

Test Series: April, 2014

**MOCK TEST PAPER – 2**  
**FINAL: GROUP – II**  
**PAPER – 7: DIRECT TAX LAWS**

*Question 1 is compulsory.*

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

**Time Allowed – 3 Hours**

**Maximum Marks – 100**

1. (a) B.P.O Ltd., a manufacturing company, which maintains accounts under mercantile system, has disclosed a net profit of ₹ 15.50 lacs for the year ending 31<sup>st</sup> March, 2014. You are required to compute the taxable income of the company for the Assessment year 2014-15, after considering the following information, duly explaining the reasons for each item of adjustment:
- (i) Advertisement expenditure includes the sum of ₹ 75,000 paid in cash to the sister concern of a director, the market value of which is ₹ 58,000.
  - (ii) Legal charges include a sum of ₹ 54,000 paid to consultant for framing a scheme of amalgamation duly approved by the Central Government.
  - (iii) Repairs of plant and machinery includes ₹ 2.20 lacs towards replacement of worn out parts of machineries.
  - (iv) A sum of ₹ 7,500 on account of liability foregone by a creditor has been taken to general reserve. The same was charged to the Revenue Account in the A.Y. 2011-12.
  - (v) Sale proceeds of import entitlements amounting to ₹ 1.75 lac has been credited to Profit & Loss Account, which the company claims as capital receipt not chargeable to income-tax.
  - (vi) Being also engaged in the biotechnology business, the company incurred the following expenditure on in-house research and development as approved by the prescribed authority:
    - (a) Research equipments purchased ₹ 1,80,000.
    - (b) Remuneration paid to scientists ₹ 85,000.
- The total amount of ₹ 2,65,000 is debited to the Profit & Loss account.
- (10 Marks)*
- (b) Ujala Co-operative Housing Society Ltd owns a building in Delhi, which stands on freehold land. There is no unbuilt area. It has 15 members, each of whom has contributed ₹ 15 lacs towards the shares in the Co-operative society. The building was completed and occupied exclusively for residential purposes by its members

before 31.3.2014. It was financed partly by the shares contributed by members and partly by bank finance. The annual value fixed by the municipality for the building is ₹ 25 Lacs, the taxes amount to ₹ 1.5 Lac.

'Amar' is a member of the society owning one of the flats. The amount outstanding by way of instalment loan payable to the society by 'Amar' is ₹ 2 Lacs. You are required to compute the value of the flat owned by 'Amar' as on 31.03.2014.

(5 Marks)

- (c) Mr. Rohit, a resident individual following cash basis of accounting, has the following assets as on 31-03-2014. Compute his net wealth as on the valuation date 31.03.2014:

		Valuation as on 31-03-2014 (₹ in lacs)
(i)	Self-occupied residential house	70
(ii)	Owning of a guest house situated 26 kms from the municipality	45
(iii)	Property used for his business	62
(iv)	One residential complex consisting of 10 dwelling units. 3 units are let out fully for the whole year. 2 other units are let out but vacant from 05-01-2014. He intended to sell the remaining 5 units which are kept vacant for want of prospective buyers for the whole year.	600

(5 Marks)

2. Ripple Tea Limited is engaged in growing and manufacturing tea in Assam and West Bengal. The company's profit and loss account for the year ended 31<sup>st</sup> March, 2014 shows a net profit of ₹ 725 lacs after debiting or crediting the following amounts:
- Depreciation ₹ 55 lacs.
  - Interest amounting to ₹ 7 lacs on term loan from a bank for purchase of machinery for one of its tea factories.
  - Repairs to factory building amounting to ₹ 16 lacs for which a sum of ₹ 10 lacs was withdrawn from Tea Deposit account maintained with National Bank for Agricultural and Rural Development (NABARD) as per section 33AB of the Income-tax Act, 1961. Assume that repairs are not of capital nature.
  - Profit from sale of green tea leaves plucked in own gardens ₹ 32 lacs.
  - ₹ 7.5 lacs on account of stamp duty and registration fees for the issue of bonus shares.

- (f) ₹ 12 lacs, being sales tax dues of earlier years determined during the year on disposal of appeals by the appellate authority, for which the company has furnished a bank guarantee to the Commercial Tax Authority.
- (g) ₹ 4.5 lacs written off as bad in respect of a trade debt transferred from Golden Tea Limited in previous year 2011-12 pursuant to a scheme of amalgamation approved by the jurisdictional High Court.
- (h) ₹ 3 lacs contributed to Employees' Welfare Trust.
- (i) Interest on inter-corporate deposit ₹ 1.5 lac and ₹ 3.50 lacs for February, 2014 and March, 2014, respectively, for which tax deducted at source was paid to the Central Government in June, 2014.

Following additional information are furnished by the management:

- (i) Depreciation as per Tax Audit Report under section 44AB ₹ 72 lacs.
- (ii) One financial institution converted arrear interest of ₹ 15 lacs into a new loan in financial year 2009-10, which is repayable in five annual instalments. The company has paid ₹ 3 lacs towards the instalment due for the financial year 2013-14 in February, 2014.
- (iii) A sum of ₹ 325 lacs deposited in NABARD on 15th June, 2014 as per the provision of Section 33AB.

Compute total income of the company for the Assessment Year 2014-15 stating the reasons for each item. Ignore provision relating to Minimum Alternate Tax.

(16 Marks)

3. (a) Mr. Bhansali, a resident Indian and aged 67 years, has derived the following income during the previous year 2013-14:

		₹
(i)	Income from business in India	3,63,000
(ii)	Commission (Gross) from a company in a foreign country (Tax paid in that country ₹ 90,000)	4,50,000
(iii)	Dividend (Gross) from a company in a foreign country (Tax paid in that country ₹ 15,600)	78,000
(iv)	Interest on fixed deposit with banks in India	2,25,000

Assuming that India does not have a double tax avoidance agreement with the foreign country, compute the total income and tax payable by Mr. Bhansali for assessment year 2014-15.

(8 Marks)

- (b) ABC Co Ltd., a domestic company, holds 51% of the share capital of XYZ Co Ltd. which is another domestic company. XYZ Co Ltd. distributed total dividend for the year ended on 31-03-2013 of ₹ 64 Lacs in the F.Y. 2013-14 and has paid dividend

distribution tax u/s 115-O. Out of the dividend received from XYZ Co Ltd., ABC Co Ltd. distributed dividend of ₹ 15 Lacs in the year 2013-14. Explain with reasons the amount of dividend chargeable to tax and dividend distribution tax payable by ABC Co Ltd. Would your answer be different if ABC Co Ltd. had distributed dividend of ₹ 72 Lacs? (4 Marks)

- (c) SRK Ltd., a company having registered head office in Bangkok, for the first time had carried out operations during the year 2013-14 of purchase of goods in India on four occasions. Immediately after purchase, the company exported the same to China. The total value of such exports was ₹ 150 Lacs, on which it earned profits of ₹ 30 Lacs, before the expenses of ₹ 15 Lacs, which were directly paid by H.O. The company seeks your advice regarding its tax liability in India.

How much of income for the A.Y. 2014-15 shall be subjected to tax? (4 Marks)

4. (a) A shareholder of a demerged Indian company received shares from the resulting company in the scheme of demerger. The shareholder wants to transfer the said shares received subsequent to the demerger for consideration. Your advice is sought on the tax consequences as to the shares received on demerger and sought to be transferred.
- (b) Dreams Ltd., made a provision on 31.3.2014 of ₹ 92,500 against a bill of supplier of raw material by charging the amount to profit and loss account and claimed deduction thereof while computing the income chargeable to tax for A.Y. 2014-15. The amount of ₹ 55,000 not paid to the party till 31.3.2014 was paid in cash on 15.7.2014. The Assessing Officer issued show cause notice to the company to rectify the computation of income for the A.Y. 2014-15 on account of payment made in cash on 15.7.2014. Can the Assessing Officer do so?
- (c) Govind Pharma Ltd., a manufacturer of drugs and pharma products, provides the following information relating to payments made to Mr. Vijay, its marketing manager in the financial year 2013-14:
- Salary @ ₹ 22,500 p.m.
  - Motor-cycle purchased for ₹ 52,000 in May, 2013 and transferred to Mr. Vijay.
  - Conveyance allowance of ₹ 7,500 p.m. which was fully spent for official purposes.
  - Reimbursement of medical expenses actually incurred by him of ₹ 18,800.
- The company asks you to compute the total income chargeable to tax in the hands of marketing manager Mr. Vijay.
- (d) Neeru Traders engaged in manufacturing activity was in receipt of sales-tax subsidy from State Government as the unit was located in a backward area. The subsidy is related to the sale of its products and payable once the production is commenced.

Neeru Traders claims that the subsidy is a capital receipt and hence cannot be included as income. (4 × 4 = 16 Marks)

5. (a) An amount of ₹ 12,50,000 paid by Totalcare Ltd., after approval by the board, to a hospital in UK for the heart surgery of its managing director was charged under medical expenses. The Assessing Officer, while completing the assessment of the company, taxed the amount so paid by the company as a perquisite in the hands of its Managing Director.

Examine critically in the context of provisions contained in Income-tax Act, 1961 as to the correctness of the action of the Assessing Officer.

- (b) Ramaswami settled 1/4th share of his property under a trust for the education and maintenance of his minor daughter, Pallavi. Under the terms of the trust deed, the income accruing to the trust, after meeting the expenses of maintenance and education of Pallavi, was to be accumulated and paid over to her on her attaining majority. The Assessing Officer assessed the income arising from 1/4th share of the property, settled for the benefit of Pallavi, in the hands of Ramaswami. Examine the correctness of the assessment.
- (c) In the assessment of a firm, the Assessing Officer made two additions (i) Unexplained cash credits ₹ 1 lac. (ii) Disallowance under section 43B. The firm filed an appeal before the CIT and being unsuccessful before the Appellate Tribunal only on the addition of unexplained cash credits. It was not successful in either forum. With regard to the disallowance under section 43B, it did not file any appeal, but preferred a revision petition before the CIT under section 264, who dismissed it on the ground that the assessment was the subject matter of an appeal to the Appellate Tribunal. The assessee relies on the Board's circular under which the CIT is empowered to accept such a petition. Is the petition maintainable?
- (d) PRT(P) Ltd. is a company in which the public are not substantially interested. Karan is a shareholder of the company holding 15% of the equity shares. The accumulated profits of the company as on 31.3.2013 amounted to ₹ 15,00,000. The company lent ₹ 1,20,000 to Karan by an account payee bank draft on 10.10.2013. The loan was not connected with the business of the company. Karan repaid the loan to the company by an account payee bank draft on 28.3.2014. Examine the effect of the borrowal and repayment of the loan by Karan on the computation of his total income for the assessment year 2014-15. (4 × 4 = 16 Marks)
6. (a) Satya Prakash Ltd. filed its return of income for the assessment year 2012-13 on 30.3.2014. The whole tax payable was already deducted at source. The Assessing Officer levied a penalty of ₹ 5,000 under section 271F. The assessee makes a submission to the CIT (Appeals) that he has furnished the return of income within the due date specified in section 139(4) and hence, no penalty should be levied under 271F. Discuss the correctness or otherwise of the stand taken by the assessee. (4 Marks)

- (b) On an application made by Mr. Deshmukh, an order was passed by the Settlement Commission on 03-01-2014 under section 245D. The said order had a mistake apparent on record. The Settlement Commission passed an amended order dated 30-04-2014 which resulted in modifying the liability of Mr. Deshmukh.

Mr. Deshmukh is of the view that order of the Settlement Commission is final and conclusive and it has no power to rectify the said mistake.

You are required to examine the following:

- (i) Correctness of claim made by Mr. Deshmukh
  - (ii) Validity of the order amended by the Settlement Commission. *(2 x 3 = 6 Marks)*
- (c) Discuss the correctness or otherwise of the following propositions in the context of the Income-tax Act, 1961:
- (i) At the time of hearing of rectification application, the Income-tax Appellate Tribunal can re-appreciate the evidence produced during the proceedings of the appeal hearing.
  - (ii) The High Court cannot interfere with the factual finding recorded by the lower authorities and the Tribunal, without any valid reasons. *(2 x 3 = 6 Marks)*
- 7 (a) Can prosecution be launched for each of the following actions or defaults committed? If yes, then explain the relevant provisions of the Act and the quantum of prescribed punishment.
- (i) The assessee had restrained and not allowed the officer authorized as per section 132(1)(iib) of the Act to inspect the documents maintained in the form of electronic record and the books of accounts.
  - (ii) The assessee deliberately has failed to comply with the requirement of section 142(1) and/or 142(2A).
  - (iii) The assessee deliberately has failed to make the payment of the tax collected under section 206C. *(3 x 2 = 6 Marks)*
- (b) Examine the obligation of the person responsible for paying the income, to deduct tax at source, in respect of the following items:
- (i) Desire Ltd., the employer, credited salary due for the financial year 2013-14 amounting to ₹ 2,40,000 to the account of Dolly, an employee, in its books of account on 31.3.2014. Dolly has not furnished any information about her income/loss from any other head or proof of investments/payments qualifying for deduction under section 80C.
  - (ii) Tony, an individual whose total sales in business during the year ending 31.3.2013 was ₹ 1.20 crores, paid ₹ 9 lacs by cheque on 1.1.2014 to a contractor (an individual), for construction of his business premises, in full and

final settlement. No amount was credited earlier to the account of the contractor in the books of Tony.

- (iii) Binny Ltd. credited ₹ 28,000 towards fees for professional services and ₹ 27,000 towards fees for technical services to the account of Himanshu in its books of account on 6.10.2013. The total sum of ₹ 55,000 was paid by cheque to Himanshu on 18.12.2013. *(3 × 2 = 6 Marks)*

- (c) A foreign company entered into contracts with several Indian companies for installation of mobile telephone system and made an application to the Authority for Advance Rulings for advance ruling on the rate of withholding tax on receipts from Indian companies. One of the Indian companies had also made an application to the Assessing Officer for determination of the rate at which tax is deductible on payment to the said foreign company. The Authority for Advance Rulings rejected the application of the foreign company on the ground that the question raised in the application is already pending before an income tax authority. Is the rejection of the application of the foreign company justified in law? *(4 Marks)*