

INTERMEDIATE EXAMINATION

GROUP I

(SYLLABUS 2008)

SUGGESTED ANSWERS TO QUESTIONS

DECEMBER 2011

Paper-7 : APPLIED DIRECT TAXATION

Time Allowed : 3 Hours

Full Marks : 100

The figures in the margin on the right side indicate full marks.

Wherever required, the candidate may make suitable assumptions and state them clearly in the answers.

Working notes should form part of the relevant answers.

All questions relate to the assessment year 2011-12 and the provisions stated relate to Income Tax Act, 1961, unless stated otherwise in the question.

Answer Question No. 1, which is compulsory and any five from the rest.

Q. 1. Choose the correct answer :

[1×25=25]

- (a) For RAJASTHALI Ltd., a company engaged in the manufacture of automotive parts, the rate of depreciation on acquiring machinery from UK on 1 January, 2011 to be used in India for the first time for AY 2011-12 will be :

A. 15%	B. 25%	C. 7.5%	D. None of these
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- (b) ARUN JAIDEV Ltd. has taken office premises on lease from Mr. X. The monthly rental amounts to ₹ 15,000-on which service tax is levied @ 10.30% thereby resulting in a total monthly expense of ₹ 16,545. TDS u/s 194I on this transaction is applicable on :

A. ₹ 15,000	B. ₹ 16,500	C. ₹ 16,545	D. Nil
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2 ♦ Suggested Answers to Question — ADT

- (c) PREM BANSAL Ltd. makes a payment of ₹ 35,000 in cash to a transporter for plying of goods carriages in a single day. The disallowance under section 40A(3) will be :

A. ₹ 35,000	B. ₹ 20,000	C. ₹ 15,000	D. Nil
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- (d) S. S. CORPORATE SECURITIES Ltd., an existing company incurred an expenditure of ₹ 1,00,000 in FY 2010-11 in connection with issue of shares to increase its share capital for a period of 10 years. The amount allowed as deduction under section 37(1) for AY 2011-12 will be :

A. ₹ 10,000	B. ₹ 20,000	C. ₹ 1,00,000	D. Nil
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- (e) PELF FINSTOCK Ltd. filed its Return of Income Tax for AY 2010-11 on 30th March, 2011. The notice for making scrutiny assessment under section 143(3) can be served on the assessee upto :

A. 30th September, 2011	B. 31st December, 2011	C. 30th March, 2012	D. 30th September, 2012
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- (f) Interest under section 234B is payable by an assessee due to the following reason :

A. Defaults in furnishing return of income	B. Defaults in payable of advance tax	C. Defaults in instalments of advance tax	D. Defaults due to non-deduction of tax at source
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- (g) The basic exemption limit for a Non-resident woman who is 70 years old for the Assessment Year 2011-12 is :

A. ₹ 1,60,000	B. ₹ 2,40,000	C. ₹ 1,90,000	D. ₹ 1,80,000
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- (h) The charging section of the Income Tax Act is:

A. Section 1	B. Section 2	C. Section 3	D. Section 4
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- (i) Deduction of profit and gains derived from export under section 10AA available to SEZ units is for _____ years.

A. 10	B. 5	C. 8	D. None of these
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- (j) In case of conflict between the provisions of Income Tax Act and the provisions of Double Taxation Avoidance Agreement (DTAA), the following shall prevail :

A. The Income Tax Act, 1961	B. DTAA	C. Whichever is beneficial to the assessee	D. Whichever is beneficial to the Income Tax authorities
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- (k) Walmart Ltd., is in the business of setting up and operation cold chain facilities. It commenced its operations on 1.4.2010 and claimed deduction of all expenditure under section 35AD. The net loss for the year ending 2010-11 is ₹ 50,00,000. The number of years for which this loss can be

carried forward is:

A. 8 years	B. 4 years	C. Infinitely	D. Cannot be carried forward
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- (l) MR. RAKESH BEHARI is a trader and deals in purchase and sales of cloth. He is required to get his accounts audited under section 44AB if his total sales/turnover exceeds:

A. ₹ 40,00,000	B. ₹ 10,00,000	C. ₹ 15,00,000	D. ₹ 60,00,000
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- (m) MAT credit under section 115JAA is allowed to be carry forward and set-off for _____ years.

A. 10	B. 8	C. 7	D. Infinitely
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- (n) Xing Ltd. is incorporated in USA, it declared of ₹ 1,00,000 to its Indian shareholders on 30th September, 2010. The rate at which Xing Ltd. is liable to pay Dividend Distribution Tax (DDT) under section 115-O is equal to :

A. 15%	B. 16.995%	C. 16.61%	D. Not liable to pay DDT
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- (o) The ceiling limit for exemption of Gratuity under section 10(10) received from the employer is:

A. ₹ 10,00,000	B. ₹ 3,50,000	C. ₹ 5,00,000	D. ₹ 3,00,000
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- (p) On 17th January, 2011, M/s. Naina sold a house property and earned a long term capital gain of ₹ 1,02,50,000. She invested a sum of ₹ 50,00,000 in bonds specified in section 54EC on 8th March, 2011. She further invested a sum of ₹ 50,00,000 in same bonds on 8th May, 2011. Taxable Income of M/s. Naina for the Assessment Year 2011-12 will be:

A. ₹ 50,00,000	B. ₹ 50,50,000	C. ₹ 1,00,50,000	D. ₹ 2,50,000
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- (q) PRARTHANA Ltd. has to make a payment of ₹ 10,00,000 to Mr. PIYUSH for certain services. PRARTHANA Ltd. is required to deduct tax at source at the rate of 10%. However, Mr. PIYUSH does not provide Permanent Account Number (PAN) to PRARTHANA Ltd. for deduction of tax from ₹ 10,00,000. The rate at which tax will be deducted by PRARTHANA Ltd. will be:

A. 10%	B. 20%	C. 30%	D. No TDS should be deducted due to non-availability of PAN
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- (r) Incomes which accrue or arise outside India but are received directly in India are taxable in case of:

A. Resident only	B. Non-Residents	C. All Assessees	D. Resident but not Ordinarily Resident
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4 ♦ Suggested Answers to Question — ADT

(s) Where the Assessing Officer is aggrieved by an order of the Commissioner of Income-tax (Appeals), further appeal in respect of same lies to:

A. Income-tax Appellate Tribunal	B. Dispute Resolution Panel	C. Central Board of Direct Taxes	D. Income-tax Settlement Commission
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(t) A company is required to pay 75% of its advance tax liability by which date:

A. 15 March of the previous year	B. 15 December of the previous year	C. 15 September of the previous year	D. 15 June of the previous year
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(u) S. Ltd. is an Indian Company which is 100% subsidiary of H. Ltd., a Foreign Company. H. Ltd. sells its products to S. Ltd. at ₹ 15 per unit. At the same time, it sells its products to an unrelated party at ₹ 20 per unit. The arm's length price as per section 92C in this transaction will be:

A. ₹ 15	B. ₹ 20	C. ₹ 15.75	D. \$ 21
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(v) R. Ltd. is registered in UK. Its control and management is wholly situated in India. R. Ltd. shall be:

A. Resident in India	B. Non-resident in India	C. Resident but not ordinarily resident	D. Resident in India if other certain conditions are satisfied
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(w) Transfer Pricing provisions are applicable if:

A. There is an international transaction between any two parties	B. There is any transaction between associated enterprises	C. There is an international transaction between associated enterprise	D. There is an international transaction between associated enterprises and the transaction is not at arm's length price
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(x) Circulars issued by the Central Board of Direct Taxes is binding on:

A. Assessee only	B. Income-tax authority only	C. Both assesseees and income tax authorities	D. On everyone except the Judiciary
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(y) Additional depreciation under section 32(1) (ia) of the Income-tax Act, 1961 is available to :

A. Plant & Machinery	B. Plant & Machinery and Buildings	C. Plant & Machinery and intangible assets	D. All depreciable assets under the Income-tax Act, 1961
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Answer 1. (a)

- (a) — C.
- (b) — D.
- (c) — D.
- (d) — D.
- (e) — A.
- (f) — B.
- (g) — A.
- (h) — D.
- (i) — D.
- (j) — C.
- (k) — C.
- (l) — D.
- (m) — A.
- (n) — D.
- (o) — A.
- (p) — D.
- (q) — B.
- (r) — C.
- (s) — A.
- (t) — B.
- (u) — A.
- (v) — A.
- (w) — D.
- (x) — B.
- (y) — A.



Q. 2. (a) Answer the following with reference to the provisions of the Income-tax Act, 1961:

- (i) Bad debt claim disallowed in an earlier assessment year, recovered subsequently. Is the sum recovered chargeable to tax?
- (ii) Return of income of a company was signed by the Company Secretary. Is the return a valid return?
- (iii) Tax deducted at source on salary paid to employees not remitted till the 'due date' for filing the return prescribed in section 139. Is the expenditure to be disallowed under section 40(a)(ia)?
- (iv) X Co. Ltd. paid ₹ 120 lakhs as compensation as per approved Voluntary Retirement Scheme (VRS) the financial year 2010-11.

How much is deductible under section 35DDA for the assessment year 2011-12?

[6]

6 ♦ Suggested Answers to Question — ADT

- (b) BHART doing manufacture and wholesale trade furnishes you the following information: Total turnover for the financial year :

2009-10	45,00,000
2010-11	55,00,000

State whether tax deduction at source provisions are attracted for the below said expenses incurred during financial year 2010-11:

Interest paid to UCO Bank	41,000
Contract payment to Raj (2 contracts of ₹ 12,000 each)	24,000
Shop rent paid (one payee)	1,90,000
Commission paid	7,000

[3]

- (c) RAJASTHALI Ltd. furnishes you the following information for the year ended 31.3.2011:

Total turnover of Unit A located in Special Economic Zone	100 lakhs
Profit of the business of Unit A	30 lakhs
Export turnover of Unit A	50 lakhs
Total turnover of Unit B located in Domestic Tariff Area (DTA)	200 lakhs
Profit of the business of Unit B	20 lakhs

Compute deduction under section 10AA for the A. Y. 2011-12.

[3]

- (d) TUSHAR had 4 heavy goods vehicles as on 1.4.2010. He acquired 7 heavy goods vehicles on 27.6.2010 sold 2 heavy goods vehicles on 31.5.2010.

He has brought forward business loss of ₹ 50,000 relating to assessment year 2007-08 of a discontinued business. Assuming that he opts for presumptive taxation of income as per section 44AE, compute his income chargeable to tax for the assessment year 2011-12.

[3]

Answer 2. (a)

- (i) Recovery of a bad debt claim disallowed in the earlier year cannot be brought to tax under section 41(4). Section 41(4) can be invoked only in a case where bad debts or part thereof has been allowed as deduction earlier under section 36(1)(vii).
- (ii) Where the return of income of a company was signed by a company secretary, although it is supposed to be signed by a Managing Director or a Director (in the absence of a Managing Director), it is a defective return, which can be rectified and not an invalid return.

Note :

- (1) *There is an alternate view that the return of income of a company, which is not signed and verified by the Managing Director or Director, is not a defective return but an invalid return and thus, void-ab-initio.*

- (2) *In case of a company not resident in India, the return of income may be signed and verified by any person who holds a valid power of attorney. Since the question does not specify the residential status of a company, it is possible to answer that the return is valid if the company is non-resident and the Company Secretary holds a valid power of attorney.*
- (iii) The salary expenditure is allowable while computing the income of the employer even though TDS has not been deposited within the due date under section 139(1). The disallowance under section 40(a)(ia) will not apply for non-deduction of tax at source from income chargeable under the head "Salaries".
- (iv) It is deductible in 5 equal annual instalments commencing from the previous year of payment. ₹ 24 lakhs, being 1/5th of ₹ 120 lakhs, is deductible under section 35DDA for the A. Y. 2011-12.

Answer 2. (b)

As the turnover of BHART for F. Y. 2000-10, i.e. ₹ 45 lakh, has exceeded the monetary limit of ₹ 40 lakh prescribed under section 44AB, he has to comply with the tax deduction provisions during the financial year 2010-11, subject to however the exemptions provided for under the relevant sections for applicability of TDS provisions.

Interest paid to UCO Bank

TDS under section 194A is not attracted in respect of interest paid to a banking company.

Contract payment of ₹ 24,000 to Rai for 2 contracts of ₹ 12,000 each

TDS provisions under section 194C would not be attracted if the amount paid to a contractor does not exceed ₹ 30,000 in a single payment or ₹ 75,000 in the aggregate during the financial year. Therefore, TDS provisions under section 194C are not attracted in this case.

Shop Rent paid to one payee – Tax has to be deducted under section 194-I as the rental payment exceeds ₹ 1,80,000.

Commission paid – Tax has to be deducted under section 194-H as the commission exceeds ₹ 5,000.

Note :

- (1) *The monetary limit of turnover for tax audit under section 44AB has been increased from ₹ 40 lakh to 60 lakh w.e.f. A. Y. 2011-12. However, for determining the applicability of TDS provisions under section 194A for F. Y. 2010-11, the turnover and monetary limit under section 44AB for F. Y. 2009-10 are relevant.*
- (2) *The Finance Act, 2010 has increased the threshold limits for applicability of TDS provisions w.e.f. 1st July, 2010. It is presumed that the payments specified in the question were made on or after 15th July, 2010, and accordingly, the reasoning has been given on the basis of the provisions as amended by the Finance Act, 2010 w.e.f. 1.7.2010.*

Answer 2. (c)

100% of the profit derived from export of articles or things or services is eligible for deduction under section 10AA, assuming that F. Y. 2010-11 falls within the first five year period commencing from the year of manufacture or production of articles or things or provision of services by the Unit in SEZ. As per section 10AA(7), the profit derived from export of articles or things or services shall be the amount which bears to the profits of the business of the undertaking, being the Unit, the same proportion as the export turnover in respect of articles or things or services bears to the total turnover of the business carried on by the undertaking.

8 ♦ Suggested Answers to Question — ADT

Deduction under section 10AA

$$\begin{aligned}
 &= \text{Profit of the business of Unit A} \times \frac{\text{Export Turnover of Unit A}}{\text{Total Turnover of Unit A}} \\
 &= ₹ 30 \text{ lakhs} \times \frac{50}{100} \\
 &= ₹ 15 \text{ lakhs}
 \end{aligned}$$

Answer 2. (d)

Computation of total income of Mr. TUSHAR for A. Y. 2011-12

Particulars	₹
Presumptive business income under section 44AE	
4 heavy goods vehicles for 2 months (4 × ₹ 5,000 × 2)	40,000
Balance 2 heavy goods vehicles for 10 months (2 × ₹ 5,000 × 10)	1,00,000
7 heavy goods vehicles for 10 months (7 × ₹ 5,000 × 10)	3,50,000
Business Income	4,90,000
Less: Brought forward business loss of discontinued business	50,000
Total Income	4,40,000

Note : The assessee is eligible for computing the income from goods carriages applying the presumptive provisions of section 44AE, since he did not own more than 10 goods carriages at any time during the previous year.

Q. 3. (a) Mr. PADAM engaged in retail trade, reports a turnover of ₹ 58,50,000 for the financial year 2010-11. His income from the said business as per books of account is computed at ₹ 2,90,000. Retail trade is the only source of his income:

- Is Mr. PADAM eligible to opt for presumptive determination of his income chargeable to tax for the assessment year 2011-12?
- If so, determine his income from retail trade as per the applicable presumptive provision.
- In case he does not opt for presumptive taxation of income from retail trade, what are his obligations under the Income-tax Act, 1961?
- What is the due date for filing his return of income under both the options? [5]

(b) MITTAL (P) Ltd., converted into a Limited Liability Partnership (LLP) by name All Trade LLP, with effect from 01.04.2010:

The following details are given to you:

Asst. year 2003-04 : Business loss brought forward	2,00,000
Asst. year 2010-11 : Business loss brought forward	5,00,000
(These are related to erstwhile MITTAL (P) Ltd.)	
Total income of All Trade LLP, for the financial year 2010-11 (Before set off of brought forward business losses of erstwhile company i.e. MITTAL (P) Ltd.)	6,00,000

Assume that all the conditions prescribed in section 47(xiii b) were satisfied by (P) Ltd. at the time of conversion into LLP:

(P)

- (i) Explain whether All Trade LLP can set off and carry forward the business loss of its predecessor i.e. MITTAL (P) Ltd.?
- (ii) State whether any change in partners of All Trade LLP at later date would have any tax consequence. [5]

(c) CHERRY Limited commenced the business of operating a three star hotel in Tirupati on 1.4.2010. It furnishes you the following information:

(i) Cost of land (acquired in June 2008)	60 lakhs
(ii) Cost of construction of hotel building	
Financial year 2008-09	30 lakhs
Financial year 2009-10	150 lakhs
(iii) Plant and Machineries (all new) acquired during financial year 2009-10	30 lakhs
[All the above expenditures were capitalized in the books of the company]	
Net profit before depreciation for the financial year 2010-11	80 lakhs

Determine the amount eligible for deduction under section 35AD of the Income-tax Act, 1961, for the assessment year 2011-12. [5]

Answer 3. (a)

- (i) Yes. Since his total turnover for the F. Y. 2010-11 is below ₹ 60 lakhs, he is eligible to opt for presumptive taxation scheme under section 44AD in respect of his retail trade business.
- (ii) His income from retail trade, applying the presumptive tax provisions under section 44AD, would be ₹ 4,68,000, being 8% of ₹ 58,50,000.
- (iii) In case he does not opt for the presumptive taxation scheme under section 44AD, and claims that his income is ₹ 2,90,000 (which is lower than the presumptive business income of ₹ 4,68,000), he has to maintain books of account as required under section 44AA(2) and also get them audited and furnish a report of such audit under section 44AB, since his total income exceeds the basic exemption limit of ₹ 1,60,000.
- (iv) In case he opts for the presumptive taxation scheme under section 44AD, the due date would be 31st July, 2011.

In case he does not opt for the presumptive taxation scheme and claims that his income is ₹ 2,90,000 as per books of account, then he has two options. If he chooses to file return without audit, the due date is 31st July 2011. If he chooses to get his books audited u/s 44AB then due date is 30th September, 2011.

Answer 3. (b)

- (i) Sub-section (6A), inserted by the Finance Act, 2010 in section 72A, provides that where a private company is succeeded by a LLP fulfilling the conditions laid down in the proviso to section 47(xiii b), then, notwithstanding anything contained in any other provision of the Income-tax Act, 1961, the

10 ♦ *Suggested Answers to Question — ADT*

accumulated loss and unabsorbed depreciation of the predecessor company shall be deemed to be the loss or allowance for depreciation of the successor LLP for the purpose of the previous year in which the business reorganisation was effected and other provisions of the Act relating to set-off and carry forward of losses and depreciation allowance shall apply accordingly.

Therefore, All Trade LLP can carry forward and set-off the business loss of ₹ 7 lakh of erstwhile. Mittal (P) Ltd. against its business income for the F. Y. 2010-11. The unabsorbed business loss will be carried forward to the next year.

- (ii) Section 47(xiiib) requires that the shareholders of the company become partners of the LLP in the same proportion as their shareholding in the company. Further, the erstwhile shareholders of the company should continue to be entitled to receive at least 50% of the profits of the LLP for a period of 5 years from the date of conversion. If the entity fails to fulfil this condition, the benefit of set-off of business loss availed by the LLP would be deemed to be the profits and gains of the LLP chargeable to tax in the previous year in which the LLP fails to fulfil the condition.

Answer 3. (c)

Under section 35AD, 100% of the capital expenditure incurred during the previous year, wholly and exclusively for the specified business, which includes the business of building and operating a hotel of two-star or above category anywhere in India which commences its operations on or after 1.4.2010, would be allowed as deduction from the business income. However, expenditure incurred on acquisition of any land, goodwill or financial instrument would not be eligible for deduction.

Further, the expenditure incurred, wholly and exclusively, for the purpose of specified business prior to commencement of operation would be allowed as deduction during the previous year in which the assessee commences operation of his specified business. A condition has been inserted that such amount incurred prior to commencement should be capitalized in the books of account of the assessee on the date of commencement of its operations.

Accordingly, the deduction under section 35AD for the A. Y. 2011-12 in the case of Cherry Ltd. would be calculated as follows, assuming that the expenditures were capitalised in the books of the company on 1.4.2010, being the date of commencement of operations —

Particulars	₹ (in lakhs)
Cost of land (not eligible for deduction under section 35AD)	Nil
Cost of construction of hotel building (₹ 30 lakhs + ₹ 150 lakhs)	180
Cost of plant and machinery	<u>30</u>
Deduction under section 35AD	<u>210</u>

Note :

For A. Y. 2011-12, the loss from specified business of operating a three star hotel would be ₹ 130 lakhs (i.e. ₹ 210 lakhs - 80 lakhs). As per section 73A, any loss computed in respect of the specified business referred to in section 35AD shall be set off only against profits and gains, if any, of any other specified business. The unabsorbed loss, if any, will be carried forward for set off against profits and gains of any specified business in the following assessment year.

Q. 4. (a) BIRLA Ltd., a cement manufacturing company, entered into an agreement with a supplier for purchase of additional cement plant. One of the conditions in the agreement was that if the supplier failed to supply the machinery within the stipulated time, the company would be compensated at 5% of the price of the respective portion of the machinery without proof of actual loss. The company received ₹ 8.50 lakhs from the supplier by way of liquidated damages on account of his failure to supply the machinery within the stipulated time. What is the nature of liquidated damages received by BIRLA Ltd. from the supplier of plant for failure to supply machinery to the company within the stipulated time—a capital receipt or a revenue receipt? [5]

(b) A public charitable trust, created under a trust deed for providing relief to poor, registered under section 12A, furnishes the following particulars of its receipts during the year ended 31st March, 2011:

	₹ in lakh
(i) Income from properties held by trust (net)	12
(ii) Income (net) from business (incidental to main objects)	25
(iii) 'Voluntary contributions from public (including the corpus donation of ₹ 4 lakh)	14

The trust applied ₹ 15 lakhs towards activities undertaken for the benefit of street urchins and "Below Poverty Line" (BPL) families during the year. The trust has also paid ₹ 18 lakh towards repayment of a loan taken a year back for the purpose of construction of a vocational training centre for the benefit of training of youth from BPL families.

Determine the Taxable Income, if any, of the trust for the assessment year 2011-12. [5]

(c) During the financial year 2010-11, the following payments/expenditures were made/incurred by Mr. ATUL GUPTA, a resident individual (whose turnover during the year ended 31.3.2010 was ₹ 39 lakhs).

- (i) Interest of ₹ 12,000 was paid to P C T & Co., a resident partnership firm, without deduction of tax at source;
- (ii) Interest of ₹ 4,000 was paid as interest to Mr. PULKIT a non-resident, without deduction of tax at source;
- (iii) ₹ 3,00,000 was paid as salary to a resident individual without deduction of tax at source;
- (iv) He had sold goods worth ₹ 5 lakhs to Mr. SANCHIT. He gave Mr. SANCHIT a cash discount of ₹ 12,000 later. Commission of ₹ 15,000 was paid to Mr. Vidyasagar on 2.7.2010. In none of these transactions, tax was deducted at source.

Briefly discuss whether any disallowance arises under the provisions of section 40(a)(i)/40(a)(ia) of the Income-tax Act, 1961. [5]

Answer 4. (a)

This issue came up before the Apex Court in *CIT v. Saurashtra Cement Ltd.* (2010) 325 ITR 422.

The Apex Court affirmed the decision of the Gujarat High Court holding that the damages were directly and intimately linked with the procurement of a capital asset i.e., the cement plant, which lead to delay in

12 ♦ Suggested Answers to Question — ADT

coming into existence of the profit-making apparatus. It was not a receipt in the course of profit earning process. Therefore, the amount received by the assessee towards compensation for sterilization of the profit earning source, not in the ordinary course of business, is a capital receipt in the hands of the assessee. Therefore, in this case, the liquidated damages of ₹ 8.50 lakhs received by Birla Ltd., from the supplier of plant for failure to supply machinery to the company within the stipulated time is a capital receipt.

Answer 4. (b)

Computation of total income of the trust for the A. Y. 2011-12

Particulars		
Income from properties held by trust	12,00,000	
Income from business incidental to the main objects of the trust	25,00,000	
Voluntary contribution other than corpus donation (Note 1)	<u>10,00,000</u>	47,00,000
Less: 15% of income accumulated or set apart under section 11(1)(a)		<u>7,05,000</u>
		39,95,000
Less: Amount applied for charitable purposes		
Activities for the benefit of street urchins and BPL families	15,00,000	
Repayment of loan taken for construction of vocational training centre (Note 2)	<u>18,00,000</u>	<u>33,00,000</u>
Taxable Income		<u>6,95,000</u>

Notes :

- (1) Section 11(1)(d) excludes from the total income of the person, any 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.
- (2) In *CIT vs. Janmabhumi Press Trust* (2000) 242 ITR 457, the Karnataka High Court held that where a debt is incurred for the purpose of the trust, the repayment of the debt would amount to an application of the income for the purpose of the trust. Therefore, repayment of loan taken for construction of the vocational training centre for the benefit of training of youth from BPL families is to be considered as application for charitable purpose.

Answer 4. (c)

Disallowance under section 40(a)(i)/40(a)(ia) of the Income-tax Act, 1961 is attracted where the assessee fails to deduct tax at source as is required under the Act, or having deducted tax at source, fails to remit the same to the credit of the Central Government within the stipulated time limit.

The assessee is a resident individual, who was not subject to tax audit during the immediately preceding previous year i.e., P. Y. 2009-10 (as his turnover is less than ₹ 40 lakh in that year) and the TDS obligations have to be considered bearing this in mind.

- (i) The obligation to deduct tax source from interest paid to a resident arises under section 194A in the case of an individual, only where he was subject to tax audit under section 44AB in the immediately preceding previous year, i.e., P. Y. 2009-10. From the data given, it is clear that he was not subject to tax audit under section 44AB in the P. Y. 2009-10. Hence, disallowance under section 40(a)(ia) is not attracted in this case.

- (ii) In the case of interest paid to a non-resident, there is obligation to deduct tax at source under section 195, hence non-deduction of tax at source will attract disallowance under section 40(a)(i).
- (iii) Disallowance under section 40(a)(ia) is not attracted for failure to deduct tax at source under section 192 from salaries.
- (iv) The obligation to deduct tax at source under section 194-H from commission paid in excess of ₹ 5,000 w.e.f. 1.7.2010 to a resident arises in the case of an individual, only where he was subject to tax audit under section 44AB in the immediately preceding previous year. From the data given, it is clear that he was not subject to tax audit under section 44AB in the P. Y. 2009-10. Hence, there is no obligation to deduct tax at source under section 194H during the P. Y. 2010-11. Therefore, disallowance under section 40(a)(ia) is not attracted in this case.

Q. 5. (a) The following are the details relating to Mr. SUNIL a resident Indian, aged 57, relating to the year ended 31.3.2011:

Income from salaries	2,20,000
Loss from house property	1,90,000
Loss from cloth business	2,40,000
Income from speculation business	30,000
Loss from specified business covered by section 35AD	20,000
Long-term capital gains from sale of urban land	2,50,000
Long-term capital loss from sale of listed shares in recognized stock exchange (STT paid)	1,10,000
Loss from card games	32,000
Income from betting	45,000
Life Insurance Premium paid	1,20,000

Compute the total income and show the items eligible for carry forward. [8]

(b) NIKITA Pvt. Ltd. is converted into NIKITA LLP on 1.1.2011. The following particulars are available to you:

(i) WDV of land as on 1.4.2010	5,00,000
(ii) WDV of machinery as on 1.4.2010	3,30,000
(iii) Patents acquired on 1.6.2010	3,00,000
(iv) Building acquired on 12.3.2009 for which deduction was allowed under section 35AD	7,00,000
(v) Above building was revalued as on the date of conversion into LLP as	12,00,000
(vi) Unabsorbed business loss as on 1.4.2010 (A. Y. 2007-08)	9,00,000

Though the conversion into LLP took place on 1.1.2011, there was disruption of business and the assets were put in to use by the LLP only from 1st March, 2011 onwards.

14 ♦ Suggested Answers to Question — ADT

The company earned profits of ₹ 8 lakhs prior to computation of depreciation.

Assuming that the necessary conditions laid down in section 47(xiii b) of the Income-tax Act, 1961 have been complied with, explain the tax treatment of the above in the hands of the LLP.

[7]

Note : "WDV of land as on 1.4.2010" may be read as "Cost of land".

Answer 5. (a)

Computation of total income of Mr. Sunil for the A. Y. 2011-12

Particulars	₹	₹
Salaries		
Income from salaries	2,20,000	
Less: Loss from house property	<u>1,90,000</u>	30,000
Profits and gains of business or profession		
Income from speculation business	30,000	
Less: Loss from cloth business set off	<u>30,000</u>	Nil
Capital gains		
Long-term capital gains from sale of urban land	2,50,000	
Less: Loss from cloth business set off	<u>2,10,000</u>	40,000
Income from other sources		
Income from betting		<u>45,000</u>
Gross total income		1,15,000
Less: Deduction under section 80C (life insurance premium paid)		<u>30,000</u>
Total income		85,000
Losses to be carried forward		
(1) Loss from cloth business (2,40,000-30,000-2,10,000)		Nil
(2) Loss from specified business covered by section 35AD		20,000

Notes :

- (i) Long-term capital gains from sale of listed shares in a recognized stock exchange is exempt under section 10(38). Loss from an exempt source cannot be set off against profits from a taxable source. Therefore, long-term capital loss on sale of listed shares cannot be set-off against long-term capital gains from sale of urban land.
- (ii) Loss from specified business covered by section 35AD can be set-off only against profits and gains of any other specified business. Therefore, such loss cannot be set off against any other income. The unabsorbed loss has to be carried forward for set-off against profits and gains of any specified business in the following year.
- (iii) Business loss cannot be set off against salary income. However, the balance business loss of ₹ 2,10,000 (₹ 2,40,000 - 30,000 set-off against income from speculation business) can be set-off against long-term capital gains of ₹ 2,50,000 from sale of urban land. Consequently, the taxable long-term capital gains would be ₹ 40,000.

- (iv) Loss from card games can neither be set off against any other income, nor can it be carried forward.
- (v) For providing deduction under Chapter VIA, gross total income has to be reduced by the amount of long-term capital gains and casual income. Therefore, the deduction under section 80C in respect of life insurance premium paid has to be restricted to ₹ 30,000 [i.e., Gross Total Income of ₹ 1,15,000 - ₹ 40,000 (LTCG) - ₹ 45,000 (Casual income)].
- (vi) Income from betting is chargeable at a flat rate of 30% under section 115BB and no expenditure or allowance can be allowed as deduction from such income, nor can any loss be set-off against such income.

Answer 5. (b)**Tax treatment of depreciation and unabsorbed business loss of a private company on its conversion into a LLP.**

The LLP would be allowed to carry forward and set-off the business loss and unabsorbed depreciation of the predecessor company [Section 72A(6A)].

1. Depreciation

The aggregate depreciation allowable to the predecessor company and successor LLP shall not exceed, in any previous year, the depreciation calculated at the prescribed rates as if the conversion had not taken place. Such depreciation shall be apportioned between the predecessor company and the successor LLP in the ratio of the number of days for which the assets were used by them [Section 32(1)].

Therefore, depreciation has to be first calculated as if the conversion had not taken place and then apportioned between the company and the LLP in the ratio of the number of days for which the assets were used by them.

		Amount	Dep. Rate	Dep. Amount
Block I	Machinery	3,30,000	15%	49,500
Block II	Patents	3,00,000	25%	75,000
				<u>1,24,500</u>

Allocation of depreciation

Depreciation on machinery and patents have to be apportioned between the company and the LLP in the ratio of the number of days for which the assets were used by them. Since patents were acquired only on 1.6.2010, it could have been used by the company for 214 days only. Therefore, the depreciation on assets has to be allocated between the company and LLP as follows -

Asset	Total depreciation for the year	Company		LLP	
		No. of days of usage	Depreciation	No. of days of usage	Depreciation
Machinery	49,500	275	44,485	31	5,015
Patents	75,000	214	65,510	31	9,490
	<u>1,24,500</u>		<u>1,09,995</u>		<u>14,505</u>

Therefore, depreciation to be allowed in the hands of the company is ₹ 1,09,995 and depreciation to be allowed in the hands of the LLP is ₹ 14,505.

2. Unabsorbed business loss to be carried forward by the LLP.

Particulars	₹
Profits of the company before depreciation	8,00,000
Less : Current year depreciation	<u>1,09,995</u>
Business income of the company after depreciation	6,90,005
Brought forward business loss	<u>9,00,000</u>
Unabsorbed business loss as on 31.12.2010 to be carried forward by the LLP	<u>2,09,995</u>

3. Actual cost of assets to the LLP

- (1) The actual cost of the block of assets in case of the LLP shall be the WDV of the block of assets as in the case of the company on the date of conversion. The WDV as on 1.1.2011 for Machinery and Patents are ₹ 2,85,515 and ₹ 2,34,490, respectively, which would be the actual cost in the case of the LLP.

WDV of Machinery as on 1.1.2011 = ₹ 3,30,000 - 44,485 = ₹ 2,85,515

WDV of Patents as on 1.1.2011 = ₹ 3,00,000 - 65,510 = ₹ 2,34,490

- (2) Land is not a depreciable asset. The cost of acquisition of land to the LLP would be the cost for which the company acquired it, as increased by the cost of improvement.

In respect of the building, deduction had been allowed in the earlier year under Section 35AD, there is no question of depreciation during the current financial year.

- Q. 6. (a)** VERTIKA Limited has two units - one engaged in manufacture of computer hardware and the other involved in developing software. As a restructuring drive, the company has decided to sell its software unit as a going concern by way of slump sale for ₹ 385 lakh to a new company called SUMEDHA Limited, in which it holds 74% equity shares.

The balance sheet of VERTIKA Limited as on 31st March, 2011 being the date on which software unit has been transferred, is given hereunder—

Balance Sheet as on 31.3.2011

Liabilities	₹ in lakh	Assets	₹ in lakh
Paid up Share Capital	300	Fixed Assets	
General Reserve	150	Hardware unit	170
Share Premium	50	Software unit	200
Revaluation Reserve	120	Debtors	
Current Liabilities		Hardware unit	140
Hardware unit	40	Software unit	110
Software unit	90	Inventories	
		Hardware unit	95
		Software unit	35
	<u>750</u>		<u>750</u>

Following additional information are furnished by the management.

- (i) The Software unit is in existence since May, 2007.
- (ii) Fixed assets of software unit includes land which was purchased at ₹ 40 lakh in the year 2004 and revalued at ₹ 60 lakh as on March 31, 2011.
- (iii) Fixed assets of software unit mirrored at ₹ 140 lakh (₹ 200 lakh minus land value ₹ 60 lakh) is written down value of depreciable assets as per books of account. However, the written down value of these assets under section 43(6) of the Income Tax Act is ₹ 90 lakh.

Ascertain the tax liability, which would arise from slump sale to SUMEDHA Limited. [8]

- (b) Mr. AGGARWAL purchased a house property on 14th April, 1979 for ₹ 1,05,000. He entered into an agreement with Mr. B for the sale of house on 15th September, 1982 and received an advance of ₹ 25,000. However, since Mr. B did not remit the balance amount, Mr. AGGARWAL forfeited the advance.

Later on, he gifted the house property to his friend Mr. A on 15th June, 1986.

Following renovations were carried out by Mr. AGGARWAL and Mr. A to the house property:

	Amount (₹)
By Mr. AGGARWAL during FY 1979-80	10,000
By Mr. AGGARWAL during FY 1983-84	50,000
By Mr. A during FY 1993-94	1,90,000

The fair market value of the property as on 1.4. 1981 is ₹ 1,50,000.

Mr. A entered into an agreement with Mr. C for sale of the house on 1st June, 1995 and received an advance of ₹ 80,000. The said amount was forfeited by Mr. A since Mr. C could not fulfil the terms of the agreement.

Finally, the house was sold by Mr. A to Mr. Sanjay on 2nd January, 2011 for a consideration of ₹ 12,00,000.

Compute the capital gains chargeable to tax in the hands of Mr. A for the assessment year 2011-12. Cost inflation indices are as under :

Financial Year	Cost Inflation Index
1981-82	100
1983-84	116
1986-87	140
1993-94	244
2010-11	711

[7]

Answer 6. (a)

As per section 50B, any profits and gains arising from the slump sale effected in the previous year shall be chargeable to income-tax as capital gains arising from the transfer of capital assets and shall be deemed to be the income of the previous year in which the transfer took place.

18 ♦ Suggested Answers to Question — ADT

If the assessee owned and held the undertaking transferred under slump sale for more than 36 months before slump sale, the capital gain shall be deemed to be long-term capital gain. Indexation benefit is not available in case of slump sale as per section 50B(2).

Ascertainment of tax liability from slump sale of software unit

Particulars	(` in lakh)
Sale consideration for slump sale of Software Unit	385
Less : Cost of acquisition being the net worth of Software Unit	185
Long term capital gains arising on slump sale (The capital gains is long-term as the Software Unit is held for more than 36 months)	<u>200</u>
Tax liability on LTCG	
Under section 112 @ 20% on ` 200 lakhs	40.00
Add : Surcharge 7½%	<u>3.00</u>
	43.00
Add : Education cess @ 2% and SHEC @ 1% i.e., totalling 3%	<u>1.29</u>
	<u>44.29</u>

Working Note :

Computation of net worth of Software Unit	(` in lakh)
(1) Book value of non-depreciable assets	
(i) Land (Revaluation not to be considered)	40
(ii) Debtors	110
(iii) Inventories	35
(2) Written down value of depreciable assets under section 43(6) (Note 1)	<u>90</u>
Aggregate value of total assets	275
Less : Current liabilities of software unit	<u>90</u>
Net worth of software unit	<u>185</u>

Note 1 : For computing net worth, the aggregate value of total assets in the case of depreciable assets shall be the written down value of the block of assets as per section 43(6).

Answer 6. (b)

Computation of capital gains chargeable to tax in the hands of Mr. A

Particulars	Amount (`)
Sale consideration	12,00,000
Less : Indexed cost of acquisition (Note 1)	<u>3,55,500</u>
	8,44,500
Less : Indexed cost of improvement (Note 2)	<u>8,60,114</u>
Long term capital loss	<u>(15,614)</u>

Note 1.

Indexed cost of acquisition is determined as under:

Cost to the previous owner i.e. Mr. Aggarwal is ` 1,05,000	
Fair Market Value on 1st April, 1981 is ` 1,50,000	
Cost to the previous owner or FMV on 1st April, 1981, whichever is more, is to be taken as cost of acquisition of Mr. A	1,50,000
Less : Advance money forfeited by Mr. A (as per section 51) (Note : Advance forfeited by Mr. Aggarwal the previous owner, should, however, not be deducted)	<u>80,000</u>
Cost of acquisition	<u>70,000</u>
Indexed cost of acquisition (70,000 × 711/140)	<u>3,55,500</u>

140 is the Cost Inflation Index for F. Y. 1986-87, being the first year in which property is held by Mr. A and 711 is the Cost Inflation Index for F. Y. 2010-11, being the year in which the property is sold.

Note 2.

Indexed cost of Improvement is determined as under:

Expenditure incurred before 1st April, 1981 should not be considered	NIL
Expenditure incurred on or after 1st April, 1981	
During 1983-84 Indexed cost of Improvement [50,000 × 711/116]	3,06,466
During 1993-94 Indexed cost of Improvement [1,90,000 × 711/244]	<u>5,53,648</u>
Total indexed cost of improvement	<u>8,60,114</u>

- Q. 7. (a)** ANJU, an individual resident retired employee of the All India Radio aged 60 years is a well-known dramatist deriving income of ` 1,10,000 from theatrical works played abroad. Tax of ` 11,000 was deducted in the country where the plays were performed. India does not have any Double Tax Avoidance Agreement under section 90 of the Income-tax Act, 1961, with that country. Her income in India amounted to ` 5,10,000. In view of tax planning she has deposited ` 70,000 in Public Provident Fund and paid contribution to approved Pension Fund of LIC ` 32,000 along with subscription to notified long-term infrastructure bonds ` 25,000. She also contributed ` 18,000 to Central Government Health Scheme during the previous year and gave payment of medical insurance premium of ` 21,000 to insure the health of her father, a non-resident aged 76 years, who is not dependent on her. Compute the tax liability of ANJU for the Assessment year 2011-12. [8]

20 ♦ Suggested Answers to Question — ADT

- (b) CHERRY Ltd. is running two industrial undertakings, one in a SEZ (Unit S) and another in a normal area (Unit N). The brief summarized details for the year ended 31.3.2011 are as under :

	(` in lacs)	
	S	N
Domestic turnover	10	100
Export turnover	120	Nil
Gross profit	20	10
Less : Expenses and depreciation	7	6
Profits derived from the unit	13	4

The brought forward business loss pertaining to Unit N is ` 2 lacs. Briefly compute the business income of the assessee. [7]

Answer 7. (a)

Computation of tax liability of Anju for the A. Y. 2011-12

Particulars	(Amount in `)	
Indian Income		5,10,000
Foreign Income		1,10,000
Gross Total Income		<u>6,20,000</u>
Less : Deduction under section 80C		
Deposit in PPF	70,000	
Under section 80CCC		
Contribution to approved Pension Fund of LIC	32,000	
	<u>1,02,000</u>	
Under section 80CCE		
The aggregate deduction under section 80C, 80CCC and 80CCD has to be restricted to ` 1,00,000	1,00,000	
Under section 80CCF		
Subscription to notified long-term infrastructure bonds. ` 25,000, restricted to ` 20,000, being the maximum deduction allowable under section 80CCF	20,000	
Under section 80D		
Contribution to Central Government Health Scheme ` 18,000. As per the Finance Act, 2010, this contribution is also allowable as deduction under section 80D, but restricted to ` 15,000	15,000	
Medical insurance premium of ` 21,000 paid for father aged 76 years. Since the father is a non-resident in India, he will not be entitled for the higher deduction of ` 20,000 eligible for a senior citizen, who is resident in India. Hence, the deduction will be restricted to maximum of ` 15,000.	15,000	
	<u>1,50,000</u>	
Total Income		<u>4,70,000</u>

Tax on Total Income		₹	₹
Income-tax {(₹ 4,70,000 – ₹ 1,90,000) × 10%}		28,000	
Add: Education cess @ 2%		560	
Add: SHEC @ 1%		280	28,840
Average rate of tax in India (i.e. 28,840/4,70,000 × 100)	6.14%		
Average rate of tax in foreign country (i.e. 11,000/1,10,000 × 100)	10%		
Rebate under section 91 on ₹ 1,10,000 @ 6.14% (lower of average Indian-tax rate or average foreign tax rate)			6,754
Tax payable in India (₹ 28,840 – ₹ 6,754)			22,086

Answer 7. (b)**Computation of business income of CHERRY Ltd.**

Particulars	₹ in lacs
Total profit derived from Units S & N (₹ 13 lacs + ₹ 4 lacs)	17
Less: Exemption under section 10AA [See Working Note below]	12
	5
Less: Brought forward business loss	2
	3

Working Note :

Computation of exemption under section 10AA in respect of Unit S located in a SEZ	₹ in lacs
Domestic turnover of Unit S	10
Export turnover of Unit S	120
Total turnover of Unit S	130
Profit derived from Unit S	13
Exemption under section 10AA	
Profit of Unit S × $\frac{\text{Export turnover of Unit S}}{\text{Total turnover of Unit S}} = 13 \times \frac{120}{130} =$	12

Note :

100% of the profit derived from export of articles or things or from services is eligible for deduction under section 10AA, assuming that F.Y.2010-11 falls within the first five year period commencing from the year of manufacture or production of articles or things or provision of services by the Unit in SEZ.

Q. 8. (a) Mrs. MITTAL furnishes the following particulars for the computation of her wealth-tax liability for the assess year 2011-12.

- (1) She owns two residential house properties, valuing ₹ 52 lakhs and ₹ 55 lakhs.
- (2) She is one of the partners in the business with her husband. The value of her interest in assets of the firm as at 31st March, 2011 is ₹ 15 lakhs. The said business is conducted in one of the house properties owned by Mrs. MITTAL.
- (3) She has two motor cars — one Indian car valued at ₹ 8 lakhs and an imported car valued at ₹ 19 lakhs.
- (4) She has invested ₹ 5,00,000 in a bank deposit for five years to meet the future expense of children on their education.
- (5) She has signed “agreement to sell” for purchase of new residential house property of ₹ 40 lakhs and has made advance payment of ₹ 20 lakhs on 15th March, 2011 and has taken possession. However, the sale deed has not been executed till 31st March, 2011. She has taken loan of ₹ 20,00,000 from bank for purchase of said property.
- (6) She has cash balance of ₹ 80,000.

Compute the wealth tax payable by Mrs. MITTAL for the assessment year 2011-12. [8]

(b) On 21.3.2010, Mr. PIYUSH gifted to his wife Mrs. PRARTHANA 200 listed shares, which had been bought by him on 19.4.2009 at ₹ 2,000 per shares. On 1.6.2010 bonus shares were allotted in the ratio of 1:1. All these shares were sold by Mrs. PRARTHANA as under.

Date of sale	Manner of sale	No. of shares	Net sales value (₹)
21.5.2010	Sold in recognized stock exchange, STT paid	100	2,20,000
21.7.2010	Private sale to an outsider	All bonus shares	1,25,000
28.2.2011	Private sale to her friend Mrs. NIKITA (Market value on this date was ₹ 2,10,000)	100	1,70,000

Briefly state the income-tax consequences in respect of the sale of the shares by Mrs. PRARTHANA showing clearly the person in whose hands the same is chargeable, the quantum and the head of income in respect of the above transactions. Detailed computation of total income is NOT required.

Net sales value represents the amount credited after all taxes, levies, brokerage, etc., and the same may be adopted for computing the capital gains.

Cost inflation index for the F. Y. 2010-11 is 711 and for the F. Y. 2009-10 is 632. [7]

Answer 8. (a)

Computation of wealth-tax payable by Mrs. MITTAL for A. Y. 2011-12

Asset	Amount in `	Reason
House Property 1	Nil	A house used exclusively for residential purpose is treated as an asset under section 2(ea). but the same is exempt under section 5(vi).
House Property 2	Nil	Building owned by a partner but used in firm's business is deemed to be used by the partner for her business purposes and is, hence, not an asset chargeable to tax under section 2(ea).
Value of interest in assets of the firm	15,00,000	Included in the net wealth of Mrs. MITTAL by virtue of section 4(1)(b). It has been assumed that the assets are those covered under section 2(ea).
Motor Cars	27,00,000	Motor cars, whether indigenous or imported, are assets chargeable to wealth-tax under section 2(ea).
Bank Deposit	Nil	Not an asset under section 2(ea) and hence, not chargeable to tax under the Wealth-tax Act.
House Property 3	40,00,000	Since the possession of the house property is taken, it is deemed as an asset and is chargeable to wealth-tax. It may be noted that only one house property is exempt under section 5(vi) and this exemption has already been availed in respect of House Property 1.
Cash balance	30,000	For an individual, cash in hand in excess of ` 50,000 shall be chargeable to wealth tax (` 80,000 – 50,000)
Gross Wealth	82,30,000	
Less : Loan borrowed from Bank	20,00,000	Money borrowed by the assessee for purchase of House Property 3 is deductible under section 2(m), since the value of House Property 3 is included in gross wealth.
New Wealth	62,30,000	

Wealth-tax payable by Mrs. Mittal will be ` 32,300 i.e. 1% of ` 32,30,000 (i.e., ` 62,30,000 - ` 30,00,000).

Answer 8. (b)

Where an asset has been transferred by an individual to his spouse otherwise than for adequate consideration, the income arising from the sale of the said asset by the spouse will be clubbed in the hands of the individual.

Where there is any accretion to the asset transferred, income arising to the transferee from such accretion will not be clubbed. Hence, the profit from sale of bonus shares allotted to Mrs. PRARTHANA will be chargeable to tax in the hands of Mrs. PRARTHANA.

24 ♦ Suggested Answers to Question — ADT

Therefore, the capital gains arising from the sale of the original shares has to be included in the hands of Mr. Piyush, and the capital gains arising from the sale of bonus shares would be taxable in the hands of Mrs. PRARTHANA.

Where an asset received by way of gift has been sold, the period of holding of the previous owner should be considered for determining whether the capital gain is long term or short term. The cost to the previous owner has to be taken as the cost of acquisition.

Income/loss to be clubbed in the hands of Mr. PIYUSH
Long-term capital gains/loss

Particulars	₹
(i) 100 shares sold on 21.5.2010 in a recognized stock exchange, STT paid. Long-term capital gains on sale of such shares is exempt under section 10(38)	Nil
(ii) Shares sold to a friend on 28.2.2011	
Sale consideration	1,70,000
Less : Indexed cost of acquisition of 100 shares ($\text{₹ } 2,000 \times 100 \times 711 / 632$)	<u>2,25,000</u>
Long term capital loss to be included in the hands of Mr. PIYUSH	<u>(55,000)</u>

Income taxable in the hands of Mrs. PRARTHANA

Short-term capital gains (on sale of 100 bonus shares)

Particulars	₹
Sale consideration	1,25,000
Less : Cost of acquisition of bonus shares	Nil
Short-term capital gains	<u>1,25,000</u>

Taxability in the hands of Mrs. NIKITA under the head "Income from other sources"

Mrs. NIKITA has received shares from her friend, Mrs. PRARTHANA for inadequate consideration. Even though shares fall within the definition of "property" under section 56(2)(vii), the provisions of section 56(2)(vii) would not be attracted in the hands of Mrs. NIKITA, since the difference between the fair market value of shares and actual sale consideration does not exceed ₹ 50,000.

