

The Suggested Answers for Part I of Paper – 5: Taxation are based on the provisions applicable for A.Y.2008-09, which is the assessment year relevant for May 2008 examination.

PAPER – 5 : TAXATION

Answer all questions

Question 1

Answer any five of the following sub-divisions with regard to the provisions of the Income-tax Act, 1961 for the assessment year 2008-09:

- (a) Ms. Vasudha contends that sale of a work of art held by her is not exigible to capital gains tax; is she correct?
- (b) Will a charitable trust forfeit the exemption granted to it, if it holds shares in a public sector company?
- (c) Deduction under Section 80CCD is available only to individuals employed by the Central Government. Discuss the correctness of this statement.
- (d) Mrs. Hemalatha has made payments of Rs. 5 lacs to a contractor (for business purposes) during the last two quarters of the year ended 31.3.2008. Her turnover for the year ended 31.3.2007 was Rs. 45 lacs. Is there any obligation to deduct tax at source?
- (e) Can an individual, who is not in India, sign the return of income from outside India? Is there any other option?
- (f) Mr. Vatsan has transferred through a duly registered document the income arising from a godown, to his son, without transferring the godown. In whose hands will the rental income from godown be charged? (5 x 2 =10 Marks)

Answer

- (a) The Finance Act, 2007 has specifically amended section 2(14)(ii) consequent to which, the term "personal effect" excludes any work of art. As a result, any work of art will be considered as a capital asset and sale of the same will attract capital gains tax. Thus, the contention of Ms. Vasudha is not correct.
- (b) According to section 13(1)(d), investment in shares in a public sector company is allowed to be made by a charitable trust. Therefore, a charitable trust holding shares in a public sector company can continue to claim exemption.
- (c) The deduction under section 80CCD is available to the individuals employed by the Central Government or any other employer. Accordingly, the statement is incorrect.
- (d) In the case of an individual, the provisions of section 194C shall apply, where the turnover from business has exceeded Rs. 40 lakhs during the financial year immediately preceding the financial year in which such payment is made and payment is made for other than for personal purposes. In the given case, since the turnover of Mrs. Hemalatha has exceeded

Rs. 40 lakhs for the year ended 31st March 2007 and the payment is relating to business activities, she shall be liable to deduct tax at source in respect of payment made to a contractor at the applicable rate.

- (e) As per section 140, return of income can be signed by an individual even if he is absent from India. Hence, an individual can himself sign the return of income from a place outside India. Alternatively, any person holding a valid power of attorney and duly authorised by the individual can also sign the return of income. However, such power of attorney shall be attached along with the return of income.
- (f) Section 60 expressly states that where there is transfer of income from an asset without transfer of the asset itself, such income shall be included in the total income of the transferor. Hence, the rental income derived from the godown shall be charged in the hands of Mr. Vatsan.

Question 2

Ramesh is the karta of Ramesh (HUF) in which the other members are his wife Padma, major son Guru and a minor daughter Champaka. The following details of this HUF, resident in India, pertaining to the year ended 31st March, 2008 are made available to you:

- (a) Rent (at Rs. 10,000 per month) received from a flat in Salem is Rs. 1,10,000. Rent of Rs. 10,000 for the month of March, 2008 was received in April, 2008.

Property tax paid Rs. 10,000.

Bank loan of Rs. 10,00,000 was taken for construction of this flat, bearing interest at 10%. Rs. 8,000 interest is in arrears pertaining to this year, which was paid by the HUF in May, 2008 only. Principal repayment during the year was Rs. 48,000.

- (b) Ramesh represents the HUF in a partnership firm M/s. Ashok & Co., engaged in turmeric business. The firm has paid interest of Rs. 1,80,000 to the HUF computed at 15%.

For the services rendered by Ramesh to this firm as the lone Working partner, the firm has paid him a remuneration of Rs. 1,50,000 as per the provisions of the partnership deed. The "book profit" of the firm in terms of Section 40(b) is Rs. 1,35,000.

- (c) The HUF is also running two businesses, as narrated below:

- (i) Retail trade in food grains:

A rough account book alone is maintained. Expense bills/vouchers are not properly maintained. The total turnover is Rs. 38 lacs. The net profit as per the rough account is Rs. 1,41,000. This has been arrived at after considering a penalty of Rs. 8,000 levied by Sales-tax authorities for misuse of "C" Form.

- (ii) Business of Civil construction:

Cash received from contractee : Rs. 31,00,000

Value of materials supplied by contractee : Rs. 7,00,000

No books of account are maintained.

- (d) The HUF has received dividend of Rs. 90,000 from shares held in a foreign company.
- (e) Tuition fees of Rs. 20,000 was paid for the purpose of part-time education of Ms. Champaka in an Indian college.
- (f) The following sums have been paid by the HUF in respect of Life Insurance Premium:

Policy holder's name	Insurer	Premium (Rs.)	Late fee (Rs.)
Mrs. Padma	LIC	30,000	500
Guru	IRDA approved private insurer	42,000	1,500

Part of the above premiums were paid from out of agricultural income of Rs. 60,000 derived from agricultural lands situated in Colombo.

You are required to compute the total income of Ramesh (HUF) for the assessment year 2008-09, showing clearly the computation under proper heads of income. You are also required to indicate with reasons, whether any item is to be considered in the hands of Ramesh (individual). (20 Marks)

Answer

Computation of Total Income of Ramesh (HUF) for the Assessment year 2008-09

Particulars	Note	Amount (Rs.)	Amount (Rs.)
Income from House Property			
Gross annual value	1	1,20,000	
Less: Municipal taxes		10,000	
Net annual value		<u>1,10,000</u>	
Less: Deductions under section 24		33,000	
(i) 30% of net annual value			
(ii) Interest on borrowed capital (10% of Rs.10,00,000)	2	<u>1,00,000</u>	
Income from house property			(23,000)

Profit and Gains of Business or Profession

Own business

(a) Profits from retail food grains business	3	1,90,000
(b) Profits from business of civil construction	4	2,48,000

Share income from partnership firm		
Interest on capital received from M/s. Ashok & Co.	5	1,44,000
		<hr/>
Income chargeable under this head		5,82,000
Income from other sources		
(a) Dividend from foreign company	6	90,000
(b) Agricultural income from lands in Colombo	7	60,000
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Income chargeable under this head		1,50,000
		<hr/>
Gross total income		7,09,000
Deduction under Chapter VI-A		
Deduction under section 80 C	8	1,00,000
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Total Income		6,09,000
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Notes:

- (1) Income from house property is chargeable on accrual basis. Rent received assumed as Gross annual value in the absence of other information on Municipal value, Standard Rent and Fair Rent.
- (2) Interest of borrowed capital under section 24(b) is allowed on the accrual basis. So deduction shall be allowed even if interest is paid after the end of the previous year.
- (3) Retail food grains trade
The assessee is not maintaining expenses bills/vouchers properly and hence will not be in a position to show a profit lesser than the presumptive profits under section 44AF.
As per section 44AF, presumptive income is 5% of Rs.38 lacs = Rs.1,90,000.
No separate deduction can be claimed in respect of any expenditure, as all expenses are deemed to be allowed. In any case, penalty for infraction of law is not an allowable expenditure.
- (4) Business of civil construction
 - (a) Since no books of account are maintained, the presumptive provisions of section 44AD will squarely apply.
 - (b) Gross receipts will not include the value of materials supplied by contractee.
 - (c) Chargeable income is 8% of Rs. 31,00,000 = Rs. 2,48,000
- (5) Share income from M/s.Ashok & Co.
 - (a) As per proviso to section 28(v), the income to be included in the hands of the partner is only to the extent allowed in the hands of the firm, due to application of section 40(b).

- (b) As per section 40(b), maximum interest allowable is 12%. Hence, the interest allowed in the hands of the firm would have been Rs. 1,44,000 only, and not Rs. 1,80,000.
- (6) Dividend from foreign company is not eligible for exemption under section 10(34).
- (7) Agricultural income from land situated outside India is not exempt under section 10(1). Since the HUF is resident, the agricultural income will form part of total income.
- (8) Deduction under section 80C:
- (a) Any sum paid to keep in force any insurance on the life of eligible person qualifies for deduction. However, late fees does not qualify for deduction under section 80C.
- (b) Insurance taken with IRDA approved private insurer is also eligible for deduction.
- (c) The source of income used for making the payment of insurance premium is immaterial.
- (d) Tuition fee paid for full-time education is allowable only in the case of individual assessee. Hindu undivided families are not eligible for deduction in respect of payment of tuition fees, whether for full time or part time education.

Deduction allowed under section 80C is as under:

S.No.	Eligible item	Amount (Rs.)
(i)	Insurance premium	72,000
(ii)	Principal repayment of housing loan from bank	48,000
		1,20,000

Deduction under section 80C restricted to Rs. 1,00,000.

Income chargeable to tax in the hands of Mr. Ramesh (Individual)

The firm has paid remuneration of Rs. 1,50,000 for services rendered by Ramesh as working partner. This will be chargeable to tax in the individual hands of Ramesh. He is the lone working partner.

The book profits of the firm in terms of section 40(b) are Rs. 1,35,000. Applying the provisions of 40(b), the maximum remuneration allowable in the hands of firm is:

		Rs.
First 75,000 of book profits	90%	67,500
Next 60,000 of book profits	60%	36,000
		1,03,500

Hence, Rs. 1,03,500 shall be chargeable to tax in the hands of Ramesh (individual).

Question 3

- (a) M/s. Vivitha & Co., a partnership firm, with four partners A, B, C and D having equal shares, furnishes the following details, summarized from the valid returns of income filed by it :

Assessment year	Item eligible for carry forward and set off
2006-07	Unabsorbed business loss Rs. 1,20,000
2007-08	Unabsorbed business loss Rs. 1,90,000
2007-08	Unabsorbed depreciation Rs. 1,20,000
2007-08	Unabsorbed long-term Capital losses:
	-from shares Rs. 1,10,000
	-from building Rs. 1,90,000

C who was a partner during the last three years, retired from the firm with effect from 1.4.2007.

The summarized results of the firm for the assessment year 2008-09 are as under:

	Rs.
Income from house property	70,000
Income from business:	
Speculation	2,20,000
Non-speculation	(-) 50,000
Capital gains	
Short-term (from sale of shares)	40,000
Long-term (from sale of building)	2,10,000
Income from other sources	60,000

Briefly discuss, how the items brought forward from earlier years can be set off in the hands of the firm for the assessment year 2008-09, in the manner most beneficial to the assessee. Also show the items to be carried forward. Computation of total income is not required. (9 Marks)

- (b) Following benefits have been granted by Ved Software Ltd. to one of its employees Mr. Badri:
- (i) Housing loan @ 6% per annum. Amount outstanding on 1.4.2007 is Rs. 6,00,000. Mr. Badri pays Rs. 12,000 per month, on 5th of each month.

- (ii) Air-conditioners purchased 4 years back for Rs. 2,00,000 have been given to Mr. Badri for Rs. 90,000.

Compute the chargeable perquisite in the hands of Mr. Badri for the assessment year 2008-09.

The lending rate of State Bank of India as on 1.4.2007 for housing loan may be taken as 10%. (6 Marks)

Answer

- (a) According to section 78(1), where there is a change in the constitution of the firm, the loss relating to outgoing partner (whether by way of retirement or death) has to be excluded for the purposes of carry forward. However, this provision does not apply in the case of unabsorbed depreciation.

Accordingly, M/s. Vivitha & Co. is entitled to carry forward the losses to the extent detailed herebelow:

Item	Loss (Rs.)	Relatable to C (Rs.)	Balance eligible for carry forward (Rs.)
Business loss of 2006-07	1,20,000	30,000	90,000
Business loss of 2007-08	1,90,000	47,500	1,42,500
Long term capital loss of 2007-08	3,00,000	75,000	2,25,000

Set off of items in the hands of M/s. Vivitha & Co. for the A.Y. 2008-2009

Particulars	Amount (Rs.)	Amount (Rs.)
1. Income from house property		
Current year as given	70,000	
Less: Brought forward depreciation (See Note 1)	70,000	NIL
2. Profits and gains of business or profession		
Current year speculation	2,20,000	
Less: Current year Non-speculation loss set off (See Note 2)	50,000	
	1,70,000	
Less: Brought forward business losses of earlier year (2006-07 Rs. 90,000 and 2007-08 Rs. 80,000) (See Note 3)	1,70,000	NIL

3. Capital gain		
Short term (from sale of shares)		40,000
Long-term (from sale of building)	2,10,000	
Less: Brought forward LTC loss of AY 2007-08 (See Note 4)	<u>2,10,000</u>	<u>NIL</u>
4. Income from other sources		
Current year before set off	60,000	
Less: Brought forward depreciation (See Note 1)	<u>50,000</u>	<u>10,000</u>
Losses to be carried forward to A.Y. 2009-10		
Business loss (Rs. 1,42,500 - Rs. 80,000)		62,500
Long term capital loss (Rs. 2,25,000 – Rs. 2,10,000)		15,000
Both these losses relate to A.Y. 2007-08.		

Notes:

- (1) Unabsorbed depreciation can be set off against income from any head. Hence it will be advantageous to set off unabsorbed depreciation against income from house property and income from other sources.
 - (2) In the current year, non-speculation business loss can be set off against speculation business income.
 - (3) Brought forward non-speculation business loss can also be set off against speculation business income of current year.
 - (4) According to section 74, brought forward long term capital losses shall be set off only against long-term capital gains of current year.
 - (5) The set-off and carry forward of losses should be most beneficial to the assessee. If the students set off brought forward depreciation against current year's business income first, then the quantum of brought forward business loss which can set off against current year's business income will be lower. This will not be beneficial to the assessee.
- (b) Perquisite value for housing loan

The value of the benefit to the assessee resulting from the provision of interest-free or concessional loan made available to the employee or any member of his household during the relevant previous year by the employer or any person on his behalf shall be determined as the sum equal to the interest computed at the rate charged per annum by the State Bank of India (SBI) as on the 1st day of the relevant previous year in respect of loans for the same purpose advanced by it. This rate should be applied on the maximum

outstanding monthly balance and the resulting amount should be reduced by the interest, if any, actually paid by him.

“Maximum outstanding monthly balance” means the aggregate outstanding balance for loan as on the last day of each month.

The perquisite value for computation is $10\% - 6\% = 4\%$

Month	Maximum outstanding balance as on last date of month	Perquisite value at 4% for the month
April, 2007	5,88,000	1,960
May, 2007	5,76,000	1,920
June, 2007	5,64,000	1,880
July, 2007	5,52,000	1,840
August, 2007	5,40,000	1,800
September, 2007	5,28,000	1,760
October, 2007	5,16,000	1,720
November, 2007	5,04,000	1,680
December, 2007	4,92,000	1,640
January, 2008	4,80,000	1,600
February, 2008	4,68,000	1,560
March, 2008	4,56,000	1,520
	Total value of this perquisite	<u>20,880</u>

Perquisite Value of Air Conditioners:

	Rs.
Original cost	2,00,000
Depreciation on SLM basis for 4 years @10% i.e. Rs.2,00,000 x10% x 4	80,000
Written down value	<u>1,20,000</u>
Amount recovered from the employee	90,000
Perquisite value	<u>30,000</u>

Chargeable perquisite in the hands of Mr. Badri for the assessment year 2008-09

	Rs.
Housing loan	20,880
Air Conditioner	30,000
Total	<u>50,880</u>

Question 4 (First Alternative)

- (a) Ms. Vasumathi purchased 10,000 equity shares of Rejesh Co. Pvt. Ltd. on 28.2.2004 for Rs. 1,20,000. The company was wound up on 31.7.2007. The following is the summarized financial position of the company as on 31.7.2007:

Liabilities	Rs.	Assets	Rs.
60,000 Equity shares	6,00,000	Agricultural lands	42,00,000
General reserve	40,00,000	Cash at bank	6,50,000
Provision for taxation	2,50,000		
	<u>48,50,000</u>		<u>48,50,000</u>

The tax liability (towards dividend distribution tax) was ascertained at Rs. 3,00,000, after considering refund due to the company. The remaining assets were distributed to the shareholders in the proportion of their shareholding. The market value of 6 acres of agricultural land (in an urban area) as on 31.7.2007 is Rs. 10,00,000 per acre.

The agricultural land received above was sold by Ms. Vasumathi on 29.2.2008 for Rs. 15,00,000.

Discuss the tax consequences in the hands of the company and Ms. Vasumathi.

Cost inflation indices are:

Financial year	Cost Inflation index	
2003-04	463	
2007-08	551	(8 Marks)

- (b) Mr. Narendra, who retired from the services of Hotel Samode Ltd., on 31.1.2008 after putting on service for 5 years, received the following amounts from the employer for the year ending on 31.3.2008:

- Salary @ Rs. 16,000 p.m. comprising of basic salary of Rs. 10,000, Dearness allowance of Rs. 3,000, City compensatory allowance of Rs. 2,000 and Night duty allowance of Rs. 1,000.
- Pension @ 30% of basic salary from 1.2.2008.
- Leave salary of Rs. 75,000 for 225 days of leave accumulated during 5 years @ 45 days leave in each year.
- Gratuity of Rs. 50,000.

Compute the total income of Mr. Narendra for the assessment year 2008-09. (6 Marks)

Answer

(a) In the hands of the company:

As per section 46(1), in case of distribution of capital assets amongst the shareholders on liquidation of the company is not regarded as "transfer" in the hands of the company. Consequently, there will be no capital gains in the hands of the company.

In the hands of Ms. Vasumathi (Shareholder)

Section 46(2) provides that such capital gains would be chargeable in the hands of the shareholder.

Particulars	Amount (Rs.)
Ms. Vasumathi holds 1/6 th of the shareholding of the company	
Market value of agricultural land received (1acre @ Rs.10 Lakhs)	10,00,000
Cash at bank [1/6 th of Rs. (6,50,000 – Rs. 3,00,000)]	58,333
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	10,58,333
Less: Deemed Dividend u/s 2(22)(c) 1/6 th of (Rs. 40,00,000- Rs. 50,000)	6,58,333
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Consideration for computing Capital Gain	4,00,000
Indexed cost of acquisition of Shares (Rs. 1,20,000 x 551/ 463)	1,42,808
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Long term capital gains	2,57,192
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Where the capital asset became the property of the assessee on the distribution of the capital assets of a company on its liquidation and the assessee has been assessed to capital gains in respect of that asset under section 46, the cost of acquisition means the fair market value of the asset on the date of distribution. Hence, the short-term capital gains in the hands of Ms. Vasumathi (shareholder) at the time of sale of urban agricultural land should be computed as follows:

Particulars	Rs.
Sale consideration	15,00,000
Less : Fair market value of the agricultural land on the date of distribution	10,00,000
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Short term capital gain	5,00,000
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Dividend u/s 2(22)(c) Rs. 6,58,333 will be exempt under section 10(34).

Note:

Since the question states that there is refund due to the company, it is assumed that the provision for taxation of Rs. 2,50,000 shown in Balance Sheet is in respect of dividend distribution tax. Therefore, the tax liability in respect of dividend distribution tax ascertained at Rs. 3,00,000 has to be reduced from bank balance while computing full

value of consideration under section 46(2). Rs. 50,000, being the difference between Rs. 3,00,000 and Rs. 2,50,000, has to be reduced from General Reserve for calculating deemed dividend under section 2(22)(c).

(b) Computation of Total Income of Mr. Narendra for A.Y. 2008-09

Particulars	Amount (Rs.)	Amount (Rs.)
Income from Salaries		
Gross salary received during 1.4.07 to 31.1.08 @ Rs. 16,000 p.m. (Rs. 16,000 x 10)		1,60,000
Pension for 2 months @ 30% of the basic salary of Rs. 10,000 p.m.		6,000
Leave Salary	75,000	
Less: Exempt under section 10(10AA) (Note1)	50,000	25,000
Gratuity	50,000	
Less: Exempt under section 10(10) (Note2)	25,000	25,000
Total Income		2,16,000

Notes:

1. Leave encashment is exempt to the extent of least of the following:

Particulars	Amount (Rs.)
(i) Statutory limit	3,00,000
(ii) Cash equivalent of leave for 30 days (30/45 x Rs. 75,000)	50,000
(iii) 10 months average salary (10 x Rs. 10,000)	1,00,000
(iv) Actual amount received	75,000

Therefore, Rs. 50,000 is exempt under section 10(10AA).

2. Gratuity is exempt to the extent of least of the following:

Particulars	Amount (Rs.)
(i) Statutory limit	3,50,000
(ii) Half month's salary for 5 years of service (5 x Rs. 5,000)	25,000
(iii) Actual gratuity received	50,000

Therefore, Rs. 25,000 is exempt under section 10(10). It is assumed that the employee is not covered under The Payment of Gratuity Act, 1972.

Question 4 (Second Alternative)

(a) Mr. Dhaval and his wife Mrs. Hetal furnish the following information:

	Rs.
(i) Salary income (computed) of Mrs. Hetal	4,60,000
(ii) Income of minor son 'B' who suffers from disability specified in Section 80U	1,08,000
(iii) Income of minor daughter 'C' from singing	86,000
(iv) Income from profession of Mr. Dhaval	7,50,000
(v) Cash gift received by 'C' on 2.10.2007 from friend of Mrs. Hetal on winning of singing competition	48,000
(vi) Income of minor married daughter 'A' from company deposit	30,000

Compute the total income of Mr. Dhaval and Mrs. Hetal for the assessment year 2008-09.
(8 Marks)

(b) Mr. Kalpesh borrowed a sum of Rs. 30 lakhs from the National Housing Bank towards purchase of a residential flat. The loan amount was disbursed directly to the flat promoter by the bank. Though the construction was completed in May, 2008, repayments towards principal and interest had been made during the year ended 31.3.2008.

In the light of the above facts, state:

- (i) Whether Mr. Kalpesh can claim deduction under Section 24 in respect of interest for the assessment year 2008-09;
- (ii) Whether deduction under Section 80C can be claimed for the above assessment year, even though the construction was completed only after the closure of the year

(6 Marks)

Answer

(a) Computation of Total Income of Mr. Dhaval and Mrs. Hetal for the A.Y. 2008-09

Particulars	Mr. Dhaval Rs.	Mrs. Hetal Rs.
Salaries		4,60,000
Profits and gains of business or profession	7,50,000	
Income from other sources		
Income by way of interest from company deposit earned by minor daughter A [See Note (d)]	30,000	
Less : Exemption under section 10(32)	1,500	28,500
Total Income	7,78,500	4,60,000

Notes:

- (a) The income of a minor child suffering from any disability of the nature specified in section 80U shall not be included in the hands of the parents. Hence, Rs. 1,08,000 being the income of minor son 'B' who suffers from disability specified under section 80U shall not be included in the hands of either of his parents.
- (b) The income derived by the minor from manual work or from any activity involving exercise of his skill, talent or specialised knowledge or experience will not be included in the income of his parent. Hence, in the given case Rs. 86,000 being the income of the minor daughter 'C' shall not be clubbed in the hands of the parents.
- (c) Under section 56(2)(vi), cash gifts received from any person/persons exceeding Rs. 50,000 during the year in aggregate is taxable. Since the cash gift in this case does not exceed Rs. 50,000 the same is not taxable.
- (d) The clubbing provisions are attracted even in respect of income of minor married daughter. The income of the minor will be included in the income of that parent whose total income is greater. Hence, income of minor married daughter 'A' from company deposit shall be clubbed in the hands of the Mr. Dhaval and exemption under section 10(32) of Rs. 1,500 per child shall be allowed in respect of such income.
- (b) (a) Interest on borrowed capital is allowed as deduction under section 24(b)
- Interest payable on loans borrowed for the purpose of acquisition, construction, repairs, renewal or reconstruction of house property can be claimed as deduction under section 24(b). Interest payable on borrowed capital for the period prior to the previous year in which the property has been acquired or constructed, can be claimed as deduction over a period of 5 years in equal annual installments commencing from the year of acquisition or completion of construction.
- It is stated that the construction is completed only in May, 2008. Hence, deduction in respect of interest on housing loan cannot be claimed in the assessment year 2008-09.
- (b) Clause (xviii) of section 80C is attracted where there is any payment for the purpose of purchase or construction of a residential house property, the income from which is chargeable to tax under the head 'Income from house property'. Such payment covers repayment of any amount borrowed from the National Housing Bank.
- However, deduction is prima facie eligible only if the income from such property is chargeable to tax under the head "Income from House Property". During the assessment year 2008-09, there is no such income chargeable under this head. Hence, deduction under section 80C cannot be claimed for A.Y. 2008-09.

Question 5

Answer any four of the following five sub-divisions with regard to the provisions of the Income-tax Act, 1961:

- (a) How is advance salary taxed in the hands of an employee? Is the tax treatment same for loan or advance against salary?
- (b) Briefly discuss about the interest chargeable under Section 234A for delay or default in furnishing return of income.
- (c) List six items of expenses which otherwise are deductible shall be disallowed, unless payments are actually made within the due date for furnishing the return of income under Section 139(1). When can the deduction be claimed, if paid after the said date?
- (d) What are the due dates of instalments and the quantum of advance tax payable by companies?
- (e) Briefly explain the term "substantial interest". State any two situations in which the same assumes importance. (4 x 4 = 16 Marks)

Answer

- (a) Advance Salary

Advance salary is taxable when it is received by the employee, irrespective of the fact whether it is due or not.

It may so happen that when advance salary is included and charged in a particular previous year, the rate of tax at which the employee is assessed may be higher than the normal rate of tax to which he would have been assessed. Section 89(1) provides for relief in these type of cases.

Loan or Advance against Salary

Loan is different from salary. When an employee takes a loan from his employer, which is repayable in certain specified installments, the loan amount cannot be brought to tax as salary of the employee.

Similarly, advance against salary is different from advance salary. It is an advance taken by the employee from his employer. This advance is generally adjusted against his salary over a specified time period. It cannot be taxed as salary.

- (b) Interest for delay or default in furnishing return of income [Section 234A]

(1) Interest under section 234A is attracted for failure to file a return of income on or before the due date mentioned in section 139(1) i.e. interest is payable where an assessee furnishes the return of income after the due date or does not furnish the return of income.

- (2) Simple interest @1% per month or part of the month is payable for the period commencing from the date immediately following the due date and ending on the following dates:

Circumstances	Ending on the following dates
Where the return is furnished after due date	The date of furnishing of the return
Where no return is furnished	The date of completion of assessment

- (3) The interest has to be calculated on the amount of tax on total income as determined under section 143(1) or on regular assessment, as reduced by the advance tax paid and any tax deducted or collected at source, any relief of tax allowed under section 90 and 90A, any deduction allowed under section 91 and tax credit allowed to be set off as per section 115JAA.

- (c) Section 43B provides that the following expenses shall not be allowed as deduction unless the payments are actually made within the due date for furnishing the return of income under section 139(1):

- (i) Any tax, duty, cess or fees under any law in force.
- (ii) Employer’s contribution to provident fund or superannuation fund or gratuity fund or any other fund for the welfare of the employees;
- (iii) Any bonus or commission paid to employees;
- (iv) Any interest on any loan borrowings from any public financial institution or State financial corporation or State industrial investment corporation.
- (v) Interest on loans and advances from a scheduled bank;
- (vi) Any sum paid as an employer in lieu of earned leave at the credit of his employee.

In case the payment is made after the due date of filing of return of income, deduction can be claimed only in the year of actual payment.

- (d) Advance tax installments payable by Companies

The due dates and quantum of advance tax shall be paid by a company assessee are as under :-

Due date of installment	Amount payable
On or before the 15 th June	Not less than 15% of advance tax liability
On or before the 15 th Sept.	Not less than 45% of advance tax liability as reduced by the amount paid in earlier installment
On or before the 15 th Dec.	Not less than 75% of advance tax liability as reduced by the amount paid in earlier installments

On or before the 15th March The whole amount of advance tax liability as reduced by the amount paid in earlier installments

(e) As per Explanation to section 40A(2), a person shall be deemed to have a substantial interest in a business or profession, if, -

- (1) in case where the business or profession is carried on by a company, such person is the beneficial owner of shares (not being shares entitled to a fixed rate of dividend, whether with or without a right to participate in profits), carrying not less than 20% of the voting power.
- (2) In any other case, such person is beneficially entitled to not less than 20% of the profits of such business or profession.

Following are the situations under which the substantial interest assumes importance

- (i) Taxability of deemed dividend under section 2(22)(e);
- (ii) Disallowance of excessive or unreasonable expenditure under section 40A(2) to an individual who has a substantial interest in the business or profession of the assessee, and
- (iii) Clubbing of salary income of spouse, under section 64(1)(ii) in respect of salary received by the spouse from a concern in which the individual has a substantial interest.

Question 6

Answer any five out of the following:

- (a) Briefly explain the nature of Service tax.
- (b) A particular service has been brought into the Service tax net with effect from 1.6.2007. Mr. Vignesh has provided this service on 20.5.2007; the payment for the same was received on 10.6.2007. Is Service tax payable on the same?
- (c) Mr. Saravanan has collected a sum of Rs. 15,000 as service tax from a client mistakenly, even though no service tax is chargeable for such service. Should the amount so collected be remitted to the credit of the Central Government?
- (d) Who are the persons liable to File Service tax returns?
- (e) Briefly explain the income variant of VAT.
- (f) What is the demerit of VAT from the view point that it is a form of consumption tax?

(5 x 2 = 10 Marks)

Answer

(a) Nature of Service Tax

Service tax is a tax on services. This is not a tax on profession, trade, calling or employment but is in respect of service rendered. If there is no service, there is no tax. Basically, service is a value addition that can be perceived but cannot be seen, as it is intangible; however, usage of some goods during the course of rendering the service would not mean that there is no 'service'. It is the predominant factor in each case, which is to be studied to arrive at a conclusion.

(b) Services performed prior to the date of levy not liable for payment of Service Tax

No service tax is payable for the part or whole of the value of services, which is attributable to services provided during the period when such services were not taxable. The time of receipt of payment towards the value of services will not be relevant for this purpose. For the service tax to be leviable, on the date on which the service was rendered, it should be exigible to the levy.

In the given case, Mr. Vignesh has provided the service on 20.05.2007 and has received the payment on 10.06.2007. Assuming that, the invoice was raised by Mr. Vignesh before 01.06.2007, he will not be liable to collect service tax.

(c) Service Tax collected by mistake

Section 73A of the Finance Act, 1994 casts an obligation on every person who has collected service tax from any recipient of service in any manner as service tax, to remit the same to the credit of the Central Government. On account of this provision, where any person has collected any amount, which is not required to be collected from any other person, in any manner as representing service tax, he should also immediately pay the amount so collected to the credit of the Central Government.

Hence, Mr. Saravanan has to remit the service tax collected by him on the non taxable services to the credit of the Central Government before the due date.

(d) Persons liable to file Service Tax Returns

Section 70 of the Finance Act, 1994 enjoins that every person liable to pay service tax shall himself assess the tax due on the services provided by him and shall furnish a return to the Superintendent of Central Excise

(e) Income Variant of VAT

The income variant of VAT allows for deductions of purchases of raw materials and components as well as depreciation on capital goods. This method provided incentives to classify purchases as current expenditure to claim set-off. In practice, however, there are many difficulties connected with the specification of any method of measuring

depreciation, which basically depends on the life of an asset as well as on the rate of inflation.

(f) Demerit of VAT

VAT is a form of consumption tax. Since the proportion of income spent on consumption is larger for the poor than for the rich, VAT tends to be regressive.

However, this weakness is inherent in all the forms of consumption tax. While it may be possible to moderate the distribution impact of VAT by taxing necessities at a lower rate, it is always advisable to moderate the distribution considerations through other programmes rather than concessions or exemptions, which create complications for administration.

Question 7

Ms. Priya rendered a taxable service to a client. A bill for Rs. 40,000 was raised on 29.4.2007; Rs. 15,000 was received from the client on 1.5.2007 and the balance on 23.5.2007. No service tax was separately charged in the bill. The questions are:

- (a) Is Ms. Priya liable to pay service tax, even though the same has not been charged by her?
- (b) In case she is liable, what is the value of taxable service and the service tax payable?

(2+4 Marks)

Answer

Section 68 of the Finance Act, 1994 casts the liability to pay service tax upon the service provider or upon the person liable to pay service tax as per Rule 2(1)(d). This liability is not contingent upon the service provider realizing or charging the service tax at the prevailing rate. The statutory liability does not get extinguished if the service provider fails to realize or charge the service tax from the service receiver. Hence, Ms. Priya is liable to pay service tax.

However, sometimes it may happen that the assessee is not able to charge service tax because of the nature of service or he fails to recover the service tax from the client / customer as he is not aware that his services are taxable. Hence, in these cases, the amount recovered from the client in lieu of having rendered the service will be taken to be inclusive of service tax and accordingly tax payable will be calculated by making back calculations.

The rates of service tax payable are:

Basic rate		12%
Education cess (2% of 12%)	=	12.24%

Service tax is payable on receipt basis

$$\text{Value of taxable service} = \frac{\text{Gross amount charged}}{(100 + \text{Effective rate})} \times 100$$

$$\text{Value of Taxable Service} = \frac{40,000 \times 100}{112.24} = \text{Rs. } 35,638$$

$$\text{Service Tax payable} = \frac{40,000 \times 12.24}{112.24} = \text{Rs. } 4,362$$

Question 8

Answer any three of the following:

- Briefly explain about the charge of service tax.
- Mr. Vasudevan has rendered freely, a service to a client which is taxable, but has not charged or received any fee from the client. Is service tax payable on such free service?
- What are the different stages of VAT? Can it be said that the entire burden falls on the final consumer?
- Briefly explain, how VAT helps in checking tax evasion and in achieving neutrality.

(3 x 3 = 9 Marks)

Answer

- Charge of Service Tax [Section 66]

Section 66 is the charging section of the Finance Act, 1994 ("the Act") which deals with the levy and collection of service tax. It prescribes the applicable rate of service tax which is to be levied on the value of various taxable services. For collection of service tax, it provides that the 'prescribed manner' needs to be followed. Applicable rate is provided in the section itself whereas the prescribed manner for collection and payment of tax is provided in the Service Tax Rules, 1994. With effect from 18.04.2006, the rate of service tax prescribed by section 66 is 12% of the value of taxable services referred to in section 65(105) of the Act. Section 65(105) provides that taxable service shall not only include service provided but also the "service to be provided". Thus,

- the charge is on the services provided or to be provided;
 - the services provided or to be provided must be the one which is covered in section 65(105);
 - the rate of tax is 12%;
 - the measure of tax is on "value of taxable services" provided which is defined in section 67.
- Service Tax not payable on Free Services

Section 67(1)(iii) of the Finance Act, 1994 ensures payment of service tax based on valuation even when consideration is not ascertainable. However, these provisions apply

only when there is consideration. If there is no consideration i.e., in case of free service, section 67 cannot apply.

Thus, no service tax is payable when value of services is zero, as the charging section 66 provides that service tax is chargeable on the value of taxable service.

Hence, if the value is zero the tax will also be zero even though the service may be taxable. However, this principle applies only when there is really a 'free service' and not when its cost is recovered through different means.

(c) Different Stages of VAT

The Value Added Tax (VAT) is a multistage tax levied as a proportion of the value added (i.e. Sale minus purchase) which is equivalent to wages plus interest, other costs and profits.

In an economy, apart from the manufacturers and final consumers, there would be wholesalers and retailers also. The wholesaler might supply to retailer, and each one of them could supply to the manufacturer and the end consumer. VAT will be collected at each stage, and wherever applicable, the manufacturer or retailer will claim input credit.

Thus, VAT is collected at each stage of production and distribution process, and in principle, its entire burden falls on the final consumer, who does not get any tax credit. Thus VAT is a broad-based tax covering the value added to each commodity by parties during the various stages of production and distribution.

(d) No Tax Evasion

It is said that VAT is a logical beauty. Under VAT, credit of duty paid is allowed against the liability on the final product manufactured or sold. Therefore, unless proper records are kept in respect of various inputs, it is not possible to claim credit. Hence, suppression of purchases or production will be difficult because it will lead to loss of revenue. A perfect system of VAT will be a perfect chain where tax evasion is difficult.

Neutrality

The greatest advantage of the system is that it does not interfere in the choice of decision for purchases. This is because the system has anti-cascading effect. How much value is added and at what stage it is added in the system of production/distribution is of no consequence. The system is neutral with regard to choice of production technique, as well as business organisation. All other things remaining the same, the issue of tax liability does not vary the decision about the source of purchase. VAT facilitates precise identification and rebate of the tax on purchases and thus ensures that there is no cascading effect of tax. In short, the allocation of resources is left to be decided by the free play of market forces and competition.