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CA FINAL NOV'19

SUBJECT- DIRECT TAX

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BRANCH - () (Date :)

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ANSWER-1**Computation of Income of Pingu Trading Pvt. Ltd. chargeable to tax for the A.Y.2019-20**

| Particulars | Rs. |
|--|-----------|
| Net profit as per profit and loss account | 33,90,000 |
| Add: Difference in the value of stocks detected on survey under section 133A on 31.03.2019 chargeable as income (See Note 1) | 3,75,000 |
| | 37,65,000 |
| Less: Income-tax refund credited in the profit and loss account, out of which interest is to be considered separately under the head "Income from other sources" | 20,000 |
| | 37,45,000 |
| Add: Expenses either not allowable or to be considered separately but charged in the profit & loss account | |
| Repair expenses on rented premises where assessee is under no obligation to incur such expenses are not allowable as per section 30(a)(i). However, if such expenses are required for carrying on the business efficiently, the same are allowable under section 37. In this case, assuming that such expenses are required for carrying on business efficiently, the same are allowable under section 37. | - |
| Advertisement in the souvenir of political party not allowable as per section 37(2B) (See Note 3) | 2,500 |
| Payment made to the wife of a director examined as per section 40A(2) and the excess payment made to be disallowed (See Note 5) | 75,000 |
| Payment made to electoral trust by cheque (See Note 6) | 1,00,000 |
| Penalty levied by the Goods and Services tax department for delayed filing of returns not allowable as being paid for infraction of law (See Note 7) | 5,300 |
| Depreciation as per books | 71,500 |
| 30% of interest paid on loan without deduction of tax at source not allowable as per section 40(a)(ia) | 24,000 |

| | | |
|--------------|---|---------------------------|
| | | 40,23,300 |
| Less: | Depreciation allowable as per Income-tax Act, 1961 | 65,000 |
| | | 39,58,300 |
| Less: | Income from specified business (warehousing charges) credited to profit and loss account, to be considered separately (See Note 8) | 15,00,000 |
| | Income from business (other than specified business) | 24,58,300 |
| | Computation of income/ loss from specified business (See Note 8) | |
| | Income from specified business | Rs. 15,00,000 |
| Less: | Deduction under section 35AD @ 100% of Rs.25 lakhs | Rs. 25,00,000 |
| | Loss from specified business to be carried forward as per section 73A | Rs. (10,00,000) |
| | Income from Other Sources | |
| | Interest on income-tax refund | 4,570 |
| | Gross Total Income | 24,62,870 |
| Less: | Deduction under section 80GGB | |
| | Contribution to political party (See Note 3) | Rs. 2,500 |
| | Contribution to an Electoral trust (See Note 3) | Rs. 1,00,000 |
| | Total Income | 23,60,370 |

(8 MARKS)

Notes:

- (1) The business premises were surveyed and differences in the figures of opening and closing stocks and sales were found which have not been disputed and accepted by the assessee. Therefore, the trading account for the year is to be re-cast to arrive at the correct amount of the gross profit/ net profit for the purpose of return of income to be filed for the previous year ended on 31.3.2019.

Revised Trading Account

| Particular | Rs. | Particular | Rs. |
|---------------------|--------------------|-------------------------------|--------------------|
| Opening Stock | 8,75,000 | Sales | 1,56,25,000 |
| | | (Rs. 1,55,50,000 +Rs. 75,000) | |
| Purchases | 1,25,75,000 | Closing Stock | 12,50,000 |
| Freight and Cartage | 1,26,000 | | |
| Gross Profit | 32,99,000 | | |
| | 1,68,75,000 | | 1,68,75,000 |

The difference of gross profit of Rs. 32,99,000 - Rs. 29,24,000 = Rs. 3,75,000 is to be added as income of the business for the year.

- (2) Bonus for the previous year 2017-18 paid after the due date for filing return for that year would have been disallowed under section 43B for the P.Y.2017-18. However, when the same has been paid in December 2018, it should be allowed as deduction in the P.Y.2018-19 (A.Y.2019-20). Since it is already included in the figure of bonus to staff debited to profit and loss account of this year, no further adjustment is required.
- (3) The amount of Rs. 2,500 paid for advertisement in the souvenir issued by a political party attracts disallowance under section 37(2B). However, such expenditure falls within the meaning assigned to "contribute" under section 293A of the Companies Act, 1956, and is hence, eligible for deduction under section 80GGB. Any contribution to the political party or electoral trust made by way of cash is not allowed as deduction under section 80GGB. Since in the present case, the payment to the political party is made by way of an account payee cheque, it is allowed as deduction under section 80GGB.
- (4) The penalty of Rs. 15,000 paid for non-fulfilment of delivery conditions of a contract for reasons beyond control is not for the breach of law but was paid for breach of contractual obligations and therefore, is an allowable expense.
- (5) It has been assumed that Rs. 25,000 is the reasonable payment for the wife of Director, working as a junior lawyer, since junior advocates of High Courts normally charge only Rs. 25,000 for the same opinion and therefore, the balance Rs. 75,000 has been disallowed.
- (6) Payment to an electoral trust qualifies for deduction under section 80GGB since the payment is made by way of a cheque. However, since the amount has been debited to profit and loss account, the same has to be added back for computing business income.
- (7) The interest of Rs. 12,750 paid on the delayed deposit of goods and services tax is for breach of contract and hence, is allowable as deduction. However, penalty of Rs. 5,300 for delay in filing of returns is not allowable since it is for breach of law.

(8) Deduction @ 100% of the capital expenditure is available under section 35AD in respect of specified business of setting up and operating a warehouse facility for storage of agricultural produce which commences operation on or after 1.04.2012. It is presumed that Rs. 25 lacs does not include expenditure on acquisition of any land.

The loss from specified business under section 35AD (warehousing) should be segregated from the income from other businesses, since, as per section 73A(1), any loss computed in respect of any specified business referred to in section 35AD shall not be set off except against profits and gains, if any, of any other specified business.

In view of the provisions of section 73A(1), the loss of Rs. 10 lacs from the specified business cannot be set-off against income from other businesses. Such loss has to be carried forward to be set-off against profit from specified business in the next assessment year. The return should be filed on or before the due date under section 139(1) for carry forward of such losses.

(8 MARKS)

ANSWER-2

ANSWER-A

Determination of net worth of Unit B of M/s. J.B. Opticals Ltd.

| | Rs. (in lacs) |
|------------------------------------|---------------|
| Written down value of fixed assets | 120 |
| Debtors | 75 |
| Stock-in-trade | 25 |
| | 220 |
| Less : Liabilities | 50 |
| Net worth | 170 |

(2 MARKS)

Comparative calculation of chargeable capital gains

| | Sale before 31.3.2019 | Sale after 31.03.2019 |
|-------------------------|--------------------------|-----------------------|
| Sale consideration | 2,25,00,000 | 2,25,00,000 |
| Less: Discount | 2,25,000 | Nil |
| Net sale consideration | 2,22,75,000 | 2,25,00,000 |
| Less: Net worth | 1,70,00,000 | 1,70,00,000 |
| Short term capital gain | 52,75,000 | N.A. |
| Long term capital gain | N.A. | 55,00,000 |
| Tax rate | 31.2% | 20.8% |
| Tax thereon | 16,45,800 | 11,44,000 |

(4 MARKS)

Computation of Net Cash flow

| | Sale before 31.3.2019 | Sale after 31.03.2019 |
|------------------------|--------------------------|-----------------------|
| Net sale consideration | 2,22,75,000 | 2,25,00,000 |
| Less: Income-tax | 16,45,800 | 11,44,000 |
| Net Cash flow | 2,06,29,200 | 2,13,56,000 |

Note: The assessee is advised to effect slump sale after 31.03.2019 as the tax liability arising out of long term capital gains is less than the tax liability arising on short term capital gains and the net cash flow is also higher, if Unit B is transferred after 31.03.2019.

(2 MARKS)

ANSWER-B

Computation of total income of Mr. Prem for A.Y.2019-20

| Particulars | Rs. (in lakhs) | |
|---|----------------|--------------|
| Profits and gains of business or profession | | |
| Profits and gains from the specified business of setting up a warehousing facility for storage of food grains and sugar <i>[See Working Note below]</i> | | 60.00 |
| Profit from business of setting up of warehouse for storage of edible oil (before providing for depreciation under section 32) | 30.00 | |
| Less: Depreciation under section 32 | | |
| 10% of Rs. 40 lakh, being (Rs. 75 lakh – Rs. 45 lakh + Rs. 10 lakh) | 4.00 | 26.00 |
| Total Income | | 86.00 |

Computation of tax liability for A.Y.2019-20

| Particulars | Rs. in lakhs |
|--|---------------|
| Tax liability under the normal provisions of the Income-tax Act, 1961 [30% of Rs. 76 lakhs (Rs. 86 lakhs – Rs. 10 lakhs) + Rs.1,12,500] | 23.93 |
| <i>Add:</i> Surcharge @10% (Since total income > Rs. 50 lakhs but does not exceed Rs. 1 crore) | 2.39 |
| | 26.32 |
| <i>Add:</i> Health and education cess @4% | 1.05 |
| Total tax liability | 27.37 |
| Adjusted Total Income | Rs. in lakhs |
| Total Income | 86.00 |
| <i>Add:</i> Deduction under section 35AD [See Working Note below] | 125.00 |
| <i>Less:</i> Depreciation under section 32 [10% of Rs. 125 lakh] | 12.50 |
| Adjusted Total Income | 198.50 |
| AMT@18.5% | 36.72 |
| <i>Add:</i> Surcharge@15% (Since adjusted total income > Rs.1 crore) | 5.51 |
| | 42.23 |
| <i>Add:</i> Health and Education cess @4% | 1.69 |
| Tax liability under section 115JC | 43.92 |
| <p>Since the regular income-tax payable is less than the AMT payable, the adjusted total income of Rs. 198.50 lakhs shall be deemed to be the total income of Mr. Prem and tax is payable @18.5% thereof <i>plus</i> surcharge@15% (since adjusted total income exceeds Rs. 1 crore) <i>plus</i> cess@4%. Therefore, the tax liability is Rs. 43.92 lakhs.</p> | |
| AMT Credit to be carried forward under section 115JD | |
| Tax liability under section 115JC | 43.92 |
| <i>Less:</i> Tax liability under the regular provisions of the Income-tax Act, 1961 | 27.37 |
| | 16.55 |

Working Note:

Computation of income from specified business under section 35AD

| | Particulars | Food Grains | Sugar | Total |
|-----|---|----------------|--------------|---------------|
| | | Rs. (in lakhs) | | |
| (A) | Profits from the specified business of setting up a warehousing facility (before providing deduction under section 35AD) Less: Deduction under section 35AD | 125.00 | 60.00 | 185.00 |
| (B) | Capital expenditure incurred prior to 1.4.2018 (i.e., prior to commencement of business) and capitalized in the books of account as on 1.4.2018 (excluding the expenditure incurred on acquisition of land) = Rs.45 lakh (Rs.120 lakh– Rs. 75 lakh) and Rs.30 lakh (Rs.90 lakh– Rs.60 lakh) | 45.00 | 30.00 | 75.00 |
| (C) | Capital expenditure incurred during the P.Y.2018-19 | 30.00 | 20.00 | 50.00 |
| (D) | Total capital expenditure (B + C) | 75.00 | 50.00 | 125.00 |
| (E) | Deduction under section 35AD 100% of capital expenditure | 75.00 | 50.00 | 125.00 |
| (F) | Profits from specified business of setting up and operating a warehousing facility for storage of food grains and sugar (A-E) | 50.00 | 10.00 | 60.00 |

Notes:

- (i) Deduction of 100% of the capital expenditure is available under section 35AD for A.Y.2019-20 in respect of specified business of setting up and operating a warehousing facility for storage of food grains and sugar.
- (ii) Since setting up and operating a warehousing facility for storage of edible oil is not a specified business, Mr. Prem is not eligible for deduction under section 35AD in respect of capital expenditure incurred for such business. Mr. Prem can, however, claim depreciation@10% under section 32 in respect of the capital expenditure incurred on buildings. It is presumed that the buildings were put to use for more than 180 days during the P.Y.2018-19.

(6 MARKS)

ANSWER-3**Computation of total income of Rhombus(P) Ltd. for the A.Y. 2019-20**

| Particulars | Rs. | Rs. |
|--|-----------------|-----------|
| Income from House Property (Note 1) | | |
| Gross Annual Value (GAV) (Rental income has been taken as GAV in the absence of other information) [Rs. 50,000 x 12] | 6,00,000 | |
| Less: Municipal taxes (not deductible since it has not been paid) | <u>Nil</u> | |
| Net Annual Value (NAV) | 6,00,000 | |
| Less: Deduction under section 24 (30% of NAV) | 1,80,000 | 4,20,000 |
| Profits and gains of business or profession | | |
| Net profit as per profit and loss account | 2,10,00,000 | |
| <i>Add:</i> Licence fee for obtaining franchise (Note 2) | 32,00,000 | |
| Municipal taxes in respect of let-out part of office premises (Note 1) | 8,000 | |
| Contribution to approved and notified scientific research association (treated separately) (Note 4) | 1,00,000 | |
| Loss due to destruction of machinery by fire (Note 5) | 2,00,000 | |
| Amount paid to contractor without deduction of tax at source [Rs.5 lakhs x 30%] (Note 6) | 1,50,000 | |
| Short-term capital loss on sale of shares of Gama Ltd. | 20,000 | |
| (Note 7) | | |
| Depreciation on tangible fixed assets (Note 8) | <u>2,20,000</u> | |
| | 2,48,98,000 | |
| <i>Less:</i> <u>Depreciation under section 32 (Note 8)</u> | | |
| Tangible fixed assets (Note 8) | 2,60,000 | |
| Intangible asset (Franchise) 25% of Rs. 32,00,000 (Note 2) | <u>8,00,000</u> | 10,60,000 |

| | | |
|--|---------------|---------------------------|
| <u>Weighted deduction under section 35(1)(ii) (Note 4)</u> | | |
| Rs. 1,00,000 x 150% (Contribution of scientific research association) | 1,50,000 | |
| Rental income to be taxed under "Income from house property" (Note 1) | 6,00,000 | |
| Dividend credited to profit and loss account to be excluded (Note 7) | <u>10,000</u> | 2,30,78,000 |
| <u>Capital Gains (Note 7)</u> | | |
| Short-term capital loss (Rs. 20 x 1000 shares) | 20,000 | |
| Less: Dividend exempt under section 10(34) | <u>10,000</u> | |
| Short-term capital loss to be carried forward to A.Y. 2020-21 | <u>10,000</u> | |
| <u>Income from Other Sources (Note 9)</u> | | |
| Deemed dividend under section 2(22)(e) subject to DDT in the hands of Theta (P) Ltd. | | <u>-</u> |
| Total Income | | <u>2,34,98,000</u> |

(10 MARKS)

Notes:

- (1) Rental income from letting out a part of the office premises is taxable under "Income from house property". Therefore, it has to be deducted while calculating business income, since the income has been credited to profit and loss account. Likewise, municipal taxes due in respect of such property, debited to profit and loss account has to be added back to compute business income.
- (2) Franchise is an intangible asset eligible for depreciation @ 25%. Since one-time licence fees of Rs. 32 lakh paid for obtaining franchise has been debited to profit and loss account, the same has to be added back. Depreciation @ 25% has to be provided in respect of the intangible asset since it has been used for more than 180 days during the year.
- (3) Rs. 32,000 paid to Beta & Co., a goods transport operator in cash is deductible while computing business income, as the limit for disallowance under section 40A(3) would be attracted in case of payment to a transport contractor only when it exceeds Rs. 35,000. Since it is already debited to profit and loss account, no further adjustment is required.

- (4) Contribution to a scientific research association approved and notified under section 35(1)(ii) is eligible for a weighted deduction of 150%. Therefore, the contribution of Rs. 1,00,000 debited to profit and loss account has been added back and Rs. 1,50,000 (being 150% of Rs. 1,00,000) has been deducted while computing business income.
- (5) Loss of Rs. 2 lakh due to destruction of machinery caused by fire is not deductible since it is capital in nature.
- (6) Payment to contractor without deduction of tax at source would attract disallowance at 30% of the expenditure under section 40(a)(ia).
- (7) As per section 94(7), where any person buys any shares within 3 months prior to the record date and sells such shares within 3 months after such date and the dividend received on such shares is exempt, then, the loss arising out of such purchase and sale of shares shall be ignored to the extent of dividend income.

| | Rs. |
|---|---------------|
| Loss on sale of shares (Rs. 100 - Rs. 80) x 1000 shares | 20,000 |
| <i>Less: Dividend exempt under section 10(34)</i> | <u>10,000</u> |
| Short-term capital loss | <u>10,000</u> |

Since short term capital loss can be set-off only against income under the head "Capital Gains", the short-term capital loss of Rs. 10,000 has to be carried forward to the next year. Dividend of Rs. 10,000 credited to profit and loss account has to be deducted and short-term capital loss of Rs. 20,000 debited to profit and loss account has to be added back.

- (8) Depreciation as per Income-tax Rules, 1962, is deductible while calculating business income. Therefore, Rs. 2.60 lakh depreciation on tangible fixed assets and Rs. 8 lakh on intangible assets is deducted. The amount of Rs. 2.20 lakh depreciation debited to profit and loss account as per books of account has been added back.
- (9) As per section 2(22)(e), any payment by a company in which the public are not substantially interested by way of loan to a shareholder, who is the beneficial owner of shares holding not less than 10% of voting power, is deemed as dividend to the extent to which to company possesses accumulated profits. Accordingly, in this case, Rs. 50,000 would be deemed as dividend under section 2(22)(e) and subject to dividend distribution tax @30% (plus surcharge @12% and health and education cess @4%) in the hands of Theta (P) Ltd. Hence, such dividend is exempt in the hands of Rhombus (P) Ltd. under section 10(34).

ANSWER-4

1. A
2. D
3. A
4. C
5. B
6. A
7. C
8. B