CASE STUDY 7

Mr. Murli Lal & Mrs. Bansuri Devi have been residing in Manpur village since their marriage. They have been actively involved in agriculture & dairy farming business in their village and sell their output in nearby villages as well. They have earned much accolades for business they run and have accrued much wealth. There have been many instances where the couple felt that they could move to a metro town to explore more but without any knowledge of business world and regulatory compliances, they felt handicapped. Their children are also settled abroad. One fine day, when they are visited by CA Puru, a fast friend of their son who usually comes down to their village quite often to know about the well- being of his friend's parents from time to time. Mrs. Bansuri Devi discusses with him about agricultural operations she manages with the help of her team in the village and scale of operations they maintain. Puru tells them about how agricultural activities are maintained and operated in the metro towns like Mumbai where he lives and practices his profession. During discussion, he tells her that one of his clients, M/s Khetibaadi Ltd., a listed company is involved in agricultural and allied operations by procuring material from nearby areas. This company is also involved in various other types of animal husbandry operations and works on the same scale as Mrs. Bansuri Devi & Mr. Murli Lal work in the village. On getting curious, Mrs. Bansuri Devi asks him about the form and style in which Khetibaadi Ltd. works in the city. Puru tells her that unlike villages, in corporate world, large businesses have to follow certain accounting standards while maintaining books and balances of their businesses. Standards related to agriculture set out accounting for agricultural activity, the management of the transformation of biological assets (living plants and animals) into agricultural produce (harvested product of the entity's biological assets). The standards generally require biological assets to be measured at fair value less costs to sell. He tells her about following activities carried out by Khetibaadi Ltd.:-

- Managing animal-related recreational activities like Zoo
- Fishing in the ocean
- Fish farming
- Development of living organisms such as cells, bacteria and viruses for research
- Growing of plants to be used in the production of drugs.

Hearing about this, Mrs. Bansuri Devi persuades Mr. Murli Lal to set up a company in town under Puru's guidance to expand their business outside village as well. CA Puru assures Mr.

Murli Lal on all his queries and tells him that he and his team will help them at every step in setting up their company. Soon, the couple, with the help of CA Puru, set up and start operating their company in Mumbai under the name & style of M/s. Bansuri Pvt. Ltd. which ventured into business of agricultural operations with Mr. Murli Lal, Mrs. Bansuri Devi and Mr. Prabhudeva as the directors of company. Mr. Prabhudeva is appointed as the managing director, as the former directors are quite busy in the business already set up at Manpur. The company got registered under GST solely in the State of the Maharashtra. During the year, the company falls short of funds and they decide to borrow funds from the market. The Board of Directors of the company resolve to borrow a sum of ₹ 20 crores from a nationalized bank at a Board meeting held on 15.1.2024. Mr. Prabhudeva, who opposes the said borrowing as not in the interest of the company has raised an issue that the said borrowing is outside the borrowing powers of the Board putting forward the following data :-

(i) Share Capital ₹ 5 crores

(ii) Reserves and Surplus ₹ 5 crores

(iii) Secured Loans ₹ 10 crores

(iv) Unsecured Loans ₹ 5 crores.

After the meeting, since Mr. Murli Lal was in Mumbai, he wanted to discuss all the tax matters with CA Puru and sits with him in his office for the same :-

1. With business expansion, Mr. Murli Lal has also purchased a controlling stake in M/s Khetibaadi Ltd. and is now a director in the said company. He wants Puru to tell him briefly about the performance of this company in tea Market as well. Puru tells him that for the previous year ended 31.03.2023, Khetibaadi Ltd.'s composite business profits before allowing deduction relating to growing and manufacturing of tea is ` 50,00,000. On 01.09.2023, it deposited a sum of ₹ 10,00,000 in the Tea Development Account. During the previous year 2021-22, this company had incurred a business loss of ₹ 15,00,000 which has been carried forward. On 25.01.2024, it withdrew ₹ 10 lakhs, from deposit account which is utilized as :-

    (1) ₹ 6,00,000 for purchase on non-depreciable asset as per the scheme specified.

    (2) ₹ 3,00,000 for purchase of machinery to be installed in the office premises;

    (3) ₹ 1,00,000 was spent for the purpose of scheme on 05.04.2024.

Mr. Murli Lal wants to know about the income of the company for the year & the tax liabilities, if any, thereon, and about which CA Puru gives him an approximate idea of at that time itself.

2. Mr. Prabhudeva had informed CA Puru about two peculiar transactions related to GST which he wanted to discuss in the presence of Mr. Murli Lal, related to M/s Bansuri Pvt. Ltd. In one of the cases, they send raw tea leaves to their registered job worker under GST, Mr. Sharma in Mangalore, Karnataka and further, the processed flavored tea, which is further delivered to the wholesalers in Telangana from the job worker's place in Mangalore itself with invoice and the e-way bill being issued by the company's department from the Mumbai office. Further, he asks him about the treatment of another transaction. They had sent a special lot of Tea "Rosa" to another job worker, Mr. Shakti Puri, in Ratlam for making flavoured tea as per the directions given. Further, due to a decline in the market of flavoured tea, they sent fresh normal unprocessed raw tea with new instructions to the job worker to hold the earlier consignment in stock till a buyer is found. The new stock is easily sold, but the old stock remained in godown of the job worker for over a year. CA Puru guides them properly about the tax treatment of these two transactions under GST.

3. Mr. Murli Lal is happy that their business has gone online as well and now they are selling their products through various e-commerce platforms. Mr. Prabhudeva shows his concern over the online selling part and wants CA Puru to keep a check on the working of the same during his audit. CA Puru assures him that his audit strategy would majorly be based on the fact that a good part of the company's business has gone online.

   In evening, Mr. Murli Lal takes Puru with him to meet his old friend Mr. Babu Lal who resides in Mumbai with his family. Mr. Babulal had requested him for a meeting with Puru so that he could discuss with the latter certain tax related issues of his family and hire his services for tax related work. Mr. Babulal tells Puru that his son Gautam is liable to pay ₹ 10,000 per month to Barkha (his ex-wife) as alimony. Gautam, being an employee of PQR Pvt. Ltd., has instructed his company's HR department to pay ₹ 10,000 per month out of his salary to his wife directly and remit the remaining salary in his account. Mr. Babulal wants to know the tax treatment of such alimony given by Gautam in his hands. Further, he tells CA Puru that he works under a partnership firm in which he and his other two sons, Mr. B & Mr. C are partners. The partnership deed provides that after his death, Mr. B & Mr. C shall continue the business of the firm subject to a condition that 20% of profit of the firm shall be given to Mrs. Daya (wife of Mr. Babu Lal). Mr. Babu Lal wants to know the tax treatment of such receipt in his wife's hands after his death. Puru satisfies Mr. Babu Lal by solving all his queries and quotes his fees to handle all the tax related matters of the family.

I. Multiple Choice Questions

1. An assessee carrying on business of growing and manufacturing tea is allowed a deduction under income tax law upon fulfilment of certain conditions like depositing amount in a deposit account opened in accordance with scheme framed by Tea Board. Deposits made in accordance with schemes framed by other Boards for agricultural commodities also qualify for similar deduction. Which of following schemes qualify in this regard?

   (a) Schemes framed by Coffee Board and Spices Board

   (b) Schemes framed by Rubber Board and Spices Board

   (c) Schemes framed by Coffee Board and Rubber Board

   (d) Schemes framed by Coffee Board, Rubber Board and Spices Board

2. Select the correct option on the basis of the following two statements :-

   STATEMENT 1:- Payment of 20% profit to Mrs. Daya is applicaton of income.

   STATEMENT 2:- Payment of alimony by Gautam to his ex-wife is diversion of Income.

   (a) Statement 1 is Correct but Statement 2 is Incorrect.

   (b) Statement 1 is Incorrect but Statement 2 is Correct.

   (c) Both the Statements are Correct.

   (d) Both the Statements are Incorrect.

3. What would be the GST Treatment of the stock lying with Mr. Shakti Puri?

   (a) Tax payable by Mr. Shakti Puri.

   (b) Tax payable by Bansuri Pvt. Ltd.

   (c) No GST liability.

   (d) Tax payable by Bansuri Pvt. Ltd. on its removal from the premises of Mr. Shakti Puri.

4. Bansuri Pvt. Ltd. is also engaged in sending raw tea leaves to job workers and selling processed tea after the job work is performed. Which of the following forms/returns is to be filed by Bansuri Pvt Ltd on GST portal in this respect :

   (a) ITC-04

   (b) ITC-03

   (c) ITC-02

   (d) ITC-01

5. W.r.t the decision taken at the 4th Board meeting, the contention of director Prabhudeva is -

   (a) Valid, as per the provisions of the Companies Act, 2013.

   (b) Invalid, as Bansuri Pvt Ltd is a Private Company.

   (c) Valid, subject to passing an Ordinary Resolution in the General Meeting.

   (d) Valid, subject to passing a Special Resolution in the General Meeting.

II. Descriptive Questions

6. Analyse whether the activities as narrated by CA Puru to Mrs. Bansuri Devi w.r.t Khetibaadi Ltd. fall within the scope of Ind AS 41 with proper reasoning.

7. You are required to state income tax implications of withdrawals from deposit account during financial year 2023-24 relevant for assessment year 2024-25.

8. What specific factors for online shopping would be considered by CA Puru in formulating the audit strategy of the company in the above case keeping in mind the concern raised by Mr. Prabhudeva?

ANSWERS TO THE CASE STUDY 7

I. Answers to the Multiple Choice Questions

1. **(c)** Schemes framed by Coffee Board and Rubber Board enjoy similar deduction under section 33AB of Income Tax Act.

2. **(d)** Both the Statements are Incorrect.

Reason: STATEMENT 1 :- Such income does not reach the assessee-firm.

Rather, such income stands diverted to the other person as such other person has a better title on such income than the title of the assessee. The firm might have received the said amount, but it so received for and on behalf of Mrs. Dayaa, who possesses the overriding title. Therefore, the amount payable to Mrs. Daya after the death of Mr. Babu Lal would be excluded from the income of the partnership firm in question.

STATEMENT 2 :- In this case, the amount of ₹ 10,000 per month is an obligation of Gautam to pay to his ex-wife out of his income and not an income in which she had over riding entitlement. In other words, this is the income of Gautam, which is applied by him to fulfill an obligation and hence, includible in his total income and a mere arrangement to pay a sum directly to his ex-wife would not make it a case of diversion of income.

3. **(b)** Tax payable by Bansuri Pvt. Ltd.

Reason: Here, sending of unprocessed tea by Bansuri Pvt Ltd to the job worker Mr. Shakti Puri in the first lot will be deemed as a supply and thus, tax would be payable on the same by the company.

4. **(a)** ITC-04.

Reason: ITC-04 is the prescribed return/form under GST Rules for giving account of goods sent on job work and received back.

5. **(b)** Invalid, as Bansuri Pvt Ltd is a Private Company.

Reason: According to the provisions of Section 180(1)(c) of the Companies Act, 2013, the powers of the Board are not uncontrolled and there are restrictions on the borrowing powers to be exercised by the Board of Directors. According to the said section, the borrowings should not exceed the aggregate of the paid-up share capital, free reserves and securities premium. While calculating the limit, the temporary loans obtained by the company from its bankers in the ordinary course of business will be excluded. However, from the figures available in the present case, the proposed borrowing of ₹ 20 crore will exceed the limit calculated as per the given information. Thus, the proposed borrowings are beyond the powers of the Board of Directors. In view of the above position, the management of any Company should take steps to pass a special resolution authorising to borrow the proposed amount of ₹ 20.00 crore, so that the requirement of Section 180(1)(c) is satisfied. Only thereafter, the proposed borrowing can be availed of.

However, Bansuri Private Limited is a Private Company and as per the MCA notification dated 5th June, 2015 which stated that this section shall not apply to private companies. Further on 4th January 2017, Specified IFSC public company would also not be required to comply with this section, unless the article of the company provides otherwise. Hence, they can avail the required Borrowing. As notified by the MCA, Section 180 of the Act (i.e. restrictions on the powers of the Board) shall not apply to a private company which has not committed a default in filing is financial statements under Section 137 or Annual Return under Section 92 with the Registrar. [Notification No. 464(E), dated 5thJune, 2015 as amended by Notification No. 583 (E), dated 13th June, 2017.]

II. Answers to the Descriptive Questions

6.

Activity	Whether in the scope of Ind AS 41?	Remarks
Managing animal- related recreational activities like Zoo	No	Since the primary purpose is to show the animals to public for recreational purposes, there is no management of biological transformation but simply control of the number of animals. Hence it will not fall in the purview of the definition of agricultural activity.
Fishing in the ocean	No	Fishing in ocean is harvesting biological assets from unmanaged sources. There is no management of biological transformation since fish grow naturally in the ocean. Hence, it will not fall in the scope of the definition of agricultural activity.
Fish farming	Yes	Managing the growth of fish and then harvest for sale is agricultural activity within the scope of Ind AS 41 since there is management of biological transformation of biological assets for sale or additional biological assets.

Development of living organisms such as cells, bacteria and viruses for research.	No	The development of living organisms for research purposes does not qualify as agricultural activity, as those organisms are not being developed for sale, or for conversion into agricultural produce or into additional biological assets. Hence, development of such organisms for the said purposes does not fall under the scope of Ind AS 41.
Growing of plants to be used in the production of drugs	Yes	If an entity grows plants for using it in production of drugs, the activity will be agricultural activity. Hence it will come under the scope of Ind AS 41.

7. Tax consequences for the A.Y. 2024-25

Particulars	(₹)
₹ 10,00,000 being the amount withdrawn from Tea Development Account has to be utilized in the prescribed manner, otherwise, the withdrawn amount would be chargeable to tax as business income. In the given case, the taxability of withdrawal amount based on their utilization is as follows:	
- ₹ 6,00,000, out of the amount withdrawn from the deposit account,utilised for purchase of non-depreciable asset as per the specified scheme. [As per section 33AB(6), no deduction would be allowed under section 33AB since amount is spent out of ₹ 10 lakh deposited in Tea Development Account, which has already been allowed as deduction in A.Y. 2023-24 **(See Working Note below)**].	Not taxable
- ₹ 3,00,000, being the amount utilized for purchase of machinery to be installed in the office premises is not a permissible utilization. Hence, the amount would be deemed as profits and gains of business of the previous year 2023-24 as per section 33AB(4).	3,00,000
- ₹ 1,00,000 was spent for the purpose of scheme on 05.04.2024. As per section 33AB(7), this amount would be taxable since the same is not utilized during the same previous year (i.e., P.Y. 2023-24) in which the amount is withdrawn from the deposit account.	1,00,000

When any part of withdrawal amount becomes taxable, the agricultural and non-agricultural portions of income must be segregated.

Accordingly, ₹ 1,60,000, being 40% of ₹ 4,00,000 (₹ 3,00,000 + ₹ 1,00,000) would be chargeable to tax as business income and the balance ₹ 2,40,000, being 60% of ₹ 4,00,000 would be agricultural income exempt from tax.

Working Note:

Computation of Business Income of Khetibaadi Ltd. for the A.Y. 2023-24

Particulars	(₹)
Composite business profits before allowing deduction under section 33AB	50,00,000
Less: Deduction under section 33AB(1) would be the lower of:	
- Amount deposited in Tea Development Account on or before 30.9.2023 [i.e., ₹ 10,00,000]	
- 40% of profits of such business [i.e., ₹ 20,00,000, being 40% of ₹ 50,00,000]	10,00,000
	40,00,000
Less: 60% of ₹ 40,00,000, being agricultural income **[as per Rule 8]**	24,00,000
Business income	16,00,000
Less: Brought forward business loss of A.Y. 2022-23 set-off as per section 72	15,00,000
Business income chargeable to tax	**1,00,000**

8. **Formulation of Audit Strategy:** While formulating the audit strategy for a company, following factors may be considered -

Specific Factors for Online Shopping: The auditor shall also obtain an understanding of the information system including the related business processes due to new venture of online shopping in the following areas:

(i) The classes of transactions in the entity's operations that are significant to the financial statements;

(ii) The procedures, within both information technology (IT) and manual systems, by which those transactions are initiated, recorded, processed, corrected as necessary, transferred to the general ledger and reported in the financial statements;

(iii) The related accounting records, supporting information and specific accounts in the financial statements that are used to initiate, record, process and report transactions; this includes the correction of incorrect information and how information is transferred to the general ledger. The records may be in either manual or electronic form;

(iv) How the information system captures events and conditions, other than transactions, that are significant to the financial statements;

(v) Controls surrounding journal entries, including non-standard journal entries used to record non-recurring, unusual transactions or adjustments.