Roll No. .... FINAL GROUP-II PAPER-7 DIRECT TAX LAWS NOV 2015

Total No. of Questions – 7 Total No. of Printed Pages –12

Time Allowed – 3 Hours Maximum Marks – 100

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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 assumptions may be made by the candidate and stated clearly in the answer.

Working notes should form part of the answer.

Question No. 1 is compulsory.

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

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

Marks

1. (a) PQR LLP, a limited liability partnership set up a unit in Special Economic Zone (SEZ) in the financial year 2010-11 for production of washing machines. The unit fulfills all the conditions of Section 10AA of the Income-tax Act. During the financial year 2013-14, it has also set up a warehousing facility in a district of Tamil Nadu for storage of agricultural produce. It fulfills all the conditions of Section 35AD. Capital expenditure in respect of warehouse amounted to ₹ 75 lakhs (including cost of land ₹ 10 lakhs). The warehouse became operational with effect from 1st April, 2014 and the expenditure of ₹ 75 lakhs was capitalized in the books on that date. **10**

Marks

Relevant details for the financial year 2014-15 are as follows :

Particulars	₹
Profit of unit located in SEZ	40,00,000
Export sales of above unit	80,00,000
Domestic sales of above unit	20,00,000
Profit from operation of warehousing facility (before considering deduction under Section 35AD)	1,05,00,000

Compute income tax (including AMT under Section 115 JC) payable by PQR LLP for Assessment Year 2015-16.

(b) SS(P) Ltd., a domestic Indian company having two undertakings engaged in manufacture of cement and steel, decided to hive off cement division to RV(P) Ltd. a domestic Indian company by way of demerger. The net book value of assets of SS(P) Ltd. before demerger was ₹ 40 crores. The net book value of assets transferred to RV(P) Ltd. was ₹ 10 crores. The demerger was made in January 2015. In the scheme of demerger, it was fixed that for each equity share of ₹ 10 each (fully paid up) of SS(P) Ltd., two equity shares of ₹ 10 each (fully paid up) were to be issued. **10**

One Mr. N.K. held 25,000 equity shares in SS(P) Ltd. which were acquired in the financial year 2001-02 for ₹ 6,00,000. Mr. N.K. received 50,000 equity shares from RV(P) Ltd. consequent to demerger in January 2015. He sold all the shares of RV(P) Ltd. for ₹ 8,00,000 in March, 2015. In this background you are requested to answer the following :

(i) Does the transaction of demerger attract any income tax liability in the hands of SS(P) Ltd. and RV(P) Ltd. ?

(ii) State the conditions in brief, which are to be satisfied under the Act for a demerger.

(iii) Compute the capital gain that could arise in the hands of Mr. N.K. on receipt of shares of RV(P) Ltd.

(iv) Compute the capital gain that could arise in the hands of Mr. N.K. on sale of shares of RV(P) Ltd.

(v) Will the sale of shares by Mr. N.K. affect the tax benefits availed by SS(P) Ltd. and/or RV(P) Ltd. ?

(vi) Is Mr. N.K. eligible to avail any tax exemption under any of the provisions of the Income-tax Act, 1961 on the sale of shares of RV(P) Ltd. ? If so, state in brief.

Note :

Financial Year	Cost inflation index
2001-02	426
2014-15	1024

2. Parik Hospitality Limited is engaged in the business of running hotels of 3-star category. The Company's Statement of Profit and Loss for the previous year ended 31st March, 2015 shows a net profit of ₹ 152 lakhs after debiting or crediting the following items : **16**

(a) Payment of ₹ 0.25 lakh and ₹ 0.30 lakh in cash on 3rd December, 2014 and 10th December, 2014 respectively for purchase of crab, lobster and squid to Mr. Raja, a fisherman and Mr. Khalid, a middleman for these products respectively.

(b) Contribution towards employees' pension scheme notified by the Central Government under Section 80 CCD for a sum of ₹ 3 lakhs calculated at 12% of basic salary and Dearness Allowance payable to the employees.

(c) Payment of ₹ 6.50 lakhs towards transportation of various materials procured by one of its hotels to M/s. Bansal Transport, a partnership firm without deduction of tax at source. The firm has furnished its Permanent Account Number in the tender document.

(d) Profit of ₹ 12 lakhs on sale of a plot of land to Avimunya Limited, a domestic company, the entire shares of which are held by the assessee company. The plot was acquired by Parik Hospitality Limited on 1st June, 2013.

(e) Contribution of ₹ 2.50 lakhs to Indian Institute of Technology with a specific direction for use of the amount for scientific research programme approved by the prescribed authority.

(f) Expense of ₹ 10 lakhs on foreign travel of two directors for a collaboration agreement with a foreign company for a brewery project to be set up. The negotiation did not succeed and the project was abandoned.

(g) Fees of ₹ 1 lakh paid to independent directors for attending Board meeting without deduction of tax at source under Section 194J.

(h) Depreciation charged ₹ 10 lakhs.

(i) ₹ 10 lakhs, being the additional compensation received from the State Government pursuant to an interim order of Court in respect of land acquired by the State Government in the previous year 2011-12.

(j) Dividend received from a foreign company ₹ 5 lakhs.

Marks

Additional information :

(i) As a corporate debt restructuring, the bank has converted unpaid interest of ₹ 10 lakhs upto 31st March, 2014 into a new loan account repayable in five equal annual installments. The first installment of ₹ 2 lakhs was paid in March, 2015 by debiting new loan account.

(ii) Depreciation as per Income-tax Act : ₹ 15 lakhs.

(iii) The company received a bill for ₹ 2 lakhs on 31st March, 2015 from a supplier of vegetables for supply made in March, 2015. The bill was omitted to be recorded in the books in March, 2015. The bill was paid in April, 2015 and the necessary entry was made in the books then.

Compute total income of Parik Hospitality Limited for the Assessment Year 2015-16 indicating the reason for treatment of each item. Ignore the provisions relating to minimum alternate tax.

3. (a) State with reasons the validity of the following statements : 4

(i) Before completing the assessment of any foreign company, the Assessing Officer has to forward a draft of the proposed order of assessment to the assessee.

(ii) Charitable trusts and institutions registered under Section 12AA, cannot claim exemption under any of the clauses of Section 10.

(b) Explain Section 278C applicable in respect of offences committed by Hindu undivided families. 2

(c) Fox Limited failed to furnish information and documents sought by the Transfer Pricing Officer (TPO). Can TPO levy penalty for such failure ? How much would be the quantum of penalty imposable for the said failure ? 4

Marks

(d) Details given below relate to investments made in new plant & machinery by companies which are eligible for deduction under Section 32 AC of the Act. 6

Company Name	Previous years	
	2013-14	2014-15
	₹ in crores	
ABC Ltd.	30	85
MNO Ltd.	20	50
RST Ltd.	70	20

Compute deduction under Section 32AC and give reasons in brief for the amount computed.

4. Answer any **four** out of the five following cases : 4×4 =16

(a) The assessment of South West Bank Limited for Assessment Year 2010-11 was made under Section 143(3) on 30th November, 2011 allowing deduction under Section 36(1) (viia) on account of provision for doubtful debts and deduction in respect of foreign exchange rate difference as claimed in the return of income. Subsequently, the Assessing Officer initiated reassessment proceeding under Section 147 in respect of deduction under Section 36(1)(viii) for special reserve created by the bank. The order under Section 147 was passed on 31st December, 2013. Later, the Principal Commissioner after examining the record of assessment initiated revisionary proceeding under Section 263 by issue of show cause notice to the bank and passed an order under Section 263 on 31st August, 2014 for disallowing in part deduction under Section 36(1)(viia) and deduction for foreign exchange rate difference. The bank claims that the order passed by the Principal Commissioner under Section 263 is barred by limitation.

Examine the correctness or otherwise of the claim of the bank.

(b) Mr. Santhanam holding 25% voting power in VKS Manufacturing Private Limited permitted his own land to be mortgaged to a bank for enabling the company to obtain a loan. Mr. Santhanam requested the company to release the property from the mortgage. The company failed to do so, but for retaining the benefit of bank loan it gave an advance of ₹ 10 lakhs to Mr. Santhanam, which was authorized by a resolution passed by the Board of Directors. The company's accumulated profit on the date of payment of advance was ₹ 50 lakhs. The Assessing Officer proposes to tax the amount of ₹ 10 lakhs by invoking the provision of Section 2(22)(e).

Is the proposition of the Assessing Officer correct in law ?

(c) X & Co. a partnership firm consisting of three partners enhanced working partner salary from ₹ 25,000 per month for each partner to ₹ 50,000 per month for each partner. The increase in working partner salary was authorised by the deed of partnership.

The Assessing Officer during the course of assessment contended that the remuneration paid to working partners @ ₹ 50,000 per month for each partner as excessive and applied Section 40A (2) (a) though the payment was within the statutory limit prescribed under Section 40(b) (v). Decide the correctness of action of the Assessing Officer.

(d) Two brothers say, A and B inherited lands equally consequent to demise of their father. Subsequently, those lands were compulsorily acquired by the State Government. Both A and B received compensation, enhanced compensation and interest on enhanced compensation. They admitted these as income in their individual status. Now the Assessing Officer wants to assess income from compulsory acquisition of lands in the status of Association of Persons (AOP).

Is the action of Assessing Officer justified in law ?

Marks

(e) A Co-operative society engaged in banking business received a letter from the Assistant Commissioner of Income-tax (ACIT), to furnish details of all persons who have made time deposit of ₹ 1 lakh or above during the period from 1.4.2013 to 31.3.2015.

There is no pending proceeding against the Co-operative society at the time of receipt of letter.

As a Chartered Accountant, what would be your advise to the co-operative society regarding legality of the notice ?

5. (a) RKJ Private Limited's assessment for Assessment Year 2011-12 was completed under Section 143(3) on 15th November, 2012. The company received a notice under Section 148 dated 15th July, 2015 requiring the company to submit a return of income for Assessment Year 2011-12 on the ground of escapement of certain income from assessment. **4**

The company has approached you for advice on the principles to be followed by it before notice under Section 143(2) for the purpose of reassessment is issued by the Assessing Officer.

State the principles to be followed by Company and the Assessing Officer.

(b) A Real Estate Investment Trust (REIT) received income of ₹ 120 lakhs from Special Purpose Vehicle company. The break-up of the income so received is as follows : **6**

Interest	₹ 90 Lakhs
Dividend	₹ 30 Lakhs

The REIT distributes ₹ 90 lakhs to its unit-holders. 40% of the unit holders are non-residents.

Examine the tax implication of the above transactions in the hands of the REIT and unit holders including the requirement to deduct tax at source.

Marks

(c) XE Ltd. is an Indian Company in which Zilla Inc., a US company has 28% shareholding and voting power. Following transactions were effected between these two companies during the financial year 2014-15. 6

(i) XE Ltd. sold 1,00,000 pieces of T-shirts at \$ 2 per T-Shirt to Zilla Inc. The identical T-Shirts were sold to unrelated party namely Kennedy Inc., at \$ 3 per T-Shirt.

(ii) XE Ltd. borrowed \$ 2,00,000 from a foreign lender based on the guarantee of Zilla Inc. For this, XE Ltd. paid \$ 10,000 as guarantee fee to Zilla Inc. To an unrelated party for the same amount of loan, Zilla Inc. collected \$ 7000 as guarantee fee.

(iii) XE Ltd. paid \$ 15,000 to Zilla Inc. for getting various potential customers details to improve its business. Zilla Inc. provided the same service to unrelated parties for \$ 10,000.

Assume the rate of exchange as 1\$ = ₹ 64

XE Ltd. is located in a Special Economic Zone (SEZ) and its income before transfer pricing adjustments for the year ended 31st March, 2015 was ₹ 1,200 lakhs.

Compute the adjustments to be made to the total income of XE Ltd. State whether it can claim deduction under Section 10AA for the income enhanced by applying transfer pricing provisions.

Marks

6. (a) Mr. Kamesh, an individual resident in India furnishes you the following particulars of income earned in India, Country "X" and Country "Y" for the previous year 2014-15. India has not entered into double taxation avoidance agreement with these two countries. **7**

Particulars	₹
Income from profession carried on in India	7,50,000
Agricultural income in Country "X" (gross)	50,000
Dividend received from a company incorporated in Country "Y" (gross)	1,50,000
Royalty income from a literary book from Country "X" (gross)	6,00,000
Expenses incurred for earning royalty	50,000
Business loss in Country "Y" (Proprietary business)	65,000
Rent from a house situated in Country "Y" (gross)	2,40,000
Municipal tax in respect of the above house (not allowed as deduction in country "Y")	10,000

Note : Business Loss in Country "Y" not eligible for set off against other incomes as per law of that country.

The rates of tax in Country "X" and Country "Y" are 10% and 25% respectively.

Compute total income and tax payable by Mr. Kamesh in India for Assessment Year 2015-16.

(b) Books of account and certain assets are found to be in possession of the person, whose premises are searched. What are the rebuttable presumptions regarding those items ? **3**

Marks

(c) Mr. Ram (age 56) is Karta of his HUF. The HUF consists of himself, his wife and two sons viz. Mr. C (age 28) and Minor D (age 16). The HUF is assessed to income tax and has business income from the year 2000-01 onwards. The business income of HUF for the year ended 31.3.2015 is ₹ 5,00,000 (computed). Mr. Ram is employed in a private company and his salary income for the same period is ₹ 6,10,000 (computed). **6**

You are requested to answer the following treating each of them as independent situations :

(i) Mr. C gave cash gift of ₹ 1,00,000 to the HUF of Mr. Ram. What would be the total income of HUF ?

(ii) The HUF has one house property fetching rent of ₹ 10,000 per month and some movable assets. There is a proposal to make a partial partition of HUF by allotting the house property to Mr. C. Is it advisable to do a partial partition ?

(iii) Minor D earned ₹ 70,000 by use of his special skill and talent. How would his income be taxed ?

(iv) A Car owned personally by Mr. Ram was blended with HUF during the year. It was leased out for a monthly rent of ₹ 10,000 from 1-10-2014. How would this income be taxed ?

Marks

7. (a) Can Commissioner (Appeals) refuse to admit an appeal even though such appeal is filed within time ? 3

(b) Mr. Madhusudan is regular in deducting tax at source and depositing the same. In respect of the quarter ended 31st December, 2014 a sum of ₹ 75,000 was deducted at source from the contractors. The statement of tax deducted at source under Section 200 was filed on 23rd March, 2015 for the quarter ended 31.12.2014. 6

(i) Is there any delay on the part of Mr. Madhusudan in filing the statement of TDS ?

(ii) If the answer to (i) above is in the affirmative, how much amount can be levied on Mr. Madhusudan for such default under section 234 E ?

(iii) Is there any remedy available to him for reduction/waiver of the levy ?

(c) Smt. Vijaya, proprietor of Lakshmi Enterprises, made turnover exceeding ₹ 100 lakhs during the previous year 2013-14. Her turnover for the year ended 31-3-2015 was ₹ 90 lakhs. 4

Decide whether provisions relating to deduction of tax at source are attracted for the following payments made during the financial year 2014-15 :

(i) Purchase commission paid to one agent ₹ 25,000 towards purchases made during the year.

(ii) Payments to Civil engineer of ₹ 5,00,000 for construction of residential house for self use.

(d) Explain the powers of Settlement Commission to amend its order. 3
