



IPCC – November 2017

DIRECT TAXATION

Test Code – 80107

Branch (MULTIPLE) (Date : 17.09.2017)

(50 Marks)

Note: All questions are compulsory.

Question 1(4 marks)

Since the unrealised rent was recovered in the P.Y.2016 -17, the same would be taxable in the A.Y.2017-18 under section 25A, irrespective of the fact that Mr. Aakarsh was not the owner of the house in that year. Further, the arrears of rent was also received in the P.Y.2016-17, and hence the same would also be taxable in the A.Y.2017-18 under section 25A, even though Mr. Aakarsh was not the owner of the house in that year. Both unrealised rent and arrears of rent would be taxable under the head "Income from house property". A deduction of 30% of unrealised rent recovered and arrears of rent would be allowed while computing income from house property of Mr. Aakarsh for A.Y.2017-18. **(2 marks)**

Computation of income from house property of Mr. Aakarsh for A.Y.2017-18

Particulars		
(i)	Unrealised rent recovered	17,000
(ii)	Arrears of rent received	<u>28,000</u>
		45,000
Less:	Deduction@30%	<u>13,500</u>
	Income from house property	<u>31,500</u>

(2 marks)

Question 2 (8 marks)

Computation of total income of Mr.Y for the A.Y. 2017-18 (3 Marks)

Particulars		
	Profits and gains of business or profession <i>(See Working Note 1 below)</i>	10,46,500
	Income from other sources <i>(See Working Note 2 below)</i>	<u>32,500</u>
	Gross Total Income	10,79,000
Less:	Deduction under section 80C (Investment in NSC)	<u>15,000</u>
	Total Income	<u>10,64,000</u>

Working Notes :

1. Computation of profits and gains of business or profession (4 Marks)

Particulars		
	Net profit as per profit and loss account	11,20,000

<i>Add:</i>	Expenses debited to profit and loss account but not allowable as deduction		
	Salary paid to brother disallowed to the extent considered unreasonable [Section 40A(2)]	2,500	
	Motor car expenses attributable to personal use not allowable (` 78,000 × ¼)	19,500	
	Depreciation debited in the books of account	55,000	
	Drawings (not allowable since it is personal in nature)	10,000	
	[See Note (iii)]		
	Investment in NSC [See Note (iii)]	<u>15,000</u>	<u>1,02,000</u>
			12,22,000
<i>Add:</i>	Under statement of closing stock		<u>12,000</u>
			12,34,000
<i>Less</i>	Under statement of opening stock		<u>8,000</u>
			12,26,000
<i>Less</i>	Contribution to a University approved and notified under section 35(1)(ii) is eligible for weighted deduction@175%. Since only the actual contribution (100%) has been debited to profit and loss account, the additional 75% has to be deducted.		<u>75,000</u>
			11,51,000
<i>Less</i>	Incomes credited to profit and loss account but not taxable as business income		
	Income from UTI [Exempt under section 10(35)]	22,000	
	Interest on debentures (taxable under the head “Income from other sources”)	17,500	
	Winnings from races (taxable under the head “Income from other sources”)	<u>15,000</u>	<u>54,500</u>
			10,96,500
<i>Less</i>	Depreciation allowable under the Income-tax Rules, 1962		<u>50,000</u>
			<u>10,46,500</u>

Notes :

- (i) Advertisement expenses of revenue nature, namely, gift of dry fruits to important customers, is incurred wholly and exclusively for business purposes. Hence, the same is allowable as deduction under section 37.
- (i) Disallowance under section 40A(3) is not attracted in respect of cash payment of ` 30,000 to A & Co., a goods transport operator, since, in case of payment made for plying, hiring or leasing goods carriages, an increased limit of ` 35,000 is applicable (i.e. payment of upto ` 35,000 can be made in cash without attracting disallowance under section 40A(3))

- (iii) Since drawings and investment in NSC have been given effect to in the profit and loss account, the same have to be added back to arrive at the business income.

2 Computation of "Income from other sources" (1 Mark)

Particulars	`
Interest on debentures	17,500
Winnings from races	<u>15,000</u>
	<u>32,500</u>

Note:

The following assumptions have been made in the above solution:

1. The figures of interest on debentures and winnings from races represent the gross income (i.e., amount received plus tax deducted at source).
2. In point no. 9 of the question, it has been given that depreciation as per Income-tax Rules, 1962 is ` 50,000. It has been assumed that, in the said figure of ` 50,000, only the proportional depreciation (i.e., 75% for business purposes) has been included in respect of motor car.

Question 3 (6marks) (2 Marks each)

- (a) Since the rent paid for hire of machinery by Trip Ltd. to Mr. Kartik exceeds ` 1,80,000, the provisions of section 194-I for deduction of tax at source are attracted.

The rate applicable for deduction of tax at source under section 194-I on rent paid for hire of plant and machinery is 2%, assuming that Mr. Kartik has furnished his permanent account number to Trip Ltd.

Therefore, the amount of tax to be deducted at source: = ` 2,50,000 x 2% = ` 5,000.
12.

Note: In case Mr. Kartik has not furnished his permanent account number to Trip Ltd., tax shall be deducted @ 20% on ` 2,50,000, by virtue of provisions of section 206AA.

- (b) As per the provisions of section 194J, a Hindu Undivided Family is required to deduct tax at source on fees paid for professional services only if it is subject to tax audit under section 44AB in the financial year preceding the current financial year.

However, if such payment made for professional services is exclusively for the personal purpose of any member of Hindu Undivided Family, then, the liability to deduct tax is not attracted.

Therefore, even if Verma (HUF) is liable to tax audit in the immediately preceding financial year, the liability to deduct tax at source is not attracted in this case since, the fees for professional service to Dr. Sarthak is paid for a personal purpose i.e. the surgery of a member of the family.

- (c) Section 194J provides for deduction of tax at source @10% from any sum paid by way of any remuneration or fees or commission, by whatever name called, to a director, which is not in the nature of salary on which tax is deductible under section 192. The threshold limit of ` 30,000 upto which the provisions of tax deduction at source are not attracted in respect of every other payment covered under section 194J is, however, not applicable in respect of sum paid to a director.

Therefore, in this case, tax@10% has to be deducted at source under section 194J in respect of the sum of ₹ 29,000 paid by XYZ Ltd. to its director. Thus, tax of ₹ 2,900 has to be deducted at source.

Question 4(6 marks) (2 Marks each)

- (i) **False:** A proviso has been inserted in section 80CCD(3) to provide that the amount received by the nominee, on closure of NPS account on the death of the assessee, shall not be deemed to be the income of the nominee.

Therefore, ₹ 9 lakhs, being the amount received by Mrs. Leena, widow of Mr. Sahitya as a nominee on closure of NPS account on his death would not be deemed as income in herhands.

- (ii) **False,** as per section 80GG, least of the following is allowed as deduction:

- (a) Actual rent paid less 10% of total income

$$96,000 \text{ minus } \frac{(10 \times 3,80,000)}{100}$$

$$= 58,000$$

- (b) 25% of total income

$$\frac{25 \times 3,80,000}{100} = ₹ 95,000$$

- (jj) Amount calculated at ₹ 5,000 p.m. = ₹ 60,000

Thus, Mr. Gopal is eligible to claim deduction of only ₹ 58,000 under section 80GG and not a flat deduction of ₹ 60,000.

- (iii) **False:** Mr. Anay has to pay ₹ 2,64,000 (₹ 32,00,000 x 11% x 9/12) towards interest on housing loan during the previous year 2016-17.

He would be eligible to claim ₹ 2,00,000 as deduction under section 24(b) under the head "Income from House Property" In addition, he can claim deduction of ₹ 50,000 under section 80EE from gross total income, in respect of the balance amount of ₹ 64,000 (₹ 2,64,000 – ₹ 2,00,000) during the P.Y. 2016-17.

Question 5 (4 marks)(1 mark each)

- (a) **False:** Any payment from an approved superannuation fund made by way of transfer to the account of an employee under a notified pension scheme referred to in section 80CCD is exempt under section 10(13). Since Atal Pension Yojana is a notified pension scheme under section 80CCD, the payment of ₹ 12 lakhs made by T Ltd. by way of transfer from an approved superannuation fund to Mr. S wayam's account under such scheme is exempt under section 10(13).

- (b) **False:** Section 10(2) exempts any sum received by an individual as a member of a HUF where such sum has been paid out of the income of the family. Therefore, ₹ 12,000 would not be included in Mr. Arpit's taxable income.

- (c) **False:** As per section 115BBDA, dividend in excess of ₹ 10 lakhs would be chargeable to tax @10% in the hands of, *inter alia*, an individual, resident in India. Section 10(34) exempts dividend distributed by domestic companies in the hands of the recipient, since

the same has been subject to dividend distribution tax under section 115-O in the hands of the company. However, the amount of dividend which is chargeable to tax under section 115BBDA would not be exempt under section 10(34). Accordingly, dividend received upto ` 10 lakh would be exempt under section 10(34) in the hands of Ms. Arpita. However, dividend in excess of `10 lakh i.e., ` 2 lakhs, would be taxable@10% in her hands.

- (d) **False:** Exemption under section 10(26AAA) is available to a Sikkimese individual not only in respect of income from any source in the state of Sikkim, but also in respect of income by way of dividend or interest on securities.

Question 6 (6 marks)

Computation of Gross Total Income of Ms. Geeta for the Assessment Year 2017-18 (4 Marks)

Particulars		
Profits and gains of business and profession		
Salary received as a partner from a partnership firm is taxable under the head "Profits and gains of business and profession"		7,50,000
Less: Brought forward business loss of Assessment Year 2016-17 to be set-off against business income		<u>7,50,000</u> Nil
Capital Gains		
Long term capital gain on sale of land (See Note 2)		5,00,000
Income from other sources		
Cash gift received from friends - since the value of cash gift exceeds ` 50,000, the entire sum is taxable	51,000	
Dividend received from a domestic company is exempt under section 10(34)	<u>Nil</u>	<u>51,000</u>
Gross Total Income		<u>5,51,000</u>

Notes :

- Balance brought forward business loss of assessment year 2016-17 of ` 5,00,000 has to be carried forward to the next year. **(1 Mark)**
- Long-term capital loss on sale of shares cannot be set-off against long-term capital gain on sale of land since loss from an exempt source cannot be set-off against profit from a taxable source. Since long-term capital gain on sale of listed shares on which STT is paid is exempt under section 10(38), loss on sale of listed shares is a loss from an exempt source. So, it cannot be set-off against long-term capital gain on sale of land, which is a profit from a taxable source. **(1 Mark)**

Question 7 (4 marks)

Since Mr. Vardaan has income only under the heads "Salaries", "Income from house property" and "Income from other sources", he does not fall under the category of a person whose accounts are required to be audited under the Income -tax Act, 1961 or any other law in force. Therefore, the due date of filing return for A.Y.2017 -18 under section 139(1), in his case, is 31st July, 2017. Since Mr. Vardaan had submitted his return of income only on 30.11.2017, the said return is a belated return under section 139(4). **(2 marks)**

Section 139(5) now permits a return furnished under section 139(1) as well as a belated return furnished under section 139(4) to be revised. Thus, a belated return under section 139(4) can also be revised. The time limit for filing a revised return is one year from the end of the relevant assessment year. In this case, the time limit would expire only on 31.3.2019. He has discovered the mistake in May 2018 itself. Therefore, Mr. Vardaan can revise the belated return of income filed by him to claim deduction under section 80C, since the time limit of one year from the end of the relevant assessment year has not elapsed. **(2 marks)**

Question 8 (6 marks)

Computation of Taxable Income of Mr. Shiv for the A.Y. 2017-18

Particulars	Rs.	Rs.
Salaries (1 Mark)		
Income from Salary (Rs. 50,000 × 12)	6,00,000	
<i>Less:</i> Loss from house property in respect of which Mr. Shiv is the deemed owner to be set off against his salary income as per section 71(1) [See Note 1] (1 Mark)		
	<u>90,000</u>	5,10,000
Capital Gains		
Long term capital gain	70,000	
<i>Less:</i> Brought forward short term capital loss of A.Y. 2014-15 set off against current year long-term capital gain as per section 74(1) & (2) [See Note 2] (1 Mark)		
	<u>70,000</u>	Nil
Balance short -term capital loss of Rs. 29,000 (Rs. 99,000 – Rs. 70,000) of A.Y.2014-15 to be carried forward to A.Y. 2018-19 [See Note 2] (1 Mark)		
Income from Other Sources		
Interest on fixed deposit with SBI (Rs. 72,000 × 100/90) (1 Mark)	80,000	
<i>Less:</i> Business loss incurred by wife includible in Mr. Shiv's hands set off against interest income as per section 71(1) [See Notes 3 & 4] (1/2 Mark)		
	<u>80,000</u>	Nil
Balance business loss of Rs. 1,70,000 (Rs. 2,50,000 – Rs. 80,000) to be carried forward to A.Y. 2018 -19 (1/2 Mark)		
Taxable Income		<u>510000</u>

Notes:

- (1) As per section 27(i), Mr. Shiv is the deemed owner of the house transferred to his minor son without adequate consideration. Hence, the income from house property would be assessable in Mr. Shiv's hands. Since there is a loss from house property transfer red to minor son without adequate consideration, Mr. Shiv can set-off the same against salary income, since he is the deemed owner of such property.
- (2) As per section 74(1) and 74(2), brought forward short-term capital loss can be set-off against long-term capital gains. Unabsorbed short-term capital loss can be carried forward for a maximum of eight assessment years (upto A.Y.202 2-23, in this case) for set-off against capital gains.
- (3) As per section 64(1)(iv), income from funds gifted to spouse by an individual and invested in business by the spouse is includible in the hands of the individual. As per *Explanation 2* to section 64, income includes "loss". Hence, in the given case, loss arising out of the business carried on by Mr. Shiv's wife is to be included in the income of Mr. Shiv, as she has carried on business with the funds gifted to her by Mr. Shiv.
- (4) As per section 71(2A), business loss cannot be set-off against salary income. However, the same can be set-off against income from other sources (consisting of interest on fixed deposit).

Question 9 (6 marks)

In the given case, Mr. Rakesh gifted a sum of Rs. 5 lacs to his brother's minor daughter on 16.4.2016 and simultaneously, his brother gifted debentures worth Rs. 6 lacs to Mr. Rakesh's wife on 18.4.2016. Mr. Rakesh's brother's minor daughter invested the gifted amount of Rs. 5 lacs in fixed deposit with Bank of India.

These transfers are in the nature of cross transfers. Accordingly, the income from the assets transferred would be assessed in the hands of the deemed transferor because the transfers are so intimately connected to form part of a single transaction and each transfer constitutes consideration for the other by being mutual or otherwise.

If two transactions are inter-connected and are part of the same transaction in such a way that it can be said that the circuitous method was adopted as a device to evade tax, the implication of clubbing provisions would be attracted¹.

As per section 64(1A), all income of a minor child is includible in the hands of the parent, whose total income, before including minor's income is higher. Accordingly, the interest income arising to Mr. Rakesh's brother's daughter from fixed deposits would be included in the total income of Mr. Rakesh's brother, assuming that Mr. Rakesh's brother's total income is higher than his wife's total income, before including minor's income. Mr. Rakesh's brother can claim exemption of Rs. 1,500 under section 10(32). **(2 Marks)**

Interest on debentures arising in the hands of Mrs. Rakesh would be taxable in the hands of Mr. Rakesh as per section 64(1)(iv). **(1 Mark)**

This is because both Mr. Rakesh and his brother are the indirect transferors of the income to their spouse and minor daughter, respectively, with an intention to reduce their burden of taxation. **(1 Mark)**

In the hands of Mr. Rakesh, interest received by his spouse on debentures of Rs. 5 lacs alone would be included and not the entire interest income on the debentures of Rs. 6 lacs, since the cross transfer is only to the extent of Rs. 5 lacs.

Hence, only proportional interest (i.e., $\frac{5}{6}$ th of interest on debentures received) Rs. 37,500 would be includible in the hands of Mr. Rakesh. **(2 Marks)**

The provisions of section 56(2)(vii) are not attracted in respect of sum of money transferred or value of debentures transferred, since in both the cases, the transfer is from a relative.
