Fundamentals Level – Skills Module

Taxation (India)

Monday 2 June 2008

Time allowed
Reading and planning: 15 minutes
Writing: 3 hours

ALL FIVE questions are compulsory and MUST be attempted.
Tax rates and allowances are 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)

ACCA

SUPPLEMENTARY INSTRUCTIONS

1. Calculations and workings need only be made to the nearest Rs.
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.

INCOME TAX FOR THE ASSESSMENT YEAR 2008–2009

I.

A. In the case of every individual other than the individuals referred to in items B and C below or Hindu undivided family or association of persons or body of individuals, whether incorporated or not, or every artificial judicial person:

(1) Where the total income does not exceed Rs.1,10,000	Nil
(2) Where the total income exceeds Rs.1,10,000 but does not exceed Rs.1,50,000	10% of the amount by which the total income exceeds Rs.1,10,000
(3) Where the total income exceeds Rs.1,50,000, but does not exceed Rs.2,50,000	Rs.4,000 plus 20% of the amount by which the total income exceeds Rs.1,50,000
(4) Where the total income exceeds Rs.2,50,000	Rs.24,000 plus 30% of the amount by which the total income exceeds Rs.2,50,000

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

(1) Where the total income does not exceed Rs.1,45,000	Nil
(2) where the total income exceeds Rs.1,45,000 but does not exceed Rs.1,50,000	10% of the amount by which the total income exceeds Rs.1,45,000
(3) Where the total income exceeds Rs.1,50,000, but does not exceed Rs.2,50,000	Rs.500 plus 20% of the amount by which the total Income exceeds Rs.1,50,000
(4) Where the total income exceeds Rs.2,50,000	Rs.20,500 plus 30% of the amount by which the total income exceeds Rs.2,50,000

C. In the case of every individual, being resident in India, who is of the age of sixty-five years or more at any time during the previous year:

(1) Where the total income does not exceed Rs.1,95,000	Nil
(2) Where the total income exceeds Rs.1,95,000 but does not exceed Rs.2,50,000	20% of the amount by which the total income exceeds Rs.1,95,000
(3) Where the total income exceeds Rs.1,50,000 but does not exceed Rs.2,50,000	Rs.11,000 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 table or under the provisions of s.111A or s.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 amount of rebate of income tax calculated under chapter VIII A and the income tax 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.

Provided that in the case of persons mentioned in item (i) above having a total income exceeding Rs.10,00,000, the total amount payable as income tax and surcharge on such income tax shall not exceed the total amount payable as income tax on a total income of Rs.10,00,000 by more than the amount of income that exceeds Rs.10,00,000.

II.

Income tax rates:

In the case of every firm

On the whole of the total income	30%

Surcharge on income tax

The amount of income tax computed at the rate specified above, or in s.111A or s.112 shall, in the case of every firm having a total income exceeding one crore of rupees, be increased by a surcharge for the purposes of the Union calculated at the rate of 10% of such income tax.

III.

In the case of a company

(i) in the case of a domestic company	30% of the total income

Surcharge on income tax

The amount of income tax computed in accordance with the above or as in s.111A or s.112 shall in the case of every company, be increased by a surcharge for the purposes of the Union calculated in the case of every domestic company having a total income exceeding one crore of rupees, at the rate of 10% of such income tax.

Education cess

2% of the income tax and surcharge payable

Secondary and higher education cess

1% of the income tax and surcharge payable

ALL FIVE questions are compulsory and MUST be attempted

1 L, an individual, retired from Government service on 30 September 2007 when he received the following amounts:

(i)	Amount to the credit of Government Provident Fund Account	Rs.18,48,000
(ii)	Retirement gratuity – calculated as per the rules	Rs.3,80,000
(iii)	Encashment of leave unutilised during service	Rs.6,20,000
(iv)	Amount from employees' insurance scheme	Rs.80,000

During his service with the Government, L received a monthly salary of Rs.40,000 and a dearness allowance of 32% thereof. He was in accommodation provided by the employer who deducted Rs.1,000 per month for this from his salary. He was allowed the use of a car for private purposes for which Rs.300 per month was deducted from his salary. On retirement, L received a monthly pension of Rs.18,600.

After retirement, L joined his brother K and set up a consultancy business on 1 December 2007 with an investment of Rs.5,00,000. The brothers shared the gains equally and for the period ended 31 March 2008 L's share of profits came to Rs.1,80,000. In arriving at the share, the firm had charged to its profits, personal expenses of the partners of Rs.80,000, interest at 24% per annum on the partners' investment of Rs.10,00,000 and rent of Rs.60,000 to K for use of his premises. The premises were earlier let by K to a third party at Rs.10,000 per month. The firm is separately assessed to tax.

During the year, L received the following additional amounts:

(i)	On maturity of a life insurance policy (including bonus)	Rs.12,00,000
(ii)	Dividends from Indian companies	Rs.1,40,000
(iii)	A gift from his non-resident son on the occasion of his sixtieth birthday	Rs.5,00,000
(iv)	A national award for exemplary service which consisted of a roll of honour, a plaque and a cash award of	Rs.10,000

L, who is proficient in singing, after retirement from Government service took up playback singing as a profession. He entered into contracts with leading film producers and up to 31 March 2008 received Rs.20,00,000 towards his remuneration. Some of the amounts received related to work to be done after 31 March 2008 but advances had been left with L, as booking advances. Such receipts amounted to Rs.7,50,000.

For this profession, L retained the services of two assistants from 1 September 2007 each of whom is being paid a monthly salary of Rs.10,000. L also maintains an office on which up to the end of the year expenses of Rs.60,000 had been incurred. He also had taken out a general insurance policy covering his throat on which a premium of Rs.75,000 was paid. Musical instruments to a value of Rs.9,00,000 were purchased in September 2007. A studio was also erected in the office premises where depreciable assets to a value of Rs.20,00,000 were installed on 12 October 2007. The installation of these assets was financed by a bank loan of Rs.25,00,000 taken out on 1 October 2007, at a rate of interest of 16% per annum. After meeting the cost of the studio, the balance of the loan was spent for his business.

Besides the above assets, L also purchased a motor car for Rs.18,00,000 in January 2008 to be exclusively used for his profession. Travel expenses in connection with his professional singing engagements cost him Rs.80,000 in the period. He always travelled for these engagements with his wife, who also acted as a secretary.

L maintained proper accounts for this profession, adopting the mercantile system of accounting. He paid accountancy and audit charges of Rs.15,000 in the year.

At the time of payment of his salary and pension the Government had deducted income tax at source of Rs.85,000. However, the film producers, at the time of payment of L's remuneration, had not deducted any income tax at source. L did not pay any advance tax in the year.

Required:

(a) Compute L's total income for the assessment year 2008–09, giving brief explanations of your treatment of the various items. (20 marks)

(b) Explain the obligations on L's part with regard to maintaining accounts in respect of his profession. (5 marks)

(c) State by when the return of income for the assessment year 2008–09 has to be filed by L. (1 mark)

(d) Compute the tax and the minimum interest payable by L for the assessment year 2008–09. (4 marks)

(30 marks)

2 Gamma Limited is engaged in a bio-technology business; it maintains accounts on a mercantile basis. For the accounting year ended 31 March 2008, Gamma's accountant has closed the books and prepared draft statements of the final accounts. The profit and loss account showed a net profit of Rs.24,50,000 after charging all expenses and dealing with claims.

A perusal of the accounts for the purposes of the preparation of a return of income for the assessment year 2008–09, reveals the following:

(i) The company is conducting in-house research and development on the basis of a programme approved by the prescribed authority. Expenses incurred in the year were as follows:

	Rs
Research equipment purchased	20,00,000
Remuneration paid to scientists	10,00,000
	30,00,000

(ii) One of the creditors of the company gave up a part of their claim against the company of Rs.16,000, which has been credited to the profit and loss account under the head 'allowances'.

(iii) In the year, the company had retained X Ltd as its advertising consultants and paid them bills totalling Rs.4,00,000 for work carried out by them. X Ltd's shares are fully held by Z, one of the directors of Gamma, and it has been found that X Ltd's charges are at least 20% more than other advertising consultants in the market.

(iv) In the year certain chemicals, which were in short supply, had to be purchased by Gamma by paying cash. Such payments amounted to Rs.1,20,000. Gamma will be able to identify the sellers and had obtained invoices from them.

(v) Repairs to machinery included Rs.2 lakhs spent on the replacement of worn-out parts.

(vi) Miscellaneous expenses included Rs.5 lakhs paid to a politician of the area in which Gamma's factory is located, to buy peace and to facilitate free movement of Gamma's transport vehicles.

(vii) Gamma held some equity shares in M Ltd which in the course of the year merged with N Ltd. In the process Gamma received shares in N Ltd, which were valued at Rs.1,00,000 over their book value. The surplus was carried to capital reserve. Both M and N are Indian companies.

(viii) Profits included Rs.3,00,000 received by Gamma from a foreign government for the use of its products.

(ix) Bata Ltd, a wholly owned subsidiary of Gamma, had been advanced Rs.5,00,000 by way of loans. In view of the poor financial conditions of Bata, Gamma wrote off this advance as a bad debt.

(x) Gamma's offices are located in a building owned by it. A part of the premises is let to a bank which pays Rs.10 lakhs as annual rent. This amount is included in the profit and loss account under 'other income'. Municipal taxes paid in the year were Rs.1,20,000. 10% of the building is in the occupation of the bank.

(xi) In the year, Gamma paid Rs.2,00,000 as brokerage to P on which income tax of Rs.22,440 was deducted at source. However, this tax was not remitted to the Government's account.

(xii) Gamma paid in the year Rs.1,00,000 as a donation to a recognised political party.

Required:

(a) Compute the total income of Gamma Limited, for the assessment year 2008–09, giving brief explanations of your treatment of the various items. (21 marks)

(b) Compute the tax payable by Gamma Limited for the assessment year 2008–09. (2 marks)

(c) State whether s.115 JB will be applicable to Gamma Limited for the assessment year 2008–09. (2 marks)

(25 marks)

3 Q, an individual, succeeded in March 1999 to his father's property being vacant land at Chennai which had been purchased by his father in March 1990 for Rs.2,00,000. Q built a residential house for himself on the land in March 2006 spending Rs.15,00,000 out of his savings. This property was sold by Q on 20 February 2008 for Rs.30,00,000. The value of the land at the time of sale was estimated at Rs.8,00,000. With the sale proceeds, Q purchased a new residence in March 2008 for Rs.25,00,000.

Q had purchased shares in an Indian company in October 2000 through a share broker for Rs.2,40,000. Brokerage paid on the transaction (not included in the price) was Rs.4,800. In March 2007 Q received 1,000 bonus shares declared by the company in the ratio of 1:1. Q sold the entire holding of shares on 20 January 2008 at Rs.300 per share paying security transaction tax at the rate of 0·20% of the proceeds.

In September 2006 Q had taken a 33 year lease of a property, paying Rs.15,000 per annum as lease rent. In August 2007 he transferred the lease to Y for a consideration of Rs.5,00,000, the new lessee agreeing to pay the lessor the rent for the lease period agreed upon.

Q had no other income for the year ended 31 March 2008.

Q had the following claims brought forward from the previous assessment years:

(i)	Capital losses –	short term – relating to:	
		assessment year 2006–07	Rs.40,000
		assessment year 2004–05	Rs.80,000
(ii)	Capital losses –	long term – relating to:	
		assessment year 2003–04	Rs.1,60,000

The cost inflation index to be adopted is: 1981–82 – 100; 1989–90 – 172; 1998–99 – 351; 2000–01 – 406; 2006–07 – 519; 2007–08 – 551.

Required:

(a) Compute Q's total income for the assessment year 2008–09, giving brief explanations of your treatment of the various items. (12 marks)

(b) Compute Q's tax payable for the assessment year 2008–09. (3 marks)

(15 marks)

4 **(a)** Sports Private Limited is an Indian company, which has an authorised capital of Rs.10 crores (divided into equity shares of Rs.100 each) and an issued and paid up capital of Rs.5 crores.

The following are the shareholders of the company:

	Equity shares held on 1 April 2007
A, an individual	50,000
B, an individual and wife of A	50,000
D, an individual and brother of A	50,000
E, an individual and wife of D	50,000
S, an individual unrelated to either A or D	3,00,000

On 1 April 2007 the company's accounts show a balance of Rs.30 lakhs in its general reserves account and an undistributed surplus of Rs.20 lakhs.

For the accounting year 1 April 2007 to 31 March 2008, the company made net profits of Rs.30 lakhs.

During the year, the company made the following loans and advances:

(1) On 20 April 2007 Rs.2,00,000 was given to A to meet his income tax liabilities.

(2) On 30 June 2007 the company paid off the arrears of taxes of Rs.18,00,000 of S and debited the payment to his individual account.

(3) On 15 September 2007 the company paid an advance of Rs.5 lakhs to Super India Private Ltd, the majority of whose shares were held by B. This advance was adjusted against the supply of machinery valued at Rs.10 lakhs on 1 December 2007.

(4) On 2 February 2008 E drew an amount of Rs.10,00,000 from the company and repaid the whole of it on 29 March 2008.

Required:

State, giving reasons, the tax implications of the above transactions in the hands of:

– **the individual shareholders; and**
– **Sports Private Limited.** (10 marks)

(b) The normal rule of taxation under the Income Tax Act 1961, is to tax in the assessment year, the income of a person of the previous year.

Required:

State and briefly explain the exceptions to this rule. (5 marks)

(15 marks)

5 **(a)** MCC Club is a members' club, formed and registered under the Societies Registration Act. For the accounting year ended 31 March 2008 it derived a surplus of Rs.2,48,000 on the sale of refreshments, beverages etc to its members and also, on the letting out of rooms to its members and their guests. These facilities were available to the members as benefits attaching to the membership of the club.

The income tax officer has required the club to file its return of income for the assessment year 2008–09 and has proposed to tax the surplus arising to the club as its business income. The club claims that the surplus accrued to it will not be income at all and hence no liability to tax exists.

Required:

(i) State, giving reasons, whether the club is right in its claim. (3 marks)

(ii) State whether your answer to (a) (i) above would be different, if the club had been formed under the Companies Act 1956, or if the benefits arising out of the membership of the club had been used only by some members. (3 marks)

(b) T is an individual, who owns a property which he has let to R, a company. The tenant, R, has to pay a monthly rent of Rs.15,000. Tax under s.194 – I on the rent has been deducted periodically by R from the monthly rent and the balance remitted by R into T's bank account. T filed his return of income by the due date declaring the income from property and claiming credit for the tax deducted at source by R from the monthly rent. On verification, the tax officer found that R had not paid to the credit of the Central Government the tax deducted by it at source on T's rent and required T to pay to the Government the tax deducted at source by R but not remitted by it to the Government's account.

Required:

State, giving reasons, whether the action of the tax officer in asking T to pay the tax deducted at source by R but not remitted by it to the Government is correct. (5 marks)

(c) C and his major sons F, G and H constitute a firm doing business. One of the clauses of the deed of partnership provides that the death of C will not affect the continuance of the firm, that the sons will continue the business of the firm subject to the condition that 20% of the net profits before distribution to F, G and H must be paid to their mother, J – subject to a minimum payment of Rs.1,50,000 every year.

C died on 10 September 2007; the firm was continued thereafter by F, G and H and in the accounts for the year ended 31 March 2008, they claimed the payment of Rs.1,50,000 to J as a proper deduction. 20% of the eligible profits for the year were Rs.2,20,000.

The income tax officer wants to disallow the claim on the basis that the allowance of a sharing of profits as a deduction is prohibited by s.40 of the Income Tax Act.

Required:

State, giving reasons, whether the opinion of the income tax officer is justified under law. (4 marks)

(15 marks)

End of Question Paper