

## **DISCLAIMER**

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## 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 the assessment year 2014-15, unless stated otherwise in the question.*

### Question 1

- (a) XYZ Ltd. is engaged in the business of manufacturing plastic bottles. Its Profit & Loss account shows a net profit of ₹ 60 lakhs for the year ended 31<sup>st</sup> March 2014, after debiting/crediting the following items:
- (i) ₹ 5 lakhs, being expenses incurred on the travelling of the wife of Managing Director, who accompanied him on tour to Beijing on invitation of Trade & Commerce Chamber, China.
  - (ii) ₹ 10,000 & ₹ 15,000 paid in cash on 15.10.2013 by two separate vouchers to a contractor who carried out certain repair work in the office premises.
  - (iii) One time license fee of ₹ 10 lakh paid to a foreign company for obtaining franchise on 1<sup>st</sup> July 2013.
  - (iv) ₹ 5 lakhs paid to S Ltd. towards feasibility study conducted for examining proposals for technological advancement relating to existing business, where the project was abandoned without creating a new asset.
  - (v) Dividend of ₹ 3,50,000 received from a foreign company, in which XYZ Ltd. holds 28% in nominal value of equity share capital of the company. ₹ 25,000 spent on earning this income.
  - (vi) Depreciation on tangible fixed assets ₹ 1,50,000.
  - (vii) ₹ 5,00,000 and ₹ 1,50,000, being amounts waived by a bank out of principal and arrear interest, respectively, in one-time settlement. The loan was obtained for meeting working capital requirements two years back.
  - (viii) Provision for gratuity based on actuarial valuation ₹ 5,00,000. Actual gratuity paid ₹ 1,50,000 was debited to provision for gratuity account.
  - (ix) The opening & closing stock of the year were ₹ 18,00,000 & ₹ 18,72,000, respectively, and were undervalued by 10% on cost.

*The Suggested Answers for Paper 7:- Direct Tax Laws are based on the provisions applicable for A.Y.2014-15, which is the assessment year relevant for November, 2014 examination.*

**Additional Information:**

- (a) Provision for audit fee of ₹ 1,00,000 was made in the books for the year ending 31/3/2013, without deducting tax at source. Such fee was paid to the auditors in September, 2013, after deducting tax u/s 194J and the tax so deducted was deposited on 7<sup>th</sup> October 2013.
- (b) During the year, the company purchased 5000 shares of RK Private Ltd. at ₹ 20 per share. The fair market value of such shares on the date of transaction was ₹ 40 per share.
- (c) Depreciation on tangible fixed assets as per Income-tax Rules : ₹ 1.75 lakhs.
- (d) A debt of ₹ 8 lakhs was claimed as bad debt in the previous year 2012-13. But the Assessing Officer allowed only ₹ 4 lakhs as bad debt. In previous year 2013-14, ₹ 3 lakhs was recovered ultimately in respect of the debt. The effect of recovery of bad debt was not given in books of account.

Compute the total income and tax payable by XYZ Ltd., giving the reasons for treatment of each item, for assessment year 2014-15. Ignore MAT provisions. (15 Marks)

- (b) ABC Constructions Ltd. furnishes the following particulars of its wealth for the valuation date 31<sup>st</sup> March 2014:

		₹
(i)	Guest House and land appurtenant thereto in rural area	10,00,000
(ii)	100 acres agricultural and acquired at Gurgaon on 9.9.2013 for construction of residential flats/commercial complex.	50,00,000
(iii)	Cash in hand as per cash book	2,50,000
(iv)	Bank Balance	5,00,000
(v)	Residential flats of identical size provided to six employees for their use in rural areas (salaries of 2 such employees exceed ₹ 10 lakhs per annum)	15,00,000
(vi)	Motor cars (including one imported car worth ₹ 20 lakhs used for hiring)	30,00,000
<b>Liabilities:</b>		
	Loan for purchase of 100 acres of agricultural land at Gurgaon.	30,00,000

Compute the net wealth of the company as on valuation date 31.3.2014, giving suitable explanation for treatment of individual items. (5 Marks)

Answer

(a) Computation of total income of XYZ Ltd. for the A.Y.2014-15

Particulars	₹	
<b>Profits and gains of business or profession</b>		
Net profit as per profit and loss account		60,00,000
<b>Add: Items debited to profit &amp; loss account but not allowable as deduction</b>		
Cash payments exceeding ₹ 20,000 in aggregate in a day to a contractor for repair work (₹ 15,000 + ₹ 10,000) (Note 2)	25,000	
Licence fee for obtaining franchise ₹10,00,000 less depreciation thereon of ₹ 2,50,000 (Note 3)	7,50,000	
Provision for gratuity (₹ 5,00,000 - ₹ 1,50,000) (Note 8)	<u>3,50,000</u>	<u>11,25,000</u>
		71,25,000
<b>Add: Difference on account of stock valuation (Note 9)</b>		<u>8,000</u>
		71,33,000
<b>Less: Items credited to profit and loss account but not taxable or taxable under a different head of income</b>		
Dividend received from foreign company less expenditure incurred to earn dividend (₹ 3,50,000 - ₹ 25,000) (Note 5)	3,25,000	
Waiver of interest on bank loan (Note 7)	<u>1,50,000</u>	<u>4,75,000</u>
		66,58,000
<b>Less: Items not debited to profit and loss account but allowable as deduction</b>		
Provision for audit fees (Note 10)	1,00,000	
Bad debts (Note 11)	<u>1,00,000</u>	<u>2,00,000</u>
		64,58,000
<b>Less: Depreciation on assets (₹ 1,50,000 - ₹ 1,75,000) (Note 6)</b>		<u>25,000</u>
		64,33,000
<b>Income from Other Sources</b>		
Dividend from specified foreign company (Note 12)	3,50,000	
Shares of closely-held company purchased for inadequate consideration (Note 13)	<u>1,00,000</u>	<u>4,50,000</u>
<b>Gross Total Income</b>		68,83,000

Deduction under Chapter VI-A		Nil
<b>Total Income</b>		<b><u>68,83,000</u></b>

**Computation of tax liability of XYZ Ltd. for A.Y. 2014-15**

Particulars	₹
Tax @15% on dividend of ₹ 3,50,000 from specified foreign company	52,500
Tax @30% on the balance total income of ₹ 65,33,000	<u>19,59,900</u>
	20,12,400
Add: Education cess @2% and Secondary and higher education cess @1%	<u>60,372</u>
<b>Total tax liability</b>	<b><u>20,72,772</u></b>

**Notes:**

- (1) Expenses on travelling of wife of Managing Director to Beijing on the invitation of Trade and Commerce Chamber, China, is an allowable expense on the grounds of commercial expediency and business consideration. Hence, disallowance is not attracted [*Hero Honda Motors Ltd. v. CIT (2005) 3 SOT 572 (Delhi)*]
- (2) Disallowance under section 40A(3) would be attracted in respect of cash payments of ₹ 10,000 and ₹ 15,000 to a contractor, since the aggregate cash payments to him in a day exceeds the limit of ₹ 20,000.
- (3) Franchise is in the nature of an intangible asset eligible for depreciation @ 25%. Since one-time licence fees of ₹ 10 lakh paid to a foreign company for obtaining franchise has been debited to profit and loss account, the same has to be added back. Depreciation @ 25% has to be provided in respect of the intangible asset, since it has been used for more than 180 days during the year.
- (4) The issue is whether payment of ₹ 5 lakhs to S Ltd. towards feasibility study conducted for examining proposals for technological advancement relating to the existing business, where the project was abandoned without creating a new asset, is allowable as revenue expenditure.

In determining whether such expenditure is capital or revenue in nature, the relevant factor is whether or not a new business/asset comes into existence. If no new asset is created, then the expenditure incurred would be of revenue nature. [*CIT v. Priya Village Roadshows Ltd. (2011) 332 ITR 594 (Del)*]

In this case, since the feasibility study was conducted by XYZ Ltd. for the existing business and the study was abandoned without creating a new asset, the expenses were of revenue nature. Since the expenditure of ₹ 5 lakhs has already been debited to profit and loss account, no further adjustment is required.

- (5) Dividend of ₹ 3,50,000 received from foreign company is to be taxed under the head "Income from other sources". Since the same has been credited to profit and loss account, it has to be deducted while computing business income. Consequently, expenditure of ₹ 25,000 relating to the same which has been debited to profit and loss account has to be added back. In effect, the net amount of ₹ 3,25,000 has to be deducted.
- (6) Depreciation of ₹1,50,000 on tangible fixed assets debited in the books of accounts has to be added back. Depreciation of ₹ 1,75,000 computed as per Income-tax Rules, 1962 is allowable. Therefore, the net amount of ₹ 25,000 has to be deducted while computing business income.
- (7) Waiver of principal amount of loan taken for trading activity is a benefit in respect of a trading-liability by way of remission or cessation thereof and is, hence, taxable under section 41(1) [*Solid Containers vs. DCIT (2009) 308 ITR 417 (Bom)*].
- Since the loan is for meeting working capital requirement, it is logical to assume that is taken for trading activity. Since the loan waiver has already been credited to profit and loss account, no adjustment is required.
- However, as per section 43B, since interest is allowable only on actual payment, deduction in respect of interest due on loan would not have been allowed as deduction in any previous year. Therefore, such interest cannot be brought to tax by invoking section 41(1). Since such interest has now been credited to profit and loss account, the same has to be deducted while computing business income.
- (8) As per section 40A(7), any provision made for payment of gratuity to employees on their retirement or on termination of employment for any reason is disallowed. However, any provision made for the purpose of payment of a sum by way of any contribution to an approved gratuity fund or for the purpose of payment of gratuity which has become payable during the previous year shall be allowed as deduction. The question does not mention that the provision of ₹ 5,00,000 is for the purpose of contribution to an approved gratuity fund. Therefore, only gratuity of ₹ 1,50,000 paid to the retired employees is allowable as deduction. Hence, the balance provision of ₹ 3,50,000 (i.e., ₹ 5,00,000 – ₹ 1,50,000) is to be added back.
- (9) Difference on account of undervaluation of opening stock and closing stock by 10% of cost to be deducted and added, respectively. Therefore, the net amount of ₹ 8,000 ( $₹ 72,000 \times 10/90$ ) has to be added.
- (10) Provision for audit fees for the year ended 31.3.2013 for which tax was not deducted in the F.Y.2012-13 but was deducted and paid in F.Y.2013-14 is allowable as deduction in the A.Y.2014-15, as per the proviso to section 40(a)(ia).
- (11) In a case where the debt ultimately recovered is less than the difference between the amount of debt and bad debt allowed earlier as deduction, such deficiency will be deductible in the previous year in which the ultimate recovery is made.

Therefore, in this case, since the ultimate recovery of ₹ 3,00,000 is less than ₹ 4,00,000 (being the difference between the debt of ₹ 8,00,000 and the amount of ₹ 4,00,000 allowed as bad debts in the previous year 2012-13), the deficiency of ₹ 1,00,000 will be deductible in the P.Y. 2013-14, being the year in which the ultimate recovery of ₹ 3,00,000 is made.

It may be noted that in a case where the net result is a deficiency, the amount recovered will not be taxable in the year of recovery. Since ₹ 3,00,000 is not credited to profit and loss account, no further adjustment is necessary.

- (12) Under section 115BBD, dividend received by an Indian company from a foreign company in which it holds 26% or more in nominal value of the equity share capital of the company, would be subject to a concessional tax rate of 15% as against the tax rate of 30% applicable to other income of a domestic company. This rate of 15% would be applied on gross dividend, in the sense, that no expenditure would be allowable in respect of such dividend.

Therefore, dividend of ₹ 3,50,000 received by XYZ Ltd. from a foreign company, in which it holds 28% in nominal value of equity share capital of the company, would be subject to tax@15% under section 115BBD. Such dividend would be taxable under the head "Income from other sources". No deduction is allowable in respect of ₹ 25,000 expended on earning this income.

- (13) Difference between the aggregate fair market value of shares of a closely held company and the consideration paid for purchase of such shares is deemed as income in the hands of the purchasing company under section 56(2)(viiia) only if the purchasing company is also a closely-held company. It is assumed that XYZ Ltd. is a closely-held company.

Since the difference exceeds ₹ 50,000, the entire sum is taxable. Therefore, ₹ 1,00,000 [5,000 × (₹ 40 – ₹ 20)] is taxable.

**(b) Computation of net wealth of ABC Constructions Ltd. as on valuation date 31.03.2014**

Particulars		₹
(i)	Guest house and land appurtenant thereto is an asset under section 2(ea)(i), irrespective of its location being in a rural area.	10,00,000
(ii)	100 acres agricultural land acquired at Gurgaon on 09.09.2013 for construction of residential flats/commercial complex is a land held as stock-in-trade by the company. Hence, the same is excluded from the definition of asset under section 2(ea), since land held as stock-in-trade for a period of ten years from the date of its acquisition is excluded from the definition of urban land.	Nil
(iii)	Cash in hand as per cash book is not an asset, since it represents the sum recorded in the books of account.	Nil

(iv)	Bank Balance is not an asset under section 2(ea)	Nil
(v)	(a) Residential flats provided to 4 employees drawing salary less than ₹ 10,00,000 per annum – not an asset, since the same is excluded from the scope of building under section 2(ea)(i)	Nil
	(b) Residential flats provided to 2 employees drawing salary exceeding ₹ 10,00,000 per annum is an asset under section 2(ea)(i) [15,00,000 × 2/6]	5,00,000
(vi)	Motor cars (excluding imported car not being an asset since it is used for hiring) [₹ 30,00,000 – ₹ 20,00,000]	10,00,000
		<b>25,00,000</b>
Less:	<b>Debts owed</b>	
	Loan for purchase of 100 acres agricultural land at Gurgaon - not deductible while computing net wealth, since it is taken for purchase of land forming part of stock-in-trade, which is not an asset under section 2(ea)	Nil
	<b>Net Wealth</b>	<b>25,00,000</b>

## Question 2

- (a) PQR Ltd., a non-banking finance company was engaged in the business of leasing and hire purchase. It purchased motor cars from Ramaha motors and leased out these vehicles to its customers. The lease agreement with the customer stated that PQR Ltd. was empowered to repossess the vehicle, in case the lessee committed a default. Registration of the vehicle in the name of lessee, during the period of lease is mandatory as per the Motor Vehicles Act, 1988. PQR Ltd. claimed ₹ 5,00,000 as depreciation on the vehicles leased out for the year ending 31/3/2014. The claim was rejected by the Assessing Officer on the ground that the assessee had merely financed the purchase of motor cars and was neither the owner nor the user of these assets. Is the action of the Assessing Officer valid? Discuss. (4 Marks)
- (b) X Ltd. has two units, unit 'N' and unit 'Y'. Unit 'N' engaged in the business of power generation installed a windmill and had a profit of ₹ 100 lakhs in Assessment Year 2014-15. X Ltd. claimed depreciation of ₹ 120 lakhs on windmill against the profit of ₹ 100 lakhs from power generation business which was eligible for deduction u/s 80-IA. Unit 'Y', engaged in manufacturing of wires, non-eligible business, had a profit of ₹ 70 lakhs for Assessment Year 2014-15.

The loss of ₹ 20 lakhs, i.e. balance depreciation not set off pertaining to unit 'N' was set-off against the profits of unit 'Y' carrying on non-eligible business, by the assessee, X Ltd. The Assessing Officer was of the view that depreciation relating to a business eligible for deduction u/s 80-IA cannot be set-off against non-eligible business income. Hence,

*unabsorbed depreciation should be carried forward to the subsequent year to be set off against eligible business income of the assessee of that year.*

*Give your views on the correctness of the action of the Assessing Officer. (4 Marks)*

- (c) *Ramji Charitable Trust, registered u/s 12AA and recognized u/s 80G of the Income-tax Act, 1961, was created for providing relief to disabled persons. It filed the return of income for the year ended 31/3/2014, declaring 'Nil' income. While completing the assessment, the Assessing Officer found that a large sum was donated to the corpus of another trust by the assessee i.e., Ramji Charitable Trust. The contention of the assessee was that such donation was made out of the permissible accumulation of income of past years upto 15% u/s 11(1)(a) of the Act.*

*The Assessing Officer added the donation so made and by invoking the Explanation to section 11(2), computed the taxable income of the assessee. Discuss the validity of the action of the Assessing Officer, in this case. (4 Marks)*

- (d) *Arihant Ltd. filed an appeal to the Commissioner (Appeals) against the order of assessment made by the Assessing Officer. The appeal was allowed by the Commissioner (Appeals). The assessee later found that he was entitled to deduction of ₹ 30,000 as bad debt u/s 36(1)(vii), which he had forgotten to claim and the related amount was also not allowed by the Assessing Officer in the course of assessment. Further, the issue of deduction was not raised by the assessee in appeal before the Commissioner (Appeals) and hence it was also not considered by him in the said appeal.*

*Subsequently, Arihant Ltd. applied to Commissioner for revision u/s 264 of the Act, to allow such deduction.*

*Examine the power of the Commissioner to grant relief to the assessee u/s 264, in such a case. (4 Marks)*

#### **Answer**

- (a) The issue under consideration in this case is whether depreciation on leased vehicles can be denied to the lessor (PQR Ltd.) on the grounds that the vehicles are registered in the name of the lessee and that the lessor is not the actual user of vehicles.

This issue came up before the Supreme Court in *I.C.D.S Ltd. v. CIT (2013) 350 ITR 527*. The Court observed that section 32 imposes a twin requirement of "ownership" and "usage for business" as conditions for claim of depreciation thereunder. As far as usage of the asset is concerned, the section requires that the asset must be used in the course of business. It does not mandate actual usage by the assessee itself.

In this case, PQR Ltd. did use the vehicles in the course of its leasing business. Hence, the requirement of section 32 has been fulfilled, notwithstanding the fact that PQR Ltd. was not the actual user of the vehicles.

In *I.C.D.S. Ltd.'s* case, the Supreme Court further observed that the Motor Vehicle Act, 1988 contains a deeming provision which creates a legal fiction of ownership in favour of

the lessee only for that Act and not for the purpose of law in general. No inference could be drawn from the registration certificate as to ownership of the vehicles, since registration in the name of the lessee during the period of lease is mandatory as per the Motor Vehicles Act, 1988.

Therefore, as long as the lessor has a right to retain the legal title against the rest of the world, it would be the owner of the asset in the eyes of law. In this case, PQR Ltd., the lessor, is the exclusive owner of the vehicle at all points of time as he is empowered to repossess the vehicle, in case the lessee committed a default. The proof of ownership lies in the lease agreement itself, which clearly points in favour of PQR Ltd.

Applying the rationale of the Supreme Court ruling in *I.C.D.S Ltd.'s case*, the action of the Assessing Officer in this case denying the depreciation claim of PQR Ltd. is not valid.

- (b) In *CIT v. Swarnagiri Wire Insulations Pvt. Ltd. (2012) 349 ITR 245*, the Karnataka High Court observed that it is a generally accepted principle that the deeming provision of a particular section cannot be breathed into another section. Therefore, the deeming provision contained in section 80-IA(5) cannot override the provisions of section 70(1).

In this case, X Ltd. had incurred loss in eligible business (power generation) on account of claiming depreciation of ₹ 120 lacs. Hence, section 80-IA becomes insignificant, since there is no profit from which this deduction can be claimed.

It is thereafter that section 70(1) comes into play, whereby an assessee is entitled to set off the losses from one source against income from another source under the same head of income. Accordingly, X Ltd. is entitled to the benefit of set off of loss of ₹20 lacs (representing balance depreciation not set-off) pertaining to Unit N engaged in eligible business of power generation against profit of ₹ 70 lacs of Unit Y carrying on non-eligible business. Therefore, the net profit of ₹ 50 lacs would be taxable in the A.Y.2014-15.

However, once set-off is allowed under section 70(1) against income from another source under the same head, a deduction to such extent is not possible in any subsequent assessment year i.e., the loss (arising on account of balance depreciation of eligible business) so set-off under section 70(1) has to be first deducted while computing profits eligible for deduction under section 80-IA in the subsequent year. Accordingly, in the A.Y.2015-16, the net profits of Unit N has to be reduced by ₹ 20 lacs for computing the profits eligible for deduction under section 80-IA in that year.

The action of the Assessing Officer in not permitting set-off of loss of eligible business against profits of non-eligible business in this case is, therefore, not correct.

- (c) As per the provisions of section 11(1)(a), accumulation upto 15% is permitted and no additional conditions are attached with such accumulation. It is an absolute exemption.

However, as per section 11(2), accumulation in excess of 15% is also allowed but subject to certain conditions mentioned therein. The provisions of section 11(2) are also subject to provisions of section 11(3)(d), which mentions that the amount accumulated in excess of 15% under section 11(2) cannot be donated to another trust. If it is so donated, it shall be deemed to be the income of the donor trust in the year of payment.

The provisions contained in section 11(3)(d), however, cannot be applied to the accumulations made under section 11(1)(a) i.e., accumulations upto 15%, in the absence of specific provisions in this regard.

It was so held by the Delhi High Court in *DIT (Exemption) v. Bagri Foundation (2012) 344 ITR 193*.

*Explanation* to section 11(2) merely provides that if donation is made out of past accumulations upto 15%, it cannot be treated as application of income for charitable purposes. This does not imply that such donations have to be added to compute total income, which is so in the case of donations out of accumulations in excess of 15% made under section 11(2).

Consequently, if the donations made by Ramji Charitable Trust to another charitable trust were out of past accumulations upto 15% under section 11(1)(a), the same would not be liable to be included in the total income.

The action of the Assessing Officer in invoking the *Explanation* to section 11(2), to add such donations while computing the total income of the trust is, therefore, not valid.

- (d) Section 264(4)(c) provides that the Commissioner shall not revise an order which has been made the subject of an appeal to the Commissioner (Appeals). This bar remains unaffected by the scope of the appeal to the Commissioner (Appeals).

Therefore, the fact that the relief claimed in the application filed by the assessee under section 264(1) was not the subject matter of appeal to the Commissioner (Appeals) does not alter the position that the order of assessment was the subject of the appeal.

The word 'order' in section 264(4)(c) refers to the order appealed against and not to the relief claimed in appeal. Therefore, the Commissioner has no power to revise any order under section 264, if the order has been made subject to an appeal to the Appellate Tribunal, even if the relief claimed in the revision is different from the relief claimed in the appeal.

It was so held by the Supreme Court in *Hindustan Aeronautics Ltd. v. CIT (2000) 243 ITR 808*.

In view of this, the Commissioner cannot exercise his powers under section 264 to revise the order of assessment and allow the deduction claimed by Arihant Ltd. in his application.

### Question 3

- (a) Mr. Ghosh held 15% equity shares in ABC Ltd., a private limited company. He gifted all the shares held by him in ABC Ltd., to his wife Mrs. Ghosh on 25/5/2013. The transfer was made without adequate consideration. On 20/6/2013, Mrs. Ghosh obtained a loan of ₹ 80,000 from ABC Ltd., when the company's accumulated profit was ₹ 50,000. What are the tax implications of the above transactions? (4 Marks)
- (b) State with reasons whether the following transactions attract income-tax in India, in the hands of recipients u/s 9 of Income-tax Act, 1961:

- (i) A non-resident German company, which did not have a permanent establishment in India, entered into an agreement for execution of electrical work in India. Separate payments were made towards drawings & designs, which were described as "Engineering Fee". The assessee contended that such business profits should be taxable in Germany as there is no business connection within the meaning of section 9(1)(i) of the Income-tax Act, 1961.
- (ii) A firm of solicitors in Mumbai engaged a barrister in UK for arguing a case before Supreme Court of India. A payment of 5000 pounds was made as per terms of professional engagement.
- (iii) Amount paid by Government of India for use of a patent developed by Mr. A, who is a non-resident.
- (iv) Sai Engineering, a non-resident foreign company entered into a collaboration agreement on 25/6/2013, with an Indian Company and was in receipt of interest on 8% debentures for ₹ 20 lakhs, issued by Indian Company, in consideration of providing technical know-how during previous year 2013-14. (4 Marks)
- (c) The concept of Permanent Establishment is one of the most important concepts in determining the tax implications of cross border transactions. Explain the significance thereof, when such transactions are governed by Double Taxation Avoidance Agreement (DTAA). (4 Marks)
- (d) From the following particulars, compute the gross total income of Mr. Z for the assessment year 2014-15.
- (i) Mr. Y transferred his residential house to Mr. Z for ₹ 10 lakh on 1.4.2013. The value of the said house as per stamp valuation authority was ₹ 18 lakhs. Mr. Z is a childhood friend of Mr. Y.
- (ii) Mr. Z received a car from his cousin on payment of ₹ 2,50,000, fair market value of which was ₹ 4,00,000.
- (iii) Land of Mr. Z was acquired by railways in 2011. On 15/12/2013, he received ₹ 1,70,000 as interest on enhanced compensation on the order of court..
- (iv) On a fixed deposit of ₹ 10 lakhs, in a bank, Mr. Z received an interest of ₹ 90,000. He had also borrowed ₹ 50 lakhs from the same bank, on security of the fixed deposit and was liable to pay ₹ 50,000 by way of interest to the bank. He, therefore, offered the difference between the two amounts i.e. ₹ 40,000 as "Income from Other Sources". (4 Marks)

#### Answer

- (a) Under section 2(22)(e), any payment by a closely-held company by way of loan or advance to its shareholder, being a person who is the beneficial owner of shares, holding not less than 10% of the voting power, is deemed as dividend to the extent to which the company possesses accumulated profits.

Therefore, in order to attract the deeming provisions under section 2(22)(e), the recipient of loan should be a registered shareholder as well as the beneficial owner of shares.

Accordingly, in this case, ₹ 50,000 (i.e., loan to the extent of accumulated profits of ABC Ltd.) would be deemed as dividend in the hands of Mrs. Ghosh, who holds 15% equity shares in ABC Ltd., under section 2(22)(e).

Thereafter, the clubbing provisions under section 64(1)(iv) would be attracted, as per which, income as arises, directly or indirectly, from asset transferred to spouse, otherwise than for adequate consideration, would be included in the hands of the transferor.

If the assets so transferred are shares in a company, the loan taken from the company is deemed as dividend income of the shareholder under section 2(22)(e) to the extent to which the company possesses accumulated profits. Thus, on account of this deeming provision, such loan is treated as income arising from the shares. It was so held by the Madras High Court in *CIT v. Vimalan (A.) (1975) 98 ITR 529*.

Accordingly, as per section 64(1)(iv), such income arising in the hands of the shareholder, Mrs. Ghosh, by virtue of section 2(22)(e) (i.e., deemed dividend of ₹ 50,000) would be included in the total income of Mr. Ghosh, who had transferred the said shares to Mrs. Ghosh without consideration.

- (b) (i) Fees for technical services is taxable under section 9(1)(vii). In this case, the separate payments made towards drawings and designs (described as "engineering fee") are in the nature of fee for technical services and, therefore, it is taxable in India by virtue of section 9(1)(vii) [*Aeg Aktiengesellschaft v. CIT (2004) 267 ITR 209 (Kar.)*].

As per *Explanation* to section 9, where income is deemed to accrue or arise in India under section 9(1)(vii), such income shall be included in the total income of the non-resident German company, regardless of whether it has a residence or place of business or business connection in India.

- (ii) As per section 9(1)(i), all income accruing or arising, whether directly or indirectly, through or from any business connection in India is deemed to accrue or arise in India.

In this case, there was a professional connection between the firm of solicitors in Mumbai and the barrister in UK. The expression "business" includes not only trade and manufacture; it includes, within its scope, "profession" as well. Therefore, the existence of professional connection amounts to existence of "business connection" under section 9(1)(i). It was so held by the Supreme Court in *Barendra Prasad Roy v. ITO (1981) 129 ITR 295*.

Hence, the amount of 5,000 pounds paid to the barrister in UK as per the terms of the professional engagement constitutes income which is deemed to accrue or arise in India under section 9(1)(i). Hence, it is taxable in India.

- (iii) As per section 9(1)(vi), income by way of royalty payable by the Government of India is deemed to accrue or arise in India. "Royalty" means consideration for, *inter alia*, use of patent. Therefore, the amount paid by Government of India for use of

patent developed by Mr. A, a non-resident, is deemed to accrue or arise in India. Hence, it is taxable in India.

- (iv) ₹ 20 lakhs, being the value of debentures issued by an Indian company in consideration of providing technical know-how, is in the nature of fee for technical services, deemed to accrue or arise in India to Sai Engineering, a non-resident foreign company, under section 9(1)(vii). Hence, it is taxable in India.

Further, as per section 9(1)(v), income by way of interest payable by a person who is a resident of India is deemed to accrue or arise in India. Therefore, interest income from debentures of an Indian company is deemed to accrue or arise in India in the hands of Sai Engineering by virtue of section 9(1)(v). Hence, it is taxable in India.

*Note – Since the question specifically requires the candidates to examine the taxability of the above transactions under section 9, the provisions of double taxation avoidance agreement, if any, applicable in the above cases, have not been taken into consideration.*

- (c) Double Taxation Avoidance Agreements (DTAAs) generally contain an Article providing that business income is taxable in the country of residence, unless the enterprise has a permanent establishment in the country of source, and such income can be attributed to the permanent establishment.

As per section 92F(iia), the term “Permanent Establishment” includes a fixed place of business through which the business of an enterprise is wholly or partly carried on.

As per this definition, to constitute a permanent establishment, there must be a place of business which is fixed and the business of the enterprise must be carried out wholly or partly through this place.

Section 9(1)(i) requires existence of business connection for deeming business income to accrue or arise in India. DTAAs, however, provide that business income is taxable only if there is a permanent establishment in India.

Therefore, in cases covered by DTAAs, where there is no permanent establishment in India, business income cannot be brought to tax due to existence of business connection as per section 9(1)(i).

However, in cases not covered by DTAAs, business income attributable to business connection is taxable.

- (d) **Computation of gross total income of Mr.Z for the A.Y.2014-15**

Particulars		₹
<b>Income from Other Sources</b>		
(i)	Receipt of immovable property for inadequate consideration attracts the provisions of section 56(2)(vii). The difference between the stamp duty value (₹ 18 lakhs) and the actual consideration (₹ 10 lakhs) would be taxable.	8,00,000

(ii)	Since car is not included in the definition of "property" under section 56(2)(vii), receipt of car for inadequate consideration would not attract the provisions of section 56(2)(vii).	-
(iii)	Interest on enhanced compensation amounting to ₹ 1,70,000 would be taxable under section 56(2)(viii) in the year of receipt. Deduction@50% is allowable under section 57(iv). Hence, the taxable interest is ₹ 85,000 (i.e., ₹ 1,70,000 – ₹ 85,000)	85,000
(iv)	Interest of ₹ 90,000 received on fixed deposit is income of Mr. Z. The interest of ₹ 50,000 on loan taken by Mr. Z from the same bank on security of the fixed deposit will not go to reduce the income by way of interest on fixed deposit [CIT v. D. V. Gopinathan (2001) 248 ITR 449].	90,000
<b>Gross Total Income</b>		<b>9,75,000</b>

#### Question 4

- (a) A partnership firm consisting of three partners R, Q, S, was engaged in the business of civil construction and received the following amounts by way of contract receipts during the financial year 2013-14:

Particulars	₹
Contract work for supply of labour	35,00,000
Value of materials supplied by the Government	<u>9,00,000</u>
	<u><b>44,00,000</b></u>

Each partner of the firm was entitled to draw ₹ 3,000 per month by way of salary as authorized by the terms of partnership deed. Interest of ₹ 1,50,000 was also paid to partner 'R' on the capital of ₹ 6,00,000 contributed by him. The profit as per books of accounts before deduction of salary to partners' and interest to partner 'R' amounted to ₹ 3,00,000.

Compute the total income of the firm, applying the provisions of section 44AD, for assessment year 2014-15. Ignore the provisions of AMT. (8 Marks)

- (b) Discuss and compute the liability for deduction of tax at source, if any, in the cases stated hereunder, for the financial year ended 31<sup>st</sup> March, 2014.
- (i) Mr. X, a resident, acquired a house property at Mumbai from Mr. Y for a consideration of ₹ 90 lakhs, on 20.6.2013. On the same day, Mr. X made two separate transactions, thereby acquiring an urban plot in Kolkata from Mr. C for a sum of ₹ 49,50,000 and rural agricultural land from Mr. D for a consideration of ₹ 60 lakhs. Would your answer be different in case the house property had been purchased on 30/4/2013? (2 Marks)

- (ii) A commission of ₹ 50,000 was retained by the consignee 'ABC Packaging Ltd.' and not remitted to the consignor 'XYZ Developers', while remitting the sale consideration. Examine the obligation of the consignor to deduct tax at source. (2 Marks)
- (iii) Mr. S won a motor car in a lucky draw held by 'P' marketing. The market price of car was ₹ 4,00,000. P marketing erroneously gave the car to Mr. S without deducting tax at source. Examine the liability of P marketing to make such payment, if any. (2 Marks)
- (iv) Raj is working with AB Ltd. He is entitled to a salary of ₹ 45,000 per month w.e.f. 1/4/2013. He has a house property which is self-occupied. He paid an interest of ₹ 80,000 on loan, during the previous year 2013-14. The loan was taken for construction of house. He has notified his employer AB Ltd. that there will be a loss of ₹ 80,000 in respect of this house property for financial year ended 31/3/2014. (2 Marks)

#### Answer

- (a) As per section 44AD, in the case of an eligible assessee being an individual, HUF or a partnership firm other than limited liability partnership, carrying on any business except the business of plying, hiring or leasing goods carriages referred under section 44AE, whose total turnover or gross receipts from such business does not exceed ₹ 1 crore, a sum equal to 8% of total turnover or gross receipts of the assessee in the previous year on account of such business or such higher sum as claimed by the assessee, shall be deemed to be profits and gains of such business chargeable to tax under the head "Profits and gains of business or profession".

Further, any deduction allowable under sections 30 to 38 shall be deemed to have been given full effect to and no further deduction under those sections shall be allowed. However, where the eligible assessee is a firm, the salary and interest paid to its partners shall be deducted from such deemed profits and gains from eligible business.

For the purpose of section 44AD, "Gross receipts" will not include the value of materials supplied by Government. Therefore, in this case, the gross receipts would be only ₹ 35,00,000.

#### Computation of total income of partnership firm for the A.Y.2014-15

Particulars	Profits equal to 8% of Gross receipts (₹)	Profits as per books of account (₹)
Profit before interest and salary	2,80,000	3,00,000
Less: Interest paid to partner "R"@12% of ₹6,00,000, assuming that such payment is authorized by the partnership deed	<u>72,000</u>	<u>72,000</u>
<b>Book Profits</b>	2,08,000	2,28,000

Less: Salary (See Note below)	<u>1,08,000</u>	<u>1,08,000</u>
	<u>1,00,000</u>	<u>1,20,000</u>
<b>Note:</b> Applying the provisions of 40(b), allowable salary would be lower of -		
(i) Actual salary	1,08,000	1,08,000
(ii) On the first ₹3,00,000 of the book profits: 90% of book profit or ₹1,50,000, whichever is higher	1,87,200 (₹2,08,000×90%)	2,05,200 (₹2,28,000×90%)

As per the provisions of section 44AD, 8% of gross receipts or a sum higher than the aforesaid sum claimed to have been earned by the firm shall be deemed to be the profits and gains of business chargeable under the head "Profits and gains of business or profession". In this case, the presumptive income computed@8% is ₹ 1,00,000. However, the firm can claim to have earned a sum higher than the said sum. In this case, if the firm claims to have earned ₹ 1,20,000 (being profits computed as per books of account) from such business, then, such sum would be deemed to be the profits and gains of such business chargeable to tax under the head "Profits and gains of business or profession".

(b)

		Amount of TDS (₹)
(i)	Since the transfer of house property at Mumbai took place after 1.6.2013 and the consideration for transfer exceeds ₹ 50 lakhs, Mr. X, being the transferee, is required to deduct tax @1% under section 194-IA on ₹ 90 lakhs, being the amount of consideration for transfer of property.	90,000
	Mr. X is not required to deduct tax as source under section 194-IA from the consideration of ₹ 49,50,000 paid to Mr. C for transfer of urban plot, since the consideration is less than ₹ 50 lakhs.	Nil
	Mr. X is also not required to deduct tax at source under section 194-IA from the consideration of ₹ 60 lakhs paid to Mr. D for transfer of rural agricultural land, since the same is specifically excluded from the scope of immovable property for the purpose of tax deduction under section 194-IA.	Nil
	Yes, the answer would be different in case the house property had been purchased on 30/4/2013. No tax is required to be deducted at source under section 194-IA if transfer of immovable property was effected before 1.6.2013	Nil

	<p><i>Note - Section 194-IA requires every transferee responsible for paying any sum as consideration for transfer of immovable property (land, other than agricultural land, or building or part of building) to deduct tax, at the rate of 1% of such sum, at the time of credit of such sum to the account of the resident transferor or at the time of payment of such sum to the resident transferor, whichever is earlier. However, no tax is required to be deducted where the consideration for transfer of an immovable property is less than ₹ 50 lakhs. Moreover, the tax is to be deducted only when the transfer of immovable property takes place on or after 01.06.2013.</i></p>	
(ii)	<p>Section 194H requires deduction of tax at source@10% from commission and brokerage payments to a resident. However, no tax is to be deducted at source where the amount of such payment does not exceed ₹ 5,000.</p> <p>In the given case, 'ABC Packaging Ltd.', the consignee, has not remitted the commission of ₹ 50,000 to the consignor 'XYZ Developers' while remitting the sales consideration.</p> <p>Since the retention of commission by the consignee/agent amounts to constructive payment of the same to him by the consignor/principal, deduction of tax at source is required to be made from the amount of commission [CBDT Circular No.619 dated 4/12/1991].</p> <p>Therefore, XYZ Developers has to deduct tax at source on ₹ 50,000 at the rate of 10%.</p>	5,000
(iii)	<p>Section 194B provides that the person responsible for paying to any person any income by way of winnings from any lottery or crossword puzzle, card game and any other game of any sort in an amount exceeding ₹10,000 shall deduct tax at source @ 30%.</p> <p>However, in case where winnings are wholly in kind, the person responsible for paying shall, before releasing the winnings, ensure that tax has been paid in respect of the winnings. Where the winnings are wholly in kind, the responsibility cast under section 194B is to ensure that tax is paid by the winner of the prize before the prize is released in his favour.</p> <p>This can be done, by collecting from the winner, a sum equal to the tax deductible at source on the winnings in kind and, thus, meeting the liability for TDS, before releasing the winnings. For</p>	

	<p>this purpose, the value of the winnings in kind shall be taken as the cost incurred by the payer in acquiring the said winnings in kind [Circular No.763 dated 7/2/1998]</p> <p>In the given case, P marketing has released the car without ensuring tax payment of ₹1,20,000, being 30% of ₹4,00,000 (being the value of car) by Mr.S.</p> <p>P Marketing is therefore liable for penalty under section 271C and prosecution under section 276B [CIT v. Hindustan Lever Ltd. (2014) 361 ITR 1 (Kar.)]</p>																					
(iv)	<p>Section 192 provides that tax is required to be deducted on the payment made as salaries. Tax is to be deducted on the estimated income at the average of income tax computed on the basis of the rates in force for the financial year in which payment is made.</p> <p>The employee may declare details of his other incomes (including loss under the head "Income from house property" but not any other loss) to his employer. In this case, since Mr. Raj has notified his employer AB Ltd. of loss from self-occupied house property, the employer has to take the same into consideration for deduction of tax at source.</p> <p>Therefore, AB Ltd. is required to deduct tax at source on the salary of ₹ 45,000 per month paid to Mr. Raj, in the following manner:</p> <table border="0" style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 60%;">Income under the head salaries (45,000 x 12)</td> <td style="text-align: right;">5,40,000</td> </tr> <tr> <td>Income under the head "house property"</td> <td style="text-align: right;"><u>(80,000)</u></td> </tr> <tr> <td style="text-align: right;"><b>Gross total income</b></td> <td style="text-align: right;"><b>4,60,000</b></td> </tr> <tr> <td>Less: Deduction under Chapter VI-A</td> <td style="text-align: right;"><u>Nil</u></td> </tr> <tr> <td style="text-align: right;"><b>Total Income</b></td> <td style="text-align: right;"><b><u>4,60,000</u></b></td> </tr> <tr> <td>Tax @ 10% on ₹2,60,000, being the amount arrived after reducing the basic exemption limit of ₹ 2,00,000 from ₹4,60,000</td> <td style="text-align: right;">26,000</td> </tr> <tr> <td>Less: Rebate under section 87A</td> <td style="text-align: right;"><u>2,000</u></td> </tr> <tr> <td></td> <td style="text-align: right;">24,000</td> </tr> <tr> <td>Add: Education cess @2% and secondary and higher education cess @1%</td> <td style="text-align: right;"><u>720</u></td> </tr> <tr> <td><b>Tax to be deducted at source</b></td> <td style="text-align: right;"><b><u>24,720</u></b></td> </tr> </table>	Income under the head salaries (45,000 x 12)	5,40,000	Income under the head "house property"	<u>(80,000)</u>	<b>Gross total income</b>	<b>4,60,000</b>	Less: Deduction under Chapter VI-A	<u>Nil</u>	<b>Total Income</b>	<b><u>4,60,000</u></b>	Tax @ 10% on ₹2,60,000, being the amount arrived after reducing the basic exemption limit of ₹ 2,00,000 from ₹4,60,000	26,000	Less: Rebate under section 87A	<u>2,000</u>		24,000	Add: Education cess @2% and secondary and higher education cess @1%	<u>720</u>	<b>Tax to be deducted at source</b>	<b><u>24,720</u></b>	24,720
Income under the head salaries (45,000 x 12)	5,40,000																					
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	24,000																					
Add: Education cess @2% and secondary and higher education cess @1%	<u>720</u>																					
<b>Tax to be deducted at source</b>	<b><u>24,720</u></b>																					

#### Question 5

- (a) Following are the details of income provided by Mr. Singh, the assessee for the financial year ended 31<sup>st</sup> March, 2014:

- (i) Rental income from property at Bangalore - ₹ 3 lakhs, Standard Rent - ₹ 2,50,000, Fair Rent - ₹ 2,80,000.
- (ii) Municipal and water tax paid during 2013-14: Current year ₹ 35,000, Arrears - ₹ 1,50,000.
- (iii) Interest on loan borrowed towards major repairs to the property: ₹ 1,50,000.
- (iv) Arrears of rent of ₹ 30,000 received during the year, which was not charged to tax in earlier years.

Further, the assessee furnished following additional information regarding sale of property at Chennai :

- (i) Mr. Singh's father acquired a residential house in April 1992 for ₹ 25,000 and thereafter gifted this property to the assessee, Mr. Singh on 1<sup>st</sup> December, 1994.
- (ii) The property, so gifted, was sold by Mr. Singh on 10<sup>th</sup> June 2013. The consideration received was ₹ 25,00,000.
- (iii) Stamp duty charges paid by the purchaser at the time of registration @ 13% (as per statutory guidelines) was ₹ 3,90,000.
- (iv) Out of the sale consideration received:
  - (a) On 2/1/2014, the assessee had purchased two adjacent flats, in the same building, and made suitable modification to make it as one unit. The investment was made by separate sale deeds, amount being ₹ 8,00,000 and ₹ 7,00,000, respectively.
  - (b) On 10/10/2013, ₹ 10 lakhs was invested in bonds issued by National Highways Authority of India, but the allotment of the bonds was made on 1.2.2014.

Compute Mr. Singh's taxable income for assessment year 2014-15.

Cost inflation index: F.Y. 1992-93 : 223; F.Y. 1993-94 : 244; F.Y. 2013-14 : 939

(10 Marks)

- (b) The Director General of Income-tax after getting the information that Mr. X is in possession of unaccounted cash of ₹ 50 lakhs, issued orders by invoking powers vested in him as per section 131(1A) of the Income-tax Act, 1961, for its seizure.

Is the order for seizure of cash issued by the Director General of Income-tax correct?

If not, does the Director General of Income-tax have any other power to seize such cash?

(3 Marks)

- (c) Rectification of an assessment order under section 154 due to subsequent change of law on retrospective basis is valid in law. Comment.

Is it valid to rectify an assessment order under section 154 due to subsequent change of law on retrospective basis? Also, state, whether a Supreme Court judgment would warrant a rectification under section 154 in respect of an order passed earlier by the Assessing Officer?

(3 Marks)

Answer

(a) Computation of taxable income of Mr. Singh for A.Y.2014-15

Particulars	₹	₹
<b>Income from house property</b>		
Gross Annual Value [Higher of Expected Rent & Actual Rent]		3,00,000
Expected Rent (lower of Fair Rent and Standard Rent)	2,50,000	
Actual Rent	3,00,000	
Less: Municipal taxes paid by Mr. Singh during the year (including arrears) [₹ 35,000 + ₹1,50,000]		<u>1,85,000</u>
Net Annual Value (NAV)		1,15,000
Less: Deductions under section 24		
(a) 30% of NAV	34,500	
(b) Interest on loan borrowed for major repairs	<u>1,50,000</u>	<u>1,84,500</u>
		(69,500)
Arrears of rent taxable under section 25B	30,000	
Less: Deduction@30%	<u>9,000</u>	<u>21,000</u>
		(48,500)
<b>Capital Gains</b>		
Full value of consideration	30,00,000	
As per section 50C, the full value of consideration would be the higher of -		
Actual Consideration	₹ 25,00,000	
Stamp Duty Value [₹ 3,90,000/13%]	₹ 30,00,000	
Less: <b>Indexed cost of acquisition</b> [₹ 25,000 × 939/223]		
As per section 49(1), cost of acquisition of the residential house gifted by Mr. Singh's father to Mr. Singh would be the cost for which Mr. Singh's father acquired the asset. The indexation benefit is also available with effect from the previous year in which the previous owner held the asset.		
[CIT v. Manjula J Shah (2013) 355 ITR 474 (Bom.)]	1,05,269	
	<u>28,94,731</u>	
Less: <b>Exemption under section 54 (₹ 8,00,000 + ₹ 7,00,000)</b>	15,00,000	
Purchase of residential house within the stipulated time (within one year before or two years after the date of sale) [Where the flats are situated side by side and the builder had effected the necessary modification to make it as one house, the assessee		

would be entitled to exemption under section 54 in respect of investment in both the flats, despite the fact that they were purchased by separate sale deeds] [CIT v. Ananda Basappa (2009) 331 ITR 211 (Kar.)]		
<b>Exemption under section 54EC</b>	10,00,000	
Investment in bonds of NHAI within six months from the date of transfer. Where the payment for bonds has been made within the six month period, exemption under section 54EC would be available even if the allotment of bonds was made after the expiry of the six months [Hindustan Unilever Ltd. v. DCIT (2010) 325 ITR 102 (Bom.)]		3,94,731
<b>Total Income</b>		<b>3,46,231</b>

- (b) Section 131(1A) deals with power of discovery and production of evidence. This section does not, however, confer the power of seizure of cash or any asset. The Director General, for the purposes of making an enquiry or investigation relating to any income concealed or likely to be concealed by any person or class of persons within his jurisdiction, shall be competent to exercise powers conferred under section 131(1), which is confined to discovery and inspection, enforcing attendance, compelling the production of books of account and other documents and issuing commissions. The power of seizure of unaccounted cash is not one of the powers conferred on the Director General under section 131(1A). Thus, the order issued by the Director General of Income-tax under section 131(1A) for seizure of cash is not correct.

However, under section 132(1)(iii), the Director General has the power to authorize any Additional Director or Additional Commissioner or Joint Director or Joint Commissioner etc. to seize money found as a result of search, if he has reason to believe that any person is in possession of any money which represents wholly or partly income which has not been disclosed.

Therefore, the proper course open to the Director General is to exercise his power under section 132(1) and authorize the Officers concerned to enter the premises where the cash is kept by Mr. X and seize such unaccounted cash.

- (c) **Rectification of assessment order under section 154 due to subsequent change of law on retrospective basis**

If the assessment order is plainly and obviously inconsistent with the specific and clear provision as amended retrospectively, undisputably there is a mistake apparent from record. In the light of the retrospective amendment, the assessment order had to be revised. [CIT vs. E. Sefton and Co. (P.) Ltd. (1989) 179 ITR 435]

In view of this, the Assessing Officer can, under section 154, rectify the order of assessment in the light of the later amendment of the law with retrospective effect.

**Rectification of assessment order under section 154 on account of subsequent judgment of Supreme Court**

The Calcutta High Court, in *Geo Miller and Co. vs. DCIT (2003) 262 ITR 237*, held that a subsequent exposition of law by Supreme Court does not render assessment order as made on mistake.

However, the Gujarat High Court, in *CIT v. Subodhchandra S. Patel (2004) 265 ITR 445*, expressed a different view that non-consideration of a judgment of the jurisdictional High Court or the Apex Court would always constitute a mistake apparent from the record, regardless of the judgment being rendered prior to or subsequent to the order proposed to be rectified.

**Question 6**

- (a) *G Ltd. is engaged in the business of growing and manufacturing tea in India. For the previous year ending on 31.03.2013, its composite business profits before allowing deduction u/s 33AB is ₹ 60,00,000. On 01.09.2013, it deposited a sum of ₹ 11,00,000 in the Tea Development Account. During the previous year 2011-12, G Ltd. had incurred a business loss of ₹ 14,00,000 which has been carried forward. On 25/01/2014, it withdraws ₹ 10 lakhs, from deposit account which is utilized as under:*
- ₹ 6,00,000 for purchase on non-depreciable asset as per the scheme specified.*
  - ₹ 3,00,000 for purchase of, machinery to be installed in the office premises.*
  - ₹ 1,00,000 was spent for the purpose of scheme on 5.4.2014.*
- (i) *You are required to determine business income of G Ltd. and the tax consequences that may arise from the above transactions in the relevant assessment year.*
- (ii) *What will be the consequence if the asset which was purchased for ₹ 6,00,000 is sold for ₹ 8,00,000 in April, 2014. (9 Marks)*
- (b) *Shallesh, an ordinarily resident but not citizen of India, has following assets/debts as on 31-03-2014.*
- (i) Land and building outside India worth ₹ 20 lakhs.*
  - (ii) He purchased a house for ₹ 50 lakhs in India and obtained a loan of ₹ 100 lakhs from HDFC bank against the mortgage of the house for his new business. The value of the house as on 31-03-2014 is ₹ 90 lakhs.*
  - (iii) He purchased one Urban land in India of ₹ 200 lakhs (Classified as agricultural land in records of the government and used for agricultural purposes.)*
  - (iv) He made a gift, shares of public limited company worth ₹ 5 lakh, to his wife on 01-04-2013 and she purchased immovable property out of the sale proceeds of*

shares as on 28-04-2013. The net worth of the house as on 31-03-2014 is ₹ 10 lakhs.

- (v) Interest of his minor son in a partnership firm in India is ₹ 5 lakhs (determined in accordance with Schedule III).
- (vi) He let out his house in India with effect from 1<sup>st</sup> October, 2013 at a monthly rent of ₹ 20,000 regularly. The value of the house is ₹ 15 lakhs as on 31-03-2014.

Prepare the statement of wealth of Shailesh on the valuation date i.e. 31-03-2014. (7 Marks)

Answer

(a) (i) Computation of Business Income of G Ltd. for the A.Y. 2013-14

Particulars	₹
Composite business profits before allowing deduction under section 33AB	60,00,000
Less: Deduction under section 33AB(1) would be the lower of:	
- Amount deposited in Tea Development Account on or before 30.9.2013 [i.e., ₹ 11,00,000]	
- 40% of profits of such business [i.e., ₹ 24,00,000, being 40% of ₹ 60,00,000]	<u>11,00,000</u>
	49,00,000
Less: 60% of ₹ 49,00,000, being agricultural income [as per Rule 8]	<u>29,40,000</u>
Business income	19,60,000
Less: Brought forward business loss of A.Y.2012-13 set-off as per section 72	<u>14,00,000</u>
Business income chargeable to tax	<u>5,60,000</u>

Computation of Business Income of G Ltd. for the A.Y. 2014-15

Particulars	₹
₹10,00,000 being the amount withdrawn from Tea Development Account has to be utilized in the prescribed manner, otherwise, the withdrawn amount would be chargeable to tax as business income. In the given case, the taxability of withdrawal amount based on their utilization is as follows:	
- ₹ 6,00,000, out of the amount withdrawn from the deposit account, utilised for purchase of non-depreciable asset as per the specified scheme.	Not taxable
[As per section 33AB(6), no deduction would be allowed under section 33AB since amount is spent out of ₹ 11 lakh deposited in Tea Development Account, which has already been allowed as deduction in A.Y.2013-14].	

- ₹ 3,00,000, being the amount utilized for purchase of machinery to be installed in the office premises is not a permissible utilization. Hence, the amount would be deemed as profits and gains of business of the previous year 2013-14 as per section 33AB(4).	3,00,000
- ₹ 1,00,000 was spent for the purpose of scheme on 05.04.2014. As per section 33AB(7), this amount would be taxable since the same is not utilized during the same previous year (i.e., P.Y. 2013-14) in which the amount is withdrawn from the deposit account.	1,00,000

The entire amount of ₹ 10 lakh (forming part of ₹ 11 lakh deposited in Tea Development Account) was deducted in the assessment year 2013-14 before segregation of agricultural and non-agricultural income. Therefore, when any part of such amount becomes taxable, the agricultural and non-agricultural portions of income must be segregated.

Accordingly, ₹ 1,60,000, being 40% of ₹ 4,00,000 (₹ 3,00,000 + ₹ 1,00,000) would be chargeable to tax as business income and the balance ₹ 2,40,000, being 60% of ₹ 4,00,000 would be agricultural income exempt from tax.

(ii) **Consequences, if asset purchased out of deposit account is sold during the previous year 2014-15**

As per section 33AB(8), if the asset is sold before the expiry of eight years from the end of the previous year in which it was acquired, then, the cost of such asset shall be deemed to be the profits and gains from business or profession of the previous year in which asset is sold.

Therefore, ₹ 6,00,000 would be deemed to be the business income (composite) for the A.Y.2015-16. However, since the full cost of the asset was deducted in the assessment year 2013-14 (being part of ₹ 11 lakh deposited in Tea Development Account) before segregation of agricultural income and non-agricultural income, the agricultural and non-agricultural portions of income should be segregated in the year in which such amount becomes taxable on account of sale of asset before the expiry of eight years. Therefore, ₹ 3,60,000, being 60% of ₹6,00,000 would represent agricultural income. The balance ₹ 2,40,000 being 40% of ₹ 6,00,000 would be chargeable to tax as business income.

Moreover, the difference between the sale consideration and purchase price of the asset would be chargeable to tax as "Short term capital gains", which is computed as follows:

Sales consideration	8,00,000
Less: Cost of acquisition	<u>6,00,000</u>
<b>Short term capital gain</b>	<b><u>2,00,000</u></b>

(b) Statement of Net Wealth of Mr. Shailesh as on valuation date 31.03.2014

		₹ in lakhs
(i)	Since Mr. Shailesh is not a citizen of India, land and building located outside India would not be includible in his net wealth, irrespective of the fact that the same are assets under section 2(ea)(i) [Section 6(i) of the Wealth-tax Act, 1957]	Nil
(ii)	<p>House purchased in India would be included in the wealth, since it is located in India and falls within the definition of asset under section 2(ea)(i).</p> <p>Further, the loan obtained from HDFC Bank is not allowable as deduction because it is obtained against the mortgage of house for his new business and not obtained for purchase of the said house.</p> <p>Mr. Shailesh has the option of claiming one of the residential houses as exempt under section 5(vi). It is more beneficial for him to claim this house as exempt, since the value of this house (₹ 90 lakhs) is higher than the other two houses (₹ 10 lakhs and ₹ 15 lakhs, respectively).</p>	Nil
(iii)	Urban land does not include land classified as agricultural land in records of the Government and used for agricultural purposes. Hence, the land so classified is not includible in the net wealth.	Nil
(iv)	The value of immovable property purchased by his wife out of sale proceeds of the shares gifted by him shall be included in the net wealth of Mr. Shailesh. Even though the shares gifted are not an asset under section 2(ea), if immovable property is purchased out of the sale proceeds of such shares, the value of immovable property, being an asset under section 2(ea), is includible in the net wealth of the transferor-spouse (Mr. Shailesh, in this case), by virtue of section 4(1)(a)(i) of the Wealth-tax Act, 1957 [ <i>M.G. Kollankulam vs CIT (1978) 115 ITR 161(Ker.)</i> ]	10
(v)	<p>The value of interest of his minor son in the assets of the partnership firm in India (determined in accordance with Schedule III) would be included in the net wealth of Mr. Shailesh, since the interest of a minor child in a partnership firm is includible in computing the net wealth of the parent as per the proviso to section 4(1)(b) of the Wealth-tax Act, 1957.</p> <p>It is assumed that the net wealth of Mr. Shailesh (before including the assets of the minor child) is higher than that of his wife.</p>	5

(vi)	Since the house in India is not let out for a minimum period of 300 days during the previous year, the same cannot be excluded from the definition of asset under section 2(ea).	15
<b>Net Wealth</b>		<b>30</b>

### Question 7

- (a) Examine the correctness of the following statements in the context of the provisions contained in the Income-tax Act, 1961.
- High Court has an inherent power under the Income-tax Act, 1961, to review an earlier order passed on merits.
  - If assessee does not pay the self-assessment tax before furnishing the return of income, the return furnished shall be deemed to be a defective return.
  - The assessee, who is required to furnish Annual Information Return fails to furnish the same. He is liable for penalty under section 271 FA of the Income-tax Act, 1961.
- (6 Marks)
- (b) An assessment completed by the Assessing Officer was set aside by the ITAT on 30-01-2013 with a specific direction to re-examine certain disallowances. Before the fresh assessment is made, the Assessing Officer discovers that some other income has escaped assessment. How should he proceed to make fresh assessment? (4 Marks)
- (c) Discuss the correctness of the following statements in the context of the provisions of Income-tax Act, 1961:
- "The Joint Commissioner of Income-tax is empowered to issue direction to the Assessing Officer as he thinks fit for the guidance of the Assessing Officer during the assessment proceedings to complete the assessment in a specific manner."
  - "Assessing Officer may direct for the audit of the accounts under section 142(2A) of the Act, during the assessment proceeding on the basis of certain grounds". (6 Marks)

### Answer

- (a) (i) The statement is not correct.

The power to review is not an inherent power and must be conferred by law specifically by express provision or by necessary implication. The appellate jurisdiction of the High Court carries with it statutory limitations under the statute.

Keeping in view the provisions of section 260A(7), the power of re-admission/restoration of the appeal is always enjoyed by the High Court. However, such power to restore the appeal cannot be treated to be a power to review the earlier order passed on merits. It was so held by the Madhya Pradesh High Court in *Deepak Kumar Garg vs. CIT (2010) 327 ITR 448*.

**(ii) The statement is correct.**

As per *Explanation* to section 139(9), the return of income shall be regarded as defective unless the tax, together with interest, if any, payable in accordance with the provisions of section 140A has been paid on or before the date of furnishing of the return.

**(iii) The statement is correct.**

A penalty of ₹ 100 per day of continuing default is payable for failure to furnish the Annual Information Return within the time prescribed i.e., on or before 31<sup>st</sup> August immediately following the financial year in which the transaction is registered or recorded.

A penalty of ₹ 500 per day of continuing default is payable for failure to furnish the Annual Information Return within the period specified in the notice under section 285BA(5).

- (b)** If an assessment is set aside and a direction is given to make a fresh assessment, then, the Assessing Officer shall make the fresh assessment under the same section in which the original assessment is made (i.e., under section 143(3)/144/147). For making such assessment, no fresh notice needs to be issued.

However, where an assessment is set aside by the Appellate Tribunal and remanded to the Assessing Officer, it is not open to him to introduce into the assessment new sources of income so as to enhance the assessment.

Any power to modify is confined to the specific disallowances which were the subject-matter of appeal to the Appellate Tribunal. This view is supported by the Punjab & Haryana High Court ruling in the case of *Kartar Singh vs. CIT (1978) 111 ITR 0184*.

In the given case, the assessment has been set aside with a specific direction to re-examine certain disallowances. Hence, in this case, the Assessing Officer has to proceed to make the fresh assessment on the basis of the direction of the Appellate Tribunal, without considering any new source of income which has escaped assessment, within the time limit prescribed under section 153(2A).

However, after completing the fresh assessment as per the direction of the Appellate authority, the Assessing Officer can proceed under section 147 to assess or reassess income chargeable to tax which has escaped assessment by issuing notice under section 148.

**(c) (i) The statement is correct.**

As per section 144A, a Joint Commissioner may, on his own motion or on a reference being made to him by the Assessing Officer or on the application of an assessee, call for and examine the record of any proceeding in which an assessment is pending.

Having regard to the nature of the case or the amount involved or for any other reason, if he considers it necessary or expedient, he may issue such directions as

he thinks fit for the guidance of the Assessing Officer during the assessment proceedings to complete the assessment in a specific manner.

Such directions shall be binding on the Assessing Officer.

However, no directions which are prejudicial to the assessee shall be issued before an opportunity is given to the assessee to be heard.

A direction as to the lines on which an investigation connected with the assessment should be made shall not be deemed to be a direction prejudicial to the assessee.

**(ii) The statement is correct.**

Section 142(2A) expressly includes within its scope, the following reasons, on the basis of which the Assessing Officer may direct special audit of accounts of an assessee with the previous approval of the Commissioner or Chief Commissioner –

- (1) nature and complexity of accounts,
- (2) volume of the accounts,
- (3) doubts about the correctness of the accounts,
- (4) multiplicity of transactions in the accounts,
- (5) specialized nature of business activity of the assessee; and
- (6) the interests of the revenue.