

INTERMEDIATE EXAMINATION

GROUP I

(SYLLABUS 2008)

SUGGESTED ANSWERS TO QUESTIONS

DECEMBER 2010

Paper-7 : APPLIED DIRECT TAXATION

Time Allowed : 3 Hours

Full Marks : 100

The figures in the margin on the right side indicate full marks.

Wherever required the candidate can make suitable assumptions and state the same clearly in the the answers.

Working note should form part of the relevant answers.

All questions relate to the assessment year 2010-11 unless stated otherwise in the questions.

Answer Question No. 1, which is compulsory and any five from the rest.

Q. 1. (a) Fill in the blanks :

1×12=12

- (i) Medical insurance premium paid otherwise than in _____ is eligible for deduction under section 80D of the Income-tax Act, 1961.
- (ii) Deemed individual is _____ (liable to tax/not liable to tax) under section 2(22)(e) of the Income-tax Act, 1961.
- (iii) Expenditure incurred towards demerger is deductible in _____ equal annual instalments under section 35DD of the Income-tax Act, 1961.
- (iv) Arrear rent is taxable after deducting _____ % as per section 25B of the Income-tax Act, 1961.
- (v) Amount received towards permission for putting up hoarding at the top of the building is taxable under the head _____.
- (vi) The cost of acquisition of 100 bonus shares, where the original shares (100 nos.) were acquired for Rs. 30,000 is _____.
- (vii) Income-tax rates are not prescribed by the _____ Act, but by the _____ Act of each year.

- (viii) It is obligatory to pay advance tax where the amount of tax is Rs. _____ or more.
- (ix) While effecting the tax deduction at source, education cess and special higher education cess totalling 3% _____ (should/need not) be also deducted from the amount due or payable to the deductee.
- (x) The term "asset" is defined in clause _____ of section 2 of the Wealth-tax Act, 1957.
- (xi) In the case of an individual or a HUF, a plot of land not exceeding _____ sq. meters in area is exempt under section 5(vi) of the Wealth-tax Act, 1957.
- (xii) In computing the net wealth of an individual, the value of assets, which on the valuation date, are held by a minor child who is a married daughter of such individual, _____ (shall/shall not) be included.

Q. 1. (b) Choose the correct alternative :

- (i) Mr. L bought a motor cycle on 10th August 2009 for Rs. 3 lacs and used it in his business. This is the only asset in the block. 20% of the usage is for personal purposes. The WDV of the block as on 31-3-2010 is:
- A. Rs. 2,70,000;
 B. Rs. 2,55,000;
 C. Rs. 2,10,000;
 D. None of the above.
- (ii) The following is not taxable as income under the head "Salaries":
- A. Commission received by a full-time director;
 B. Remuneration received by a partner;
 C. Allowances received by an employee;
 D. Free accommodation given to an employee.
- (iii) Following Form Number is to be used for filing the return of income by an individual having business income :
- A. Form No.1;
 B. Form No.2;
 C. Form No.4;
 D. Form No. 4A.
- (iv) Income received in India in previous year is taxable in the hands of :
- A. Resident;
 B. Not-resident;
 C. Non ordinarily resident;
 D. All above.
- (v) Following is not a capital receipt :
- A. Dividend on investment;
 B. Bonus shares;
 C. Sale of know-how;
 D. Compensation received for vacating business place.

Q. 1. (c) State with reasons whether the following statements are True or False (Answers without reasons are not eligible for any credit) : 1×8=8

- (i) Political parties governed by section 13A of the Income-tax Act, 1961 have to file their returns of income within the time limit prescribed under section 139(1) even if there is no income chargeable to tax under the Act.
- (ii) 'Gross total income' means aggregate of income computed under various heads and after allowing deduction under Chapter VI-A.
- (iii) Municipal tax in respect of staff quarters is deductible only if it is paid, in computing business income.
- (iv) Amount received under Keyman insurance policy is not exempt under section 10(10D) of the Income-tax Act, 1961.
- (v) Market value of donation given in kind is also eligible for deduction under section 80G of the Income-tax Act, 1961.
- (vi) Amount received under Reverse Mortgage Scheme is taxable as income under the head 'income from other sources'.
- (vii) Advertisement in any souvenir, brochure, pamphlet or the like published by a political party is not deductible under section 37(2B) of the Income-tax Act, 1961.
- (viii) Vacant site held as stock-in-trade is not liable for wealth tax for 12 years from the end of the year in which it was acquired.

Answer 1. (a)

- (i) Cash
- (ii) liable to tax.
- (iii) Five
- (iv) 30
- (v) "Income from other sources"
- (vi) Nil
- (vii) Income-tax, Finance
- (viii) 10,000
- (ix) need not
- (x) (ea)
- (xi) 500
- (xii) shall not

Answer 1. (b)

- (i) A — Rs. 2,70,000
- (ii) B — Remuneration received by a partner
- (iii) C — Form No. 4
- (iv) A — All above.
- (v) D — Compensation received for vacating business place.

Answer 1. (c)

- (i) **False** — As per section 139(4B) of the Income-tax Act, 1961, political parties have to file return if the total income assessable (without giving effect of the provisions of section 13A of the Act) exceeds the maximum amount which is not chargeable to tax. Therefore if the income of a political party is below taxable limit, there is no need to file its return of income.
- (ii) **False** — As per section 80B(5) of the Income-tax Act, 1961, "Gross total income" means the aggregate total income of various heads of income but **before** making any deduction under Chapter VI-A of the Act. Therefore, the said statement is incorrect.
- (iii) **True** — Staff quarters form part of business asset and the municipal tax actually paid is only deductible under section 43B of the Income-tax Act, 1961.
- (iv) **True** — Amount received under Keyman insurance policy is not exempt under section 10(10D) of the Act.
- (v) **False** — Donation given in kind is not eligible for deduction under section 80G of the Income-tax Act, 1961.
- (vi) **False** — Amount received under Reverse Mortgage Scheme does not have the character of income; hence it is not chargeable to tax under the Act.
- (vii) **True** — As per section 37(2B) of the Income-tax Act, 1961, such expenditure shall not be eligible for deduction.
- (viii) **False** — As per Explanation 1 to section 2(ea) of the WT Act, any land held as stock-in-trade for a period of 10 years from the date of acquisition is not liable for wealth tax.

Q. 2. (a) Janak received the following gifts during the financial year 2009-10 :

Cash gift from father-in-law	Rs. 25,000
Cash gift from friends on the occasion of marriage	Rs. 37,000
Gift by way of wrist watch from a friend. Value of the watch	Rs. 12,000
Shares received as gift from wife's friend. Market value as on the date of gift	Rs. 51,000

State the taxability of each item above. Calculation of total amount liable to tax is not required.

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(b) Parvez(P) Ltd. confers of electricity benefit to its employee Mr. Ashwin. Annual consumption as per meter reading was 3200 units. Determine the value of perquisite in the following cases:

- (i) Electricity meter is in the name of Mr. Ashwin and the rate of electricity is Rs. 5 per unit paid by Parvez(P) Ltd. to the State Electricity Board (Give brief reason). 2
- (ii) Electricity meter is in the name of Parvez(P) Ltd. and the rate of electricity charged by the State Electricity Board is Rs. 5 per unit. Is this chargeable in all situations? 2
- (iii) Parvez(P) Ltd. is a power generating company. The manufacturing cost is Rs. 1.90 per unit but supplied to public @Rs. 5 per unit. However, it charges Re. 1 per unit from its employees. 1

(c) Discuss the conditions to be fulfilled for the applicability of section 35AD of the Income-tax Act, 1961. 5

Answer 2. (a)

Gifts of property received from non-relative by an individual is taxable. Where the gift is received at the time of marriage or where the item received as gift does not fall within the definition of "property" given in the Explanation to section 56(2)(vii), the same will not be taxable as income from other sources.

Cash gift from father-in-law Rs. 25,000 being parent of the spouse of the individual is not liable to tax.

Cash gifts from friends Rs. 37,000 having been received on the occasion of marriage of the donee is not liable to tax.

Gift by way of wrist watch from a friend, of value Rs. 12,000 is not covered by the term 'property' given in Explanation to section 56(2)(vii). Hence not liable to tax.

Gifts in the form of shares received from non-relative is liable to tax as income under the head 'other sources' as the term 'property' given in Explanation to section 56(2)(vii) includes shares and securities.

Answer 2. (b)

- (i) As the electric meter is in the name of the employee, it is his obligation to pay the bill. However, as the bill has been paid by the employer, it is an obligation of employee discharged by the employer. It is always taxable u/s.17(2)(iv).

Perquisite value of free electricity is Rs. 16,000 (3200×5).

- (ii) Perquisite value of free electricity will be Rs. 16,000.

It shall be assessed to tax only if the employee is a 'specified employee' as per section 17(2)(iii).

- (ii) Perquisite value of electricity supplied = $3200 \times (1.90 \text{ minus } 1.00) = \text{Rs. } 2,880$.

Answer 2. (c)

Section 35AD of the Income-tax Act, 1961 applies to the specified business which fulfils all the following conditions, namely :—

- (i) it is not set up by splitting up, or the reconstruction, of a business already in existence;
- (ii) it is not set up by the transfer to the specified business of machinery or plant previously used for any purpose;
- (iii) where the business is of the nature referred to in sub-clause (iii) of clause (c) of sub-section (8), such business,—
- (a) is owned by a company formed and registered in India under the Companies Act, 1956 (1 of 1956) or by a consortium of such companies or by an authority or a board or a corporation established or constituted under any Central or State Act;
- (b) has been approved by the Petroleum and Natural Gas Regulatory Board established under sub-section (1) of section 3 of the Petroleum and Natural Gas Regulatory Board Act, 2006 (19 of 2006) and notified by the Central Government in the Official Gazette in this behalf;
- (c) has made not less than such proportion of its total pipeline capacity as specified by regulations made by the Petroleum and Natural Gas Regulatory Board established under sub-section (1) of section 3 of the Petroleum and Natural Gas Regulatory Board Act, 2006 available for use on common carrier basis by any person other than the assessee or an associated person; and
- (d) fulfils any other condition as may be prescribed.

- Q. 3. (a)** Ramesh owns a house at Hyderabad. Its municipal valuation is Rs. 24,000. He incurred the following expenditure in respect of the house property :
- (i) Municipal Tax at 20%;
 - (ii) Fire insurance premium Rs. 2,000; and
 - (iii) Land revenue Rs. 2,400.
- He had taken bank loan of Rs. 25,000 at 16% per annum on April 1, 2007; the whole amount is still unpaid. The house was completed on April 1, 2009.
- Find the income from house property for the assessment year 2010-11 for the following situations :
- (i) If the assessee uses house for self-occupation throughout the previous year, and
 - (ii) If the house is let out for residential purpose on monthly rent of Rs. 2,500 from April 1, 2009 to December 31, 2009 and self and self occupied for the remaining period. 5
- (b)** Mr. Ramesh, aged 62, paid Rs. 4,800, Rs. 11,000 and Rs. 28,000 on 15-9-2009, 12-12-2009 and 15-3-2010 respectively as advance tax instalments. He filed return of income for the assessment year 2010-11 showing total income of Rs. 5,57,400; he is entitled to tax credit of Rs. 12,003 on account of tax deducted at source. Ascertain the interest, if any, chargeable under section 234C of the Income-tax Act, 1961. 5
- (c)** What is the income-tax treatment of consequence of repurchase or buy back of shares or specified securities by a company? 5

Answer 3. (a)**Computation of income from house property**

	Rs.
(i) Self-occupied throughout the year	
Annual value	Nil
Less : Interest on loan (point ii and iii below)	6,400
Loss from house property	6,400
(ii) House let-out for 9 months and self-occupied for 3 months	
Let out period of 9 months	
Annual value	30,000
(Since the actual rent received is more, the same should be taken)	
Proportionate value for 9 months	22,500
Less : Municipal tax at 20% of 24,000 for 9 months i.e. $4,800 \times 3/4$	3,600
Net annual value	18,900
Less : deduction u/s 24	
(i) Standard deduction at 30% of NAV	5,670
(ii) Interest on loan (current year)	4,000
(iii) 1/5 of interest on loan (3 years)	2,400
(25,000 × 16% × 3 × 1/5)	

Proportionate interest for 9 months (6,400 × 3/4)	4,800	
Total deduction u/s 24		10,470
Income chargeable for the let out period	(A)	8,430
Self-occupied portion		
Annual value		Nil
Less : interest on loan (for 3 months)		1,600
Loss from house property	(B)	1,600
Income from house property for whole year (A) + (B)		6,830

Answer 3. (b)**Computation of interest u/s 234C**

	Rs.
(i) Tax on income of Rs. 5,57,400	73,357
(ii) Less : tax deducted at source	12,003
Assessed tax (i-ii)	61,354
30% of assessed tax	18,406
Tax paid on or before 15-9-09	4,800
60% of assessed tax	36,812
Tax paid on or before 15-12-09 (4,800 + 11,000)	15,800
100% of assessed tax	61,354
Tax paid on or before 15-3-10 (15,800 + 28,000)	43,800

Shortfall :	Rs.	Default (months)	Int. at 1%
30% on or before 15-9-09	13,606	3	408
60% on or before 15-12-10	21,012	3	630
100% on or before 15-3-10	17,554	1	175
Interest payable u/s 234C			1,213

Answer 3. (c)

Income-tax treatment of consequence of repurchase or buy back of shares or specified securities by a company.

In case Shares treated as Stock-in-Trade are exchanged for Shares of other Companies,

Business Profit = Market Value of Shares exchanged Less Book Value of Original Shares [Orient Trading Co. Ltd. 224 ITR 371 (SC)].

At per the provisions in Sec. 46A of the the Income-tax Act, 1961,

- (1) Where a shareholder receives any consideration from the company for purchase of its own shares or other specified securities, it is a **transfer chargeable under the head Capital Gains**.
- (2) The capital gains is taxable **in the previous year** in which the shares or securities are purchased by the Company.
- (3) **Capital Gains** = Value of Consideration Received Less Cost of Acquisition or Indexed cost of acquisition.
- (4) **No deemed dividend** : In case of buy back of shares, there is no question of deemed dividend u/s 2(22)(d)

Q. 4. (a) Following are the details of income of Mr. Subramani for the financial year 2009-2010 :

Income from property in Sri Lanka remitted by the tenant to the assessee	
in India through SBI	Rs. 2,10,000
Profit from business in India	Rs. 1,00,000
Loss from business in Sri Lanka (whose control and management of business wholly remained in India)	Rs. 80,000
Dividend from shares in foreign companies received outside India	Rs. 60,000
Interest on deposits in Indian companies	Rs. 1,20,000

Determine the total income in terms of the Income-tax Act, 1961 in the following situations :

- (i) Resident and ordinarily resident of India;
- (ii) Resident but not ordinarily resident of India;
- (iii) Non-resident.

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(b) The question whether a particular income is income from salary or is income from business depends upon whether the contract is a *contract of service* or is a *contract for service*. Discuss. Also explain with the help of one example.

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Answer 4. (a)

Scope of total income under different residential status situations

Particulars	Resident and ordinarily resident	Resident but not ordinarily resident	Non-resident
Income from property in Sri Lanka, rent remitted by the tenant received in India	2,10,000	2,10,000	2,10,000
Profit from business in India	1,00,000	1,00,000	1,00,000
Loss from business in Sri Lanka whose control and management remained wholly in India.	(-) 80,000	(-) 80,000	Not taxable since the aspect of the control and management of foreign business is not a relevant factor.
Dividend from shares in foreign company received outside India	60,000	Not taxable	Not taxable
Interest on deposits in India companies	1,20,000	1,20,000	1,20,000
Total income	4,10,000	3,50,000	4,30,000

Answer 4. (b)

Particulars	Contract of Service	Contract for Service
1. Meaning	Employer-Employee relationship is vital. The Employee does the work for his master.	In this contract, a person offers his services to any person who is willing to pay the charges therefor.
2. Control	Control and supervision vests in the the Master (employer). The servant (employee) is bound to follow the master's directions.	The day-to-day control is normally absent in the case of contract for service
3. Execution of work	Employee works under the close supervision of his Employer who determines the manner of execution of work. (Control over What should be done and How)	The person executing the job is answerable only for the work to be carried out in accordance with the terms of contract. He has discretion to do the work in his own way. (Control over what should be done and not how to do it)
4. Remuneration	An employee works for remuneration, which may be paid monthly or in lumps sum or on any suitable basis as per agreement	The person rendering the service is entitled to the fruits of his labour, and also liable for the losses.
5. Example	Abhisekh Khan, an actor, is an employee of LMN P Ltd. He gets a remuneration of Rs. 10 lakhs p.m. He acts in several films but producers pay the fees for those services directly to LMN P Ltd. Here, employer-employee relationship exists between his and LMN P Ltd. Hence his remuneration will be assessed as Salary.	Amitabh is an actor. He acts in several films at a time with remuneration ranging from Rs. 90 Lakhs to Rs. 2 crores. The producers of films pay him directly for his services. There is no employer-employee relationship between the producers and him. The receipts constitute business income.

Q. 5. (a) Manish owned a land located in Chennai-Bangalore highway in Tambaram Municipal Corporation limits, which was acquired by NHAI in the financial year 2009-10 for Rs. 10,00,000. The land had been purchased by Manish on 2-4-1980 for Rs. 10,000. The fair market value of the land as on 1-4-1981 was Rs. 19,000.

Yet another piece of urban land located in Chennai purchased in April, 2006 for Rs. 25 lakhs was sold by him in February, 2010 for Rs. 35 lakhs, but the sale deed thereof, was not registered till 31-3-2010. The possession was given to the buyer on 31.1.2010 and the sale deed was finally registered on 16-4-2010. The value adopted by the Stamp Valuation Authority was Rs. 38 lakhs. Manish paid 2% of the sale consideration towards brokerage. Manish deposited Rs. 10 lakhs in

Capital Gain Deposit Account of SBI on 20-11-2010 in order to avail exemption under section 54F of the Income-tax Act, 1961 subsequently by constructing a residential house.

Cost inflation indices are 632 for the FY 2009-10, 519 for the FY 2006-07 and 100 for the FY 1981-82.

Compute the capital gain chargeable to tax arising as a result of these transactions. 10

- (b) One of the exceptions to the rule that the income of the previous year shall be assessed in the subsequent assessment year is the shipping business of non-resident. Discuss briefly the assessment aspect of such income from shipping business. 5

Answer 5. (a)

Computation of Capital Gains

	Property 1	Property 2
Sale consideration	10,00,000	38,00,000
Less : Brokerage @ 2%		70,000
Net Sale consideration	10,00,000	37,30,000
Less : Indexed cost of acquisition		
Rs. 19,000 × 632/100	1,20,080	
Rs. 25,00,000 × 632/519		30,44,316
Long-term capital gain	8,79,920	6,85,684
Aggregate long-term capital gain	15,65,604	
Less : Amount deposited in capital gain deposit scheme not eligible for deduction as the deposit was made beyond the due date specified in section 139(1) of the Act.	Nil	
Taxable long term capital gain	15,65,604	

Notes :

- The value adopted by the Stamp valuation authority should be adopted as per section 50C.
- As per the extended definition of the term "transfer" as per section 2(47), where the possession has been given and full consideration has been received, transfer is deemed to have taken place. That the registration of the deed of conveyance took place in the subsequent year is immaterial. The capital gain will be chargeable to tax in the current year.

Answer 5. (b)

Shipping Business of Non-Resident [Section 172] :

- Assessee should be a **non-resident**.
- He should either be the **owner** of the ship or has **chartered** the ship.
- The ship carries passengers, goods, livestock, mail or goods shipped at a port in India.
- The non-resident assessee may or may not have an agent in India.

- (e) 7.5% of amount of such carriage including demurrage and handling charges shall be **deemed as income** of the assessee. [u/s 44B]
- (f) The **Master of the Ship should file the return and pay tax** on such income before departure or must make necessary arrangements for payment of such tax **within 30 days** of departure of the ship.
- (g) If the above conditions are fulfilled, the Collector or Customs shall grant the port clearance.
- (h) This assessment is **mandatory**. The Assessing Officer may call for such accounts as to determine the tax liability.

Q. 6. (a) Devender, aged 55, resident in India, furnishes the following information for the previous year ended 31-3-2010 :

	Rs.
House property income (Net)	18,500
Business income	5,000
Capital gains (short-term)	22,000
Capital gains (long-term)	2,500
Income from horse race	15,000
Income from card games	16,000

Additional information are as follows :

Brought forward business loss for AY 2002-03	12,000
Unabsorbed depreciation for AY 2008-09	6,000
Long-term capital loss for AY 2007-08	12,000
Loss from horse race suffered in AY 2007-08	8,000
Speculative loss for AY 2006-07	10,000

Devender has taken a life insurance policy for his major son working in a software company for a salary of Rs. 5 lacs per annum. He has paid premium of Rs. 60,000 in cash for a capital sum assured of Rs. 2,00,000/-.

He has paid PPF of Rs. 70,000 by raising a hand loan from his friend.

Calculate total income and tax liability. State the items to be carried forward.

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- (b) Discuss the provisions of the Income-tax Act, 1961 requiring quoting of PAN mandatory in the context of TDS rates and filing of declarations by the deductees. Also discuss the related TDS areas relating to mandatory quoting of PAN.

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Answer 6. (a)**Computation of taxable income :**

	Rs.	Rs.
Income from House property		18,500
Profits and gains of business or profession :		
Business income	5,000	
Less : Brought forward business loss	12,000	
Chargeable business income		Nil
Capital gains :		
Long-term capital gains	2,500	
Less : Brought forward long term loss	12,000	
Net LTCG		Nil
Short term capital gains	22,000	
Less : Unabsorbed depreciation allowance	6,000	
Net STCG		16,000
Income from other sources :		
Income from horse race	15,000	
Card games income	16,000	
Income chargeable under this head		31,000
Gross Total Income		65,500
Less : Short-term capital gains		16,000
Adjusted gross total income for Chap VIA only		49,500
Less : Deduction under Chapter VIA		
(a) Under section 80-C		
LIP Not to exceed 20% of sum assured	40,000	
Public Provident Fund	70,000	
Maximum permissible amount	1,00,000	
Above cannot exceed		49,500
Total income		16,000
Tax on above		Nil

Though the total income consists of STCG Rs. 16,000, since the amount of STCG is lower than Rs. 1,60,000, no tax is payable.

Note :

- Business loss of Rs. 7,000 pertaining to the AY 2002-03 cannot be carried forward any further, since the maximum 8 years period has expired.
- Long-term capital loss Rs. 7,500 pertaining to the AY 2007-08 can be carried forward.
- Unabsorbed depreciation allowance can be set off against any income except salaries.

Answer 6. (b)

Mandatory PAN requirement in the context of TDS :

Sec 206AA has brought in the mandatory requirement of the PAN. The salient features of this section are :

- (1) Notwithstanding anything contained in any other provisions of the Act, any person entitled to receive any sum or income or amount, on which tax is deductible under Chapter XVIIIB (hereafter referred to as deductee) shall furnish his Permanent Account Number to the person responsible for deducting such tax (hereafter referred to as deductor), failing which tax shall be deducted at the higher of the following rates, namely :-
 - (i) at the rate specified in the relevant provision of this Act; or
 - (ii) at the rate or rates in force; or
 - (iii) at the rate of twenty per cent.
- (2) No declaration under sub-section (1) or sub-section (1A) or sub-section (1C) of section 197A shall be valid unless the person furnishes his Permanent Account Number in such declaration.
- (3) In case any declaration becomes invalid under sub-section (2), the deductor shall deduct the tax at source in accordance with the provisions of sub-section (1).
- (4) No certificate under section 197 shall be granted unless the application made under that section contains the Permanent Account Number of the applicant.
- (5) The deductee shall furnish his Permanent Account Number to the deductor and both shall indicate the same in all the correspondence, bills, vouchers and other documents which are sent to each other.
- (6) Where the Permanent Account Number provided to the deductor is invalid or does not belong to the deductee, it shall be deemed that the deductee has not furnished his Permanent Account Number to the deductor and the provisions of sub-section (1) shall apply accordingly.

Q. 7. (a) Ravan has furnished the following information as on 31-3-2010 :

- (i) Cash in hand Rs. 75,000;
- (ii) Cash at bank Rs. 10,00,000;
- (iii) Residential house (loan taken to purchase this house Rs. 5,00,000) Rs. 45,00,000;
- (iv) Land in rural area (within 5 kms from Bhopal municipality) Rs. 48,00,000;
- (v) Land in urban area (construction not permitted under the law, loan taken to purchase this land Rs. 3,00,000) Rs. 28,00,000;
- (vi) Motor car for personal use Rs. 14,00,000;
- (vii) Jewellery Rs. 6,00,000;
- (viii) Aircraft for personal use (loan taken to purchase aircraft Rs. 20,00,000) Rs. 1,00,00,000;
- (ix) Farm house situated within 20 kms from local limits of municipal corporation Rs. 24,00,000 and
- (x) One let-out residential house given on rent throughout year (loan taken to construct this house Rs. 2,00,000) Rs. 20,00,000.

Ascertain the net wealth as on 31-3-2010 and the wealth tax payable for the assessment year 2010-11.

(b) Is e-filing of income-tax return mandatory for all assessees? Also state the assessees for whom the same is mandatory. 3

(c) Can a revised return of income be further revised? 2

Answer 7. (a)

Calculation of net wealth of Ravan as on 31.3.2010 :

	Rs.
Cash in hand in excess of Rs. 50,000	25,000
Cash at bank (not an asset)	—
Residential house (exempted)	—
Land in rural area within 5 kms from Bhopal [is an asset since it is within 8 kms from Bhopal municipality]	48,00,000
Land in urban area [Not an asset since building construction is not permissible]	—
Motor car for personal use	14,00,000
Jewellery	6,00,000
Aircraft for personal use	1,00,00,000
Farm house	24,00,000
Residential house let out for minimum period of 300 days Is not an asset	—
Gross wealth	1,92,25,000
<i>Less</i> : Loan on aircraft	20,000
Net Wealth	1,72,25,000
Tax on net wealth (1,72,25,000 – 30,00,000) at 1%	1,42,250

Answer 7. (b)

E-filing of income-tax return is mandatory for the following assesseees :

- (i) A firm which is required to furnish the return in Form ITR-5 and to whom provisions of section 44AB are applicable;
- (ii) A company which is required to furnish the return in Form ITR-6; and
- (iii) Individual and HUF assesseees whose accounts are required to be audited under section 44AB of the Act and whose return is to be furnished in Form ITR-4.

Answer 7. (c)

Revision of revised return

If the assessee discovers any omission or any wrong statement in a return, it is possible to revise such return subject to time limit prescribed in section 139(5). The time limit being one year from the end of the relevant assessment year or before the completion of the assessment, whichever is earlier.

Further a revised return could be revised any number of times, provided the revision is made within the prescribed time limit.

Q. 8. Answer any three of the following :

5×3=15

- (a) Discuss the tax issues including cost of acquisition and period of holding, in the hands of the shareholder determined after demerger, covering deemed dividend and capital gains.
- (b) What is meant by “arm’s length price” in the context of transfer pricing provisions? Name the six methods used for computing the arm’s length price.
- (c) Mrs. Sukanya is a qualified cost accountant. She is a salaried employee in a firm of cost accountants in which Mr. Ashok (her husband) is a partner. Mr. Ashok’s share in the firm is 10%. His younger brother holds 10% share in this firm. Mrs. Sykanya draws a salary of Rs. 18,000 per month from the firm. This is however paid in kind and not in cash. Mr. Ashok’s income by way of sitting-fees from the various boards of the companies in which he is an independent director is Rs. 3,50,000. Will Mrs. Sukanya’s income be clubbed with that of Mr. Ashok under section 64 of the Income-tax Act, 1961?
- (d) Narang Txtiles Ltd. purchased a machinery from Germany for Euro 1,00,000 on 3.9.2009 through a term loan from Fortune Bank Ltd. The exchange rate on the date of acquisition was Rs. 65. The assessee took a forward exchange rate on 05.10.2009 when the rate specified in the contract was Rs. 67 per USD. Compute depreciation for the assessment years 2009-10 and 2010-11. Ignore additional depreciation.
- (e) Discuss the wealth tax consequences of (i) Conversion by an individual of his self-acquired property into joint family property, and (ii) Gift by way of book entries.

Answer 8. (a)

Cost of acquisition and period of holding in the hands of the shareholder determined after demerger :

A shareholder of de-merged company gets some shares of resulting company (i.e. new company to which some part of business is transferred) after de-merger. Such transfer is not treated as dividend distributed by the de-merged company [Section 2(22)(v) of Income-tax Act].

Issue of shares of resulting company to shareholders of de-merged company will not be treated as “Transfer” and hence will not attract any capital gains. [section 47(vid) of Income-tax Act].

The shareholder will have shares of the original i.e. company which has de-merged. If he sales such shares, capital gain may arise. In such cases, the cost of acquisition of original shares will be bifurcated between the resulting company and the original (de-merged) company in proportion to net book value of assets transferred in de-merger to the net worth of original company before demerger. [sections 49(2C) and 45(2D) of Income-tax Act]. e.g. assume that net worth of original i.e. de-merged company was Rs one hundred lakhs and net book value of assets transferred to resulting company was Rs. 25 lakhs. If the cost of acquisition of original shares at the hands of shareholder was Rs. 1,000, cost of acquisition of resulting company will be Rs. 250 and cost of acquisition of original shares will be Rs. 750. Thus, total cost of acquisition of original shares is bifurcated between resulting company and original company in ratio of book value of assets transferred to the net worth of original company.

Capital gains will arise. only when the shares of the resulting company is sold by the shareholder. If the shareholder sells the shares of resulting company, the period for which original shares were held will also be considered to determine whether the gain is a short term gain or a long term gain. [section 2(42A)(g)].

Answer 8. (b)

Computation of the arm's length price :

If there is transaction between two entities called associate enterprises, arm's length price will be computed for income tax purposes.

Arm's length price is the price applied (or proposed to be applied) when two unrelated persons enter into a transaction in uncontrolled conditions [section 92F]

Persons are said to be unrelated if they are not associated or deemed to be associated enterprise according to section 92A.

Method of computing arm's length price - Arm's length price can be computed by one of the following methods [section 92C]

- a. Comparable uncontrolled price method
- b. Resale price method
- c. Cost plus method
- d. Profit split method
- e. Transactional net margin method
- f. Such other method as may be prescribed by the Board.

Answer 8. (c)

Clubbing of income of spouse :

Section 64(1)(ii) provides for clubbing of income arising to spouse of individual by way of salary, fee or remuneration, whether in cash or in kind, from a concern in which such individual has a substantial interest.

As per Explanation 2 to sec 64(1), for the purposes of clause (ii), an individual shall be deemed to have a substantial interest in a partnership concern, if such person is entitled, or such person and one or more of his relatives are entitled in the aggregate, at any time during the previous year, to not less than twenty per cent of the profits of such concern. Here, Mr. Ashok and his brother hold 20% share in the firm and hence prima facie, the provisions of sec 64(1)(ii) apply.

As per Explanation 1 to sec 64(1), for the purposes of clause (ii), the individual in computing whose total income referred to in that clause is to be included, shall be the husband or wife whose total income (excluding the income referred to in that clause) is greater.

However, the proviso to section 64(1)(ii) enjoins that such the provisions of section 64(1)(ii) will not apply to any income earned by spouse if the spouse possesses technical qualifications and the income is solely attributable to the application of his or her technical knowledge or professional knowledge or experience.

Therefore, the case appears to fall squarely within the aforesaid proviso and the clubbing provisions of section 64(1)(ii) cannot be invoked to club the salary income of Mrs. SUkanya in Mr. Ashok's hands.

Answer 8. (d)**Computation of Depreciation :**

	Rs.
Cost of the Asset (Euro 1,00,000 × Rs. 65.00)	65,00,000
Less: Depreciation @50% of 15% (Put to use for more than 180 days) (Rs. 65,00,000 × 15%) for AY 2009-2010	(9,75,000)
WDV as on 31.03.2009.	55,25,000
Add: Exchange Rate Difference (Rs. 2 × Euro 1,00,000)	2,00,000
WDV for claiming depreciation	57,25,000
Less: Depreciation @ 15% for AY 2010-2011 (Rs. 57,25,000 × 15%)	(8,58,750)
WDV as on 31.03.2010	48,66,250

Answer 8. (e)

Conversion by an individual of his self-acquired property into joint family property - If an individual is a member of a Hindu undivided family and he converts his separate property into property belonging to his Hindu undivided family, through the act of impressing such property with the character of property belonging to the family or throwing it into common stock of the family, or if he transfers his separate property to his Hindu undivided family, directly or indirectly, without adequate consideration, the converted or transferred property shall be deemed to be the property of the individual and the value of such property is includible in his net wealth [Section 4(1A)].

If there was such transfer and if the converted or transferred property becomes the subject matter of a total or a partial partition among the members of the family, the converted or transferred property or any part thereof, which is received by the spouse of the transferor, is deemed to be the asset of the transferor and is includible in his net wealth.

Gifts by book entries - Where a gift of money from one person to another is made by means of entries in the books of account maintained by the person making the gift, or by an individual, or a Hindu undivided family, or a firm or an association of persons, or a body of individuals with whom he has business connection, the value of such gift will be included in the net wealth of the person making the gifts, unless he proves to the satisfaction of the Wealth-tax Officer that the money had actually been delivered to the other person at the time the entries were made [Section 4(5A)].