

Test Series: February, 2016

MOCK TEST PAPER – 1
FINAL COURSE: GROUP – II
PAPER – 7: DIRECT TAX LAWS
Question No. 1 is compulsory.

Answer any five questions from the remaining six questions.

Time Allowed – 3 Hours

Maximum Marks – 100

1. (a) Sushine LLP, is carrying on two businesses viz. Textile manufacture and Operation of warehousing facility for storage of wheat. The following are the particulars for the year ended 31st March 2016.

Net profit as per Profit & Loss Account:

From Textile Manufacture	Rs. 10,25,000
From Operation of warehousing facility storage of wheat	Rs. 20,50,000

The following items are debited to Profit & Loss Account:

- (i) Keyman insurance policy premium paid Rs. 1,55,000.
- (ii) Working partner salary Rs. 36 lakhs (i.e., Rs. 1 lakh each per month for 3 partners).
- (iii) Interest on capital payable to partners @ 15% on total capital of Rs. 100 lakhs.
- (iv) Depreciation on Plant & Machineries of textile business Rs. 35 lakhs.
- (v) Depreciation on textile factory building Rs. 5 lakhs.

Other Information:

Eligible depreciation under section 32 for the previous year 2015-16 are-

- (i) On plant & machineries of textile business Rs. 27 lakhs.
- (ii) On factory building relating to textile business Rs. 4 lakhs.

The assessee set up and operating a warehousing facility for storage of wheat since 1st April, 2014. It incurred capital expenditure towards construction of warehousing facility during the period from 1st June, 2012 to 31st March, 2014 as under:

Cost of land (acquired on 1st June, 2012) Rs. 30 lakhs.

Cost of construction of warehousing building, construction completed on 31st March, 2014 Rs. 50 lakhs.

The income of the firm for the previous year 2014-15 (Assessment Year 2015-16) is given below:

Income from Textile manufacture Rs. 12 lakhs.

Income from warehouse facility Rs. 60 lakhs (before deduction under section 35AD)

The firm originally had 4 equal partners and one partner retired on 31-3-2015. The partnership agreement authorizes payment of salary and interest on capital which are debited to Profit & Loss Account.

You are requested to compute the total income of the firm for the A.Y.2016-17.

Note: Ignore Alternate Minimum Tax (AMT) under section 115 JC. (10 Marks)

- (b) On 1st February 2013, a charitable trust, was formed, whose income can be exempt under section 11 of the Income-tax Act, 1961. It earned an income of Rs. 3,60,000 for the financial year ended 31st March, 2016.

On 30th March, 2016, it made an application for registration with the Commissioner of Income-tax, explaining that for good and sufficient reasons, it was prevented from filing the application earlier.

State:

- (i) by which date the application for registration should have been filed;
- (ii) whether such an application could have been filed before the formation of the trust;
- (iii) in the absence of an order of registration from the Commissioner, can the trust be deemed to be registered;
- (iv) the steps to be taken by the trust to secure exemption from income-tax;
- (v) whether a certificate of registration once granted can be cancelled and if so, the conditions there for. (10 Marks)

2. Compute the total income and tax payable by the Jupiter Ltd, engaged in the business of manufacturing fertilizers since 1st April 2009, for the assessment year 2016-17 (ignore MAT provisions). Its profit and loss account shows a net profit of Rs. 500 lakhs for the year ended 31-03-2016 after debiting and crediting the following items:

- ◆ Depreciation provided in accounts as per straight line basis Rs. 30 lakhs.
(Note: Normal depreciation allowable as per the Income-tax Rules, 1962 is Rs. 48 lakhs)
- ◆ The company has made cash payments for purchases and expenditure as below:
On 14-06-2015 Rs. 5 lakhs (Due to strike by bank staff)
On 25-10-2015 Rs. 7 lakhs (Due to cash demanded by the supplier)
On 01-12-2015 Rs. 10 lakhs (a bank holiday)
Payment made to transport operator for hiring of lorry as follows:

17-07-2015: Rs. 50,000

28-01-2016: Rs. 75,000

12-02-2016: Rs. 32,000

- ◆ Rs. 5 lakhs contribution to a University approved and notified under section 35(1)(ii).
 - ◆ Sales tax of Rs. 1.45 lakhs, pertaining to the year ended 31-03-2015, was paid on 07-11-2015.
 - ◆ Rent paid and professional charges to a consultant including service tax was Rs. 5,61,800 and Rs. 2,24,720 respectively. Tax was not deducted on the service tax portion for both the payments.
 - ◆ The company has also purchased goods of Rs. 55 lakhs from M/s. Care Ltd. in which Directors have substantial interest. The market value of the goods is Rs. 54 lakhs.
 - ◆ The company has incurred legal expenses for the following:
 - ◆ Issue of Bonus shares Rs. 10 lakhs.
 - ◆ Alteration of Memorandum of Association Rs. 2 lakhs (in connection with increase of authorized capital).
 - ◆ Donation paid to a political party Rs. 25 lakhs - by way of cheque. *(16 Marks)*
3. (a) In an order of assessment for the A.Y. 2014-15, the assessee noticed a mistake for which application under section 154 was moved and the order was rectified. Subsequently, the assessee moved further application for rectification under section 154 which was rejected by the Assessing Officer on the ground that the order once rectified cannot be rectified again. Is the contention of the Assessing Officer correct? *(4 Marks)*
- (b) The return for A.Y.2014-15 was filed on time as per section 139(1). The assessee during the course of assessment proceedings under section 143(2), noticed certain omissions and therefore filed a revised return on 25.5.2016. The Assessing Officer ignoring the revised return so filed framed the order on 11.6.2016. Is the action of Assessing Officer correct? *(4 Marks)*
- (c) Star Ltd., a domestic company, purchases its own unlisted shares on 17th October, 2015. The consideration for buyback amounted to Rs. 22 lakhs, which was paid on the same day. Star Ltd. had received Rs. 14 lakhs on issue of these shares one year back. Compute the additional income-tax payable by Star Ltd. Further, determine the interest, if any, payable if such tax is paid to the credit of the Central Government on 12th January, 2016. Would there be any tax implication in the hands of the shareholders? Discuss. *(4 Marks)*

- (d) An appeal was preferred by the assessee to the Appellate Tribunal and allowed by it. The assessee later found that he was entitled to a certain deduction, which was neither claimed by him nor allowed by the Assessing Officer in the course of assessment. The issue of deduction was not raised by the assessee in the appeal before the Tribunal and was not considered by it. Examine the power of the Commissioner to revise under section 264 the order of assessment in order to allow such deduction on an application by the assessee. (4 Marks)
4. (a) Seizures were made from Mr. Shalin pursuant to a search conducted in his premises. He filed an application for settlement by claiming to have received the amount by way of loans from several persons. The Settlement Commission accepted his statement and made an order. The CBI, however, conducted enquiry at the instance of the Revenue regarding the claimed amount of loans and opined that the alleged lenders had no means or financial capacity to advance such huge loans to Mr. Shalin and were mere name lenders only. The Commissioner filed an application under section 245D(6) praying for the order to be declared void and for withdrawal of benefit granted. Mr. Shalin, however, contended that the order of the Settlement Commission was final and any fresh analysis would amount to sitting in judgement over an earlier decision, for which the Settlement Commission was not empowered. Discuss the correctness of Mr. Shalin's contention. (4 Marks)
- (b) Mrs. Vidya, a resident Indian aged 25, furnishes the following the particulars of income earned during the previous year 2015-16:

	(Rs. In lacs)
Income from stage performances in country M	12.00
Tax paid in country M	1.80
Income from stage performances in India	19.20
Life Insurance Premium paid	1.10
Medical Insurance Premium paid for her mother aged 70 years (paid through credit card)	0.32

Compute her total income and tax liability for the assessment year 2016-17. There is no Double Taxation Avoidance Agreement between India and country M. (8 Marks)

- (c) Discuss whether transfer pricing provisions under the Income-tax Act, 1961 are attracted in respect of the following cases -
- (i) Transfer of technical knowhow by Aznara Ltd., an Indian company, to Arihant Inc., a Canadian company, which guarantees 15% of the borrowings of Aznara Ltd.
- (ii) Ms. Niharika, a resident Indian, is a director of Dolls Ltd, an Indian company. Dolls Ltd. pays salary of Rs. 45 lakhs per annum to Twisha, who is Ms. Niharika's daughter.

- (iii) Aman Ltd., an Indian company, has two units Light & Dark. Light, which commenced business three years back, is engaged in the development of a highway project, for which purpose an agreement has been entered into with the Central Government. Dark is carrying on the business of trading in cement. Dark transfers cement of the value of Rs. 65 lakhs to Light for Rs. 45 lakhs.
- (iv) Scientific research services provided by Starworld Inc., a France company to Thrill Ltd., an Indian company. Starworld Inc. is a "specified foreign company" as defined in section 115BBD, in relation to Thrill Ltd. *(4 Marks)*
5. (a) How is inventory on the date of dissolution of a firm to be valued, where the firm's business is to be continued by one of its partners, in a case where the dissolution has taken place on or after 1.4.2015? What was the manner in which such inventory would have been valued had the dissolution taken place on 31.3.2015?
- (b) Shubhan & Co., the sole proprietary concern of Mr. Shubhan got converted into partnership after his death on 15.10.2015 by his two sons and the business of Shubhan & Co., was continued to be carried in the same manner. There were business losses of Rs. 7.50 Lacs till 31.03.2015. The net results of the business for the year ended 31.03.2016 were profits of Rs. 10 Lacs. The partners want to set off the losses of Rs. 7.50 Lacs from the profits of the firm. Can they do so?
- (c) Shining Star Ltd. is engaged in the business of constructing residential and commercial properties. One of the building properties was included in the closing stock in the Balance Sheet. The said building was let out for a monthly rent as suitable buyers could not be found. All other buildings had been sold by the company. State with reasons whether the income by way of rent from the unsold property is assessable as income from business or income from house property.
- (d) The information and details given in the return, relating to a claim made, is not incorrect but the claim so made has been found to be wrong and not allowable by the Assessing Officer and therefore added to income assessed for the relevant assessment year. The Assessing Officer for the reason of incorrect claim made in the return, which was disallowed during the assessment by adding to income, invoked the provisions of section 271(1)(c). Is the Assessing Officer correct in doing so? *(4 Marks each)*
6. (a) Following issues have been raised by Nayak Limited in connection with its eligibility for claiming deduction under section 80-IB for your consideration and advice for the assessment year 2016-17:
- (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? (4 Marks)
- (b) Power Ltd. set up a manufacturing unit in Gaya, a notified backward area in the state of Bihar on 15.07.2015. It invested Rs. 30 crore in new plant and machinery on 15.7.2015. Further, it invested Rs. 25 crore in the plant and machinery on 13.01.2016, out of which Rs. 5 crore was second hand plant and machinery. Compute the depreciation allowable under section 32. Is Power Ltd. entitled for any other benefit in respect of such investment? If so, what is the benefit available?

Would your answer change where such manufacturing unit is set up by a firm, say, Power LLP, instead of Power Ltd.? (4 Marks)

- (c) Mr. Ayush, a dealer in shares, received the following without consideration during the P.Y.2015-16 from his friend Mr. Yashwin, -
- (1) Cash gift of Rs. 75,000 on his anniversary, 25th May, 2015.
 - (2) Bullion, the fair market value of which was Rs. 60,000, on his birthday, 25th June, 2015.
 - (3) A plot of land at Chennai on 21st August, 2015, the stamp value of which is Rs. 5 lakh on that date. Mr. Yashwin had purchased the land in September, 2009.

Mr. Ayush purchased from his friend Mr. Charan, who is also a dealer in shares, 1000 shares of MNO Ltd. @ Rs. 400 each on 19th June, 2015, the fair market value of which was Rs. 600 each on that date. Mr. Ayush sold these shares in the course of his business on 15th August, 2015.

Further, on 1st December, 2015, Mr. Ayush took possession of property (building) booked by him two years back at Rs. 20 lakh. The stamp duty value of the property as on 1st December, 2015 was Rs. 32 lakh and on the date of booking was Rs. 23 lakh. He had paid Rs. 1 lakh by cheque as down payment on the date of booking.

On 21st March, 2016, he sold the plot of land at Chennai for Rs. 7 lakh.

Compute the income of Mr. Ayush chargeable under the head "Income from other sources" and "Capital Gains" for A.Y.2016-17. (4 Marks)

- (d) "Proceedings cannot be initiated under the Act, unless a proper notice to this effect has been served upon." In this context answer:
- (i) What are the prescribed modes of service of such notice?
 - (ii) On whom should the notice be addressed and served upon in the cases where the assessee is a dissolved firm, a deceased person and a partitioned HUF.

(4 Marks)

7. (a) Black & White Airlines Ltd. has paid a sum of Rs. 12 lakhs during the year ended 31-3-2016 to Airports Authority of India towards landing and parking charges. The company has deducted tax at source@2% under section 194C on the said payment and remitted the tax deducted within the prescribed time. The Assessing Officer contended that landing and parking charges were levied for use of the land of the airport and hence, the payment was in the nature of rent attracting TDS@10% under section 194-I. Discuss the correctness or otherwise of the contention of the Assessing Officer. *(5 Marks)*
- (b) Mrs. Sonam, a resident of India, owned for the financial year ended on 31-03-2016, a house property in Australia purchased in July, 2005; a shop in Malasiya purchased in June, 2007 and space in a commercial complex in Canada purchased in April, 2013. She is also having authority to operate the bank account (maintained with Citibank, Australia) of a company owned by her daughter and son-in-law since July, 2014. She has been served in July, 2016 with the notices issued under section 148 of the Act for assessment years 2004-05 to 2015-16. She, for the reason of challenging the action of the Assessing Officer for issuing notices under section 148 for last 12 years, seeks your opinion. Advise her suitably. *(5 Marks)*
- (c) Discuss the correctness or otherwise of the following with reference to the provisions of the Income-tax Act, 1961.
- (i) A High Court does not have an inherent power to review an earlier order passed by it on merits.
- (ii) The Income-tax Appellate Tribunal cannot amend its orders. *(6 Marks)*