

**PAPER 7: DIRECT TAXES**  
**MAY 1999**

Answer all questions

**Question 1**

How will you deal with the following issues in the computation of income from business for the asst. year 1999-2000? **(3×5=15 marks)**

- (a) A company wants to claim depreciation on technical knowhow acquired in August, 1997 for the manufacture of a new product for its business at a lumpsum cost of Rs.12 lacs.
- (b) A company imported machinery on 15.09.1998 at a cost of Rs.10 crores. The custom duty payable thereon was 20 percent. The company claimed Modvat Credit of Rs.1 crore against purchase of raw materials. The rate of depreciation on the machinery is 20 percent. Assuming that it was put to use on 15.10.1998, what is the depreciation allowable on the machinery?
- (c) A company was a lessee of an old building under an agreement with the lessor. It demolished the old building and built a new building on the same site at a cost of Rs.10 lakhs and was permitted to reoccupy the new building for a further period of 20years at the old rent. It claimed the expenditure of Rs.10 lakhs as revenue expenditure.
- (d) A company issued 1,00,000 debentures of the face value of Rs.100 each at a discount of Rs.10 per debenture. The discount of Rs.10 lakhs is claimed as an expenditure incurred for the purpose of business by the company.
- (e) Bharat Mines Ltd. An Indian Company, entered into an agreement with British Mines Ltd, a company registered in the United Kingdom for rendering technical services in India for exploration and extractions of ores. The consideration fixed was £5,00,000 and was arrived at as follows:

|   |            |
|---|------------|
| Drawings, designs prepared in UK                              | £ 1,00,000 |
| Engineering services rendered in India                        | £ 2,00,000 |
| Salary and allowances paid to staff deputed for work in India | £ 2,00,000 |

Discuss the taxability of above payments in the hands of British Mines Ltd. (the company registered in UK) in view of Section 115A.

**Question 2**

- (a) AB and Co. is a partnership firm consisting of 2 partners A and B. A search took place in the premises of this firm on 1.5.1999 and as a result thereof., the Assessing Officer arrived at the undisclosed income of the Block period on the basis of the evidence and materials found and information collected by him:

|   |                  |
|---|------------------|
| (a) Investments in immovable property outside the books | 5,00,000         |
| (b) Investments in benami names                         | 2,00,000         |
| (c) Unexplained credits in accounts                     | 10,00,000        |
| (d) Undisclosed stock-in-trade                          | 2,00,000         |
|   | <u>19,00,000</u> |

The position of the assessment of the block period is as under:

| Previous year | Income/ Loss assessed                       |
|---------------|---|
| 1990-91       | + 50,000                                    |
| 1991-92       | + 60,000                                    |
| 1992-93       | - 70,000                                    |
| 1993-94       | + 10,000( after set off or loss of 1992-93) |
| 1994-95       | 90,000                                      |
| 1995-96       | 1,00,000                                    |
| 1996-97       | 1,10,000                                    |
| 1997-98       | 1,20,000                                    |
| 1998-99       | 1,50,000 As per return- assessment pending  |

The salary and interest paid to the partners in the different previous years are as follows and have been deducted in arriving at the total income of three years:

| Previous year | Salary to A<br>Rs. | Interest to B<br>Rs. |
|---------------|--------------------|----------------------|
| 1993-94       | 25,000             | 10,000               |
| 1994-95       | 25,000             | 10,000               |
| 1995-96       | 25,000             | 10,000               |
| 1996-97       | 25,000             | 10,000               |
| 1997-98       | 25,000             | 10,000               |
| 1998-99       | 25,000             | 10,000               |

You are required to arrive at the undisclosed income of the Block period under Chapter XIV-B

**(8 marks)**

(b) The total income of a non-resident Indian includes:

|                         |          |
|-------------------------|----------|
| Investment income (net) | 50,000   |
| Long term capital gains | 25,000   |
| Other income            | 75,000   |
| Total income            | 1,50,000 |

What will be the tax payable by him in respect of asst.year, 1999-2000 on the above income under Chapter XII A of the Income Tax Act? In what manner can the tax liability be reduced in this case?

**(4 marks)**

### Question 3

(a) A foreign company has put forth the following arguments amongst others to say that provisions of Section 115JA regarding minimum alternate tax is not applicable to it:

- The company does not prepare the accounts in accordance with the provisions of Part II and Part III of Schedule VI of the Companies Act, 1956.
- It does not lay its accounts before the General Meeting in accordance with Section 210 of the Companies Act, since no meeting is held in India.
- It does not declare any dividends in India.

Discuss the validity or otherwise of the above arguments. Give reasons

**(8 marks)**

(b) Discuss the validity as well as consequences of the alienation of assets of a business by an assessee during the pendency of a proceeding under the Income Tax Act.

**(4 marks)**

### Question 4

Write notes on:

- Employee Welfare Funds contemplated under Section 10(23AA).
- Valuation of inventory for tax purposes in view of insertion of Section 145A
- Set off and carry forward of loss under the head "Income from house property" in view of insertion of Section 71B
- Deduction in respect of repayment of loan taken for higher education as contemplated under Section 80E

**(4×4= 16 marks)**

### Question 5

(a) Anand Mohan gifted a house property to Miss Hemalatha on 15.3.1997. Miss Hemalatha married Anand Mohan's son Ravi Mohan on 1.2.1999. The income from the gifted property was Rs.30, 000 which was added by the Assessing Officer in the hands of Anand Mohan under the provisions of Section 64(1) Clause (vi). Is this inclusion justified in law?

**(5 marks)**

- (b) An employee of a company has income from house property as well as other sources, besides his salary. The income from house property is a loss. He wants to know whether his income from these two sources can be considered for the purpose of deduction of tax at source when deducting tax under Section 192 on 'Salaries' **(5 marks)**

**Question 6**

- (a) Explain the term 'Amalgamation' as defined in Section 2(IB) of the Income tax Act. **(4 marks)**
- (b) X Co.Ltd was amalgamated with Y Ltd. With effect from 29<sup>th</sup> August, 1998. The written down value of its block of assets as on 1<sup>st</sup> April, 1998, the rate of depreciation on each block and the values at which the block of assets were transferred by X CO. Ltd to Y co. Ltd are given below:

| Block of asset    | Rate of depreciation | w.d.v in the hands of X Co.Ltd as on 1.4.98 | Transfer value to Y Co. Ltd., Rs. |
|-------------------|----------------------|---|-----------------------------------|
| Buildings         | 10 percent           | 10,00,000                                   | 9,00,000                          |
| Plant & Machinery | 25 percent           | 25,00,000                                   | 24,00,000                         |
| Furniture         | 10 percent           | 5,00,000                                    | 4,50,000                          |

You are required to work out the deductions admissible under Section 32 by way of depreciation to X Co. Ltd and to Y Co. Ltd in respect of these assets for the financial year 1998-99 relevant to the asst. year, 1999-2000. It may be noted that amalgamation is in terms of Section 2(IB) of the Income Tax Act. **(8 marks)**

**Question 7**

- (a) On finding that the assessee had claimed excessive depreciation for the year 1995-96, the Assessing Officer initiates action under Section 147 and completes the reassessment. Subsequently, the Assessing Officer having reason to believe that the assessee had failed to disclose certain other income, proceeds on 14.5.1998 to recompute the income under Section 147. The assessee on receipt of the second notice contends that the Assessing Officer is not empowered to initiate reassessment proceedings for second time. Discuss the validity or otherwise of the action of the Assessing Officer. Discuss the position, if the earlier reassessment proceedings had remained pending with the Assessing Officer. **(4 marks)**
- (b) The accounts of Someshwasr & Co. was rejected by the Assessing Officer, who estimated the income applying the gross profit rate as in the earlier year, not allowing any specific expenditure. Further, he made an addition of Rs.20, 000 under Section 40A (3) for certain cash payments effected in respect of purchases. Discuss the validity of the action of the Assessing Officer. **(4 marks)**

**Question 8**

Kanthikar and his wife are partners in a firm A & C. engaged in manufacture of footwear. Their minor son Rishi has been admitted to benefits of partnership. The profit-sharing ratio are:

|                | Profit | Loss |
|----------------|--------|------|
| Kanthikar      | 40%    | 50%  |
| Mrs. Kanthikar | 30%    | 50%  |
| Rishi          | 30%    | -    |

**(15 Marks)**

The abridged Balance Sheet of the firm as on 31.03.1999 is as under

| Capital & Liabilities | Rs. | Assets | Rs. |
|-----------------------|-----|--------|-----|
| Capital:              |     |        |     |

|                    |                  |                  |                  |
|--------------------|------------------|------------------|------------------|
| Kanthikar          | 15,00,000        | Urban house plot | 19,60,000        |
| Mrs. Kanthikar     | 10,00,000        | Jewellery        | 3,80,000         |
| Rishi              | 10,00,000        | Housing Complex  | 34,20,000        |
| Bank Loan          | 4,58,000         | Cash in hand     | 40,000           |
| Income-tax payable | 44,000           | Cash at Bank     | 4,30,000         |
| Loan creditors     | 18,00,000        | Stock-in-trade   | 1,68,000         |
| Trade Creditors    | 5,96,000         |                  |                  |
| Total              | <b>63,98,000</b> | Total            | <b>63,98,000</b> |

As regards the above Balance Sheet, the following further information are available:

1. The Urban house plot is of area 490sq. meters. The bank loan is in respect of this plot. The market value as on 31.3.1999 is Rs.10,000 per sq meter
2. The Housing complex consists of 3 houses of identical area in Delhi, constructed two years back on leasehold land, the lease to expire on 20.01.2040.

The firm carries on business in one of the above three units. The other two residential units have been let out. The pertinent details are:

|   | Unit 1    | Unit 2   |
|---|-----------|----------|
| Let out during the year ended 31.3.99 for                     | 10 months | 9 months |
| Rent per month  | 18,000    | 18,000   |
| Repair expenses born by tenant                                | 28,000    | 18,000   |
| Deposits received from tenants (Interest paid thereon @ 9%pa) | 6,00,000  | 6,00,000 |

The tenant in Unit 2 was running a taxi hire concern and the firm had entered into an agreement with the tenant that he shall provide 2,000 kms of free taxi travel to the firm for its business use. The normal taxi fare charged is around Rs.4 per km. The firm has utilized the 2,000 kms.

The municipal taxes levied for the whole complex are Rs.12, 000 per month.

3. Loan creditors of Rs.18,00,000 relate to the above complex
4. The market value of jewellery is Rs.6,20,000.

Compute the interest of the audit partners and Rishi in the firm M/s A & Co. as on 31.3.1999 for the purpose of computation of net wealth in their respective individual hands. In whose hands will Rishi's net wealth be assessed?