PAPER 7: DIRECT TAXES
MAY-98

Answer all the questions

Question 1

The following issues arise for consideration in connection with the tax audit of a company under section 44AB of the Income tax Act, 1961:

a) The turnover of the business of the company for the year ended 31.3.1997 amounted to Rs.38 lakhs. On verification, it is found that the company maintains a separate account in which the sales tax recovered is credited and the sales tax paid is debited. This amounted to Rs.3.80 lakhs. It is also found that sales of scrap of Rs.3 lakhs have been credited to an account under the heading "Miscellaneous income". Is this company liable to tax audit? Give your reasons in brief. **(3 marks)**

b) In another company's case, engaged in the execution of building contracts, it is found that the total value of the contract is Rs.60 lakhs. The work commenced in June, 1996 and as on 31st March 1997, the running bills submitted amounted to Rs.35 lakhs. The value of the work estimated at 75 percent. The whole building as completed in the previous year ending 31st March, 1998.Will the company is liable to tax audit, if so, in which year? Give your reasons in brief? **(3 marks)**

c) Draw up a checklist of items which you would check about expenditure incurred under the following heads:

   i. Expenditure on Advertising **(2 marks)**

   ii. Expenditure incurred on foreign travel of an employee **(3 marks)**

   iii. Expenditure on the maintenance of a guest house **(3 marks)**

Question 2.

a) A foreign enterprise has an Indian subsidiary carrying on business in constructional operations. It deputes two of its employees to render services in India for the Indian subsidiary and pays their remuneration for such services. One of the employees is a technician having specialized knowledge in constructional operations and the other is a sales manager to advise on marketing. Your advice is sought as to what extent and under what conditions the remuneration paid by the foreign enterprise to its two employees will be exempt under the I.T.Act,1961 **(6 marks)**

b) Your advice is sought about the circumstances in which interest leviable under section 234A, Section 234B and Section 234C may be reduced or waived. What will be your advice? **(6 marks)**

Question 3

(a) The accounts of Alpha Ltd. A domestic company, prepared in accordance with the provisions of Part II and Part III of Schedule VI to the companies Act, shows the following position:

Profit before Depreciation	Rs.100 lakhs
Less: Depreciation of the current year	Rs.10 lakhs
Net Profit	Rs.90 lakhs

The previous year of the company is the financial year ending 31st March,1998.The profit of Rs.100 lakhs includes profits amounting to Rs.20 lakhs in respect of exports qualifying for deduction under section 80HHC and profits of Rs.10 lakhs qualifying for deduction under Section 80-IA.

The profit computed in accordance with the provisions of the IT Act is as under:

Profit before Depreciation	Rs.70 lacs
Less: Depreciation as per IT Rules	Rs.60 lacs
Balance	Rs.10 lacs

The company is eligible to carry forward the following amounts from assessment year 1997-98:

Unabsorbed Depreciation Rs.40 lacs

Business loss	Rs.10 lacs

You are required to examine:

(i) The application of Section 115-JA

(ii) The eligibility for tax credit in the subsequent years

(b) Welfare Trust is a private discretionary trust which derived income from the following sources in respect of assessment year 1989-99

Income from house property	Rs.25,000
Income from units of the Unit Trust of India	Rs.15,000
Capital gains-Long term	Rs.20,000
Total Income	Rs.60,000

What will be tax liability of the trust? **(6 marks)**

Question 4

(a) What do you understand by the term "Block period"? How is the undisclosed income of such period computed? **(7 marks)**

(b) Discuss the provisions regarding the levy op penalty in respect of such undisclosed income. **(5 marks)**

Question 5

(a) Soman and Co. carry on business as brokers and underwriters of shares, on which they are entitled to brokerage and underwriting commission. Warran Ltd. was a company which offered 1, 00,000 shares of Rs.10 each for public subscription. Soman and Co. were appointed under-writers to this issue. It was entitled to 5 percent brokerage and 10 percent underwriting commission on this issue.75,000 shares were taken up by the public and the under writers subscribed to the remaining shares. What will be the tax effect in the hands of Soman and Co. as a result of this issue? **(4 marks)**

(b) Sundar, a citizen of India, is a consultant retained by a foreign company. His services were utilized by the foreign company outside India, for which he was paid $1, 00,000 as remuneration. He repatriated $80,000 in convertible foreign exchange within 6 months of the previous year ended 31.3.1997. What is the deduction for which Sundar will be eligible under the IT Act in respect of his income? **(4 marks)**

(c) A domestic company's total income was determined at a loss of Rs.20 lakhs for the year ended 31.3.1997. It has distributed the following dividends to its share holders in respect of the previous year ended 31st March, 1997.The paid-up share capital of the company on that date was Rs.50 lakhs:

1) Interim dividend at 10 percent on 31.10.1996
2) Bonus shares in the ratio 1:10 on 30.6.1997
3) Final dividend at 10 per cent on 31.10.1997

What are the tax consequences of such distribution in the hands of the company? **(4 marks)**

Question 6

(a) Mr. Raja received a house in May, 1996 by way of Gift from Mr. Guru who had purchased the same in April, 1970 for Rs.12, 00,000.The cost of improvements incurred by Guru were Rs.2,55,000 in March, 1978 and Rs.3,40,000 in November,1988.The fair market value of the house as on 1st April, 1981 was 9,14,000.Before this house was gifted to Raja, Guru had received an advance of Rs.3,00,000 in March, 1996 towards sale of this house from Laxman but the sale did not materialize and the advance was forfeited by Guru. The house was sold by Raja in Maerchj, 1988 for Rs.48, 00,000.Ascertain the capital gains chargeable to tax. The cost of inflation indices are: **(9 marks)**

Financial year	Index
1980-81	100
1988-89	169
1997-98	331

(b) A plot of land purchased 5 years back by ram Janaki trust was acquired by Government of India for construction of an over-bridge ion Mumbai. The compensation awarded by Revenue Authorities was at Rs.5, 00,000. The trust preferred an appeal against the order for increase in the compensation awarded to it. The appellate authority increased the compensation by further Rs.4 lakhs in August, 1997 but the amount was actually received in April, 1998.

You are required to compute the capital gains, if any, arising to the trust in respect of additional compensation received by it and state the year of its taxability **(5 marks)**

Question 7

Compute the net wealth of Mr.Jayanthilal, a resident individual as on 31.3.1998 from the following furnished particulars:

1) He has a house property at Delhi, valued at Rs.12, 00,000 which is occupied by a firm in which he is a partner for its business purposes. Another house at Mumbai, valued at Rs.8,00,000 is being used for his own business.
2) Vehicles for personal use Market value

Motor car	Rs.4,40,000
Motor van	Rs.2,20,000
Jeep	Rs.2,16,000

3) Cash in hand
4) Jewellary
5) Mr.Jayanthilal has gifted to a trust a commercial property situated at Chennai purchased 5 years back for Rs.10,00,000 for the benefit of the smaller HUF consisting of himself and his wife
6) He had transferred an urban house plot in Februrary, 1991 in favour of his niece which was not revocable during her lifetime. This niece died on 14.3.1998.Mr. Jayanthilal could get the title to the plot retransferred to his name only on 15.4.1998 despite sincere and honest efforts. The market value of the house as on 31.3.1998 is Rs.9,40,000

   Mr.Jayanthilal is the holder of an impartible estate in which urban agricultural lands of the value of Rs.4, 30,000 as on 31.3.1998 are comprised. **(10 marks)**

Question 8

(a) A and B are partners in firm sharing profit and losses equally. They decided to admit C as a partner with effect from 1.4.1997, with revised profit sharing ratios of 1\3rd each. Discuss the incidence of Gift tax, arising out of transfer of shares by A and B in favour of C. **(5 marks)**

(b) X created a trust of his properties making his wife and two sons equal beneficiaries thereof. The trust was irrevocable. X's wife executed a release deed under which she released her, one thi4rd interest in trust property in favour of her two sons. The Gift tax officer brought to tax the value of the interest of Mrs. in the trust property. Is this valid? Give your reasons in brief **(3 marks)**

(c) Harsh, a non-resident and a non-citizen of India, made a gift of 10,000 dollars to Nidhi, a resident of India , by purchasing a bank draft in Dubai and sending it by post to Nidhi, Nidhi claims that the gift is exempt from Gift Tax. Is this claim sustainable? **(2 marks)**