

Paper 7: DIRECT TAXES
NOVEMBER 1997

Answer all the questions

Question 1

- (a) Discuss the validity of proposals to rectify proceedings under section 154 of the Income-tax Act, 1961 in the following circumstances:
1. Despite intimation of death of assessee, the Assessing Officer had completed the assessment without bringing the legal representative on record; this order is sought to be rectified by bringing legal representative on record **(3 marks)**
 2. In an assessment, credit for tax deducted at source (TDS) had been taken according to the assessment year of the payee; this is sought to be changed to the assessment year with reference to the date of issue of TDS certificate by the payee and to withdrawal interest granted earlier U/s. 244 **(2 marks)**
 3. Assessing Officer omitted to grant to the assessee interest under section 244(IA) on refund found to be payable in an order passed pursuant to appellate order, assessee is seeking grant of said interest. **(3 marks)**
 4. Assessee's claim for double taxation relief was rejected in original, proceedings as there was not even evidence of tax in foreign country; assessee now seeks rectification on the strength of documents coming to his possession later on **(2 marks)**
- (b) (i) Can deduction be claimed by a company, under the Income Tax Act, 1961 for the full discount on issue of debentures in the year of issue itself? Discuss **(2 Marks)**
- (ii) In the case of a resident assessee, are municipal taxes paid on the immovable properties situated outside India, a permissible deduction in the computation of Income? Discuss. **(2 Marks)**
- (iii) What is the nature of income arising from agricultural operations carried out in Sri Lanka in the hands of a resident individual? Discuss **(2 Marks)**

Question 2

- a) Prarthana Welfare Society proposes to start an educational institution solely for educational purposes. The educational institution is proposed to be an autonomous one, not affiliated to any University or Board. Through there is no profit motive at all, there is likely to be some surplus from out of the fees collected from students. The society seeks your advice as to whether the income of the educational institution will be exempt under section 10(22) of the Income tax Act, 1961. You are required to offer your views. **(5 marks)**
- b) Malini Chitis is a partnership firm engaged in chit business. Three of its partners are sub-scribes in a chit group conducted by the firm. After the auction is over each month, the firm pays to each subscriber his share of dividend. Discuss whether the share of dividend paid by the firm to three partners participating in a chit group can be treated as a commission paid to partners and hence disallowed under section 40(b) of the Income-tax Act, 1961. **(4 marks)**
- c) Vayudoot Bros. an AOP, had submitted its return of income for the assessment year, 1995-96 on 31.8.1995 showing an income of Rs.37, 200. No assessment was made on the return. Two of the members of the AOP had been assessed in respect of the share income from the AOP. In August, 1997, the audit party points out to the Assessing Officer that Vayudoot Bros. have claimed excessive depreciation of Rs.3, 000. The Assessing Officer has issued notice under section 148 on Vayudoot Bros. seeking to assess the income of the income of the AOP. Can this be done? **(7 marks)**

Question 3

- (a) ABC Inc., a non resident investor company is a beneficiary of a contributory trust established in India. The application for advance ruling under section 245Q by ABC Inc., on a question affecting the trust involving inter alia, provisions of sections 161 to 164 is resisted by the Department on two grounds: (1)

This is a question which really affects the contributory trust in India, and that the applicant though a non-resident, cannot avail the benefits of Chapter XIX-B for getting clarifications about a resident assessee's liability to income tax merely because they have some mutual connections;(2) Since the ruling given would bind only the applicant and the Department, any action at the time of assessment of the Indian trust cannot be questioned on the basis of the ruling and hence the ruling would be infructuous. Discuss the pros and cons of the objections of the Department. **(6 marks)**

- (b) Mr. Pari is following mercantile system of accounting for his business and hybrid system of accounting for income from house property. In the earlier year, he was following hybrid system of accounting for computing his business income. The stocks are valued at cost in both years Depreciation is provided for on straight line method. Mr.Pari wants to know about the disclosure requirements and method of accounting under section 145 of the Income –tax Act,1961 for the assessment year 1997-98.Briefly advice him on the same and draft a simple relating to the disclosure of significant accounting policies covering these points from the information furnished **(6 marks)**
- (c) Venkat & Co. is a partnership concern which has filed its return of income for the assessment year, 1996-97. the certified copy of the partnership deed shows that two of the partners would receive fixed sums annually and not any specific share in the profit s of the firm. The Assessing Officer is of the opinion that as the individual shares of the partners are not specified in partnership deed, the partnership concern cannot be assessed as a firm for the purposes of the Income-tax Act, 1961 and proposes to assess it as an AOP. Is the contention of the Assessing Officer correct? **(4 marks)**

Question 4

- (a) Mr.Apoorva Shantilal filed his return of income for the assessment year, 1 996-97 on 29.8.1996 showing a loss of Rs.11,42,000.The same represented unabsorbed depreciation of foundry business of Rs.9,00,000 and the balance, loss in foundry business.

During the previous year relevant to the assessment year, 1997-98, two businesses were carried on by him- a steel rolling mill at Kanpur and a fertilizer manufacturing company at Cuttack. The foundry business was not carried on. Separate books of accounts are being maintained for the two businesses carried on at different places. The following information is made available to you:

[1] Relating to steel rolling mill at Kanpur

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|---|--------------|
| (a) Business Income prior to depreciation and following adjustments | Rs.4,20,000 |
| (b) Opening WDV of factory building Rs.6,20,000. This building constructed 5 years back, was sold for | Rs.10,28,000 |
| (c) Machinery (Entitled to Depreciation at 25%) Opening WDV | Rs.3,20,000 |
| All machines sold in March, 1997 for | Rs.5,10,000 |
| (d) Car opening WDV (Purchased in March, 1995) | Rs.1,20,000 |

[2] Relating to fertilizer unit at Cuttack

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|---|--------------|
| (a) Factory building (Purchased in March,1995)Opening WDV | Rs.2,80,000 |
| (b) Machinery (Rate of depreciation 25%) purchased in June,1996 | Rs.44,40,000 |
| (c) Jeep Opening WDV (Purchased in March, 1994) | Rs.1,80,000 |
| (d) Furniture Opening WDV | Rs.80,000 |
| (e) Business income prior to above adjustments | Rs.6,22,000 |

Compute the total income of Mr-Apoorva Shantilal for the Assessment Year, 1997-98 **(12 marks)**

- (b) Q was ousted as a partner from a partnership firm. Subsequently, a new firm was constituted which used the entire assets of the earlier firm without rendering accounts to Q. Q challenged the action by commencing legal proceedings and the matter was settled, Q being paid Rs.70,000 on account of her share in the partnership. Is the amount paid to her deductible as business expenditure? **(4 marks)**

Question 5

- (a) Nithin & Co., a partnership firm, was dissolved on 31.3.1996. The dues of the firm were received by its erstwhile partners during the period May, 1996 to November, 1996. Can the same be taxed in the hands of the firm for the assessment year, 1997-98? If not, in whose hands can they be taxed? **(6 marks)**
- (b) Aashik was a director in a private company floated by his brother. He resigned, from directorship of the company with effect from 31st March, 1996. For the assessment year 1996-97, tax and interest were found against the company. As the Departmental authorities could not recover the outstanding dues from the company, proceedings were initiated against Aashik under section 179(1) of Income-tax Act. His salary from his employer, Punjab Roadways was attached in August, 1996. Subsequently, the company filed a revision petition for the stay against Aashik be stayed? **(4 marks)**
- (c) Does redemption of preference shares amount to 'transfer' within the meaning of section 2(47) of the Income-tax Act in the hands of the shareholder? What will be the nature of excess realization by a shareholder over the cost of acquisition of such shares for purposes of income taxation? Discuss **(6 marks)**

Question 6

- (a) Mr. Kailash owns a farmhouse situated within 23kms from the local limits of Jodhpur Municipal Corporation. The valuation of this house property has been referred to the Valuation Officer who has valued the house property adopting land and building method, contending that he is not bound to value the house as per rules forming part B of Schedule III to the Wealth-tax Act. Is the contention of the Valuation Officer correct? **(4 marks)**
- (b) Can penalty under section 18 of the Wealth-tax Act be levied on the legal representatives of the deceased for defaults committed by deceased for which the penalty proceedings have been initiated against the deceased prior to his death? **(6 marks)**

Question 7

In April, 1996 Shankar gave a gift of Rs.2, 000 equity shares of Rs.100 each held by him in A Ltd. towards the educational needs of his son studying 10th standard in Public School. Shankar has plans to educate him further in the Engineering course in India. Reasonable expenditure on the education of his son is estimated at Rs.3 lakhs. A Ltd is interlocked with B Ltd. and both are investment companies having 20% share in each other. The Share capital of A Ltd and B Ltd. consists of fully paid up 5,000 equity shares of Rs.100 respectively. The shares are not quoted in the market. The maintainable profits of B Ltd. is quantified at Rs.2 lakhs. The Balance Sheet of A Ltd. As on 31.3.96 is as follows: **(10 Marks)**

Liabilities	Rs.	Assets	Rs.
500 Equity shares of Rs.100 each	5,00,000	Fixed Assets	8,00,000
Reserves and Surplus	3,00,000	Investment in 1,000 equity shares in B Ltd.	1,00,000
Secured Loans	2,00,000	Advance tax less Provision for Tax	1,00,000
	10,00,000		10,00,000

Ascertain the value of taxable gifts made by Shankar assuming that the value of fixed assets as per schedule is Rs.10 lakhs. **(10 marks)**