

The Suggested Answers for Paper 7: - Direct Taxes are based on the provisions applicable for A.Y. 2008-09, which is the assessment year relevant for May, 2008 examination.

PAPER – 7 : DIRECT TAXES

Answer all questions

Question 1

The net profit for the year ended on 31.3.2008 of India Biotech Ltd. engaged in the business of bio-technology works out to Rs.45 lacs after debit/credit of the following items:

- (i) Profit of Rs.2,50,000 from a hedging contract entered into for meeting out the loss in foreign currency payments towards an imported machinery of Rs.80 lacs installed on 1.2.2008.
- (ii) Incidental charges of Rs.20 lacs paid to a financial institution for taking short-term loan of Rs.25 crores repayable in 18 months.
- (iii) Commission of Rs.25,000 paid to a recovery agent for getting realisation of an old outstanding.
- (iv) Registration fees of Rs.20,000 and listing fees of Rs.30,000 paid to the Registrar of Companies and the Stock Exchange respectively on the issue of bonus shares.
- (v) Amount of Rs.1,00,000 towards carry forward losses for Asst. year 1998-99 of X Ltd., which got merged with the company during the financial year 2003-04.
- (vi) Interest received from banks of Rs.90,000 net of TDS of Rs.10,000.
- (vii) Amount of Rs.1,50,000 incurred towards reconditioning of generator.
- (viii) Employees share to the EPF for the month of March, 2008 of Rs.40,000. The amount was deposited with the PF Commissioner on 22.4.2008.

Compute the total income of the company for Asst. year 2008-09 and give brief reasons for the treatment given to each of the items. (13 Marks)

Answer

Computation of Total Income of India Biotech Ltd. for A.Y. 2008-09

Particulars	Amount Rs.	Amount Rs.
Income from business		
Net Profit as per profit and loss account		45,00,000
Less: Items credited but to be considered separately		

Profit from hedging contract	2,50,000	
Interest from banks	<u>90,000</u>	<u>3,40,000</u>
		41,60,000
Add: Employee's share already charged in Profit & Loss Account but not deposited within the due date specified under the PF Act as per section 36(1)(va)		<u>40,000</u>
		42,00,000
Add: Depreciation on plant and machinery on account of hedging profit (7.5% on Rs.2,50,000)	18,750	
Additional depreciation (10% on Rs.2,50,000)	<u>25,000</u>	<u>43,750</u>
		42,43,750
Income from other sources		
Interest received from banks (gross)		<u>1,00,000</u>
Total Income		<u>43,43,750</u>

Notes -

- Hedging contract is entered into to safeguard the loss in currency fluctuation. The profit from such contract entered into for meeting loss in foreign currency payments towards imported machinery has to be adjusted against the cost of plant and machinery. Consequently, the same will have an impact on depreciation and additional depreciation on imported plant and machinery. It is presumed that the conditions for claim of additional depreciation are satisfied and accordingly, the additional depreciation has been charged to profit and loss account. Since there is a reduction in the cost of plant and machinery on account of the hedging profit of Rs.2,50,000, the excess depreciation and additional depreciation debited to the profit and loss account have to be added back to the profits.
- Incidental charges incurred for raising short term loan from financial institutions is allowable as deduction, since, as per CBDT letter F.No.32/6/62-IT(A-1) dated 16.1.1963,-
 - it is in respect of a short term loan of a duration of not more than 2 years; and
 - it does not exceed 1% of Rs.25 crores, being the amount of loan raised.
- Commission of Rs.25,000 paid to a recovery agent for realisation of old outstanding is an allowable expense under section 37 as per DCIT v. Super Tannery (India) Ltd. (2005) 274 ITR 338 (All). It is assumed that the company has deducted tax at source and remitted the same in accordance with the provisions of section 194H.

4. The Supreme Court has, in CIT v. General Insurance Corporation (2006) 286 ITR 232, observed that the issue of bonus shares does not result in expansion of the capital base of the company. Therefore, the expenditure incurred by the company on account of registration fees and listing fees for the issue of bonus shares is allowable as revenue expenditure.
5. As per section 72A, the unabsorbed business loss of the amalgamating company shall be deemed to be the loss of the amalgamated company for the previous year in which the amalgamation took place. Therefore, such loss can be set-off against the income of the amalgamated company in the year of amalgamation and the balance, if any, can be carried forward and set-off against the business income of the amalgamated company in the subsequent years. Such loss can be carried forward by the amalgamated company for a maximum period of 8 years from the year of amalgamation. In this case, the amalgamation took place in the financial year 2003-04 and therefore, the 8 year period has not expired in the financial year 2007-08. Therefore, the set-off of losses of Rs.1 lakh relating to X Ltd. is in order. It is assumed that the conditions specified in section 72A are satisfied.
6. Interest received from banks is chargeable to tax under the head "Income from other sources", assuming that there is no nexus between the interest income and the business of the assessee. For this purpose, the net amount of interest has to be grossed up by adding the amount of TDS of Rs.10,000. Since the net interest of Rs.90,000 is credited to profit and loss account, the same has to be reduced to compute the business income.
7. Expenditure on reconditioning of the generator is in the nature of normal repairs and is eligible for deduction under section 31.
8. As per section 2(24)(x), "income" includes any sum received by an employer from his employees as contributions to any provident fund. Section 36(1)(va) permits the employer to claim deduction in respect of such employee contributions to PF provided they are remitted within the due date specified under the PF Act, which is the 15th day of the succeeding month with a grace period of 5 days. Therefore, the due date in this case would be 20th April, 2008. However, since the amount of Rs.40,000 was deposited with the PF commissioner only on 22nd April, 2008, the same will not be allowed as deduction while computing the business income.

Question 2

- (a) A notice to levy penalty u/s 271(1)(c) was issued on 11.6.07. The assessee in response thereto filed on 13.7.07 a written submission requesting to decide the matter. The A.O. before whom this reply was filed retired on 31.7.07 and the officer, who succeeded him passed the penalty order without providing any further opportunity, but by taking into cognizance the reply filed by the assessee. Whether the order by the A.O. is valid?

(3 Marks)

- (b) An order for A.Y. 2006-07 was passed by the A.O. as per section 143(3), but the typist wrongly typed in the order assessment year as 2005-06 and the relevant previous year as ending on 31.3.2005. Assessee claimed in appeal that the same is an invalid order which was not accepted by the CIT(A) on the ground of error of clerical nature. What do you say about the correctness of the order of the CIT(A)? (3 Marks)
- (c) "Proceedings cannot be initiated under the Act, unless a proper notice to this effect has been served upon." In this context answer:
- (i) What are the prescribed modes of service of such notice?
 - (ii) On whom should the notice be addressed and served upon in the cases where the assessee is a company, a dissolved firm, a deceased person and a partitioned HUF. (5 Marks)

Answer

- (a) As per the provisions of section 129, whenever an Assessing Officer ceases to exercise jurisdiction and he is succeeded by another, then, the authority so succeeding may continue the proceedings from the stage at which the proceedings were left by the predecessor provided the assessee does not demand that before the proceeding is so continued he may be re-heard by the successor officer. In the present case, the assessee had only filed a written submission in respect of the notice for levy of penalty. However, he had not specifically requested to be reheard at the time of change in office. Accordingly, the penalty order passed by the successor officer without providing any further opportunity to be reheard is a valid order. This was also held by the Apex Court in the case of Pradip Lamp Works v. CIT (2001) 249 ITR 797.
- (b) Section 292B provides that no return of income, assessment, notice or summons furnished or made or issued or taken in pursuance of any of the provisions of the Income-tax Act shall be invalid or deemed to be invalid merely by reason of any mistake, defect or omission in such return of income, assessment or notice etc., if such return of income, assessment, notice, summons etc. is in substance and effect in conformity with or according to the intent and purpose of the Act. Therefore, a clerical mistake cannot invalidate an otherwise valid assessment. Thus, the typographical error in the assessment order as to assessment year and previous year does not make the same invalid unless established otherwise. Accordingly, the action of the Commissioner of Income-tax (Appeals) in not accepting the claim of the assessee is valid.
- (c) (i) According to section 282(1), a notice may be served on the person named therein either by post or as if it was a summon issued by a Court under Code of Civil Procedure, 1908.
- (ii) The service of notice in the given cases should be on the persons mentioned hereunder:-

Person	Notice be addressed and served on
A company	Principal officer of the company
A dissolved firm	Any person (not being a minor) who was a partner immediately before dissolution.
A deceased person	The legal heirs of the deceased.
A partitioned HUF	Last Manager of the HUF, or, if he is dead, then, all adult members of the erstwhile HUF.

Question 3

- (a) M/s. Nagdiwala Enterprises, a partnership firm constituted by a doctor and a non-doctor engaged in running a multispeciality hospital, seeks your opinion in the context of provisions of the Act as to allowability/chargeability of the following transactions for preparing its return for A.Y. 2008-09:
- (a) Depreciation on the instruments, imported from U.K. for Rs.2 lacs cleared by customs on 22.3.2008 on payment of duty of Rs.1 lakh, installed and ready for use on 26.3.2008. Only one operation with the help of such instruments was performed till 31.3.2008.
 - (b) The book profits calculated as per section 40(b) are Rs.3 lacs and payment of salary to working partners was Rs.1 lakh. Clause for payment of salary to working partners though appears in the deed, but the same is silent as to quantum and the manner of distribution.
 - (c) Salary of Rs.10,000 p.m. paid to the wife of a partner for working as an anesthetist. The normal salary of an anesthetist in the town is Rs.7,500 p.m. or less.
 - (d) Purchase of medicines in cash on 18.12.2007 for Rs.35,000.
 - (e) Revenue expenditure of Rs.10,000 incurred for promoting family planning amongst its employees.
 - (f) Interest of Rs.3,000 paid on an overdraft of Rs.1 lac taken for making payment of installment of advance tax of Rs.1.25 lacs. (8 Marks)
- (b) An assessee, who is aggrieved by all or any of the following orders, is desirous to know the available remedial recourse and the time limit against each under the Income-tax Act, 1961:
- (i) passed under section 143(3) by the A.O.
 - (ii) passed under section 263 by the CIT.
 - (iii) passed under section 272A by the Director General.
 - (iv) passed under section 254 by the ITAT. (6 Marks)

Answer

- (a) The allowability/chargeability of each of the transactions entered into by M/s Nagdiwala Enterprises for the purpose of computation of income for Assessment Year 2008-09 shall be as under:-
- (a) The surgical instruments used by a firm engaged in the business of running a hospital are covered under the category of Plant & Machinery, on which the rate of depreciation is 15%. The depreciation on the instruments imported from U.K. is allowable to the firm since the same were put to use during the previous year ended on 31.3.08 because of performing of one operation. However, the same were used in the previous year for less than 180 days and accordingly the allowable depreciation will be one half of the normal depreciation. The cost of instruments is Rs.3 lakh and the amount of depreciation thereon works out to Rs.22,500 [$3,00,000 \times 15\% \times \frac{1}{2}$].
- (b) As per section 40(b), payment of remuneration to a working partner is allowable as deduction only if it is authorised by and in accordance with the terms of the partnership deed. CBDT Circular No.739 dated 25.3.96 clarifies that no deduction in respect of remuneration paid to partners is allowable unless the partnership deed either specifies the amount of remuneration payable to each individual working partner or lays down the manner of quantifying such remuneration. If the partnership deed contains a clause for payment of salary to working partners without specifying the manner of quantification or manner of distribution of such salary, the payment of salary to the working partners cannot be construed to be authorised by and in accordance with the partnership deed.
- (c) Section 40A(2) provides that if any expenditure in respect of which payment has been made to, inter alia, any relative of the partner of a firm and the Assessing Officer is of the opinion that such expenditure is excessive or unreasonable having regard to the fair market value of the services for which the payment is made, then disallowance under this section is attracted to the extent the same is excessive or unreasonable. In this case, salary of Rs.10,000 p.m. is paid to the partner's wife, who is working as an anesthetist. The fair market value of a similar service is Rs.7500 p.m. Therefore, disallowance under section 40A(2) is attracted to the extent of Rs.2500 p.m., since to that extent, the same is excessive.
- (d) Section 40A(3) provides for 100% disallowance of an expenditure, in respect of which payment is made in a sum exceeding Rs.20,000 otherwise than by way of account payee cheque or account payee bank draft. Therefore, the entire amount of Rs.35,000 incurred for purchase of medicines in cash is disallowed under section 40A(3).
- (e) Section 36(1)(ix) provides for deduction in respect of expenditure incurred by companies to promote family planning amongst its employees. However, since the assessee in this case is a partnership firm, such expenses are not allowable as deduction under section 36(1)(ix).

- (f) Interest on the overdraft taken for making payment of installment of advance tax is not allowable under section 37(1) since it is not an expenditure wholly and exclusively incurred for the purpose of business as held by the Apex Court in the case of East India Pharmaceutical Works Ltd. v. CIT (1997) 224 ITR 627.
- (b) (i) An assessee, aggrieved by the order passed under section 143(3) by the Assessing Officer, can file an appeal before the Commissioner of Income-tax (Appeals) under section 246A(1) within 30 days of the date of service of the notice of demand relating to the assessment. However, where the assessee does not want to prefer an appeal, then he can move a revision petition before the Commissioner of Income-tax under section 264 within a period of one year from the date of on which the order was communicated to him or the date on which he otherwise came to know of it, whichever is earlier.
- (ii) An assessee, aggrieved by the order passed under section 263 by the Commissioner of Income-tax, can file an appeal to Income-tax Appellate Tribunal under section 253(1)(c) within 60 days of the date on which the order sought to be appealed against is communicated to the assessee.
- (iii) An assessee, aggrieved by the order passed under section 272A by the Director General, can file an appeal before the Income-tax Appellate Tribunal under section 253(1)(c) within 60 days of the date on which the order sought to be appealed against is communicated to the assessee.
- (iv) An assessee, aggrieved by the order passed under section 254 by the Income-tax Appellate Tribunal, can file an appeal before the High Court under section 260A within 120 days from the date of receipt of order of Income-tax Appellate Tribunal, only where the order gives rise to a substantial question of law.

Question 4

- (a) State with reasons, based on the provisions of the Act, as to chargeability of the following receipts to tax in the assessment year 2008-09:
- (1) Rent of Rs.60,000 charged from tenants occupying houses constructed on the land situated in India and used for agricultural purposes.
 - (2) Rameshwar Das Birla National award of Rs.51,000 was given to Mr. X, a Chartered Accountant by "Rameshwar Dasji Birla Smarak Kosh" for his contributions and work.
 - (3) Hundi superscribing "contributions in this hundi form part of corpus of trust fund" kept at Lord Venkateshwara Temple, Tirumala, was opened on 30.3.2008. Cash of Rs.100 lacs and valuable articles worth Rs.250 lacs were found to have been contributed by the devotees.
 - (4) Minister of Surface Transport was in receipt besides salary an amount of Rs.2,000 p.m. as entertainment allowance.
 - (5) Rent of Rs.30,000 for the period 1.4.2005 to 30.6.2005 due till the property sold out by the owner on 16.5.2007 was received on 12.2.2008 because of an order of court.

(2 × 5 = 10 Marks)

- (b) Tax Recovery Officer can recover the arrears of demand from the assessee in default by sale of the attached property after making a proclamation. How can such proclamation be made by the Tax Recovery Officer? (3 Marks)

Answer

- (a) (1) Section 10(1) exempts agricultural income. The meaning and scope of agricultural income is defined in section 2(1A). According to Explanation 2 to section 2(1A), any income derived from any building from the use of such building for any purpose (including letting for residential purposes or for the purpose of any business or profession) other than agriculture shall not be agricultural income. It appears that in this case, the house was occupied for residential purposes. Therefore, the rent of Rs.60,000 from letting out of houses constructed on agricultural land shall not be treated as agricultural income by virtue of Explanation 2 to section 2(1A). Hence, such income would be chargeable to tax.
- (2) Section 10(17A)(i) exempts any payment made in pursuance of any award instituted in public interest by the Central Government or any State Government or instituted by any other body and approved by the Central Government in this behalf. As per Notification No.199/19/98-IT(A-II) dated 15.11.2000, the Rameshwar Das Birla National Award instituted by Rameshwar Dasji Birla Smarak Kosh was approved by the Central Government only for three assessment years 1999-2000 to 2001-02. Hence, for A.Y.2008-09, no exemption would be available under section 10(17A).
- (3) As per section 11(1)(d), income in the form of voluntary contributions made with a specific direction that they shall form part of the corpus of the trust or institution shall not be included in the total income of the recipient. Therefore, in order to get the benefit under this section, it is necessary that the donor gives a specific direction that the voluntary contribution made by him should form part of the corpus of the trust. However, in this case, the donors have not given any specific directions that the contribution should form part of the corpus of the trust. Therefore, the benefit of exemption under section 11(1)(d) would not be available to the collections made through the hundi and such collections would be treated as income from the property held under trust.

It may be noted that the provision relating to taxability of anonymous donations @ 30% under section 115BBC does not apply to voluntary contributions received by a trust or institution created or established wholly for religious purposes.

Note - As per section 11(1)(d), income in the form of voluntary contributions made with a specific direction that they shall form part of the corpus of the trust or institution shall not be included in the total income of the recipient. In the given case, there is a specific declaration by the temple authorities that the contributions being put in the hundi would form part of the corpus of the trust fund. Therefore, it is possible to presume that those who put the contributions in the hundi give a tacit declaration that the contributions would form part of the corpus. Hence, a view can

be taken that such contributions shall not be included in the total income of the recipient.

- (4) The entertainment allowance received by the Minister of Surface Transport is taxable under the head "Salaries". However, deduction under section 16(ii) is allowable to the extent of least of the following –
- (i) 1/5th of the salary
 - (ii) Rs.5,000
 - (iii) Actual entertainment allowance received, i.e., Rs.24,000 in this case.
- (5) As per section 25AA, unrealised rent would be deemed to be the income chargeable under the head "Income from house property". Accordingly, it would be chargeable to income-tax as income of that previous year in which such rent is realised whether or not the assessee is the owner of that property in that previous year. Therefore, in this case, unrealised rent of Rs.30,000 would be charged to tax in the P.Y.2007-08 under the head "Income from house property" even though he is no longer the owner of the house property.

- (b) The mode of attachment and sale of both movable and immovable property is dealt with in the Second Schedule to the Income-tax Act:

Immovable property [Rule 54 of Schedule II to the Income-tax Act,1961]

Where the Tax Recovery Officer orders sale of immovable property which has been attached under the provisions of Act, he has to make a proclamation thereof in accordance with Rule 54 of the second schedule. Various modes of such proclamation are:

- (a) by beat of drum or other customary mode on or near such property;
- (b) by publication in a local news paper or in the Official Gazette or in both.

However, where the property to be sold is divided into lots, then it is not necessary to make the proclamation for each lot of property separately, unless the Tax Recovery Officer considers that proper notice of the sale cannot be otherwise given.

Movable Property [Rules 38 & 39 of Schedule II to the Income-tax Act,1961]

Where the Tax Recovery Officer orders sale of movable property, he should issue a proclamation in the language of the district of the intended sale, specifying the time and place of sale and whether the sale is subject to confirmation or not.

The proclamation should be made by beat of drum or other customary mode, -

- (a) in the case of property attached by actual seizure –
 - (i) in the village in which the property was seized, or, if the property was seized in a town or city, then, in the locality in which it was seized; and
 - (ii) at such other places as the Tax Recovery Officer may direct;
- (b) in the case of property attached otherwise than by actual seizure, in such places, if any, as the Tax Recovery Officer may direct.

A copy of the proclamation should also be affixed in a conspicuous part of the office of the Tax Recovery Officer.

Question 5

- (a) Examine the following cases and state whether the same are liable for penalty as per the provisions of the Income-tax Act:
- (i) Raman & Associates had made payment in excess of the limits prescribed to the contractors for carrying out labour job work at various sites, but had not deducted tax at source as per section 194C.
 - (ii) Hotels and Hotels were asked by Income-tax Officer (CIB) to furnish details of all such tourists who stayed in their hotels and had paid bill amount in excess of Rs.10,000. They have not furnished the requisite information inspite of various reminders.
 - (iii) An assessee whose turnover in the previous year was Rs.20 lacs had neither opted to be taxed as per section 44AF of the Act nor had kept and maintained books of accounts. (2 × 3 = 6 Marks)
- (b) Explain the meaning of “eligible business” referred to in section 80-IE granting tax holiday in respect of profits and gains of certain undertakings in North-Eastern States. (4 Marks)
- (c) Examine the correctness of the statement “that the jurisdiction of an Assessing Officer cannot be objected by the assessee”. (4 Marks)

Answer

- (a) (i) Penalty under section 271C is attracted for failure to deduct tax at source. The penalty would be a sum equal to the amount of tax which such person has failed to deduct. Such penalty can be imposed only by the Joint Commissioner. Therefore, Raman & Associates shall be liable for penalty under section 271C equal to the amount of tax which they have failed to deduct under section 194C from the payments made to the contractors.
- (ii) Section 133(6) empowers an Income-tax Officer to require any person to furnish information in relation to such points or matters which will be useful for or relevant to any enquiry or proceeding under the Act. Failure on the part of an assessee to furnish the information in relation to such points or matters as required by the Income-tax Officer makes him liable for penalty under section 272A(2) of Rs.100 for every day during which the failure continues.

Note – In a case where no proceeding is pending, the Income-tax Officer can exercise this power only after obtaining the approval of the Director or Commissioner, as the case may be. In this case, it is presumed that the Income-tax

Officer has obtained the approval of the Director or Commissioner before exercising this power.

- (iii) In this case, since the assessee has not opted for presumptive taxation under section 44AF, he has to maintain books of accounts as prescribed under section 44AA. Since he has not maintained the books of accounts, he is liable to pay a penalty of Rs.25,000 under section 271A for default in complying with the provisions of section 44AA.
- (b) Eligible business as referred to in section 80-IE of the Act means the business of :
- (a) hotel (not below two star category),
 - (b) adventure and leisure sports including ropeways;
 - (c) providing medical and health services in the nature of nursing home with a minimum capacity of 25 beds;
 - (d) running an old-age home;
 - (e) operating vocational training institute for hotel management, catering and food craft, entrepreneurship development, nursing and para-medical, civil aviation related training, fashion designing and industrial training;
 - (f) running information technology related training center;
 - (g) manufacturing of information technology hardware; and
 - (h) bio-technology.
- (c) According to section 124(3), the assessee can raise a question as to the jurisdiction of an Assessing Officer within the prescribed time limit as under:
- (i) where a return has been filed under section 139(1) or section 115WD(1), then, within one month from the date of service of notice under section 142(1) or section 115WE(2) or section 143(2) or before the completion of assessment, whichever is earlier.
 - (ii) where no return has been filed, then, within the expiry of time allowed by the notice under section 115WD(2) or section 142(1) or section 115WH(1) or section 148 for filing the return or within the time allowed to show cause as to why best judgment assessment under section 115WF or section 144 should not be made, whichever is earlier.

Where the assessee calls in question the jurisdiction of an Assessing Officer and the Assessing Officer is not satisfied with such claim, he shall refer the matter for determination by the Director General or Chief Commissioner or Commissioner before the assessment is made.

Therefore, in view of the above provisions, the statement that "the jurisdiction of an Assessing Officer cannot be objected by the assessee" is not correct.

Question 6

- (a) "Income-tax Act, 1961 extends to whole of India". What meaning has been assigned to "India" under this Act? (3 Marks)
- (b) Explain those conditions which are required to be fulfilled by both the predecessor and successor co-operative banks in order to claim benefit of Section 72AB of the Act? (5 Marks)
- (c) Specify all those public facilities which have been notified by CBDT as infrastructure facility for the purpose of section 36(1)(viii). (5 Marks)

Answer

- (a) The Finance Act, 2007, has, with retrospective effect from 25.08.1976, substituted section 2(25A) by defining the term "India" to mean the territory of India as referred to in Article 1 of the Constitution, its territorial waters, seabed and sub-soil underlying such waters, continental shelf, exclusive economic zone or any other maritime zone as referred to in the Territorial Waters, Continental Shelf, Exclusive Economic Zone and other Maritime Zones Act, 1976 and the air space above its territory and territorial waters.
- (b) The benefit of carry forward and set-off of accumulated loss and unabsorbed depreciation allowance in case of business reorganisation of co-operative banks would be available under section 72AB only on fulfillment of the following conditions -
- (a) Conditions to be fulfilled by the predecessor bank
- (1) it should have been engaged in the business of banking for three or more years; and
 - (2) it should have held at least three-fourths of the book value of fixed assets as on the date of the business reorganisation, continuously for two years prior to the date of business reorganisation.
- (b) Conditions to be fulfilled by the successor bank
- (1) it should hold at least three-fourths of the book value of fixed assets of the predecessor co-operative bank acquired through business reorganisation, continuously for a minimum period of five years immediately succeeding the date of business reorganisation;
 - (2) it continues the business of the predecessor co-operative bank for a minimum period of five years from the date of business reorganisation; and
 - (3) it fulfils such other conditions as may be prescribed to ensure the revival of the business of the predecessor cooperative bank or to ensure that the business reorganisation is for genuine business purpose.

- (c) The CBDT, vide Notification No. 188/2006 dated 20.07.2006, has notified the following public facilities as infrastructure facility for the purpose of section 36(1)(viii):
- (1) Inland Container Depot and Container Freight Station notified under the Customs Act, 1962
 - (2) Mass Rapid Transit system
 - (3) Light Rail Transit system
 - (4) Expressways
 - (5) Intra-urban or semi-urban roads like ring roads or urban by-passes or flyovers
 - (6) Bus and truck terminals
 - (7) Subways
 - (8) Road dividers
 - (9) Bulk Handling Terminals which are developed or maintained or operated for development of rail system
 - (10) Multilevel Computerised Car Parking.

Question 7

Answer the following in the context of provisions contained in Income-tax Act, 1961:

- (a) Ram Kripa Kuber Gramin Bank, a co-operative society engaged in banking business, provided training to its employees before regular employment. The employees undergoing such training were required to execute a contract bond and to furnish security deposit. Certain such employees left the services of the bank in between and as per terms of the contract the security deposit was forfeited and the recoveries against notice pay and training charges were also made. A.O. taxed these amounts as income which is objected and claimed to be not subject to tax by the bank.
- (b) The A.O. within the powers vested in him under section 142(2A), while examining the accounts of PNF Ltd., had ordered to get the same audited. The company challenges this order on the ground "that the opportunity was not provided to them by the A.O. prior to passing of such an order".
- (c) Assessment for A.Y. 2002-03 was completed as per section 143(3) considering the various claims so made by the assessee on 23.12.2003. Subsequently, this was reopened under section 147 on certain issues, but excluding the claim of the assessee as to "Lease Equalisation Fund". The order of reassessment was passed on 24.11.2006. The Commissioner within the powers vested under section 263 passed an order on 11.1.2008 rejecting the claim of assessee as to "Lease Equalisation Fund". The assessee challenges that the action of the CIT is not sustainable because the same was barred by limitation. (4 × 3 = 12 Marks)

Answer

- (a) The facts given in the question are similar to the facts in the case of Gorakhpur Kshetriya Gramin Bank v. CIT (2007) 292 ITR 205 decided by the Allahabad High Court. In that case, the High Court observed that for claiming exemption under section 80P(2)(a)(i), the assessee is required to establish that the income is attributable to carrying on the business of banking. The business of banking cannot be carried on without the aid of the employees. Therefore, the amounts recovered from the employees, who have left the job in between as per terms of the contract, and forfeiture of the security deposit are amounts attributable to the activity of carrying on the business of banking. It was not a case where the assessee, apart from carrying on the business of banking, was also running the training institute for training persons in the banking industry for providing services of trained persons to other banks. Thus, the Court held that receipts on account of pay recovered from resigned staff, recovery of training cost and security forfeiture were allowable as deduction.

Therefore, the action of Assessing Officer to tax the amounts recovered by Ram Kripa Kuber Gramin Bank as income chargeable to tax is incorrect because the amount recovered by the bank shall be treated as an income attributable to the banking business and would be eligible for deduction under section 80P.

- (b) The Assessing Officer had passed an order to get the accounts audited under section 142(2A) without providing the assessee an opportunity of being heard before issuing such order. The Apex Court, in the case of Rajesh Kumar v. DCIT (2006) 287 ITR 91, has observed that the order under section 142(2A) is a quasi judicial order. Therefore, the principles of natural justice have to be applied and the assessee has to be given an opportunity of being heard before directing the special audit. The principles of natural justice are based on two principles, namely, (i) nobody shall be condemned unheard; (ii) nobody shall be a judge of his own cause. Once it is held that the assessee suffers civil consequences and any order passed would be prejudicial to him, the principles of natural justice must be held to be implicit.

Accordingly, to give effect to this observation of the Supreme Court, the Finance Act, 2007 has inserted a proviso to section 142(2A) to provide that the Assessing Officer shall not direct the assessee to get the accounts so audited unless the assessee has been given a reasonable opportunity of being heard.

Therefore, in this case, the order of the Assessing Officer is not valid since the assessee was not given an opportunity of being heard prior to passing of such order.

- (c) This issue was settled by the Supreme Court in CIT v. Alagendran Finance Ltd. (2007) 293 ITR 1. The Supreme Court observed that though there was no doubt that once an order of assessment is reopened, the previous assessment will be held to be set aside and the whole proceedings would start afresh, however, it would not mean that even

when the subject-matter of reassessment is distinct and different, the entire proceeding would be deemed to have been reopened. The doctrine of merger would apply only in a case where the subject-matter of reassessment and the subject-matter of assessment are the same. However, in this case, the revision proceedings related to Lease Equalisation Fund, which was not the subject matter of reassessment. Therefore, the doctrine of merger does not apply in this case and the revision proceedings are barred by limitation.

Section 263(2) provides no order shall be made under section 263(1) after the expiry of two years from the end of the financial year in which the order sought to be revised was passed. The period of limitation as referred to in section 263(2) relates to the assessment in which the claim of the assessee as to Lease Equalisation Fund was considered by the Assessing Officer. This issue was not the subject matter of reassessment proceedings. Accordingly, the period of limitation shall be reckoned with reference to the original assessment order and not from the date of the order of reassessment. Therefore, in this case, the revision proceedings are barred by limitation since the original assessment order was made on 23.12.2003 and the revision should have been made by 31.3.2006.

Question 8

- (a) State with reasons whether the following constitute assets chargeable to wealth-tax on the valuation date 31.3.2008:
- (i) Agricultural farm house situated 26 kms outside the municipal limits of Jaipur, but within 22 kms of Niwai Municipal Corporation.
 - (ii) Factory building and godowns leased out on rent.
 - (iii) Silver and gold in the jewellers shop
 - (iv) Aircraft held by a shipping company having turnover of Rs.800 crores for exclusive use of its managing director.
 - (v) A cash balance of Rs.1,50,000. (5 Marks)
- (b) Rakesh, a married coparcener having no son but two minor daughters, gets a commercial property on disruption of the HUF on 17.3.2008. He, therefore, seeks your advice to know in whose hands the value of this property would be subject to wealth-tax on the valuation date 31.3.2008. (3 Marks)
- (c) How can the arrear demand of wealth-tax be recovered by the department where the assessee dies prior to making payment thereof? (2 Marks)

Answer

- (a) (i) According to the definition of the term 'asset' under section 2(ea), building includes a farm house situated within 25 kms from the local limits of a municipality.

Therefore, the farm house situated within 25 kms from the local limits of Niwai Municipal Corporation is an asset as per section 2(ea) of the Wealth-tax Act.

- (ii) There are some exceptions to the chargeability of building to wealth-tax. One of the exceptions is property in the nature of commercial establishments or complexes. Therefore, factory buildings and godowns leased out on rent are not assets within the meaning of section 2(ea) of the Wealth-tax Act.
 - (iii) The silver and gold lying in a jeweller's shop are not assets under section 2(ea) of the Wealth-tax Act as the same constitute stock-in-trade of the assessee.
 - (iv) The definition of asset under section 2(ea) includes yachts, boats and aircrafts, other than those used by the assessee for commercial purposes. Therefore, the aircraft held by a shipping company for the exclusive use of its managing director is an asset chargeable to tax.
 - (v) The cash in hand in excess of Rs.50,000 is an asset chargeable to wealth-tax in case of individuals and HUFs. In case of any other person, any cash not recorded in the books will only be treated as an asset.
- (b) The facts given in the question are similar to the facts of the case decided by the Apex Court in the case of Narendra Nath v. CWT (1969) 74 ITR 190 wherein it was held by the Court that if a co-parcener not having a son but having two minor daughters receives his share in the joint family property on disruption, then, such property would belong to the HUF comprising of himself, his wife and minor daughters and cannot be assessed as his individual property.

It may be noted that any property in the nature of commercial establishments are excluded from the definition of asset under section 2(ea). Therefore, commercial property received by Rajesh would not be chargeable to wealth-tax on the valuation date.

- (c) Where the assessee dies prior to making of payment of demand of wealth tax, the same shall be recovered as per section 19(1) out of the estate of the deceased from his executor, administrator or other legal representative. The executor, administrator or other legal representative shall be liable to pay out of the estate of the deceased person, to the extent to which the estate is capable of meeting the charge, the wealth tax assessed as payable by such person if he had not died.