PAPER – 7: DIRECT TAX LAWS

Working notes should form part of the answer.

*Question No.**1** is compulsory.*

*Answer any **five** questions from the remaining **six** questions.*

All questions relate to Assessment Year 2015-16, unless stated otherwise in the question.

Question 1

(a) MNO Corporation LLP, is carrying on two businesses viz. Textile manufacture and Operation of cold chain facility. It gives you the following information for the year ended 31st March, 2015:

Net profit as per Profit & Loss Account:

From Textile Manufacture	*`10,25,000*
From Operation of cold chain facility	*`20,50,000*

The following items are debited to Profit & Loss Account:

(i) Interest on capital payable to partners @ 15% on total capital of `100 lakhs.

(ii) Working partner salary `36 lakhs (i.e., `1 lakh each per month for 3 partners).

(iii) Depreciation on textile factory building `5 lakhs.

(iv) Depreciation on Plant & Machineries of textile business `35 lakhs.

(v) Keyman insurance policy premium paid `1,55,000.

Other Information:

Eligible depreciation under section 32 for the previous year 2014-15 are-

(i) On Plant & Machineries of textile business `27 lakhs.

(ii) On factory building relating to textile business ` 4 lakhs.

The assessee set up and operating a cold chain facility since 1st April, 2013. It incurred capital expenditure towards construction of cold chain facility during the period from 1st June, 2011 to 31st March, 2013 as under:

Cost of land (acquired on 1st June, 2011) `30 lakhs.

Cost of construction of building and machineries installed till 31st March, 2013 `50 lakhs.

The Suggested Answers for Paper 7:- Direct Tax Laws are based on the provisions of direct tax laws, as amended by the Finance (No.2) Act, 2014. The relevant assessment year is A.Y.2015-16, which is the assessment year applicable for May, 2015 examination.

The income of the firm for the previous year 2013-14 (Assessment Year 2014-15) is given below:

Income from Textile manufacture `12 lakhs.

Income from cold chain facility `60 lakhs (before deduction under section 35AD)

The firm originally had 4 equal partners and one partner retired on 31-3-2014. 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.2015-16.

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

(b) Explain the term "Urban Land" as per the Wealth-tax Act, 1957. *(5 Marks)*

(c) State with brief reasons whether the following statements are valid/invalid under the Wealth-tax Act, 1957:

(i) Determination of net wealth is dependent on the system of book-keeping adopted by the assessee.

(ii) Unrecorded cash of `1 lakh as on 31-3-2015 is an 'asset' for the firm and hence, to be included in its net wealth.

(iii) Mr. Tom transferred his vacant site to his wife in connection with an agreement to live apart. The vacant site is liable to wealth-tax in the hands of Mr. Tom even though it is given to his wife.

(iv) Penalty for concealment of wealth could be levied on legal representative though proceedings were initiated on the assessee when he was alive.

(v) A company incorporated in Sri Lanka is liable to wealth-tax in respect of assets held in India. *(5 Marks)*

Answer

(a) Computation of total income MNO Corporation LLP for the A.Y.2015-16

Particulars		`	
Profits and Gains from Business or Profession			
Net profit as per profit and loss account (` 10,25,000 + ` 20,50,000)			30,75,000
Add: Items debited to profit & loss account but not allowable as deduction/to be considered separately			
(1)	Interest on capital payable to partners in excess of 12% disallowed under section 40(b) (` 100 lakhs × 3%)	3,00,000	
(2)	Working Partner's salary (to be considered separately)	36,00,000	

(3)	Depreciation as per books of account (` 5 lakhs + ` 35 lakhs) relating to textile business	40,00,000	
(4)	Keyman insurance premium paid (allowable as deduction, since it is incurred wholly and exclusively for the purpose of business – Circular No.762 dated 18.2.1998)	-	
			79,00,000
			1,09,75,000
Less: Depreciation under section 32 of the Income-tax Act, 1961 (relating to textile business) [` 27 lakhs + ` 4 lakhs]			31,00,000
Book Profit			**78,75,000**
Less: Remuneration to working partners [Subject to limits specified in section 40(b)]			
On first ` 3,00,000 of book profit	90% of book profit or `1,50,000, whichever is higher	2,70,000	
On the balance of book profit ` 75,75,000 [` 78,75,000 – ` 3,00,000]	60% of balance book profit	45,45,000	
		48,15,000	
Restricted to actual remuneration paid			36,00,000
Income under the head Profits and gains of business or profession			**42,75,000**
Income from textile manufacturing business **[See Notes 5 & 6]**			20,25,000
Income from specified business of operating a cold chain facility [` 42,75,000 - ` 20,25,000]		22,50,000	
Less: Set-off of brought forward loss of specified business under section 73A **[See Notes 1 to 4 below]**		11,25,000	11,25,000
Total Income			**31,50,000**

Notes:

(1) Computation of loss of specified business of setting up and operating a cold chain facility for P.Y.2013-14 relevant to Assessment Year 2014-15

Particulars	`
Income from cold chain facility [before deduction under section 35AD]	60,00,000
Less: Deduction under section 35AD [150% of ` 50,00,000] **[See Notes 2 & 3]**	75,00,000
Loss of specified business for P.Y.2013-14	15,00,000

Loss to be carried forward as per section 73A read with section 78 [`15,00,000 × ¾] to be set-off against profits of any specified business of the subsequent years **[See Note 4 below]** ` 11,25,000

(2) The specified business of setting up and operating a cold chain facility would be eligible for weighted deduction@150% of the capital expenditure, if the operations are commenced on or after 1.4.2012 **[Section 35AD(1A)]**. In this case, since the operations have commenced on 1.4.2013, the specified business qualifies for weighted deduction @ 150% of capital expenditure.

(3) Expenditure of capital nature would, however, not include any expenditure incurred on acquisition of land **[Section 35AD(8)(f)]**. Therefore, in this case, only cost of ` 50 lakhs on construction of building and machinery installed would qualify for deduction under section 35AD, assuming that such expenditure has been capitalized in the books of account as on 1.4.2013 (being the date of commencement of operations), since the same was incurred prior to commencement of operations **[Proviso to section 35AD(1)]**.

(4) Section 78(1) does not permit carry forward of losses pertaining to the share of a retired or deceased partner. Therefore, in this case, since one of the four partners have retired on 31.3.2014, his share of loss (` 3,75,000, being ¼th of `15 lakh) for the previous year 2013-14 (A.Y.2014-15) cannot be carried forward to the previous year 2014-15 (A.Y.2015-16).

(5) **Computation of profit from textile manufacturing business**

Particulars	`
Profits and Gains from Business or Profession	
Net profit as per profit and loss account	10,25,000
Add: Depreciation as per books of account (`5 lakhs + `35 lakhs) relating to textile business	40,00,000
	50,25,000
Less: Depreciation under section 32 of the Income-tax Act, 1961 (relating to textile business)	31,00,000
	19,25,000
Add: Interest on capital of ` 3,00,000 disallowed [apportioned in the ratio of net profits of textile business and specified business as per profit and loss account (1:2)] [1/3 × ` 3,00,000] **[See Note 6 below]**	1,00,000
	20,25,000

(6) Loss of specified business can be carried forward indefinitely for set-off only against profits of any specified business. Therefore, it becomes necessary to segregate the income of ` 42.75 lakhs computed under the head "Profits and gains of business or profession", so that brought forward loss from specified business relating to P.Y.2013-14 can be set-off against profits of specified business of the P.Y.2014-15.

For this purpose, while computing profits of textile manufacturing business included in the business income of ` 42.75 lakhs, the depreciation as per books of account has to be added back and the depreciation as per the Income-tax Act, 1961 has to be reduced from the net profit of ` 10.25 lakhs pertaining to textile business, since the depreciation adjustments clearly relate to textile business.

There is no effect of adjustment of partners' remuneration, since the entire remuneration which has been added back is allowable as the same is within the limits as per section 40(b)(v).

It is only the interest on capital amounting to ` 3 lakhs (which has been added back while computing business income) which has to be apportioned between textile manufacturing business and specified business.

The solution has been worked out apportioning the interest on capital in the ratio of 1:2 between textile manufacturing and specified business, being the ratio of the net profit of these two businesses as per profit and loss account. The solution can also be worked out by apportioning interest on capital on any other logical basis.

(b) The definition of "urban land" as per clause (b) of *Explanation 1* of section 2(ea) of the Wealth-tax Act, 1957 is as follows:

Inclusions within the definition of "urban land"

(i)	Land situated in any area which is comprised within the jurisdiction of a municipality or a cantonment board and which has a population of not less than 10,000.		
(ii)	Land situated in any area, within the distance, measured aerially, in relation to the range of population according to the last preceding census as shown hereunder –		
		Shortest aerial distance from the local limits of a municipality or cantonment board referred to in item (a)	Population according to the last preceding census of which the relevant figures have been published before the first day of the previous year.
	(1)	≤ 2 kilometers	> 10,000 ≤ 1,00,000
	(2)	≤ 6 kilometers	> 1,00,000 ≤ 10,00,000
	(3)	≤ 8 kilometers	> 10,00,000

Exclusions from the definition of "urban land"

(i) Land classified as agricultural land in the records of the Government and used for agricultural purposes;

(ii) Land on which construction of building is not permissible under any law for the time being in force in the area in which such land is situated;

(iii) Land occupied by any building which has been constructed with the approval of the appropriate authority;

(iv) Any unused land held by the assessee for industrial purposes for a period of two years from the date of its acquisition by him;

(v) Any land held by the assessee as stock-in-trade for a period of ten years from the date of its acquisition by him.

(c)

	Validity/ Invalidity of the statement	Reason for validity/invalidity of the statement
(i)	**Invalid**	Determination of net wealth is not dependent on the system of book keeping adopted by the assessee. The value of any asset, other than cash, would be the value as on the valuation date determined in the manner laid down in Schedule III.
(ii)	**Invalid**	Even though cash in hand not recorded in the books of account would constitute an asset in case of persons other than individuals and HUFs as per section 2(ea)(vi) of the Wealth-tax Act, 1957, the same would not be included in the firm's net wealth, since firm is not an entity assessable to wealth-tax as per section 3 of the Wealth-tax Act, 1957. However, the value of a partner's interest in the assets (including unrecorded cash) of the firm would be includible in his net wealth as per section 4(1)(b) of the Wealth-tax Act, 1957.
(iii)	**Invalid**	The deeming provision under section 4(1)(a)(i) of the Wealth-tax Act, 1957 would apply only in respect of asset transferred to spouse otherwise than for adequate consideration or in connection with an agreement to live apart. In this case, since Mr. Tom has transferred vacant site to his wife in connection with an agreement to live apart, the deeming provisions would not be attracted and the asset would be taxable in the hands of his wife.
(iv)	**Invalid**	Section 19 of the Wealth-tax Act, 1957 determines the liability of legal representative for the defaults committed by the deceased assessee. According to section 19(3), the provisions of sections 14, 15 and 17 shall apply to legal representative as they apply to any person referred to in those sections. However, there is no reference to section 18 dealing with penalty in section 19(3). In view of the legal position, penalty under section 18 of Wealth-tax Act, 1957 can neither be levied nor penalty proceedings already initiated be continued on the legal representative for the defaults

		committed by deceased against whom penalty proceedings have been initiated prior to his death *[CWT v. H.S.Chauhan (2000) 245 ITR 704 (Delhi)].*
(v)	**Valid**	As per section 6 of the Wealth-tax Act, 1957, in case of a company not resident in India, the value of assets and debts located outside India shall not be taken into account in computing its net wealth on the valuation date. However, the value of assets held in India[1] by such company (the company incorporated in Sri Lanka, in this case) would be liable to wealth-tax.

Question 2

Moon India Ltd. engaged in manufacturing activity furnishes the following details:

Net profit as per Profit and Loss Account ` 50,00,000.

(i) The company took a loan of ` 12,00,000 in the financial year 2011-12 for the purpose of relocation of its office premises. The lender waived ` 8,00,000 in the financial year 2014-15 and it is credited in the profit and loss account.

(ii) Depreciation charged to Profit and Loss Account is ` 16,00,000. Depreciation as per Income-tax Act, 1961 amounts to ` 28,00,000 which includes the following:

Depreciation rate meant for computers has been adopted for (i) accessories like printers and scanners; and (ii) EPABX. The written down value of these as on 1-4-2014 is given below:

(a) Printers and Scanners ` 50,000

(b) EPABX ` 2,00,000

Assume that there were no additions during the year.

(iii) It incurred ` 2,50,000 as expenditure for public issue of shares. The public issue could not materialize on account of non-clearance by SEBI. This amount is charged to Profit & Loss Account.

(iv) It incurred expenditure of ` 2,00,000 towards issue of debentures. This amount has been capitalized in the books.

(v) The company paid ` 1,00,000 as compounding fee for violations in the pollution control regulations. This has been charged as revenue expenditure.

(vi) The company lost cash of ` 25,00,000 due to theft when it was withdrawn from bank and taken to administrative office. It is not insured and hence, fully charged as revenue expenditure.

[1] Other than the value of assets in India represented by any loans or debts owing to the assessee in any case where the interest on such loans or debts is not to be included in the total income of the assessee under section 10 of the Income-tax Act, 1961.

(vii) ` 5,00,000 was spent during the year towards permitted CSR activities as per 135 of the Companies Act, 2013. This is charged to Profit and Loss Account.

(viii) It paid ` 2,00,000 to share broker for transacting shares listed in stock exchange and ` 1,00,000 to commodity broker for commodity transactions at MCX. Both the amounts are debited to Profit and Loss Account and no tax was deducted at source on these payments.

(ix) The company during the year employed 115 new workers in factory which was 20% of the existing work force and 18 employees in the registered office which was equal to 10% of the existing employee strength. It paid ` 20,00,000 and ` 8,00,000, respectively, as additional wages and salary.

(x) It paid ` 50,000 to an electoral trust by cash and ` 1,00,000 by cheque to a registered political party. Both these are debited to Profit and Loss Account.

Compute the total income of the company for the assessment year 2015-16. Give reasons in brief for treatment of each of the above items. Ignore MAT provisions. (16 Marks)

Answer

(a) Computation of Total Income of Moon India Ltd. for the A.Y.2015-16

Particulars	Amount (`)	
Profits and Gains from Business and Profession		
Net profit as per profit and loss account		50,00,000
Add: **Items debited but to be considered separately or to be disallowed**		
Depreciation as per books of account **(Note 1)**	16,00,000	
Expenditure on public issue of shares which could not materialize due to non-clearance by SEBI **(Note 2)**	2,50,000	
Compounding fee paid for violating pollution control regulations **(Note 3)**	1,00,000	
Loss of cash in transit from bank to administrative office on account of theft **(Note 4)**	-	
Expenditure towards permitted CSR activities as per section 135 of the Companies Act, 2013 **(Note 5)**	5,00,000	
Payment to share-broker without deducting tax at source **(Note 6)**	-	
Payment to commodity broker without deducting tax at source **(Note 6)**	30,000	
Donations to electoral trust and registered political party **(Note 7)**	1,50,000	
		26,30,000
		76,30,000

***Less:* Items credited but to be considered separately / Expenditure to be allowed**		
Depreciation allowable under the Income-tax Act, 1961 **(Note 1)**	27,10,000	
Waiver of loan taken for relocation of office premises **(Note 8)**	8,00,000	
Expenditure on issue of debentures **(Note 9)**	2,00,000	
		37,10,000
Gross Total Income		**39,20,000**
Less: **Deduction under Chapter VI-A**		
Under section 80GGB [Donation to registered political party] **(Note 7)**	1,00,000	
Under section 80JJAA **(Note 10)**	6,00,000	7,00,000
Total Income		**32,20,000**

Notes:

(1) Depreciation as per books of account charged to profit and loss account (i.e., ` 16 lakhs) has to be added back and depreciation calculated as per Income-tax Rules, 1962 (i.e. ` 27.10 lakhs) is allowable as deduction under section 32.

Computer accessories and peripherals like printer and scanner form an integral part of the computer system and they cannot be used without the computer; hence, they are eligible for depreciation@60% *[CIT v. BSES Yamuna Powers Ltd. (2013) 358 ITR 47 (Del.)].*

However, EPABX is not a computer and is, hence, not entitled to higher depreciation@60% *[Federal Bank Ltd. v. ACIT (2011) 332 ITR 319 (Kerala)]*.

Therefore, depreciation as per Income-tax Act, 1961 would be ` 27.10 lakhs, which is computed as follows –

Particulars	`
Depreciation computed as per Income-tax Act, 1961	28,00,000
Less: Depreciation@60% wrongly provided in respect of EPABX = 60% of ` 2,00,000	1,20,000
	26,80,000
Add: Depreciation@15% on EPABX = 15% of ` 2,00,000	30,000
Correct Depreciation as per Income-tax Act, 1961	27,10,000

(2) Share issue expenses incurred by the company constitutes a capital expenditure, even though it could not go in for the public issue on account of non-clearance by SEBI. Though the efforts were aborted, the fact remains that the expenditure incurred was only for the purpose of expansion of the capital base. The capital nature of the expenditure would not be lost on account of the abortive efforts [*Mascon Technical Services Ltd. v. CIT (2013) 358 ITR 545 (Mad.)].*

Since the expenditure has been charged to profit and loss account, the same has to be added back.

(3) The amount paid for compounding an offence is inevitably a penalty and the mere fact that it has been described as compounding fee cannot, in any way, alter the character of the payment which is in the nature of penalty. Hence, the same is not allowable as revenue expenditure [*Millenia Developers P Ltd. v. Deputy CIT (2010) 322 ITR 401 (Kar.)].*

Since the compounding fee has been charged to profit and loss account, the same has to be added back.

(4) In order to determine whether any loss from theft, dacoity, embezzlement, etc., is deductible or not, what is material is whether the loss incurred by theft, dacoity, etc., is incidental to the carrying on of the business. It does not make much difference whether such act is committed by the employees of the assessee or by strangers [*G.G. Dandekar Machine Works Ltd. v. CIT (1993) 202 ITR 161 (Bom.)].*

In this case the loss due to theft took place when cash was withdrawn from bank and taken to administrative office. Hence, it is incidental to business and thus, allowable as revenue expenditure. Since the same has already been charged as revenue expenditure, no further adjustment is required.

(5) Any expenditure incurred by an assessee on the activities relating to corporate social responsibility referred to in section 135 of the Companies Act, 2013 shall not be deemed to have been incurred for the purpose of business and hence, shall not be allowed as deduction under section 37. Since the expenditure has been charged to profit and loss account, the same has to be added back for computing business income.

It is assumed that the CSR expenditure is not of the nature described in sections 30 to 36 of the Income-tax Act, 1961, and hence, does not qualify for deductions under those sections.

(6) The payments to share broker and commodity broker are in the nature of commission. However, payment for transaction in securities has been particularly excluded from the scope of section 194H. Hence, payment of ` 2 lakhs to a share broker for transacting shares listed in stock exchange (which falls within the meaning of securities) would not be disallowed for non-deduction of tax at source.[2]

However, payment of ` 1 lakh to a commodity broker for commodity transactions at MCX would attract disallowance@30% under section 40(a)(ia), due to non-deduction of tax at source under section 194H.

[2] Since the income from transacting in shares has not been separately mentioned in the question, it is assumed that such income is included in the net profit of ` 50 lacs in the profit and loss account and therefore, commission paid to share broker has been allowed as deduction from such income.

(7) Donation to an electoral trust and a registered political party is not an allowable expenditure under section 37 since it is not laid out wholly or exclusively for the purposes of business or profession. Hence, the same has to be added back while computing business income.

However, donation made by a company to an electoral trust or registered political party is allowable deduction under section 80GGB from gross total income, subject to the condition that payment is made otherwise than by way of cash. Since the donation to electoral trust is made in cash, the same does not qualify for deduction under section 80GGB. However, donation of ` 1 lakh by cheque to a registered political party would be eligible for deduction under section 80GGB.

(8) Since the loan was taken by Moon India Ltd. for the purpose of relocating its office premises i.e., for acquisition of a capital asset, namely, a new office, the waiver of the same cannot be said to be a waiver or remission of trading liability to attract taxability under section 41(1). Waiver of such loan, being capital in nature, is not taxable *[CIT v. Softworks Computers P Ltd. (2013) 354 ITR 16 (Bom.)].* In this case, since the loan of ` 8 lakh waived has been credited to profit and loss account, the same must be deducted for computing business income.

(9) The expenditure on issue of debentures is not in the nature of capital expenditure and is laid out or expended wholly and exclusively for the purpose of the assessee's business and is therefore, allowable as a deduction. The act of borrowing money is incidental to the carrying on of business, the loan obtained is not an asset or an advantage of enduring nature, the expenditure is made for securing the use of money for a certain period, and it is irrelevant to consider the object with which the loan was obtained *[India Cements Ltd. v. CIT (1966) 60 ITR 52 (SC)].*

Since the said expenditure has been capitalized in the books of account, the same has to be deducted to compute business income.

(10) Deduction of 30% of additional wages paid to the new regular workmen employed by the assessee in a factory is allowable under section 80JJAA, where the gross total income of an Indian company includes profits and gains derived from the manufacture of goods in a factory.

"Additional wages" means the wages paid to the new regular workmen in excess of 100 workmen employed during the previous year. In case of an existing factory, the number of regular workmen employed during the year should be 10% or more of the existing number of workmen employed on the last day of the previous year.

In this case, 115 new workmen are employed in the factory during the P.Y.2014-15 and the new workmen employed in the factory constitute 20% of the existing workforce, the company is eligible for deduction under section 80JJAA, assuming that these workmen are regular workmen. The deduction under section 80JJAA

would be available in respect of wages paid to these 115 workers who are over the existing workers of 575 in factory.

Therefore, deduction under section 80JJAA would be Rs.6,00,000, being 30% × ` 20,00,000.

No deduction is allowable under section 80JJAA in respect of additional salaries paid to new employees working in a place other than a factory (registered office, in this case).

Note *- It is logical to assume that the additional wages of ` 20 lakh and salaries of ` 8 lakh have been debited to profit and loss account. Hence, no further adjustment is required to be made regarding such wages and salaries while computing business income.*

Question 3

(a) A public charitable trust registered under section 12AA runs a hospital and also a medical college. It furnishes you the following information for the year ended 31st March, 2015:

(i) Gross receipt from Hospital ` 425 lakhs

(ii) Income from business - incidental to main objects ` 2 lakhs.

(iii) Voluntary contributions received from public ` 32 lakhs. It include corpus donation of ` 3 lakhs and anonymous donation of ` 5 lakhs.

Note: *Voluntary contributions are included in Gross receipt given in (i) above.*

(iv) Hospital operational expenses incurred ` 105 lakhs. (This does not include capital expenditures and depreciation)

(v) Income from Medical College (solely for education purpose) ` 10 lakhs. Gross receipts of college for the year ` 90 lakhs.

(vi) Gross receipt given in (i) above includes a sum of ` 55 lakhs which has accrued but not received. However, a sum of ` 18 lakhs was received only on 31st day of March, 2015.

(vii) The trust set apart ` 80 lakhs for acquiring a building to expand its hospital. But the amount was paid in May 2015 when sale deed was registered in its name.

(viii) In June, 2014, the trust purchased and installed new computer software for ` 28 lakhs. The rate of depreciation is 60% as per Income-tax Act, 1961.

(ix) The trust incurred ` 35 lakhs towards purchase of laptops, computers and printers for the hospital.

(x) It repaid loan of ` 15 lakhs taken earlier for construction of hospital building.

Compute the total income of the trust for the assessment year 2015-16 in order to avail maximum benefits within the four comers of law. (8 Marks)

(b) With brief reasons answer the following in terms of Chapter VI-A of the Income-tax Act, 1961:

(i) Mr. Raju invested ` 60,000 in listed units of Rajiv Gandhi Equity Saving Scheme (RGESS) during the financial year 2014-15. How much he can claim deduction in respect of such investment?

(ii) Mr. Jaju deposited ` 65,000 with life insurance corporation for the maintenance of his mother who suffers from disability of 90%. She is wholly dependent on him. How much is deductible?

(iii) Mr. Shiva has gross total income of ` 3,75,000. He has given the following donations:

National Children's Fund	*` 25,000 - by cheque*
Prime Minister's Drought Relief Fund	*` 30,000 - by cheque*
National Blood Transfusion Council	*` 40,000 - by cash*
National Illness Assistance Fund	*` 20,000 - equally by cash and cheque.*

Compute the amount deductible under section. 80G.

(iv) Mr. Manoj, a computer software engineer, co-authored a book on advanced computer programming alongwith his friend. He received ` 4,10,000 as lump sum royalty in March, 2015. How much of royalty is taxable? (8 Marks)

Answer

(a) Computation of total income of the trust for the A.Y.2015-16

Particulars	(` in lacs)	(` in lacs)
Gross receipts from Hospital (other than voluntary contribution of ` 32 lakhs) [` 425 lacs – ` 32 lacs]		393.00
Less: Hospital operational expenses		105.00
		288.00
Income from business – incidental to main object[3]		2.00
		290.00
Add: Voluntary contributions other than corpus donations of ` 3 lakhs		29.00
		319.00

[3] It is assumed that separate books of account are maintained by the trust in respect of such business

Less: Anonymous donation taxable@30% under section 115BBC **[See Note 1]**		3.40
		315.60
Less: 15% of income eligible for accumulation or being set apart without any condition under section 11(1)(a)[4]		47.34
		268.26
Less: Deemed application as per *Explanation 2* to section 11(1)[5]		
(i) Amount accrued but not received during the previous year	55.00	
(ii) Income received on 31st March 2015	18.00	73.00
		195.26
Less: Amount applied for the purposes of hospital **[See Note 2]**		
- Cost of new computer software [Assuming that the same was purchased for the purposes of the hospital]	28.00	
- Cost of laptops, computers and printers purchased for the hospital *[Capital expenditure can be claimed as application of income. It was so held in S.RM.M.CT.M. Tiruppani Trust v. CIT (1998) 230 ITR 636]*	35.00	
- Repayment of loan taken earlier for construction of hospital building - repayment of a debt incurred for the purpose of trust is application of income *[CIT v. Janmbhoomi Press Trust (2000) 242 ITR 703 (Kar.)]*	15.00	78.00
		117.26
Less: Amount set apart for acquisition of a building to expand its hospital **[See Note 3]**		
[The amount spent in May 2015 in the immediately following year can be treated as application in the P.Y.2014-15, provided a notice in writing is given to the Assessing Officer as required under section 11(2)]		80.00
		37.26

[4] A possible alternate view arising on account of the interpretation of the Supreme Court ruling in *CIT v. Programme for Community Organisation (2001) 116 Taxman 608* is that 15% of gross receipts would be eligible for accumulation under section 11(1)(a).

[5] It is assumed that an option has been exercised in writing before the expiry of the time allowed under section 139(1) to treat such income as deemed application of income in the previous year in which the income is derived.

Income of ` 10 lakhs from Medical College – exempt under section 10(23C)(iiiad) as gross receipts do not exceed Rs 1 crore.		Nil
Total income [other than anonymous donation taxable under section 115BBC]		**37.26**
Add: Anonymous donation taxable @30%		3.40
Total Income of the trust (including anonymous donation taxable@30%)		**40.66**
In order to minimize and / or reduce the tax liability, the trustees may give a notice in writing to the Assessing Officer in the prescribed manner about their intention to accumulate minimum of ` 34.76 lakhs [` 37.26 lakhs *minus* ` 2.50 lakhs (basic exemption limit)] specifying the period and the purpose for which the accumulation is proposed to be made and invest such sum in the modes specified under section 11(5). This accumulation would be in compliance with section 11(2) and in such a case, no tax will be payable on the total income (other than anonymous donations taxable@30% under section 115BBC) of ` 37.26 lakhs.		

Notes:

(1) As per section 115BBC(1), the anonymous donations in excess of the higher of the following would be subject to tax@30%;

- ` 1.60 lakh, being 5% of the total donations received i.e., 5% of ` 32 lakh; or
- ` 1 lakh

Therefore, anonymous donations of ` 3.4 lakh (` 5 lakh – ` 1.60 lakh) would be subject to tax@30% under section 115BBC.

As per section 13(7), such anonymous donations are not eligible for the benefit of exclusion from total income under sections 11 and 12.

(2) As per section 11(6), where the cost of assets is claimed as application, no deduction for depreciation on such assets would be allowed in determining income for the purposes of application. Therefore, since cost of new computer software, laptops, computers and printers purchased for the hospital has been claimed as application of income, no depreciation would be allowed on these assets while determining income for the purposes of application.

(3) The word "applied" used in section 11 does not necessarily imply "spent". Even if a certain amount is irretrievably earmarked and allocated for charitable purposes, the said amount can be deemed to have been applied for charitable purposes. *[CIT vs. Trustees of H.E.H. Nizams Charitable Trust, (1981) 131 ITR 497 (AP).]*

(4) A view is taken that 15% of `1.60 lakhs, representing the amount of anonymous donations exempt from the applicability of tax@30% (and hence, chargeable to tax at normal rates), is also eligible for retention/ accumulation without conditions in line with other voluntary contributions. The above solution has been worked out on the basis of this view.

However, it is possible that the language used in section 13(7) may also be interpreted to mean that anonymous donations chargeable to tax at normal rates are not eligible for retention/accumulation. In such a case, the whole of the anonymous donations of ` 5 lakhs has to deducted from ` 319 lakhs to arrive at ` 314 lakhs and 15% of ` 314 lakhs, being ` 47.10 lakhs, would be eligible for accumulation under section 11(1)(a) without any condition.

(b)

	Deduction (`)	**Reasons**
(i)	25,000	As per section 80CCG, an assessee, being a resident individual would be allowed a deduction in computation of total income of 50% of the amount invested in the listed equity shares or listed units of an equity oriented fund in accordance with Rajiv Gandhi Equity Saving Scheme, 2013, provided the gross total income of the assessee does not exceed ` 12 lakhs and he is a new retail investor. Mr. Raju is eligible for deduction under section 80CCG of - - ` 30,000, being 50% of ` 60,000 invested in listed units of Rajiv Gandhi Equity Saving Scheme; or - ` 25,000, whichever is lower. It is assumed that the gross total income of Mr. Raju does not exceed ` 12 lakhs during the previous year 2014-15 and he is a new retail investor.
(ii)	1,00,000	As per section 80DD, an assessee, being an individual or HUF, who is resident in India during the previous year, and has - - incurred any expenditure for medical treatment (including nursing), training and rehabilitation of person dependent on him, who is suffering from disability or - paid or deposited any amount under a scheme framed by LIC or other insurer for the maintenance of a dependent, being a person with disability, would be eligible for deduction of ` 50,000, in case the dependent is a person with disability. In case the dependent is a

<table>
<tr><td></td><td></td><td>person with severe disability, the deduction under this section would be ` 1,00,000.<br>Mr. Jaju would be eligible for deduction under section 80DD since he has deposited money with LIC for maintenance of his mother, who suffers from severe disability (80% or more of one or more disabilities) and is wholly dependent on him.<br>A flat deduction of ` 1,00,000 would be available to him under section 80DD, irrespective of the amount deposited with LIC.</td></tr>
<tr><td>(iii)</td><td>60,000</td><td>Mr. Shiva would be eligible for deduction under section 80G in respect of the donations made during the previous year as follows:
<table>
<tr><th>Donation to</th><th>Amount of donation (`)</th><th>Mode of donation</th><th>% of donation eligible for deduction</th><th>Amount of deduction (`)</th></tr>
<tr><td>National Children's Fund</td><td>25,000</td><td>Cheque</td><td>100%</td><td>25,000</td></tr>
<tr><td>Prime Minister's Drought Relief Fund</td><td>30,000</td><td>Cheque</td><td>50%</td><td>15,000</td></tr>
<tr><td>National Blood Transfusion Council</td><td>40,000</td><td>Cash</td><td>100%</td><td>Nil
(Cash donation in excess of ` 10,000 would <u>not</u> qualify for deduction)</td></tr>
<tr><td>National Illness Assistance Fund</td><td>20,000</td><td>`10,000 by cheque<br>&<br>`10,000 by cash</td><td>100%</td><td>20,000
(The whole amount qualifies for deduction, since cash donation in this case does not exceed ` 10,000)</td></tr>
</table></td></tr>
</table>

(iv)	3,00,000	The entire royalty would be first included in Manoj's income under the head "Income from other sources". Thereafter, Mr. Manoj is eligible for deduction from gross total income under section 80QQB, of the whole of the income derived by him on account of any lumpsum consideration in the form of royalty in respect of a book, being a work of literary or scientific nature, or ` 3,00,000, whichever is less. Book on Advanced computer programming would fall within the description of work of literary or scientific nature *[Dassault Systems K.K. In Re. (2010) 322 ITR 125 (AAR)].* In this case, the eligible deduction under section 80QQB would be the lower of ` 4,10,000, being the amount of lumpsum royalty received by Manoj or ` 3,00,000. The net effect is that out of ` 4,10,000 included in Manoj's income, he can claim deduction of ` 3,00,000 under section 80QQB. The balance of ` 1,10,000 would form part of his total income.

Note – It has been assumed that Mr. Raju, Mr. Jaju and Mr. Manoj are resident Indians.

Question 4

*Answer any **four** out of the following **five** cases:*

(a) A & Co. Ltd., a property developer and builder, disclosed unsold flats as stock in trade in its books of account as well as in wealth tax return. It let out those flats and offered the same as income from house property by claiming statutory deduction under section 24 of the Act. The Assessing Officer disallowed statutory deduction and taxed the same as income from business. Decide the correctness of the action of the Assessing Officer.

(b) Mr. X had a leasehold property since 5th May, 2008. The leasehold rights were converted into freehold on 20th May, 2014. The said property was sold on 10th January, 2015. The assessee claimed the capital gain as long-term capital gain. The Assessing Officer contended the same as short-term as the property was acquired by converting the leasehold right into freehold right only on 20th May, 2014. Is Mr. X justified in his claim?

(c) Mr. Manas is a distributor of lottery tickets. He won `6,00,000 as prize money on unsold lottery tickets. It was offered as business income. The Assessing Officer wants to tax the same as lottery winning at the rate prescribed under section 115BB. Is he justified?

(d) Maitri Jeans (P) Ltd. is in the business of manufacturing jeans. For the assessment year 2015-16 it paid tax@18.50% on its book profit computed under section 115JB. The Assessing Officer though satisfied that it is liable to pay book profit tax U/s. 115JB, wants to charge interest under sections 234B and 234C as no advance tax was paid during the financial year 2014-15. The company seeks your opinion on the proposed levy of interest. Advice.

(e) Mango Ltd. has inadvertently claimed deduction in respect of provision made for payment of gratuity in its return of income. However, this was shown as disallowance U/s. 40A(7) in the tax audit report filed U/s. 44AB. The Assessing Officer initiated proceedings for levy of penalty under section 271(1)(c). The company pleads that the claim was inadvertent as the return was computer fed and e-filed by its administrative staff. Decide the correctness of action proposed by the Assessing Officer. (4 x 4 = 16 Marks)

Answer

(a) The issue under consideration in this case is whether rental income derived from the let out flats disclosed as stock-in trade in the books of accounts as well as in wealth tax return of A & Co. Ltd., a property dealer, would be taxable under the head "Income from house Property" or "Profits and gains of business or profession".

As per section 22, the annual value of property consisting of any buildings or lands appurtenant thereto of which the assessee is the owner, other than such portions of such property as he may occupy for the purposes of any business or profession carried on by him the profits of which are chargeable to income-tax, shall be chargeable to income-tax under the head "Income from house property".

Therefore, only property occupied by the assessee for the purpose of his own business is excluded from the scope of section 22. As a logical corollary, section 22 does not exclude from its scope, income from property held as stock-in-trade.

The Calcutta High Court, in *Azimganj Estate (P.) Ltd. v. CIT (2013) 352 ITR 82,* observed that the rental income from the unsold flats of a builder shall be taxable as "Income from house property" as provided under section 22 and since it specifically falls under this head, it cannot be taxed under the head "Profit and gains from business or profession". Therefore, the assessee would be entitled to claim statutory deduction of 30% from such rental income as per section 24. The fact that the flats have been claimed as not chargeable to wealth-tax, treating the same as stock-in-trade, will not affect the computation of income under the Income-tax Act, 1961.

Thus, the rental income from the unsold flats of a builder, A & Co. Ltd., in this case, shall be taxable as "Income from house property" as provided under section 22 and since it specifically falls under this head, it cannot be taxed under the head "Profit and gains from business or profession".

A & Co. Ltd. would be entitled to claim statutory deduction of 30% from such rental income as per section 24.

Therefore, the action of the Assessing Officer in this case denying the statutory deduction and treating the income from let-out flats as business income is not correct.

(b) The issue under consideration in this case is where a leasehold property is purchased and converted into freehold property at a later point of time and then sold, should the

period of holding be reckoned from the date of purchase or from the date of conversion for determining whether the resultant capital gains is short-term or long-term.

The facts of the case are similar to the facts in *CIT v. Smt. Rama Rani Kalia (2013) 358 ITR 0499 (All.).* In that case, it was observed that the conversion of leasehold property into freehold property was nothing but improvement of the title over the property, as the assessee was the owner prior to conversion. Further, the difference between "short-term capital asset" and "long-term capital asset" is the period for which the property has been held by the assessee and not the nature of title over the property.

The lessee of the property has rights as the owner of the property subject to the covenants of the lease deed. Accordingly, the lessee may, subject to covenants of the lease deed, transfer the leasehold rights of the property with the consent of the lessor.

The Allahabad High Court, thus, held that conversion of rights of the lessee from leasehold to freehold is only by way of improvement of his rights over the property, which he enjoyed. It would not have any effect on the taxability of gain from such property, which is related to the period for which the property is held, both as leasehold and as freehold.

Therefore, in this case, the period of holding of the property by Mr. X would be reckoned from 5th May 2008 to 10th January 2015, which is more than 36 months. Consequently, the resultant capital gains would be long-term.

Thus, the claim of Mr. X to treat the capital gain as long term capital gain, is justified.

(c) The issue under consideration is whether winnings of prize money on unsold lottery tickets held by the distributor of lottery tickets can be subject to tax at the rate of 30% prescribed under section 115BB.

In *CIT v. Manjoo and Co. (2011) 335 ITR 527,* the Kerala High Court observed that the receipt of winnings from lottery by the distributor was not on account of any physical or intellectual effort made by him and therefore cannot be said to be "income earned" by him in business.

The unsold lottery tickets cease to be stock-in-trade of the distributor because, after the draw, those tickets are unsalable and have no value except waste paper value and the distributor will get nothing on account of the tickets except any prize winning ticket if held by him, which, if produced will entitle him for the prize money.

Hence, the receipt of the prize money is not in his capacity as a lottery distributor but as a holder of the lottery ticket which won the prize. The Lottery Department also does not treat it as business income received by the distributor but instead treats it as prize money paid on which tax is deducted at source.

Further, winnings from lotteries are assessable under the special provisions of section 115BB, irrespective of the head under which such income falls.

Therefore, the Kerala High Court held that the rate of 30% prescribed under section 115BB would be applicable on prize money winnings received by a distributor on unsold lottery tickets held by him.

Applying the rationale of the Kerala High Court ruling to the case on hand, the Assessing Officer's intention to tax the prize money received by the distributor on unsold lottery tickets held by him at the rate prescribed under section 115BB is justified.

(d) The issue under consideration is whether interest under sections 234B and 234C can be levied where a company is assessed on the basis of its book profit under section 115JB.

The Supreme Court, in *Joint CIT v. Rolta India Ltd. (2011) 330 ITR 470*, observed that there is a specific provision in section 115JB(5) providing that all other provisions of the Income-tax Act, 1961 shall apply to every assessee, being a company, mentioned in that section. Section 115JB is a self-contained code pertaining to MAT, and by virtue of sub-section (5) thereof, the liability for payment of advance tax would be attracted.

According to section 207, tax shall be payable in advance during any financial year, in accordance with the provisions of sections 208 to 219 (both inclusive), in respect of the total income of the assessee which would be chargeable to tax for the assessment year immediately following that financial year.

Under section 115JB(1), where the tax payable on total income is less than 18.5% of "book profit" of a company, the "book profit" would be deemed to be the total income and tax would be payable at the rate of 18.5%.

Since in such cases, the book profit is deemed to be the total income, therefore, as per the provisions of section 207, tax shall be payable in advance in respect of such book profit (which is deemed to be the total income) also.

Therefore, if a company defaults in payment of advance tax in respect of tax payable under section 115JB, it would be liable to pay interest under sections 234B and 234C.

Therefore, even though Maitri Jeans (P) Ltd. is assessed on the basis of its book profit under section 115JB for A.Y.2015-16, it is liable to pay advance tax. Since Maitri Jeans (P) Ltd. has not paid any advance tax during the financial year 2014-15, the levy of interest under section 234B and 234C is valid.

(e) The issue under consideration is whether the penalty under section 271(1)(c) would be attracted if an assessee has wrongly claimed deduction of provision made for payment of gratuity in its return of income, though the same was shown as disallowed under section 40A(7) in the statement of particulars filed along with tax audit report under section 44AB.

This issue came up before the Supreme Court in *Price Waterhouse Coopers Pvt. Ltd. v. CIT (2012) 348 ITR 306.* The Supreme Court observed that the fact that the tax audit report filed along with the return unequivocally stated that provision for gratuity was not

allowable under section 40A(7) indicates that the assessee made a computation error in its return of income.

Penalty under section 271(1)(c) is leviable for concealment of particulars of income or furnishing of inaccurate particulars of income by any person.

The contents of the tax audit report showed that there was no question of the assessee concealing the income or furnishing any inaccurate particulars.

It is evident from the facts, that the assessee had committed an inadvertent and bona fide error and had not intended to or attempted to either conceal its income or furnish inaccurate particulars.

Therefore, action of the Assessing Officer initiating penalty proceedings under section 271(1)(c), is not correct.

Note *– Answers to all sub-parts of question 4 are based on interpretation of case laws. The answers given above are based on particular legal decisions wherein the facts of the case and issue under consideration are similar to the facts given and issue(s) raised in the questions. However, it may also be possible to answer some of these questions on the basis of other case laws wherein the facts and issue(s) are similar.*

Question 5

(a) Mr. Ramesh purchased a plot of land in Chennai in June 2005 for ` 50 lakhs. He decided to sell the property to Mr. Mahesh for ` 80 lakhs and received an advance of ` 2 lakhs in May, 2009. Mr. Mahesh was unable to complete the agreement and hence, the entire advance was forfeited by Mr. Ramesh.

Again Mr. Ramesh entered into an agreement to sell the property to Mr. Rakesh for ` 95 lakhs and received advance money of ` 2.50 lakhs in August, 2014. But again the transfer did not materialise due to which the advance money was again forfeited.

On 4th January, 2015, the property was finally sold to Mr. Mukesh for ` 105 lakhs and the stamp duty value on that date was ` 125 lakhs. During financial year 2014-15, Mr. Ramesh earned business income of ` 25 lakhs.

He acquired a new residential property for ` 130 lakhs by investing entire sale consideration and his business income.

Determine the total income of Mr. Ramesh for the assessment year 2015-16.

Cost inflation index are :

Financial year	***Cost inflation index***
2005-06	*497*
2009-10	*632*
2014-15	*1024*

(7 Marks)

(b) Specify with reason, whether the following acts can be considered as (i) Tax planning; or (ii) Tax management; or (iii) Tax evasion.

(i) An individual tax payer making tax saver deposit of `1,00,000 in a nationalised bank.

(ii) A partnership firm obtaining declaration from lenders/depositors in Form No. 15G/15H and forwarding the same to income-tax authorities.

(iii) A company installed an air-conditioner costing ` 75,000 at the residence of a director as per terms of his appointment but treats it as fitted in quality control section in the factory. This is with the objective to treat it as plant for the purpose of computing depreciation.

(iv) RR Ltd. issued a credit note for `80,000 as brokerage payable to Mr. Ramana who is the son of the managing director of the company. The purpose is to increase the total income of Mr. Ramana from `4,00,000 to `4,80,000 and reduce the income of RR Ltd. correspondingly.

(v) A company remitted provident fund contribution of both its own contribution and employees' contribution on monthly basis before due date. (5 Marks)

(c) The business premises of Mr. Amit was subjected to a survey under section 133A of the Act. There were some incriminating materials found at the time of survey. The assessee apprehends reopening of assessments of the earlier years. He wants to know whether he can approach the Settlement Commission.

Explain briefly the basic conditions to be satisfied and the benefits that may accrue to Mr. Amit by approaching the Settlement Commission. (4 Marks)

Answer

(a) Computation of total income of Mr. Ramesh for A.Y.2015-16

Particulars		` in lakhs	` in lakhs
Business Income			25.00
Capital Gains			
Full value of consideration		125.00	
As per section 50C, the full value of consideration would be the higher of -			
Actual Consideration	` 105 lakhs		
Stamp Duty Value	` 125 lakhs		
Less: Indexed cost of acquisition **(See Note 1)**		98.90	
		26.10	
Less: Exemption under section 54F **(See Note 2)**		26.10	
Long-term capital gain			Nil

Income from other sources **(See Note 3)**		2.50
Total Income		**27.50**

Notes:

(1) **Computation of indexed cost of acquisition:**

Particulars	` in lakhs
Cost of acquisition	50.00
Less: Advance received from Mr. Mahesh in the previous year 2009-10 and forfeited (to be reduced from cost of acquisition as per section 51, since the same was received before 1.4.2014)	2.00
Cost for the purpose of indexation	48.00
Indexed cost of acquisition (` 48 lakhs x 1024/497)	98.90

(2) When capital gain is assessed on notional basis as per the provisions of section 50C, and the higher value i.e., the stamp duty value of ` 125 lakhs under section 50C has been adopted as the full value of consideration, the entire amount of ` 130 lakhs reinvested in the residential house within the prescribed period should be considered for the purpose of exemption under section 54F, irrespective of the source of funds for such reinvestment *[Gouli Mahadevappa v. ITO (2013) 356 ITR 90 (Kar.)]*.

In this case, since the cost of the new residential property acquired (` 130 lakhs) is more than the stamp duty value of ` 125 lakhs of the land transferred, the whole of the capital gain of ` 26.10 lakh would be exempt under section 54F.

(3) Advance of ` 2.50 lakhs received by Mr. Ramesh from Mr. Rakesh in August, 2014 which was forfeited due to the transfer not having materialized, is taxable as per section 56(2)(ix) under the head "Income from other sources", since the same was received on or after 1st April, 2014. Hence, such amount would not be reduced to compute the indexed cost of acquisition while determining capital gains on sale of the property.

(b) Tax Planning / Tax Management / Tax Evasion

	Answer	Reason
1.	Tax planning	Making a tax saver deposit of ` 1,00,000 in a nationalized bank for claiming deduction under section 80C by an individual is a permitted tax planning measure under the provisions of income-tax law.
2.	Tax management	Obtaining declaration from lenders/depositors in Form No. 15G/15H by a partnership firm and forwarding the same to Income-tax authorities is in the nature of compliance of statutory obligation under the Income-tax Act, 1961.

3.	Tax evasion	An air conditioner fitted at the residence of a director as per the terms of his appointment would be a furniture qualifying for depreciation@10%, whereas an air conditioner fitted in a factory would be a plant qualifying for a higher depreciation@15%. The wrong treatment unjustifiably increases the amount of depreciation and consequently, reduces profit and consequent tax liability. Treatment of air-conditioner fitted at the residence of a director as a plant fitted at the factory would tantamount to furnishing of false particulars with an attempt to evade tax.
4.	Tax evasion	Issuance of a credit note for ` 80,000 by RR Ltd. as brokerage payable to Mr. Ramana, the son of the Managing Director, to increase his total income from ` 4 lakh to ` 4.80 lakh and to correspondingly reduce the company's total income is a method of reducing the tax liability of the company by recording a fictitious transaction. The company is liable to tax at a flat rate of 30% whereas Mr. Ramana is liable to pay tax @ 10% above the basic exemption limit of ` 2,50,000, since his total income does not exceed ` 5,00,000. Further, Mr. Ramana would also eligible for rebate of ` 2,000 under section 87A. Reducing tax liability by recording a fictitious transaction would tantamount to tax evasion.
5.	Tax management	Remitting of own contribution to provident fund and employees contribution to provident fund on a monthly basis before due date is proper compliance of the statutory obligations.

(c) An assessee may, at any stage of a **case** relating to him, make an application in the prescribed form and manner to the Settlement Commission under section 245C. "Case" means any proceeding for assessment which may be pending before an Assessing Officer on the date on which such application is made. Thus, the basic condition for making an application before the Settlement Commission under section 245C is that there must be a proceeding for assessment pending before an Assessing Officer on the date on which the application is made.

A proceeding for assessment or reassessment or recomputation under section 147 shall be deemed to have commenced from the date on which a notice under section 148 is issued.

In this case, Mr. Amit cannot approach the Settlement Commission merely due to his apprehension that assessment of earlier years may be reopened, since there is no case pending before an Assessing Officer.

Therefore, he has to wait for the Assessing Officer to issue notice under section 148. Thereafter, he can make an application to the Settlement Commission under section 245C, since there would be a "case pending" before the Assessing Officer on that date.

Another basic condition to be satisfied for making an application is that the additional amount of income-tax payable on the income disclosed in the application should exceed ` 10 lakh, and such tax and interest thereon which would have been paid had the income disclosed in the application been declared in the return of income should be paid on or before the date of making the application and proof of such payment should be attached with the application.

If the Settlement Commission is satisfied that Mr. Amit has co-operated in the proceedings and made true and full disclosure of his income and the manner in which it has been derived, it may, subject to such conditions as it may think fit to impose, grant to Mr. Amit -

(i) immunity from prosecution for any offence under the Income-tax Act, 1961 / Wealth-tax Act, 1957, where the proceedings for such prosecution have been instituted on or after the date of receipt of application under section 245C; and

(ii) immunity from imposition of penalty under the Income-tax Act, 1961, either wholly or in part, with respect to the case covered by the settlement.

This is the benefit that may accrue to Mr. Amit, if he approaches the Settlement Commission.

Question 6

(a) Macline Cola Co. of UK entered into contracts with three Indian companies namely ABC Ltd., Pepsi Co. Ltd. and Coca Cola Ltd. for supplying know-how. Macline Cola Co. made an application to the Authority for Advance Rulings (AAR) on the rate of withholding tax on receipts applicable to it.

Also, Coco Cola Ltd. also made an application to the Assessing Officer for determination of the rate at which tax is deductible on the payment made to non-resident company i.e., Macline Cola Co.

The Authority for Advance Rulings (AAR) rejected the application of Macline Cola Co. on the ground that the question raised in the application is already pending before an Income-tax authority.

Explain whether the rejection of application by the AAR is justified in justified in law?

(4 Marks)

(b) The Income-tax Appellate Tribunal (ITAT) passed an order providing relief as prayed by the assessee on 4-01-2010. In December, 2013 the Tribunal found a mistake apparent from the record and immediately it rectified the mistake and passed an order.

Is the order passed by the Tribunal barred by limitation?

What would be your answer, if the mistake was identified by the Assessing Officer who filed a rectification petition in December, 2013 and the Tribunal passes the rectification order, say, in December, 2015? (4 Marks)

(c) Assessment of Bhajan Ltd. was completed U/s. 143(3) with an addition of ` 15 lakhs to the returned income. The assessee-company preferred appeal before the Commissioner (Appeals) which is pending now.

In this backdrop, answer the following:

(i) Based on fresh information that there was escapement of income for the same assessment year, can the Assessing Officer initiate reassessment proceedings when the appeal is pending before Commissioner (Appeals)?

(ii) Can the Assessing Officer pass an order U/s. 154 for rectification of mistake in respect of issues not being subject matter of appeal?

(iii) Can the assessee-company seek revision U/s. 264 in respect of matters other than those preferred in appeal?

(iv) Can the Commissioner make a revision U/s. 263 both in respect of matters covered in appeal and other matters? (8 Marks)

Answer

(a) The matter relates to the admission or rejection of the application filed before the Authority for Advance Rulings on the ground specified in clause (i) of the first proviso to section 245R(2). The said clause provides that the Authority shall not allow the application where the question raised in the application is already pending before any income-tax authority or Appellate Tribunal or any court.

In this case, no application had been filed or contention urged by the applicant foreign company, namely Macline Cola Co., before any income-tax authority/Appellate Tribunal/court, raising the question raised in the application filed with AAR. However, one of the Indian companies, namely, Coca Cola Ltd., had raised the question before the Assessing Officer, not on the applicant's behalf or with a view to benefit the applicant, but only to safeguard its own interest, as it had a statutory duty to deduct the proper amount of tax from payments made to the foreign company. Although the question raised pertains to one of the payments made or to be made to the non-resident applicant, it was not one pending determination before any income-tax authority in the applicant's case.

Therefore, as held in *Ericsson Telephone Corporation India AB v. CIT (1997) 224 ITR 203 (AAR),* the application filed by the Indian company, Coca Cola Ltd., before the Assessing Officer cannot be treated to have been filed by the foreign company, Macline Cola Co.

Hence, the rejection of the application of Macline Cola Co. by the AAR on the ground that the question raised in the application is already pending before an income-tax authority is not justified.

(b) Section 254(2), dealing with the power of the Appellate Tribunal to pass an order for rectification of mistakes, is in two parts. The first part refers to the *suo moto* exercise of the power of rectification by the Appellate Tribunal, whereas the second part refers to rectification on an application filed by the assessee or Assessing Officer bringing any mistake apparent from the record to the attention of the Appellate Tribunal.

If the Income-tax Appellate Tribunal, *suo moto,* makes the rectification of its order, then the order has to be passed within 4 years from the date of order to be rectified. In this case since the rectification order is passed in December, 2013 i.e., within 4 years from 4.1.2010, being the date of the order to be rectified, the rectification order passed by the Tribunal is not barred by limitation.

Where the application for rectification is made by the Assessing Officer or the assessee within four years from the date of the order to be rectified, the Appellate Tribunal is bound to decide the application on merits and not on the ground of limitation i.e., order can be passed after expiry of 4 years from date of order sought to be revised. However, the application for rectification cannot be filed by the Assessing Officer belatedly after 4 years ***[****Ajith Kumar Pitaliya v. ITO (2008) 167 Taxmann 24 (M.P.)].*

In this case, since the rectification petition by the Assessing Officer was filed before the expiry of 4 years, the rectification order passed by the Tribunal is valid, even though the order was passed after the expiry of the 4 year period.

(c) **(i)** As per the third proviso to section 147, the Assessing Officer may assess or reassess such income, other than the income involving matters which are the subject matters of any appeal, reference or revision, which is chargeable to tax and has escaped assessment. The doctrine of partial merger would apply in this case.

Therefore, even when an appeal is pending before Commissioner (Appeals), the Assessing Officer can initiate reassessment proceedings in respect of income chargeable to tax which has escaped assessment, provided such income is not the subject matter of the appeal before the Commissioner (Appeals) i.e., such income which has escaped assessment does not form part of the additions of `15 lakhs to the returned income, which is the subject matter of appeal.

(ii) As per section 154(1A), the Assessing Officer can pass an order under 154(1) to rectify a mistake apparent from the record, provided the rectification is in relation to a matter, other than the matter which has been considered and decided in the appeal before Commissioner (Appeals). The doctrine of partial merger holds good for section 154 also.

Since the issue under consideration in this case relates to rectification of a mistake in respect of a matter which is not the subject matter of appeal, the Assessing Officer can pass an order under section 154 for rectification of the same provided the same is a mistake apparent from the record.

(iii) As per section 264(4), the Commissioner shall not revise any order under section 264, where such order has been made the subject of an appeal to the Commissioner (Appeals). Thus, the concept of total merger would apply in the case of section 264.

Therefore, under section 264, the Commissioner cannot revise an order which is pending before the Commissioner (Appeals), even if the revision pertains to a matter, other than the matter(s) covered in the appeal.

(iv) As per section 263, the Commissioner has the power to revise an order prejudicial to revenue, even if the order is the subject matter of appeal before Commissioner (Appeals). However, the power of the Commissioner under section 263 shall extend to only such matters as had not been considered and decided in such appeal. Here again, the doctrine of partial merger would apply.

In a case where the appeal is pending but not yet decided, the Commissioner cannot exercise his revisionary jurisdiction in respect of those issues which are the subject matter of appeal [*CWT v. Sampathmal Chordia (2002) 256 ITR 440 (Mad.)].*

Question 7

(a) Apple Iron Ltd. paid ` 10 lakhs to a lawyer on 01-08-2014 for the professional services rendered by him to the company, without deducting tax at source. Again another payment of ` 5 lakhs was due on 31-12-2014. The company deducted tax at source before making payment on 31-12-2014 for the entire amount of ` 15 lakhs.

The tax deducted at source was, however, remitted by the company on 30th March, 2015.

Compute the interest chargeable U/s. 201(IA) of the Income-tax Act, 1961. (4 Marks)

(b) Examine the correctness of the claim made by the assessee in the below mentioned case.

Mr. Johny has business income of ` 4,28,000 and salary income of ` 1,30,000 for the financial year 2014-15. His minor son has agricultural income of ` 1,00,000 for the same year. The Assessing Officer clubbed the agricultural income of minor son for determining the income tax liability of Mr. Johny.

Mr. Johny contends that the agricultural income is exempt U/s. 10(1) and not covered by section 2(24) and hence, should not be clubbed even for adopting higher income-tax rate. (4 Marks)

(c) Examine the taxability and applicability of TDS provisions in the following cases:

(i) Miss Sony, a resident, received ` 3,80,000 on 31-10.2014 on maturity of her life insurance policy taken on 01-11-2005. The policy sum assured is ` 2,00,000 and the annual premium being ` 45,000.

(ii) Miss Puja, a resident, received ` 1,20,000 on 01-05-2014 on maturity of her life insurance policy taken on 10-4-2010. The policy sum assured is ` 1,00,000 and the annual premium being ` 32,000. (4 Marks)

(d) The assessment of SBC Ltd. was completed U/s. 143(3) and a notice of demand U/s. 156 was issued for ` 13 lakhs for the assessment year 2013-14 requiring the company to pay the demand within 30 days.

On appeal before the Commissioner (Appeals), the demand was reduced to ` 10 lakhs. Is the Assessing Officer required to issue a fresh notice of demand to continue tax recovery proceedings?

What would be your answer, if the Commissioner (Appeals) enhanced the income and the resultant tax demand is ` 15 lakhs i.e., an increase of ` 2 lakhs? (4 Marks)

Answer

(a) Computation of interest chargeable under section 201(1A)

As per the provisions of section 201(1A), if a person who is liable to deduct tax at source fails to deduct tax at source or after deducting such tax, fails to pay the tax as required by or under the Act, then he is liable to pay simple interest as follows -

@ 1% for every month or part of month on the amount of such tax from the date on which such tax was deductible to the date on which such tax is actually deducted; and

@ 1½% for every month or part of month on the amount of such tax from the date on which such tax was deducted to the date on which tax is actually paid.

In this case, tax is deductible@10% under section 194J in respect of fees for professional services. Tax of ` 1 lakh (10% of ` 10 lakh) was deductible on 1.8.2014 but actually deducted on 31.12.2014. Tax of ` 1.50 lakhs [10% of ` 15 lakh (i.e., ` 10 lakh + ` 5 lakh)] deducted on 31.12.2014 was paid only on 30.3.2015. Since there has been a delay in deduction and deposit of tax, interest under section 201(1A) is attracted.

Therefore, in the given case, interest under section 201(1A) would be computed as under:

Particulars	`
1% on tax deductible but not deducted i.e., 1% on ` 1,00,000 for 5 months (from 01.08.2014 to 31.12.2014)	5,000
1½% on tax deducted but not deposited i.e., 1½% on ` 1,50,000 for 3 months (from 31.12.2014 to 30.03.2015)	6,750
Total interest payable under section 201(1A)	**11,750**

(b) The facts of the case are similar to *Suresh Chand Talera v. Union of India (2006) 282 ITR (341) (M.P).*

In that case, the High Court observed that the definition of income under section 2(24) is inclusive and not exhaustive. Hence, the fact that agricultural income has not been specified as one of the items in section 2(24) does not mean that agricultural income is not included in the word "income" wherever the word "income" has been used in the Act.

Section 10 provides that in computing the income of the previous year of a person, any income falling in any of the clauses mentioned therein shall not be included. The first clause mentioned therein is "agricultural income". Thus, section 10 makes it clear that agricultural income is income but by express provision therein, agricultural income has been excluded from the total income of an assessee for the purpose of levy of income-tax.

However, section 4(1), which is the charging section, provides that while the total income of a person is to be determined in accordance with the provisions of the Income-tax Act, 1961, the rate or rates at which income-tax will be paid on such income for any assessment year will be stipulated in the relevant Finance Act. The Annual Finance Act provides that the net agricultural income shall be taken into account in the manner provided therein for the purpose of determining the rates of income-tax applicable to the income of the assessee.

Therefore, agricultural income of the minor child of the assessee has to be included in the income of the assessee for the purpose of determining the rate of income-tax applicable to the income of the assessee.

Applying the rationale of the above ruling, the contention of Mr. Johny is incorrect. The agricultural income of his minor son, has to be included in the income of Mr. Johny for rate purposes, since the phrase "income as arises or accrues to his minor child" used in section 64(1A) includes agricultural income also.

(c) Section 194DA, inserted by the Finance (No.2) Act, 2014 with effect from 1st October, 2014, provides for deduction of tax @2% on any sum payable to a resident under a life insurance policy, including the sum allocated by way of bonus, other than the amount which is exempt under section 10(10D). Such tax has to be deducted at the time of payment.

However, tax deduction is required only if the payment or aggregate amount of such payment in a financial year to an assessee is ` 1,00,000 or more.

(i) In this case, since the annual premium of ` 45,000 exceeds ` 40,000, being 20% of sum assured of ` 2,00,000, in respect of a policy taken before 1.4.2012, the maturity proceeds of ` 3,80,000 received by Miss Sony on 31.10.2014 would not be exempt under section 10(10D) in her hands.

Since the payment to Miss Sony is made on or after 1.10.2014, the provisions of section 194DA would be attracted and tax is required to be deducted at source @ 2%.

(ii) In this case, the annual premium of ` 32,000 exceeds `20,000, being 20% of sum assured of ` 1,00,000, in respect of a policy taken before 1.4.2012 and

consequently, the maturity proceeds of ` 1,20,000 received on 1.5.2014 would not be exempt under section 10(10D) in the hands of Miss Puja.

However, the provisions for tax deduction at source under section 194DA are not attracted in this case, since the maturity proceeds were received before 01.10.2014. Therefore, no tax is required to be deducted at source under section 194DA in this case.

Note *– The question has been answered considering that Miss Sony and Miss Puja are "due to receive" the maturity proceeds of life insurance policy on the dates specified thereunder. Due to the use of the word "received" in the question, it is possible to answer that TDS has to be computed in the first case [i.e., payment of maturity proceeds to Miss Sony] under section 194DA by grossing up the amount paid to Miss Sony.*

(d) (i) Demand reduced in the order Commissioner(Appeals)

No fresh notice of demand is required to be served by the Assessing Officer. The Assessing Officer is only required to give an intimation of the fact of reduction of demand to ` 10 lakhs to SBC Ltd.

The proceedings initiated on the basis of the original notice of demand may be continued in relation to the reduced amount of ` 10 lakhs from the stage at which such proceedings stood immediately before disposal of appeal.

(ii) Demand enhanced in the order of Commissioner (Appeals)

A fresh notice of demand has to be given only in respect of ` 2 lakhs, being the amount of enhancement.

Any proceedings in relation to ` 13 lakhs covered by the original notice of demand served upon SBC Ltd. may be continued from the stage at which such proceedings stood immediately before disposal of appeal.

Note - *Section 220(1A) provides that where any notice of demand has been served upon an assessee and any appeal or other proceeding, as the case may be, is filed or initiated in respect of the amount specified in the said notice of demand, then such demand shall be deemed to be valid till the disposal of appeal by the last appellate authority or disposal of proceedings, as the case may be, and any such notice of demand shall have effect as provided in section 3 of the Taxation Laws (Continuation and Validation of Recovery Proceedings) Act, 1964.*

The above answer is based on the provisions of section 220(1A) read with section 3 of the Taxation Laws (Continuation and Validation of Recovery Proceedings) Act, 1964.