

Fundamentals Level – Skills Module

# Taxation (India)

Monday 3 December 2007

**Time allowed**

Reading and planning: 15 minutes

Writing: 3 hours

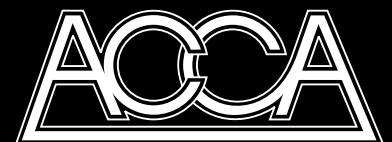
ALL FIVE questions are compulsory and MUST be attempted.  
Tax rates and allowances are printed on pages 2–3.

**Do NOT open this paper until instructed by the supervisor.**

**During reading and planning time only the question paper may be annotated. You must NOT write in your answer booklet until instructed by the supervisor.**

**This question paper must not be removed from the examination hall.**

The Association of Chartered Certified Accountants



# Paper F6 (IND)

## SUPPLEMENTARY INSTRUCTIONS

1. Calculations and workings need only be made to the nearest rupee.
2. All apportionments should be made to the nearest month.
3. All workings should be shown.

## TAX RATES AND ALLOWANCES

The following rates of tax and allowances are to be used when answering the questions

### Rates of income tax applicable to the assessment year 2007–08

#### Para A–1

To every individual or Hindu undivided family or association of persons, whether incorporated or not, or every artificial judicial person.

These rates do not apply to (i) a woman resident in India and aged below 65 and (ii) resident individuals of 65 years and more for whom separate rates are prescribed.

	Rate of income tax
(i) Where the total income does not exceed Rs.1,00,000	Nil
(ii) Where the total income exceeds Rs.1,00,000 but does not exceed Rs.1,50,000	10% of the amount by which the total income exceeds Rs.1,00,000;
(iii) Where the total income exceeds Rs.1,50,000 but does not exceed Rs.2,50,000	Rs.5,000 plus 20% of the amount by which the total income exceeds Rs.1,50,000;
(iv) Where the total income exceeds Rs.2,50,000	Rs.25,000 plus 30% of the amount by which the total income exceeds Rs.2,50,000.

#### Para A–2

In the case of every individual, being a woman resident in India and below the age of 65 years at any time during the previous year.

	Rate of income tax
(i) Where the total income does not exceed Rs.1,35,000	Nil
(ii) Where the total income exceeds Rs.1,35,000 but does not exceed Rs.1,50,000	10% of the amount by which the total income exceeds Rs.1,35,000;
(iii) Where the total income exceeds Rs.1,50,000 but does not exceed Rs.2,50,000	Rs.5,000 plus 20% of the amount by which the total income exceeds Rs.1,50,000;
(iv) Where the total income exceeds Rs.2,50,000	Rs.21,000 plus 30% of the amount by which the total income exceeds Rs.2,50,000.

### Para A–3

In the case of every individual, who is of the age of 65 years or more at any time during the previous year.

	<b>Rate of income tax</b>
(i) Where the total income does not exceed Rs.1,85,000	Nil
(ii) Where the total income exceeds Rs.1,85,000 but does not exceed Rs.2,50,000	20% of the amount by which the total income exceeds Rs.1,85,000;
(iii) Where the total income exceeds Rs.2,50,000	Rs.13,000 plus 30% of the amount by which the total income exceeds Rs.2,50,000.

### Surcharge on income tax

The amount of income tax computed in accordance with the above provisions or by Section 111A or Section 112 shall –

- (i) In the case of every individual or Hindu undivided family or association of persons or body of individuals having a total income exceeding Rs.10,00,000, be reduced by the rebate of income tax calculated under chapter VIII A and the income tax as so reduced be increased by a surcharge for the purposes of the union calculated at the rate of 10% of such income tax;
- (ii) In the case of every person, other than those mentioned in (i) above, be increased by a surcharge for the purposes of the union calculated at the rate of 10% of such income tax.

### Para B

In the case of every cooperative society.

	<b>Rate of income tax</b>
(i) Where the total income does not exceed Rs.10,000	10% of the total income
(ii) Where the total income exceeds Rs.10,000 but does not exceed Rs.20,000	Rs.1,000 plus 20% of the amount by which the total income exceeds Rs.10,000
(iii) Where the total income exceeds Rs.20,000	Rs.3,000 plus 30% of the amount by which the total income exceeds Rs.20,000

### Para C

In the case of every firm.

	<b>Rate of income tax</b>
On the whole of the total income	30%
Surcharge on income tax	10% of the income tax

### Para E

In the case of every domestic company.

	<b>Rate of income tax</b>
On the whole of the total income	30%
Surcharge on income tax	10% of the income tax

### Education cess

2% of the income tax and surcharge determined as payable.

**ALL FIVE questions are compulsory and MUST be attempted**

1 Mrs S is an Indian citizen and has furnished the following details to enable you to prepare her return of income tax for the assessment year 2007–08.

She owns two house properties as follows:

	House No. 1 Let out Rs.	House No.2 Self-occupied Rs.
Municipal valuation	1,80,000	96,000
Fair rent	2,00,000	1,20,000
Standard rent	2,00,000	1,00,000
Rental income received per month	18,000	—
Municipal taxes: annual	54,000	28,000
paid in year*	81,000	14,000
Interest on mortgages taken for repairs**	—	24,000

\* The municipal taxes on both properties were paid by Mrs S's consulting business (see below).

\*\* The mortgage loan on the self-occupied property was taken out on 20 February 2005. The annual instalment to be repaid is Rs.25,000.

Mrs S had received, as part of the bequest from her late father, a house in Delhi, in January 2006. This house was a residential house which had been vacant since November 2005 and was sold by Mrs S in May 2006 for Rs.90,00,000. This house had been purchased by her father in 1981 for Rs.15,00,000. Mrs S purchased a new house in December 2006 for Rs.75,00,000.

Mrs S carries on a small consultancy business in interior decoration. She maintains her books for this business on a cash basis and a review of the books revealed the following:

	Rs.
Total collections in the year	2,50,000
Receivables at the beginning of the year	40,000
Receivables at the end of the year	80,000
Amount paid to junior staff (for 13 months including March 2006)	1,56,000
Conveyance and travel expenses	60,000
Books and periodicals (relating to her business of interior decoration)	25,000
Municipal taxes paid (as above)	
let out property	81,000
self-occupied house	14,000
Repair works on the let out property	24,000

Mrs S uses half of her owner occupied house for the purposes of her business.

In October 2006, Mrs S received a present of Rs.80,000 from one of her clients, who was pleased with the interior decoration work carried out for him by Mrs S. She also received Rs.40,000 from her close relatives in February 2007 on the completion of her 62nd birthday. No individual contribution exceeded Rs.1,000.

Mrs S has fixed deposits with banks of Rs.10,00,000, on which she receives interest at 6.25% per annum. Mrs S has also paid Rs.15,00,000 into the Post Office Special Deposit account for senior citizens, on which she receives interest of 9% per annum.

In addition, the savings bank accounts which Mrs S has with private sector banks, yielded her an interest income of Rs.12,000 in the year.

Mrs S paid Rs.1,00,000 into her Public Provident Fund Account in the year and purchased infrastructure bonds for Rs.30,000.

**Required:**

- (a) **Compute the total income of Mrs S for the assessment year 2007–08, giving explanations as to the treatment of the various items listed above.** (22 marks)
- (b) **Compute the tax payable by Mrs S for the assessment year 2007–08.** (3 marks)

Note: relevant cost inflation index figures are: 1981–82: 100; 2006–07: 519.

**(25 marks)**

- 2 PQR Plc (PQR) is a public limited company. Its profits for the accounting year ended 31 March 2007 were Rs.8,40,000 after charging all expenses and claims and after taking into account all receipts. Details of some of these are as under:
- (1) PQR has taken on a long leasehold building as the location for its offices. The lease runs for 33 years from 1 April 2005 and PQR has an option to extend it by a further period of 33 years. The lease deed also permits the lessee to put up any building or superstructure on the land but states that, at the termination of the lease, either the lessor will take possession of any structure on the land or the lessee can pull down the new structure and hand over the vacant land to the lessor. The existing building was pulled down and a new building was erected by PQR on the leased land at a cost of Rs.12,00,000 in October 2006. The cost of construction has been debited to the repairs account.
  - (2) PQR received in August 2006, Rs.1,25,000 as technical fees from a foreign company under the terms of a collaboration agreement approved by the Central Government.
  - (3) Some time in 1999–2000, PQR had collected from its customers sales tax of Rs.80,000 and had remitted this to the Government. Some businesses including PQR, had challenged the levy and the High Court allowed the appeal and held that the sales tax department had no authority to levy the tax. The State Government failed in its appeal to the Supreme Court against the High Court's order. The State Government refunded the collections plus interest of Rs.10,000 to PQR in January 2007. The receipt was credited to the general reserve by PQR.
  - (4) PQR was allotted an industrial plot by the Government. No activity has so far been carried out in this area by PQR. In this year, PQR paid an instalment towards the purchase price of the plot to the Government of Rs.1,20,000 and also, incurred maintenance charges of Rs.1000. Both the payments were charged to revenue.
  - (5) Two employees of PQR retired voluntarily in the year. PQR paid them Rs.3,00,000 each under an approved scheme and debited the payment to the salaries account.
  - (6) PQR had paid a total of Rs.10,000 as banking cash transaction tax in the year and Rs.1,20,000 as fringe benefit advance tax, in September. The two payments were debited to the taxes paid account.
  - (7) Advertisement charges paid include Rs.50,000 paid to a political party for the publication of an advertisement in its souvenir.
  - (8) PQR received from C, one of its suppliers of raw materials, Rs.50,000 as damages for delayed supplies. The amount was credited to the interest received account.
  - (9) PQR had to increase its authorised capital in the year due to an allotment of bonus shares. The costs to alter the memorandum and articles of association for this amounted to Rs.25,000 and these were debited to the taxes paid account.
  - (10) PQR paid Rs.1,00,000 as interest to some non-resident creditors. No tax was deducted from this payment at source.
  - (11) Capital expenditure of Rs.60,000, incurred by PQR to promote family planning amongst its employees, was debited to workmen's welfare expenses.
  - (12) PQR paid Rs.20,000 in cash towards the purchase of raw materials.
  - (13) PQR owned a small building, which had been sold in 2005. Rs.60,000, being rent arrears from the tenant, was received in November 2006 and was credited to the interest received account.
  - (14) Some non-trading investments, carried in the books at Rs.2,10,000 at the beginning of the year, were written off at the year end, due to the receipt of a directive from the Government. This amount was adjusted for against the general reserves.
  - (15) Revenue expenditure on scientific research by an in-house development facility, on a project approved by the prescribed authority, totalled Rs.2,00,000 for the year.
  - (16) PQR debited its profit and loss account with the depreciation amount due to it under the Income Tax Rules.

On 1 April 2006 PQR had a debit balance of Rs.3,00,000 in its profit and loss account. The following entitlements were also carried forward from the prior years.

- |                                                                    |  |              |
|--------------------------------------------------------------------|--|--------------|
| – Business losses:                                                 |  |              |
| relating to the assessment year 2003–04                            |  | Rs.13,60,000 |
| relating to the assessment year 1995–96                            |  | Rs.1,40,000  |
| – Unabsorbed depreciation                                          |  | Rs.5,20,000  |
| – Long-term capital losses relating to the assessment year 2005–06 |  | Rs.1,10,000  |

**Required:**

- (a) Calculate the total income of PQR Plc for the assessment year 2007–08, giving reasons for your treatment of the various claims listed in (1) to (16) above; (25 marks)
- (b) Calculate the income tax payable by PQR Plc for the assessment year 2007–08. Your answer should include an examination of PQR's liability to minimum alternative tax. (5 marks)

**(30 marks)**

- 3 M Company Limited has two divisions, one of which is engaged in the manufacture and sale of agricultural implements and the other in the manufacture and sale of tractors. Due to recurring losses, the company proceeded to restructure and decided to retain the tractors division and sell the agricultural implements division as of 31 March 2007. A consideration of Rs.100 lakhs was agreed to for this slump sale of the agricultural implements division to a new company called M (Amritsor) Limited, in which the seller (M Company Limited) held 60% of the equity shares.

The abridged balance sheet of M Company Limited as at 31 March 2007 was as under:

	<b>Tractors division Rs. in lakhs</b>	<b>Agricultural implements division Rs. in lakhs</b>
Book value of fixed assets	150	35
Current assets	200	20
Liabilities	75	10
Share capital (paid up)	300	–
General reserves	70	–
Revaluation of assets reserve	30	–

The agricultural implements division was established on 1 April 2003. The written down value of the block of assets pertaining to this unit, as on 31 March 2007, was Rs.45 lakhs.

**Required:**

- (a) **Determine the liability to capital gains tax arising on the agricultural implements division's slump sale.** (7 marks)
- (b) **Suggest a method by which, without changing the sale consideration, the tax liability could be kept to a minimum.** (8 marks)

Note: relevant cost inflation index figures are 1981–82 100; 2006–07 519.

**(15 marks)**



**4 Determine the allowability or otherwise of the following claims, providing relevant reasons to justify your decision in the following cases:**

- (a) W is a doctor by profession. In the course of a raid by the police authorities, carried out in the previous year, W was found to be running, clandestinely, an unlicensed laboratory manufacturing tablets and selling the manufactured product whilst practising as a doctor. He is assessed for income tax and pays taxes regularly. The police seized the tablets and destroyed them in terms of the law and proceeded against W in criminal proceedings. The value of the tablets so seized and destroyed is estimated to be Rs.2,40,000.

In a return filed for the year during which the police raid took place, W claimed Rs.2,40,000 as a loss arising as a result of the confiscation of the illegal tablets destroyed by the police.

**Required:**

**State, giving reasons, whether or not, the claim is allowable. (5 marks)**

- (b) X filed a return of income with his assessing officer showing an income of Rs.12,60,000. On scrutiny of the return, the assessing officer felt that the accounts of X were complicated and had to be subjected to a further audit. The assessing officer approached his Commissioner directly and obtained his sanction to appoint a firm of chartered accountants to furnish a report.

On coming to know of this development, X filed an appeal against the order in the High Court alleging that he was not afforded a reasonable opportunity to present his case before the appointment of the special auditor.

**Required:**

**State, giving reasons, whether or not X is right in his contention. (5 marks)**

- (c) Y is a taxpayer and on scrutiny of the return of income filed by him, the assessing officer, seeking to elicit information on certain payments of interest, issued a show cause notice proposing disallowance of the claim. No reply was received from Y and the assessing officer finalised the assessment by disallowing the interest and levied tax. Subsequently, the assessing officer served a notice of personal hearing under Section 282 of the Income Tax Act, on the chartered accountant representative of Y by affixture, attaching the assessment order along with it at a place of business which was not functional, Y having ceased doing business from that place. Restraint and arrest proceedings against Y were also initiated.

Y filed a writ petition in the High Court against the Department contending that he had not been afforded a proper opportunity to represent his case, no notice had been served on him and, if it had been done, he would have furnished full and correct details of the interest payments. Y further contended that the entire assessment proceedings must be quashed.

**Required:**

**State, giving reasons, whether or not this is an acceptable claim. (5 marks)**

**(15 marks)**

- 5 (a) T is a foreign citizen and is not a person of Indian origin. Since 1990, T has been visiting Chennai in India for 95 days every year to attend and participate in the annual music festival held in that city.

**Required:**

**Determine T's residential status for purposes of Indian income tax for the assessment year 2007–08.**

(7 marks)

- (b) L is a girl who was married on 28 May 2004 to Q. Q is the son of Mrs C, who gifted to L Rs.5,00,000 in cash on 30 October 2004. This amount was utilised by L, on the same day, to become a partner of a firm where her capital contribution was Rs.10,00,000. The balance of money required to be brought in as capital by L was borrowed from her father.

For the year ended 31 March 2007 the capital in the firm has remained constant and the share of profits allocated to L was Rs.9,60,000.

**Required:**

- (i) **State, giving reasons, whether any part of the profits of the firm will be taxed in the hands of Mrs C.**  
(3 marks)
- (ii) **State, giving reasons, whether and if so, how your answer to (i) above would have been different if Mrs C's gift to L had been made on 20 January 2004.**  
(2 marks)
- (c) **In the case of a return of income to be filed by an individual, state the circumstances in which such a return can be signed by a person other than the individual himself.**  
(3 marks)

**(15 marks)**

**End of Question Paper**