

Roll No.

**FINAL
GROUP-II PAPER-7
DIRECT TAX LAWS**

Total No. of Questions – 7

Time Allowed – 3 Hours

Total No. of Pages – 11

Maximum Marks – 100

2013
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Answers to questions are to be given only in English except in the case of candidates who have opted for Hindi Medium. If a candidate has not opted for Hindi medium, his/her answers in Hindi will not be valued.

Wherever appropriate, suitable assumption/s should be made and indicated in the answer by the candidate.

Working notes should form part of the answer.

Question No. 1 is compulsory.

Answer any five questions from the remaining six questions.

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1. (a) Tani purchased a land at a cost of ₹ 10 lakhs in the financial year 1982-83 and held the same as her capital asset till 31st March, 2010. Tani started her real estate business on 1st April, 2010 and converted the said land into stock-in-trade of her business on the said date, when the fair market value of the land was ₹ 150 lakhs. **10**

She constructed 20 flats of equal size, quality and dimension. Cost of construction of each flat is ₹ 8 lakhs. Construction was completed in December, 2012. She sold 15 flats at ₹ 20 lakhs per flat between January, 2013 and March, 2013. Remaining 5 flats were held in stock as on 31st March, 2013.

She invested ₹ 50 lakhs in bonds issued by Rural Electrification Corporation Ltd. on 31st March, 2013.

Compute the amount of chargeable capital gain and business income in the hands of Tani arising from above transactions for Assessment Year 2013-14 indicating clearly the reasons for treatment for each item. Cost Inflation Index: FY 1982-83 109; FY 2010-11 711; FY 2012-13 852.

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(b) ABC Ltd. owns the following assets as on 31st March, 2013. State whether the assets are chargeable to wealth tax indicating reasons in brief.

- (i) Land at Delhi purchased in 2010 on which a residential complex consisting of 12 flats, to be sold on ownership basis, is under construction for last one year.
- (ii) Three office flats at Mumbai purchased in financial year 2005-06 for resale.
- (iii) Shares of group companies, break up value of which is ₹ 7.50 lakhs.
- (iv) Cash at construction site ₹ 2.50 lakhs not recorded in the books of account.
- (v) Residential flat in occupation of company's whole time director drawing a salary of ₹ 9 lakhs per annum.

(c) Anil has a house property in Delhi. He constructed the said property in 1985 at a cost of ₹ 40 lakhs. He has let out the property at ₹ 25,000 per month for a period of three years from 1st October, 2012. The half yearly municipal tax is ₹ 12,500 which is borne by him. The house was constructed on freehold land measuring 10000 sq. ft. The built up area of the house is 2000 sq. ft. Compute the value of the house property for wealth tax purpose as on the valuation date 31st March, 2013.

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2. The Profit & Loss Account of ST Private Limited for the year ended 2013 shows a profit of ₹ 75 lakhs after debiting the following items:

- (i) ₹ 2 lakhs contributed to Employees' Welfare Trust.
- (ii) ₹ 12 lakhs paid towards course fee and hostel expenses for MBA course of a close relative of a director. The relative is not in employment with the company.
- (iii) ₹ 3.50 lakhs being expenses incurred on installation of a traffic signal, so as to facilitate its employees coming to office to overcome traffic jam and save office time.
- (iv) ₹ 3 lakhs spent of gift items distributed to various dealers under the company's sales incentive scheme.
- (v) ₹ 6 lakhs being expenses incurred on the travelling of the wife of MD, who accompanied him on tour to Singapore on invitation of Trade and Commerce Chamber, Singapore.
- (vi) ₹ 3 lakhs being amount paid in March 2013 consequent upon change in currency rate due to exchange fluctuation in excess of the amount due to the supplier of machinery.
- (vii) ₹ 18,000 and ₹ 9,000 paid in cash on 25th October, 2012 by two separate vouchers to a contractor who carried out certain repair work in the office premises.
- (viii) Interest of ₹ 2 lakhs was paid in March, 2013 to a company on a loan taken from a company. Tax deducted at source from such interest was deposited in July, 2013.

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Additional Information:

- (a) Provision for audit fee of ₹ 6 lakhs was made in the books for the year ended 31st March, 2012 without deducting tax at source. Such fee was paid to the auditors in September, 2012 after deducting tax under Section 194J and the tax so deducted was deposited on 7th October, 2012.
- (b) During the year the company purchased 10,000 shares of VK Private Limited at ₹ 40 per share. The fair market value of such shares on the date of transaction was ₹ 60 per share.

Compute total income of ST Private Limited for Assessment Year 2013-14 and tax payable on such income indicating reasons for treatment of each item. Ignore the provisions relating to minimum alternate tax.

3. (a) Mr. Shakti purchased a residential house in June, 2001 for ₹ 22 lakhs. He sold the house on 1st December, 2012 for ₹ 100 lakhs. He paid brokerage at 2% on sale price. He invested ₹ 80 lakhs in April, 2013 in equity shares of Shakti Manufacturing Private Limited, a newly formed manufacturing company which qualifies to be a medium enterprise under the Micro, Small and Medium Enterprises Development Act, 2006. Mr. Shakti holds 80% of share capital of the company.

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The company utilised the sum of ₹ 80 lakhs in the following manner:

- (i) Purchase of new machinery during April, 2013 ₹ 70 lakhs (including ₹ 10 lakhs for purchase of computers).
- (ii) Deposit in specified bank on 25th September, 2013 ₹ 10 lakhs.

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The due date for filing return of income for Mr. Shakti for Assessment Year 2013-14 is 30th September, 2013. Assume that he files the return on 28th September, 2013.

Compute the taxable capital gain arising from the above transaction for Assessment Year 2013-14. Cost Inflation Index: FY 2001-02 426; FY 2012-13 852.

(b) Discuss the taxability or otherwise of the following transactions under Section 56(2) of the Income-tax Act: 4

- (i) Bharat is the Karta of Bharat HUF. Sujata, daughter of Bharat is a member of the HUF. She transferred a house property to the HUF without any consideration. The value of the house property for stamp duty purpose is ₹ 10 lakhs.
- (ii) JD Private Limited issued 50,000 equity shares of face value of ₹ 10 per share at a premium of ₹ 60 per share. The fair market value of the share as per prescribed rule is ₹ 50 per share.

(c) What are the "specified domestic transactions" which are subject to transfer pricing provisions ? 6

4. (a) Discuss the liability for deduction of tax at source in the Financial Year 2012-13 in the following cases: 8

- (i) Mr. A has been running a sole proprietary business whose accounts are audited under Section 44AB of the Income-tax Act every year. He pays a monthly rent of ₹ 15,000 for the office premises to Mr. X, the landlord. Besides, he also pays service charge of ₹ 10,000 per month to Mr. X towards the use of furniture and fixtures.

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- (ii) By virtue of an agreement with a catering organization, a nationalized bank pays ₹ 50,000 per month towards supply of food, snacks, etc. during the office hours to the employees of the bank.
- (iii) A notified infrastructure debt fund eligible for exemption under Section 10(47) of the Income-tax Act pays interest of ₹ 5 lakhs to a company incorporated in USA. US Company incurred expenditure of ₹ 12,000 for earning such interest. The fund also pays interest of ₹ 3 lakhs to Mr. X, who is a resident of a notified jurisdictional area.
- (b) XYZ Limited's Profit & Loss Account for the year ended 31st March, 2013 shows a net profit of ₹ 75 lakhs after debiting / crediting the following items:
- (i) Depreciation ₹ 24 lakhs (including ₹ 4 lakhs on revaluation).
- (ii) Interest to financial institution not paid before due date of filing return of income ₹ 6 lakhs.
- (iii) Provision for doubtful debts ₹ 1 lakh.
- (iv) Provision for unascertained liabilities ₹ 2 lakhs.
- (v) Transfer to General Reserve ₹ 5 lakhs.
- (vi) Net Agricultural Income ₹ 16 lakhs.
- (vii) Amount withdrawn from Reserve created during 2009-10 ₹ 3 lakhs. (Book profit was increased by the amount transferred to such reserve in Assessment Year 2010-11)

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Other Information :

Brought forward loss and unabsorbed depreciation as per books are ₹ 10 lakhs and ₹ 10 lakhs respectively.

Compute minimum alternate tax under Section 115JB for Assessment Year 2013-14.

5. Attempt any **four** questions out of the following questions :

4×4
=16

- (a) The partnership deed of a firm does not specify the remuneration payable to each individual working partner but lays down the manner of fixing the remuneration as follows:

In case the book profits of the firm are up to ₹ 3 lakhs, then the partners would be entitled to remuneration up to ₹ 1.50 lakhs or 90% of book profits, whichever is more. In respect of balance book profits, it is 60%. "Book profits" shall be computed as defined in Section 40(b) of the Income-tax Act. In case there is a loss in a particular year, the partners shall not be entitled to any remuneration. Remuneration payable to the working partners should be credited to the respective accounts at the time of closing of the accounting year and the working partners shall be entitled to equal remuneration.

Can the firm claim deduction in respect of remuneration paid to the working partners ?

- (b) Transfer fees are received by a cooperative housing society from its incoming and outgoing members. Are such transfer fees liable to tax in the hands of the cooperative society ?

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- (c) The Assessing Officer accepted the returned income filed by RL Ltd. for the particular assessment year. However, the Assessing Officer initiated a reassessment proceeding under Section 147 as he had reason to believe that the income had escaped assessment due to claim and allowance of club fees, gifts and presents and provision for leave encashment and accordingly, he issued notice under Section 148. However, after sufficient enquiries made by him he came to the conclusion that no additions were required on account of these expenses. But instead he made additions on account of disallowances under Section 14A and Section 40(a)(ia) in respect of other expenses which were not the original "reason to believe" and passed his reassessment order under Section 147. The Assessing Officer is of the opinion that Explanation 3 to Section 147 permits him to assess the income which has escaped assessment and which comes to his notice subsequently in the course of proceeding under Section 147, even though the said issues were not part of the reasons recorded in the notice under Section 148. Is the action of the Assessing Officer valid ?
- (d) Y. Ltd. was amalgamated with X. Ltd. in accordance with a scheme of amalgamation. Assets and liabilities were transferred and vested with X. Ltd. X. Ltd. is of the view that excess consideration paid by it over the value of net assets acquired from Y. Ltd. should be considered as goodwill arising on amalgamation. X. Ltd. claimed depreciation on such goodwill, but the claim was rejected by the Assessing Officer on the ground that goodwill is not an asset falling under Explanation 3 to Section 32(1) of the Income-tax Act. Is the action of the Assessing Officer valid ?

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- (e) R. Ltd. was engaged in the business of manufacturing and trading activities.

The company was declared a sick industrial company and as a part of a restructuring programme, a part of the term loan for purchase of machinery and cash credit and interest was waived. The Assessing Officer was of the view that the waiver of loans and interest amounted to remission or cessation of liability and was taxable under Section 41(1) of the Income-tax Act. Give your views on the correctness of the action of the Assessing Officer.

6. (a) Z, a resident Indian aged 21 years, earned a sum of ₹ 10 lakhs during the previous year 2012-13 from playing badminton matches in a country with which India does not have double taxation avoidance agreement. Tax of ₹ 2 lakhs was levied on such income in the source country. In India he earned ₹ 15 lakhs during the previous year 2012-13 from playing badminton matches. He has deposited ₹ 1 lakh in public provident fund and ₹ 50,000 in IDFC Infrastructure Bonds during the year. Compute his income tax liability for Assessment Year 2013-14. 8
- (b) Discuss with reasons whether the following statements are correct: 4
- (i) Mahesh, a resident and ordinarily resident in India and having a house property and a bank account outside India is not required to file return of income for Assessment Year 2013-14, if his total income is below the maximum amount not liable to tax.
- (ii) Rectification of an assessment order under Section 154 due to subsequent change of law on retrospective basis is valid in law.

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- (c) Discuss how an appeal before Income Tax Appellate Tribunal be dealt with when there is a difference of opinion amongst the members of bench.
7. (a) In course of scrutiny assessment of Mr. X, the Assessing Officer, on the basis of information available with him sought an explanation for the source of the expenditure of ₹ 20 lakhs incurred on the wedding of his daughter. The said expenditure was neither recorded in the books of account maintained nor was the explanation offered by Mr. X satisfactory. What are the consequences ? 6
- (b) Mr. A has gifted a house property valued at ₹ 50 lakhs to his wife, Mrs. B, who in turn has gifted the same to Mrs. C, their daughter-in-law. The house was let out at ₹ 25,000 per month throughout the year. Compute total income of Mr. A and Mrs. C. 4
- Will your answer be different if the said property was gifted to his son, husband of Mrs. C ?
- (c) Mr. K, who has attained 63 years has the following income during the previous year 2012-13: 6
- Salary Income ₹ 6,80,000
 - Interest on savings bank account with Allahabad Bank ₹ 16,000
- Other particulars given by Mr. K are as under :
- (i) Insurance premium paid to Max Life Insurance Ltd. amounting to ₹ 25,000 under a policy taken on life of his son. The policy was taken on 20th July, 2011 and the sum assured is ₹ 1,80,000.

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- (ii) Insurance premium paid to Life Insurance Corporation of India amounting to ₹ 22,000 under a policy taken on his life on 20th April, 2012 and the sum assured is ₹ 2,00,000
- (iii) Premium of ₹ 18,000 paid by cheque on health insurance for self to National Insurance Corporation Ltd. and payment in cash of ₹ 5,000 to a hospital for preventive health check-up for self.

Compute total income of Mr. K for Assessment Year 2013-14 on the basis of above particulars.

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