
PAPER—7 : DIRECT TAXES
MAY 2000

Answer all questions.

Question 1

You are consulted on the justifiability of the following claims. Your advice is to be framed based on the provisions of the Income-tax Act, 1961:

- (i) A liability towards expenditure as per agreement was provided in the books. However it was disputed for payment, before a court of Law on interpretation of clauses of the agreement. Can it be claimed in the year of provision? **(3 marks)**
- (ii) A company paid the full consideration for building acquired for its Administrative Office and occupied the same as the possession was taken. The Registration could not take place before the end of the previous year for some reason or other. Can the depreciation claim be made? **(3 marks)**
- (iii) Secret Commission was paid and debited under Commission Account. Is it allowable expenditure? **(3 Marks)**
- (iv) Mr. Govind won the first prize in the lottery ticket and the prize money was a Maruti car worth Rs. 2 lakhs. According to Section 194B, tax has to be deducted at source from the winnings of lottery at the time of payment of the prize money. What is the procedure to be adopted before handing over the Maruti car to Mr. Govind? **(3 Marks)**
- (v) A private trust has two individuals and one HUF as beneficiaries and their shares were equal. The trust borrowed certain amounts on which interest payable to a single lender was Rs. 15,000. Is the trust obliged to deduct tax at source at the time of payment/credit of such interest to the lender? **(3 marks)**

Question 2

- (a) The assessee was a company carrying on business of manufacture and sale of art-silk cloth. It purchased machinery worth Rs. 4 lakhs on 1-5-1995 and insured it with United India Assurance Ltd., against fire, flood, earthquake etc. Depreciation was granted at 15% for each assessment year. The insurance policy contained a reinstatement clause requiring the insurance company to pay the value of the machinery, as on the date of fire etc, in case of destruction or loss. A fire broke out in August, 1999 causing extensive damage to the machinery of the assessee rendering them totally useless. The assessee company received a sum of Rs. 6 lakhs from the insurance company on 15th March, 2000. Discuss the issues arising on account on the transactions and their tax treatment. **(8 marks)**

[Cost Inflation index for financial year 1995-96 and 1999-2000 are 281 and 389 respectively].

- (b) An Assessee purchases know-how for manufacture of fuel injection pipes on 10.4.1998. He wants proportional reduction for six assessment years U/s.35AB of the Act commencing from A.Y. 1999-2000. Is this allowable? **(4 marks)**

Question 3

Raman & Co. Ltd., is a closely held company engaged in manufacture of insecticides and fertilizers. The value of Plant and Machinery owned by the company is Rs. 55 lakhs. Its profit and loss account for the year ended 31.3.2000 was as under: **(14 marks)**

	Rs.	Rs.
Domestic Sales	22,23,900	
Export Sales	5,76,100	
Other Receipts	<u>2,00,000</u>	<u>30,00,000</u>

Less: Expenses

Depreciation	4,16,000	
Salary & Wages	1,34,500	
Entertainment expenses	10,000	
Travelling expenses	36,000	
Y2K Expenses	5,000	
Income-tax	3,50,000	
Wealth-tax	8,000	
Outstanding customs duty	17,500	
Provision for unascertained Liabilities	70,000	
Proposed dividends	60,000	
Loss of subsidiary company	30,000	
Consultation fees paid to a tax Consultant	21,000	
Salary and perquisites of Managing Director	1,80,000	
Excise duty	75,500	14,13,500
	Net Profit	15,86,500

The assessee claims the following as deductions:

- Deduction under section 80 HHC, foreign exchange remittance being Rs. 50,000
- Deduction under section 80-IB—30% of Rs. 15,86,500
- Excise duty pertaining to 1995-96 paid during 1999-2000 Rs. 75,500
- Depreciation under section 32 is Rs. 5,36,500.

The following further particulars are furnished.

	For tax purposes Rs.	For accounting purposes Rs.
Brought forward loss of 1996-97	11,80,000	9,10,000
Unabsorbed depreciation	Nil	2,45,000

Calculate the tax liability of the company.

Question 4

- (i) Mr.Gautham, who is not a supporting manufacturer, gives the following particulars and his only source of income is from the proprietary export business: **(8 marks)**

Trading and Manufacturing Account			
To Purchase of Trading of goods	10,00,000	By Sales Export Trading Goods	12,00,000
To Purchase of raw materials for Marketing	5,00,000	By Sales Export Manufactured Goods FOB	9,00,000
To Wages, electricity etc. for manufacturing	2,00,000		
To Gross profit	4,00,000		

	21,00,000		21,00,000
To Administration Expenses	3,00,000	By Gross Profit	4,00,000
To Net Profit	6,00,000	By Brokerage, Commission, Interest, Rent, etc.	2,00,000
		Duty draw back and Profit on sale of Import Licence	3,00,000
	9,00,000		9,00,000

(ii) Balance sheet of JB Optical Limited as on 31.03.1999 reads as under: (5 marks)

Paid-up Capital		Rs.2,52,00,000
	Unit 'A'	Unit "B"
	(Rs.)	(Rs.)
Fixed Assets	1,00,00,000	1,50,00,000
Debtors	1,00,00,000	75,00,000
Liabilities	28,00,000	50,00,000
Stock-in-trade	50,00,000	25,00,000
Reserves		1,48,00,000
Share premium		22,00,000
(Revaluation Reserve)		(70,00,000)

The company acquired Unit 'B' on 1.04.1997. They made certain capital additions in the form of Generator Set and additional building etc., for Rs. 25 lacs during the year 1997-98. The Members of the company have authorized the Board in their meeting held on 28.01.2000 to dispose of the Unit 'B'. The company decides to sell the Unit 'B' by way of slump sale for Rs. 225.00 lacs as consideration. The buyer has agreed with the vendor-company to give time for putting through the sale but not later than 30.06.2000 subject to a discount of 1% on agreed sale consideration. However, this discount is not applicable if the sale is completed after 31.03.2000. The company now approaches you to advise them as a measure of tax planning to determine the date of sale keeping in view of the capital gains tax.

Question 5

(a) Ravi Traders, A partnership firm consisting of three partners, 'A', 'B' and 'C' is assessed to Income-tax as partnership firm assessed as such. 'B' and 'C' retired from the partnership with effect from 31st December, 1998. 'A' took over the business and continued as a Proprietor. The Stock-in-trade as at 31st December, 1998 was valued at average purchase price for settlement of accounts, which was the system consistently followed. On these facts, you are consulted on the following issued: (4 Marks)

Under which provisions of the Income-tax Act, 1961 M/s. Ravi Traders for the period 1.4.1998 to 31.3.1999 shall be assessed for the assessment year 1999-2000? Can the Assessing Officer dispute the stock valuation in the assessment of the firm?

(b) 'A' desires to admit three partners from 1st April, 2000. Amongst the partners, it is agreed that two partners, shall be the working partners and be paid remuneration, your advice is sought as to the requirements to see that the remuneration to the working partners is allowable in the hands of the firm under the Income-tax Act. (4 Marks)

Question 6

(a) A Foreign company has the following two options before it for the Negotiation with an Indian Company. It seeks your advice as to the incidence to tax, under the provisions of Income-tax Act, 1961, to exercise the better option: (6 Marks)

- Receiving Royalty for the user of rights of manufacturing process.
- Outright sale of Manufacturing Process.

- (b) Amalgamation of companies 'A' and 'B' has been approved by the BIFR in order to rehabilitate the sick company 'B'. During the course of assessment of 'B' company, the Assessing Officer refuses to allow carry forward of losses under Section 72-A of the Income-tax Act for the reason that the activities of the sick company has been closed consequent to labour unrest and that the loss suffered by the said company was 'Capital Loss'. Is the Assessing Officer justified? **(3 Marks)**
- (c) Anand entered into an agreement for sale of certain properties in which there were tenants subject to vacant possession. He had accordingly to pay certain consideration to the tenants for their agreeing to vacate the properties and claimed such payments to secure vacant possession as incurred in connection with the transfer of the property within the meaning of section 48(1) of the Act. Would 'A' succeed in his claim? **(3 Marks)**

Question 7

- (i) The assessment of Shah Ltd for the assessment year 1997-98 was completed U/s. 143(3) on 30.6.99. There was an audit objection that interest on Borrowed ought to have been disallowed partly as there was diversion of Borrowed Funds to sister concerns without charge of interest. Shah Ltd. did not accept the audit objection. On these facts
- What are the options to revenue to deal with audit objection.
 - Can the assessment be reopened? **(4 Marks)**
- (ii) Penalty is not leviable, if certain conditions are satisfied, in the case of block assessment – Discuss.
- (iii) Ajay is employed as senior executive of Manu Ltd. offers rights to its existing shareholders in the ration of 1:1 on 15th February, 2000, at Rs. 150 per share. Ajay was offered 500 shares at Rs.150, which he exercised. On these facts you are consulted by Ajay as to
- The tax consequences for the assessment year 2000-01.
 - If Ajay is already a shareholder of 250 shares, allotted in Public issue will it make any difference? **(4 Marks)**

Question 8

- (a) The net wealth of a firm consisting of three partners Balu, Kausik and Deepu having equal shares and a capital contribution of Rs. 7,00,000/-, Rs.3,00,000 and Rs.2, 00,000/- respectively is as under: **(5 Marks)**

	Rs.
(i) Value of assets located outside India	20,00,000
(ii) Value of assets located in India	50,00,000
(iii) Debts incurred in relation to assets in India	10,00,000

Determine the value of interest of the partners in the firm under the Wealth-tax Act, 1957.

- (b) Mr. Vinod assessed to Wealth-tax furnished the following particulars as on valuation date 31st March, 2000: **(6 Marks)**
- His father Anand, who had both immovable and movable assets and assessed to wealth-tax executed a will during his life time appointing executors, related to Anand as uncles. Anand died on 30.09.1999.
 - The executors of the will pointed out that late Anand did not file his return of wealth for the valuation dated 31.9.1998 and 31.3.1999.
 - The executors had completed partial distribution of Estate by 31st March, 2000 and as a consequence he was in receipt of immovable assets valued at Rs.20.00 lakhs.
- On these facts, you are consulted as to (a) How Vinod should proceed for filing his return of wealth as at 31.03.2000 and (b) What is his liability in respect of his late father's wealth-tax Assessment, under the provisions of the act.

iv. In the above facts, what would be the position under the Wealth-tax Act, if Anand has not executed any will?

(c) Discuss treatment for Wealth-tax as on valuation date 31.3.2000, on the following issues in the hands of Raghu: **(4 Marks)**

A private specific trust was created by 'Ramu', in the month of September, 1994, setting an immovable asset from which rental income is derived. According to the trust, Ramu's only Major son 'Raghu' is entitled to receive rental income upto 31st March, 2000 and thereafter the income shall be received by Raghu's children. Ramu died in 1996. The capitalized value of the property as at 31.3.2000 is Rs. 15 lakhs. The property is rented at an income of Rs.75,000 per year. In the financial year 1999-2000, there was unrealized rent of Rs. 50,000.