. Is this correct?
- (b) A company had an inventory of closing stock on 31.03.02, the cost of manufacture of which was Rs.10 lakhs. Since the goods were liable to excise duty, a provision of Rs. 10 lakhs towards the duty was also made in the accounts.
Since the excise duty was eligible for deduction only on actual payment, the company valued the closing stock at cost viz., Rs.10 lakhs. Discuss the position from the taxation point of view.
- (c) A Hindu Undivided Family owns a property which has been let out to a firm carrying on business. The family is a partner in the firm through the Karta. No rent has been charged by the H.U.F from the firm for use of the premises by the firm. The Assessing Officer, however, has taxed the family on the notional income from property based on municipal valuation. Is this decision justified?

Question 4**(2×6=12 Marks)**

- (a) An institution has been established wholly for charitable and religious purposes within the meaning of Sections 11 and 12 of the I.T.Act. Donations made to such an institution do not automatically qualify for deduction U/s. 80G. discuss the validity of this proposition. .
- (b) Expenditure on medical treatment of an assessee and members of his family constitutes a major elements of a household budget, particularly if he or a member of his family suffers from physical disability . Discuss the relevant provisions which provide relief or deductions available to a non-salaried person, in this respect.

Question 5

- (a) A Public Sector Company has engaged you to frame a scheme of voluntary separation for its employees in order that the amount received by the employees under the scheme would qualify for tax exemption U/s. 10(10C). What points would you bear in mind while drawing up the scheme? What will be the tax treatment of the payments under the scheme in the hands of the company? **(6 Marks)**
- (b) What is meant by the term “Demerger”? What are the exemptions and benefits available as a result of a demerger transactions? **(4 Marks)**

Question 6

- (a) Aries Tubes Private Ltd., went into liquidation on 1.6.03. The company was seized and possessed of the following funds prior to the distribution of assets to the shareholders: **(7 Marks)**

Share capital	Rs.	5,00,000
Reserves prior to 1.6.2003	Rs.	3,00,000
Excess realization in the course of liquidation	Rs.	<u>5,00,000</u>
Total	Rs.	<u>13,00,000</u>

There are 5 shareholders, each of whom received Rs.2,60,000 from the liquidation in full settlement. The shareholders desires to invest the resultant element of capital gains in long term specified assets as defined in Sec.54EC. You are required to examine the various issues and advice the shareholders about their liability to I.T.

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- (b) A partnership firm, consisting of three partners A , B and C was engaged in the business of Civil Construction and received the following amounts by way of contract receipts: **(5 Marks)**

Contract work for supply of labour	Rs. 30,00,000
Value of materials supplied by Government	<u>8,00,000</u>
Total value of contract	<u>38,00,000</u>

Each partner of the firm was entitled to draw Rs.2,500 by way of salary as authorized by the terms of the partnership deed. Interest of Rs.1,00,000 was also paid to partners C on the capital of Rs.5,00,000 contributed by him. The profit as per books of accounts, before deduction of salary to partners and interest to partner C amounted to Rs.2,50,000. Compute the total income of the firm, applying the provisions of sec.44AD.

Question 7

- (a) E-commerce transactions have replaced concepts generally associated with international transactions traditionally. Discuss briefly the issues involving such transactions. **(7 Marks)**
- (b) Explain the doctrine of form and substance in the context of tax planning. **(4 Marks)**
- (c) What is the deduction allowable in respect of donations for political purposes? How will expenditure on advertisements in souvenirs of political parties be dealt with, in computing income from business ? **(5 Marks)**

Question 8

- (a) A company incorporated outside India is not liable to wealth tax in India. **(2 Marks)**
- (b) A co-operative society formed for the purpose of construction of residential flats for its members acquired a large area of urban land for Rs.3 crores. The society had a membership of 10 members, all having equal share. The Assessing Officer proposes to tax urban land in the hands of the society. **(8 Marks)**
- What is meant by urban land?
 - Is the action of the Assessing Officer correct?
 - Can the members of the society be assessed on their share in the value of the urban land?