Test Series: August, 2016

MOCK TEST PAPER – 1

FINAL COURSE: GROUP – II

PAPER – 5: ADVANCED MANAGEMENT ACCOUNTING

*Question No. **1** is compulsory*
*Answer any **five** questions from the remaining **six** questions*

Time Allowed – 3 Hours **Maximum Marks – 100**

1. (a) Canterbury Ltd. makes two products C_1 and C_2, whose respective fixed costs are F_1 and F_2. You are given that the unit contribution of C_2 is one. fifth less than the unit contribution of C_1, that the total of F_1 and F_2 is Rs. 1,50,000, that the BEP of C_1 is 1,800 units (for BEP of C_1 F_2 is not considered) and that 3,000 units is the indifference point between C_1 and C_2 (i.e. C_1 and C_2 make equal profits at 3,000 unit volume, considering their respective fixed costs). There is no inventory buildup as whatever is produced is sold.

Required

Find out the values F_1 and F_2 and units contributions of C_1 and C_2. *(5 Marks)*

(b) Fisher Appliances Ltd. (FPL) is a multiple product manufacturer. FPL produces the unit and all overheads are associated with the delivery of units to its customers.

Particulars	**Budget**	**Actual**
Overheads (Rs.)	20,000	19,500
Output (units)	10,000	10,500
Customer Deliveries (no.'s)	20	19

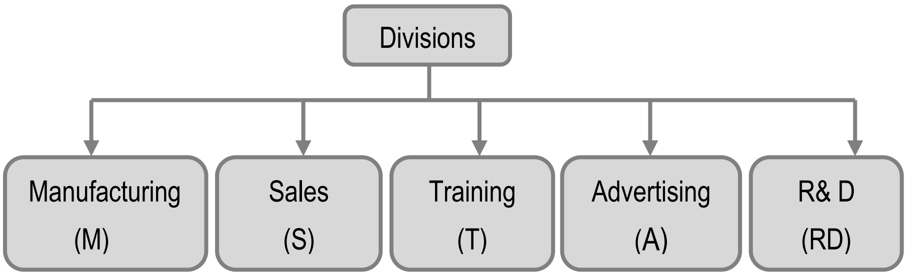
Required

Calculate Efficiency Variance and Expenditure Variance by adopting ABC approach.

(5 Marks)

(c) Datacom Limited is a state-owned large public company in the telecommunications sector. One of its main planning and control tools is the preparation and use of traditional annual budgets.

Its divisional structure is as under:



Division T, A and RD incur substantial amount on discretionary expenses.

Required

Identify the possibilities of introducing a Zero Based Budgeting system for Division T, A and RD. *(5 Marks)*

(d) Explain following statement

– Assignment problem is special case of transportation problem; it can also be solved by transportation methods. *(5 Marks)*

2. (a) P & G International Ltd. (PGIL) has developed a new product 'α^3'which is about to be launched into the market. Company has spent Rs. 30,00,000 on R&D of product 'α^3'. It has also bought a machine to produce the product 'α^3' costing Rs. 11,25,000 with a capacity of producing 1,100 units per week. Machine has no residual value.

The company has decided to charge price that will change with the cumulative numbers of units sold:

Cumulative Sales (units)	Selling Price Rs. per unit
0 to 2,200	750
2,201 to 7,700	600
7,701 to 15,950	525
15,951 to 59,950	450
59,951 and above	300

Based on these selling prices, it is expected that sales demand will be as shown below:

Weeks	Sales Demand per week (units)
1-10	220
11-20	550
21-30	825

31-70	1,100
71-80	880
81-90	660
91-100	440
101-110	220
Thereafter	NIL

Unit variable costs are expected to be as follows:

	Rs. per unit
First 2,200 units	375
Next 13,750 units	300
Next 22,000 units	225
Next 22,000 units	188
Thereafter	225

PGIL uses just-in-time production system. Following is the total contribution statement of the product ' α^3 ' for its Introduction and Growth phase:

	Introduction	Growth	
Weeks	1 - 10	11 - 30	
Number of units Produced and Sold	2,200	5,500	8,250
Selling Price per unit (Rs.)	750	600	525
Variable Cost per unit (Rs.)	375	300	300
Contribution per unit (Rs.)	375	300	225
Total Contribution (Rs.)	8,25,000	16,50,000	18,56,250

Required

(i) Prepare the total contribution statement for each of the remaining two phases of the product's life cycle.

(ii) Discuss Pricing Strategy of the product ' α^3 '.

(iii) Find possible reasons for the changes in cost during the life cycle of the product ' α^3 '.

Note: Ignore the time value of money. *(11 Marks)*

(b) Hindustan Bikes Ltd. (HBL) formerly known as HELCO is an Indian multinational company. It's headquarter is located in Bengaluru, India. It has been founded in the year 1990 as a manufacturer of locomotives. The company is presently listed locally as well as in international stock market. HBL's parent company is Hindustan Group. The management of HBL recognizes the need to establish a culture at the company so that –

"Do the right things, right the first time, every time".

Management has provide you following actual information for the most recent month of the current year:

Cost Data Rs.

Customer Support Centre Cost	35 per hr.
Equipment Testing Cost	18 per hr.
Warranty Repair Cost	1,560 per bike
Manufacturing Rework Cost	228 per bike

Volume and Activity Data

Bikes Requiring Manufacturing Rework	3,200 bikes
Bikes Requiring Warranty Repair	2,600 bikes
Production Line Equipment Testing Time	1,600 hrs.
Customer Support Centre Time	2,000 hrs.

Additional information

HBL carried out a quality review of its existing suppliers to enhance quality levels during the month at a cost of Rs. 1,25,000. Due to the quality issues in the month, the bike production line experienced unproductive 'down time' which cost Rs. 7,70,000.

Required

Prepare a statement showing 'Total Quality Cost'. *(5 Marks)*

3. (a) The following table gives the activities in a construction project and the time durations with associated probability of each activity:

Activity	Predecessors	Time (in Days)	Probability
A	---	6	0.50
		8	0.50
B	---	4	0.30
		5	0.20
		6	0.50

C	A	8	0.50
		16	0.50
D	A, B	8	0.30
		10	0.70
E	C, D	2	0.20
		4	0.80

To simulate the project, use the following random numbers taking the first five random numbers digits (representing the five activities) for each trial and so on:

11, 16, 23, 72, 94; 83, 83, 02, 97, 99; 83, 10, 93, 4, 33; 53, 49, 94, 37, 7

Required

Determine the 'Critical Path' and the 'Project Duration' for each trial. *(8 Marks)*

(b) A Hotel having 50 single rooms is having 80% occupancy in normal season (8 months) and 50% in off- season (4 months) in a year (take 30 days month).

Annual Fixed Expenses (Rs. Lakh)

Salary of the Staff (excluding Room Attendant)…………………………..7.50

Repair & Maintenance………………………………………………………..2.60

Depreciation on Building & Furniture………………………………………2.40

Other Fixed Expenses like Dusting, Sweeping etc………………………3.25

Total 15.75

Variable Expenses (per Guest per Day)

Linen, Laundry & Security Support………………………………… Rs. 30.00

Electricity & Other Facilities………………………………………….. Rs. 20.00

Misc Expenses like Attendant etc……………………………………Rs. 25.00

Management wishes to make a Margin of 25% of Total Cost.

Required

(i) Calculate the Tariff Rate per Room.

(ii) Calculate the Break Even Occupancy in Normal Season assuming 50% Occupancy is Off-Season.

(iii) Management is proposing 10% cut in Tariff to improve Occupancy at 100% and 70% in Normal Season and Off-Season respectively. Give your views on it.

(iv) What is the minimum rise in Occupancy % to take care of risk of fall in Profit due to Tariff-Cut? *(8 Marks)*

4. (a) 'EXE' Ltd. manufactures a product called 'HN-2'. The company is organized into two divisions, viz., Division 'KXA' and Division 'KXB'. Division 'KXA' manufactures 'HN-2' and Division 'KXB', which manufactures the containers, packs 'HN-2' in the containers and stores them by using a special protective material called 'P-6'. The details of the expenses incurred by Division 'KXB' during 2015 are as under:

	(Rs.)
Direct Materials including 'P-6'	5,25,000
Direct Labour	3,75,000
Supervision	60,000
Maintenance of Machine	27,000
Rent of a part of the Warehouse used	33,750
Depreciation of Machine	1,12,500
Miscellaneous Overheads	1,18,125
Administration Overheads apportioned to the Division	1,80,000

'WYE' Ltd. a company engaged in warehousing of a variety of a products, approached 'EXE' Ltd. to undertake to manufacture the containers required on contract basis for a period of four years for Rs. 9,37,500 per annum and/or store the packed product for a further sum of Rs. 1,87,500 per annum.

Division 'KXB' uses a machine for the manufacture of containers This machine was installed four years ago at a capital cost of Rs. 9,00,000 and it has a useful life of four more years. It can be currently sold at Rs. 1,87,500.

Division 'KXB' purchased 'P-6' worth Rs. 7,50,000 during the last year. Out of this, one-fifth was used during the last year and the cost thereof is included in the material cost of 2015. The original purchase price of 'P-6' was Rs. 3,750 per tonne but, if sold now, the stock of 'P-6' would fetch only Rs. 3,000 per tonne. Its current replacement cost is Rs. 4,500 per tonne.

Division 'KXB' hired a warehouse for storage of the product for Rs. 67,500 per annum. It uses only half of the space and has taken only half the amount of rent into account. The remaining space of the warehouse is idle.

Required

Evaluate the following three proposals on a four-year term basis and state recommendations.

(i) If the contract for manufacture of the containers and the storage of the product, 'HN-2' is given to 'WYE' ltd. Division 'KXB' will be close down. In that event the supervisory staff will be transferred to another department and there will be 100% saving in direct labour cost.

(ii) If 'EXE' Ltd. continues to store the product 'HN-2' and leaves the manufacture of the containers to 'WYE' Ltd., The machine in Division 'KXB' will not be required and the storage space requirements cannot be dispensed with. The supervisory staff will be required to be retained in Division 'KXB' and only 10% of all material will be used. The saving on account of labour retrenchment will come to Rs. 18,750 per annum. The miscellaneous overheads will be reduced by 80%.

(iii) If 'EXE' Ltd. continues to manufacture the containers and leaves the storage of 'HN-2' to 'WYE' Ltd. Division 'KXB' will retain the machine and the warehouse space for use. The supervisory staff will also be retained and 90% of all materials will be required. The labour force will continue and the miscellaneous overheads will be reduced by 20%. *(12 Marks)*

(b) How do you know whether an alternative solution exists for a transportation problem? *(4 Marks)*

5. (a) Turn Wood Ltd. has two divisions Division 'TXR' and Division 'TQR'. Both divisions are independent. Each division serves a different market in the furniture industry.

Division 'TXR' manufactures furniture that is used by the canteens/ coffee bars. The division plans to introduce cushioned seat for the counter chairs. A cushioned seat currently made by the Division 'TQR' for use on its stylish stool could be modified for use on the new counter chair. Division 'TQR' can make the necessary modifications to the cushioned seat easily.

The raw materials used in Division 'TXR' seat are slightly different and should cost about 20 percent more than those used in Division 'TQR' stylish stool. However, the labour time should be the same because the seat fabrication operation is basically the same.

Division 'TQR' is operating at full capacity. By making the cushion seats for Division 'TXR', Division 'TQR' have to cut its production of stylish stools. However, Division 'TQR' can increase its production of normal stools. The labour time freed by not having to fabricate the frame or assemble the stylish stool can be shifted to the frame fabrication and assembly of the normal stool. Division 'TQR' can switch its labour force between these two models of stools without any loss of efficiency. Labour hours cannot be increase. Division 'TQR' has excess demand for both products. Following are Division 'TQR''s standard costs for the two stools and a schedule of Division 'TQR''s manufacturing overhead.

'TQR' DIVISION

Standard Selling Price and Cost

	Stylish Stool		Normal Stool	
	(Rs.)	(Rs.)	(Rs.)	(Rs.)
Selling Price		225.00		160.00
Less: Raw Materials				
Framing	32.60		39.04	
Cushioned Seat				
- Padding	9.60		---	
- Vinyl	16.00		---	
Moulded Seat (Purchased)	--	58.20	24.00	63.04
Less: Direct Labour				
Frame Fabrication				
- (0.5 × Rs. 30.00/DLH#)	15.00		---	
- (0.5 × Rs. 30.00/DLH)	---		15.00	
Cushion Fabrication				
- (0.5 × Rs. 30.00/DLH)	15.00		---	
Assembly*				
- (0.5 × Rs. 30.00/DLH)	15.00		---	
- (0.3 × Rs. 30.00/DLH)	--	45.00	9.00	24.00
Less: Manufacturing Overhead				
- (1.5 DLH × Rs. 51.20/DLH)		76.80		---
- (0.8 DLH × Rs. 51.20/DLH)		---		40.96
Profit / (Loss)		45.00		32.00

(*)Attaching seats to frames and attaching rubber feet

(#) DLH refers to Direct Labour Hour

'TQR' DIVISION

Manufacturing Overhead Budget

Overhead Item	(Rs.)
Indirect Material (Variable - at Current Market Prices)	16,80,000
Indirect Labour (Variable)	15,00,000
Supervision (Non Variable)	10,00,000
Power (Use Varies with Activity; Rates are Fixed)	7,20,000
Heat and Light (Non Variable - Same Regardless of Production)	5,60,000
Miscellaneous Overheads (Non Variable - Any Change in Amounts or Rates is Independent of Production)	8,00,000
Depreciation (Fixed)	68,00,000
Employee Benefits (20% of Supervision, Direct and Indirect Labour)	23,00,000
Total Overhead	1,53,60,000
Capacity in DLH	3,00,000
Overhead Rate / DLH	Rs. 51.20

Required

Assume that you are the corporate controller. What transfer price would you recommend for a 200 unit lot of seats? *(12 Marks)*

(b) Tri-max Ltd. has produced the following figures relating to production for the week ended 27th Jan

	Production (in units)	
	Budgeted	Actual
Product A	200	200
Product B	200	150
Product C	50	70

Standard production times were:

Standard hours per unit

Product A……………………………………………………… 10

Product B……………………………………………………… 5

Product C……………………………………………………… 2

During the week, 2,800 hours were worked on production.

Required

Calculate the production volume ratio and efficiency ratio for the week ended 27[st] Jan. *(4 Marks)*

6. (a) Given below is an iteration in a simplex table for a maximization objective linear programming product mix problem for products x, y and z. Each of these products is processed in three machines KA-07, KB-27 & KC-49 and each machine has limited available hours.

$C_j \rightarrow$			30	40	20	0	0	0
C_B	**Basic Variable (B)**	**Value of Basic Variables b (=X_B)**	**x**	**y**	**z**	**s_1**	**s_2**	**s_3**
30	x	250	1	0	-26/16	10/16	-12/16	0
40	y	625	0	1	31/16	-7/16	10/16	0
0	s_3	125	0	0	11/16	-3/16	1/8	1

s_1, s_2 and s_3 are slack variables for machine KA-07, KB-27 and KC-49 respectively. Answer the following questions, giving reasons in brief:

(i) Is this solution 'Feasible'?

(ii) Is this solution 'Degenerate'?

(iii) Which of these machines is being used to the full capacity when producing according to this solution?

(iv) How much would you be prepared to pay for another hour of capacity each on machine KA-07, machine KB-27, and machine KC-49?

(v) If the company wishes to expand the production capacity, which of the three resources should be given priority?

(vi) What happens if 16 machine hours are lost due to some mechanical problem in machine KB-27?

(vii) A customer would like to have one unit of product z and is willing to pay higher price for z in order to get it. How much should the price be increased so that the company's profit remains unchanged?

(viii) A new product is proposed to be introduced which would require processing time of 4 hours on machine KA-07, 2 hours on machine KB-27 and 4 hours on machine KC-49. It would yield a profit of Rs. 12 per unit. Do you think it is advisable to introduce this product? *(8 Marks)*

(b) Oxford Health Care Co. (OHCC) is a pharmaceutical firm, operating its entire business through its four customers Qx_1, Qx_2, Qx_3, and Qx_4. Qx_1 and Qx_2 are small pharmaceutical stores while Qx_3 and Qx_4 are large discount stores with attached pharmacies. OHCC uses discount pricing strategy and prices its products at variable cost plus 25%.

Item	Small Pharmaceuticals		Large Pharmaceuticals		Activity Rate
	Qx_1	Qx_2	Qx_3	Qx_4	
Number of Orders	4	9	6	3	Rs.750
Order Size (Rs.)	40,000	20,000	4,25,000	4,00,000	n/a
Average Discount (%)	4.50	9.50	17.50	11.50	n/a
Regular Deliveries	4	9	6	3	Rs.375
Expedited Deliveries	2	0	2	0	Rs.1,250
General Administration Cost (Rs.)	20,250		48,375		

Required

(i) Prepare a 'Customer Profitability Statement' that shows the profit from each customer and each customer channel.

(ii) Recommend some points to improve OHCC's profit. *(8 Marks)*

7. Answer any **four** of the following questions:

(a) Well Fit Ltd. is engaged in business of manufacturing branded readymade garments. It has a single manufacturing facility at harbour city. Raw material is supplied by various suppliers.

Majority of its revenue comes from export to Euro Zone and US. To strengthen its position further in the Global Market, it is planning to enhance quality and provide assurance through long term warranty.

For the coming years company has set objective to reduce the quality costs in each of the primary activities in its value chain.

Required

State the primary activities as per Porter's Value Chain Analysis in the value chain of Well Fit Ltd with brief description. *(4 Marks)*

(b) Z Security Ltd. (ZSL) is a leading IT security solutions and ISO 9001 certified company. The solutions are well integrated systems that simplify IT security management across the length and depth of devices and on multiple platforms. ZSL has recently developed an Antivirus Software and company expects to have life cycle of less than one year. It was decided that it would be appropriate to adopt a market skimming pricing policy for the launch of the product. This Software is currently in the Introduction stage of its life cycle and is generating significant unit profits.

Required

Explain, with reasons, the changes, if any, to the unit selling price that could occur when the Software moves from the Introduction stage to Growth stage of its life cycle.

Also suggest necessary strategies at this stage. *(4 Marks)*

(c) Write a note on Six Sigma. *(4 Marks)*

(d) What are the steps in simulation? *(4 Marks)*

(e) Explain the learning curve ratio with an example. *(4 Marks)*

Test Series : August, 2016

MOCK TEST PAPER – 1

FINAL COURSE: GROUP – II

PAPER – 5: ADVANCED MANAGEMENT ACCOUNTING

SUGGESTED ANSWERS/HINTS

1. (a) Let K_{c1} be the Contribution per unit of Product C_1.

Therefore Contribution per unit of Product $C_2 = K_{c2} = 4/5K_{c1} = 0.8K_{c1}$

Given $F_1 + F_2 = 1,50,000$,

$F_1 = 1,800K_{c1}$ (Break even volume × contribution per unit)

Therefore $F_2 = 1,50,000 – 1,800K_{c1}$.

$3,000K_{c1} – F_1 = 3,000 \times 0.8K_{c1} – F_2$ or $3,000K_{c1} – F_1 = 2,400K_{c1} - F_2$ (Indifference point)

i.e., $3,000K_{c1} – 1,800K_{c1} = 2,400K_{c1} – 1,50,000 + 1,800K_{c1}$

i.e., $3,000K_{c1} = 1,50,000$, Therefore K_{c1} = Rs.50/- (1,50,000 / 3,000)

Therefore Contribution per unit of C_1 = Rs.50

Fixed Cost of $C_1 = F_1$ = Rs.90,000 (1,800 × 50)

Therefore Contribution per unit of C_2 is Rs.50 × 0.8 = Rs.40 and

Fixed cost of $C_2 = F_2$ = Rs.60,000 (1,50,000 – 90,000)

The value of F_1 = Rs.90,000, F_2 = Rs.60,000 and C_1 = Rs.50 and C_2 = Rs.40

(b) Computation of Variances

Efficiency Variance	=	Cost Impact of *undertaking activities* more/ less than *standard*
	=	(21 deliveries* – 19 deliveries) × Rs. 1,000
	=	Rs. 2,000 F

(*) $\left(\frac{20\,\text{Deliveries}}{10{,}000\,\text{units.}}\right) \times 10{,}500\,\text{units}$

Expenditure Variance	=	Cost impact of paying more/ less than standard for actual activities undertaken
	=	19 deliveries × Rs. 1,000 – Rs. 19,500
	=	Rs. 500 (A)

(c) Discretionary costs are those that are incurred, typically each year, in an amount that is approved as part of the normal budget process. However, there is no clear relationship between the volume of services and the amount of cost that must be incurred. Manager must decide and justify the level that is deemed to be appropriate. This justification is to be made a fresh without making reference to previous level of spending in his/her department.

Zero based budgeting is undoubtedly most effective in terms of discretionary costs. The bottom line of a zero based budgeting is that it is important to understand what types of objectives are being accomplished by discretionary cost centers and what resources being devoted to accomplishing various objectives. This will allows a prioritization, so that organization can evaluate the likely impact of substantial increase or decrease in the resources allocated to the discretionary center.

Accordingly, ZBB has extensive potential application to the division T, A and RD.

(d) The assignment problem is special case of transportation problem; it can also be solved by transportation method. But the solution obtained by applying this method would be severely degenerate. This is because the optimality test in the transportation method requires that there must be m+n-1 allocations/assignments. But due to the special structure of assignment problem of order n × n, any solution cannot have more than n assignments. Thus, the assignment problem is naturally degenerate. In order to remove degeneracy, n-1* number of dummy allocations will be required in order to proceed with the transportation method. Thus, the problem of degeneracy at each solution makes the transportation method computationally inefficient for solving an assignment problem.

$(*)\ \underline{m+n-1} - n \Rightarrow \underline{n+n-1} - n \Rightarrow \underline{2n-1} - n \Rightarrow \underline{n-1}$

2. (a) (i) Total Contribution Statement

Statement Showing "Total Contribution- for remaining two phases"

Particulars	Maturity		Decline
Weeks	31 - 50	51 - 70	71 - 110
Number of units Produced and Sold	22,000	22,000	22,000
Selling Price per unit (Rs.)	450	450	300
Less: Unit Variable Cost (Rs.)	225	188	225
Unit Contribution (Rs.)	225	262	75
Total Contribution (Rs.)	49,50,000	57,64,000	16,50,000

(ii) Pricing Strategy for Product α^3

PGIL is following the skimming price strategy that's why it has planned to launch the product α^3 initially with high price tag.

A skimming strategy may be recommended when a firm has incurred large sums of money on research and development for a new product.

In the problem, PGIL has incurred a huge amount on research and development. Also, it is very difficult to start with a low price and then raise the price. Raising a low price may annoy potential customers.

Price of the product α^3 is decreasing gradually stage by stage. This is happening because PGIL wants to tap the mass market by lowering the price.

(iii) Possible Reasons for the changes in cost during the life cycle of the product 'α^3'

Product life cycle costing involves tracing of costs and revenues of each product over several calendar periods throughout their entire life cycle. Possible reasons for the changes in cost during the life cycle of the product are as follows:

PGIL is expecting reduction in unit cost of the product α^3 over the life of product as a consequence of economies of scale and learning / experience curves.

Learning effect may be the possible reason for reduction in per unit cost if the process is labour intensive. When a new product or process is started, performance of worker is not at its best and learning phenomenon takes place. As the experience is gained, the performance of worker improves, time taken per unit reduces and thus his productivity goes up. The amount of improvement or experience gained is reflected in a decrease in cost.

Till the stage of maturity, PGIL is in the expansion mode. The PGIL may be able to take advantages of quantity discount offered by suppliers or may negotiate the price with suppliers.

Product α^3 has the least variable cost Rs.188 in last phase of maturity stage; this is because a product which is in the mature stage may require less marketing support than a product which is in the growth stage so, there is a saving of marketing cost per unit.

Again the cost per unit of the product α^3 jumps to Rs. 225 in decline stage. As soon as the product reaches its decline stage, the need or demand for the product disappear and quantity discount may not be available. Even PGIL may have to incur heavy marketing expenses for stock clearance.

Workings

Statement of Cumulative Sales along with Sales Price and Variable Cost

Weeks	Demand *per week*	Total Sales	Cumulative Sales	Selling Price per unit (Rs.)	Variable Cost per unit (Rs.)
1 - 10	220	2,200	2,200	750	375
11 - 20	550	5,500	7,700	600	300
21 - 30	825	8,250	15,950	525	300
31 - 50	1,100	22,000	37,950	450	225
51 - 70	1,100	22,000	59,950	450	188
71 - 80	880	8,800	68,750	300	225
81 - 90	660	6,600	75,350	300	225
91 - 100	440	4,400	79,750	300	225
101 - 110	220	2,200	81,950	300	225

(b) Statement Showing "Total Quality Cost"

Particulars of Costs	Rs.
Prevention Costs	
Supplier Review	1,25,000
Appraisal Costs	
Equipment Testing (Rs.18 × 1,600 hrs.)	28,800
Internal Failure Costs	
Down Time	7,70,000
Manufacturing Rework (Rs.228 × 3,200 bikes)	7,29,600
External Failure Costs	
Customer Support (Rs.35 × 2,000 hrs.)	70,000
Warranty Repair (Rs.1,560 × 2,600 bikes)	40,56,000
Total Quality Costs	**57,79,400**

3. (a) Random Numbers Allocation for *each activity*

Activity	Time (in Days)	Probability	Cumulative Probability	Allocated Random Number
A	6	0.50	0.50	00-49
	8	0.50	1.00	50-99

B	4	0.30	0.30	00-29
	5	0.20	0.50	30-49
	6	0.50	1.00	50-99
C	8	0.50	0.50	00-49
	16	0.50	1.00	50-99
D	8	0.30	0.30	00-29
	10	0.70	1.00	30-99
E	2	0.20	0.20	00-19
	4	0.80	1.00	20-99

Simulation Table

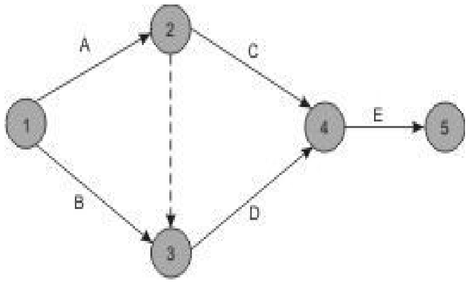
Trial	A		B		C		D		E	
	R. No.	Time	R. No.	Time	R. No.	Time	R. No.	Time	R. No.	Time
1	11	6	16	4	23	8	72	10	94	4
2	83	8	83	6	02	8	97	10	99	4
3	83	8	10	4	93	16	4	8	33	4
4	53	8	49	5	94	16	37	10	7	2

Determination of "Critical Path and Project Duration for *each trial*"

Trial	Project Duration			Critical Path
	1–2–4–5 (A–C–E)	1–2–3–4–5 (A–D–E)	1–3–4–5 (B–D–E)	
1	18 (6 + 8 + 4)	**20** (6 + 10 + 4)	18 (4 + 10 + 4)	1–2–3–4–5 (A–D–E)
2	20 (8 + 8 + 4)	**22** (8 + 10 + 4)	20 (6 + 10 + 4)	1–2–3–4–5 (A–D–E)
3	**28** (8 + 16 + 4)	20 (8 + 8 + 4)	16 (4 + 8 + 4)	1–2–4–5 (A–C–E)
4	**26** (8 + 16 + 2)	20 (8 + 10 + 2)	17 (5 + 10 + 2)	1–2–4–5 (A–C–E)

Working Note

The Network for the given problem:



(b) **(i)**

Variable Cost *per Room-Day*	=	Rs.75
		(Rs.30 + Rs.20 + Rs.25)
Total Occupancy	=	12,600 Room-Days
		(50 × 30 × 8 × 0.8 + 50 × 30 × 4 × 0.5)
Total Variable Cost	=	Rs.9.45 lakhs
		(12,600 Room-Days × Rs.75)
Fixed Cost	=	Rs.15.75 lakhs
Total Cost	=	Rs.25.20 lakhs
		(Rs.9.45 lakhs + Rs.15.75 lakhs)
Profit (25% of Total Cost)	=	Rs.6.30 lakhs
		(25% of Rs.25.20 lakhs)
Tariff *per Day*	=	Rs.250.00
		[(Rs.25, 20,000 + Rs.6,30,000) / 12,600 Room-Days]

(ii)

Contribution *per Day*	=	Rs.175.00
		(Rs.250 − Rs.75)
BEP (Room–Day)	=	9,000 Room-Days
		(Rs.15,75,000 / Rs.175)
During Off Season *for 4 months*		
Rooms Occupied	=	3,000 Days
		(50 × 30 × 4 × 0.5)
For BEP,		
Occupancy During Normal Period		
	=	6,000 Days i.e. Occupancy 50%

(iii)

If 10% Discount is allowed,		
Tariff	=	Rs.225 *per Room-Day*
Contribution per Room-Day (with tariff cut)	=	Rs.150 (Rs.225 − Rs.75)

Total Occupancy = 16,200 Room-Days

(50 × 30 × 8) + (50 × 30 × 4 × 0.7)

Total Contribution *for the year* = Rs.24.30 lakhs

(16,200 Room-Days × Rs.150)

Fixed Cost (unchanged) = Rs.15.75 lakhs

Profit = Rs.8.55 lakhs

As the Proposal increases the Profit, it may be accepted.

(iv) To maintain the Same Profit,

Contribution Required = Rs.22.05 lakhs

With New Tariff,

Contribution *per day* = Rs.150

Number of Room-Days Occupied

= 14,700 Room-Days

(Rs.22,05,000 / 150)

Increase % in Occ. Required = 16.67 %

[(14,700 – 12,600) / 12,600]

4. (a) Statement Showing Evaluation of Alternatives

	Alternative One	Alternative Two	Alternative Three
Manufacture of Containers	**'WYE' Ltd**	**'WYE' Ltd**	**'EXE' Ltd**
Storage of Product	**'WYE' Ltd**	**'EXE' Ltd**	**'WYE' Ltd**
Cash Inflows (including avoidable cost):			
Direct Materials *other than 'P-6'* (W.N.-1)	3,75,000	3,37,500	37,500
Direct Labour (W.N.-4)	3,75,000	18,750	-
Rent of a part of Warehouse (W.N.-6)	67,500	-	-
Maintenance of Machine (W.N.-7)	27,000	27,000	-
Miscellaneous Overhead (W.N.-8)	1,18,125	94,500	23,625
Total Cash Inflows p.a. ...(A)	9,62,625	4,77,750	61,125
Cash Outflows:			
Contract Fee to 'WYE' Ltd.			
For Manufacture	9,37,500	9,37,500	-
For Packing and Storage	1,87,500		1,87,500

Total Outflow p.a. ...(B)	11,25,000	9,37,500	1,87,500
Net Cash Outflow p.a. ...(C) = (A) - (B)	1,62,375	4,59,750	1,26,375
Cash Outflows for 4 years [(C) × 4]	6,49,500	18,39,000	5,05,500
One Time Income / Inflow:			
'P-6' (W.N.-3)	(4,80,000)	(4,32,000)	(48,000)
Machine (W.N.-5)	(1,87,500)	(1,87,500)	-
Net Cash Outflow	(18,000)	12,19,500	4,57,500

Therefore it is in the interest of 'EXE' Ltd. to *shut down* Division 'KXB'.

Working Note

(1) Direct Material other than 'P-6'

Direct material including 'P-6'	Rs.5,25,000
Use of 'P-6' 1/5th of Rs.7,50,000	Rs.1,50,000
	Rs.3,75,000

Alternative One:

The material will be avoidable cost if Division 'KXB' is closed down.

Alternative Two:

Savings: Rs.3,37,500 (Rs.3,75,000 − Rs.37,500) if manufacture is given to 'WYE' Ltd. and storage remains with 'EXE' Ltd.

Alternative Three:

Savings: Rs.37,500 [Rs.3,75,000 − (90% of Rs.3,75,000)] if manufacture is done by 'EXE' Ltd. and storage given to 'WYE' Ltd.

(2) 'P-6' –Stock

Stock in 2015	Rs.7,50,000
Used last year (1/5th)	Rs.1,50,000
Balance Stock	Rs.6,00,000

It is given that original price is Rs.3,750

Therefore, 160 tonnes (Rs.6,00,000 / Rs.3,750) 'P-6' is there.

(3) 'P-6' –Value

Alternative One:

Manufacturing and Storage is done by 'WYE' Ltd. Therefore it will be sold at Rs.3,000 per tonne.

Cash inflow will be Rs.4,80,000 (Rs.3,000 × 160)

Alternative Two:

10% of all material will be used. It means 90% of 160 tonne will be sold.

Cash inflow will be Rs.4,32,000 (160 × 0.90 × Rs.3,000)

Alternative Three:

In this situation storage is done by 'WYE' Ltd. Therefore only 10% of whole quantity of 160 tonnes will be sold in market at Rs.3,000 per tonne.

Cash inflow will be Rs.48,000 (16 × Rs.3,000)

(4) Direct Labour Cost

Alternative One:

Avoidable Cost, if Deptt. KXB is closed (saving) Rs.3,75,000

Alternative Two:

If manufacturing is given to 'WYE' Ltd. and 'EXE' Ltd. continues to store the product, saving on account of labour retrenchment will be only Rs.18,750.

Alternative Three:

If manufacturing is done by 'EXE' Ltd. then labour force will continue. It means impact of labour cost in third alternative will be nil.

(5) Machine

Machine is used for manufacturing of containers. It is not required in alternative one and two. Therefore, it will be sold and there will be one time cash inflow of Rs.1,87,500 under alternative one and two.

(6) Rent of Warehouse

The hire charge of warehouse is Rs.67,500 per annum. The remaining space of the warehouse is idle. It means, when department 'KXB' is closed, cash outflow of Rs.67,500 will be avoided. Therefore, cash flow for alternatives two and three will not be disturbed on this account.

(7) Maintenance of Machine

Maintenance of machine is required for manufacturing. It means Rs.27,000 will be avoidable cost for alternative one and two. In third alternative this cost will continue to be there.

(8) Miscellaneous Overhead

Miscellaneous overhead of Rs.1,18,125 will be avoidable cost for alternative one. For second alternative 80% of this i.e. Rs.94,500 will be avoidable cost. For third alternative 20% of Rs.1,18,125 i.e. Rs.23,625 will be avoidable cost.

(9) Supervisory Staff

Supervisory staff will be transferred to another department in the first alternative. It means cash flow will not be affected. In the second and third alternatives, supervisory staff will be retained and it means no additional cash flow or relevant cost due to decision.

(10) Depreciation

Depreciation does not affect the cash flow. Therefore it is not relevant for these decisions.

(b) The Δ_{ij} matrix or $C_{ij} - (u_i + v_j)$ matrix, where C_{ij} is the cost matrix and $(u_i + v_j)$ is the cell evaluation matrix for unallocated cell.

The Δ_{ij} matrix has one or more 'Zero' elements, indicating that, if that cell is brought into the solution, the optional cost will not change though the allocation changes.

Thus, a 'Zero' element in the Δ_{ij} matrix reveals the possibility of an alternative solution.

5. (a) Working Note

(1) Statement Showing Variable Cost *per* 200-unit lot

	(Rs.)	(Rs.)
Cushion Material:		
- Padding	9.60	
- Vinyl	16.00	
Total Cushion Material	25.60	
Cost Increase by 20%	5.12	
Cost of Cushioned Seat		30.72
Cushion Fabrication Labour (Rs.30 × 0.5)		15.00
Variable Overhead (W.N.-2) (Rs.20 × 0.5)		10.00
Variable Cost *per Cushioned Seat*		55.72
Total Variable Cost *per* 200-unit lot (Rs.55.72 × 200)		11,144

(2) Statement Showing Fixed Overhead & Variable Overhead Rate per Direct Labour Hour

	Variable Amount		Fixed Amount	
	(Rs.)	(Rs.)	(Rs.)	(Rs.)
	Total	Per DLH	Total	Per DLH
Indirect Material	16,80,000	5.60	---	---
Indirect Labour	15,00,000	5.00	---	---

Supervision	---	---	10,00,000	3.33
Power	7,20,000	2.40	---	---
Heat and Light	---	---	5,60,000	1.87
Miscellaneous Overheads	---	---	8,00,000	2.67
Depreciation	---	---	68,00,000	22.67
Employee Benefits:				
- 20% Direct Labour*	18,00,000	6.00	---	---
- 20% Supervision	---	---	2,00,000	0.66
- 20% Indirect Labour	3,00,000	1.00	---	---
	60,00,000	20.00	93,60,000	31.20

Variable Overhead Rate = Rs.60,00,000 ÷ 3,00,000

= Rs.20.00 / DLH

Fixed Overhead Rate = Rs.93,60,000 ÷ 3,00,000

= Rs.31.20 / DLH

* Direct Labour Cost

0.2 (Rs.10,00,000 + DL + Rs.15,00,000) = Rs.23,00,000

0.2 DL = Rs.18,00,000

DL = Rs.90,00,000

(3) Statement Showing "Loss of Contribution Margin from Outside Sales"

	Stylish Stool (Rs.)	Normal Stool (Rs.)
Selling Price	225.00	160.00
Less: Material	58.20	63.04
Less: Labour	45.00 (Rs.30.00 × 1.5)	24.00 (Rs.30.00 × 0.8)
Less: Variable Overhead	30.00 (Rs.20.00 × 1.5)	16.00 (Rs.20.00 × 0.8)
Contribution Margin *per unit*	91.80	56.96
Units Produced (units)	200	250 (W.N.- 4)
	18,360	14,240

Amount of Contribution Margin Lost as a result of shifting production to the Normal Stool Rs.4,120 (Rs.18,360 – Rs.14,240).

(4) Number of Economy Office Stools *that can be produced*

Labour Hours *to make* a 200-unit lot of Stylish Stools (1.50 × 200)	300 Hrs
Less: Labour Hours *to make* a 200-unit lot of Cushioned Seats*	100 Hrs
Labour Hours *available for* Normal Stool	200Hrs

* (0.50 × 200)

Labour hours *required to make* one Normal Stool	0.8 Hrs / Stool
Use of Extra Labour *devoted to* Normal Stool Production (200 / 0.8)	250 Stools

Since the 'TQR' Division is operating at Full Capacity, the Transfer Price must consider the Division's Variable Costs of Manufacturing the Seat *plus* the Lost Contribution Margin that will result from *losing outside sales*. Thus, the Transfer Price (W.N.-1 & 3) equals to Rs.15,264 (Rs.11,144 + Rs.4,120).

(b) Production Volume Ratio = $\frac{\text{StandardHoursProduced}}{\text{BudgetedHours}} \times 100$

$$= \frac{(200 \times 10) + (150 \times 5) + (70 \times 2)}{(200 \times 10) + (200 \times 5) + (50 \times 2)} \times 100$$

= 93.23%

Efficiency Ratio = $\frac{\text{StandardHoursProduced}}{\text{ActualHours}} \times 100$

$$= \frac{(200 \times 10) + (150 \times 5) + (70 \times 2)}{2{,}800} \times 100$$

= 103.21%

6. Workings

$C_j \rightarrow$			30	40	20	0	0	0
C_B	Basic Variable (B)	Value of Basic Variables b (=X_B)	x	y	z	s_1	s_2	s_3
30	x	250	1	0	-26/16	10/16	-12/16	0
40	y	625	0	1	31/16	-7/16	10/16	0
0	s_3	125	0	0	11/16	-3/16	1/8	1
		$Z_j = \sum C_{Bi} X_j$	30	40	115/4	5/4	5/2	0
		$C_j - Z_j$	0	0	-35/4	-5/4	-5/2	0

(i) Yes, because the given solution has no artificial variable in the basis.

(ii) No, solution is not degenerate as none of the basic variables has zero quantity.

Basic Variables	x	y	s_3
Quantity	250	625	125

(A solution degenerates if the Quantity of one or more basic variables is zero)

(iii) Machine KA-07 and KB-27 are being used to the full capacity because, the slack variable s_1 and s_2 corresponding to them has a zero value in the solution.

(iv) The shadow price of hours on machine KA-07, machine KB-27 and machine KC-49 are being Rs.5/4, Rs.5/2 and Rs.0, respectively, these are the maximum prices one would be prepared to pay for another hour of capacity for these three machines.

(v) Machine KB-27 may be given priority as its shadow price is the highest.

(vi) When 16 hours are lost, then production of x would increase by 12 units and that of y would decrease by 10 units and the total profit decrease by Rs.40.

(vii) $C_j - Z_j$ for z being -35/4, production of each unit of z would cause a reduction of 35/4 rupee. Thus, the price for z should be increased by at least 35/4 rupee to ensure no reduction of profits.

(viii) Shadow prices of times on machines KA-07, KB-27 and KC-49 are Rs.5/4, Rs.5/2 and Rs.0. Production of a unit of the proposed new product would, therefore, reduce profit by Rs.10 [(4 hrs. × Rs.5/4) + (2 hrs. × Rs.5/2) + (4 hrs. × Rs.0)]. Since the product would yield a profit of Rs.12, it would result in a net increase in profit at a rate of Rs.2 per unit. It is advisable, therefore to introduce it.

(b) Statement Showing "Customer Profitability Analysis"

Particulars	Qx_1	Qx_2	Channel Total	Qx_3	Qx_4	Channel Total
	Small Stores			Large Stores		
Revenue	1,60,000	1,80,000	3,40,000	25,50,000	12,00,000	37,50,000
Discount	7,200	17,100	24,300	4,46,250	1,38,000	5,84,250
Net Revenue	1,52,800	1,62,900	3,15,700	21,03,750	10,62,000	31,65,750
Variable Costs	1,28,000	1,44,000	2,72,000	20,40,000	9,60,000	30,00,000
Contribution Margin	24,800	18,900	43,700	63,750	1,02,000	1,65,750
Order Processing	3,000	6,750	9,750	4,500	2,250	6,750

Regular Deliveries	1,500	3,375	4,875	2,250	1,125	3,375
Expedited Deliveries	2,500	---	2,500	2,500	---	2,500
Customer Profit	17,800	8,775	26,575	54,500	98,625	1,53,125
Channel Cost			20,250			48,375
Channel Profit			6,325			1,04,750

Recommendations

Small Pharmaceuticals

Even though Qx_1 has lower sales volume (11% lesser from Qx_2), it is contributing around 67% of small store's profit as its order is for larger quantities and discount offered is very less.

OHCC is only just at breakeven point with small pharmaceuticals. To improve profit OHCC should:

(i) Coordinate with Qx_2 to *increase order size* and try to *negotiate a smaller discount*.

(ii) Try to work with Qx_1 to *reduce expedited deliveries*.

Large Pharmaceuticals

OHCC makes substantial profit from the large pharmaceuticals. Qx_4 alone contributing around 55% of total customer's profit and its order is for larger quantities. Therefore, Qx_4 is most favorable customer and may be given *little extra attention.* For Qx_3, OHCC may have *no options* but to treat it as less profitable customer as Qx_3 accounts more than 60% of sales.

7. (a) Primary activities are the activities that are directly involved in transforming inputs into outputs and delivery and after-sales support to output. Following are the primary activities in the value chain of Well Fit Ltd.:-

(i) Inbound Logistics: These activities are related to the material handling and warehousing. It also covers transporting raw material from the supplier to the place of processing inside the factory.

(ii) Operations: These activities are directly responsible for the transformation of raw material into final product for the delivery to the consumers.

(iii) Outbound Logistics: These activities are involved in movement of finished goods to the point of sales. Order processing and distribution are major part of these activities.

(iv) **Marketing and Sales:** These activities are performed for demand creation and customer solicitation. Communication, pricing and channel management are major part of these activities.

(v) **Service:** These activities are performed after selling the goods to the consumers. Installation, repair and parts replacement are some examples of these activities.

(b) Following acceptance by early innovators, conventional consumers start following their lead. New competitors are likely to now enter the market attracted by the opportunities for large scale production and profit. ZSL may wish to discourage competitors from entering the market by lowering the price and thereby lowering the unit profitability. The price needs to be lowered so that the product becomes attractive to different market segments thus increasing demand to achieve the growth in sales volume. Strategies at this stage may include the following:

(i) Improving quality and adding new features such as Data Theft Protection, Parental Control, Web Protection, Improved Scan Engine, Anti Spyware, Anti Malware etc.

(ii) Sourcing new market segments/ distribution channels.

(iii) Changing marketing strategy to increase demand.

(iv) Lowering price to attract price-sensitive buyers.

(c) Continuous improvement can be brought into the organisational culture by introducing continuously changing planned targets. One such target can be six-sigma accuracy. The sigma accuracy means the process is 99.999998% accurate. That is the process will/can produce only 0.002 defects per million. This is the structural meaning of six-sigma. In quality practice, six-sigma means 3.4 parts per million.

Six sigma is the statistical measure used to ensure quality of products and services. The six sigma academy has developed a break through strategy consisting of measure, analyze, improve and control, that allows companies to make exceptional bottom-line improvements.

In addition to the material and labour savings, which flow directly to the bottom line, a company engaged in six sigma can expect to see:

(i) Improved customer satisfaction.

(ii) Reduction cycle time.

(iii) Increased productivity.

(iv) Reduction in total defect.

(v) Improved process flow.

Six Sigma Capability Chart

Sigma	Parts per Million
Six Sigma	3.4 Defects per Million
Five Sigma	233 Defects per Million
Four Sigma	6,120 Defects per Million
Three Sigma	66,807 Defects per Million
Two Sigma	3,08,537 Defects per Million
One Sigma	6,90,000 Defects per Million

There is an optimum level of output for a firm as a whole. This is so because there is a certain level of output beyond which its net revenue will not rise. The ideal transfer price under these circumstances will be that which will motivate these managers to produce at this level of output.

Essentially, it means that some division in a business house might have to produce its output at a level less than its full capacity and in all such cases a transfer price may be imposed centrally.

(d) Steps in the simulation process:

- Define the problem and system you intend to simulate.
- Formulate the model you intend to use.
- Test the model, compare with behaviour of the actual problem environment.
- Identify and collect data to test the model.
- Run the simulation.
- Analyse the results of the simulation and, if desired, change the solution you are evaluating.
- Rerun the simulation to tests the new solution.
- Validate the simulation i.e., increase the chances of valid inferences.

(e) As the production quantity of a given item is doubled, the cost of the item decreases at a fixed rate. This phenomenon is the basic premise on which the theory of learning curve has been formulated. As the quantity produced doubles, the absolute amount of cost increase will be successively smaller but the rate of decrease will remain fixed.

In the initial stage of a new product or a new process, the learning effect pattern is so regular that the rate of decline established at the outset can be used to predict labour cost well in advance. The effect of experience on cost is summarized in the learning curve ratio or improvement ratio.

$$\text{Learning curve ratio} = \frac{\text{Average labour cost of first 2N units}}{\text{Average labour cost of first N units}}$$

For example, if the average labour cost for the first 500 units is Rs.25 and the average labour cost for the first 1,000 units is Rs.20, the learning curve ratio is (Rs.20/25) or 80%. Since the average cost per unit of 1,000 units is Rs.20, the average cost per unit of first 2,000 units is likely to be 80% of Rs.20 or Rs.16.

Test Series: August, 2016

MOCK TEST PAPER – 1

FINAL COURSE: GROUP – II

PAPER – 6: INFORMATION SYSTEMS CONTROL AND AUDIT

Question No. **1** is compulsory.

Attempt any **five** questions from the remaining **six** Questions.

Time Allowed – 3 Hours **Maximum Marks – 100**

1. (a) You are appointed as an auditor by the Top management of an enterprise to conduct an audit and evaluate the performance of various controls under managerial controls. Discuss the major concerns that you should address under different activities involved in Programming Management Control Phase. *(6 Marks)*

   (b) 'When risks are identified and analyzed in an Information System, it is not always appropriate to implement controls to counter them'. Some risks may be minor, and it may not be cost effective to implement expensive control processes for them. A task has been assigned to you by the top management to formulate various risk management strategies under different situations. Discuss *(6 Marks)*

   (c) 'Data integrity is a reflection of the accuracy, correctness, validity, and currency of the data'. What can be major Data Integrity Policies to ensure the same. *(4 Marks)*

   (d) Mention all the phases that are prescribed under the methodology of developing a Business Continuity Plan. *(4 Marks)*

2. (a) Discuss the activities performed by an Internal Auditor as suggested by The Institute of Internal Auditors (IIA)? *(6 Marks)*

   (b) Define Information Security Policy. What are the major issues that are addressed by Information Security Policy? *(6 Marks)*

   (c) A company has decided to outsource its recovery process to a third party site. What are the issues that should be considered by the security administrators while drafting the contract? *(4 Marks)*

3. (a) What do you mean by Expert System? What are the need and benefits of Expert system? *(6 Marks)*

   (b) Discuss advantages of Continuous Audit Techniques. *(6 Marks)*

   (c) Define Incremental Backup. Also discuss its advantages and disadvantages.

   (4 Marks)

4. (a) What do you mean by the term 'Audit Trail'? How can Audit Trail be used to support security objectives? *(6 Marks)*

(b) Discuss some benefits of Enterprise Resource Planning (ERP)? *(6 Marks)*

(c) Discuss the need for Controls in an Information System. *(4 Marks)*

5. (a) The COBIT 5 framework describes seven categories of enablers. Discuss them, in brief. *(6 Marks)*

(b) What do you understand by the term 'Community Cloud'? Discuss its characteristics. *(6 Marks)*

(c) How System Maintenance can be categorized? *(4 Marks)*

6. (a) Write a short note on 'Service Strategy' of IT Infrastructure Library (ITIL) framework. *(6 Marks)*

(b) Discuss Prototyping Model and its strengths. *(6 Marks)*

(c) Differentiate between Decision Support system and Traditional Management Information System (MIS). *(4 Marks)*

7. Write short notes on any **four** of the following:

(a) Classification of Information System Controls on the basis of objectives

(b) Developer related issues in achieving System development objectives

(c) Feasibility Study under SDLC

(d) Components of Mobile Computing

(e) PDCA Cyclic Process of ISO 27001 *(4 × 4 = 16 Marks)*

Test Series: August, 2016

MOCK TEST PAPER – 1

FINAL COURSE: GROUP – II

PAPER – 6: INFORMATION SYSTEMS CONTROL AND AUDIT

SUGGESTED ANSWERS/HINTS

1. (a) As an auditor, the major concerns that would be addressed under different activities involved in Programming Management Control Phase are as follows:

- **Planning:** They should evaluate whether the nature of and extent of planning are appropriate to the different types of software that are developed or acquired and how well the planning work is being undertaken.
- **Control:** They must evaluate whether the nature of an extent of control activities undertaken are appropriate for the different types of software that are developed or acquired. They must gather evidence on whether the control procedures are operating reliably.
- **Design:** Auditors should find out whether programmers use some type of systematic approach to design. Auditors can obtain evidence of the design practices used by undertaking interviews, observations, and reviews of documentation.
- **Coding:** Auditors should seek evidence on the level of care exercised by programming management in choosing a module implementation and integration strategy. Auditors determine whether programming management ensures that programmers follow structured programming conventions.
- **Testing:** Auditors can use interviews, observations, and examination of documentation to evaluate how well unit testing is conducted. They are concerned primarily with the quality of integration testing work carried out by information systems professionals rather than end users.
- **Operation and Maintenance:** Auditors need to ensure effectively and timely reporting of maintenance needs occurs and maintenance is carried out in a well-controlled manner. Auditors should ensure that management has implemented a review system and assigned responsibility for monitoring the status of operational programs.

(b) **Risk Management Strategies:** When risks are identified and analyzed, it is not always appropriate to implement controls to counter them. Some risks may be minor, and it may not be cost effective to implement expensive control processes for them. Various risk management strategies are as follows:

- **Tolerate/Accept the risk**. One of the primary functions of management is managing risk. Some risks may be considered minor because their impact and probability of occurrence is low. In this case, consciously accepting the risk as a cost of doing business is appropriate, as well as periodically reviewing the risk to ensure its impact remains low.
- **Terminate/Eliminate the risk**. It is possible for a risk to be associated with the use of a particular technology, supplier, or vendor. The risk can be eliminated by replacing the technology with more robust products and by seeking more capable suppliers and vendors.
- **Transfer/Share the risk.** Risk mitigation approaches can be shared with trading partners and suppliers. A good example is outsourcing infrastructure management. In such a case, the supplier mitigates the risks associated with managing the IT infrastructure by being more capable and having access to more highly skilled staff than the primary organization. Risk also may be mitigated by transferring the cost of realized risk to an insurance provider.
- **Treat/mitigate the risk.** Where other options have been eliminated, suitable controls must be devised and implemented to prevent the risk from manifesting itself or to minimize its effects.
- **Turn back.** Where the probability or impact of the risk is very low, then management may decide to ignore the risk.

(c) Major Data Integrity Policies to ensure accuracy, correctness, validity, and currency of the data are as under:

- **Virus-Signature Updating:** Virus signatures must be updated automatically when they are made available from the vendor through enabling of automatic updates.
- **Software Testing:** All software must be tested in a suitable test environment before installation on production systems.
- **Division of Environments:** The division of environments into Development, Test, and Production is required for critical systems.
- **Offsite Backup Storage:** Backups must be sent offsite for permanent storage.
- **Quarter-End and Year-End Backups:** Quarter-end and year-end backups must be done separately from the normal schedule for accounting purposes
- **Disaster Recovery:** A comprehensive disaster-recovery plan must be used to ensure continuity of the corporate business in the event of an outage.

(d) The methodology for developing a business continuity plan can be sub-divided into eight different phases. These phases are as below:

(i) Pre-Planning Activities (Business Continuity Plan Initiation),

(ii) Vulnerability Assessment and General Definition of Requirements,

(iii) Business Impact Analysis,

(iv) Detailed Definition of Requirements,

(v) Plan Development,

(vi) Testing Program,

(vii) Maintenance Program, and

(viii) Initial Plan Testing and Plan Implementation.

2. (a) IT Governance can be evaluated by both external as well internal auditors. The following guidance is from internal audit perspective as issued by **The Institute of Internal Auditors (IIA)**. It outlines specific areas and critical aspects relating to governance structure and practices, which can be reviewed as part of internal audit. Internal audit activities in evaluating the IT governance structure and practices within an enterprise can evaluate several key components that lead to effective IT governance. These are briefly explained below:

- **Leadership:** The following aspects need to be verified by the auditor:
  - Evaluate the relationship between IT objectives and the current/strategic needs of the organization and the ability of IT leadership to effectively communicate this relationship to IT and organizational personnel.
  - Assess the involvement of IT leadership in the development and on-going execution of the organization's strategic goals.
  - Determine how IT will be measured in helping the organization achieve these goals.
  - Review how roles and responsibilities are assigned within the IT organization and how they are executed.
  - Review the role of senior management and the board in helping establish and maintain strong IT governance.
- **Organizational Structure:** The following aspects need to be assessed by the auditor:
  - Review how organization management and IT personnel are interacting and communicating current and future needs across the organization.
  - This should include the existence of necessary roles and reporting relationships to allow IT to meet the needs of the organization, while providing the opportunity to have requirements addressed via formal evaluation and prioritization. In addition, how IT mirrors the organization structure in its enterprise architecture should also be included.

- **Processes:** The following aspects need to be checked by the auditor:
    - Evaluate IT process activities and the controls in place to mitigate risks to the organization and whether they provide the necessary assurance regarding processes and underlying systems.
    - What processes are used by the IT organization to support the IT environment and consistent delivery of expected services?
- **Risks:** The following aspects need to be reviewed by the auditor:
    - Review the processes used by the IT organization to identify, assess, and monitor/mitigate risks within the IT environment.
    - Additionally, determine the accountability that personnel have within risk management and how well these expectations are being met.
- **Controls: The following aspects need to be verified by the auditor:**
    - Assess key controls that are defined by IT to manage its activities and the support of the overall organization.
    - Ownership, documentation, and reporting of self-validation aspects should be reviewed by the internal audit activity.
    - Additionally, the control set should be robust enough to address identified risks based on the organization's risk appetite and tolerance levels, as well as any compliance requirements.
- **Performance Measurement/Monitoring: The following aspects need to be verified by the auditor:**
    - Evaluate the framework and systems in place to measure and monitor organizational outcomes where support from IT plays an important part in the internal outputs in IT operations and developments.

(b) Information Security Policy: An Information Security Policy is the statement of intent by the management about how to protect a company's information assets. It is a formal statement of the rules, which give access to people to an organization's technology and information assets, and which they must abide. In its basic form, a information security policy is a document that describes an organization's information security controls and activities. The policy does not specify technologies or specific solutions; it defines a specific set of intentions and conditions that help protect a company's information assets and its ability to conduct business.

An Information Security Policy is the essential foundation for an effective and comprehensive information security program. It is the primary way in which management's information security concerns are translated into specific measurable and testable goals and objectives. It provides guidance to the people, who build, install, and maintain information systems.

This policy does not need to be extremely extensive, but clearly state senior management's commitment to information security, be under change and version control and be signed by the appropriate senior manager. The policy should at least address the following issues:

- a definition of information security,
- reasons why information security is important to the organization, and its goals and principles,
- a brief explanation of the security policies, principles, standards and compliance requirements,
- definition of all relevant information security responsibilities; and
- reference to supporting documentation.

The auditor should ensure that the policy is readily accessible to all employees and that all employees are aware of its existence and understand its contents. The policy may be a stand-alone statement or part of more extensive documentation (e.g. a security policy manual) that defines how the information security policy is implemented in the organization.

(c) If a third-party site is to be used for recovery purposes, security administrators must ensure that a contract is written to cover the following issues:

- How soon the site will be made available subsequent to a disaster;
- The number of organizations that will be allowed to use the site concurrently in the event of a disaster;
- The priority to be given to concurrent users of the site in the event of a common disaster;
- The period during which the site can be used;
- The conditions under which the site can be used;
- The facilities and services the site provider agrees to make available;
- Procedures to ensure security of company's data from being accessed/damaged by other users of the facility; and
- What controls will be in place for working at the off-site facility.

3. (a) Expert System – An Expert System is highly developed DSS that utilizes knowledge generally possessed by an expert to share a problem. Expert Systems are software systems that imitate the reasoning processes of human experts and provide decision makers with the type of advice they would normally receive from such expert systems.

Need for Expert Systems – Major reasons for the need of Expert Systems is given as follows:

- Expert labor is expensive and scarce. Knowledge workers employee, who routinely work with data and information to carry out their day-to-day duties are not easy to find and keep and companies are often faced with a shortage of talent in key positions.
- Moreover, no matter how bright or knowledgeable certain people are, they often can handle only a few factors at a time.
- Both these limitations imposed by human information processing capability and the rushed pace at which business is conducted today put a practical limit on the quality of human decision making this putting a need for expert systems.

The key benefits of Expert System is as follows:

- Expert System preserves knowledge that might be lost through retirement, resignation or death of an acknowledged company expert.
- Expert System puts information into an active-form so it can be summoned almost as a real-life expert might be summoned.
- Expert System assists novices in thinking the way experienced professional do.
- Expert System is not subjected to such human fallings as fatigue, being too busy, or being emotional.
- Expert System can be effectively used as a strategic tool in the areas of marketing products, cutting costs and improving products.

(b) Some of the advantages of continuous audit techniques are given as under:

- **Timely, Comprehensive and Detailed Auditing** – Evidence would be available more timely and in a comprehensive manner. The entire processing can be evaluated and analyzed rather than examining the inputs and the outputs only.
- **Surprise test capability** – As evidences are collected from the system itself by using continuous audit techniques, auditors can gather evidence without the systems staff and application system users being aware that evidence is being collected at that particular moment. This brings in the surprise test advantages.
- **Information to system staff on meeting of objectives** – Continuous audit techniques provides information to systems staff regarding the test vehicle to be used in evaluating whether an application system meets the objectives of asset safeguarding, data integrity, effectiveness, and efficiency.

- **Training for new users** – Using the Integrated Test Facility (ITF), new users can submit data to the application system, and obtain feedback on any mistakes they make via the system's error reports.

(c) **Incremental Backup:** An Incremental Backup captures files that were created or changed since the last backup, regardless of backup type. The last backup can be a full backup or simply the last incremental backup. With incremental backups, one full backup is done first and subsequent backup runs are just the changed files and new files added since the last backup. For example - Suppose an Incremental backup job or task is to be done every night from Monday to Friday. This first backup on Monday will be a full backup since no backups have been taken prior to this. However, on Tuesday, the incremental backup will only backup the files that have changed since Monday and the backup on Wednesday will include only the changes and new files since Tuesday's backup. The cycle continues this way.

Advantages

- Much faster backups.
- Efficient use of storage space as files is not duplicated. Much less storage space used compared to running full backups and even differential backups.

Disadvantages

- Restores are slower than with a full backup and differential backups.
- Restores are a little more complicated. All backup sets (first full backup and all incremental backups) are needed to perform a restore.

4. (a) **Audit Trails:** Audit trails are logs that can be designed to record activity at the system, application, and user level. When properly implemented, audit trails provide an important detective control to help accomplish security policy objectives. Many operating systems allow management to select the level of auditing to be provided by the system. This determines 'which events will be recorded in the log'. An effective audit policy will capture all significant events without cluttering the log with trivial activity. Audit trail controls attempt to ensure that a chronological record of all events that have occurred in a system is maintained. This record is needed to answer queries, fulfill statutory requirements, detect the consequences of error and allow system monitoring and tuning. The accounting audit trail shows the source and nature of data and processes that update the database. The operations audit trail maintains a record of attempted or actual resource consumption within a system.

Audit Trail Objectives: Audit trails can be used to support security objectives in three ways:

- **Detecting Unauthorized Access*:*** The primary objective of real-time detection is to protect the system from outsiders who are attempting to breach system controls. A real-time audit trail can also be used to report on changes in system performance that may indicate infestation by a virus or worm. Depending upon how much activity is being logged and reviewed; real-time detection can impose a significant overhead on the operating system, which can degrade operational performance. After-the-fact detection logs can be stored electronically and reviewed periodically or as needed. When properly designed, they can be used to determine if unauthorized access was accomplished, or attempted and failed.

- **Reconstructing Events*:*** Audit analysis can be used to reconstruct the steps that led to events such as system failures, security violations by individuals, or application processing errors. Knowledge of the conditions that existed at the time of a system failure can be used to assign responsibility and to avoid similar situations in the future. Audit trail analysis also plays an important role in accounting control. For example, by maintaining a record of all changes to account balances, the audit trail can be used to reconstruct accounting data files that were corrupted by a system failure.
- **Personal Accountability*:*** Audit trails can be used to monitor user activity at the lowest level of detail. This capability is a preventive control that can be used to influence behavior. Individuals are likely to violate an organization's security policy if they know that their actions are not recorded in an audit log.

(b) Some benefits of Enterprise Resource Planning (ERP) are as follows:

- Streamlining processes and workflows with a single integrated system.
- Reduce redundant data entry and processes and in other hand it shares information across the department.
- Establish uniform processes that are based on recognized best business practices.
- Improved workflow and efficiency.
- Improved customer satisfaction based on improved on-time delivery, increased quality, shortened delivery times.
- Reduced inventory costs resulting from better planning, tracking and forecasting of requirements.
- Turn collections faster based on better visibility into accounts and fewer billing and/or delivery errors.
- Decrease in vendor pricing by taking better advantage of quantity breaks and tracking vendor performance.
- Track actual costs of activities and perform activity based costing.
- Provide a consolidated picture of sales, inventory and receivables.

(c) Some of the reasons for Controls in Information Systems are as follows:

- Technology has impacted what can be done in business in terms of information as a business enabler. It has increased the ability to capture, store, analyze and process tremendous amounts of data and information by empowering the business decision maker. IT department may store all financial records centrally. For example, a large multinational company with offices in many locations may store all its computer data in just one centralised data centre. If a poorly controlled computer system is compared to a poorly controlled manual system, it would be akin to placing an organisation's financial records on a table in the street and placing a pen and a bottle of correction fluid nearby. Without adequate controls, anyone could look at the records and make amendments, some of which could remain undetected.
- Today's dynamic global enterprises need information integrity, reliability and validity for timely flow of accurate information throughout the organization. The goals to reduce the probability of organizational costs of data loss, computer loss, computer abuse, incorrect decision making and to maintain the privacy; an organization's management must set up a system of internal controls. Safeguarding assets to maintain accurate data readily available and its integrity to achieve system effectiveness and efficiency is a significant control process.
- A well designed information system should have controls built in for all its sensitive or critical sections. For example, the general procedure to ensure that adequate safeguards over access to assets and facilities can be translated into an IS-related set of control procedures, covering access safeguards over computer programs, data and any related equipment. IS control procedure may include Strategy and direction; General Organization and Management; Access to IT resources, including data and programs; System development methodologies and change control; Operation procedures; System Programming and technical support functions; Qualify Assurance Procedures; Physical Access Controls; BCP and DRP; Network and Communication; Database Administration; Protective and detective mechanisms against internal/external attacks etc..

5. (a) Enablers are factors that, individually and collectively, influence whether something will work; in this case, governance and management over enterprise IT. Enablers are driven by the goals cascade, i.e., higher-level IT related goals defining 'what the different enablers should achieve'. The COBIT 5 framework describes seven categories of enablers which are as follows:

- **Principles, Policies and Frameworks** are the vehicle to translate the desired behavior into practical guidance for day-to-day management.

- **Processes** describe an organized set of practices and activities to achieve certain objectives and produce a set of outputs in support of achieving overall IT-related goals.
- **Organizational structures** are the key decision-making entities in an enterprise.
- **Culture, Ethics and Behavior** of individuals and of the enterprise is very often underestimated as a success factor in governance and management activities.
- **Information** is pervasive throughout any organization and includes all information produced and used by the enterprise. Information is required for keeping the organization running and well governed, but at the operational level, information is very often the key product of the enterprise itself.
- **Services, Infrastructure and Applications** include the infrastructure, technology and applications that provide the enterprise with information technology processing and services.
- **People, Skills and Competencies** are linked to people and are required for successful completion of all activities and for making correct decisions and taking corrective actions.

(b) Community Cloud: The community cloud is the cloud infrastructure that is provisioned for exclusive use by a specific community of consumers from organizations that have shared concerns (eg. mission security requirements, policy, and compliance considerations). It may be owned, managed, and operated by one or more of the organizations in the community, a third party or some combination of them, and it may exist on or off premises. In this, a private cloud is shared between several organizations.

Characteristics of Community Clouds are as follows:

- **Collaborative and Distributive Maintenance:** In this, no single company has full control over the whole cloud. This is usually distributive and hence better cooperation provides better results.
- **Partially Secure:** This refers to the property of the community cloud where few organizations share the cloud, so there is a possibility that the data can be leaked from one organization to another, though it is safe from the external world.
- **Cost Effective:** As the complete cloud if being shared by several organizations or community, not only the responsibility gets shared; the community cloud becomes cost effective too.

(c) System Maintenance can be categorized in the following ways:

- **Scheduled Maintenance:** Scheduled maintenance is anticipated and can be planned for operational continuity and avoidance of anticipated risks. For example, the implementation of a new inventory coding scheme can be planned in advance, security checks may be promulgated etc.
- **Rescue Maintenance:** Rescue maintenance refers to previously undetected malfunctions that were not anticipated but require immediate troubleshooting solution. A system that is properly developed and tested should have few occasions of rescue maintenance.
- **Corrective Maintenance:** Corrective maintenance deals with fixing bugs in the code or defects found during the executions. A defect can result from design errors, logic errors coding errors, data processing and system performance errors. The need for corrective maintenance is usually initiated by bug reports drawn up by the end users. Examples of corrective maintenance include correcting a failure to test for all possible conditions or a failure to process the last record in a file.
- **Adaptive Maintenance:** Adaptive maintenance consists of adapting software to changes in the environment, such as the hardware or the operating system. The term environment in this context refers to the totality of all conditions and influences, which act from outside upon the system, for example, business rule, government policies, work patterns, software and hardware operating platforms. The need for adaptive maintenance can only be recognized by monitoring the environment.
- **Perfective Maintenance:** Perfective maintenance mainly deals with accommodating to the new or changed user requirements and concerns functional enhancements to the system and activities to increase the system's performance or to enhance its user interface.
- **Preventive Maintenance:** Preventive maintenance concerns with the activities aimed at increasing the system's maintainability, such as updating documentation, adding comments, and improving the modular structure of the system. The long-term effect of corrective, adaptive and perfective changes increases the system's complexity. As a large program is continuously changed, its complexity, which reflects deteriorating structure, increases unless work is done to maintain or reduce it. This work is known as preventive change.

6. **(a)** **Service Strategy of ITIL Framework:** The centre and origin point of the ITIL Service Lifecycle, the ITIL Service Strategy (SS) volume, provides guidance on clarification and prioritization of service-provider investments in services. It provides guidance on leveraging service management capabilities to effectively deliver value to customers and illustrate value for service providers. The Service Strategy volume provides guidance on the design, development, and implementation of service management, not only as an organizational capability, but also as a strategic asset. It provides guidance on the principles underpinning the practice of service management to aid the development of service management policies, guidelines, and processes across the ITIL Service Lifecycle.

- **IT Service Generation:** IT Service Management (ITSM) refers to the implementation and management of quality information technology services and is performed by IT service providers through People, Process and Information Technology.
- **Service Portfolio Management:** IT portfolio management is the application of systematic management to the investments, projects and activities of enterprise Information Technology (IT) departments.
- **Financial Management:** Financial Management for IT Services" aim is to give accurate and cost effective stewardship of IT assets and resources used in providing IT Services.
- **Demand Management:** Demand management is a planning methodology used to manage and forecast the demand of products and services.
- **Business Relationship Management:** Business Relationship Management is a formal approach to understanding, defining, and supporting a broad spectrum of inter–business activities related to providing and consuming knowledge and services via networks.

(b) **Prototyping Model:** The goal of prototyping approach is to develop a small or pilot version called a prototype of part or all of a system. A prototype is a usable system or system component that is built quickly and at a lesser cost, and with the intention of modifying/replicating/expanding or even replacing it by a full-scale and fully operational system. As users work with the prototype, they learn about the system criticalities and make suggestions about the ways to manage it. These suggestions are then incorporated to improve the prototype, which is also used and evaluated. Finally, when a prototype is developed that satisfies all user requirements, either it is refined and turned into the final system or it is scrapped. If it is scrapped, the knowledge gained from building the prototype is used to develop the real system.

The generic phases of this model are to Identify Information System Requirements, Develop the initial prototype, Test and Revise; and obtain user Signoff of the Approved Prototype.

Some of the strengths of Prototyping Model as identified by the experts and practitioners include the following:

- It improves both user participation in system development and communication among project stakeholders.

- It is especially useful for resolving unclear objectives; developing and validating user requirements; experimenting with or comparing various design solutions, or investigating both performance and the human computer interface.
- Potential exists for exploiting knowledge gained in an early iteration as later iterations are developed.
- It helps to easily identify, confusing or difficult functions and missing functionality.
- It enables to generate specifications for a production application.
- It encourages innovation and flexible designs.
- It provides for quick implementation of an incomplete, but functional, application.
- It typically results in a better definition of these users' needs and requirements than does the traditional systems development approach.
- A very short time period is normally required to develop and start experimenting with a prototype. This short time period allows system users to immediately evaluate proposed system changes.
- Since system users experiment with each version of the prototype through an interactive process, errors are hopefully detected and eliminated early in the developmental process. As a result, the information system ultimately implemented should be more reliable and less costly to develop than when the traditional systems development approach is employed.

(c) The difference between Decision Support System (DSS) and Traditional MIS are as follows:

Dimensions	Decision Support System	Traditional MIS
Philosophy	Providing integrated tools, data, models, and languages to end users	Providing structured information to end users
Orientation	External orientation	Internal orientation
Flexibility	Highly flexible	Relatively inflexible
Analytical capability	More analytical capability	Little analytical capability
System analysis	Emphasis on tools to be used in decision process	Emphasis on information requirement analysis

System design	Interactive process	System development based on static information requirements

7. (a) Classification of Information System Controls on the basis of "Objective of Controls" is as under:

- **Preventive Controls:** Preventive Controls are those inputs, which are designed to prevent an error, omission or malicious act occurring. Some of the examples of preventive controls can be use of passwords to gain access to a financial system; Employing qualified personnel; Segregation of duties; Access control; Vaccination against diseases; Documentation; Prescribing appropriate books for a course; Training and retraining of staff; Authorization of transaction; Validation, edit checks in the application; Firewalls; Anti-virus software (sometimes this acts like a corrective control also), etc., and Passwords.
- **Detective Controls:** These controls are designed to detect errors, omissions or malicious acts that occur and report the occurrence. Examples of detective controls include use of automatic expenditure profiling where management gets regular reports of spend to date against profiled spend; Hash totals; Check points in production jobs; Echo control in telecommunications; Error message over tape labels; Duplicate checking of calculations; Periodic performance reporting with variances; Past-due accounts report; The internal audit functions; Intrusion detection system; Cash counts and bank reconciliation, and monitoring expenditures against budgeted amount.
- **Corrective Controls:** Corrective controls are designed to reduce the impact or correct an error once it has been detected. Corrective controls may include the use of default dates on invoices where an operator has tried to enter the incorrect date. A Business Continuity Plan (BCP) is considered to be a corrective control. Some of the other Corrective Controls may be Contingency planning; Backup procedure; Rerun procedures; Change input value to an application system; and Investigate budget variance and report violations.
- **Compensatory Controls:** Controls are basically designed to reduce the probability of threats, which can exploit the vulnerabilities of an asset and cause a loss to that asset. While designing the appropriate control one thing should be kept in mind **- "The cost of the lock should not be more than the cost of the assets it protects."** Sometimes, while designing and implementing controls, organizations because of different constraints like financial, administrative or operational, may not be able to implement appropriate controls. In such a scenario, there should be adequate compensatory measures, which may although not be as efficient as the appropriate control, but reduce the probability of loss to the assets. Such

measures are called compensatory controls.

(b) **Developer Related Issues in achieving System Development Objectives**: It refers to the issues and challenges with regard to the developers. Some of the critical bottlenecks are mentioned as follows:

- **Lack of Standard Project Management and System Development Methodologies:** Some organizations do not formalize their project management and system development methodologies, thereby making it very difficult to consistently complete projects on time or within budget.
- **Overworked or Under-Trained Development Staff:** In many cases, system developers often lack sufficient educational background and requisite state of the art skills. Furthermore, many companies do a little to help their development personnel stay technically sound, and more so a training plan and training budget do not exist.

(c) **Feasibility Study under SDLC:** After possible solution options are identified, project feasibility i.e. the likelihood that these systems will be useful for the organization is determined. A feasibility study is carried out by the system analysts, which refers to a process of evaluating alternative systems through cost/benefit analysis so that the most feasible and desirable system can be selected for development. The Feasibility Study of a system is evaluated under following dimensions described briefly as follows:

- **Technical:** Is the technology needed available?
- **Financial:** Is the solution viable financially?
- **Economic:** Return on Investment?
- **Schedule/Time:** Can the system be delivered on time?
- **Resources:** Are human resources reluctant for the solution?
- **Operational:** How will the solution work?
- **Behavioral:** Is the solution going to bring any adverse effect on quality of work life?
- **Legal:** Is the solution valid in legal terms?

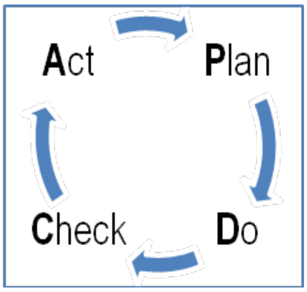
(d) The key components of Mobile Computing are as follows:

- **Mobile Communication:** This refers to the infrastructure put in place to ensure that seamless and reliable communication goes on. This would include communication properties, protocols, data formats and concrete technologies.
- **Mobile Hardware:** This includes mobile devices or device components that receive or access the service of mobility. They would range from Portable laptops, Smart Phones, Tablet PCs, and Personal Digital Assistants (PDA) that

use an existing and established network to operate on. At the back end, there are various servers like Application Servers, Database Servers and Servers with wireless support, WAP gateway, a Communications Server and/or MCSS (Mobile Communications Server Switch) or a wireless gateway embedded in wireless carrier's network (this server provide communications functionality to allow the handheld device to communicate with the internet or Intranet Infrastructure). The characteristics of mobile computing hardware are defined by the size and form factor, weight, microprocessor, primary storage, secondary storage, screen size and type, means of input, means of output, battery life, communications capabilities, expandability and durability of the device.

- **Mobile Software:** Mobile Software is the actual programme that runs on the mobile hardware and deals with the characteristics and requirements of mobile applications. It is the operating system of that appliance and is the essential component that makes the mobile device operates. Mobile applications popularly called Apps are being developed by organizations for use by customers but these apps could represent risks, in terms of flow of data as well as personal identification risks, introduction of malware and access to personal information of mobile owner.

(e) The PDCA cyclic process of ISO 27001 is as under:



- **The Plan Phase (Establishing the ISMS) –** This phase serves to plan the basic organization of information security, set objectives for information security and choose the appropriate security controls (the standard contains a catalogue of 133 possible controls).
- **The Do Phase (Implementing and Working of ISMS) –** This phase includes carrying out everything that was planned during the previous phase.
- **The Check Phase (Monitoring and Review of the ISMS) –** The purpose of this phase is to monitor the functioning of the ISMS through various "channels", and check whether the results meet the set objectives.
- **The Act Phase (Update and Improvement of the ISMS) –** The purpose of this phase is to improve everything that was identified as non-compliant in the previous phase.

The cycle of these four phases never ends, and all the activities must be implemented cyclically in order to keep the ISMS effective.

Test Series: August, 2016

MOCK TEST PAPER – 1

FINAL: GROUP – II

PAPER – 7: DIRECT TAX LAWS

*Question **1** is compulsory*

*Answer any **five** questions from the remaining **six** questions.*

Time Allowed – 3 Hours **Maximum Marks – 100**

1 (a) Compute the quantum of depreciation available under section 32 of the Income-tax Act, 1961 and any other benefit available in respect of the following items of Plant and Machinery purchased by Raymond Textile Ltd., which is engaged in the manufacture of textile fabrics, for the year ended 31-3-2016:

	(Rs. In crores)
New machinery installed on 1-5-2015	84
New Windmill purchased and installed on 18-6-2015.	22
Items purchased after 30th November 2015:	
Lorries for transporting goods to sales depots	3
Fork-lift-trucks, used inside factory	4
Computers installed in office premises	1
Computers installed in factory	2
New imported machinery	12

The new imported machinery arrived at Chennai port on 30-03-2016 and was installed on 3-4-2016. All other items were installed during the year ended 31-3-2016.The company was newly started during the year.

Also, compute the WDV of the various blocks of assets. *(10 Marks)*

(b) Your client, Sangam Ltd. has two industrial undertakings-one engaged in production of audio music CDs and cassettes and the other engaged in production of video CDs. As a restructuring drive, the company has decided to sell its undertaking producing video CDs as a going concern by way of slump sale for Rs. 450 Lacs to a new company called Digitech Ltd., in which it holds 75% equity shares. The balance sheet of Sangam Ltd. as on 31st March, 2016 reads as follows:

	Rs. In Lacs	
	Audio Unit	**Video Unit**
Fixed Assets	150	225

Debtors	150	112.5
Inventories	75	37.5
Liabilities	42	75
Paid up share capital	Rs. 378 Lacs	
General Reserve	Rs. 222 Lacs	
Share premium	Rs. 33 Lacs	
Revaluation Reserve	Rs. 140 Lacs	

The company set up the video unit on 1st April, 2010. The written down value of the block of assets for tax purpose as on 31st March, 2016 is Rs. 200 lacs of which Rs. 85 lacs are attributable to video unit.

(i) Determine the tax liability which would arise to Sangam Ltd. from slump sale;

(ii) Suggest modification of the restructuring plan of Sangam Ltd. without changing the amount of consideration so as to make it more tax efficient. *(10 Marks)*

2. MILTON Ltd. is engaged in the business of manufacturing plastic bottles. Its Profit & Loss account shows a net profit of Rs.60 lakhs for the year ended 31st March 2016, after debiting/crediting the following items:

(i) Rs.10,000 &Rs.15,000 paid in cash on 19.11.2015 by two separate vouchers to a contractor who carried out certain repair work in the office premises.

(ii) One time license fee of Rs.10 lakh paid to a foreign company for obtaining franchise on 1stAugust 2015.

(iii) Dividend of Rs.3,50,000 received from a foreign company, in which MILTON Ltd. holds 28% in nominal value of equity share capital of the company. Rs.25,000 spent on earning this income.

(iv) Depreciation on tangible fixed assets Rs.1,50,000.

(v) Rs.5,00,000 and Rs.1,50,000, being amounts waived by a bank out of principal and arrear interest, respectively, in one-time settlement. The loan was obtained for meeting working capital requirements two years back.

(vi) Provision for gratuity based on actuarial valuation Rs.5,00,000. Actual gratuity paid Rs.1,50,000 was debited to provision for gratuity account.

(vii) The opening & closing stock of the year were Rs.18,00,000 & Rs.18,72,000, respectively, and were undervalued by 10% on cost.

Additional Information:

(a) Provision for audit fee of Rs.1,00,000 was made in the books for the year ending 31/3/2015, without deducting tax at source. Such fee was paid to the auditors in September, 2015, after deducting tax u/s 194J and the tax so deducted was deposited on 5th October 2015.

(b) During the year, the company purchased 5000 shares of TQ Private Ltd. at Rs.20 per share. The fair market value of such shares on the date of transaction was Rs. 40 per share.

(c) Depreciation on tangible fixed assets as per Income-tax Rules : Rs.1.75 lakhs.

(d) A debt of Rs.8 lakhs was claimed as bad debt in the previous year 2014-15. But the Assessing Officer allowed only Rs.4 lakhs as bad debt. In previous year 2015-16, Rs.3 lakhs was recovered ultimately in respect of the debt. The effect of recovery of bad debt was not given in books of account.

Compute the total income and tax payable by MILTON Ltd., giving the reasons for treatment of each item, for assessment year 2016-17. Ignore MAT provisions. *(16 Marks)*

3. (a) Mr. Mahesh, an individual resident in India aged 48 years, furnishes you the following particulars of income earned in India, Foreign Countries "Y" and "Z" for the previous year 2015-16. Compute the total income and tax payable by Mr. Mahesh in India for A.Y. 2016-17 assuming that India has not entered into double taxation avoidance agreement with countries Y&Z.

Particulars	Rs.
Indian Income:	
Income from business carried on in Delhi	9,20,000
Interest on savings bank with Dena Bank	24,000
Income earned in Foreign Country "Y" [Rate of tax – 12%]:	
Agricultural income in Country "Y"	72,000
Royalty income from a book on art from Country "Y" (Gross)	8,00,000
Expenses incurred for earning royalty	70,000
Income earned in Foreign Country "Z" [Rate of tax – 23%]:	
Dividend received from a company incorporated in Country "Z"	2,25,000
Rent from a house situated in Country "Z" (gross)	3,30,000
Municipal tax paid in respect of the above house (not allowed as deduction in Country "Z")	10,000

(8 Marks)

(b) Sonal purchased a residential house in Meerut from her colleague Sonam at Rs. 20 lacs on 10th January, 2016. The value determined by the Stamp Valuation Authority for stamp duty purpose amounted to Rs.25 lakhs. Sonam had purchased the house on 31st January, 2013 at a cost of Rs.8 lakhs. Sonal sold the flat for Rs.40 lacs on 15th March, 2016.

Determine the effect of the above transactions on the assessments of Sonal and Sonam for assessment year 2016-17, assuming that value for stamp duty purpose in case of the second sale was not more than the sale consideration. *(4 Marks)*

(c) Mr. Tamal gifted a sum of Rs. 9 lakhs to his brother's wife Mrs. Reema on 30.8.2015. On 10.9.2015, his brother, Mr. Tapan gifted a sum of Rs. 7 lakhs to Mr. Tamal's wife, Shikha. The gifted amounts were invested as fixed deposits in banks by Mrs. Reema and Mrs. Shikha on 1.10.2015 at 8% interest. Discuss the consequences of the above under the provisions of the Income-tax Act, 1961 in the hands of Mr. Tamal and Mr. Tapan. *(4 Marks)*

4. (a) Mr. Kartik sold his residential house in Chennai and purchased two residential flats adjacent to each other on the same day vide two separate registered sale deeds from two different persons. The builder had certified that he had effected necessary modification to make it one residential apartment. Mr. Kartik sought exemption under section 54 in respect of the investment made in purchase of the two residential flats. The Assessing Officer, however, gave exemption under section 54 to the extent of purchase of one residential flat only contending that sub-section (1) of section 54 clearly restricts the benefit of exemption to purchase one residential house only and the two flats cannot be treated as one residential unit since –

   (i) the flats were purchased through different sale deeds; and

   (ii) it was found by the Inspector that, before its sale to the assessee, the residential flats were in occupation of two different tenants.

   Discuss the correctness of the contention of the Assessing Officer. *(4 Marks)*

(b) PQ Limited, an Indian company, is engaged in manufacturing electronic components. 74% of shares of the company are held by PQ Inc., incorporated in USA. PQ Limited has borrowed funds from PQ Inc. at LIBOR plus 150 basis points. The LIBOR prevalent at the time of borrowing is 4% for US $. The borrowings allowed under the External Commercial Borrowings guidelines issued under Foreign Exchange Management Act are LIBOR plus 200 basis points. Discuss whether the borrowing made by PQ Limited is at arm's length ('LIBOR' means London Inter-Bank Offer Rate). *(4 Marks)*

(c) Steel Ltd. incurred expenditure amounting to Rs. 3,00,000 in connection with the issue of rights shares and Rs. 2,00,000 in connection with the issue of bonus shares for the year ended 31.3.2016. The company seeks your opinion in the matter of eligibility for deduction of the expenditure incurred from its business profits for the assessment year 2016-17. *(4 Marks)*

(d) The proprietary firm of "Mr. Pradeep" a practicing Chartered Accountant, was converted into partnership on 01.09.2015 when his son joined him in the firm for 50% share. All the assets and liabilities of the erstwhile proprietary firm were transferred into the newly constituted partnership firm.

   "Mr. Pradeep" was credited and paid an amount of Rs. 5 lacs in his account from the firm. Explain as to chargeability of this amount of Rs. 5 lacs in the hands of "Mr. Pradeep" when it stands paid for:

(i) transfer of business into partnership;

(ii) goodwill by the incoming partner. *(4 Marks)*

5. (a) Sunflower Ltd. set up a manufacturing unit in Vaishali district of Bihar on 1st April, 2015. The company invested Rs. 20 crore in acquisition of new plant and machinery on 3rd May, 2015 and another Rs.20 crore in acquisition of plant and machinery on 21st December, 2015, out of which Rs.10 crore was second hand plant and machinery. The new plant and machinery were installed and put to use from the date of acquisition. You are required to calculate the depreciation allowable under section 32.

Discuss whether Sunflower Ltd. would be eligible for any other benefit in respect of such investment in plant and machinery.

What would be the position if such manufacturing unit is set up by Sunflower& Co., a firm, instead of Sunflower Ltd.? *(6 Marks)*

(b) Discuss, with the aid of case laws, whether the following expenditure would qualify for deduction under section 37 while computing income under the head "Profits and gains of business or profession" –

(i) Commission paid to doctors by a diagnostic centre for referring patients for diagnosis;

(ii) Amount paid by a construction company as regularization fee for compounding an offence for violating building bye-laws; and

(iii) Freebies provided by pharmaceutical companies to medical practitioners.

(6 Marks)

(c) X Co Ltd., a domestic company, holds 51% of the share capital of Y Co Ltd. which is another domestic company. Y Co Ltd. paid total dividend of Rs. 50 Lacs for the year ended on 31-03-2015 in the F.Y. 2015-16. Out of the dividend received from Y Co Ltd., X Co Ltd. distributed dividend of Rs. 15 Lacs in the financial year 2015-16.

Explain with reasons the amount of dividend chargeable to tax and dividend distribution tax payable by X Co Ltd. Would your answer be different if X Co Ltd. had distributed dividend of Rs. 60Lacs? *(4 Marks)*

6. (a) Discuss, with the aid of decided case laws, the correctness or otherwise of the following statements –

(i) The Appellate Tribunal has the power to re-appreciate the correctness of its earlier decision under section 254(2);

(ii) An assessee can make a fresh claim (i.e., a claim not made in the return of income) before an appellate authority only by filing a revised return of income;

(6 Marks)

(b) PMT Ltd., engaged in the specified business of setting up and operating a warehousing facility for storage of food grains, filed its return of income for A.Y.2013-14 on 28th September, 2013. In the return of income of the earlier year i.e., A.Y.2012-13, PMT Ltd. had claimed deduction@100% of cost of Rs. 8 lakhs incurred on purchase of the first building on 1.1.2012 for operating the warehousing facility. In computing its business income for A.Y.2013-14, it had claimed a weighted deduction@150% of the cost of Rs. 10 lakhs incurred on purchase of the second building on 1.4.2012 for operating the warehousing facility under section 35AD. PMT Ltd. had commenced operations on 1.1.2012, whereas the benefit of weighted deduction@150% was available only where the business was commenced on or after 1.4.2012. The company was under the impression that since the new building was purchased on 1.4.2012, it was eligible for weighted deduction@150% under section 35AD. The Assessing Officer, disallowed Rs. 5 lakhs, being the excess 50% of cost of the second building which was claimed as weighted deduction under section 35AD, since the same was only eligible for deduction@100%. He also levied penalty under section 271(1)(c). PMT Ltd. agreed with the disallowance made but contended that there no concealment of particulars of income so as to attract penalty under section 271(1)(c), since it had furnished all the details correctly in its return of income and no information given by the company was found to be incorrect or erroneous or false. Discuss the correctness of PMT Ltd.'s contention. *(6 Marks)*

(c) Mr. A carrying on a business as sole proprietor, died on 31stMarch, 2015. On his death, the same business was continued by his legal heirs, by forming a firm. As on 31stMarch 2015, a determined business loss of Rs. 5 lacs is to be carried forward under the Income-tax Act, 1961.

Does the firm consisting of all legal heirs of Mr. A, get a right to have this loss adjusted against its current income? *(4 Marks)*

7. (a) For facilitating expeditious resolution of disputes relating to international transactions involving transfer pricing and foreign companies, the Income-tax Act, 1961, has provided for "alternate dispute resolution mechanism". In this context, you are required to answer the following:

(i) What meanings have been assigned to "dispute resolution panel" and the "eligible assessee" under this mechanism?

(ii) When can a grievance for resolution be filed by an assessee?

(iii) What evidences are being considered by the panel to redress the grievance of the assessee? *(6 Marks)*

(b) Discuss the correctness or otherwise of the following statements –

(i) Interest on recurring deposits are not subject to tax deduction at source.

(ii) All co-operative banks are exempted from the requirement to deduct tax at source on interest on time deposits credited/paid to its members. *(6 Marks)*

(c) The business premises of Mr. Sumit was subjected to a survey under section 133A of the Act. There were some incriminating materials found at the time of survey. The assessee apprehends reopening of assessments of the earlier years. He wants to know whether he can approach the Settlement Commission.

Explain briefly the basic conditions to be satisfied and the benefits that may accrue to Mr. Sumit by approaching the Settlement Commission. *(4 Marks)*

Test Series: August, 2016

MOCK TEST PAPER – 1

FINAL: GROUP – II

PAPER – 7 : DIRECT TAX LAWS

SUGGESTED ANSWERS/HINTS

1. (a) **Computation of depreciation allowance under section 32 for the A.Y. 2016-17**

Particulars	Normal Depreciation [u/s 32(1)(ii)] (Rs. in crores)	Additional Depreciation [u/s 32(1)(iia)] (Rs. in crores)
(A) Plant and Machinery (15% block) (Put to use for 180 days or more)		
- New machinery installed on 01.05.2015	84.00	84.00
Normal Depreciation@15% & additional deprecation @20%	**12.60**	**16.80**
(B) Plant and Machinery (15% block) (Put to use for less than 180 days – hence, depreciation is restricted to 7.5%, being 50% of 15%)		
- Lorries for transporting goods to depots	3.00	-
- Fork-lift trucks, used inside a factory	4.00	4.00
	7.00	4.00
Normal Depreciation @ 7.5% & additional depreciation @10%	**0.53**	**0.40**
(C) Plant and Machinery (60% block) (Put to use for less than 180 days, hence depreciation restricted to 30%, i.e., 50% of 60%)		
- Computers installed in office premises	1.00	-
- Computers installed in factory	2.00	2.00
	3.00	2.00
Normal depreciation@30% & additional depreciation@10%	**0.90**	**0.20**
(D) Plant and Machinery (80% block) (Put to use for 180 days or more) *(See Note 1)*		
- New windmill purchased and installed on 18.06.2015	22.00	22.00
Normal Depreciation@80% & additional depreciation @20%	**17.60**	**4.40**

Total depreciation and additional depreciation		
- Plant and Machinery (15% block) (A +B)	13.13	17.20
- Plant and Machinery (60% block) (C)	0.90	0.20
- Plant and Machinery (80% block) (D)	17.60	4.40
Depreciation available under section 32 = Rs. 53.43 crores		

Computation of Written Down Value (WDV) as on 01.04.2016

Particulars		Plant & Machinery		
		15%	60%	80%
		(Rs. in crores)		
WDV as on 01.04.2015 (The company was started during the year only – as given in question)		Nil	Nil	
Add: Plant and Machinery acquired during the year				
- New Machinery installed on 01.05.2015	84.00			
- Lorries for transporting goods to sales depots	3.00			
- Fork-lift trucks, used inside factory	4.00			
- New imported machinery	12.00	103.00	-	
- New Windmill purchased and installed on 18.6. 2015		-	-	22.00
- Computers installed in office premises		-	1.00	-
- Computers installed in factory		-	2.00	-
		103.00	3.00	22.00
Less: Asset sold during the year		Nil	Nil	Nil
WDV as on 31.3.2016 (before charging depreciation)		103.00	3.00	22.00
Less: Depreciation for the P.Y.2015-16				
- Normal depreciation		13.13	0.90	17.60
- Additional depreciation		17.20	0.20	4.40
WDV as on 1.4.2016		**72.67**	**1.90**	**0.00**

Computation of deduction under section 32AC for the A.Y.2016-2017

(See Notes 2 to 6 below)

Particulars	(Rs. in crore)
Plant and Machinery acquired and installed during the previous year	
- New Machinery installed on 1.05.2015	84.00
- New Windmill purchased and installed on 18.06.2015	-
- Fork-lift trucks, used inside factory	4.00
- Computers installed in factory	2.00
	90.00
15% of Rs. 90 crore, being aggregate investment in new plant and machinery acquired and installed during the P.Y.2015-16	13.50

Notes:

(1) Windmills and any specially designed devices which run on windmills installed on or after 1.4.2014 would be eligible for depreciation@80%.

(2) From the A.Y.2015-16, a company would be entitled for deduction under section 32AC if the investment in new plant and machinery acquired and installed during the previous year exceeds Rs.25 crores. The deduction under section 32AC would be in addition to the depreciation allowable under section 32 for that year. However, such deduction would not go to reduce the written down value of plant and machinery.

(3) New imported machinery was not installed during the previous year 2015-16. Hence, it would not be eligible for deduction under section 32AC and additional depreciation for A.Y. 2016-17. It would also not be eligible for normal depreciation for A.Y. 2016-17, since it was not put to use in the P.Y. 2015-16, being the year of acquisition.

(4) It may be noted that investment in the following plant and machinery would neither be eligible for deduction under section 32AC nor for additional depreciation under section 32(1)(iia):

   (a) Lorries for transporting goods to sales depots, being vehicles/road transport vehicles; and

   (b) Computers installed in office premises.

(5) As per section 2(28) of the Motor Vehicles Act, 1988, the definition of a "vehicle" excludes, *inter alia*, a vehicle of special type adapted for use only in a

factory or in any enclosed premises. Therefore, fork-lift trucks used inside the factory would not fall within the definition of "vehicle". Hence, it is eligible for additional deprecation under section 32(1)(iia) and deduction under section 32AC.

(6) The deduction under section 32AC would not be allowed in respect of the windmill since the whole of the actual cost of the windmill is allowed as deduction by way of depreciation @ 80% and additional depreciation @ 20% [Section 32AC(4)(v)].

(7) As per third proviso to section 32(1)(ii), the 50% balance additional depreciation in respect of machinery and computer put to use for less than 180 days would be allowed as deduction in the Assessment year 2017-18.

(b) (i) As per section 50B, any profits or gains arising from the slump sale in the previous year is 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 takes place.

If the assessee owned and held the undertaking transferred under slump sale for more than 36 months before such slump sale, the capital gain shall be deemed to be long-term capital gain.

Particulars	Rs.
Calculation of capital gains	
Slump sale consideration	4,50,00,000
Less: Cost of acquisition (net worth) [See Working Note below]	1,60,00,000
Long-term capital gain	**2,90,00,000**
Calculation of tax liability	
Income tax @ 20%	58,00,000
Surcharge @ 7%	4,06,000
	62,06,000
Education cess @ 3%	1,86,180
Total tax liability	**63,92,180**

Working Note:

Net worth of Video unit	Rs.
WDV of block of assets	85,00,000
Debtors	1,12,50,000
Inventories	37,50,000
	2,35,00,000
Less: Liabilities	75,00,000
Net worth	**1,60,00,000**

Note - Indexation benefit is not available in the case of slump sale as per section 50B(2)

(ii) (a) Transfer of any capital asset from a holding company to its 100% Indian subsidiary company is exempt from tax under section 47(iv). Therefore, if it is possible for Sangam Ltd to acquire the entire shareholding of Digitech Ltd and then make a slump sale, the resultant capital gain shall not attract capital gains tax.

However, Sangam Ltd should not transfer any shares in Digitech Ltd for a period of 8 years from the date of such (slump) sale.

(b) Alternatively, if acquisition of 25% share is not feasible, Sangam Ltd. may think about demerger plan of video unit to get benefit of section 47(vib) of the Income-tax Act, 1961.

2. Computation of total income of MILTON Ltd. for the A.Y.2016-17

Particulars	Rs.	
Profits and gains of business or profession		
Net profit as per profit and loss account		60,00,000
Add: **Items debited to profit & loss account but not allowable as deduction**		
Cash payments exceeding Rs. 20,000 in aggregate in a day to a contractor for repair work (Rs. 15,000 + Rs. 10,000) **(Note 1)**	25,000	
Licence fee for obtaining franchise Rs.10,00,000 *less* depreciation thereon of Rs. 2,50,000 **(Note 2)**	7,50,000	
Provision for gratuity (Rs. 5,00,000 - Rs. 1,50,000) **(Note 6)**	3,50,000	11,25,000
		71,25,000
Add: Difference on account of stock valuation **(Note 7)**		8,000
		71,33,000
Less: **Items credited to profit and loss account but not taxable or taxable under a different head of income**		
Dividend received from foreign company less expenditure incurred to earn dividend (Rs. 3,50,000 - Rs. 25,000) **(Note 3)**	3,25,000	
Waiver of interest on bank loan **(Note 5)**	1,50,000	4,75,000
		66,58,000

Less:	**Items not debited to profit and loss account but allowable as deduction**		
	Provision for audit fees **(Note 8)**	30,000	
	Bad debts **(Note 9)**	1,00,000	1,30,000
			65,28,000
Less:	Depreciation on assets (Rs. 1,50,000 - Rs. 1,75,000) (**Note 4)**		25,000
			65,03,000
Income from Other Sources			
Dividend from specified foreign company **(Note 10)**		3,50,000	
Shares of closely-held company purchased for inadequate consideration **(Note 11)**		1,00,000	4,50,000
Gross Total Income			69,53,000
Deduction under Chapter VI-A			Nil
Total Income			**69,53,000**

Computation of tax liability of MILTON Ltd. for A.Y. 2016-17

Particulars	Rs.
Tax @15% on dividend of Rs. 3,50,000 from specified foreign company	52,500
Tax @30% on the balance total income of Rs. 66,03,000	19,80,900
	20,33,400
Add: Education cess @2% and Secondary and higher education cess @1%	61,002
Total tax liability	**20,94,402**

Notes:

(1) Disallowance under section 40A(3) would be attracted in respect of cash payments of Rs. 10,000 and Rs. 15,000 to a contractor, since the aggregate cash payments to him in a day exceeds the limit of Rs. 20,000.

(2) Franchise is in the nature of an intangible asset eligible for depreciation @ 25%. Since one-time licence fees of Rs. 10 lakh paid to a foreign company for obtaining franchise has been debited to profit and loss account, the same has to be added back. Depreciation @ 25% has to be provided in respect of the intangible asset, since it has been used for more than 180 days during the year.

(3) Dividend of Rs. 3,50,000 received from foreign company is to be taxed under the head "Income from other sources". Since the same has been credited to profit and loss account, it has to be deducted while computing business income.

Consequently, expenditure of Rs. 25,000 relating to the same which has been debited to profit and loss account has to be added back. In effect, the net amount of Rs. 3,25,000 has to be deducted.

(4) Depreciation of Rs.1,50,000 on tangible fixed assets debited in the books of accounts has to be added back. Depreciation of Rs. 1,75,000 computed as per Income-tax Rules, 1962 is allowable. Therefore, the net amount of Rs. 25,000 has to be deducted while computing business income.

(5) Waiver of principal amount of loan taken for trading activity is a benefit in respect of a trading-liability by way of remission or cessation thereof and is, hence, taxable under section 41(1) *[Solid Containers vs. DCIT (2009) 308 ITR 417 (Bom)].*

Since the loan is for meeting working capital requirement, it is logical to assume that is taken for trading activity. Since the loan waiver has already been credited to profit and loss account, no adjustment is required.

However, as per section 43B, since interest is allowable only on actual payment, deduction in respect of interest due on loan would not have been allowed as deduction in any previous year. Therefore, such interest cannot be brought to tax by invoking section 41(1). Since such interest has now been credited to profit and loss account, the same has to be deducted while computing business income.

(6) As per section 40A(7), any provision made for payment of gratuity to employees on their retirement or on termination of employment for any reason is disallowed. However, any provision made for the purpose of payment of a sum by way of any contribution to an approved gratuity fund or for the purpose of payment of gratuity which has become payable during the previous year shall be allowed as deduction. The question does not mention that the provision of Rs. 5,00,000 is for the purpose of contribution to an approved gratuity fund. Therefore, only gratuity of Rs. 1,50,000 paid to the retired employees is allowable as deduction. Hence, the balance provision of Rs. 3,50,000 (i.e., Rs. 5,00,000 – Rs. 1,50,000) is to be added back.

(7) Difference on account of undervaluation of opening stock and closing stock by 10% of cost to be deducted and added, respectively. Therefore, the net amount of Rs. 8,000 (Rs. 72,000 × 10/90) has to be added.

(8) Rs. 30,000, being 30% of Rs. 1,00,000, representing provision for audit fees for the year ended 31.3.2015 for which tax was not deducted in the F.Y. 2014-15 would have been disallowed while computing deduction for F.Y.2014-15. Since the tax is deducted and paid in F.Y.2015-16, Rs. 30,000 would be allowable as deduction in the A.Y.2016-17, as per the proviso to section 40(a)(ia).

(9) In a case where the debt ultimately recovered is less than the difference between the amount of debt and bad debt allowed earlier as deduction, such deficiency will be deductible in the previous year in which the ultimate recovery is made. Therefore, in this case, since the ultimate recovery of Rs. 3,00,000 is less than Rs. 4,00,000 (being the difference between the debt of Rs. 8,00,000 and the amount of Rs. 4,00,000 allowed as bad debts in the previous year 2014-15), the deficiency of

Rs. 1,00,000 will be deductible in the P.Y. 2015-16, being the year in which the ultimate recovery of Rs. 3,00,000 is made.

It may be noted that in a case where the net result is a deficiency, the amount recovered will not be taxable in the year of recovery. Since Rs. 3,00,000 is not credited to profit and loss account, no further adjustment is necessary.

(10) Under section 115BBD, dividend received by an Indian company from a foreign company in which it holds 26% or more in nominal value of the equity share capital of the company, would be subject to a concessional tax rate of 15% as against the tax rate of 30% applicable to other income of a domestic company. This rate of 15% would be applied on gross dividend, in the sense, that no expenditure would be allowable in respect of such dividend.

Therefore, dividend of Rs. 3,50,000 received by MILTON Ltd. from a foreign company, in which it holds 28% in nominal value of equity share capital of the company, would be subject to tax@15% under section 115BBD. Such dividend would be taxable under the head "Income from other sources". No deduction is allowable in respect of Rs. 25,000 expended on earning this income.

(11) Difference between the aggregate fair market value of shares of a closely held company and the consideration paid for purchase of such shares is deemed as income in the hands of the purchasing company under section 56(2)(viia) only if the purchasing company is also a closely-held company. It is assumed that MILTON Ltd. is a closely-held company.

Since the difference exceeds Rs. 50,000, the entire sum is taxable. Therefore, Rs. 1,00,000 [5,000 × (Rs. 40 – Rs. 20)] is taxable.

3. (a) Computation of total income of Mr. Mahesh for A.Y.2016-17

Particulars	Rs.	Rs.
Income from House Property [House situated in Country Z]		
Gross Annual Value[1]	3,30,000	
Less: Municipal taxes paid in Country Z	10,000	
Net Annual Value	3,20,000	
Less: Deduction under section 24 – 30% of NAV	96,000	
		2,24,000
Profits and Gains of Business or Profession		
Income from business carried on in India		9,20,000

[1]Rental income has been taken as GAV in the absence of other information relating to fair rent, municipal value etc.

Income from Other Sources		
Interest on savings bank with Dena Bank	24,000	
Agricultural income in Country Y	72,000	
Dividend received from a company in Country Z	2,25,000	
Royalty income from a book of art in Country Y (after deducting expenses of Rs.70,000)	7,30,000	10,51,000
Gross Total Income		**21,95,000**
Less: **Deduction under Chapter VIA**		
Under section 80QQB – Royalty income of a resident from a work of art[2]		3,00,000
Under section 80TTA – Interest on savings bank account, subject to a maximum of Rs.10,000.		10,000
Total Income		**18,85,000**

Computation of tax liability of Mr. Mahesh for A.Y.2016-17

Particulars	Rs.
Tax on total income [30% of Rs.8,85,000 + Rs.1,25,000]	3,90,500
Add: Education cess and SHEC@3%	11,715
	4,02,215
Less: Rebate under section 91 **(See Working Note below)**	1,56,057
Tax Payable	**2,46,158**
Tax payable (rounded off)	2,46,160

Calculation of Rebate under section 91:		**Rs.**
Average rate of tax in India [i.e., Rs. 4,02,215/Rs. 18,85,000 x 100]	**21.34%**	
Average rate of tax in country Y	**12%**	
Doubly taxed income pertaining to country Y[3]	**Rs.**	
Agricultural Income	72,000	
Royalty Income [Rs.8,00,000 – Rs.70,000 (Expenses) –	4,30,000	

[2] It is assumed that the royalty earned outside India has been brought into India in convertible foreign exchange within a period of six months from the end of the previous year.

[3]Doubly taxed income includes only that part of income which is included in the assessees total income. The amount deducted under Chapter VIA is not doubly taxed and hence, no relief is allowable in respect of such amount – *CIT v. Dr. R.N. Jhanji (1990) 185 ITR 586 (Raj.).*

Rs.3,00,000 (deduction under section 80QQB)]		
	5,02,000	
Rebate under section 91 on Rs. 5,02,000 @12% [being the lower of average Indian tax rate (21.34%) and foreign tax rate (12%)]		60,240
Average rate of tax in country Z	**23%**	
Doubly taxed income pertaining to country Z		
Income from house property	2,24,000	
Dividend	2,25,000	
	4,49,000	
Rebate under section 91 on Rs. 4,49,000 @21.34% (being the lower of average Indian tax rate (21.34%) and foreign tax rate (23%)]		95,817
Total rebate under section 91 (Country Y + Country Z)		**1,56,057**

Note: Mr. Mahesh shall be allowed deduction under section 91, since the following conditions are fulfilled:-

(a) He is a resident in India during the relevant previous year i.e., P.Y.2015-16.

(b) The income in question accrues or arises to him outside India in foreign countries Y & Z during that previous year and such income is not deemed to accrue or arise in India during the previous year.

(c) The income in question has been subjected to income-tax in the foreign countries "Y" and "Z" in his hands and it is presumed that he has paid tax on such income in those countries.

(d) There is no agreement under section 90 for the relief or avoidance of double taxation between India and Countries Y and Z where the income has accrued or arisen.

(b) Tax treatment in the hands of the seller, Ms. Sonam

Section 50C provides that where the consideration received or accruing as a result of transfer of a capital asset, being land or building or both, is less than the value adopted or assessed or assessable by an authority of a State Government for the purpose of payment of stamp duty in respect of such transfer, the value so adopted or assessed or assessable shall be deemed to be the full value of the consideration received or accruing as a result of such transfer for computing capital gain.

In the instant case, Ms. Sonam sold the residential house in Meerut to her colleague Ms. Sonal for Rs. 20 lacs, whereas the stamp duty value was Rs. 25 lacs. Therefore, stamp duty value shall be deemed to be the full value of consideration for sale of the property. Therefore, short-term capital gain arising to Ms. Sonam for assessment year 2016-17 will be Rs. 17 lacs (i.e. Rs. 25 lacs - Rs. 8 lacs). The gain is a short-term capital gain since the residential house was held by her for a period of less than 36 months immediately preceding the date of transfer.

Tax treatment in the hands of the buyer, Ms. Sonal

The taxability provisions under section 56(2)(vii) includes within its scope, any immovable property, being land or building or both, received for inadequate consideration by an individual or HUF.

As per section 56(2)(vii), where any immovable property is received for a consideration which is less than the stamp duty by an amount exceeding Rs. 50,000, the difference between the stamp duty value and the consideration shall be chargeable to tax in the hands of the recipient (Individual/HUF) as the income from other sources. The provisions of section 56(2)(vii) would be attracted in this case, since the difference exceeds Rs. 50,000. Therefore, Rs. 5 lacs, being the difference between the stamp duty value of the property (i.e., Rs.25 lacs) and the actual consideration (i.e., Rs.20 lacs) would be taxable in the hands of Ms. Sonal, under the head 'Income from Other Sources'.

As per section 49(4), the cost of acquisition of such property for computing capital gains would be the value which has been taken into account for section 56(2)(vii). Accordingly Rs. 25 lacs would be taken as the cost of acquisition of the residential house. Therefore, on sale of the residential house by Ms. Sonal, Rs. 15lacs (i.e. Rs. 40 lacs – Rs. 25 lacs) would be chargeable to tax as short-term capital gain in her hands for A.Y. 2016-17.

(c) In this case, Mr. Tamal gifted a sum of Rs. 9 lakhs to his brother's wife Mrs. Reema on 30.8.2015 and simultaneously, his brother, Mr. Tapan gifted a sum of Rs. 7 lakhs to Mr. Tamal's wife, Shikha, on 10.09.2015. The gifted amounts were invested as fixed deposits in banks by Mrs. Reema and Mrs. Shikha. These transfers are in the nature of cross transfers. Accordingly, the income from the assets transferred would be assessed in the hands of the deemed transferor because the transfers are so intimately connected to form part of a single transaction and each transfer constitutes consideration for the other by being mutual or otherwise.

If two transactions are inter-connected and are part of the same transaction in such a way that it can be said that the circuitous method was adopted as a device to evade tax, the implication of clubbing provisions would be attracted. It was so held by the Apex Court in *CIT vs. Keshavji Morarji (1967) 66 ITR 142*.

Accordingly, the interest income arising to Tamal's wife, Shikha, in the form of interest on fixed deposits would be included in the total income of Mr. Tamal and interest income arising in the hands of his brother Tapan's wife, Reema, would be taxable in the hands of Mr. Tapan as per section 64(1), to the extent of amount of cross transfers i.e., Rs.7 lakhs.

This is because both Mr. Tamal and his brother, Mr. Tapan are the indirect transferors of the income to their respective spouses with an intention to reduce their burden of taxation.

However, the interest income earned by Mrs. Reema on fixed deposit of Rs. 7 lakhs alone would be included in the hands of Mr. Tapan and not the interest income on the entire fixed deposit of Rs. 9 lakhs, since the cross transfer is only to the extent of Rs. 7 lakhs.

4. (a) This issue came up before the Karnataka High Court in *CIT v. D. Ananda Basappa (2009) 309 ITR 329*. The Court observed that the assessee had shown that the flats were situated side by side and the builder had also certified that he had effected modification of the flats to make them one unit by opening the door between the apartments. Therefore, it was immaterial that the flats were occupied by two different tenants prior to sale or that it was purchased through different sale deeds. The Court observed that these were not the grounds to hold that the assessee did not have the intention to purchase the two flats as one unit. The Court held that the assessee was entitled to exemption under section 54 in respect of purchase of both the flats to form one residential house.

Applying the ratio of the above decision to the case on hand, Mr. Kartik is entitled to exemption under section 54 in respect of purchase of two flats to form **one residential house**. Therefore, the contention of the Assessing Officer is not correct.

(b) One of the methods for determination of arm's length price in an international transaction is Comparable Uncontrolled Price method (CUP). Under the CUP method, the price charged or paid for property transferred or services rendered in a comparable uncontrolled transaction, or a number of such transactions, is identified. Such price is adjusted to account for differences, if any, between the international transaction and the comparable uncontrolled transaction or between the enterprises entering into such transactions, which could materially affect the price in the open market. The adjusted price so arrived at is taken to be an arm's length price in respect of the property transferred or services provided in the international transaction.

PQ Inc., USA and PQ Limited, the Indian company are associated enterprises since the former holds 74% shares in the latter.

The arm's length rate of interest can be determined by using CUP method having regard to the rate of interest on external commercial borrowing permissible as per guidelines issued under Foreign Exchange Management Act. The interest rate permissible is LIBOR plus 200 basis points i.e., 4% + 2% = 6%, which can be taken as the arm's length rate. The interest rate applicable on the borrowing by PQ Limited, India from PQ Inc., USA, is LIBOR plus 150 basis points i.e., 4% + 1.5% = 5.5%. Since the rate of interest, i.e. 5.5% is less than the arm's length rate of 6%, the borrowing made by the PQ Ltd. is not at arm's length. However, in this case, the taxable income of PQ Ltd., India, would be lower if the arm's length rate is applied. Hence, no adjustment is required since the law of transfer pricing will not apply if there is a negative impact on the existing profits.

(c) The Supreme Court has, in *Brooke Bond India Ltd. v. CIT (1997) 225 ITR 798 (SC),* held that expenditure incurred by a company in connection with issue of shares with a view to increase its share capital is directly related to the expansion of its capital base and, therefore it constitutes a capital expenditure.

The issue of rights shares results in expansion of the capital base of Steel Ltd. Hence, expenditure of Rs.3,00,000 incurred by the company in connection with the issue of rights shares is a capital expenditure and is not allowable as a business expenditure.

On the other hand, the issue of bonus shares does not result in inflow of fresh funds or increase in the capital employed. It is mere capitalization of reserves. The total funds available with the company and its capital structure will remain the same on issue of bonus shares. The Supreme Court, in *CIT v. General Insurance Corporation (2006) 286 ITR 232*, considered the effect of issue of bonus shares and ruled that expenditure incurred in connection with the issue of bonus shares was allowable as revenue expenditure. Hence, the expenditure amounting to Rs.2,00,000 incurred in connection with the issue of bonus shares is deductible from its business profits for the assessment year 2016-17.

(d) **(i)** **If the amount was paid for transfer of business/profession to partnership**

Where a proprietary business is converted into a partnership, the exclusive interest of the proprietor is reduced and the business assets become assets of the firm in which other partner(s) get an interest. Consequently, there is a transfer of interest.

Further, section 47 which lists the transactions not regarded as "transfer" for levy of capital gains tax, does not include within its scope, transfer of capital assets consequent to succession of a sole proprietary concern by a partnership firm. Therefore, the transfer of capital assets by a sole proprietary concern consequent to its conversion into a partnership firm constitutes a transfer.

Since consideration of Rs.5 lacs **is received for such transfer**, profit or gain accrues to the transferor for the purposes of section 45. The amount of Rs. 5 lacs would be the full value of consideration received as a result of transfer and the capital gains resulting from this transfer would be chargeable to tax.

(ii) **If the amount is paid by the incoming partner for Goodwill**

The Supreme Court, in *CIT v. B.C. Srinivasa Setty (1981) 128 ITR 294*, observed that the income chargeable to capital gains tax is to be computed by deducting from the full value of consideration "the cost of acquisition of the capital asset". If it is not possible to ascertain the cost of acquisition, then, transfer of such asset is not chargeable to tax.

Section 55(2)(a) provides that the cost of acquisition of certain self-generated assets, including goodwill of a business, is Nil. Therefore, in respect of these self-generated assets covered under section 55(2)(a), the decision of the Supreme Court in *B.C. Srinivasa Setty's* case would not apply. However, in respect of other self-generated assets, including goodwill of profession, the decision of the Supreme Court in *B.C. Srinivasa Setty's case,* would continue to be applicable.

In effect, in case of self-generated assets not covered under section 55(2)(a), since the cost is not ascertainable, there would be no capital gains tax liability.

Therefore, in this case, since the consideration of Rs.5 lakhs is paid towards goodwill of a profession, whose cost is **NOT** to be taken as 'Nil' since it is not covered under section 55(2)(a), the liability to capital gains tax will not arise.

5. (a) (i) Computation of depreciation under section 32 for Sunflower Ltd. for A.Y. 2016-17

Particulars		**Rs. (in crores)**
Plant and machinery acquired on 03.05.2015		20.00
Plant and machinery acquired on 21.12.2015		20.00
WDV as on 31.03.2016		**40.00**
Less: Depreciation @ 15% on Rs. 20 crore	3.00	
Depreciation @ 7.5% (50% of 15%) on Rs. 20 crore	1.50	
Additional Depreciation@35% on Rs. 20 crore	7.00	
Additional Depreciation@17.5% (50% of 35%) on Rs. 10 crore	1.75	13.25
WDV as on 01.04.2016		**26.75**

Sunflower Ltd. would also be eligible for benefit of deduction under sections 32AC and 32AD.

Computation of deduction under section 32AC & 32AD for Sunflower Ltd. for A.Y. 2016-17

Particulars	**Rs.(in crores)**
Deduction under section 32AC(1A) @ 15% on Rs. 30 crore (since investment in new plant and machinery acquired and	4.50

installed in the previous year 2015-16 by Sunflower Ltd., a manufacturing company, exceeds Rs. 25 crore)	
Deduction under section 32AD @ 15% on Rs. 30 crore (since the manufacturing unit is set up in a notified backward area in the State of Bihar)	4.50
Total benefit	**9.00**

(ii) Yes, the answer would be different, where the manufacturing unit is set up by a firm. The deduction under section 32AC is available only to corporate assessees, and therefore, the deduction of Rs. 4.50 crore under section 32AC would not be available if the manufacturing unit is set up by Sunflower& Co., a firm. However, the firm would be eligible for deduction of Rs. 4.50 crore under section 32AD.

Notes:

(1) As per the second proviso to section 32(1)(ii), where an asset acquired during the previous year is put to use for less than 180 days in that previous year, the amount of deduction allowable as normal depreciation and additional depreciation would be restricted to 50% of amount computed in accordance with the prescribed percentage.

Therefore, normal depreciation on plant and machinery acquired and put to use on 21st December, 2015 is restricted to 7.5% (being 50% of 15%) and additional depreciation is restricted to 17.5% (being 50% of 35%).

(2) As per third proviso to section 32(1)(ii), the balance additional depreciation of Rs. 1.75 crore, being 50% of Rs. 3.50 crore (35% of Rs. 10 crore) would be allowed as deduction in the A.Y.2017-18.

(3) As per section 32(1)(iia), additional depreciation is allowable in the case of any new machinery or plant acquired and installed after 31.3.2005 by an assessee engaged, *inter alia*, in the business of manufacture or production of any article or thing. In this case, since new plant and machinery acquired was installed by a manufacturing unit set up in a notified backward area in the State of Bihar, the rate of additional depreciation is 35% of actual cost of new plant and machinery. Since new plant and machinery of Rs. 10 crore was put to use for less than 180 days, additional depreciation@17.5% (50% of 35%) is allowable as deduction. However, additional depreciation shall not be allowed in respect of second hand plant and machinery of Rs. 10 crore.

Likewise, the benefit available under sections 32AC and 32AD would not be allowed in respect of second hand plant and machinery.

Accordingly, additional depreciation and deduction under sections 32AC and 32AD have not been provided on Rs. 10 crore, being the actual cost of second hand plant and machinery acquired and installed in the previous year.

(b) (i) No; the expenditure is not allowable as deduction under section 37.

The Punjab & Haryana High Court, in *CIT v. Kap Scan and Diagnostic Centre P. Ltd. (2012) 344 ITR 476*, observed that as per the Indian Medical Council (Professional Conduct, Etiquette and Ethics) Regulations, 2002, no physician shall give, solicit, receive, or offer to give, solicit or receive, any gift, gratuity, commission or bonus in consideration of a return for referring any patient for medical treatment.

The demanding as well as paying of such commission is bad in law. It is not a fair practice and is opposed to public policy. Applying the rationale and considering the purpose of *Explanation* to section 37(1), the assessee would not be entitled to deduction of payments made in contravention of law. Similarly, payments which are opposed to public policy being in the nature of unlawful consideration cannot also be claimed as deduction.Thus, the High Court held that commission paid to doctors for referring patients for diagnosis is not allowable as a business expenditure

(ii) No; the expenditure is not allowable as deduction under section 37.

The Karnataka High Court in**,** *Millennia Developers (P) Ltd. v. DCIT (2010) 322 ITR 401,* held that the amount paid by way of regularisation fee to compoundan offence for deviations made while constructing a structure and for violating the plan sanctioned in terms of approved building bye laws is in the nature of penalty, and hence does not qualify for deduction under section 37. Merely describing the payment as a regularisation fee or compounding fee would not alter the character of the payment.

(iii) No; the expenditure is not allowable as deduction under section 37.

The Himachal Pradesh High Court in, *Confederation of Indian Pharmaceutical Industry (SSI) v. CBDT (2013) 353 ITR 388*, observed that as per Indian Medical Council (Professional Conduct, Etiquette and Ethics) Regulations, 2002, every medical practitioner and his or her professional associate is prohibited from accepting any gift, travel facility, hospitality, cash or monetary grant from any pharmaceutical and allied health sector industries. This is a salutary regulation in the interest of the patients and the public, considering the increase in complaints against the medical practitioners prescribing branded medicines instead of generic medicines, solely in lieu of gifts and other freebies granted to them by some particular pharmaceutical industries.

The Court also observed that CBDT, considering the fact that the claim of any expense incurred in providing freebies to medical practitioners is in violation of the provisions of Indian Medical Council (Professional Conduct, Etiquette and Ethics) Regulations, 2002, has, *vide Circular No.5/2012 dated 1.8.2012*, clarified that the expenditure so incurred shall be inadmissible under section 37(1). The disallowance shall be made in the hands of such pharmaceutical company which has provided aforesaid freebies and claimed it as a deductible expense in its accounts against income.

Note: The Court, however, observed that if the assessee satisfies the assessing authority that the expenditure incurred is not in violation of the regulations framed by the Medical Council then it may legitimately claim a deduction, but it is for the assessee to satisfy the Assessing Officer that the expense is not in violation of the Medical Council Regulations.

(c) The dividend received by X Co Ltd. from Y Co Ltd. is exempt from tax under section 10(34) if such dividend is covered by section 115-O.

X Co Ltd., while paying dividend distribution tax under section 115-O, is eligible to reduce the dividend received from its subsidiary company from the dividend paid / declared by it in the same financial year. Since, the dividend of Rs. 15 lacs paid by X Co Ltd. is less than the dividend of Rs. 25.5 lacs received from its subsidiary, i.e., Y Co Ltd., the tax liability under section 115-O would be Nil.

In case X Co. Ltd. had distributed dividend of Rs. 60 Lacs, the dividend distribution tax to be paid by X Co. Ltd. shall be computed as follows:

Particulars	Rs. in lakh
Dividend distributed by X Co. Ltd.	60.00
Less: Dividend received from subsidiary Y Co. Ltd. (51% of Rs. 50 lacs)	25.50
Net distributed profits	**34.50**
Add: Increase for the purpose of grossing up of dividend (34.5 x 15 /85)	6.09
Gross dividend	**40.59**
Additional income-tax payable by X Co. Ltd. u/s 115-O [15% of Rs. 40.59 lakh]	6.09
Add: Surcharge@12%	0.73
	6.82
Add: Education cess@2% and SHEC@1%	0.20
	7.02

Note: As per new sub-section (1B) of section 115-O, for the purpose of grossing up, the rate specified in sub-section (1) has to be considered. The rate specified in sub-section (1) is 15%. Further, in the example given in the Explanatory Memorandum to the Finance (No.2) Bill, 2014, grossing up has been done at the rate of 15%

However, it is also possible to take a view that grossing up should be done at the rate of 17.304% (that is, 15% plus surcharge@12% plus education cess and SHEC@3%), which is the effective rate of dividend distribution tax.

6. (a) (i) The statement is not correct.

In *CIT v. Earnest Exports Ltd. (2010) 323 ITR 577,* the Bombay High Court observed that the power under section 254(2) is limited to rectification of a mistake apparent on record and therefore, the Tribunal must restrict itself within those parameters. Section 254(2) is not a carte blanche for the Tribunal to change its own view by substituting a view which it believes should have been taken in the first instance. Section 254(2) is not a mandate to unsettle decisions taken after due reflection. The High Court, therefore, held that re-appreciation of the correctness of the earlier decision on merits is beyond the scope of the power conferred under section 254(2)

(ii) The statement is not correct.

The Bombay High Court, in CIT v. Pruthvi Brokers & Shareholders (2012) 349 ITR 336, observed the decision of the Supreme Court, in the case of *Jute Corporation of India Ltd. v. CIT (1991) 187 ITR 688* and *National Thermal Power Corporation. Ltd v. CIT (1998) 229 ITR 383*, that an assessee is entitled to raise additional claims before the appellate authorities. The appellate authorities have jurisdiction to permit additional claims before them, however, the exercise of such jurisdiction is entirely the authorities' discretion.

The Bombay High Court held that additional grounds can be raised before the Appellate Authority even otherwise than by way of filing return of income. However, in case the claim has to be made before the Assessing Officer, the same can only be made by way of filing a revised return of income.

(b) The issue under consideration in this case is whether making an incorrect claim in the return of income would tantamount to concealment of particulars or furnishing of inaccurate particulars for attracting the penal provisions under section 271(1)(c) when no information given in the return of income is found to be incorrect.

This issue came up before the Supreme Court in *CIT v. Reliance Petro Products Pvt. Ltd. (2010) 322 ITR 158*. The Supreme Court observed that in order to attract the penal provisions of section 271(1)(c), there has to be concealment of the particulars of income or furnishing inaccurate particulars of income. Where no information given in the return is found to be incorrect or inaccurate, the assessee cannot be held guilty of furnishing inaccurate particulars. Making an incorrect claim (i.e. a claim which has been disallowed) would not, by itself, tantamount to furnishing inaccurate particulars.

The Apex Court held that where there is no finding that any details supplied by the assessee in its return are incorrect or erroneous or false, there is no question of imposing penalty under section 271(1)(c). A mere making of a claim, which is not sustainable in law, by itself, will not amount to furnishing inaccurate particulars regarding the income of the assessee.

Applying the rationale of the above Supreme Court ruling to the case on hand, penalty under section 271(1)(c) cannot be imposed on PMT Ltd. merely for making an incorrect claim which is not sustainable in law, since the company had furnished all the details in the return of income correctly and no information given by the company was found to be incorrect or erroneous or false.

The contention of PMT Ltd. is, therefore, correct.

(c) Section 78(2) provides that where a person carrying on any business or profession has been succeeded in such capacity by another person, otherwise than by inheritance, then, the successor is not entitled to carry forward and set-off the loss of the predecessor against his income. This implies that generally, set-off of business losses should be claimed by the same person who suffered the loss and the only exception to this provision is when the business passes on to another person by inheritance.

The facts of case given in the question are similar to the case *CITv. Madhukant M. Mehta (2001) 247 ITR 805*, where the Supreme Court has held that if the business is succeeded by inheritance, the legal heirs are entitled to the benefit of carry forward of the loss of the predecessor. Even if the legal heirs constitute themselves as a partnership firm, the benefit of carry forward and set off of the loss of the predecessor would be available to the firm.

In this case, the business of Mr. A was continued by his legal heirs after his death by constituting a firm. Hence, the exception contained in section 78(2) along with the decision of the Apex Court discussed above, would apply in this case. Therefore, the firm is entitled to carry forward the business loss of Rs. 5 lacs of Mr. A.

7. (a) (i) The term "Dispute Resolution Panel" has been defined to mean a collegium comprising of three Principal Commissioners or Commissioners of Income-tax constituted by the Board for this purpose.

The term "Eligible Assessee" means any person in whose case the variation referred to in section 144C(1) in the income or loss returned arises as a consequence of the order of the Transfer Pricing Officer passed under section 92CA(3) and any foreign company.

(ii) The Assessing Officer shall forward a draft of the proposed order of assessment to the eligible assessee and on receipt of such order, the eligible assessee shall, within thirty days of the receipt of the draft order, file his acceptance of the variations to the Assessing Officer or file his objections, if any, to such variation, with the Dispute Resolution Panel and the Assessing Officer.

(iii) The Dispute Resolution Panel shall, in a case where any objections are received, take into consideration:-

(a) the draft order

(b) the objections filed by the assessee

(c) the evidence furnished by the assessee

(d) the report, if any, of the Assessing Officer, Valuation Officer or Transfer Pricing Officer or any other authority

(e) the records relating to the draft order

(f) the evidence collected by, or caused to be collected by it

(g) the result of any enquiry made by or caused to the made by it,

and issue such directions, as it thinks fit, for the guidance of the Assessing Officer to enable him to complete the assessment.

(b) (i) The statement is not correct.

Prior to amendment by the Finance Act, 2015, the definition of "time deposits" under section 194A excluded "recurring deposit" from its scope. Therefore, payment of interest on recurring deposits by banking company or co-operative bank was not subject to TDS under section 194A.

Since recurring deposit is also made for a fixed tenure and is, therefore, similar to time deposit, the definition of 'time deposits' in section 194A has been amended by the Finance Act, 2015 with effect from 1st June, 2015 to include "recurring deposits" within its scope for the purposes of deduction of tax under section 194A. Therefore, interest on recurring deposits would now be subject to tax deduction under section 194A. It may be noted that the existing threshold limit of Rs. 10,000 for non-deduction of tax shall also be applicable in case of interest payment on recurring deposits.

(ii) The statement is not correct.

Section 194A(3)(v) has been amended by the Finance Act, 2015 to specifically provide that with effect from 1st June, 2015, the exemption available thereunder from deduction of tax at source from payment of interest to members by a co-operative society shall not apply to the payment of interest by the co-operative banks to its members.

However, the exemption available under section 194A(3)(viia)(a) to primary agricultural credit society or a primary credit society or a co-operative land mortgage bank or a co-operative land development bank from deduction of tax in respect of interest credited or paid on deposits shall continue to apply. Therefore, these co-operative credit societies/banks would not be required to deduct tax on interest credited or paid to depositors consequent to amendment of section 194A(3)(v).

Further, the exemption under section 194A(3)(v) from deduction of tax from interest paid by a co-operative society to another co-operative society shall continue to apply to co-operative banks and, therefore, a co-operative bank shall not be required to deduct tax from the payment of interest on time deposit to a depositor, being a co-operative society.

(c) An assessee may, at any stage of a **case** relating to him, make an application in the prescribed form and manner to the Settlement Commission under section 245C. "Case" means any proceeding for assessment which may be pending before an Assessing Officer on the date on which such application is made. Thus, the basic condition for making an application before the Settlement Commission under section 245C is that there must be a proceeding for assessment pending before an Assessing Officer on the date on which the application is made.

A proceeding for assessment or reassessment or recomputation under section 147 shall be deemed to have commenced from the date on which a notice under section 148 is issued.

In this case, Mr. Sumit cannot approach the Settlement Commission merely due to his apprehension that assessment of earlier years may be reopened, since there is no case pending before an Assessing Officer.

Therefore, he has to wait for the Assessing Officer to issue notice under section 148. Thereafter, he can make an application to the Settlement Commission under section 245C, since there would be a "case pending" before the Assessing Officer on that date.

Another basic condition to be satisfied for making an application is that the additional amount of income-tax payable on the income disclosed in the application should exceed Rs. 10 lakh, and such tax and interest thereon which would have been paid had the income disclosed in the application been declared in the return of income should be paid on or before the date of making the application and proof of such payment should be attached with the application.

If the Settlement Commission is satisfied that Mr. Sumit has co-operated in the proceedings and made true and full disclosure of his income and the manner in which it has been derived, it may, subject to such conditions as it may think fit to impose, grant to Mr. Sumit -

(i) immunity from prosecution for any offence under the Income-tax Act, 1961 / Wealth-tax Act, 1957, where the proceedings for such prosecution have been instituted on or after the date of receipt of application under section 245C; and

(ii) immunity from imposition of penalty under the Income-tax Act, 1961, either wholly or in part, with respect to the case covered by the settlement.

This is the benefit that may accrue to Mr. Sumit, if he approaches the Settlement Commission.

Note: Where a notice under section 148 is issued for any assessment year, a proceeding under section 147 shall be deemed to have commenced on the date of issue of such notice and the assessee can approach the Settlement Commission for other assessment years as well, even if notice under section 148 for such other assessment years has not been issued but could have been issued on date. However, a return of income for such other assessment years should have been furnished under section 139 or the response to notice under section 142.

Test Series: August, 2016

MOCK TEST PAPER – 1

FINAL COURSE: GROUP – II

PAPER – 8: INDIRECT TAX LAWS

Question No. 1 is compulsory.

Attempt any five questions from the remaining six Questions.

(Wherever appropriate, suitable assumption should be made and indicated in the answer by the candidate)

Time Allowed – 3 Hours **Maximum Marks – 100**

1. (a) The following information is provided in respect of manufacture of a product "Z" for the purpose of captive consumption in the same factory. You are required to determine the value for purpose of duty of excise in terms of rule 8 of the Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000:

	Rs.
Cost of direct materials (includes central excise duty Rs. 1,875*)	16,875
Cost of direct employees	12,300
Consumable stores and repairs	8,400
Quality control cost	4,300
Research & development cost	2,700
Administrative cost:	
Production related	3,000
Others	1,500
Selling and distribution cost	3,600
Scrap value realized	1,500

*Note: CENVAT credit of the excise duty so paid is available. *(5 Marks)*

(b) Reliable Bank Ltd. furnishes the following information relating to services provided and the gross amount received. Compute the value of taxable service and service tax payable:

		Rs. (Lakhs)
(i)	Administration charges collected for extending home loans	10
(ii)	Discount earned on bills discounted	4.5
(iii)	Value of sale and purchase of forward contract	5.7
(iv)	Charges received on credit card and debit card facilities	3.8

	extended	
(v)	Commission received for service rendered to Government for tax collection	6.0
(vi)	Margin earned on reverse repo transaction	25.0

Note: Reliable Bank Ltd. is not eligible for small service providers' exemption under *Notification No. 33/2012 – ST dated 20.06.2012.* *(10 Marks)*

(c) Compute export duty from the following data:

(i) FOB price of goods: US $ 1,00,000.

(ii) Shipping bill presented electronically on 26.04.2016.

(iii) Proper officer passed order permitting clearance and loading of goods for export (Let Export Order) on 04.05.2016.

(iv) Rate of exchange and rate of export duty are as under:

	Rate of Exchange	**Rate of Export Duty**
On 26.04.2016	1 US $ = Rs. 55	10%
On 04.05.2016	1 US $ = Rs. 56	8%

(v) Rate of exchange is notified for export by Central Board of Excise and Customs.

(Make suitable assumptions wherever required and show the workings.) *(5 Marks)*

2. (a) Under what circumstances can the central excise registration be revoked or suspended or cancelled? *(4 Marks)*

(b) (i) XYZ Ltd., a service provider, has been granted the acceptance of being a large tax payer unit by the Chief Commissioner of Central Excise, Large Tax payer Unit on 12.12.2015. XYZ Ltd. wants to know the procedure to be followed by it as a large tax payer and the facilities available to it under service tax law. You are required to advice XYZ Ltd. in this regard. *(4 Marks)*

(ii) Specify the circumstances under which the Commissioner of Central Excise may order special audit under section 72A of the Finance Act, 1994. *(4 Marks)*

(c) When shall the safeguard duty under section 8B of the Customs Tariff Act, 1975 be not imposed? Discuss briefly. *(4 Marks)*

3. (a) The assessee was engaged in the manufacture and sale of cookies from branded outlets of "Cookies Man". The assessee had acquired this brand name from a foreign company. The assessee was selling some of these cookies in plastic pouches/containers on which the brand name described above was printed. No brand name was affixed or inscribed on the cookies. Excise duty was duly paid on the cookies sold in the said pouches/containers. However, on the cookies sold

loosely from the counter of the same retail outlet with plain plates and tissue paper, duty was not paid. The retail outlet did not receive any loose cookies nor did they manufacture them. They received all cookies in sealed pouches/containers. Those sold loosely were taken out of the containers and displayed for sale separately. The assessee contended that SSI exemption would be available on cookies sold loosely as they did not bear the brand name.

Department denied exemption on cookies sold loosely as claimed by the assessee.

Examine, with the help of a decided case law whether the manufacture and sale of specified goods, not physically bearing a brand name, from branded sales outlets would disentitle an assessee to avail the benefit of small scale exemption. *(4 Marks)*

(b) 'P' has entered into an agreement with QR Ltd. for running a canteen in QR Ltd.'s premises for its employees. QR Ltd. has provided the place on rent and reimburses certain expenses for maintenance and running the canteen.

'P' charges cash from individual customers for food, eatables and beverages supplied according to rates stipulated in the menu card. 'P' is of the view that since it is not providing any service to QR Ltd. but only selling goods in its canteen to individual customers, it is not liable to pay any service tax. Furthermore, since it is paying VAT on the sale of food and beverages, there should not be any service tax liability on the activity undertaken by him.

Examine the situation and discuss if 'P' is liable to pay service tax with the help of a decided case law, if any. *(8 Marks)*

(c) Examine, with the help of a decided case law, whether it is mandatory for the Customs Officers to make available the seized documents to the person (from whose custody such documents were seized) for making copies thereof. *(4 Marks)*

4. (a) Which reasons shall not be considered as special and adequate reasons for awarding sentence of imprisonment for a term of less than six months as per section 9(3) of the Central Excise Act, 1944? *(4 Marks)*

(b) Mr. M owns a residential building in a prime commercial locality. Basement of the building is leased to Mr. N, a wholesaler. One-fourth of the basement is used by Mr. N as his office and remaining portion is used as a godown for storing his merchandise. Ground floor of the building is given on rent to Mr. O who uses the same as a guest house for his business contacts. First floor of the building is occupied by Mr. M. and his family. Second floor is given on rent to Mr. P who uses the same as his residence. There is a large vacant land in the backyard of the building which is also given on rent to a parking contractor, Mr. Q who has set up a parking facility on the said land.

Separate rent/lease deeds have been executed in respect of each floor of the building and vacant land given on rent/lease.

Examine the service tax liability of Mr. M with respect to the residential building owned by him. *(8 Marks)*

(c) Briefly state the rights of the owner of warehoused goods under section 64 of the Customs Act, 1962. *(4 Marks)*

5. (a) Briefly explain the procedure to be followed by the Authority for Advance Rulings on receipt of application for advance ruling under the Central Excise Act, 1944.

(4 Marks)

(b) Based on the Place of Provision of Service Rules, 2012 (PoPS Rules), determine the place of provision of service as well as their taxability in each of the following independent cases:

(1) A Delhi based builder provides construction services to Gujarat based company in respect of construction of its new building in Afghanistan.

(2) A UK based company has been awarded mineral exploration contract in respect of specific sites in Zimbabwe by a Hyderabad based corporation.

(8 Marks)

(c) Which class of importers is required to pay customs duty electronically? Name the dedicated payment gateway set up by the Board (CBEC) to use e-payment facility easily by an importer. *(4 Marks)*

6. (a) Write a short note on desk review under Excise Audit, 2000. *(4 Marks)*

Or

Write a brief note on the warehousing procedure for goods removed from the factory under the Central Excise Act, 1944 and the rules made thereunder. *(4 Marks)*

(b) Vaishno Ltd. has obtained a patent for a process to extract coal from mines in February, 2012. Vaishno Ltd. entered into an agreement with Shakti Ltd. in April, 2012 to allow Shakti Ltd. to use its patented process to extract coals from mines for next three years. The consideration payable by Shakti Ltd. for using the patented process has been fixed @ Rs. 1000 per tonne of coal extracted. The quantum of coal extracted by Shakti Ltd. and other relevant details are given in the following table:

Financial Year	**Output [in tonnes]**	**Date of issuance of invoice**	**Date of receipt of payment**
2012-13	2,000	05.07.2013	26.08.2013
2013-14	3,000	13.04.2014	03.04.2014
2014-15	4,000	11.04.2015	20.05.2015

You are required to determine the point of taxation in the above case. *(8 Marks)*

(c) Explain salient features of post export Export Promotion Capital Goods (EPCG) scheme. *(4 Marks)*

7. (a) Mention the power of Settlement Commission to grant immunity from prosecution and penalty under section 32K of the Central Excise Act, 1944. *(4 Marks)*

(b) Comment on the applicability of service tax in the following independent cases:

(i) Service provided by a private transport operator to Scholar Boys Higher Secondary School in relation to transportation of students to and from the school.

(ii) Services provided by way of vehicle parking to general public in a shopping mall.

(iii) Exhibiting movies on television channels.

(iv) Transport facility provided by a School (not recognized by Government) to its students through a fleet of buses and cabs owned by the School. *(8 Marks)*

(c) Mr. Sai wants to import by air a laptop from USA. Such laptop has been used by Mr. Shyam - the seller for few months there. Mr. Sai contends that he can freely import such laptop without any restriction/ authorization. Examine the correctness of Mr. Sai's claim in the light of the provisions of FTP 2015-2020. *(4 Marks)*

Test Series: August, 2016

MOCK TEST PAPER – 1

FINAL COURSE: GROUP – II

PAPER – 8: INDIRECT TAX LAWS

SUGGESTED ANSWERS / HINTS

1. (a) As per rule 8 of the Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000, the value of the excisable goods used for captive consumption is 110% of the cost of production of such goods.

The cost of production is to be determined as per 'Cost Accounting Standard (CAS)-4: Cost of Production for Captive Consumption' issued by ICWAI [*CBEC Circular No. 692/8/2003 dated 13.02.2003]*.

Computation of cost of production as per CAS-4 and value of the excisable goods

Particulars		Rs.
Cost of direct materials	Rs. 16,875	
Less: Central excise duty	Rs. 1,875 (Note-1)	15,000
Cost of direct employees		12,300
Consumable stores and repairs		8,400
Quality control cost		4,300
Research and development cost		2,700
Administrative cost (production related) [Note-2]		3,000
Total		45,700
Less: Scrap value realized		1,500
Cost of production as per CAS-4		44,200
Value of excisable goods [Rs. 44,200× 110%]		48,620

Notes:

1. Since CENVAT credit is available on central excise duty paid on direct materials, it has been deducted from the cost of direct materials in accordance with the Cost Accounting Standard-4.
2. Administrative overheads in relation to activities other than manufacturing activities have not been included in cost of production [CAS-4].
3. Selling and distribution cost have not been considered while computing the cost of production as they are not in relation to production activity [CAS-4].

(b) Computation of value of taxable service and service tax payable by Reliable Bank Ltd.

Sl. No.	Particulars	Amount (Rs.)
(i)	Administration charges for extending home loans [Note 1]	10,00,000
(ii)	Discount earned on bills discounted [Note 2]	-
(iii)	Value of sale and purchase of forward contract [Note 3]	-
(iv)	Charges received on credit and debit card facilities extended [Note 4]	3,80,000
(v)	Commission received for service rendered to Government for tax collection [Note 5]	6,00,000
(vi)	Margin earned on reverse repo transaction [Note 6]	-
	Total	19,80,000
	Value of taxable service Rs. $\left[19{,}80{,}000 \times \frac{100}{114.5}\right]$ rounded off [since total amount received are given]	17,29,258
	Service tax payable [Rs. 17,29,258 × 14.5%] (including Swachh Bharat Cess)(rounded off)	2,50,742

Notes:

1. Service of extending loans in so far as the consideration is represented by way of interest is covered in the negative list. However, any charges collected over and above the interest represent taxable consideration and is thus, liable to service tax.
2. Services of bills discounting, to the extent the consideration is represented by way of discount, is covered in the negative list of services as such discounting is also a manner of extending credit facility or a loan.
3. Sale or purchase of forward contracts, being transaction in money, is outside the scope of the definition of service.
4. Credit extended through credit and debit cards is not in the nature of loan or advance for interest and thus, the charges received on account of such extended credit is in fact, the consideration for the services rendered by way of credit card.
5. Commission received for service rendered to Government for tax collection is neither transactions in money which is excluded from the definition of service nor covered in negative list or under any exemption notification and is thus,

liable to service tax.

6. Reverse repo being a security, which is goods is excluded from the definition of service.

(c) Computation of export duty

Particulars	Amount (US $)
FOB price of goods [Note 1]	1,00,000
	Amount (Rs.)
Value in Indian currency (US $ 1,00,000 x Rs. 55) [Note 2]	55,00,000
Export duty @ 8% [Note 3]	**4,40,000**

Notes:

1. As per section 14(1) of the Customs Act, 1962, assessable value of the export goods is the transaction value of such goods which is the price actually paid or payable for the goods when sold for export from India for delivery at the time and place of exportation.
2. As per third proviso to section 14(1) of the Customs Act, 1962, assessable value has to be calculated with reference to the rate of exchange notified by the CBEC on the date of presentation of shipping bill of export.
3. As per section 16(1)(a) of the Customs Act, 1962, in case of goods entered for export, the rate of duty prevalent on the date on which the proper officer makes an order permitting clearance and loading of the goods for exportation, is considered.

2. (a) The certificate of excise registration can be suspended or revoked by the Deputy Commissioner or the Assistant Commissioner of Central Excise under the following circumstances:

(i) when the assessee or any person under his employment has committed any breach of the provisions of the Central Excise Act or any rules made there under.

(ii) when the assessee or a person under his employment has been convicted of an offence under section 161 read with section 109 or section 116 of the Indian Penal Code.

Further, a registration certificate granted online may be cancelled after giving a reasonable opportunity to the assessee to represent his case against the proposed cancellation by the Deputy or Assistant Commissioner of Central Excise, in any of the following situations, namely:—

(a) where on verification , the premises proposed to be registered is found to be non-existent;

(b) where the assessee does not respond to request for rectification of error noticed during the verification of the premises within 15 days of intimation;

(c) where there is substantial mis-declaration in the application form; and

(d) where the factory has closed and there are no dues pending against the assessee

(b) (i) Rule 10 of Service Tax Rules, 1994 lays down the procedure and facilities for the large taxpayer. The provisions of this rule as applicable to XYZ Ltd. are given hereunder:

(1) XYZ Ltd. shall have to submit the prescribed returns for each of the registered premises. If XYZ Ltd. has obtained a centralized registration under rule 4(2) of Service Tax Rules, 1994, it shall submit a consolidated return for all such premises.

(2) XYZ Ltd., on demand, may be required to make available the financial, stores and CENVAT credit records in electronic media, such as, compact disc or tape for the purposes of carrying out any scrutiny and verification, as may be necessary.

(3) XYZ Ltd. may, with intimation of at least 30 days in advance, opt out to be a large taxpayer from the first day of the following financial year.

(4) Any notice issued but not adjudged by any of the Central Excise Officer administering the Act or rules made thereunder immediately before the date of grant of acceptance by the Chief Commissioner of Central Excise, Large Taxpayer Unit (12.12.2015 in this case), shall be deemed to have been issued by Central Excise Officers of the said unit.

(5) Provisions of Service Tax Rules, in so far as they are not inconsistent with the provisions of this rule shall mutatis mutandis apply in case of XYZ Ltd.

(ii) The Commissioner of Central Excise may order special audit under section 72A(1) of the Finance Act, 1994 if he has reasons to believe that any person liable to pay service tax-

(a) has failed to declare or determine the value of a taxable service correctly; or

(b) has availed and utilised credit of duty or tax paid—

(i) which is not within the normal limits having regard to the nature of taxable service provided, the extent of capital goods used or the type of inputs or input services used, or any other relevant factors as he may deem appropriate; or

(ii) by means of fraud, collusion, or any wilful misstatement or suppression of facts; or

(c) has operations spread out in multiple locations and it is not possible to obtain a true and complete picture of his accounts from the registered premises falling under the jurisdiction of the said Commissioner.

(c) The safeguard duty under section 8B of the Customs Tariff Act, 1975 is not imposed on the import of the following types of articles:

(i) Articles originating from a developing country, so long as the share of imports of that article from that country does not exceed 3% of the total imports of that article into India;

(ii) Articles originating from more than one developing country, so long as the aggregate of imports from developing countries each with less than 3% import share taken together does not exceed 9% of the total imports of that article into India;

(iii) Articles imported by a 100% EOU or units in a Special Economic Zone unless the duty is specifically made applicable on them or the article imported is either cleared as such into DTA or used in the manufacture of any goods that are cleared into DTA. In such cases, safeguard duty shall be levied on that portion of the article so cleared or so used as was leviable when it was imported into India.

3. (a) Yes, the manufacture and sale of specified goods not physically bearing a brand name, from branded sales outlets would disentitle an assessee to avail benefit of small scale exemption.

The facts of the given case are similar to the case of *CCEx vs. Australian Foods India (P) Ltd. 2013 (287) ELT 385 (SC)* wherein the Supreme Court held, that it is not necessary for goods to be stamped with a trade or brand name to be considered as branded goods for the purpose of SSI exemption, after making following observations:

(i) Physical manifestation of the brand name on goods is not a compulsory requirement as such an interpretation would lead to absurd results in case of goods, which are incapable of physically bearing brand names viz., liquids, soft drinks, milk, dairy products, powders etc. Such goods would continue to be branded good, as long as its environment conveys so viz. packaging/wrapping, invoices, accessories etc.

(ii) The test of whether the goods is branded or unbranded, must not be the physical presence of the brand name on the goods, but whether it is used in relation to such specified goods for the purpose of indicating a connection in the course of trade between such specified goods and some person using such name with or without any indication of the identity of the person.

(iii) Once it is established that a specified good is a branded good, whether it is sold without any trade name on it, or by another manufacturer, it does not cease to be a branded good of the first manufacturer. Therefore, soft drinks of a certain company do not cease to be manufactured branded goods of that company simply because they are served in plain glasses, without any indication of the company, in a private restaurant.

(b) P is liable to pay service tax in the given case. Section 66E(i) of the Finance Act, 1994 provides that service portion in an activity wherein goods, being food or any other article of human consumption or any drink (whether or not intoxicating) is supplied in any manner as part of the activity, is a declared service and is liable to service tax. Since the activity undertaken by 'P' involves supply of food, eatables and beverages, the same would fall in the category of declared service as defined under section 66E(i) and would be thus, liable to service tax.

Further, the Allahabad High Court in the case of *Indian Coffee Workers' Co-operative Society Limited v. CCE & ST 2014 (34) STR 546 (All.)* - which involved similar facts - held that the assessee (running the canteen in the premises of a company) was an outdoor caterer because services provided as a caterer were at place other than his own. The High Court clarified that taxability or the charge of tax does not depend on whether and to what extent the person engaging the service consumes the edibles and beverages supplied, wholly or in part. What is material is whether the service of an outdoor caterer is provided to another person.

Further the High Court elaborated that the charge of tax in the cases of VAT is distinct from the charge of tax for service tax. The charge of service tax is not on the sale of goods but on the taxable service provided. Hence, the fact that the assessee had paid VAT on the supply of food and beverages to those who consume them at the canteen, would not exclude the liability of the assessee for the payment of service tax in respect of the taxable service provided by the assessee as an outdoor caterer. Based on the observation made above, the High Court held that the assessee was liable for the payment of service tax as an outdoor caterer.

(c) Section 110(4) of the Customs Act, 1962 provides that the person from whose custody any documents are seized under sub-section (3) shall be entitled to make copies thereof or take extract therefrom in the presence of a officer of Customs. Thus, Customs Officers are required to make available the seized documents to the person from whose custody such documents were seized, if such person wants to make copies thereof.

The above mentioned issue came up for consideration before the Bombay High Court in case of *Manish Lalit Kumar Bavishi v. Addl. Dir. General, DRI 2011 (272) E.L.T. 42.* The High Court held that from the language of section 110(4), it was apparent that the Customs officers were mandatorily required to make available the documents asked for. It was the party concerned who had the choice of either asking for the document or seeking extract.

If any document was seized during the course of any action by an officer under the provisions of the Customs Act, that officer was bound to make available those documents. The denial by the Revenue to make the documents available was clearly an act without jurisdiction.

4. **(a)** As per section 9(3) of the Central Excise Act, 1944, for the purposes of section 9(1) or 9(2), the following shall not be considered as special and adequate reasons for awarding a sentence of imprisonment for a term of less than six months, namely:

(i) the fact that the accused has been convicted for the first time for an offence under this Act;

(ii) the fact that in any proceeding under this Act, other than a prosecution, the accused has been ordered to pay a penalty or the goods in relation to such proceedings have been ordered to be confiscated or any other action has been taken against him for the same act which constitutes the offence;

(iii) the fact that the accused was not the principal offender and was acting merely as a carrier of goods or otherwise was a secondary party in the commission of the offence:

(iv) the age of the accused (too young or too old)

(b) Renting of immovable property (whether residential or commercial) is a declared service under section 66E(a) of Finance Act, 1994. However, services by way of renting of residential dwelling for use as residence are covered in negative list of services and are thus, not liable to service tax.

Since, Mr. M has let out different floors of his residential building to different tenants and separate rent/lease deeds have been executed in respect of each floor of such building and vacant land given on rent/lease, principle of bundled service will not apply. In this backdrop, the taxability of each of the floor of the building and vacant land owned by Mr. M is discussed as under:

(i) *Basement*: As per section 65B(41) of the Act, renting includes letting, leasing, licensing or other similar arrangements in respect of immovable property. Therefore, leasing out of the basement of the building to Mr. N would not be covered under negative list of services as Mr. N uses the basement for commercial purpose. Thus, it would be liable to service tax as declared service.

(ii) *Ground floor*: Renting of ground floor of the building to Mr. O for being used as a guest house will not be covered under negative list of services since Mr. O uses it for commercial purpose. Thus, it would be liable to service tax as declared service.

(iii) *First floor*: Since Mr. M uses the first floor of the building himself, it would not be a service and thus, would not be liable to service tax.

(iv) *Second floor*: Renting of second floor of the building to Mr. P for being used as a residence would not be chargeable to service tax as it is covered in negative list of services under section 66D(m) of Finance Act, 1994.

(v) *Vacant land*: Though vacant land is also an immovable property, renting thereof to Mr. Q, a parking contractor, will not be covered under negative list of services since Mr. Q uses it for commercial purpose. Thus, it would be liable to service tax as declared service.

(c) Section 64 of Customs Act 1962, provides that with the sanction of the proper officer, and on payment of the prescribed fees, the owner of any goods either before or after warehousing the same -

(a) inspect the goods;

(b) separate damaged or deteriorated goods from the rest;

(c) sort the goods or change the containers for the preservation, sale, export or disposal of the goods;

(d) deal with the goods & their containers in such manner as may be necessary to prevent loss, deterioration or damage to the goods;

(e) show the goods for sale;

(f) take samples of the goods without entry for home consumption, if the proper officer so permits, without payment of duty on such samples.

5. (a) As per section 23D of the Central Excise Act, 1944, the procedure to be followed by the Authority for Advance Rulings on receipt of application for advance ruling is:-

1. On receipt of application for advance ruling, the Authority will forward a copy to the relevant Principal Commissioner of Central Excise or Commissioner of Central Excise.

2. The Authority may accept or reject the application. Application can be rejected in the following cases, but only after giving an opportunity of being heard to the applicant:

   (i) where the question raised in the application is already pending before any Central Excise Officer, the Appellate Tribunal or any Court; or

   (ii) where the question raised is the same as in a matter already decided by any Appellate Tribunal or any Court.

   Where the application is rejected, reasons for such rejection have to be given in the order.

3. The Authority will pass an order of admission or rejection of the application and send a copy of such order to the applicant and the Principal Commissioner of Central Excise or Commissioner of Central Excise.

4. After admission of the application, the Authority can further examine any material placed before it and on request can provide an opportunity of being heard to the applicant.

5. The Authority will pronounce the advance ruling, in writing, within 90 days of receipt of application.

6. Duly signed copies of the advance ruling will be sent to the applicant and the Principal Commissioner of Central Excise or Commissioner of Central Excise.

(b) **(1)** In this situation, if rule 5 of the Place of Provision of Service Rules, 2012 (PoPS Rules), is applied, then place of provision of service would be location of property which is Afghanistan. Since Afghanistan falls within non-taxable territory, the foregoing construction services will not be taxable.

However, if rule 8 of the PoPS Rules is applied, the place of provision of service will be the location of the service receiver i.e., Gujarat [which falls within the taxable territory] and resultantly, construction services will be taxable.

As per rule 14 of the PoPS Rules, if the place of provision of service is determinable in terms of more than one rule, the same is determined as per the rule that occurs later. Therefore, the place of provision in this case will be Gujarat and the service will be taxable (as per rule 8).

(2) In this case, since specific sites in respect of which mineral exploration is to be carried out are located in Zimbabwe, the place of provision of service as per rule 5 of the PoPS Rules will be Zimbabwe which does not fall within the ambit of 'taxable territory' and resultantly these services will not be taxable. The fact that service providing company is located in UK and service recipient is located in Hyderabad (India) is not significant.

(c) E-payment of customs duty is mandatory for-

(i) Importers paying customs duty of Rs. 1,00,000 or more per bill of entry

(ii) Importers registered under Accredited Client Programme

The dedicated payment gateway set up by the Board is called 'ICEGATE' [Indian Customs Electronic Commerce/Electronic Data interchange (EC/EDI) Gateway].

6. **(a)** Desk Review is the first step in Excise Audit, 2000. Upon assignment of an audit, the auditor is required to be sufficiently prepared before the visit to the unit. For this purpose, the auditor reviews all the information available about the unit, its operations, and reasons for selection for audit and possible issues that can be identified at desk review stage. Perusal of assessee's profile, annual report, trial balance, cost audit report and income-tax audit report is involved in desk review. Since this can be done without interacting with the assessee, it is known as 'desk review'.

Department has also decided to take help of practicing chartered/cost accountants in desk review of Excise Audit 2000

Or

The procedure for warehousing of goods removed from a factory is detailed below:

(i) The consignor shall prepare an application for removal of goods from a factory to a warehouse in quadruplicate and also prepare an invoice for goods to be warehoused.

(ii) He has to send original, duplicate and triplicate application and duplicate invoice along with goods to the warehouse of destination. The quadruplicate copy of application has to be sent to the Superintendent of Central Excise in-charge of his factory within 24 hours.

(iii) Within 24 hours of receipt of the goods the consignee shall verify the goods with all the copies of application.

(iv) The consignee has to send:

 (a) Original copy to Superintendent-in-charge of his warehouse.

 (b) Duplicate copy of consignor and retain the triplicate for record.

(v) The Superintendent-in-charge of the warehouse shall countersign the application received by him and send the same to Superintendent-in-charge of the consignor.

(vi) The consignor shall retain the duplicate application duly endorsed by the consignee for his record.

(b) Rule 8 of the Point of Taxation Rules, 2011 (PoTR), inter alia, applies in respect of payments pertaining to patents, where the whole amount of the consideration for the provision of service is not ascertainable at the time when service was performed, and subsequently the use or the benefit of these services by a person other than the provider gives rise to any payment of consideration. The service shall be treated as provided each time when a payment in respect of such use or the benefit is received by the provider in respect thereof, or an invoice is issued by the provider, whichever is earlier.

Since in the given case, whole amount of the consideration for the provision of patent is not ascertainable at the time when service was performed and subsequently the use of these services by Shakti Ltd. gives right to any payment of consideration, both the conditions specified in rule 8 get satisfied. Therefore, the point of taxation of Vaishno Ltd. for various financial years, determined as per rule 8, is as under:

Financial Year	Point of Taxation	Reason
2012-13	05.07.2013	Date of issuance of invoice [05.07.2013] falls before date of payment [26.08.2013]
2013-14	03.04.2014	Date of payment [03.04.2014] precedes date of issuance of invoice [13.04.2014]
2014-15	11.04.2015	Date of issuance of invoice [11.04.2015] falls before date of payment [20.05.2015]

(c) In EPCG scheme, first capital goods are imported without payment of customs duty and then export obligation is fulfilled.

In case of post export EPCG scheme, the capital goods are imported on full payment of applicable duties in cash. Later, basic customs duty paid on Capital Goods shall be remitted in the form of freely transferable duty credit scrips.

These Duty Credit Scrips can be used for payment of applicable custom duties for imports and applicable excise duties for domestic procurement. All other provisions of EPCG Scheme apply to post export EPCG scheme also.

Specific Export Obligation under this Scheme shall be 85% of the applicable specific EO [6 times of duty saved on capital goods imported under EPCG scheme to be fulfilled in 6 years reckoned from authorization issue date]. Average EO remains unchanged.

Duty remission shall be in proportion to the Export Obligation fulfilled.

The advantage of the scheme is that the exporter does not have any specific export obligation when he imports capital goods on payment of full customs duty. Later, he gets remission on the basis of exports made by him.

7. (a) The Settlement Commission can grant immunity under section 32K of Central Excise Act, 1944 from prosecution for any offence under the Act and either wholly or in part from the imposition of penalty if it is satisfied that the applicant has made full and true disclosure of his duty liability and co-operated with the Commission in the proceedings before it. However, if prosecution has already been launched before submission of application for settlement, the immunity against such prosecution cannot be granted.

Further, if the payment is not made as per the settlement order or any particulars are concealed or any false evidence is given, the immunity shall stand withdrawn.

(b) (i) **Exempt.** Services provided TO an educational institution by way of transportation of students are exempt from service tax vide *Notification No. 25/2012 ST dated 20.06.2012.*

(ii) **Taxable.** Services provided by way of vehicle parking to general public are not exempt from service tax.

(iii) **Taxable.** The benefit of exemption in relation to services provided by way of transfer of copyrights of cinematograph films is available only when such films are exhibited in a cinema hall or theatre. Therefore, exhibition of cinematograph films on television channels is taxable [*Notification No. 25/2012 ST dated 20.06.2012]*

(iv) **Exempt.** Services provided by an educational institution to its students are exempt from service tax even if such educational institution is not recognized by Government [*Notification No. 25/2012 ST dated 20.06.2012*].

(c) Import of second hand capital goods including their re-furnished/re-conditioned spares is allowed freely. However, import of second hand PC, laptop, air conditioner, DG set, photocopier will require authorization. In view of above, Mr. Sai's claim is not correct as second hand laptops can be imported only against an authorization.

DFIA or the inputs imported against it can be transferred after the fulfillment of the export obligation. A minimum 20% value addition is required for issuance of DFIA except for items in gems and jewellery sector.