

Paper 7: Direct Taxes
Answer All Questions

Question 1:

14 Marks

HGP, a partnership firm engaged in the business of running a heritage hotel approved by the competent authority provides the following information relating to the year ended on 31.03.2008 –

(a) Net profit as per P&L A/c of Rs.200 Lakhs was arrived at after charge of the following –

- (i) Depreciation on hotel building having W.D.V. on 01.04.2007 of Rs.500 Lakhs was charged by treating the same as Plant and Machinery.
- (ii) Expenses of Rs.1,00,000 incurred for the purposes of promoting family planning among its employees.
- (iii) Payment of Rs.50,000 for an advertisement published in the souvenir released on 15th August by Bharatiya Janta Party.
- (iv) Compensation of Rs.1,00,000 paid to the suppliers of automatic kitchen appliances because of termination of the contract after the receipt of 50% of appliances.
- (v) Wines and liquor imported in F.Y. 2006–07 for Rs.20 Lakhs and were available in the stocks on 01.04.2007 for Rs.5 Lakhs were confiscated by the Govt. authority and therefore were written off.
- (vi) Expenses of Rs.20 Lakhs incurred on replacement of carpets in the foyer, lounge and bar.

(b) Out of amount credited to the reserve created u/s 80HHD (1) in the F.Y. 2002–03, an amount of Rs.15 Lakhs could not be utilized for the purposes as per section 80HHD(4) till 31.03.2008.

(c) Amount of Rs.4 Lakhs equal to U.K.£5,000 was remitted and paid to a travel agent resident of U.K. as commission for the booking of international tourists in the hotel. Tax at source was not deducted out of such payment.

(d) Amount of Rs.40,000 each was paid in cash to the suppliers of vegetables, milk products and eggs on 11.02.2008 because of suspension of banking operations due to strike of bank employees.

(e) Amount of Rs.5 Lakhs written off in the F.Y. 2005–06 as irrecoverable from a Travel agent. An amount of Rs.2 Lakhs out of it was recovered on 13.03.2008 and credited to Reserve account.

Compute the income chargeable to tax for the Assessment Year 2008–09 and give reasons in brief for treatment given to each of the items.

Question 2:

7 Marks

(a) Anush Motors Ltd. an Indian Company declared income of Rs.300 Crores computed in accordance with Chapter IV–D but before making any adjustments in respect of the following transactions for the year ended on 31.03.2008 –

- (i) 10,000 cars sold to Rida Ltd. which holds 30% shares in Anush Motors Ltd. At a price which is less by \$200 each car than the price charged from Shington Ltd.
- (ii) Royalty of \$1,20,00,000 was paid to Kyoto Ltd. for the use of technical know–how in the manufacturing of car. However, Kyoto Ltd. Had provided the same know–how to another Indian Company for \$90,00,000.
- (iii) Loan of Euro 1,000 Crores carrying interest @ 10% p.a. advanced by Dorf Ltd. a German Company was outstanding on 31.03.2008. The total book value of assets of Anush Motors Ltd. on the date was Rs.90,000 Crores. The said German Company had also advanced a loan of similar amount to another Indian Company @ 9% p.a. Total interest paid for the year was Euro 100 Crores.

Explain in brief the provisions of the act effecting all these transactions and compute the income of the Company chargeable to tax for A.Y. 2008–09 keeping in mind that the value of 1\$ and of 1 Euro was Rs.50 and Rs.55 respectively throughout the year.

Question 2:**6 Marks**

- (b) Simran Pharma Ltd. manufacturer of drugs and pharma products provides the following information relating to payments made to its marketing manager in the year 2007–08 –
- (a) Salary at Rs.20,000 p.m.
 - (b) Motor Cycle purchased for Rs.45,000 in June, 2007 was given free of cost.
 - (c) Conveyance allowance of Rs.5,000 p.m. which was allowed to him as exempt u/s 10(14).
 - (d) Tickets worth Rs.4,000 for a cricket match between India and England.
 - (e) Reimbursement of medical expenses incurred actually by him of Rs.17,500.
- The Company asks you to compute the amount of –
- (a) Income chargeable to tax in the hands of Marketing Manager
 - (b) Payments covered under Fringe Benefits, amount chargeable to FBT and the amount of such tax thereon

Question 3**4 Marks**

- (a) XYZ Ltd. engaged in the business of manufacturing of Industrial Cables imported a car on 26.02.2001 from Japan which costed in total of Rs.53,00,000. The car was used from 01.03.2001 continuously for the purposes of its business by the Company. The A.O. in the month of June, 2008 while completing the assessment u/s 143(3) of the Act, for A.Y. 2005–06, noted that the Company had claimed depreciation @ 25% since Assessment Year 2002–2003 on this car in the block of assets. Therefore issued notices u/s 148 r.w.s. 147 for A.Y. 2001–02 to 2005–06.

Examine the validity of the action of the Assessing Officer in the context of the provisions of the Act.

Question 3**5 Marks**

- (b) Easy call Ltd. to provide telecom services in Mumbai obtained a licence on 11.04.2005 for a period of 10 years ending on 31.03.2015 against a fee of Rs.27 Lakhs to be paid in 3 instalments of Rs.10 Lakhs, Rs.9 Lakhs and 8 Lakhs by April 2005, April 2006 and April 2007 respectively. Explain how the payment made for licence fee shall be dealt with under the Income Tax Act, 1961 and work out the amount, if any, deductible in this respect out of income chargeable to tax for Assessment Year 2008–2009 and in subsequent years.

Question 3**3 Marks**

- (c) Smt. Kanti engaged in the business of growing, curing, roasting and grounding of coffee after mixing chicory had total income of Rs.3,25,000 from this business which was her only source of income during the year ended on 31.03.2008. She consults you to have an opinion whether she is required to file return of income for the Assessment Year 2008–09 as per provisions of section 139(1) of the Act.

Question 3**3 Marks**

- (d) An amount of Rs.5 Lakhs was paid on 17.03.2008 to the parents of Amit by the Government of Maharashtra as a compensation to the grieved family whose only son Amit lost his life in Mumbai local train serial bomb blasts. Explain with reasons is the amount of compensation received chargeable to tax in A.Y. 2008–09?

Question 4(a):**6 Marks**

A piece of land owned by Mr. Mishra located on Jaipur–Delhi highway was acquired by NHAI in the Financial Year 2004–05, but the award ordered in F.Y. 2005–06 was paid in the F.Y. 2007–08.

This land was purchased by him on 02.04.1978 for Rs.1,000. The fair market value of the land as on 01.04.1981 was Rs.900. Compensation paid was Rs.5 Lakhs.

Other piece of land located in Chennai purchased in April, 2004 for Rs.25 Lakhs was also sold by him in February, 2008 for Rs.35 Lakhs, but sale deed there of could not be executed by 31.03.2008. The value for the purpose of stamp duty applied by the Stamp Valuation Authority was Rs.38 Lakhs.

Compute the income chargeable to tax arising as a result of these transactions in the A.Y. 2008–09. The CII for the F.Y. 2004–05, 2005–06 and 2007–08 are 480, 519, 551 respectively.

Question 4(b):

4 Marks

Neptune is a shipliner used in carrying passengers and cargo owned by M/s Thomas & Thomas of U.K. The ship carried the passengers and cargo in June, 2007 from Singapore to Mumbai and vice versa and collected charges thereof amounting Rs.200 Lakhs. It left Mumbai port on 15.06.2007 for its journey to Korea. No other journey to India was undertaken by any of the vessels of the Company during the year ended on 31.03.2008. The Non-resident Company had authorized its Indian agent to comply with the income tax provisions.

You are consulted by the Company to explain about the procedure as to return of income to be filed and the period within which the assessment thereof will be completed by the A.O.

Question 4(c):

4 Marks

Raja Ltd. made provisions on 31.03.2003 of Rs.85,500 against a bill of supplier of raw material by charging the amount to P&L account and claimed deduction thereof while computing the income chargeable to tax for A.Y. 2003–04. The amount of Rs.40,000 not paid to the party till 31.03.2007 was paid in cash on 11.06.2007. A.O. issued show cause notice to the Company to rectify the computation of income for the A.Y. 2003–04 on account of payment made in cash on 11.06.2007. Can the Assessing Officer do so?

Question 5(a):

11 Marks

The business premises of Ram Bharose Ltd. and the residence of two of its Directors at Delhi were searched under section 132 of the Act by the DDI, Delhi. The search was concluded on 9.08.2008 and following were also seized besides other papers and records –

- (i) Papers found in the drawer of an accountant relating to Shri Krishna Ltd., Mumbai indicating details of various business transactions. However, Ram Bharose Ltd. is not having any direct or indirect connection of any nature with these transactions and Shri Krishna Ltd., Mumbai and its Directors.
- (ii) Jewellery worth Rs.5 Lakhs from the bed room of one of the Director, which was claimed by him to be of his married daughter.
- (iii) Papers recording certain transactions of income and expenses having direct nexus with the business of the Company for the period from 16.04.2005 to date of search. It was admitted by the Director that the transactions recorded in such papers have not been incorporated in the books.

You are required to answer on the basis of aforesaid and the provisions of Act, following questions–

- (a) What action the DDI shall be taking in respect of the seized papers relating to of Shri Krishna Ltd., Mumbai?
- (b) Whether the contention raised by the Director as to jewellery found from his bedroom will be acceptable?

Comment [SPD1]: Date of conclusion of search?? Is date of conclusion of search and last authorisation for search same??

- (c) What presumption shall be drawn in respect of the papers which indicate transactions not recorded in the books?
- (d) Proceedings for how many years shall now be taken up and within which time limit the assessment thereof be completed by the A.O.?
- (e) Can the Company move an application for settlement of case as per Chapter XIX – A of the Act?

Question 5(b):

4 Marks

An individual resident in India, having income earned outside India in a country with which no agreement u/s 90 exists asks you to explain whether the credit of the tax paid over the income in that country will be allowed to him in India.

Question 6(a):

6 Marks

Prakash a member in two AOPs namely “AOP & Co.” and “Prakash & Akash” provides the following details of his income for the year ended on 31.03.2008 –

- (a) AOP & Co assessed at normal rates of tax had credited in his account amount of Rs.96,000 as interest on capital, Rs.96,000 as salary and Rs.20,000 as share of profit.
- (b) A house property located at Jaipur was purchased on 01.07.2001 with the borrowed capital in Prakash & Akash jointly shared equally and occupied by both of them for self residential purposes. Total interest paid for the year 2007–08 on the borrowed capital was Rs.1,60,000.

Compute the income and the tax liability thereon for the A.Y. 2008–09 and support your answer with brief reasons and the provisions of the Act.

Question 6(b):

3 Marks

What is the quantum of penalty that could be levied in each of the following cases –

- (a) Failure to get books of accounts audited as required under section 44AB of the Income Tax Act within the time prescribed under the Act.
- (b) Failure to get books of accounts audited in reponse to the notice issued under section 142(2A) of the Income Tax Act.
- (c) Failure to furnish audit report as required under section 92E of the Income Tax Act.

Question 7:

- (i) A Trust created for charitable purposes also derived income by letting out halls for functions. The Director of Income Tax (Exemptions) cancelled the registration on the ground that the trust was carrying on commercial activity. **(3 Marks)**
- (ii) The Assessing Officer issued notices u/s 133 to four banks requiring particulars relating to a customer in a specific format duly verified in a prescribed manner. One of the banks refused to part with the information on the ground that the letter did not specify about any proceeding pending against the said customer under the Income Tax Act. **(3 Marks)**
- (iii) Mr. Siddharth was a partner in a Firm, representing his HUF, holding 25% of the share in the Firm. His wife, Vineetha a house lady was admitted in her individual capacity in the Firm for 25% share. She was paid remuneration which has been proposed by the Assessing Officer to be clubbed in the hands of Siddharth (HUF) by invoking section 64 of the Act. **(4 Marks)**

Question 8(a):**5 Marks**

Mr. Rajpal gives the particulars of the various assets held by him on 31.03.2008 and requests you to compute his net wealth by explaining in brief that why the same was dealt with like that –

- (a) Jewellery gifted to wife from time to time in total of Rs.1 Lakh and were available with her on the valuation date having a market value of Rs.5 Lakhs.
- (b) A flat in Mumbai purchased under instalment scheme in 1987 for Rs.6 Lakhs and used for own residence since then. The market value of it was Rs.20 Lakhs on 31.03.2008 and instalment of Rs.1 Lakh was also outstanding.
- (c) He is a qualified engineer and was in possession of instruments used for his professional activity. The value of all such instruments was Rs.1 Lakh.
- (d) Urban land purchased for Rs.2 Lakhs in August 2005 located at Jaipur, in the name of his son who is suffering from a disability specified u/s 80U. the age of his son on 31.03.2008 was 10 years and value of land was Rs.5 Lakhs.
- (e) House located in Noida shown in WT Return for AY 2007–08 at Rs.40 Lakhs was sold on 20.03.2008 for Rs.45 Lakhs but the sale deed thereof was executed on 03.04.2008.

Question 8(b):**5 Marks**

Examine the correctness of the statement that “All types of land held by an assessee on the valuation date are treated as ‘Urban Land’ under the Wealth Tax Act.”