Test Series: March, 2018

MOCK TEST PAPER

FINAL (OLD) COURSE: GROUP – II

PAPER – 7: DIRECT TAX LAWS

*Question **1** is compulsory*

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

Working Notes should form part of the answer. Wherever necessary, suitable assumptions may be made by the candidates and disclosed by way of a note.

All questions relate to Assessment Year 2018-19, unless stated otherwise in the question.

Total Marks: 100 Marks **Time Allowed: 3 Hours**

1. (a) Samrat Ltd. has an undertaking (Unit-A) in Special Economic Zone (SEZ) and another undertaking (Unit- B) in Free Trade Zone (FTZ) for developing computer software. It furnishes the following particulars for its 3rd year of operations ended on 31st March, 2018:

	Unit A ₹ (In lacs)	**Unit B** ₹ (In lacs)
Total Sales:	150	100
Export Sales :	125	10
(Inclusive of ₹ 15 lacs for onsite development of computer software outside India by Unit A)		
Profit earned	54	36
[After claim of bad debts under section 36(1)(vii) in Unit A]		

Plant and machinery acquired and installed in the 1st year of operation has been depreciated at 15% on straight line method (SLM) basis and depreciation of ₹ 9 lacs was charged to profit and loss account in the proportion of sales during the previous year.

₹ 100 lacs were realized out of export sales in time and balance of ₹ 25 lacs becomes irrecoverable due to bankruptcy of one of the foreign buyers in Unit-A.

Compute the deduction under section 10AA of the Income-tax Act, 1961 and total income of Samrat Ltd. for the Assessment Year 2018-19. Ignore additional depreciation, if applicable. ***(10 Marks)***

(b) Superb Tyres & Tubes (P) Ltd, Delhi was incorporated on 30.07.2017 for manufacture of tyres and tubes for motor vehicles. The company commenced its manufacturing operations on 01.09.2017. The total cost of the plant and machinery installed is ₹ 120 lakhs. The said plant and machinery included second hand plant and machinery bought for ₹ 25 lakhs and new plant and machinery for scientific research relating to the business of the assessee acquired at a cost of ₹15 lakhs.

Compute the amount of depreciation allowable under section 32 of the Income-tax Act, 1961 in respect of the assessment year 2018-19 assuming assets acquired by making payment through account payee cheque. Furnish explanations in support of your computation. ***(4 Marks)***

(c) ABC Limited has two units. Unit I is engaged in manufacture of television and Unit II is involved in manufacturing of Air conditioner. As a restructuring drive, the company has decided to sell its Unit II as a going concern by way of slump sale for ₹ 385 lacs to a new company called D Limited, in which it holds 76% equity shares.

The balance sheet of ABC limited as on 31st March 2018, being the date on which Unit II has been transferred, is given hereunder –

Balance Sheet as on 31.3.2018

Liabilities	₹ (in lacs)	Assets	₹ (in lacs)
Paid up Share Capital	300	Fixed Assets	
General Reserve	150	Unit I	170
Share Premium	50	Unit II	200
Revaluation Reserve	120	Debtors	
Current Liabilities		Unit I	140
Unit I	40	Unit II	110
Unit II	90	Inventories	
		Unit I	95
		Unit II	35
	750		**750**

Following additional information are furnished by the management:

(1) The Unit II is in existence since July, 2014.

(2) Fixed assets of Unit II includes land which was purchased at ₹ 50 lacs in the year 2008 and revalued at ₹ 75 lacs as on March 31, 2018.

(3) Fixed assets of Unit II mirrored at ₹ 125 lacs (₹ 200 lacs minus land value ₹ 75 lacs) is written down value of depreciable assets as per books of account. However, the written down value of these assets under section 43(6) of the Income-tax Act, 1961 is ₹ 80 lacs.

Ascertain the tax liability, which would arise from slump sale to ABC Limited. ***(6 Marks)***

2. Organic Ltd., engaged in the business of manufacturing, shows a net profit of ₹ 450 lakhs from its profit and loss account for the year ended 31-03-2018 after debiting and crediting the following items:

(i) Depreciation provided in accounts as per straight line basis ₹ 30 lakhs.

(ii) The company has made cash payments for purchases and expenditure as below:

On 20-07-2017 ₹ 5.5 lakhs (for purchase of agricultural produce)

On 17-01-2018 ₹ 6 lakhs (Due to cash demanded by the supplier)

On 01-04-2017 ₹ 12 lakhs (a bank holiday)

Cash payments made to transport operator for hiring of lorry are as follows:

10-06-2017 ₹ 25,000; 25-08-2017 ₹ 70,000; 10-02-2018 ₹ 40,000.

(iii) ₹ 10 lakhs paid to Kaira Ltd., towards feasibility study conducted for examining proposals for technological advancement relating to the existing business. The project was abandoned later.

(iv) It incurred revenue expenditure of ₹ 7.5 lakhs towards scientific research on in-house approved research and development facility under section 35(2AB).

(v) Dividend received from a foreign company ₹ 6 lakhs, in which Organic Ltd. holds 30% in nominal value of equity share capital of the company. ₹ 50,000 spent on earning this income.

(vi) Professional charges to a consultant including GST shown separately was ₹ 2,95,000. Tax was not deducted on the GST portion on the payment.

(vii) The company has also purchased goods of ₹ 55 lakhs from M/s. ABC Ltd. in which Directors have substantial interest. The market value of the goods is ₹ 50 lakhs.

(viii) Employer's contribution of ₹ 3.5 lakhs and Employee's contribution of ₹ 3.5 lakhs to the Provident Fund for the month of March, 2018 were remitted on 14th August, 2018.

(ix) It paid ₹ 75,000 to an electoral trust by cash and ₹ 1,25,000 by cheque to a registered political party. Both these are debited to Profit and Loss Account.

Additional information

(1) Depreciation allowable as per the Income-tax Rules, 1962 is ₹ 48 lakhs.

(2) There was a purchase of second hand machinery of ₹ 50 lakhs on 23.10.2017 by a bearer cheque in single payment. Depreciation on such plant and machinery has not been included in amount of depreciation provided in (1).

(3) Out of an amount of ₹ 3 lakhs written off in the F.Y. 2013-14 as irrevocable from a debtor; ₹ 1.5 lakhs was recovered on 19-9-2017 and credited to a reserve account.

Compute the total income of Organic Ltd. for the Assessment Year 2018-19 indicating in brief, the reason for treatment of each item. Ignore the provisions relating to minimum alternate tax. ***(16 Marks)***

3. (a) Mr. Ram purchased a plot of land in Chennai in August 2006 for ₹ 50 lakhs. He decided to sell the land to Mr. Mathur for ₹ 85 lakhs and received an advance of ₹ 2 lakhs in October, 2010. Mr. Mathur was unable to complete the agreement and hence, the entire advance was forfeited by Mr. Ram.

Again Mr. Ram entered into an agreement to sell the land to Mr. Shyam for ₹ 90 lakhs and received advance money of ₹ 2.50 lakhs in June, 2017. But again the transfer did not materialise due to which the advance money was again forfeited.

On 10th February, 2018, the land was finally sold to Ms. Meera for ₹ 115 lakhs and the stamp duty value on that date was ₹ 170 lakhs. During financial year 2017-18, Mr. Ram earned business income of ₹ 30 lakhs.

He acquired a new residential property for ₹ 130 lakhs by investing entire sale consideration and his business income.

Determine the total income and tax payable by Mr. Ram for the assessment year 2018-19.

Cost inflation index are:

Financial year	Cost inflation index	
2005-06	117	
2009-10	148	
2017-18	272	***(8 Marks)***

(b) Mr. Sujit was a partner in a firm, representing his HUF, holding 30% of the share in the firm. His wife Anjali, a house lady, was admitted in her individual capacity in the firm for 30% share. She was paid remuneration which has been proposed by the Assessing Officer to be clubbed in the hands of Sujit-HUF by invoking section 64 of the Act. Examine the validity of the Assessing Officer's action. ***(4 Marks)***

(c) The following information pertains to Mr. John, a non-resident Indian for the previous year 2017-18:

	Particulars	**₹**	**₹**
(i)	Interest on debentures of MNO Ltd. (subscribed in convertible foreign exchange)	1,20,000	
	Less: Interest on loan taken for purchase of debentures	20,000	1,00,000
(ii)	Long-term capital gains on sale of debentures subscribed in convertible foreign currency:		
	Purchase on 10th June, 2004	4,50,000	
	Sale on 15th March 2018	6,25,000	
		1,75,000	
	Less: Commission to brokers	7,000	1,68,000
(iii)	Re-investment the sale proceed for purchase of shares of ABC Ltd. on 30th April, 2018		4,50,000

Cost Inflation Index: F.Y. 2004-05 - 113; F.Y.2017-18 – 272.

Compute the amount of tax payable by Mr. john for Assessment Year 2018-19, if he opts for the provisions of Chapter XII-A of the Income-tax Act, 1961. Ignore the effect of first proviso to section 48. ***(4 Marks)***

4. (a) Kumar & Co., a partnership firm consisting of three partners, enhanced working partner salary from ₹ 30,000 per month for each partner to ₹ 55,000 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 @ ₹ 55,000 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. ***(4 Marks)***

(b) Shikhar Ltd., engaged in the business of owning, operating and managing hotels, allowed the employees to receive tips from the customers, by virtue of their employment. The tips were also collected directly by the hotel-company from the customers, when payment was made by them through credit cards. The hotel-company thereafter disbursed the tips to the employees. The Assessing Officer treated the receipt of the tips as income under the head "Salary" in the hands of the various employees and held that the company was liable to deduct tax at source from such payments under section 192. Since the company had not deducted tax at source on such payments, the Assessing Officer treated the company as an assessee-in-default under section 201(1). Discuss the correctness of the action of the Assessing Officer. ***(4 Marks)***

(c) SD & Co. a partnership firm, was dissolved and as per dissolution deed of the partnership firm, with effect from 17th August, 2017. Sanjay, one of the partners of erstwhile firm took over the entire business of the partnership firm in his individual capacity including fixed assets, current assets and liabilities and the other partners was paid his dues. He then continued the business as a sole proprietor with effect from that date. The assessee, relying on section 78(2), claimed the set-off of the losses suffered by the erstwhile partnership firm against his income earned as an individual proprietor, considering the case as a inheritance of business. The claim of the assesse was disallowed by the Assessing Officer.

Examine the correctness of the action of the Assessing Officer. ***(4 Marks)***

(d) A Ltd. has two divisions, division X and division Y. It has transferred division X to ABC Ltd. pursuant to a scheme of demerger which satisfies the conditions of section 2(19AA). A Ltd. had a debt of ₹ 5 lakhs in division X which stood transferred to ABC Ltd. The said debt has been written off as bad in the accounts of ABC Ltd. Can ABC Ltd. claim deduction on account of the bad debt?

(4 Marks)

5. (a) Indico Pvt. Ltd. is a domestic company in India. Den Pvt. Ltd. is a company incorporated in Country 'X' and it is a non-resident in India. Den Pvt. Ltd. forms a company Zen Pvt. Ltd, its 100% subsidiary, in Country 'Y'. Zen Pvt. Ltd. and Indico Pvt. Ltd. form a joint venture company Revolution (P) Ltd. in India on 10.04.2017. There is no other activity in Zen Pvt. Ltd. As per the joint venture agreement, 49% of Revolution (P) Ltd's equity is allotted to Zen Pvt. Ltd. and 51% is allotted to Indico Pvt. Ltd.

Zen Pvt. Ltd. is also designated as a permitted transferee of Den Pvt. Ltd. Permitted transferee means that though shares of Revolution (P) Ltd. are held by Zen Pvt. Ltd, all rights of voting, management, right to sell etc., are vested in Den Pvt. Ltd.

On 28.02.2018, the shares of Revolution (P) Ltd. held by Zen Pvt. Ltd. are sold to C Pvt. Ltd., a company connected to the Indico Pvt. Ltd. group. The India-Country 'Y' tax treaty provides for non-taxation of capital gains in the Source Country and Country 'Y' charges no capital gains tax in its domestic law. So, as per the tax treaty with Country 'Y', capital gains arising to Zen Pvt. Ltd. are not taxable in India.

Examine, whether General Anti-Avoidance Rules (GAAR) can be invoked to deny the treaty benefit assuming that the other conditions prescribed for application of GAAR are satisfied. ***(4 Marks)***

(b) Examine the correctness or otherwise of the following with reference to the provisions of the Income-tax Act, 1961.

(i) Commissioner (Appeals) has no power to decide a matter that was not raised before him.

(ii) The Income-tax Appellate Tribunal cannot amend its orders.

(iii) A case before the Appellate Tribunal cannot be dealt when there is a difference of opinion amongst the members of the Bench. ***(6 Marks)***

(c) RIDA Inc., a German Company, holds 45% of equity in Info tech Ltd., an Indian Company. Info tech Ltd. is engaged in development of software and maintenance of the same for customers across the globe. Its clientele includes RIDA Inc.

During the financial year 2017-18, Info tech Ltd. had spent 1500 man hours for developing and maintaining software for RIDA Inc. with each hour being billed at ₹ 2,500. Cost incurred by Info tech Ltd. for executing work for RIDA Inc. amounts to ₹ 25 lakhs.

Info tech Ltd. had also undertaken developing software for Mira Industries, for which Info tech Ltd. had billed at ₹ 2,700 per man hour. The persons working for Mira Industries and RIDA Inc. were part of the same team and were of matching credentials and calibre. Info tech Ltd. made a gross profit of 50% on Mira Industries work. Info tech Ltd.'s transactions with RIDA Inc. are comparable to transactions with Mira Industries, subject to the following differences:

(i) RIDA Inc. gives technical knowhow support to Info tech Ltd., which can be valued at 10% of the normal gross profit. Mira Industries does not provide any such support.

(ii) Since the work for RIDA Inc. involved huge number of man hours, a quantity discount of 15% of normal gross profits was given.

(iii) Info tech Ltd. had offered 90 days credit to RIDA Inc., the cost of which is measured at 5% of the normal billing rate. No such discount was offered to Mira Industries.

Compute arm's length price as per cost plus method and the amount of increase in total income of Info tech Ltd. ***(6 Marks)***

6. (a) "Noorie", a resident of India, owned for the financial year ended on 31-03-2018, a house property in Australia purchased in July, 2008; a shop in London purchased in June, 2009 and space in a commercial complex in Dubai purchased in April, 2015. She is also having authority to operate the bank account (maintained with Citibank, Australia) of a company owned by her daughter and son-in-law since August, 2016.

She has been served in July, 2018 with the notices issued under section 148 of the Act for assessment years 2007-08 to 2017-18. She, for the reason of challenging the action of the Assessing Officer for issuing notices under section 148 for last 11 years, seeks your opinion. Advise her suitably. ***(4 Marks)***

(b) The Assessing Officer issued notices under section 133 to four banks requiring particulars relating to a customer in a specific format duly verified in a prescribed manner. One of the banks refused to part with the information on the ground that the letter did not specify about any proceeding pending against the said customer under the Income-tax Act, 1961. Discuss the correctness of action of the bank in refusing to furnish the particulars as required by the Assessing Officer.

(4 Marks)

(c) Explain the circumstances under which the Assessing Officer can resort to provisional attachment of the property of the assessee. Also state the period of time for which such attachment can take place.

When can the Assessing Officer revoke provisional assessment of property? Discuss. ***(5 Marks)***

(d) The Assessing Officer lodged a complaint against M/s Emerald, a firm, under section 276CC of the Income-tax Act 1961 for failure to furnish its return of income for the A.Y.2018-19 within the due date under section 139(1). The tax payable on the assessed income, as reduced by the advance tax paid and tax deducted at source, was ₹ 60,000. The appeal filed by the firm against the order of assessment was allowed by the Commissioner (Appeals). The Assessing Officer passed an order giving effect to the order of the Commissioner (Appeals). The tax payable by the firm as per the said order of the Assessing Officer was ₹ 1,000. The Assessing Officer has accepted the order of the Commissioner (Appeals) and has not referred an appeal against it to the Income-tax Appellate Tribunal. The firm desires to know about the maintainability of the prosecution proceeding in the facts and circumstances of the case.

Advise the firm suitably. ***(3 Marks)***

7. (a) Purchase commission of ₹ 25,000 was paid to Mr. Kashi, an agent, on 11th August, 2017 by Mac Ltd. towards purchase made from him without deducting tax at source. Later on, a further commission of ₹ 55,000 was due to him on 31st January, 2018 from which tax of ₹ 4,000 was deducted at source. The tax so deducted was deposited on 25th August, 2018. Compute the amount of interest chargeable under section 201(1A). ***(4 Marks)***

(b) ABC Ltd. failed to deduct tax at source under section 194J in respect of fees for professional services paid by it. The Assessing Officer levied penalty under section 271C for failure to deduct tax at source. In addition, the Assessing Officer also levied penalty under section 272A(2)(c) for failure to furnish return under section 206 and under section 272A(2)(g) for failure to furnish certificate of tax deducted at source as per the requirement of section 203. Is the action of the Assessing Officer correct in law? ***(4 Marks)***

(c) Thirsty Drink Inc. of UK entered into contracts with three Indian companies namely Thumbs Up Ltd., Pepsi Co. Ltd. and Coca Cola Ltd. for supplying know-how. Thirsty Drink Inc. made an application to the Authority for Advance Rulings (AAR) on the rate of withholding tax on receipts applicable to it.

Also, Thumbs Up Ltd. also made an application to the Assessing Officer for determination of the rate at which tax is deductible on the payment made to non-resident company i.e., Thirsty Drink Inc. The Authority for Advance Rulings (AAR) rejected the application of Thirsty Drink Inc. on the ground that the question raised in the application is already pending before an Income-tax authority.

Examine whether the rejection of application by the AAR is justified in justified in law? ***(3 Marks)***

(d) The Income-tax Act, 1961 provides for taxation of a certain income earned by Mr. Sahu. The Double Taxation Avoidance Agreement, which applies to Mr. Sahu, excludes the income earned by Mr. Sahu from the purview of tax. Is Mr. Sahu liable to pay tax on the income earned by him? Examine.

(5 Marks)