

MAY 2010

FINAL (NEW COURSE)
GROUP-II PAPER-7
DIRECT TAX LAWS

Roll No.....

Total No. of Questions—7]

Time Allowed—3 Hours

[Total No. of Printed Pages—8

Maximum Marks—100

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Answers to questions are to be given only in English except in the case of candidates who have opted for Hindi medium. If a candidate who has not opted for Hindi medium, answers in Hindi, his answers in Hindi will not be valued.

Answer **all** questions.

Marks

1. Aditya, Avirup and Avigyan carried on business of running hotels in partnership from 1st April, 2000 to 31st March, 2007. In order to increase its scale of operation and meet its fund requirement the firm decided to carry on its business through Corporate route. For that purpose, a company under the name and style "Triple A Hospitality Private Limited" was formed on 1st April, 2008 and the business of the partnership firm as a whole was succeeded to by the Company with effect from 1st June, 2008. 20

The Company's Profit and Loss Account for the year ended 31st March, 2010 shows a net profit of Rs. 450 lacs after debit/credit of the following items :

- (a) Interest of Rs. 3 lacs paid to Allahabad Bank on a term loan taken for the purpose of acquiring a land at Bhubaneswar for a new hotel to be set up.
- (b) Depreciation charged Rs. 40 lacs.
- (c) Rs. 2 lacs credited on account of waiver of dues obtained from a supplier of the erstwhile firm against supply of certain materials.

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- (d) Rs. 1.18 lacs being the aggregate of amounts paid in cash to Rajaram, a transport contractor as follows :

Date of Payment	Rs. in Lacs
5th June, 2009	0.15
20th July, 2009	0.21
20th September, 2009	0.22
3rd November, 2009	0.26
5th November, 2009	0.36

Tax was not deducted at source as Rajaram submitted a certificate Under Section 197(1), which he had obtained from the TDS circle of the Income-tax Department.

- (e) Rs. 0.50 lac, being proportionate part of the cost of animals (purchased and kept for entertainment of the guests of hotel) amortised as per the accounting policy of the company.
- (f) Rs. 0.10 lacs credited on account of sale proceeds of carcass of animal which died during the year.
- (g) Provision for bad and doubtful debts Rs. 12 lacs.
- (h) Payment of Rs. 25 lacs to some employees as compensation for voluntary retirement, as per scheme.
- (i) Foreign exchange fluctuation loss (net) amounting to Rs. 30 lacs arising from restatement of the year-end liabilities to foreign suppliers of provisions and beverages as per the requirement of Accounting Standard 11 of the Institute of Chartered Accountants of India.

Other Information :

- (i) Depreciation as per the Income-tax Act Rs. 65 lacs.
- (ii) Cost of animal died as referred to in (f) above was Rs. 2 lacs.

(iii) Debt of Rs. 4 lacs due from one corporate customer for three months has been written off during the year after giving few reminders by debiting provision for bad and doubtful debts account.

(iv) The erstwhile firm was allowed exemption of Rs. 50 lacs Under Section 47(xiii) in respect of long-term capital assets transferred to the company.

(v) The Company's voting rights till 31st March, 2009 were held as follows :

Aditya	40%
Avirup	30%
Avigyan	15%
Others	15%

During the year shares constituting 36% voting rights were sold by Aditya to his son-in-law, Avishek.

(vi) Unabsorbed business loss and unabsorbed depreciation of Rs. 10 lacs each have been carried forward from Assessment Year 2008-09.

(vii) The Company has a subsidiary Company, Tours & Travels Private Limited (A Closely Held Company). During the year the company obtained a temporary loan of Rs. 12 lacs from its subsidiary company. Accumulated profit of the subsidiary company was Rs. 30 lacs at the time of payment of the loan. The loan was repaid by the company before the end of the year.

Compute total income of Triple A Hospitality Private Limited for the Assessment Year 2010-11 indicating reason for treatment of each of the items. Ignore the provisions relating to minimum alternate tax.

2. (a) Explain in brief, the treatment as to their taxability and or allowability, under the provisions of Income Tax Act, 1961, for the assessment year 2010-2011 in the following cases :

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(i) 'A' Ltd., an Investment Company received dividend income of Rs. 1,00,000 on its investment in shares. It incurred interest expenditure of Rs. 2,00,000 on the borrowed capital utilized in the investment of shares.

- (ii) 'B' Ltd. is a Company engaged in the business of Financing and Investment in Shares. It suffered loss in an amount of Rs. 3,00,000 on account of futures and options, a transaction in the form of derivatives in which the underlying asset was shares. 3
- (iii) 'C' Ltd., which did not have any active business carried on by it incurred capital expenditure on Scientific Research amounting to Rs. 5,00,000 that related to its Subsidiary Companies. 3
- (b) State the situation under which the clubbing provisions of Income tax operate as to the incomes of husband and wife. 4
3. (a) Indian Gas Limited commenced its operation of the Business of laying and operating a cross country natural gas pipeline net work for distribution on 1st July, 2008. The Company incurred capital expenditure of Rs. 300 lacs (including cost of land Rs. 45 lacs and cost of financial instrument Rs. 5 lacs) during the period from 1st April, 2007 to 30th June, 2008. The Company did not claim deduction for such expenditure in the earlier assessment years. The entire expenditure was capitalised on 1st July, 2008. Further, during the Previous year 2009-10, the company incurred capital expenditure of Rs. 200 lacs exclusively for the said business. 6
- (i) Compute the amount of deduction allowable Under Section 35AD assuming that the company has fulfilled all the conditions specified in Section 35AD.
- (ii) If the company has loss from such business in the assessment year 2010-11, how the same is to be set off and carried forward ?
- (b) (i) An electoral trust approved by the Central Board of Direct Tax is not liable to income tax in respect of voluntary contribution received and other income—Discuss the correctness of the statement. 2
- (ii) What is the effect of contribution made by an individual to electoral trust on his taxable income ? 1

- (c) Kala purchased a residential flat from her friend Bala at Rs. 10 lacs in the city of Jaipur on 3rd October, 2009. The value determined by the Stamp Duty Authority for stamp duty purpose amounted to Rs. 15 lacs. Bala had purchased the flat on 1st January, 2007 at a cost of Rs. 3.50 lacs. Kala sold the flat for Rs. 20 lacs on 30th March, 2010. 5

Determine the effect of the above transactions on the assessments of Bala and Kala for assessment year 2010-11, assuming that value for stamp duty purpose in case of the second sale was not more than the sale consideration.

4. (a) Explain the applicability of the provision relating to the deduction of tax at source in the following transactions :
- (i) Max Limited pays Rs. 1 lac to Mini Limited, a resident contractor who, under the contract dated 15th October, 2009, manufactures a product according to specification of Max Limited by using materials purchased from Max Limited. 2
- (ii) A Company operating a Television Channel makes payment of Rs. 5 lacs to a former cricketer for making running commentary of a one-day cricket match. 2
- (iii) EL Limited, a Foreign Company pays outside India salary to its employee, Mr. Raghavan, a Foreign national and a non-resident for services rendered in India. 2
- (b) Discuss the taxability of the Balance amount withdrawn by an employee from the recognized provident fund at the time of leaving the service ? 5
- (c) The Assessing officer has the power to make an assessment to the best of his judgement, in certain situations. What are they ? 3
5. (a) Does the Income-tax Appellate Tribunal have the following powers ? 4
- (i) Power to allow the assessee to urge any ground of appeal which was not raised by him before the Commissioner (Appeals);
- (ii) Power to review its own order.

- (b) Ankit Private Limited in its return of Income claimed a sum of Rs. 40,000 as a deduction on account of payments for stamp duty and registration charges from the Income shown under the head "Income from house property". The Assessing Officer disallowed the claim of the assessee company in the assessment order passed under Section 143(3). Examine the correctness of the action of the Assessing Officer. 3
- (c) Following issues have been raised by Navi Limited in connection with its eligibility for claiming deduction under Section 80-IB for your consideration; and advise, for the assessment year 2010-2011. 7
- (i) It operates two separate industrial units, One unit is eligible for deduction under Section 80-IB, while the other unit is not eligible for such deduction. If the eligible unit has profit and the other unit has loss, should it claim deduction after setting off the loss of the other unit against profit of the eligible unit ?
- (ii) Its profit from one unit includes sale of import entitlement, duty drawback and interest from customers for delayed payment. Is it permissible to claim deduction on these items of income ?
6. (a) The assessment of CNK Associates, a partnership firm for the assessment year 2007-08 was made under Section 143(3) on 31st July, 2009. The Assessing Officer made two additions to the income of the assessee viz. (a) addition of Rs. 2 lacs under Section 40(a)(ia) due to non-furnishing of evidence of payment of TDS and (ii) addition of Rs. 5 lacs on account of unexplained cash credit. The assessee contested addition on account of unexplained cash credit in appeal to the Commissioner (Appeals). The appeal was decided in January, 2010 against the assessee. The assessee approaches you for your suggestion as to whether it should apply for revision to the Commissioner under Section 264 or rectification to the Assessing Officer under Section 154 as regards disallowance under Section 40(a)(ia). What should be your suggestion ? 4

- (b) Cosmos Limited, a company incorporated in Mauritius has a branch office in Hyderabad opened in April, 2008. The Indian branch has filed return of income for assessment year 2009-10 disclosing income of Rs. 50 lacs. It paid tax at the rate applicable to domestic company i.e 30% plus education cess of the basis of paragraph 2 of the Article 24 (Non-Discrimination) of the Double Tax Avoidance Agreement between India and Mauritius, which reads as follows :

"The taxation on a permanent establishment which an enterprise of a Contracting State has in the other Contracting State shall not be less favourably levied in that other State than the taxation levied on enterprises of that other State carrying on the same activities in the same circumstances."

However, the Assessing Officer computed tax on the Indian branch at the rate applicable to a Foreign Company i.e. 40% plus education cess.

Is the action of the Assessing Officer in accordance with law ?

- (c) Asha Memorial Trust running hospitals is registered under Section 12A. Following particulars relevant for the previous year ended 31st March, 2010 are furnished to enable you to compute tax liability of the trust. 6
- (i) Income from running of hospitals Rs. 14.25 lacs.
 - (ii) Donation received (including anonymous donation Rs. 3 lacs) Rs. 5.75 lacs.
 - (iii) Amount applied for the purposes of hospital Rs. 13 lacs.
 - (iv) The trust had accumulated Rs. 15 lacs under Section 11(2) in the Financial year 2003-04 for a period of five years for extension of one of its hospitals. The trust has spent Rs. 13.50 lacs for the said purpose till 31st March, 2009.

Compute the taxable income of the trust and tax payable by Asha Memorial Trust for the assessment year 2010-11.

7. (a) NKP Limited engaged in Industrial activity has furnished the following particulars of its assets as at the valuation date 31st March, 2010. Compute the Net Wealth Tax and Wealth Tax liability of the company for the assessment year 2010-11. 7.
- (i) One hectare of vacant land was allotted to the company at Ahmedabad by the State Government for industrial purpose in May, 2006 on permanent lease basis on payment of a non-refundable premium of Rs. 4 lacs. The terms of allotment includes that in the event the lessee transfers the lease, 50% of the unearned increase in the value should be made over to the lessor. The construction work for the proposed factory has not been started. The value of the land as on 31st March, 2010 is Rs. 50 lacs.
- (ii) The Company is a partner of a firm with 30% shares whose net assets as on 31st March, 2010 is Rs. 150 lacs. Its capital as on that date is Rs. 20 lacs out of total capital of Rs. 70 lacs.
- (iii) It has let out a building with effect from 1st October, 2009 at a monthly rent of Rs. 1 lac for a period of 10 years. The tenant has made a deposit of Rs. 3 lacs. Annual Corporation Tax of Rs. 1 lac is borne by the tenant. The building is on a freehold land. The written down value of the building is Rs. 80 lacs.
- (b) 'H' filed his return of net wealth for the assessment year 2006-07. Penalty proceeding Under Section 18 for concealing particulars of net wealth was initiated by the Assessing Officer in 2008. 'H' died in January, 2009. The estate of 'H' devolved on his wife, 'W', who also died on October, 2009. Thereafter, the estate devolved on their daughter 'D'. The Assessing Officer passed penalty order on 28th February, 2010 and served notice of demand for penalty on 'D'. Is the action of the Assessing Officer valid in law ? 3