

**MOCK TEST PAPER – 2**

**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) “Nikko Pacific” is an exclusive resort located in a famous Island of Pacific Ocean that vows to isolate its guests from the hustle and bustle of everyday life. Its leading principle is “all contemporary amenity wrapped in old-world charisma”. Each of the resort’s 18 villas has a separate theme like Castle, Majestic, Ambassador, Royal Chateau, Coconut, Lemon, Balinese etc and guests often ask for a specific villa when they make reservations. Villas are Ideal for families or friends travelling together and these villas feature luxurious accommodation spanning two floors. Since it is located within a 300-acre estate on white sand beach, the resort offers its guests a wide variety of outdoor activities such as horseback riding, hiking, diving, snorkeling, sailing, golf and so on. Guests could also while away the day relaxing in the pool and availing themselves of the resort’s world-famous spa “Nikko Spa”. The dining room, which only has three tables for the public, is acceptable proud of its 4-star rating.

*Required*

Develop a Balanced Scorecard for “Nikko Pacific”. It is sufficient to give two measures in each of the four perspectives. *(5 Marks)*

- (b) A public company responsible for the supply of domestic gas has been approached by several prospective customers in a rural area adjacent to a high-pressure main. As a condition of its license to operate as a utility, the company is obliged to respond positively to current needs provided the financial viability of the company is not put at risk. New customers are charged Rs. 250 each for connection to the system.

Once a meter is installed, a standing charge of Rs. 10 per quarter is billed. Charges for gas are levied at Rs. 400 per 1,000 metered units.

A postal survey of the area containing, according to the rating authority, 5,000 domestic units, elicited a 40% response rate. 95% of those who responded confirmed that they wished to become gas users and expressed their willingness to pay the connection charge.

Although it is recognized that a small percentage of those willing to pay for connection may not actually choose to use gas, it is expected that the average household will burn 50 metered units per month. There will be some seasonal differences.

The company's marginal cost of capital is 17% pa and supplies of bulk gas cost the company Rs. 0.065 per metered unit.

*Required*

Determine what the maximum capital project cost can be to allow the company to provide the service required if wastage of 15% has to be allowed. (5 Marks)

- (c) State whether each of the following independent activities is value-added or non-value-added:
- (i) Polishing of furniture used by a systems engineer in a software firm.
  - (ii) Maintenance by a software company of receivables management software for a banking company.
  - (iii) Painting of pencils manufactured by a pencil factory.
  - (iv) Cleaning of customers' computer key boards by a computer repair centre.
  - (v) Providing, brake adjustments in cars received for service by a car service station. (5 Marks)
- (d) A car rental agency has collected the following data on the demand for five-seater vehicles over the past 50 days.

<b>Daily Demand</b>	4	5	6	7	8
<b>No. of Days</b>	4	10	16	14	6

The agency has only 6 cars at present.

Use the following 5 random numbers to generate 5 days of demand for the rental agency

Random Nos: 15, 48, 71, 56, 90

*Required*

- (i) What is the average number of cars rented per day for the 5 days?
  - (ii) How many rentals will be lost over the 5 days? (5 Marks)
2. (a) Your Bank Ltd., was established on the 30<sup>th</sup> September, 1940 under the provisions of Co-operative Societies Act by the eminent professionals to encourage self-help, thrift, cooperation among members. Bank was issued Banking License under Banking Regulation Act, 1949 on October 25, 1986 to carry out the Banking Business within the national capital and since then the Bank has been growing

continuously. At present, Bank has large number of membership of individuals from different sections. The Bank has 12 branches in the NCT of Delhi. Bank offers 'traditional counter service'. Opening hours are designed to coincide with local market days.

Board of Directors were worried from growing popularity of new style banks. These banks offer diverse range of services such as direct access to executive management, a single point of contact to coordinate all banking needs, appointment banking to save time, free online banking services 24/7, free unlimited ATM access etc.

It has now been decided that the bank will focus on "What Customers Want" and will use a balanced scorecard to achieve this goal.

*Required*

Produce, for each of the three non-financial perspectives of a 'Balanced Scorecard', an objective and a performance measure that the bank could use with appropriate reason. (8 Marks)

- (b) Recently, Ministry of Health and Family Welfare along with Drug Control Department have come hard on health care centres for charging exorbitant fees from their patients. Care Ltd., a leading integrated healthcare delivery provider company is feeling pinch of measures taken by authorities and facing margin pressures due to this. Care Ltd. is operating in a competitive environment so; it's difficult to increase patient numbers also. Management Consultant of the company has come out with some plan for cost control and reduction.

Care Ltd. provides treatment under package system where fees is charged irrespective of days a patient stays in the hospital. Consultant has estimated 2.50 patient days per patient. He wants to reduce it to 2 days. By doing this, consultant has targeted the general variable cost of Rs. 500 per patient day. Annually 15,000 patients visit to the hospital for treatment.

Medical Superintendent has some concerns with that of Consultant's plan. According to him, reducing the patient stay would be detrimental to the full recovery of patient. They would come again for admission thereby increasing current readmission rate from 3% to 5%; it means readmitting 300 additional patients per year. Company has to spend Rs. 25,00,000 more to accommodate this increase in readmission. But Consultant has found blessing in disguise in this. He said every readmission is treated as new admission so it would result in additional cash flow of Rs. 4,500 per patient in the form of admission fees.

*Required*

- (i) Calculate the impact of Management Consultant's plan on profit of the company.

- (ii) Also comment on result and other factors that should be kept in mind before taking any decision. (8 Marks)

3. (a) Smart Ltd. has prepared the following statement for the month of April 2015.

Particulars	Budget Details	Static Budget	Actual
Units produced & Sold		4,000	3,200
		Rs.	Rs.
Direct Materials	3 kg p.u. @ Rs. 15 per kg.	1,80,000	1,55,000
Direct Labour	1 hr. p.u. @ Rs. 36 per hour	1,44,000	1,12,800
Variable Overhead	1 hr. p.u. @ Rs. 22 per hour	88,000	73,600
Fixed Overhead		90,000	84,000
Total Cost		5,02,000	4,25,400
Sales		6,00,000	4,48,000
Profit		98,000	22,600

During the month 10,000 kg. of materials and 3,100 direct labour hours were utilized.

*Required*

Prepare a flexible budget for the month. (5 Marks)

- (b) The following table shows all the necessary information on the available supply from each warehouse, the requirement of each market and the unit transportation cost in rupees from each warehouse to each market.

Warehouses	Markets				Supply
	I	II	III	IV	
A	5	2	4	3	22
B	4	8	1	6	15
C	4	6	7	5	8
Requirement	7	12	17	9	45/45

The shipping clerk has worked out the following schedule from experience:

12 units from A to II, 1 unit from A to III, 9 units from A to IV, 15 units from B to III, 7 units from C to I and 1 unit from C to III.

*Required*

- (i) Check if the clerk has made the 'Optimal Schedule'.  
(ii) Find the 'Optimal Schedule' and 'Minimum Total Shipping Cost'.

- (iii) Carrier of route C to II offers to transport entire supply of warehouse C at a reduced price. By how much must the rate be reduced by the Carrier before the clerk should consider giving him business?
- (iv) If the supply from warehouse B reduces to 11 units and simultaneously the requirement of market III reduces to 13 units, find the 'Optimal Transportation Schedule'.
- (v) Further, if supply from warehouse A also reduces to 19 units and simultaneously the requirement of III reduces further to 10 units, will the optimal solution of part (iv) change? (11 Marks)
4. (a) Celestial Electronics and Consumer Durables Corporation (CECDC), is a Taiwan (a state, Republic of China) based consumer electronics manufacturer. To expand its market share in South Asia it has formed CECD India Pvt. Ltd. (CIPL) in India. For the purpose of performance evaluation, the Indian part is treated as responsibility centre. CIPL imports components from the CECD and assembles these components into a LED TV to make it saleable in the Indian market. To manufacture an LED TV two units of component 'L<sub>x</sub>' are required. The following cost is incurred by the CECD to manufacture a unit of component 'L<sub>x</sub>':

	Amount (TWD)
Direct Material*	440.00
Direct Labour (3 hours)	120.00
Variable Overheads	40.00

(\*) purchased from domestic market.

CECDC incurs TWD 30 per unit as Wharfage Charges.

CECDC has a normal manufacturing capacity of 5,00,000 units of component 'L<sub>x</sub>' per annum, 70% of its production is exported to CIPL and rest are sold to other South-east Asian countries at TWD 750 per component. The tax authorities both in Taiwan and India, consider TWD 750 (= Rs.1,500) per component 'L<sub>x</sub>' as arm's length price for all transfers to CIPL. CIPL incurs Rs.10 per unit as shipment charges.

The cost data relevant to the LED TVs are as follows:

	Amount (Rs.)
Variable Costs per unit:	
Direct Material (excluding component 'L <sub>x</sub> ')	6,200
Direct Labour	115
Fixed Cost:	
Office and Administrative Overheads	1,18,00,000
Selling & Distribution Overheads	2,58,00,000

CIPL can sell 1,75,000 units of LED TV at Rs.11,000 per unit.

There is a dispute on the transfer pricing of component 'L<sub>x</sub>' between the CECDC and CIPL. CECDC is in favour of charging TWD 750 per component to CIPL as it is the arm's length price and it has to pay tax on this. On the other hand CIPL in its argument saying that the substitute of component 'L<sub>x</sub>' can be purchased from the Indian market at Rs.1,490 only and moreover it has to pay import duty on import of component 'L<sub>x</sub>' so the transfer price suggested by CECDC is not acceptable.

The following are the direct / indirect tax structure in India and Taiwan:

Type of Tax / Duty	India	Taiwan
Corporate Tax Rate	30%	25%
Import (Custom) Duty	10%	15%
	Nil	Nil

*Required*

From the above information, Calculate:

- (i) Minimum Price at which CECDC can transfer component 'L<sub>x</sub>' to CIPL.
- (ii) Maximum Price that can be paid by CIPL to CECDC for each component 'L<sub>x</sub>'.
- (iii) Profitability Statement for the group in TWD.

Note:

- (i) For Duty and Tax calculation, consider arm's length price only.
- (ii) Ignore the DTAA and other tax provisions.
- (iii) Conversion Rate 1 INR = 0.50 TWD (12 Marks)

(b) State the pricing policy most suitable in each of the following independent situations:

- (i) The company makes original equipments and does defence contract work. There are other companies which also undertake such projects.
- (ii) The product made by a company is new to the market. It is expected to enjoy a long-term demand. Competition is expected very soon, since the product will be desirable to most customers.
- (iii) Stock of processed ready-to-eat product, whose shelf-life will soon be over in the next 2 months. The product is going to be discontinued.
- (iv) A company sells a homogeneous product in a highly competitive market.

(Candidates need to only write the pricing policy with the corresponding sub-division numbers of the questions.) (4 Marks)

5. (a) Blue Mountains Ltd. (BML) has developed a new product 'K-2' which is about to be launched into the market. Company has spent Rs. 30,00,000 on R&D of product 'K-2'. It has also bought a machine to produce the product 'K-2' 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

BML uses just-in-time production system. Following is the total contribution statement of the product 'K-2' for its Introduction and Growth phase:

Weeks	Introduction	Growth	
	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 'K-2'.
- (iii) Find possible reasons for the changes in cost during the life cycle of the product 'K-2'.

Note: Ignore the time value of money.

(8 Marks)

(b) The following are the information regarding overheads of a company:

- (a) Overheads cost variance = Rs. 2,800 (A)
- (b) Overheads volume variance = Rs. 2,000 (A)
- (c) Budgeted overheads = Rs. 12,000
- (d) Actual overhead recovery rate = Rs. 8 per hour
- (e) Budgeted hours for the period = 2,400 hours

Compute the following:

- (i) Overheads expenditure variance.
- (ii) Actual incurred overheads.
- (iii) Actual hours for actual production.
- (iv) Overheads capacity variance.
- (v) Overheads efficiency variance.
- (vi) Standard hours for actual production.

(8 Marks)



6. (a) The following table relates to a network:

Activity	Normal Time (Days)	Crash Time (Days)	Normal Cost (Rs.)	Crash Cost (Rs.)
1-2	5	4	30,000	40,000
2-3	6	4	48,000	70,000
2-4	8	7	1,25,000	1,50,000
2-5	9	6	75,000	1,20,000
3-4	5	4	82,000	1,00,000
4-5	7	5	50,000	84,000

The overhead cost per day is Rs. 5,000 and the contract includes a penalty clause of Rs. 15,000 per day if the project is not completed in 20 days.

*Required*

- (i) Draw the network and calculate the normal duration and its cost.
- (ii) Find out:
- (1) the lowest cost and the associated time.
  - (2) the lowest time and the associated cost. (8 Marks)
- (b) A company is producing three products P, Q & R. Relevant information is given below:

Product	P	Q	R
Raw material per unit (kg)	20	12	30
Machine hours per unit (hours)	3	5	4
Selling price per unit (Rs.)	500	400	800
Maximum limit of production Unit	1,500	1,500	750

Only 9,200 hours are available for production at a cost of Rs.20 per hour and maximum 50,000 kgs. of material @ Rs. 20 per kg., can be obtained.

(Only product mix quantities are to be shown, calculation of total profit at that product mix not required to be shown)

*Required*

On the basis of the above information determine the product-mix to give the highest profit if at least two products are produced. (8 Marks)

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

- (a) The Gifts Company makes mementos for offering chief guests and other dignitaries at functions. A customer wants 4 identical pieces of hand-crafted gifts for 4 dignitaries invited to its function.

For this product, the Gifts Company estimates the following costs for the 1st unit of the product.

Particulars of Costs	Rs. / unit
Direct Variable Costs (excluding labour)	2,000
Direct Labour (20 hours @ Rs. 50 hour)	1,000

90 % learning curve ratio is applicable and one labourer works for one customer's order.

*Required*

- (i) What is the price per piece to be quoted for this customer if the targeted contribution is Rs. 1,500 per unit?
- (ii) If 4 different labourers made the 4 products simultaneously to ensure faster delivery to the customer, can the price at (i) above be quoted? Why? (4 Marks)
- (b) Classify the following items appropriately under the three measures used in the Theory of Constraints:
- (i) Research and Development Cost
  - (ii) Rental/Utilities
  - (iii) Finished Goods Inventory
  - (iv) Depreciation
  - (v) Labour Cost
  - (vi) Stock of Raw Materials
  - (vii) Sales
  - (viii) Cost of Equipment and Buildings (4 Marks)
- (c) Will the initial solution for a minimization problem obtained by Vogel's Approximation Method and the Least Cost Method be the same? Why? (4 Marks)
- (d) Pick out from each of the following items, costs that can be classified under 'committed fixed costs' or 'discretionary fixed costs'.
- (i) Annual increase of salary and wages of administrative staff by 5% as per agreement

- (ii) New advertisement for existing products is recommended by the Marketing Department for achieving sales quantities that were budgeted for at the beginning of the year.
- (iii) Rents paid for the factory premises for the past 6 months and the rents payable for the next six months. Production is going on in the factory.
- (iv) Research costs on a product that has reached 'maturity' phase in its life cycle and the research costs which may be needed on introducing a cheaper substitute into the market for facing competition. (4 Marks)
- (e) The following matrix was obtained after performing row minimum operations on rows  $R_1$  and  $R_2$  in an assignment problem for minimization. Entries "xx" represent some positive numbers. (It is not meant that all "xx" numbers are equal). (Candidates may use cell references as  $C_i R_j$  for uniformity. e.g.  $C_1 R_1$  represents the cell at the intersection of Column1 ( $C_1$ ) and Row 1 ( $R_1$ ) etc.

	$C_1$	$C_2$	$C_3$
$R_1$	0	xx	xx
$R_2$	xx	0	xx
$R_3$	xx	xx	xx

*Required*

State two circumstances under which an optimal solution is obtained just after the row minimum and column minimum operations. (4 Marks)

**MOCK TEST PAPER – 2**  
**FINAL COURSE: GROUP – II**  
**PAPER – 5: ADVANCED MANAGEMENT ACCOUNTING**  
**SUGGESTED ANSWERS/HINTS**

1. (a) The following is a possible Balanced Scorecard for “Nikko Pacific”

<b>Financial Perspective</b>	Economic Value Added
	Revenue <i>per villa</i>
<b>Customer Perspective</b>	% repeat customers
	Number of customer complaints
<b>Internal Business</b>	Service rating of spa
	Staff hours <i>per guest</i>
	% cost spent for maintenance
	Travel guide rank for restaurant
<b>Innovation and Learning</b>	Employee retention
	Number of new services offered

- (b) Working Notes

1. No. of Customer = 1,900  
 $(5,000 \times 40\% \times 95\%)$
2. Consumption of Gas = 11,40,000 Metered units  
 $(1,900 \times 50 \text{ mt.} \times 12 \text{ months})$
- Gas Supply = 13,41,176 Metered units  
 $\{11,40,000 \times (100 \div 85)\}$
3. Cash Inflow

(Rs.)	
Rent $(1,900 \times 4 \text{ Quarters} \times \text{Rs.}10)$	76,000
Add: Consumption Charge $(11,40,000 \times \text{Rs.}0.4)$	4,56,000
Less: Cost of Company $(13,41,176 \times \text{Rs.}0.065)$	87,176
Cash Inflow p.a.	4,44,824

One Time Connection Charge = Rs.4,75,000  
(Rs.250 × 1,900 customers)

**Maximum Capital Project Cost**

(Can be to allow the company to provide the service required)

By Following the Concept of Perpetuity

(Investment – Rs.4,75,000) × 17% = Rs.4,44,824

∴ Investment = Rs.30,91,612

(c)

Sl. No	Item	Value Added / Non Value Added
(i)	Polishing furniture used by a Systems Engineer in a software firm.	Non-Value Added
(ii)	Maintenance by a software company of receivables management software for a banking company.	Value-Added
(iii)	Painting of pencils manufactured by a pencil factory.	Value-Added
(iv)	Customers' computer key board cleaning by a computer repair centre.	Value-Added
(v)	Providing brake adjustments in cars for repairs by a care service station.	Value-Added

(d)

Daily Demand	Days	Probability	Cumulative Probability	Random Assigned	No.
4	4	0.08	0.08	00 – 07	
5	10	0.20	0.28	08 – 27	
6	16	0.32	0.60	28 – 59	
7	14	0.28	0.88	60 – 87	
8	6	0.12	1.00	88 – 99	

Day	Random No.	Demand	No. of Cars on Rent	Rent Lost
1	15	5	5	---
2	48	6	6	---
3	71	7	6	1

4	56	6	6	---
5	90	8	6	2
Total			29	3

Average no. of Cars Rented are  $5.8 \left( \frac{29\text{Cars}}{5} \right)$

Rental Lost equals to 3 Cars

## 2. (a) Internal Business Process Perspective

Objective: Cross-sell Products

Measure: Products Purchased *per customer*

Reason: Cross-selling, or encouragement customers to purchase additional products e.g. insurance, forex etc. is a *measure of customer satisfaction*. Only if a service is perceived as highly satisfactory the service would be repeated/ additional products or services would be accepted.

### Learning and Growth Perspective

Objective: Increase the Number of New Products or Services Sold

Measure: Number of Customers Buying the New Products/ New Services

Reason: Long term financial success requires bank to create new products / services (e.g. internet banking, ATM access) that will meet emerging needs of current / future customers such as 24/7 banking.

### Customer Perspective

Objective: Increase Customer Loyalty

Measure: Number of Accounts Closed or Closure Request Received

Reason: Customer loyalty describes the extent to which bank maintains durable relations to its customers. The share of existing customers should have a high importance as it indicates about image and reputation. Closure request is not a good sign for bank. Bank should investigate reasons for the same and take appropriate actions to improve services offered to retain customers.



Other **Objectives** and **Measures** are also possible but they must relate to the bank's **Goal**.

(b) (i) **Impact of Management Consultant's Plan on Profit of the Care Ltd.**

**Statement Showing Cost Benefit Analysis**

Particulars	Rs.
Cost:	
Incremental Cost <i>due to</i> Increased Readmission	25,00,000
Benefit:	
Saving in General Variable Cost <i>due to</i> Reduction in Patient Days [15,000 Patients × (2.5 Days – 2.0 Days) × Rs. 500]	37,50,000
Revenue from Increased Readmission (300 Patients × Rs.4,500)	13,50,000
Incremental Benefit	26,00,000

(ii) **Comment**

Primary goal of investor-owned firms is shareholder wealth maximization, which translates to stock price maximization. Management consultant's plan is looking good for the Care Ltd. as there is a positive impact on the profitability of the company (refer Cost Benefit Analysis).

Also Care Ltd. operates in a competitive environment so for its survival, it has to work on plans like above.

But there is also the second side of a coin that cannot also be ignored i.e. humanity values and business ethics. Discharging patients before their full recovery will add discomfort and disruption in their lives which cannot be quantified into money. There could be other severe consequences as well because of this practice. For gaining extra benefits, Care Ltd. cannot play with the life of patients. It would put a question mark on the business ethics of the Care Ltd.

May be Care Ltd. would able to earn incremental profit due to this practice in *short run* but It will tarnish the image of the Care Ltd. which would hurt profitability in the *long run*.

So, before taking any decision on this plan, Care Ltd. should analyze both *quantitative as well as qualitative factors*.

3. (a) **Statement Showing "Flexible Budget for 3,200 units Activity Level"**

Particulars	Amount (Rs.)
Sales $\left( \frac{\text{Rs. 6,00,000}}{4,000 \text{ units}} \times 3,200 \text{ units} \right)$	4,80,000
Less: Variable Cost	
Direct Material (3,200 units × 3 kg. per unit × Rs.15 per kg.)	1,44,000

Direct Labour (3,200 units × 1 hr. per unit × Rs.36 per hr.)	1,15,200
Variable Overhead (3,200 units × 1 hr. per unit × Rs.22 per hr.)	70,400
Contribution	1,50,400
Less: Fixed Overhead	90,000
Profit	60,400

(b) (i) The Initial basic solution worked out by the shipping clerk is as follows-

Warehouse	Market				Supply
	I	II	III	IV	
A	5	2 <span style="border: 1px solid black; padding: 2px;">12</span>	4 <span style="border: 1px solid black; padding: 2px;">1</span>	3 <span style="border: 1px solid black; padding: 2px;">9</span>	22
B	4	8	1 <span style="border: 1px solid black; padding: 2px;">15</span>	6	15
C	4 <span style="border: 1px solid black; padding: 2px;">7</span>	6	7 <span style="border: 1px solid black; padding: 2px;">1</span>	5	8
Req.	7	12	17	9	45

The initial solution is tested for optimality. The total number of independent allocations is 6 which is equal to the desired  $(m + n - 1)$  allocations. We introduce  $u_i$ 's ( $i = 1, 2, 3$ ) and  $v_j$ 's ( $j = 1, 2, 3, 4$ ). Let us assume  $u_1 = 0$ , remaining  $u_i$ 's and  $v_j$ 's are calculated as below-

**$(u_i + v_j)$  Matrix for Allocated / Unallocated Cells**

					$u_i$
	1	2	4	3	0
	-2	-1	1	0	-3
	4	5	7	6	3
$v_j$	1	2	4	3	

Now we calculate  $\Delta_{ij} = C_{ij} - (u_i + v_j)$  for non basic cells which are given in the table below-

**$\Delta_{ij}$  Matrix**

4			
6	9		6



	1		-1
--	---	--	----

Since one of the  $\Delta_{ij}$ 's is negative, the schedule worked out by the clerk is not the optimal solution.

- (ii) Introduce in the cell with negative  $\Delta_{ij}$  [ $R_3C_4$ ], an assignment. The reallocation is done as follows-

	12	1	9
		+1	-1
		15	
7		1	
		-1	+1

**Revised Allocation Table**

	12	2	8
		15	
7			1

Now we test the above improved initial solution for optimality-

**$(u_i + v_j)$  Matrix for Allocated / Unallocated Cells**

				$u_i$	
	2	2	4	3	0
	-1	-1	1	0	-3
	4	4	6	5	2
$v_j$	2	2	4	3	

Now we calculate  $\Delta_{ij} = C_{ij} - (u_i + v_j)$  for non basic cells which are given in the table below-

**$\Delta_{ij}$  Matrix**

3			
5	9		6

	2	1	
--	---	---	--

Since all  $\Delta_{ij}$  for non basic cells are positive, the solution as calculated in the above table is the optimal solution. The supply of units from each warehouse to markets, along with the transportation cost is given below-

Warehouse	Market	Units	Cost per unit (Rs.)	Total Cost (Rs.)
A	II	12	2	24
A	III	2	4	8
A	IV	8	3	24
B	III	15	1	15
C	I	7	4	28
C	IV	1	5	5
Minimum Total Shipping Cost				104

- (iii) If the clerk wants to consider the carrier of route C to II only, instead of 7 units to I and 1 unit to IV, it will involve shifting of 7 units from (A, II) to (A, I) and 1 unit to (A, IV) which results in the following table-

Warehouse	Market				Supply
	I	II	III	IV	
A	5 <span style="border: 1px solid black; padding: 2px;">7</span>	2 <span style="border: 1px solid black; padding: 2px;">4</span>	4 <span style="border: 1px solid black; padding: 2px;">2</span>	3 <span style="border: 1px solid black; padding: 2px;">9</span>	22
B	4	8	1 <span style="border: 1px solid black; padding: 2px;">15</span>	6	15
C	4	6 <span style="border: 1px solid black; padding: 2px;">8</span>	7	5	8
Req.	7	12	17	9	45

The transportation cost will become-

Warehouse	Market	Units	Cost per unit (Rs.)	Total Cost (Rs.)
A	I	7	5	35
A	II	4	2	8
A	III	2	4	8

A	IV	9	3	27
B	III	15	1	15
C	II	8	6	48
Minimum Total Shipping Cost				141

The total shipping cost will be Rs.141.

Additional Transportation Cost Rs.37.

The carrier of C to II must reduce the cost by Rs.4.63 (Rs.37/8) so that the total cost of transportation remains the same and clerk can give him business.

(iv) Revised transportation table is shown below-

Warehouse	Market				Supply
	I	II	III	IV	
A	5	2 <span style="border: 1px solid black; padding: 2px;">12</span>	4 <span style="border: 1px solid black; padding: 2px;">2</span>	3 <span style="border: 1px solid black; padding: 2px;">8</span>	22
B	4	8	1 <span style="border: 1px solid black; padding: 2px;">11</span>	6	15/11
C	4 <span style="border: 1px solid black; padding: 2px;">7</span>	6	7	5 <span style="border: 1px solid black; padding: 2px;">1</span>	8
Req.	7	12	17/13	9	45

Since the alterations are restricted to allocated cells only, the present alterations do not disturb the optimal allocation schedule.

(v) In this situation, alterations are not restricted to allocated cells since allocation in cell (A, III) is 2 units only while reduction in requirement of Market III as well as supply of Warehouse A is 3 units. Therefore, it is essential to make alterations in allocations, check solution for optimality test and iterate if required.

4. (a) (i) The minimum price at which CECDL can transfer component 'L<sub>x</sub>' to CIPL is Variable Cost per unit *plus* Corporate Tax attributable to per unit of component 'L<sub>x</sub>'

**Minimum Transfer Price per unit of component 'L<sub>x</sub>'**

	Amount (TWD)
Direct Material	440.00

Direct Labour	120.00
Variable Overheads	40.00
Wharfage Charges	30.00
Corporate Tax attributable to per unit of component 'Lx' (W.N.1)	30.00
Total	660.00

Minimum Transfer Price *per unit* of component 'Lx' is 660 TWD or Rs.1,320

- (ii) Maximum Transfer Price that CIPL can pay to CECDC for every unit of component 'Lx' is the market price of component 'Lx' in domestic market *minus* cost of import (if any).

**Maximum Transfer Price *per unit* of component 'Lx'**

	Amount (Rs.)
Market Price of component 'Lx' (Indian Market)	1,490.00
Less: Import Duty (750 TWD × 2 × 10%)	150.00
Less: Shipment Cost	10.00
Total	1,330.00

Maximum Transfer Price that CIPL can pay to CECDC for every unit of component 'Lx' is Rs.1,330 or 665 TWD.

- (iii) **Profitability Statement for the Group (TWD' 000)**

Particulars	LED TV	Component 'Lx'	Total
Sales Revenue	9,62,500 (1,75,000 units × Rs.11,000 × 0.50)	1,12,500 (1,50,000 units × 750TWD)	10,75,000
<b>Total Revenue</b>			<b>10,75,000</b>
Variable Manufacturing Cost (Component 'Lx')	2,10,000 (3,50,000 units × 600 TWD)	90,000 (1,50,000 units × 600TWD)	3,00,000
Wharfage Charges	10,500 (3,50,000 units × 30 TWD)	4,500 (1,50,000 units × 30TWD)	15,000
Other Variable Manufacturing Cost (excluding 'Lx')	5,52,562.50 (1,75,000 units × Rs.6,315 × 0.50)	---	5,52,562.50
Import Duty	26,250	---	26,250

	(10% × 3,50,000 units × 750TWD)		
Shipment Cost	1,750 (3,50,000 units × Rs.10 × 0.50)	---	1,750
Office and Admin. Overheads	5,900 (Rs.1,18,00,000 × 0.50)	---	5,900
Selling & Dist. Overheads	12,900 (Rs.2,58,00,000 × 0.50)	---	12,900
Corp. Taxes (W.N. 2 & 3)	30,191.25 (Rs.60,382.50 × 0.50)	15,000	45,191.25
<b>Total Cost</b>			<b>9,59,553.75</b>
Profit		...(A) – (B)	1,15,446.25

### Working Notes

#### W.N.-1

#### Corporate Tax Attributable to *per unit* of Component 'Lx' (TWD)

	Amount
Profit <i>per unit</i> (750 TWD – 440 TWD – 120 TWD – 40 TWD – 30 TWD)	120
Corporate tax <i>per unit</i> (25% on 120 TWD)	30

#### W.N.-2

#### Calculation of Corporate Tax paid by CIPL (Rs. ' 000)

	Amount
Sales Revenue (1,75,000 units × Rs.11,000)	19,25,000
<i>Less: Variable Costs:</i>	
Component 'Lx' (3,50,000 units × 750 TWD × Rs.2)	5,25,000
Other Variable Costs (1,75,000 units × Rs. 6,315)	11,05,125
<i>Less: Import Duty 10% of (3,50,000 units × 750 TWD × Rs.2)</i>	52,500
<i>Less: Shipment Cost (3,50,000 units × Rs.10)</i>	3,500
<i>Less: Fixed Overheads</i>	
Office and Administrative Overheads	11,800
Selling and Distribution Overheads	25,800
Taxable Profit	2,01,275
Tax Payable @30%	60,382.50

**W.N.-3****Calculation of Corporate Tax paid by CECD (TWD)**

	<b>Amount</b>
Profit <i>per unit</i> (750 TWD – 440 TWD – 120 TWD – 40 TWD – 30 TWD)	120
No. of units to be sold	5,00,000
Total Profit ( 120 TWD × 5,00,000 units)	6,00,00,000
Corporate Tax @ 25%	1,50,00,000

**(b) Pricing Decision**

- (i) Sealed Bid Pricing
- (ii) Penetration Pricing
- (iii) Any price that the market will pay (even below variable cost any cash received)
- (iv) Going rate pricing or market price

**5. (a) (i) Total Contribution Statement****Statement Showing “Total Contribution- for remaining two phases”**

<b>Particulars</b>	<b>Maturity</b>		<b>Decline</b>
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 K-2**

BML is following the skimming price strategy that's why it has planned to launch the product K-2 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, BML 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 K-2 is decreasing gradually stage by stage. This is happening because BML 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 'K-2'**

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:

BML is expecting reduction in unit cost of the product K-2 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, BML is in the expansion mode. The BML may be able to take advantages of quantity discount offered by suppliers or may negotiate the price with suppliers.

Product K-2 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 K-2 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 BML may have to incur heavy marketing expenses for stock clearance.

**Workings**

**Statement of Cumulative Sales along with Sales Price and Variable Cost**

<b>Weeks</b>	<b>Demand per week</b>	<b>Total Sales</b>	<b>Cumulative Sales</b>	<b>Selling Price per unit (Rs.)</b>	<b>Variable Cost per unit (Rs.)</b>
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) Overheads Cost Variance = Rs. 2,800 (A)  
Overheads Volume Variance = Rs. 2,000 (A)  
Budgeted Overheads = Rs. 12,000  
Actual Overhead Recovery Rate = Rs. 8 per hour  
Budgeted Hours *for the period* = 2,400 hours
- (i) Overheads Expenditure Variance = Overheads Cost Variance (-)  
Overheads Volume Variance  
= Rs. 2,800 (A) - Rs. 2,000 (A)  
= Rs. 800 (A)
- (ii) Overheads Expenditure Variance = Budgeted Overheads (-) Actual Overheads  
⇒ Rs. 800(A) = Rs. 12,000 (-) Actual Overheads  
Therefore, Actual Overheads = Rs. 12,800
- (iii) Actual hours for actual production =  $\frac{\text{Actual Overheads}}{\text{Actual Overhead Recovery Rate Per Hour}}$   
=  $\frac{\text{Rs. 12,800}}{\text{Rs. 8}}$   
= 1,600 hours
- For (iv), (v) & (vi) refer Working Note*
- (iv) Overheads Capacity Variance = Budgeted Overheads for Actual Hours  
(-) Budgeted Overheads  
= Rs. 5 x 1,600 hrs. - Rs. 12,000  
= Rs. 8,000 - Rs. 12,000  
= Rs. 4,000 (A)
- (v) Overheads Efficiency Variance = Absorbed Overheads (-) Budgeted Overheads for Actual Hour  
= Rs. 10,000 - Rs. 5 x 1,600 hours  
= Rs. 2,000 (F)



(vi) Standard hours for actual production

$$= \frac{\text{Absorbed Overheads}}{\text{Standard Overhead Rate per hour}}$$

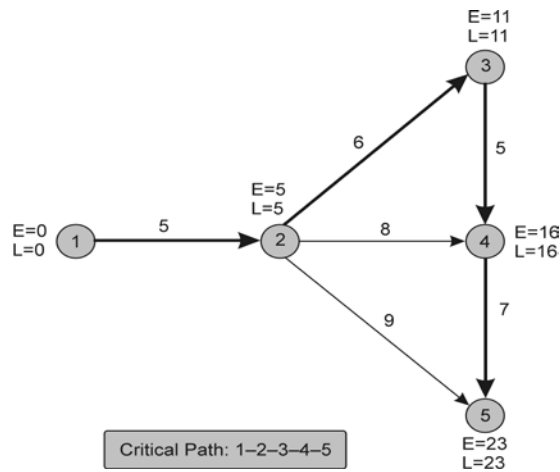
$$= \frac{\text{Rs. } 10,000}{\text{Rs. } 5}$$

$$= 2,000$$

**Working Notes:**

Overhead Cost Variance	= Absorbed Overheads
	(-) Actual Overheads
⇒ Rs. 2,800 (A)	= Absorbed Overheads (-) Rs.12,800
Therefore, Absorbed Overheads	= Rs.10,000
Standard Rate <i>per hour</i>	= $\frac{\text{Budgeted Overheads}}{\text{Budgeted Hours}}$
	= $\frac{\text{₹ } 12,000}{2,400\text{hours}} = \text{Rs. } 5$

6. (a) (i) The **network** for the given problem



Normal Duration = 23 Days  
 Associated Cost = Rs.5,70,000  
 (Refer Statement Showing Project Cost & Duration)

(ii) Lowest Cost = Rs. 5,42,000

Associated Time = 20 Days  
 (Refer Statement Showing Project Cost & Duration)

Lowest Time = 17 Days

Associated Cost = Rs. 5,79,000  
 (Refer Statement Showing Project Cost & Duration)

**Workings**

**Statement Showing "Project Cost & Duration"**

Length	Job Crashed	Crashing Cost	Normal Cost	Indirect Cost	Penalty	Total Cost
23	–	–	Rs.4,10,000	Rs.1,15,000 (Rs.5,000 × 23 Days)	Rs.45,000 (Rs.15,000 × 3 Days)	<b>Rs.5,70,00</b>
22	1–2	Rs.10,000 (Rs.10,000 × 1 Day)	Rs.4,10,000	Rs.1,10,000 (Rs.5,000 × 22 Days)	Rs.30,000 (Rs.15,000 × 2 Days)	Rs.5,60,00
20	2–3	Rs.32,000 (Rs.10,000 + Rs.11,000 × 2 Days)	Rs.4,10,000	Rs.1,00,000 (Rs.5,000 × 20 Days)	Rs.0 (Rs.15,000 × 0 Days)	<b>Rs.5,42,00</b>
18	4–5	Rs.66,000 (Rs.32,000 + Rs.17,000 × 2 Days)	Rs.4,10,000	Rs.90,000 (Rs.5,000 × 18 Days)	Rs.0 (Rs.15,000 × 0 Days)	Rs.5,66,00
17	3–4	Rs.84,000 (Rs.66,000 + Rs.18,000 × 1 Day)	Rs.4,10,000	Rs.85,000 (Rs.5,000 × 17 Days)	Rs.0 (Rs.15,000 × 0 Days)	<b>Rs.5,79,00</b>

**Statement Showing “Cost Slope of each activity”**

Activity	Normal		Crash		Cost Slopes		
	Duration (Days)	Cost (Rs.)	Duration (Days)	Cost (Rs.)	ΔT (Days)	ΔC (Rs.)	ΔC/ΔT (Rs.)
1-2	5	30,000	4	40,000	1	10,000	10,000
2-3	6	48,000	4	70,000	2	22,000	11,000
2-4	8	1,25,000	7	1,50,000	1	25,000	25,000
2-5	9	75,000	6	1,20,000	3	45,000	15,000
3-4	5	82,000	4	1,00,000	1	18,000	18,000
4-5	7	50,000	5	84,000	2	34,000	17,000
Total		4,10,000					

**(b) Computation of Contribution per Key Factor(s) for Various Products**

Particulars	Products		
	P	Q	R
Selling Price p. u. (Rs.)	500	400	800
Variable Cost p. u. (Rs.):			
Material	400 (Rs.20 × 20 Kg.)	240 (Rs.20 × 12 Kg.)	600 (Rs.20 × 30 Kg.)
Machine Charge	60 (Rs.20 × 3 hrs)	100 (Rs. 20 × 5 hrs)	80 (Rs.20 × 4 hrs)
Total Variable Cost p. u. (Rs.)	460	340	680
Contribution p. u. (Rs.)	40	60	120
<b>Ranking</b>	<b>III</b>	<b>II</b>	<b>I</b>
Requirement of Material (Kg.)	20	12	30
Contribution per Kg.(Rs.)	2.00	5.00	4.00
<b>Ranking</b>	<b>III</b>	<b>I</b>	<b>II</b>
Requirement of Machine Hours (Hrs.)	3	5	4
Contribution per hour(Rs.)	13.33	12.00	30.00
<b>Ranking</b>	<b>II</b>	<b>III</b>	<b>I</b>

It is clear from the above ranking(s):-

- I. Contribution per Unit is maximum in case of product Q & R.
- II. Contribution per Kg. of Raw Material also maximum in case of product Q & R.
- III. Contribution per Machine Hour is maximum in case of product P & R.

So product R is common in all cases and priority shall be given for production of 'R'. Balance resources should be divided between other two products P & Q.

**Statement Showing Balance Resources for Product P & Q**

Resources	Maximum Availability (a)	Maximum Production (b)	Consumption of Resources p.u. (c)	Total Cons. (d) = (b) x (c)	Balance (a) - (d)
Material	50,000 Kg.	750	30 Kg.	22,500 Kg.	27,500 Kg.
Machine Hrs.	9,200 Hrs.	750	4 Hrs.	3,000 Hrs.	6,200 Hrs.

The production of P & Q may be calculated with the help of following equations by utilizing balance resources: -

$$20P + 12Q = 27,500 \dots(i)$$

$$3P + 5Q = 6,200 \dots(ii)$$

Then,

$$30P + 18Q = 41,250$$

*...equation (i) multiplied by 1.5*

$$30P + 50Q = 62,000$$

*...equation (ii) multiplied by 10*

$$\begin{array}{r} - & - & - \\ -32Q & = & -20,750 \end{array}$$

$$Q = 648.43 \text{ i.e. } 648 \text{ units}$$

Putting the value of Q in equation (ii)

$$3P + (5 \times 648) = 6,200$$

Or  $3P = 2,960$

Or  $P = 986 \text{ units}$

So the of Product Mix is

$$P = 986 \text{ units}$$

$$Q = 648 \text{ units}$$

$$R = 750 \text{ units}$$

7. (a) (i) **Price to be Quoted**

	<b>Rs. / u</b> <b>Avg. / unit (4 units)</b>
Variable Cost	2,000
Labour	810
Target Contribution	1,500
Price to be Quoted	4,310

- (ii) No, the company cannot quote this price for varying products because the learning curve Ratio does not apply to non-repeated jobs. Each product will carry a different price according to its direct labour hours.

(b) **Theory of Constraints**

<b>Three Measures of Theory of Constraints</b>	<b>Item</b>
Throughput Contribution	(vii) Sales
Investments	(i) Research and Development Cost
	(iii) Finished Goods Inventory
	(vi) Stock of Raw material
	(viii) Cost of Equipment and Building
Operating Costs	(ii) Rent/Utilities
	(iv) Depreciation
	(v) Labour Cost

- (c) The initial solution need not be the same under both methods.

Vogel's Approximation Method uses the differences between the minimum and the next minimum costs for each row and column.

This is the penalty or opportunity cost of not utilising the next best alternative. The highest penalty is given the 1<sup>st</sup> preference. This need not be the lowest cost.

For example if a row has minimum cost as 3, and the next minimum as 2, penalty is 1; whereas if another row has minimum 4 and next minimum 6, penalty is 2, and this row is given preference. But least cost given preference to the lowest cost cell, irrespective of the next cost.

Vogel's Approximation Method will to result in a more optimal solution than least cost.

They will be the same only when the maximum penalty and the minimum cost coincide.

(d) Committed Fixed Costs Vs Discretionary Fixed Costs

Committed Fixed Costs	Discretionary Fixed Costs
(i) Salary and wage increase	(ii) New Advertisement Cost
(iii) Rents payable for the next 6 months	(iv) Research cost for substitutes

(e) Situation 1: On performing minimum operation in Row 3, if  $C_3R_3$  is zero, the optimal solution is obtained.

0	xx	xx
xx	0	xx
xx	xx	0

Optimal solution =  $C_1R_1, C_2R_2$  &  $C_3R_3$

Situation 2: On performing minimum operation in Row 3, if  $C_2R_3$  is zero, then it necessitates the performance of minimum operation in  $C_3$ . On account of this, if either  $C_3R_3$  or  $C_3R_2$  is zero then the optimal solution is obtained

0	xx	xx	And	0	xx	xx	or	0	xx	xx	Optimal = $C_1R_1, C_2R_2$ & $C_3R_3$
xx	0	xx		xx	0	xx		xx	0	0	OR
xx	0	xx		xx	0	0		xx	0	xx	Optimal = $C_1R_1, C_2R_3$ & $C_3R_2$

(i.e.,  $C_2R_3$  and  $C_3R_3$  are zero after Row minimum and column minimum operation respectively)

(or  $C_2R_3$  and  $C_3R_2$  are zero after Row minimum and column minimum operation respectively).

Situation 3: On performing minimum operation in Row 3, if  $C_1R_3$  is zero, then it necessitates the performance of minimum operation in  $C_3$ . On account of this, if either  $C_3R_3$  or  $C_3R_1$  is zero then the optimal solution is obtained.(i.e.,  $C_1R_3$  and  $C_3R_3$  are zero after Row minimum and column minimum operation respectively).

0	xx	xx	And	0	xx	xx	or	0	xx	0	Optimal = $C_1R_1, C_2R_2$ & $C_3R_3$
xx	0	xx		xx	0	0		xx	0	xx	OR
0	xx	xx		0	xx	0		0	0	xx	Optimal = $C_1R_3, C_2R_2$ & $C_3R_1$

(i.e.,  $C_1R_3$  and  $C_3R_3$  are zero after Row minimum and column minimum operation respectively)

or  $C_1R_3$  and  $C_3R_1$  are zero after Row minimum and column minimum operation respectively).

Test Series: March, 2016

**MOCK TEST PAPER – 2**

**FINAL COURSE: GROUP – II**

**PAPER – 6: INFORMATION SYSTEMS CONTROL & AUDIT**

*Question No. 1 is compulsory.*

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

**Time Allowed – 3 Hours**

**Maximum Marks – 100**

1. (a) (i) The company ABC intends to appoint an auditor for its investigation and present to its management. Discuss the various SEBI norms that the management would consider while selecting Auditor for its enterprise. (6 Marks)
- (ii) Furthermore, the company intends to utilize the services of a professional analyst to conduct a preliminary investigation and present a report on smooth implementation of the ideas of the new subsidiary. The analyst submitted the report suggesting the implementation of new system in place for which SDLC (System Development Life Cycle) was suggested. What are the possible advantages of SDLC from the perspective of Information Systems (IS) Audit? (6 Marks)
- (b) Discuss major techniques to commit cyber frauds. (8 Marks)
2. (a) Differentiate between Black Box Testing and White Box Testing. (6 Marks)
- (b) Differentiate between Emergency Plan and Test Plan. (6 Marks)
- (c) Discuss the maintenance tasks undertaken in the development of a Business Continuity Planning (BCP), in brief. (4 Marks)
3. (a) Discuss the issues relating to the performance of evidence collection and understanding the reliability of controls. (8 Marks)
- (b) Discuss major audit issues of Operational Layer with reference to application security audit. (8 Marks)
4. (a) Discuss, in brief, the major objectives to achieve the goals of Cloud Computing. (6 Marks)
- (b) Discuss the roles of “Steering Committee” and “Project Manager” with reference to System Development Life Cycle (SDLC). (6 Marks)
- (c) What do you understand by the term “Compensatory Controls”? (4 Marks)
5. (a) What do you understand by “Asynchronous Attacks”. Explain various forms of Asynchronous Attacks in brief. (6 Marks)

- (b) Discuss the components of "Internal Control". *(6 Marks)*
- (c) Discuss the benefits of Governance of Enterprise IT (GEIT). *(4 Marks)*
- 6. (a) Discuss "Programming Management Controls" under SDLC. *(6 Marks)*
- (b) Discuss some of the characteristics of an effective Management Information System (MIS). *(6 Marks)*
- (c) Discuss disadvantages/limitations of the use of the continuous audit system techniques. *(4 Marks)*
- 7. Write short notes on any **four** of the following:
  - (a) Benefits of Enterprise Resource Planning (ERP)
  - (b) Impact of Cyber Frauds in Enterprises
  - (c) [Section 72] Penalty for breach of confidentiality and privacy" in IT Amendment Act, 2000
  - (d) "Integrity" in Cloud Computing
  - (e) Weaknesses of Waterfall model *(4 × 4 = 16 Marks)*



**MOCK TEST PAPER – 2**

**FINAL COURSE: GROUP – II**

**PAPER – 6: INFORMATION SYSTEMS CONTROL & AUDIT**

**SUGGESTED ANSWERS/HINTS**

1. (a) (i) The SEBI norms for selection of Auditors are as follows:
- Auditor must have minimum 3 years of experience in IT audit of Securities Industry participants e.g. stock exchanges, clearing houses, depositories etc. The audit experience should have covered all the Major Areas mentioned under SEBI's Audit Terms of Reference (TOR).
  - The Auditor must have experience in/direct access to experienced resources in the areas covered under TOR. It is recommended that resources employed shall have relevant industry recognized certifications e.g. CISA (Certified Information Systems Auditor) from ISACA, CISM (Certified Information Securities Manager) from ISACA, GSNA (GIAC Systems and Network Auditor), CISSP (Certified Information Systems Security Professional) from International Information Systems Security Certification Consortium, commonly known as (ISC)<sup>2</sup>.
  - The Auditor should have IT audit/governance frameworks and processes conforming to industry leading practices like CoBIT.
  - The Auditor must not have any conflict of interest in conducting fair, objective and independent audit of the Exchange/Depository. It should not have been engaged over the last three years in any consulting engagement with any departments/units of the entity being audited.
  - The Auditor may not have any cases pending against its previous auditees, which fall under SEBI's jurisdiction, which point to its incompetence and/or unsuitability to perform the audit task.
- (ii) From the perspective of the IS Audit, the following are the possible advantages of System Development Life Cycle (SDLC):
- The IS auditor can have clear understanding of various phases of the SDLC on the basis of the detailed documentation created during each phase of the SDLC.
  - The IS Auditor on the basis of his/her examination, can state in his/her report about the compliance by the IS management of the procedures, if any, set by the management.

- The IS Auditor, if has a technical knowledge and ability of different areas of SDLC, can be a guide during the various phases of SDLC.
- The IS auditor can provide an evaluation of the methods and techniques used through the various development phases of the SDLC.

(b) Following are the major techniques to commit cyber frauds:

- **Hacking:** It refers to unauthorized access and use of computer systems, usually by means of personal computer and a telecommunication network. Normally, hackers do not intend to cause any damage.
- **Cracking:** Crackers are hackers with malicious intentions, which means, unauthorized entry. Now across the world hacking is a general term, with two nomenclatures namely: Ethical and Un-ethical hacking. Un-ethical hacking is classified as Cracking.
- **Data Diddling:** Changing data before, during, or after it is entered into the system in order to delete, alter, or add key system data is referred as data diddling.
- **Data Leakage:** It refers to the unauthorized copying of company data such as computer files.
- **Denial of Service (DoS) Attack:** It refers to an action or series of actions that prevents access to a software system by its intended/authorized users; causes the delay of its time-critical operations; or prevents any part of the system from functioning.
- **Internet Terrorism:** It refers to the using Internet to disrupt electronic commerce and to destroy company and individual communications.
- **Logic Time Bombs:** These are the program that lies idle until some specified circumstances or a particular time triggers it. Once triggered, the bomb sabotages the system by destroying programs, data or both.
- **Masquerading or Impersonation:** In this case, perpetrator gains access to the system by pretending to be an authorized user.
- **Password Cracking:** Intruder penetrates a system's defense, steals the file containing valid passwords, decrypts them and then uses them to gain access to system resources such as programs, files and data.
- **Piggybacking:** It refers to the tapping into a telecommunication line and latching on to a legitimate user before s/he logs into the system.
- **Round Down:** Computer rounds down all interest calculations to 2 decimal places. Remaining fraction is placed in account controlled by perpetrator.

- **Scavenging or Dumpster Diving:** It refers to the gaining access to confidential information by searching corporate records.
  - **Social Engineering Techniques:** In this case, perpetrator tricks an employee into giving out the information needed to get into the system.
  - **Super Zapping:** It refers to the unauthorized use of special system programs to bypass regular system controls and performs illegal acts.
  - **Trap Door:** In this technique, perpetrator enters in the system using a back door that bypasses normal system controls and perpetrates fraud.
2. (a) **Black Box Testing:** Black Box Testing takes an external perspective of the test object, to derive test cases. These tests can be functional or non-functional, though usually functional. The test designer selects typical inputs including simple, extreme, valid and invalid input-cases and executes to uncover errors. There is no knowledge of the test object's internal structure.

This method of test design is applicable to all levels of software testing i.e. unit, integration, functional testing, system and acceptance. The higher the level, hence the bigger and more complex the box, the more one is forced to use black box testing to simplify. While this method can uncover unimplemented parts of the specification, one cannot be sure that all existent paths are tested. If a module performs a function, which is not supposed to, the black box test does not identify it.

**White Box Testing:** It uses an internal perspective of the system to design test cases based on internal structure. It requires programming skills to identify all paths through the software. The tester chooses test case inputs to exercise paths through the code and determines the appropriate outputs. Since the tests are based on the actual implementation, if the implementation changes, the tests probably will need to change, too. It is applicable at the unit, integration and system levels of the testing process; it is typically applied to the unit. While it normally tests paths within a unit, it can also test paths between units during integration, and between subsystems during a system level test. After obtaining a clear picture of the internal workings of a product, tests can be conducted to ensure that the internal operation of the product conforms to specifications and all the internal components are adequately exercised.

- (b) **Emergency Plan:** The Emergency Plan specifies the actions to be undertaken immediately when a disaster occurs. Management must identify those situations that require the plan to be invoked e.g., major fire, major structural damage, and terrorist attack. The actions to be initiated can vary depending on the nature of the disaster that occurs. If an enterprise undertakes a comprehensive security review program, the threat identification and exposure analysis phases involve identifying those situations that require the emergency plan to be invoked.

When the situations that evoke the plan have been identified, four aspects of the emergency plan must be articulated. First, the plan must show 'who is to be notified immediately when the disaster occurs - management, police, fire department, medicos, and so on'. Second, the plan must show actions to be undertaken, such as shutdown of equipment, removal of files, and termination of power. Third, any evacuation procedures required must be specified. Fourth, return procedures (e.g., conditions that must be met before the site is considered safe) must be designated. In all cases, the personnel responsible for the actions must be identified, and the protocols to be followed must be specified clearly.

**Test Plan:** The purpose of the Test Plan is to identify deficiencies in the emergency, backup, or recovery plans or in the preparedness of an organization and its personnel for facing a disaster. It must enable a range of disasters to be simulated and specify the criteria by which the emergency, backup, and recovery plans can be deemed satisfactory. Periodically, test plans must be invoked. Unfortunately, top managers are often unwilling to carry out a test because daily operations are disrupted. They also fear a real disaster could arise as a result of the test procedures.

To facilitate testing, a phased approach can be adopted. First, the disaster recovery plan can be tested by desk checking and inspection and walkthroughs, much like the validation procedures adopted for programs. Next, a disaster can be simulated at a convenient time-for example, during a slow period in the day. Anyone, who will be affected by the test (e.g. personnel and customers) also might be given prior notice of the test so they are prepared. Finally, disasters could be simulated without warning at any time. These are the acid tests of the organization's ability to recover from a catastrophe.

- (c) The maintenance tasks undertaken in development of Business Continuity Planning (BCP) are to:
- Determine the ownership and responsibility for maintaining the various BCP strategies within the enterprise;
  - Identify the BCP maintenance triggers to ensure that any organizational, operational, and structural changes are communicated to the personnel who are accountable for ensuring that the plan remains up-to-date;
  - Determine the maintenance regime to ensure the plan remains up-to-date;
  - Determine the maintenance processes to update the plan; and
  - Implement version control procedures to ensure that the plan is maintained up-to-date.

3. (a) The performance of evidence collection and understanding the reliability of controls involves issues like-

- **Data retention and storage:** A client's storage capabilities may restrict the amount of historical data that can be retained "on-line" and readily accessible to the auditor. If the client has insufficient data retention capacities, the auditor may not be able to review a whole reporting period transactions on the computer system. For example, the client's computer system may save data on detachable storage device by summarising transactions into monthly, weekly or period end balances.
- **Absence of input documents:** Transaction data may be entered into the computer directly without the presence of supporting documentation e.g. input of telephone orders into a telesales system. The increasing use of EDI will result in less paperwork being available for audit examination.
- **Non-availability of audit trail:** The audit trails in some computer systems may exist for only a short period of time. The absence of an audit trail will make the auditor's job very difficult and may call for an audit approach which involves auditing around the computer system by seeking other sources of evidence to provide assurance that the computer input has been correctly processed and output.
- **Lack of availability of printed output:** The results of transaction processing may not produce a hard copy form of output, i.e. a printed record. In the absence of physical output, it may be necessary for an auditor to directly access the electronic data retained on the client's computer. This is normally achieved by having the client provide a computer terminal and being granted "read" access to the required data files.
- **Audit evidence:** Certain transactions may be generated automatically by the computer system. For example, a fixed asset system may automatically calculate depreciation on assets at the end of each calendar month. The depreciation charge may be automatically transferred (journalised) from the fixed assets register to the depreciation account and hence to the client's income and expenditure account.
- **Legal issues:** The use of computers to carry out trading activities is also increasing. More organisations in both the public and private sector intend to make use of EDI and electronic trading over the Internet. This can create problems with contracts, e.g. when is the contract made, where is it made (legal jurisdiction), what are the terms of the contract and are the parties to the contract.

The admissibility of the evidence provided by a client's computer system may need special consideration. The laws regarding the admissibility of computer

evidence varies from one country to another. Within a country laws may even vary between one state and another. If the auditor intends to gather evidence for use in a court, s(he) should firstly find out what the local or national laws stipulate on the subject.

In addition, the admissibility of evidence may vary from one court to another. What is applicable in a civil court may not be applicable in a criminal court.

(b) **Operational Layer:** The operational layer audit issues include the following:

- **User Accounts and Access Rights:** This includes defining unique user accounts and providing them access rights appropriate to their roles and responsibilities. Auditor needs to always ensure the use of unique user IDs, and these need to be traceable to individual for whom created. In case, guest IDs are used then test of same should also be there. Likewise, vendor accounts and third-party accounts should be reviewed. In essence, users and applications should be uniquely identifiable.
- **Password Controls:** In general, password strength, password minimum length, password age, password non-repetition and automated lockout after three attempts should be set as a minimum. Auditor needs to check whether there are applications where password controls are weak. In case such instances are found, then auditor may look for compensating controls against such issues.
- **Segregation of Duties:** As frauds due to collusions / lack of segregations increase across the world, importance of the Segregation of Duties also increases. As defined earlier, Segregation of duties is a basic internal control that prevents or detects errors and irregularities by assigning to separate individuals' responsibility for initiating and recording transactions and custody of assets to separate individuals. Example to illustrate:
  - Record keeper of asset must not be asset keeper.
  - Cashier who creates a cash voucher in system, must not have right to authorize payments.
  - Maker must not be checker.

Auditor needs to check that there is no violation of above principle. Any violation may have serious repercussions, the same need to be immediately communicated to those charged with governance.

4. (a) Some of the pertinent objectives in order to achieve the goals of Cloud Computing are as follows:
- To create a highly efficient IT ecosystem, where resources are pooled together and costs are aligned with what resources are actually used;

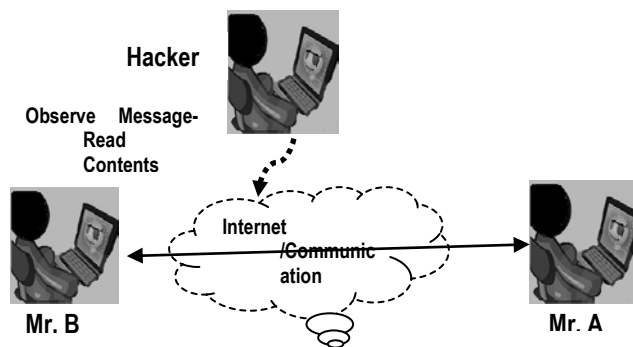
- To access services and data from anywhere at any time;
  - To scale the IT ecosystem quickly, easily and cost-effectively based on the evolving business needs;
  - To consolidate IT infrastructure into a more integrated and manageable environment;
  - To reduce costs related to IT energy/power consumption;
  - To enable or improve "Anywhere Access" (AA) for ever increasing users; and
  - To enable rapid provision of resources as needed.
- (b) Steering Committee is a special high power committee of experts to accord approvals for go-ahead and implementations. Some of the functions of Steering Committee involved in SDLC are as follows:
- To provide overall directions and ensures appropriate representation of affected parties;
  - To be responsible for all cost and timetables;
  - To conduct a regular review of progress of the project in the meetings of steering committee, which may involve co-ordination and advisory functions; and
  - To undertake corrective actions like rescheduling, re-staffing, change in the project objectives and need for redesigning.

**Role of Project Manager in SDLC:** A project manager is normally responsible for more than one project and liaising with the client or the affected functions. S/he is responsible for delivery of the project deliverables within the time/budget and periodically reviews the progress of the project with the project leader and his/her team.

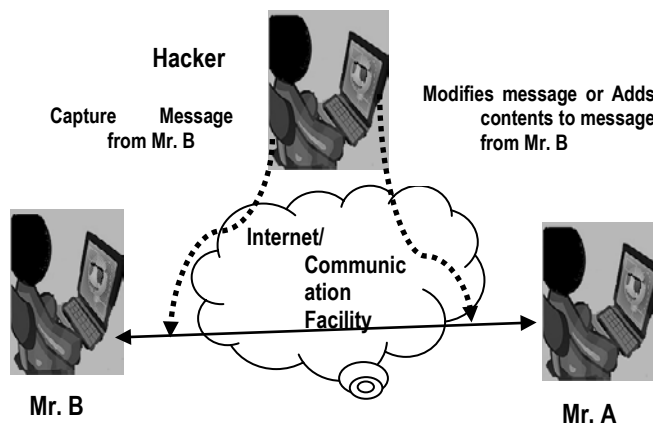
- (c) **Compensatory Controls:** Controls are basically designed to reduce the probability of threats, which can exploit the vulnerabilities of an asset and cause a loss to that asset. While designing the appropriate control one thing should be kept in mind - "The cost of the lock should not be more 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.
5. (a) **Asynchronous Attacks:** They occur in many environments where data can be moved asynchronously across telecommunication lines. Numerous transmissions must wait for the clearance of the line before data being transmitted. Data that is

waiting to be transmitted are liable to unauthorized access called asynchronous attack. These attacks are hard to detect because they are usually very small pin like insertions. There are many forms of asynchronous attacks; some of them are as follows:

- **Data Leakage:** Data is a critical resource for an organization to function effectively. Data leakage involves leaking information out of the computer by means of dumping files to paper or stealing computer reports and tape.
- **Wire-tapping:** This involves spying on information being transmitted over telecommunication network as shown in the Fig below.



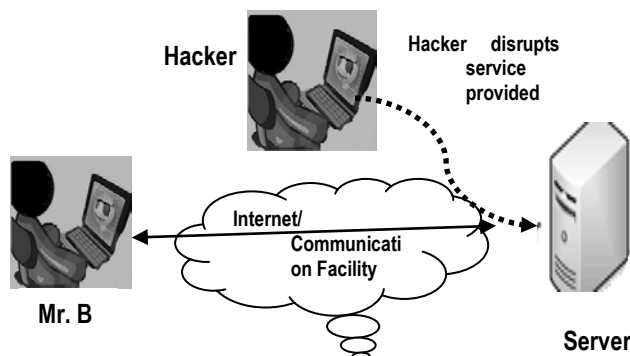
- **Piggybacking:** This is the act of following an authorized person through a secured door or electronically attaching to an authorized telecommunication link that intercepts and alters transmissions. This involves intercepting communication between the operating system and the user and modifying them or substituting new messages. A special terminal is tapped into the communication for this purpose as shown in the Fig. below.



- **Shutting Down of the Computer/Denial of Service:** This is initiated through terminals or microcomputers that are directly or indirectly connected to the



computer. Individuals, who know the high-level systems log on-ID initiate shutting down process. The security measure will function effectively if there are appropriate access controls on the logging on through a telecommunication network. When overloading happens some systems have been proved to be vulnerable to shutting themselves. Hackers use this technique to shut down computer systems over the Internet, as shown in the Fig. below.



(b) Internal controls comprise of the following five interrelated components:

- **Control Environment:** Elements that establish the control context in which specific accounting systems and control procedures must operate. The control environment is manifested in management's operating style, the ways authority and responsibility are assigned, the functional method of the audit committee, the methods used to plan and monitor performance and so on.
- **Risk Assessment:** Elements that identify and analyze the risks faced by an organisation and the way the risk can be managed. Both external and internal auditors are concerned with errors or irregularities that cause material losses to an organisation.
- **Control Activities:** Elements that operate to ensure transactions are authorized, duties are segregated, adequate documents and records are maintained, assets and records are safeguarded, and independent checks on performance and valuation of records. These are called accounting controls. Internal auditors are also concerned with administrative controls to achieve effectiveness and efficiency objectives.
- **Information and Communication:** Elements, in which information is identified, captured and exchanged in a timely and appropriate form to allow personnel to discharge their responsibilities.
- **Monitoring:** Elements that ensure internal controls operate reliably over time. The best internal controls are worthless if the company does not monitor them and make changes when they are not working.

- (c) The benefits of Governance of Enterprise IT (GEIT) are as follows:
- It provides a consistent approach integrated and aligned with the enterprise governance approach.
  - It ensures that IT-related decisions are made in line with the enterprise's strategies and objectives.
  - It ensures that IT-related processes are overseen effectively and transparently.
  - It confirms compliance with legal and regulatory requirements.
  - It ensures that the governance requirements for board members are met.

6. (a) **Programming Management Controls:** Program development and implementation is a major phase within the systems development life cycle. The primary objectives of this phase are to produce or acquire and to implement high-quality programs. The program development life cycle comprises six major phases – Planning; Design; Control; Coding; Testing; and Operation and Maintenance with Control phase running in parallel for all other phases as shown in the Table below. The purpose of the control phase during software development or acquisition is to monitor progress against plan and to ensure software released for production use is authentic, accurate, and complete.

**Phases of Program Development Life Cycle**

Phase	Controls
<b>Planning</b>	Techniques like Work Breakdown Structures (WBS), Gantt Charts and PERT (Program Evaluation and Review Technique) Charts can be used to monitor progress against plan.
<b>Design</b>	A systematic approach to program design, such as any of the structured design approaches or object-oriented design is adopted.
<b>Coding</b>	Programmers must choose a module implementation and integration strategy (like Top-down, Bottom-up and Threads approach), a coding strategy (that follows the precepts of structured programming), and a documentation strategy (to ensure program code is easily readable and understandable).
<b>Testing</b>	Unit Testing, Integration Testing and Whole-of-Program Testing are undertaken in this. These tests are to ensure that a developed or acquired program achieves its specified requirements.
<b>Operation and Maintenance</b>	Management establishes formal mechanisms to monitor the status of operational programs so maintenance needs can be identified on a timely basis.

(b) Major characteristic of an effective Management Information System (MIS) are as follows:

- **Management Oriented** – It means that efforts for the development of the information system should start from an appraisal of management needs and overall business objectives. Such a system is not necessarily for top management only but may also meet the information requirements of middle level or operating levels of management as well.
- **Management Directed** – Because of management orientation of MIS, it is necessary that management should actively direct the system's development efforts. For system's effectiveness, it is necessary for management to devote their sufficient time not only at the stage of designing the system but for its review as well to ensure that the implemented system meets the specifications of the designed system.
- **Integrated** – The best approach for developing information systems is the integrated approach as all the functional and operational information sub-systems are tied together into one entity. An integrated Information system has the capability of generating more meaningful information to management as it takes a comprehensive view or a complete look at the interlocking sub-systems that operate within a company.
- **Common Data Flows** – It means the use of common input, processing and output procedures and media whenever required. Data is captured by the system analysts only once and as close to its original source as possible. Afterwards, they try to utilize a minimum of data processing procedures and sub-systems to process the data and strive to minimize the number of output documents and reports produced by the system. This eliminates duplication in data collections, simplifies operations and produces an efficient information system.
- **Heavy Planning Element** – An MIS usually takes one to three years and sometimes even longer period to get established firmly within a company. Therefore, a MIS designer must be present in MIS development and should consider future enterprise objectives and requirements of information as per the organization structure of the enterprise as per requirements.
- **Sub System Concept** – Even though the information system is viewed as a single entity, it must be broken down into digestible sub-systems, which can be implemented one at a time by developing a phased plan. The breaking down of MIS into meaningful sub-systems sets the stage for this phasing plan.
- **Common Database** – Database is the mortar that holds the functional systems together. It is defined as a "super-file", which consolidates and integrates data records formerly stored in many separate data files. The organization of a

database allows it to be accessed by several information sub-systems and thus, eliminates the necessity of duplication in data storage, updating, deletion and protection.

- **Computerized** - Though MIS can be implemented without using a computer; the use of computers increases the effectiveness of the system. In fact, its use equips the system to handle a wide variety of applications by providing their information requirements quickly. Other necessary attributes of the computer to MIS are accuracy and consistency in processing data and reduction in clerical staff. These attributes make computer a prime requirement in management information system.

(c) The following are some of the disadvantages/limitations of the use of the continuous audit system:

- Auditors should be able to obtain resources required from the organization to support development, implementation, operation, and maintenance of continuous audit techniques.
- Continuous audit techniques are more likely to be used if auditors are involved in the development work associated with a new application system.
- Auditors need the knowledge and experience of working with computer systems to be able to use continuous audit techniques effectively and efficiently.
- Continuous auditing techniques are more likely to be used where the audit trail is less visible and the costs of errors and irregularities are high.
- Continuous audit techniques are unlikely to be effective unless they are implemented in an application system that is relatively stable.

7. (a) 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.
- (b) The impact of cyber frauds on enterprises can be viewed under the following dimensions:
- **Financial Loss:** Cyber frauds lead to actual cash loss to target company/organization. For example, wrongfully withdrawal of money from bank accounts.
  - **Legal Repercussions:** Entities hit by cyber frauds are caught in legal liabilities to their customers. Section 43A of the Information Technology Act, 2000, fixes liability for companies/organizations having secured data of customers. These entities need to ensure that such data is well protected. In case a fraudster breaks into such database, it adds to the liability of entities.
  - **Loss of credibility or Competitive Edge:** News that an organizations database has been hit by fraudsters, leads to loss of competitive advantage. This also leads to lose credibility. There have been instances where share prices of such companies went down, as the news of such attach percolated to the market.
  - **Disclosure of Confidential, Sensitive or Embarrassing Information:** Cyber-attack may expose critical information in public domain. For example, the instances of individuals leaking information about governments secret programs.
  - **Sabotage:** The above situation may lead to misuse of such information by enemy country.
- (c) **[Section 72] Penalty for breach of confidentiality and privacy** Save as otherwise provided in this Act or any other law for the time being in force, any person who, in pursuance of any of the powers conferred under this Act, rules or regulations made thereunder, has secured access to any electronic record, book, register, correspondence, information, document or other material without the consent of the person concerned discloses such electronic record, book, register, correspondence, information, document or other material to any other person shall be punished with imprisonment for a term which may extend to two years, or with fine which may extend to one lakh rupees, or with both.

- (d) **Integrity in Cloud Computing:** Integrity refers to the prevention of unauthorized modification of data and it ensures that data is of high quality, correct, consistent and accessible. After moving the data to the cloud, owner hopes that their data and applications are secure. It should be insured that the data is not changed after being moved to the cloud. It is important to verify if one's data has been tampered with or deleted. Strong data integrity is the basis of all the service models such as Software as a Service (SaaS), Platform as a Service (PaaS) and Infrastructure as a Service (IaaS). Methods like digital signature, Redundant Array of Independent Disks (RAID) strategies etc. are some ways to preserve integrity in Cloud computing. The most direct way to enforce the integrity control is to employ cryptographic hash function. For example, a solution is developed as underlying data structure using hash tree for authenticated network storage.
- (e) Weaknesses of Waterfall Model are as follows:
- It is criticized to be inflexible, slow, costly, and cumbersome due to significant structure and tight controls.
  - Project progresses forward, with only slight movement backward.
  - There is a little to iterate, which may be essential in situations.
  - It depends upon early identification and specification of requirements, even if the users may not be able to clearly define 'what they need early in the project'.
  - Requirement inconsistencies, missing system components and unexpected development needs are often discovered during design and coding.
  - Problems are often not discovered until system testing.
  - System performance cannot be tested until the system is almost fully coded, and under capacity may be difficult to correct.
  - It is difficult to respond to changes, which may occur later in the life cycle, and if undertaken it proves costly and are thus discouraged.
  - It leads to excessive documentation, whose updation to assure integrity is an uphill task and often time-consuming.
  - Written specifications are often difficult for users to read and thoroughly appreciate.
  - It promotes the gap between users and developers with clear vision of responsibility.

Test Series: March, 2016

**MOCK TEST PAPER – 2**  
**FINAL COURSE: GROUP – II**  
**PAPER – 7: DIRECT TAX LAWS**  
**Question No. 1 is compulsory.**

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

**Time Allowed – 3 Hours**

**Maximum Marks – 100**

1. (a) Sheetal Textile Ltd., is engaged in the manufacture of textile fabrics, provides below the following information in respect of the items of Plant and Machinery purchased for the year ended 31-3-2016.

	(Rs. in crores)
<u>Items of Plant &amp; Machinery purchased after 30th December 2015:</u>	
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
<u>Other items of Plant &amp; Machinery:</u>	
New machinery installed on 1-5-2015	84
New Windmill purchased and installed on 19-7-2015.	22

The new imported machinery arrived at Mumbai 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.

You are required to compute the quantum of depreciation available under section 32 of the Income-tax Act, 1961 and any other benefit available to Sheetal Textile Ltd in respect of the above items of Plant & Machinery for the year ended 31.3.2016.

Also, compute the WDV of the various blocks of assets.

Will your answer be different if the above assessee is a partnership firm? (12 Marks)

- (b) Compute the tax liability, if any, for the assessment year 2016-17, of a public charitable trust, created under a trust deed for providing relief to disabled persons, registered under section 12AA, from the following particulars of its receipts during the year ended 31st March, 2016 -

	<b>Particulars</b>	<b>Rs. (in Lacs)</b>
(i)	Income from properties held by trust (net)	20
(ii)	Voluntary contributions from public (including the corpus donation of Rs. 6 Lacs)	11
(iii)	Income (net) from business (incidental to main objects)	17

The trust applied Rs. 20 lacs towards various activities and programmes undertaken for the benefit of autistic persons during the year. The trust has also paid Rs.10 lacs towards repayment of a loan taken a year back for the purpose of construction of its centre for training the disabled persons in various handicraft works.  
(8 Marks)

2. For the assessment year 2016-17, you are required to compute the total income of M/s. Lotus, a firm, consisting of three partners namely, Mr. Lalit, Mr. Mohan and Mr. Naresh, carried on the business of purchase and sale of refrigerators in wholesale and manufacture and sale of pencils under a deed of partnership executed on 1.4.2011. Mr. Lalit, Mr. Mohan and Mr. Naresh were partners in their individual capacity.

The deed of partnership provided for payment of salary amounting to Rs. 1,25,000 each to Mr. Lalit and Mr. Naresh, who were the working partners. A new deed of partnership was executed on 1.10.2015 which, apart from providing for payment of salary to the two working partners as mentioned in the deed of partnership executed on 1.4.2011, for the first time provided for payment of simple interest @ 12% per annum on the balances standing to the credit of the Capital accounts of partners from 1.4.2015.

The firm was dissolved on 31.3.2016 and the capital assets of the firm were distributed among the partners on 20.4.2016. The net profit of the firm for the year ended 31.3.2016 after payment of salary to the working partners and debit/credit of the following items to the Profit and Loss Account was Rs. 1,50,000:

- (i) Interest amounting to Rs. 1,00,000 paid to the partners on the balances standing to the credit of their capital accounts from 1.4.2015 to 31.3.2016
- (ii) Interest amounting to Rs. 50,000 paid to the partners on the balances standing to the credit of their Current accounts from 1.4.2015 to 31.3.2016
- (iii) Interest amounting to Rs. 20,000 paid to the Hindu undivided family of partner Mr. Lalit @ 18% per annum.
- (iv) Payment of Rs. 25,000 towards purchase of refrigerators made by crossed cheque on 1.11.2015.
- (v) Rs. 30,000 being the value of gold jewellery received as gift from a manufacturer for achieving sales target.



- (vi) Depreciation amounting to Rs. 15,000 on motor car bought and used exclusively for business purposes, but not registered in the name of the firm.
- (vii) Depreciation under section 32(1)(ii) amounting to Rs. 37,500 of new machinery bought and installed for manufacture of pencils on 1.11.2015 at a cost of Rs. 5,00,000.
- (viii) Interest amounting to Rs. 25,000 received from bank on fixed deposits made out of surplus funds.

The firm furnishes the following information relating to it:

- (a) Closing stock-in-trade was valued at Rs. 60,000 as per the method of lower of cost or net realizable value consistently followed by it. The net realizable value of the closing stock-in-trade was Rs. 65,000.
  - (b) Brought forward business loss relating to the assessment year 2015-16 was Rs. 50,000.
  - (c) The fair market value of the capital assets as on 31.3.2016 was Rs. 20,00,000 and the cost of their acquisition was Rs. 15,00,000. (16 Marks)
3. (a) Stalwart Ltd., a French company has a subsidiary, IND Ltd. in India. Stalwart Ltd. sells computer monitors to IND Ltd. for resale in India. Stalwart Ltd. also sells computer monitors to FMP Ltd., another computer reseller. It sells 50,000 computer monitors to IND. Ltd. at Rs. 11,000 per unit. The price fixed for FMP Ltd. is Rs. 10,000 per unit. The warranty in case of sale of monitors by IND Ltd. is handled by IND Ltd. However, for sale of monitors by FMP Ltd., Stalwart Ltd. is responsible for the warranty for 3 months. Both Stalwart Ltd. and IND Ltd. offer extended warranty at a standard rate of Rs. 1,000 per annum. On these facts, how is the assessment of IND Ltd. going to be affected? (5 Marks)
- (b) Mr. Malik held 17% equity shares in Aqua Ltd., a private limited company. He gifted all the shares held by him in Aqua Ltd., to his wife Mrs. Malik on 18/5/2015. The transfer was made without adequate consideration. On 1/8/2015, Mrs. Malik obtained a loan of Rs. 80,000 from Aqua Ltd., when the company's accumulated profit was Rs. 50,000. What are the tax implications of the above transactions? (5 Marks)
- (c) From the following particulars, compute the gross total income of Mr. Anshul for the assessment year 2016-17:
- (i) Mr. Sumit transferred his residential house to Mr. Anshul for Rs.10 lakh on 1.4.2015. The value of the said house as per stamp valuation authority was Rs.18 lakhs. Mr. Anshul is a childhood friend of Mr. Sumit.
  - (ii) Land of Mr. Anshul was acquired by railways in 2013. On 20/11/2015, he received Rs.1,70,000 as interest on enhanced compensation on the order of court.

- (iii) On a fixed deposit of Rs. 10 lakhs, in a bank, Mr. Anshul received an interest of Rs.90,000. He had also borrowed Rs. 50 lakhs from the same bank, on security of the fixed deposit and was liable to pay Rs.50,000 by way of interest to the bank. He, therefore, offered the difference between the two amounts i.e. Rs. 40,000 as "Income from Other Sources". (6 Marks)
4. (a) Ravi owns a residential house which is self-occupied and also a residential plot. He sells the house on 28.2.2016 and the residential plot on 4.3.2016 for Rs.13 lacs and Rs.10 lacs, respectively. The house was purchased on 17.10.2000 for Rs.4.5 lacs and the plot on 13.12.1999 for Rs.3 lacs. Ravi has purchased a new residential house on 3.5.2016 for Rs.7 lacs. Compute the income chargeable under the head "Capital Gain" for the A.Y. 2016-17. Cost inflation indices for the financial year 1999-2000, 2000-2001 and 2015-16 are 389, 406 and 1081, respectively. (4 Marks)
- (b) Can the following transactions be covered under section 43B for disallowance?
- (i) A bank guarantee given by a company towards disputed tax liabilities.
- (ii) Interest payable to Sales Tax Department but not paid before the due date specified in section 139(1). (4 Marks)
- (c) Saraf Limited acquired a machine on 1st April, 2015 for Rs. 10 crores by availing 70% loan facility from a bank. The machine was put to regular use from 31st January, 2016. Interest on loan is charged at 12% per annum.
- Advise Saraf Limited on the treatment of interest payment made on this loan and depreciation allowable for A.Y. 2016-17. Assume that this machine is the only machine in the said block of assets. (4 Marks)
- (d) The following are the particulars of income of three investment funds for P.Y.2015-16:

Particulars	Rs. in lakh		
	Cell	Chip	Cubical
Business Income		2	(2)
Capital Gains	16	14	(6)
Income from other sources	4	4	8

Compute the total income of the investment funds and unit-holders for A.Y.2016-17, assuming that:

- (i) each investment fund has 20 unit holders each having one unit; and
- (ii) income from investment in the investment fund is the only income of the unit-holder.

If Investment Fund Cubical has the following income components for A.Y.2017-18, what would be the total income of the fund for that year?

Business Income Rs.2 lakh

Capital Gains Rs.9 lakh

Income from other source Rs.8 lakh

(4 Marks)

5. (a) Mandeep, the owner of a land situated in Punjab used for growing thereon different types of fruits, paddy, vegetables and flowers, received from Indiatimes Movies Ltd., Amritsar, Rs.5 lacs as rent towards the use of this land for shooting of a film. The amount so received was accounted by him in the books as revenue derived from land and claimed to be exempt under section 10(1). He now wants to confirm from you whether the amount has been correctly treated by him as agricultural income.

(4 Marks)

- (b) The concept of Permanent Establishment is one of the most important concepts in determining the tax implications of cross border transactions. Explain the significance thereof, when such transactions are governed by Double Taxation Avoidance Agreements (DTAA).

(4 Marks)

- (c) The Assessing Officer has served a notice proposing to levy penalty under section 271(1)(c) of the Income-tax Act, 1961, as the variation of income assessed to income returned and also the tax effect was more than thirty percent. The addition arose consequent to the disallowance of claim of assessee relating to certain exemption. The assessee wants to reply to the effect that there was no *mens rea* or conscious act of concealment on his part and that the claim made was bonafide, the levy of penalty under section 271(1)(c) is not valid. You are requested to help the assessee in this regard in drafting a suitable reply.

(4 Marks)

- (d) The premises of Shivam were subjected to a search under section 132 of the Act. The search was authorized and the warrant was signed by the Joint Commissioner of Income-tax having jurisdiction over the assessee. The assessee challenged the validity of search, since section 132(1) does not empower Joint Commissioner to authorise a search under the Act. Decide the correctness of the contention raised by the assessee.

(4 Marks)

6. (a) An enterprise engaged in manufacturing of Aluminum wires discontinued its activities and decided to lease out its factory building, plant and machinery and furniture from 1.4.2015 on a consolidated lease rent of Rs.50,000 per month. Compute the income for Assessment Year 2016-17 of the assessee from following information:

	Rs.
(i) Interest received on deposits	1,00,000
(ii) Brokerage paid on hundi loan taken	2,000
(iii) Factory licence fees paid for the year	1,000

- |   |                  |
|---|------------------|
| (iv) Interest paid on hundi and other loans which were given as deposits on interest to others  | 75,000           |
| (v) Expenses incurred on repairs of building, plant and machinery   | 15,000           |
| (vi) Fire insurance premium of plant and machinery and furniture  | 12,000           |
| (vii) Depreciation for the year   | 1,47,500         |
| (viii) Legal fees paid to an advocate for drafting and registering the lease agreement  | 1,500            |
| (ix) Interest paid includes an amount of Rs. 25,000 remitted to a non-resident outside India on which tax was not deducted at source. |                  |
| (x) There is unabsorbed depreciation of Rs. 2,75,000 of the Assessment Years 2014-15 and 2015-16.                                     | <i>(6 Marks)</i> |
- (b) Compute the deduction available to Mr. Himanshu, employed with XYZ Ltd., under Chapter VI-A for A.Y.2016-17 from the following particulars of investments and payments made by him during the previous year 2015-16:
- Deposited Rs.1,20,000 in public provident fund
  - Paid life insurance premium of Rs.15,000 on the policy taken on 1.5.2012 to insure his life (Sum assured – Rs.1,20,000).
  - Deposited Rs.30,000 in a five year term deposit with bank.
  - Contributed Rs.1,80,000, being 15% of his salary, to the NPS of the Central Government. A matching contribution was made by XYZ Ltd. *(6 Marks)*
- (c) Dishant received a notice under section 148 from the Assessing Officer for A.Y. 2012-13 on the ground that depreciation on certain assets was allowed in excess. The Assessing Officer recorded the reason for reopening. The original assessment was completed under section 143(3). In course of reassessment proceeding, the Assessing Officer also disallowed certain sum under section 14A in respect of expenses purported to be in relation to dividend from companies and tax-free interest. However, the Assessing Officer did not record the reason for applying the provisions of section 147 in respect of the issue of disallowance under section 14A and passed the order disallowing the excess depreciation and also certain sum under section 14A. Is there any infirmity in the order passed by the Assessing Officer? *(4 Marks)*
7. (a) Discuss the correctness or otherwise of the following propositions in the context of the Income-tax Act, 1961:
- (i) The powers of the Commissioner of Income-tax (Appeals) to enhance the assessment are plenary and quite wide.
  - (ii) A High Court does not have an inherent power to review an earlier order passed by it on merits. *(6 Marks)*

- (b) Butter Cocoa Co. of UK entered into contracts with three Indian companies namely XYZ Ltd., Goodday Co. Ltd. and Bakers Ltd. for supplying know-how. Butter Cocoa Co. made an application to the Authority for Advance Rulings (AAR) on the rate of withholding tax on receipts applicable to it.

Also, Bakers Ltd. also made an application to the Assessing Officer for determination of the rate at which tax is deductible on the payment made to non-resident company i.e., Butter Cocoa Co.

The Authority for Advance Rulings (AAR) rejected the application of Butter Cocoa Co. on the ground that the question raised in the application is already pending before an Income-tax authority.

Explain whether the rejection of application by the AAR is justified in law?

*(6 Marks)*

- (c) "Air Pacific Ltd." has paid a sum of Rs.12 lakhs during the year ended 31-3-2016 to Airports Authority of India towards landing and parking charges. The company has deducted tax at source@2% under section 194C on the said payment and remitted the tax deducted within the prescribed time. The Assessing Officer contended that landing and parking charges were levied for use of the land of the airport and hence, the payment was in the nature of rent attracting TDS@10% under section 194-I. Discuss the correctness or otherwise of the contention of the Assessing Officer.

*(4 Marks)*

**MOCK TEST PAPER – 2**  
**FINAL COURSE: 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)]	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 depreciation @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	<u>4.00</u>	<u>4.00</u>
	<u>7.00</u>	<u>4.00</u>
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	<u>2.00</u>	<u>2.00</u>
	<u>3.00</u>	<u>2.00</u>
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	22.00	22.00

19.07.2015		
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%
	<b>(Rs. in crores)</b>		
WDV as on 01.04.2015 (The company was started during the year only – as given in question)	Nil	Nil	
<i>Add:</i> 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 <u>12.00</u>	103.00	-	
- New Windmill purchased and installed on 19.7.2015	-	-	22.00
- Computers installed in office premises	-	1.00	-
- Computers installed in factory	-	<u>2.00</u>	-
	<u>103.00</u>	3.00	22.00
<i>Less:</i> Asset sold during the year	<u>Nil</u>	<u>Nil</u>	<u>Nil</u>
WDV as on 31.3.2016 (before charging depreciation)	103.00	3.00	22.00
<i>Less:</i> Depreciation for the P.Y.2015-16			
- Normal depreciation	13.13	0.90	17.60
- Additional depreciation	<u>17.20</u>	<u>0.20</u>	<u>4.40</u>
<b>WDV as on 1.4.2016</b>	<b><u>72.67</u></b>	<b><u>1.90</u></b>	<b><u>0.00</u></b>

### Computation of deduction under section 32AC for the A.Y. 2016-17

(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 19.07.2015	-
- Fork-lift trucks, used inside factory	4.00
- Computers installed in factory	<u>2.00</u>
	<b><u>90.00</u></b>
15% of Rs. 90 crore, being aggregate investment in new plant and machinery acquired and installed during the P.Y.2015-16	13.50

If the assessee is a partnership firm instead of a company

Yes, the answer would be different in respect of deduction under section 32AC, since this deduction is available only to an assessee, being a company engaged in the business of manufacture or production of any article or thing. Therefore, a partnership firm would not be eligible for deduction under section 32AC.

However, depreciation and additional depreciation computed under section 32(1)(ii) and 32(1)(iia), respectively, and the written down of the block of assets would remain the same, even if the assessee is a firm.

#### 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)(ia):
- Lorries for transporting goods to sales depots, being vehicles/road transport vehicles; and
  - 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 depreciation under section 32(1)(ia) 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)].

(b) **Computation of total income of the trust for the A.Y. 2016-17**

Particulars	Rs.	Rs.
Income from properties held by trust	20,00,000	
Income from business incidental to the main objects of the trust	17,00,000	
Voluntary Contribution other than corpus donation ( <b>Note 1</b> )	5,00,000	42,00,000
Less: 15% of income accumulated or set apart under section 11(1)(a)		6,45,000
		35,55,000
<b>Less: Amount applied for charitable purposes</b>		
Activities and programmes for the benefit of autistic persons	20,00,000	
Repayment of loan taken for construction of training centre ( <b>Note 2</b> )	10,00,000	30,00,000
<b>Taxable Income</b>		<b>5,55,000</b>

**Computation of tax liability of the trust for the A.Y. 2016-17**

Particulars	Rs.	Rs.
Upto Rs. 2,50,000	Nil	
Rs. 2,50,000 – Rs. 5,00,000	25,000	

Rs. 5,00,000 – Rs. 5,55,000	11,000	36,000
Add: Education cess @ 2%		720
Add: Secondary and higher education cess @ 1%		360
<b>Total tax liability</b>		<b>37,080</b>

**Notes:**

- (1) Section 11(1)(d) excludes from the total income of the person, any income in the form of voluntary contributions made with a specific direction that they shall form part of the corpus of the trust or institution.
- (2) In *CIT vs. Janmabhoomi Press Trust (2000) 242 ITR 703*, the Karnataka High Court held that where a debt is incurred for the purpose of the trust, the repayment of the debt would amount to an application of the income for the purpose of the trust. Therefore, repayment of loan taken for construction of training centre for disabled persons is to be considered as application for charitable purpose.

**2. Computation of total income of M/s. Lotus for the A.Y. 2016-17**

Particulars	Rs.	Rs.
Net profit as per profit & loss account		1,50,000
Add: Interest to partners on capital accounts for the period from 1.4.2015 to 30.9.2015 (Rs. 1,00,000 but deduction limited to 6 months only hence 50% thereof is deductible and the balance is added) <b>[Note (i)]</b>	50,000	
Interest to partners on current accounts from 1.4.2015 to 31.3.2016—not authorized by the deed, hence disallowed <b>[Note (ii)]</b> .	50,000	
100% of Rs. 25,000 paid towards purchase of refrigerator otherwise than by way of account payee cheque (being stock in trade, hence disallowed) <b>[Note (iv)]</b> .	25,000	
Difference on account of valuation of closing stock-in-trade at market value (Rs. 65,000 less Rs. 60,000) <b>[Note (ix)]</b>	5,000	
Salary paid to working partners considered separately.	2,50,000	3,80,000
		5,30,000
Less: Additional depreciation on new machinery (Rs. 5,00,000 x 20%) = Rs. 1,00,000. Only 50% is allowable as deduction. <b>[Note (vii)]</b>		50,000
		4,80,000
Less: Interest received from bank on fixed deposits		

considered separately		25,000
		4,55,000
Less: Salary to working partners -		
(i) As per limit in section 40(b)		
On first Rs. 3,00,000 @ 90%	2,70,000	
On the balance of Rs. 1,55,000 @ 60%	93,000	
	3,63,000	
(ii) Salary actually paid	2,50,000	
Deduction allowed being (i) or (ii) whichever is less		2,50,000
		2,05,000
Less: Business loss relating to assessment year 2015-16 set off		50,000
<b>Income from business</b>		<b>1,55,000</b>
<b>Income from other sources</b>		
Interest received from bank on fixed deposits		25,000
<b>Gross Total Income</b>		<b>1,80,000</b>

#### Explanation for the treatment of various items

- (i) Interest to partners authorised by the partnership deed will be allowed as deduction only for the period beginning with the date of the partnership deed and not for any earlier period as per section 40(b)(iv). Therefore, interest paid to the partners on the balances standing to the credit of their capital accounts from 1.10.2015 alone is eligible for deduction, since the partnership deed was executed only on 1.10.2015. Interest for the period prior to 1.10.2015 is not allowed.
- (ii) The partnership deed of 1.10.2015 provides for payment of interest on balances in capital accounts of partners only. As such, the interest paid on the balances standing to the credit of the current accounts of partners is not allowable under section 40(b). The Kerala High Court has, in *Novel Distributing Enterprises v. DCIT (2001) 251 ITR 704 (Ker)*, on identical facts, held that interest paid to the partners on their current account balances is not allowable.
- (iii) Since Mr. Lalit is a partner in his individual capacity, interest paid to the Hindu Undivided Family of partner Mr. Lalit does not attract disallowance under section 40(b)(iv).
- (iv) Section 40A(3) provides for disallowances @ 100% of the expenditure incurred otherwise than by an account payee cheque/account payee bank draft. Since the firm has made payment of Rs. 25,000 towards purchase of refrigerators by a

crossed cheque and not by an account payee cheque, 100% of such expenditure would be disallowed.

- (v) Gold jewellery valued at Rs. 30,000 received as gift from a manufacturer for achieving sales target is taxable under section 28(iv), being a benefit arising from business.
  - (vi) Depreciation on motor car bought and used exclusively for the purposes of business is allowable though not registered in the name of the firm in view of the ratio of the decision of the Supreme Court in *Mysore Minerals Ltd. v. CIT (1999) 239 ITR 775*.
  - (vii) The firm is entitled to additional depreciation @ 20% under section 32(1)(ia) in respect of the new machinery installed for manufacture of pencils. Since the new machinery is put to use for less than 180 days during the relevant previous year, the additional depreciation is restricted to 50% of the prescribed rate of 20% i.e. it is restricted to 10%. The balance additional depreciation can be claimed in the immediately succeeding financial year.
  - (viii) Interest received from bank on fixed deposits made out of surplus funds is assessable under the head 'Income from other sources'. Hence, it is not taken into account for the purpose of computing book-profit.
  - (ix) As per para 24 of ICDS II : Valuation of Inventories, closing stock has to be valued at net realizable value in the case of a dissolved firm. As such, the closing stock-in-trade of the firm has to be valued at the net realizable value.
  - (x) Net profit shown in the profit and loss account computed in the manner laid down in Chapter IV-D as increased by the aggregate amount of the remuneration paid or payable to all the partners constitutes book profit as per *Explanation 3* to section 40(b). Carry forward and set off of business loss is covered under Chapter VI. Hence, brought forward business loss relating to the assessment year 2015-16 is not considered for calculation of book-profit.
  - (xi) Section 45(4) is not applicable to the firm for the assessment year 2016-17, though the dissolution of the firm took place on 31.3.2016, as there was no transfer by way of distribution of capital assets during the relevant previous year. The distribution of the capital assets took place on 20.4.2016. The capital gains will, therefore, be assessable in the assessment year 2017-18.
- 3. (a)** Stalwart Ltd., the foreign company and IND Ltd., the Indian company are associated enterprises since Stalwart Ltd. is the holding company of IND Ltd. Stalwart Ltd. sells computer monitors to IND Ltd. for resale in India. Stalwart Ltd. also sells identical computer monitors to FMP Ltd., which is not an associated enterprise. The price charged by Stalwart Ltd. for a similar product transferred in comparable uncontrolled transaction is, therefore, identifiable. Therefore, Comparable Uncontrolled Price (CUP) method for determining arm's length price can be applied.

While applying CUP method, the price in comparable uncontrolled transaction needs to be adjusted to account for difference, if any, between the international transaction (i.e. transaction between Stalwart Ltd. and IND Ltd.) and uncontrolled transaction (i.e. transaction between Stalwart Ltd. and FMP Ltd.) and the price so adjusted shall be the arm's length price for the international transaction.

For sale of monitors by FMP Ltd., Stalwart Ltd. is responsible for warranty for 3 months. The price charged by Stalwart Ltd. to FMP Ltd. includes the charge for warranty for 3 months. Hence arm's length price for computer monitors being sold by Stalwart Ltd. to IND Ltd. would be:

Particulars	No. of units	Rs.
Sale price charged by Stalwart Ltd. to FMP Ltd.		10,000
Less: Cost of warranty included in the price charged to FMP Ltd. (Rs.1,000 x 3 /12)		250
<b>Arm's length price</b>		<b>9,750</b>
Actual price paid by IND Ltd. to Stalwart Ltd.		11,000
<b>Difference per unit</b>		<b>1,250</b>
No. of units supplied by Stalwart Ltd. to IND Ltd.	50,000	
Addition required to be made in the computation of total income of IND Ltd. (1,250 × 50,000)		6,25,00,000

No deduction under chapter VI-A would be allowable in respect of the enhanced income of Rs.6.25 crores.

**Note:** It is assumed that IND Ltd. has not entered into an advance pricing agreement or opted to be subject to Safe Harbour Rules.

- (b) Under section 2(22)(e), any payment by a closely-held company by way of loan or advance to its shareholder, being a person who is the beneficial owner of shares, holding not less than 10% of the voting power, is deemed as dividend to the extent to which the company possesses accumulated profits.

Therefore, in order to attract the deeming provisions under section 2(22)(e), the recipient of loan should be a registered shareholder as well as the beneficial owner of shares.

Accordingly, in this case, Rs.50,000 (i.e., loan to the extent of accumulated profits of Aqua Ltd.) would be deemed as dividend in the hands of Mrs. Malik, who holds 17% equity shares in Aqua Ltd., under section 2(22)(e).

Thereafter, the clubbing provisions under section 64(1)(iv) would be attracted, as per which, income as arises, directly or indirectly, from asset transferred to spouse,

otherwise than for adequate consideration, would be included in the hands of the transferor.

If the assets so transferred are shares in a company, the loan taken from the company is deemed as dividend income of the shareholder under section 2(22)(e) to the extent to which the company possesses accumulated profits. Thus, on account of this deeming provision, such loan is treated as income arising from the shares. It was so held by the Madras High Court in *CIT v. Vimalan (A.) (1975) 98 ITR 529*.

Accordingly, as per section 64(1)(iv), such income arising in the hands of the shareholder, Mrs. Malik, by virtue of section 2(22)(e) (i.e., deemed dividend of Rs. 50,000) would be included in the total income of Mr. Malik, who had transferred the said shares to Mrs. Malik without consideration.

**(c) Computation of gross total income of Mr. Anshul for the A.Y.2016-17**

Particulars		Rs.
<b>Income from Other Sources</b>		
(i)	Receipt of immovable property for inadequate consideration attracts the provisions of section 56(2)(vii). The difference between the stamp duty value (Rs. 18 lakhs) and the actual consideration (Rs. 10 lakhs) would be taxable.	8,00,000
(ii)	Interest on enhanced compensation amounting to Rs. 1,70,000 would be taxable under section 56(2)(viii) in the year of receipt. Deduction@50% is allowable under section 57(iv). Hence, the taxable interest is Rs. 85,000 (i.e., Rs. 1,70,000 – Rs. 85,000)	85,000
(iii)	Interest of Rs. 90,000 received on fixed deposit is income of Mr. Anshul. The interest of Rs. 50,000 on loan taken by Mr. Anshul from the same bank on security of the fixed deposit will not go to reduce the income by way of interest on fixed deposit [ <i>CIT v. D. V. Gopinathan (2001) 248 ITR 449</i> ].	90,000
<b>Gross Total Income</b>		<b>9,75,000</b>

**4. (a) Computation of Capital Gains of Ravi for the A.Y.2016-17**

Particulars		Rs.
<b>Sale of house on 28.2.2016</b>		
	Sale consideration received	13,00,000
	Less: Indexed cost of acquisition Rs. 4,50,000 x 1081/406	<u>11,98,153</u>
	Long term capital gain	1,01,847
	Less: Exemption under section 54 (lower of capital gains or	<u>1,01,847</u>

amount invested)	
<b>Taxable capital gain</b>	<b><u>Nil</u></b>
<b>Sale of house plot on 4.3.2016</b>	
Sale consideration received	10,00,000
Less: Indexed cost of acquisition Rs. 3,00,000 x 1081/389	<u>8,33,676</u>
Long term capital gain	1,66,324
Less: Exemption under section 54F	
Investment for the purpose of section 54F is Rs. 5,98,153 (i.e. Rs. 7,00,000 – Rs. 1,01,847), which is less than the net consideration on sale of plot. Therefore, only proportionate capital gain would be exempt under section 54F.	
[Capital gain × Amount invested / Net sale consideration] i.e., [Rs. 1,66,324 × Rs. 5,98,153 / Rs. 10,00,000]	<u>99,487</u>
<b>Taxable capital gain</b>	<b><u>66,837</u></b>

- (b) (i) For claiming deduction of any expense enumerated under section 43B, the requirement is, the actual payment and not deemed payment. Furnishing of bank guarantee cannot be equated with actual payment. Actual payment requires that money must flow from the assessee to the public exchequer as specified in section 43B. Therefore, deduction of an expense covered under section 43B cannot be claimed by merely furnishing a bank guarantee [*CIT v. McDowell & Co Ltd (2009) 314 ITR 167 (SC)*]

- (ii) Interest payable to Sales tax department is part of sales tax.

Therefore, interest payable to sales tax department, which is not paid before the “due date” of filing of return of income, would attract disallowance under section 43B [*Mewar Motors v. CIT (2003) 260 ITR 218 (Raj)*]

- (c) (i) **Interest on term loan for purchase of machinery:** As per section 36(1)(iii), interest paid in respect of capital borrowed for acquisition of an asset for a period beginning from the date of borrowal of loan for acquiring the asset till the date on which such asset is first put to use is not allowable as deduction but has to be capitalised by adding the same to the cost of the asset. Therefore, interest@12% p.a. for a period of 10 months from 1<sup>st</sup> April, 2015 to 31<sup>st</sup> January, 2016 on Rs. 7 crores, being the amount of loan, is to be capitalized.

Cost of machinery	10,00,00,000
Add: Interest [12% × 10/12 × Rs.7,00,00,000]	<u>70,00,000</u>
Actual Cost of machinery	<b><u>10,70,00,000</u></b>

Interest @12% for two months (February, 2016 & March, 2016) after the asset is put to use is allowable as deduction under section 36(1)(iii)  $[12\% \times 2/12 \times \text{Rs.}7,00,00,000]$  **14,00,000**

**(ii) Depreciation**

	Rs.
Since the machinery is put to use for less than 180 days in the previous year 2015-16, the depreciation would be restricted to 50% of the amount calculated at the prescribed percentage of 15%. Therefore, depreciation = $50\% \times [15\% \times \text{Rs.}10,70,00,000]$	80,25,000
Likewise, the additional depreciation would also be restricted to 50% of the amount calculated at the prescribed percentage of 20%, assuming that Saraf Ltd. is engaged in the manufacture or production of any article or thing and that the machinery acquired is a new machinery. Therefore, additional depreciation = $50\% \times [20\% \times \text{Rs.}10,70,00,000]$	<u>1,07,00,000</u>
	<b><u>1,87,25,000</u></b>

**Note:** The company shall not be entitled for investment allowance under section 32AC since the investment in plant and machinery does not exceed Rs.25 crores.

ICDS IX relating to borrowing costs in respect of assets also mandates capitalization from the date of borrowing and upto the date such asset is first put to use.

**(d) Computation of total income of the investment fund for A.Y.2016-17**

Particulars	Rs.		
	Cell	Chip	Cubical
Business Income	Nil	2,00,000	Nil
Total Income	Nil	2,00,000	Nil

**Computation of total income of a unit holder of the following investment funds for A.Y.2016-17**

Particulars	Rs.		
	Cell	Chip	Cubical
Capital Gains	80,000	70,000	-
Income from other sources	20,000	20,000	30,000
Total Income	1,00,000	90,000	30,000



**Notes:**

- (i) The total income of Investment Fund Chip would be chargeable to tax@30% if the fund is a company or firm and at the maximum marginal rate, in any other case.
- (ii) In case of Investment Fund Cubical, the business loss of Rs. 2 lakh is set-off against income from other sources of Rs. 8 lakh. Loss of Rs. 6 lakh under the head capital gains cannot be set-off. The same has to be carried forward by the Investment Fund for set-off in the subsequent years.
- (iii) For A.Y.2017-18, the brought forward capital loss of Rs. 6 lakh can be set-off against capital gains of Rs. 9 lakh. Business income of Rs. 2 lakh would be taxable in the hands of the Investment Fund.

Capital gains of Rs. 3 lakh (Rs. 9 lakh – Rs.6 lakh) and Income from other sources of Rs. 8 lakh would be taxable in the hands of the unit-holders. The total income of each unit holder for A.Y.2017-18 would be Rs. 55,000, comprising of –

Capital gains = Rs.15,000 [i.e., Rs. 3 lakh/20]

Income from other sources = Rs. 40,000 [i.e., Rs. 8 lakh / 20]

5. (a) The income received by Mr. Mandeep from a filmmaker for allowing them to shoot a film in the agricultural land owned by him is not in the nature of agricultural income because it was neither received by him against the sale of agricultural produce obtained nor for carrying out the normal agricultural operations on the land. The amount paid was only for the purpose of shooting of a film on such land.

To claim exemption for agricultural income under section 10(1), the conditions contained in section 2(1A) (a) to (c) have to be first complied with/fulfilled by the assessee. The Madras High Court in the case of *B. Nagi Reddi v. CIT (2002) 258 ITR 719*, following the judgment of Apex Court in the case of *CIT v Raja Benoy Kumar Sahas Roy (1957) 32 ITR 466*, has held, on identical facts, that the income derived for allowing a shooting of film in the agricultural land cannot be treated as agricultural income, as it has no nexus with the land, except that it was carried out on agricultural land.

- (b) Double Taxation Avoidance Agreements (DTAAs) generally contain an Article providing that business income is taxable in the country of residence, unless the enterprise has a permanent establishment in the country of source, and such income can be attributed to the permanent establishment.

As per section 92F(iia), the term “Permanent Establishment” includes a fixed place of business through which the business of an enterprise is wholly or partly carried on.

As per this definition, to constitute a permanent establishment, there must be a place of business which is fixed and the business of the enterprise must be carried out wholly or partly through this place.

Section 9(1)(i) requires existence of business connection for deeming business income to accrue or arise in India. DTAA's however provide that business income is taxable only if there is a permanent establishment in India.

Therefore, in cases covered by DTAA's, where there is no permanent establishment in India, business income cannot be brought to tax due to existence of business connection as per section 9(1)(i).

However, in cases not covered by DTAA's, business income attributable to business connection is taxable.

- (c) The Supreme Court, in the case of *Union of India v. Dharmendra Textile Processors (2007) 295 ITR 244*, observed that the object behind the enactment of section 271(1)(c) read with the *Explanations* is to provide a remedy for loss of revenue. The penalty under that provision is a civil liability. The Supreme Court held that in cases related to imposition of penalty under section 271(1)(c), wilful concealment is not an essential ingredient for attracting civil liability as is the case in the matter of prosecution under section 276C.

Therefore, while considering an appeal against an order made under section 271(1)(c), what is required to be examined is the record which the officer imposing penalty had before him and if that record can sustain the finding that there has been concealment, that would be sufficient to sustain the penalty. Hence, there is no need for the revenue to prove that concealment was done by the assessee 'willfully' in order to impose penalty under section 271(1)(c).

Hence, it will not help the assessee to raise defence on the lines that there was no *mens rea*.

However, every addition to the income returned does not warrant levy of concealment penalty under section 271(1)(c). The addition should be consequent to an act of concealment or withholding a fact or furnishing of inaccurate particulars of income. Where the assessee has furnished all particulars and has claimed an exemption on an honest belief that he is entitled to the same, merely because the exemption is not allowable does not warrant levy of penalty under section 271(1)(c). This has been held so, in a number of decisions. In *CIT v. Reliance Petroproducts (P) Ltd. (2010) 322 ITR 158 (SC)*, it was held that merely making an incorrect claim which is not sustainable in law, by itself, cannot tantamount to furnishing inaccurate particulars regarding the income of the assessee.

The reply should be prepared on the above lines.

- (d) Under section 132(1), the income-tax authorities listed therein are empowered to authorise other income-tax authorities to conduct search and seizure operations. The authorities empowered to issue authorization include such Additional Director, Additional Commissioner, Joint Director and Joint Commissioner as are empowered by the CBDT to do so.

However, a Joint Commissioner can issue warrant of authorization only if he has been specifically empowered to do so by the CBDT. Therefore, if the Joint Commissioner has not been specifically empowered by the CBDT to do so, the contention of the assessee would hold good.

6. (a) The income derived from leased assets shall be chargeable to tax as 'Income from other sources' under section 56(2)(iii) but the computation thereof shall be made after allowing deductions specified under sections 30, 31 and 32 subject to section 38. This is as per the provisions of section 57(ii) and 57(iii).

**Computation of income under the head “Income from other sources”**

Particulars	Rs.	Rs.
(A) Lease Rent for 12 months @ Rs. 50,000 p.m.		6,00,000
Less: Expenses and deductions allowable under section 57(ii) & 57(iii):		
Repairs	15,000	
Fire Insurance Premium	12,000	
Legal expenses for drafting of lease agreement	1,500	
Factory Licence fee	1,000	
Depreciation for the year	1,47,500	
Unabsorbed depreciation of earlier assessment years – eligible for deduction ( <b>Note 1</b> )	<u>2,75,000</u>	<u>4,52,000</u>
		1,48,000
(B) Interest on Deposits	1,00,000	
Less: Expenses allowable under section 57(i)		
Brokerage Rs. 2,000		
Interest on hundi loans ( <b>Note 2</b> ) Rs. <u>50,000</u>	<u>52,000</u>	<u>48,000</u>
<b>Total Income</b>		<b><u>1,96,000</u></b>

**Note:**

1. Unabsorbed depreciation of Rs. 2,75,000 pertains to earlier assessment years. The unabsorbed depreciation shall form part of the current year depreciation and can be set off against any other head of income. Accordingly, the amount of Rs. 2,75,000 is adjustable / allowed to be set off against 'Income from other sources'.

2. Since deposits are made by investing amount received on hundi and other loans, the interest on hundi and other loans would be eligible for deduction from the income arising on such deposits.
3. Interest paid to non-resident is not eligible for deduction as the tax has not been deducted at source.

**(b) (i) Deduction available to Mr. Himanshu under Chapter VI-A for A.Y.2016-17**

Section	Particulars	Rs.	Rs.
80C	Deposit in public provident fund	1,20,000	
	Life insurance premium paid Rs.15,000 (deduction restricted to Rs.12,000, being 10% of Rs.1,20,000, being sum assured, since the policy was taken after 31.3.2012)	12,000	
	Five year term deposit with bank	30,000	
		1,62,000	
80CCD(1)	Restricted to Contribution to NPS of the Central Government, Rs.1,30,000 [Rs.1,80,000 – Rs.50,000, being deduction under section 80CCD(1B)], restricted to 10% of salary [Rs.1,80,000 x 10/15] <b>[See Note 1]</b>		1,50,000
			1,20,000
			2,70,000
80CCE	Aggregate deduction under section 80C and 80CCD(1), Rs.2,70,000, but restricted to		1,50,000
80CCD(1B)	Rs.50,000 would be eligible for deduction in respect of contribution to NPS of the Central Government		50,000
80CCD(2)	Employer contribution to NPS, restricted to 10% of salary <b>[See Note 2]</b>		1,20,000
<b>Deduction under Chapter VI-A</b>			<b>3,20,000</b>

**Notes:**

- (1) The deduction under section 80CCD(1B) would not be subject to overall limit of Rs.1.50 lakh under section 80CCE. Therefore, it is more beneficial for Mr. A to claim deduction under section 80CCD(1B) first in respect of contribution to NPS. Thereafter, the remaining amount of

Rs.1,30,000 can be claimed as deduction under section 80CCD(1), subject to a maximum of 10% of salary.

- (2) The entire employer's contribution to notified pension scheme has to be first included under the head "Salaries" while computing gross total income and thereafter, deduction under section 80CCD(2) would be allowed, subject to a maximum of 10% of salary.

- (c) *Explanation 3* to section 147 permits the Assessing Officer to assess or reassess the income in respect of any issue (which has escaped assessment) which comes to his notice subsequently in the course of proceedings under section 147, even though the reason for such issue does not form part of the reasons recorded under section 148(2).

Therefore, in the instant case, the Assessing Officer has the power to disallow expenses under section 14A in addition to disallowing excess depreciation for which notice under section 148 was issued even though the reason for issue relating to disallowance under section 14A was not recorded under section 148(2).

Hence, there is no deficiency in the order passed by the Assessing Officer.

7. (a) (i) The proposition is **correct** in law. The Supreme Court has, in *CIT vs. MFMPan & Co. (1958) 33 ITR 182* and *CIT vs. Kanpur Coal Syndicate (1964) 53 ITR 225*, held that in disposing of an appeal before him, the appellate authority can travel over a whole range of the assessment order. The scope of his powers is co-terminus with that of the Assessing Officer. He can do what the Assessing Officer can do and can also direct him to do, what he has failed to do. He can assess income from sources which have been considered by the Assessing Officer but not brought to tax. He can consider every aspect of the assessment order and give appropriate reliefs.

The Allahabad High Court has, in *CIT v. Kashi Nath Chandiwala (2006) 280 ITR 318*, held that the appellate authority is empowered to consider and decide any matter arising out of the proceedings in which the order appealed against was passed notwithstanding the fact that such matter was not raised before him by the assessee. The Commissioner (Appeals) is entitled to direct additions in respect of items of income not considered by the Assessing Officer.

Further, the Apex Court has, in the case of *Jute Corporation of India Ltd. vs. CIT (1991) 187 ITR 688*, held that the appellate authority is vested with all the plenary powers which the subordinate authority may have in the matter.

Thus, the powers of the Commissioner of Income-tax (Appeals) in enhancing the assessment are very wide and plenary.

- (ii) The proposition is **not correct** in law. The Supreme Court, in *CIT v. Meghalaya*

*Steels Ltd. (2015) 377 ITR 112*, observed that the power of review would inhere on High Courts, being courts of record under article 215 of the Constitution of India. There is nothing in article 226 of the Constitution to preclude a High Court from exercising the power of review which inheres in every court of plenary jurisdiction to prevent miscarriage of justice or to correct grave and palpable errors committed by it. The Supreme Court further observed that section 260A(7) does not purport in any manner to curtail or restrict the application of the provisions of the Code of Civil Procedure. Section 260A(7) only states that all the provisions that would apply qua appeals in the Code of Civil Procedure would apply to appeals under section 260A. The Supreme Court opined that this does not in any manner suggest either that the other provisions of the Code of Civil Procedure are necessarily excluded or that the High Court's inherent jurisdiction is in any manner affected.

- (b) The matter relates to the admission or rejection of the application filed before the Authority for Advance Rulings on the ground specified in clause (i) of the first proviso to section 245R(2). The said clause provides that the Authority shall not allow the application where the question raised in the application is already pending before any income-tax authority or Appellate Tribunal or any court.

In this case, no application had been filed or contention urged by the applicant foreign company, namely Butter Cocoa Co., before any income-tax authority/Appellate Tribunal/court, raising the question raised in the application filed with AAR. However, one of the Indian companies, namely, Bakers Ltd., had raised the question before the Assessing Officer, not on the applicant's behalf or with a view to benefit the applicant, but only to safeguard its own interest, as it had a statutory duty to deduct the proper amount of tax from payments made to the foreign company. Although the question raised pertains to one of the payments made or to be made to the non-resident applicant, it was not one pending determination before any income-tax authority in the applicant's case.

Therefore, as held in *Ericsson Telephone Corporation India AB v. CIT (1997) 224 ITR 203 (AAR)*, the application filed by the Indian company, Bakers Ltd., before the Assessing Officer cannot be treated to have been filed by the foreign company, Butter Cocoa Co.

Hence, the rejection of the application of Butter Cocoa Co. by the AAR on the ground that the question raised in the application is already pending before an income-tax authority is not justified.

- (c) The issue as to whether the charges fixed by the Airport Authority of India (AAI) for landing and take-off facilities and parking facility for the aircraft are for the "use of the land" by the airline company came up before the Supreme Court in *Japan Airlines Co. Ltd. v. CIT / CIT v. Singapore Airlines Ltd. (2015) 377 ITR 372*.

The Supreme Court observed that the charges which are fixed by the AAI for landing and take-off services as well as for parking of aircrafts are not for the "use of the land". These charges are for services and facilities offered in connection with the aircraft operation at the airport which include providing of air traffic services, ground safety services, aeronautical communication facilities, installation and maintenance of navigational aids and meteorological services at the airport.

There are various international protocols which mandate all authorities manning and managing these airports to construct the airport of desired standards which are stipulated in the protocols. The services which are required to be provided by these authorities, like AAI, are aimed at passengers' safety as well as for safe landing and parking of the aircrafts. Therefore, the services are not restricted to merely permitting "use of the land" of airport. On the contrary, it encompasses all the facilities that are to be compulsorily offered by the AAI in tune with the requirements of the protocol.

The Supreme Court observed that the charges levied on air-traffic includes landing charges, lighting charges, approach and aerodrome control charges, aircraft parking charges, aerobridge charges, hangar charges, passenger service charges, cargo charges, etc. Thus, when the airlines pay for these charges, treating such charges as charges for "use of the land" would tantamount to adopting a totally simplistic approach which is far away from the reality.

The Supreme Court opined that the substance behind such charges has to be considered and when the issue is viewed from this angle, keeping the larger picture in mind, it becomes very clear that the charges are not for use of the land *per se* and, therefore, it cannot be treated as "rent" within the meaning of section 194-I. The Supreme Court, thus, concurred with the view taken by the Madras High Court in *Singapore Airlines* case and overruled the view taken by the Delhi High Court in *United Airlines/Japan Airlines* case.

Applying the rationale of the Supreme Court ruling to the facts of this case, the contention of the Assessing Officer that landing and parking charges are levied for use of the land of airport and hence, the charges are in the nature of rent to attract the provisions of tax deduction at source under section 194-I is **not** correct.

Test Series: March, 2016

**MOCK TEST PAPER – 2**  
**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) XYZ Ltd. is engaged in the manufacture of both excisable and non-excisable goods in a factory building rented by them from October 1, 2014. From the following particulars for the period October 1, 2014 to March 31, 2015, state briefly with suitable explanations, whether XYZ Ltd. could claim the benefit of exemption in terms of *Notification No. 8/2003-CE dated 01.03.2003* for the financial year 2015-16:

		Rs. (in lakhs)
(i)	Clearances of excisable goods bearing brand name of MNO Ltd.	60
(ii)	Export sales of excisable goods to Nepal	80
(iii)	Export sales to USA and Canada	120
(iv)	Clearances of goods (duty paid based on Annual capacity of production under section 3A of the Central Excise Act, 1944)	70
(v)	Clearances of goods subject to valuation based on retail sale price under section 4A of the Central Excise Act, 1944 (the said goods are cleared at MRP and are eligible for 30% abatement)	200
(vi)	Job work under Notification No. 214/86-CE dated 25-3-86	60

During the period April 1, 2014 to September 30, 2014, the previous tenant of the factory building presently occupied by XYZ Ltd. had cleared excisable goods of the aggregate value of Rs. 120 lakh. (5 Marks)

- (b) Ashoka Pvt. Ltd. commenced its business on 15<sup>th</sup> October, 20XX in Delhi. It has provided following services upto 31<sup>st</sup> March of the next year. Determine its service tax liability for the said financial year from the information given below:



S. No.	Particulars	(Rs.)*
(i)	Services provided by way of plastering of walls	8,00,000
(ii)	Service provided in the execution of a works contract for construction of a new building	13,50,000

\*representing the total amount charged for the works contract

Excise duty of Rs. 1,50,000 has been paid on the inputs used for provision of aforesaid services [provided under a brand name owned by Ashoka Pvt. Ltd.].

Apart from the aforesaid services, Ashoka Pvt. Ltd. has also provided the taxable services worth Rs. 4,00,000 (not in the nature of works contract) under brand name of other person – not eligible for any abatement. Excise duty of Rs. 40,000 has been paid on the inputs used for provision of these services. Rate of service tax is 14%.

Note: Ashoka Pvt. Ltd. cannot determine the value of works contract services provided by it in terms of rule 2A(i) of the Service Tax (Determination of Value) Rules, 2006. (10 Marks)

- (c) Sugam Corporation Limited imported some goods from US. The details of the transaction are as follows:-

Authority	Rate of exchange
CBEC	1 US \$=Rs. 62
RBI	1 US \$=Rs. 61

CIF value of the goods is \$ 1,50,000

Rate of basic custom duty is 10%

Rate of education cess is 2%

Rate of secondary and higher education cess is 1%

If similar goods were manufactured in India, excise duty payable as per Tariff is 12.5%. Additional duty of customs leviable under section 3(5) of the Customs Tariff Act is exempt.

Calculate assessable value and total duty payable thereon. (5 Marks)

2. (a) Swipe Engineers Ltd. removed goods from their factory at Delhi on 20.04.20XX for sale from their depot at Mumbai. On that date, the normal transaction value of goods at Delhi factory was Rs. 20,000 while the normal transaction value at Mumbai depot was Rs. 19,000. The rate of duty was 12.5% ad-valorem. The said goods were sold from Mumbai depot on 15.05.20XX. On that date, the normal transaction value at Mumbai depot was Rs. 22,000 and rate of duty was 16%. M/s. Swipe Engineers Ltd. paid the duty on Rs. 20,000 at the rate of 12.5%.

The Central Excise Department claimed that central excise duty should be levied @ 16% on the value of Rs. 22,000.

Examine whether Department's claim is correct. (4 Marks)

- (b) Compute in each of the following independent cases, the taxable value of services provided by an authorized dealer in foreign exchange to its customers. Show working notes as may be required.
- (i) 2500 US \$ are sold by Mr. X to the 'Yummy Cook', an authorized dealer @ Rs. 62.50 per US \$. The RBI reference rate is Rs. 63.00 for that day.
- (ii) Rs. 80,00,000 is changed into Canadian \$ and the exchange rate offered is Rs. 50 per Canadian \$. RBI reference rate for conversion of INR into Canadian \$ is not available.
- (iii) Mr. Exchange gets 1,00,000 Euro converted into 5,00,000 Dirham. RBI reference rate is 1 Euro = Rs. 70 and 1 Dirham = Rs. 16, for that day. (8 Marks)
- (c) With reference to section 9A(1A) of the Customs Tariff Act, 1975, mention the ways that constitute circumvention of antidumping duty imposed on an article which may warrant action by the Central Government. (4 Marks)
3. (a) Whether production of mustard oil and oil cake from mustard seeds amounts to manufacture? You are required to examine the situation with the help of a decided case law. (4 Marks)
- (b) Sohan Lal is engaged in the activity of preparation of a place for organizing event or function by way of erection/laying of pandal and shamiana. He is of the view that service tax is not leviable on his activity as it is a transaction involving "transfer of right to use goods" and hence, is a deemed sale.
- Examine whether the contention of Sohan Lal is valid in law. (8 Marks)
- (c) M/s. Chander Exports, an EOU, is purchasing electricity generated by the captive power plant of its sister unit. The furnace oil required for running the captive power plant was imported by the assessee (M/s. Chander Exports) and supplied to sister unit for generation of electricity. The assessee claimed exemption on import of furnace oil under the relevant exemption notification.

The assessee had sought a clarification from the Development Commissioner seeking as to whether import of furnace oil and receipt of electricity would be liable to duty. The Development Commissioner replied in favour of the assessee and thereafter, the assessee claimed the exemption.

A show cause notice demanding duty was issued on the assessee invoking extended period of limitation of 5 years on grounds that the entitlement of duty free

import of fuel for its captive power plant lies with the owner of the captive power plant, and not with the consumer of electricity generated from that power plant.

Is the action of the Department in invoking the extended period of limitation justified in light of the provisions of the Customs Act, 1962? Discuss with the help of a decided case law. *(4 Marks)*

4. (a) Records seized by Department during investigation but not relied upon in the show cause notice should be returned within 30 days of issue of show cause notice. Explain the validity of the said statement with reference to the Central Excise Law, as amended. *(4 Marks)*
- (b) Discuss, in brief, whether the following payments constitute a consideration for provision of service:
- (1) Imposition of fine or penalty for breaking of law.
  - (2) Advance forfeited for cancellation of an agreement to provide a service.
  - (3) Security deposits forfeited for damages caused by service receiver in the course of receiving a service.
  - (4) Demurrages payable for use of service beyond the period initially agreed upon: e.g. retention of containers beyond the normal period. *(8 Marks)*
- (c) 'Ocean King', a vessel containing the goods imported by PQR Ltd. entered the Indian Territorial waters on 24.05.20XX. It arrived at the customs port on 26.05.20XX and the Import Manifest was submitted on 29.05.20XX. However, the entry inwards was given to the vessel on 04.06.20XX. An 'Into Bond' Bill of Entry was presented by PQR Ltd. on 06.06.20XX and thus, the goods were classified, valued and stored in the bonded warehouse.

PQR Ltd. presented the 'Ex-Bond' Bill of Entry in respect of such goods on 01.07.20XX and cleared the goods from the bonded warehouse on 05.07.20XX. The rate of customs duty was increased from 8% to 10% on 04.07.20XX.

At what rate should PQR Ltd. pay the customs duty on the goods imported by it?

*(4 Marks)*

5. (a) ST & Co. deposits the required amount of Rs. 1,00,000 as pre-deposit under section 35F of the Central Excise Act, 1944 on 30-09-20XX and files an appeal before the CESTAT. The said appeal is decided in favour of ST & Co. on 30-11-20XX. ST & Co. forwards a letter seeking refund of pre-deposit on 7-12-20XX and the same was refunded on 15-12-20XX. Explain whether ST & Co. is entitled to payment of interest on refund of such pre deposit and compute the amount of interest payable. *(4 Marks)*
- (b) Mona Limited entered into a contract with Meena Limited for construction of a new building to be used primarily for the purpose of commerce or industry for a total

consideration of Rs. 500 lakh on May 01, 20XX. The said services fall within the purview of 'works contract services'. The initial booking amount of Rs. 100 lakh was billed and received on the date of contract itself.

It was further agreed that Rs. 170 lakh, Rs. 140 lakh, Rs. 90 lakh respectively would be received on completion of 50%, 75% and 100% of the construction work of the building. Determine the point of taxation in respect of each of following stages of completion with the help of relevant details furnished as under:

Stage	% of completion of the building	Date of completion	Date of issuance of invoice	Date of payment of stipulated amount
I	50%	June 20, 20XX	June 30, 20XX	August 25, 20XX
II	75%	July 30, 20XX	September 25, 20XX	August 30, 20XX
III	100%	September 25, 20XX	October 03, 20XX	October 01, 20XX

A certificate from Chartered Engineer registered with Institution of Engineers has been obtained for each stage of completion of the building.

Give brief reasons for your answer. (8 Marks)

- (c) M/s. CIB imports copper concentrate from different suppliers. At the time of import, the seller issues a provisional invoice and the goods are provisionally assessed under section 18 of the Customs Act, 1962 based on the invoice. When the final invoice is raised, based on the price prevalent in the London Metal Exchange on a predetermined date based on the covenant in the contract between the buyer and seller, the assessments are finalized on such invoices.

M/s CIB has filed a refund claim arising out of the finalization of the bill of entry by the authorities. The Department, however, has rejected the refund claim on the grounds of unjust enrichment. Discuss whether the action of the department is correct in law? (4 Marks)

6. (a) With reference to the provisions of Settlement Commission, explain the term 'case' as provided under section 31(c) of the Central Excise Act, 1944. (4 Marks)

Or

Write a brief note on "cancellation of export documents" with reference to rule 19 of the Central Excise Rules, 2002. (4 Marks)

- (b) Mention the procedure for obtaining electronic rebate of service tax paid on specified services used for the export of goods, through ICES system. (8 Marks)
- (c) Briefly explain the salient features of Special Economic Zones. (4 Marks)

7. (a) Can the Department file an appeal in respect of the same assessee if in respect of some years, no appeal was filed in matters involving identical dispute? Discuss with reference to the provisions of the Central Excise Act, 1944. (4 Marks)
- (b) Tough (P) Ltd., a service provider, has availed and utilized credit of excise duty without actual receipt of excisable goods. A personal penalty of Rs. 1,90,000 has been imposed on Mr. Pawan, Manager of Tough (P) Ltd. and Rs. 72,000 on Miss Saakshi, an officer of Tough (P) Ltd. who were in charge of, and were responsible to, Tough (P) Ltd. for the conduct of its business at the time of such availment and utilization of the credit.
- Discuss whether such penalty can be imposed on Mr. Pawan and Miss Saakshi under section 78A of Finance Act, 1994. Can penalty be imposed on manager or officer of a company in any other case? Explain. (8 Marks)
- (c) Differentiate between Advance Authorisation and DFIA (Duty Free Import Authorisation) (4 Marks)

**MOCK TEST PAPER – 2**  
**FINAL COURSE: GROUP – II**  
**PAPER – 8: INDIRECT TAX LAWS**  
**SUGGESTED ANSWERS / HINTS**

1. (a) Computation of value of clearances for home consumption in the financial year 2014-15

S.No.	Particulars	Rs. (in lakh)
(i)	Clearances of excisable goods bearing brand name of MNO Ltd. (Note-1)	Nil
(ii)	Export sales of excisable goods to Nepal (Note-1)	80
(iii)	Export sales to USA and Canada (Note-1)	Nil
(iv)	Clearances of goods on which duty has been paid under section 3A of the Central Excise Act	70
(v)	Clearances of goods subject to valuation under section 4A of the Central Excise Act (Note-2)	140
(vi)	Job work under <i>Notification No. 214/86-CE</i> (Note-1)	Nil
(vii)	Clearances of previous tenant of the building occupied by XYZ Ltd. (Note- 3)	<u>120</u>
	Total	<u>410</u>

**Notes:**

1. In order to claim the benefit of exemption under *Notification No. 8/2003 C.E. dated 01.03.2003* in a financial year, the total turnover of a unit should not exceed ₹ 400 lakh in the preceding financial year. *Notification No. 8/2003 C.E. dated 01.03.2003* provides that for the purpose of computing the turnover of Rs. 400 lakh:-
  - (a) clearances bearing the brand name or trade name of another person are excluded.
  - (b) export turnover is excluded. However, exports to Nepal and Bhutan are not excluded as these are treated as “clearance for home consumption”.
  - (c) clearances under specified job work notifications are excluded and *Notification No. 214/86 CE dated 25.03.86* is one of the specified notification.

2. In case of the goods subject to valuation under section 4A of the Central Excise Act, 1944, value for the purpose of the SSI exemption would mean value fixed under section 4A i.e., retail sale price less abatement. Hence, value of such clearances would be Rs. 200 lakh × 70% = Rs. 140 lakh.
3. For the purpose of computing the turnover of Rs. 400 lakh, all the clearances made by different manufacturers from the same factory are to be clubbed together. Hence, clearances, worth Rs. 120 lakh of previous tenant of the building occupied by XYZ Ltd. have been added.

**Conclusion:** Since the value of clearances for home consumption exceeds Rs. 400 lakh in the financial year 2014-15, XYZ Ltd. is not eligible to claim the benefit of exemption under *Notification No. 8/2003 – C.E. dated 01.03.2003* in the financial year 2015-16.

**(b) Computation of service tax liability of Ashoka Pvt. Ltd.**

Particulars	(Rs.)
<b>Services provided under the brand name owned by Ashoka Pvt. Ltd.</b>	
Services provided by way of plastering of walls [Note 1]	5,60,000
Services provided in the execution of works contract for construction of a new building [Note 2]	5,40,000
Total value of taxable services	11,00,000
Less: Exemption for small service providers [Note 4]	10,00,000
Value of taxable services liable to service tax	1,00,000
Service tax payable @ 14% [ $1,00,000 \times 14\%$ ] [Note 3] (A)	14,000
<b>Services provided under the brand name of other person</b>	
Value of taxable services provided under brand name of other person	4,00,000
Service tax payable @ 14% [ $4,00,000 \times 14\%$ ] [Note 4] (B)	56,000
Total service tax payable (A) + (B)	70,000
Less: CENVAT credit available [Note 5]	40,000
Service tax payable in cash	30,000

**Notes:**

1. Rule 2A(ii)(B)(ii) of the Service Tax (Determination of Value) Rules, 2006 provides that in case of works contracts entered into maintenance or repair or completion and finishing services such as glazing or plastering or floor and wall tiling or installation of electrical fittings of immovable property, service tax shall be payable on 70% of the total amount charged for the works contract.

Therefore, for plastering of walls, the value of service portion would be Rs. 5,60,000 [70% x Rs. 8,00,000].

2. As per Explanation 1(a)(i) to rule 2A of the Service Tax (Determination of Value) Rules, 2006, original works inter alia means all new constructions. Further, as per rule 2A(ii)(A), in case of works contracts entered into for execution of original works, service tax is payable on 40% of the total amount charged for the works contract. Therefore, for construction of new building, the value of service portion would be Rs. 5,40,000 [40% x Rs. 13,50,000].
3. As per Explanation 2 to rule 2A of Service Tax (Determination of Value) Rules, 2006, the provider of taxable service cannot take CENVAT credit of duties paid on any inputs, used in or in relation to the works contract, under the provisions of CENVAT Credit Rules, 2004. Hence, excise duty of Rs. 1,50,000 paid on inputs used for provision of works contract service under rule 2A(ii) of the Service Tax Valuation Rules cannot be availed.
4. Since Ashoka Pvt. Ltd. has commenced the business in the given financial year, its aggregate value of taxable services are nil in the preceding financial year. Thus, it is eligible for small service providers' (SSP) exemption in the given financial year. However, said exemption is not available in respect of taxable services provided under a brand name of another person [Notification No. 33/2012 ST dated 20.06.2012].
5. Since the services provided under brand name of other person are not in the nature of works contract, CENVAT credit of excise duty paid on inputs used for provision of such services can be availed.

Also, since SSP exemption is not available in respect of such services, there would not be any restriction for availment of CENVAT credit on inputs used in provision for such service [Notification No. 33/2012 ST dated 20.06.2012].

**(c) Computation of assessable value and total custom duty payable**

Particulars	Amount
CIF Value	\$ 1,50,000.00
Add : Landing charges @ 1% of CIF value (Note – 1)	\$ 1,500.00
	\$ 1,51,500.00
Assessable value (in Rs.) = \$1,51,500 × Rs. 62 (Note -2)	Rs. 93,93,000.00
Add: Basic custom duty @ 10% (Rs. 93,93,000 × 10%)	Rs. 9,39,300.00
	Rs. 1,03,32,300.00
Add: Additional duty leviable under section 3(1) of Customs Tariff Act (Rs. 1,03,32,300 × 12.5%)	Rs. 12,91,537.50



Education cess [(Rs. 9,39,300 + Rs. 12,91,537.50) × 2%]	Rs. 44,616.75
Secondary and Higher Education Cess [(Rs. 9,39,300 + Rs. 12,91,537.50) × 1%]	Rs. 22,308.38
Total custom duty payable (Rs. 9,39,300+ Rs. 12,91,537.50 +Rs. 44,616.75 + Rs. 22,308.38)	Rs. 22,97,762.63
Total custom duty payable (Rounded off)	Rs. 22,97,763

**Notes :-**

- (1) Landing charges at the rate of 1% of the CIF value of the imported goods, shall be added, whether ascertainable or not [First proviso to rule 10(2) of the Customs Valuation (Determination of Value of Imported Goods) Rules, 2007].
- (2) The applicable exchange rate is the rate notified by CBEC [Explanation to section 14(1) of the customs Act, 1962].

2. (a) The Department's claim is not correct in the instant case.

Rule 7 of the Central Excise (Determination of Price of Excisable Goods) Rules, 2000, *inter alia*, provides that where excisable goods are not sold at the factory gate but are transferred to a depot, the assessable value for the goods cleared from factory is the normal transaction value of such goods at the depot at or about the same time at which the goods as being valued are removed from the factory or warehouse.

In the given case, Rs. 20,000 represents value on 20.04.20XX (time of removal), but it is not the value prevalent at the depot. Similarly, Rs. 22,000 represents depot price, but then it is not the price prevalent on 20.04.20XX (time of removal).

The correct value to be adopted in this case is the depot price of such goods (normal transaction value) on 20.04.20XX i.e., Rs. 19,000.

Further, the applicable rate of duty shall be the rate of duty in force on the date when such goods are removed from the factory. Hence, the correct rate of duty will be 12.5% and not 16%.

- (b) (i) Value of taxable service = (RBI reference rate for US \$ – Selling rate for US \$) × Total units of US \$ [Rule 2B of the Service Tax (Determination of Value) Rules, 2006]

$$= \text{Rs. } (63-62.50) \times 2,500 = \text{Rs. } 1,250$$

- (ii) First proviso to rule 2B of the aforesaid rules provides that if the RBI reference rate for a currency is not available:

Value of taxable service = 1% of the gross amount of Indian Rupees provided/received by money changer

=1% of ₹ 80,00,000 = ₹ 80,000

- (iii) Second proviso to rule 2B of the aforesaid rules provides that in case neither of the currencies exchanged is Indian Rupee:

Value of taxable service = 1% of the lesser of the two amounts the money changer would have received by converting any of the two currencies into Indian Rupee at that time at the reference rate provided by RBI

Hence, in the given case, value of taxable service would be 1% of the lower of the following:-

(a) Euro 1,00,000 × ₹ 70 = ₹ 70,00,000

(b) Dirham 5,00,000 × ₹ 16 = ₹ 80,00,000

Value of taxable service = 1% of ₹ 70,00,000 = ₹ 70,000

- (c) As per section 9A(1A) of the Customs Tariff Act, 1975, following are the ways that would constitute circumvention (avoiding levy of duty by unscrupulous means) of antidumping duty imposed on an article that may warrant action by the Central Government:

- (i) altering the description or name or composition of the article subject to such anti-dumping duty,
- (ii) import of such article in an unassembled or disassembled form,
- (iii) changing the country of its origin or export, or
- (iv) any other manner, whereby the anti-dumping duty so imposed is rendered ineffective.

In such cases, investigation can be carried out by Central Government and then anti dumping can be imposed on such articles.

3. (a) The activity of producing mustard oil and oil cake from mustard seeds amounts to manufacture. This particular issue has been decided by the Supreme Court in the case of *Jai Bhagwan Oil and Floor Mills v. UOI 2009 (239) ELT 401 (SC)*. In the instant case, the Apex Court held that the true test to ascertain whether a process is a manufacturing process producing a new and distinct article is whether the article produced is regarded in the trade, by those who deal in it, as a marketable product distinct in identity from the commodity/raw material involved in the manufacture.

When mustard seeds were subjected to the process of extraction whereby mustard oil and oil cake were produced, the process involved manufacture of mustard oil as also the manufacture of oil cake. It was certainly not a mere process of cleaning, repairing, reconditioning, recycling or assembling. Oil cake had a distinct and different identity from mustard seeds and it had a separate name, character and use different from mustard seed. Oil cake was not a waste to be thrown away, but was

a valuable product with a distinct name, character, use and marketability. Resultantly, it can be concluded that the said process amounts to manufacture.

- (b) The issue that whether the activity of erection/laying of pandal and shamiana is a service or deemed sale involving transfer of right to use goods has been addressed in Board's *Circular No. 168/3/2013 ST dated 15.04.2013*. The Circular clarifies as under:
- (i) The activity of providing pandal and shamiana along with erection thereof is generally coupled with other incidental activities like supply of crockery, furniture, sound system, lighting arrangements, etc. It is a reasonably specialized job and is carried out by the supplier with the help of his own labour.
  - (ii) For a transaction to be regarded as "transfer of right to use goods", the transfer has to be coupled with effective control and possession. In the case of *Rashtriya Ispat Nigam Ltd. v. CTO 1990 77 STC 182*, the High Court held that since the effective control and possession was with the supplier, there is no transfer of right to use (upheld subsequently by Supreme Court in *2002 126 STC 0114*).
  - (iii) Further, in *Harbans Lal v. State of Haryana 1993 088 STC 0357*, the High Court held that if pandal, is given to the customers for use only after having been erected, then it is not transfer of right to use goods.
  - (iv) In the case of *BSNL v. UOI 2006 (2) S.T.R. 161 (S.C.)*, the Supreme Court held that to constitute the transaction for the transfer of the right to use the goods, the transaction must have the following attributes:-
    - (a) There must be goods available for delivery;
    - (b) There must be a consensus ad idem as to the identity of the goods;
    - (c) The transferee should have a legal right to use the goods and, consequently, all legal consequences of such use including any permissions or licenses required therefor should be available to the transferee;
    - (d) For the period during which the transferee has such legal right, it has to be the exclusion of the transferor: this is the necessary concomitant or the plain language of the statute, viz., a "transfer of the right to use" and not merely a license to use the goods :
    - (e) Having transferred the right to use the goods during the period for which it is to be transferred, the owner cannot again transfer the same right to others.
  - (v) Applying the ratio of these judgments and the test formulated by Supreme

Court in the case of *BSNL v. UOI*, the activity of providing *pandal* and *shamiana* along with erection thereof and other incidental activities do not amount to transfer of right to use goods because effective possession and control over the *pandal* or *shamiana* remains with the service provider, even after the erection is complete and the specially made-up space for temporary use handed over to the customer.

- (vi) Hence, services provided by way of erection of *pandal* or *shamiana* is a declared service, under section 66E(f) of Finance Act, 1994 and would attract service tax.

In the light of the above-mentioned Circular, the contention of Sohan Lal is not valid in law.

- (c) The facts of the given case are similar to the case of *Uniworth Textiles Ltd. vs. CCEx. 2013 (288) ELT 161 (SC)*, wherein the Supreme Court noted that section 28 of the Customs Act, 1962 clearly contemplates that for invoking extended period of limitation, the intention to deliberately default is a mandatory pre-requisite.

However, the assessee acted *bona fide* and claimed exemption by seeking clarification from the Development Commissioner. Hence, it could be inferred that assessee made efforts to adhere to the law rather than its breach.

The Apex Court held that mere non-payment of duties could not be equated with collusion or wilful misstatement or suppression of facts as then there would be no form of non-payment which would amount to ordinary default. Something more must be shown to construe the acts of the assessee as fit for applicability of extended period of limitation.

Therefore, in view of the above-mentioned ruling of the Supreme Court, the action of the Department of invoking extended period of limitation is not justified in the light of the provisions of the Customs Act, 1962.

4. (a) Yes, the statement is valid. As per rule 24 A of the Central Excise Rules, 2002, the books of accounts or other documents, seized by the Central Excise Officer or produced by an assessee or any other person, which have not been relied on for the issue of notice under the Act or the rules made thereunder, shall be returned within thirty days of the issue of said notice or within thirty days from the date of expiry of the period for issue of said notice:

Further, the Principal Commissioner of Central Excise or Commissioner of Central Excise, may order for the retention of such books of accounts or documents, for reasons to be recorded in writing and the Central Excise Officer shall intimate to the assessee or such person about such retention.

- (b) (1) No, since fine or penalty are legal consequences of a person's actions and are

not in the nature of consideration for an activity.

- (2) Yes, such forfeited advance represents consideration for the agreement that was entered into for provision of service.
  - (3) Yes. Since forfeited security deposits are for damages caused by the service receiver in course of receiving the service and not for accidental damages due to unforeseen actions, they relate to provision of service and thus, would constitute a consideration for provision of service [Rule 6(2)(vi) of the Service Tax (Determination of Value) Rules, 2006].
  - (4) Yes, demurrages payable for use of services beyond the period initially agreed upon constitute consideration for provision of service as per rule 6(1)(x) of the Service Tax (Determination of Value) Rules, 2006.
- (c) As per section 15(1)(b) of the Customs Act 1962, the relevant date for determination of rate of duty and tariff valuation in case of warehoused goods is the date when a bill of entry for home consumption (ex-bond bill of entry) in respect of such goods has been presented under section 68 of the Customs Act, 1962. Therefore, in the given problem, the relevant date for determination of rate of duty is 01.07.20XX (date of presentation of ex-bond bill of entry) and not 05.07.20XX when the goods are actually removed from the warehouse. Thus, the customs duty will be payable at 8% and not 10%.
5. (a) Section 35FF of the Central Excise Act, 1944 provides for payment of interest @ 6% per annum on the delayed refund of pre-deposit from the date of the payment of pre-deposit to the date of its refund.
- Therefore, ST & Co. will be entitled to payment of interest on such delayed refund of pre-deposit as under:
- No. of days of delay = 76 days [01.10.20XX – 15.12.20XX]
- Thus, interest payable on refund of pre-deposit of Rs. 1,00,000 will be Rs. 1,249 (rounded off)
- [Rs. 1,00,000 x 6% x 76/365].
- (b) Works contract service is notified as a “continuous supply of service” vide *Notification No. 38/2012 ST dated 20.6.2012* issued under rule 2(c) of Point of Taxation Rules, 2011 (PoTR). In case of continuous supply of service, the date of completion of each event which requires the service receiver to make any payment to service provider, as specified in the contract shall be deemed to be the date of completion of provision of service [Clause (i) of proviso to rule 3 of PoTR]. The point of taxation will, then, be determined accordingly in terms of provisions of rule 3 of PoTR.

Therefore, in the given case, the date of completion of various stages of construction - which require payments to be made (including initial booking) - will be considered as dates of completion of service and point of taxation will be determined in accordance with rule 3 as under:

Stage of Completion	Point of taxation
Initial booking	May 01, 20XX as the date of completion of service, date of issuance of invoice and date of payment are the same.
50%	Since invoice has been issued within 30 days of completion of service (June 20, 20XX), point of taxation is date of invoice (June 30, 20XX) or date of payment (August 25, 20XX) whichever is earlier, i.e. June 30, 20XX.
75%	Since invoice has not been issued within 30 days of completion of service (July 30, 20XX), point of taxation is date of completion of service (July 30, 20XX) or date of payment (August 30, 20XX) whichever is earlier, i.e. July 30, 20XX.
100%	Since invoice has been issued within 30 days of completion of service (September 25, 20XX), point of taxation is date of invoice (October 03, 20XX) or date of payment (October 01, 20XX) whichever is earlier, i.e. October 01, 20XX.

- (c) Section 18 (dealing with provisional assessment) incorporates the principle of unjust enrichment in case of refund arising out of finalization of provisional assessment. Sub-section (5) of section 18 of Customs Act, 1962 provides that if any amount is found to be refundable after finalisation of provisional assessment, such refund will be subject to doctrine of unjust enrichment.

Further, section 28D places the onus on the person who has paid duty to prove that he has not passed on the incidence of such duty. In the absence of any proof from such person, section 28D deems that the burden of duty has been passed on to the buyer.

Therefore, in the given case, the Department's action will be correct if M/s CIB does not produce any evidence of bearing the burden of duty.

6. (a) As per section 31(c) of Central Excise Act, the term '**case**' means any proceeding under Central Excise Act or any other Act for the levy, assessment and collection of excise duty, pending before an adjudicating authority on the date on which an application under section 32E(1) is made. Thus, application to Settlement Commission can be made only when a 'case' is pending before adjudicating authority on date of application in accordance with section 32E(1) read with section

31(c) of Central Excise Act.

However, any proceeding referred back in any appeal/ revision by any court, Appellate Tribunal or any other authority, to the adjudicating authority for a fresh adjudication/ decision is not deemed to be a proceeding pending within the meaning of this clause.

**Or**

If the excisable goods cleared under A.R.E. 1 are not exported for any reason and the exporter intends to divert the goods for home consumption, he may request in writing the authority which accepted the Bond or Letter of Undertaking [LUT] to allow cancellation of application, and diversion of goods for consumption in India. He will be permitted to do so if he pays the duty as specified in the application along with interest on such duty from the date of removal for export from the factory or warehouse till the date of payment of duty. The permission shall be granted within three working days. Since duty assessment on A.R.E. 1 has to be done in normal course, there will not be any need for re-assessment by the Department or the assessee unless there are reasons to believe that the assessment was not correct. After discharge of duty, the exporter may take credit in his running bond (where bond is furnished) on the basis of letter of permission, invoice and GAR-7 Challans on which duty is paid. He shall also record these facts in the Daily Stock Account.

If the exporter, after clearing the goods for export without payment of duty, intends to change the destination or buyer or port or place of export, he may do so provided he informs the Bond/LUT accepting Authority in writing about the changes and makes necessary changes in all the copies of A.R.E. 1 and the invoices. If he intends to cancel the original export documents and issue fresh ones, the same may be done under permission and authentication by bond/LUT accepting authority which will ensure that the serial no. and date of the initial documents are endorsed on the fresh documents. In such cases, if bond was furnished for single consignment, fresh bond may not be asked.

- (b)** As per *Notification No. 41/2012 ST dated 29.06.2012*, the procedure for obtaining electronic rebate through ICES system is as follows:-
- (i) The exporter should register his bank account number and central excise registration number or service tax code number (STC), as the case may be, with Customs ICES. The exporter who does not have STC can obtain the same by filing a declaration in Form A-2 to the jurisdictional Assistant/Deputy Commissioner.
  - (ii) While presenting the electronic shipping bill/bill of export to the proper officer of Customs, the exporter should declare therein to the effect that-
    - (1) the rebate of service tax is claimed electronically through ICES system on the basis of the notified 'schedule of rates';

- (2) no further rebate will be claimed on the basis of the documents or in any other manner even if the rebate obtained is less than the service tax paid on the services;
  - (3) conditions of the notification have been fulfilled.
  - (iii) Rebate of service tax shall be calculated electronically by the ICES system, by applying the rate specified in the schedule against the said goods, as a percentage of the FOB value.
  - (iv) Rebate so calculated will be deposited in the bank account of the exporter.
  - (v) Shipping bill/bill of export on which rebate has been claimed electronically in the manner discussed above should not be used for claiming rebate on the basis of documents.
  - (vi) Minimum service tax rebate for an electronic shipping bill/bill of export is Rs. 50.
- (c)** The salient features of Special Economic Zones (SEZ) are as follows:
- (i) SEZ is deemed as a separate island outside India where inputs, capital goods and input services can be obtained without payment of duties and taxes such as customs duty, excise duty, central sales tax, State VAT and service tax.
  - (ii) For the sheer objective of ensuring consistent development of SEZ, an exclusive Act namely Special Economic Zone Act, 2005 (hereinafter abbreviated as SEZ Act) was passed. The twin prime purposes of foregoing Act are to ensure smooth operations in SEZ as well as Single Window Clearance with a view to set up either an SEZ or a Unit in SEZ.
  - (iii) An SEZ may be established under SEZ Act, either jointly or severally by the Central Government, State Government, or any person for manufacture of goods or rendering services or for both or as a Free Trade and Warehousing Zone.
  - (iv) All goods manufactured in SEZ are expected to be exported out of India. However, if cleared in DTA, normal import duty will become payable.
  - (v) Any goods imported directly from outside India or procured from within India shall be allowed to be imported in SEZ without payment of customs duties.
  - (vi) SEZ could be set up for manufacturing goods, rendering of services, production, processing, assembling, trading, repair, re-making, re-conditioning and re-engineering, making of gold, silver and other articles of precious metals and jewellery.
  - (vii) It shall be under the administrative control of the Development Commissioner. All activities in the SEZ, unless otherwise specified, shall be carried out



through self certification procedure.

(viii) Supply of goods to SEZ from DTA are 'exports' and are entitled to export benefits.

7. (a) It has been held by the Supreme Court in the case of *C.K Gangadharan v. CIT, Cochin, 2008 (228) ELT 497* that merely because Revenue has not preferred an appeal in some cases, it would not prevent the Revenue to prefer an appeal in another case if it is in the public interest or there is just cause for doing so or for a pronouncement by the higher Court when divergent views are expressed by the different High Courts.

However, the Supreme Court has given a conflicting decision in the case of *CIT v. J.K. Charitable Trust 2008 (232) ELT 769 (SC 3 members bench)* wherein it has held that if in respect of some years, in respect of same assessee, no appeal was filed involving an identical dispute, revenue can be precluded from filing an appeal if the fact situation in subsequent years remains the same.

Further, it may be noted that section 35R, *inter alia*, provides that where in pursuance of any instruction issued by CBEC with regard to fixing monetary limits for filing appeal etc., Central Excise Officer has not filed any appeal against any decision passed under the provisions of the Act, then it shall not preclude such officer from filing appeal in any other case involving the same or similar issues or questions of law.

- (b) Section 78A of the Finance Act, 1994 makes a director, manager, secretary or other officer of the company personally liable to a penalty upto ₹ 1 lakh in case of certain specified contraventions committed by the company. Such penalty is leviable if the director, manager, secretary or other officer of the company was in charge of, and was responsible to, the company for the conduct of business of such company at a time when any of the specified contraventions was committed provided the same was within the knowledge of such director, manager, secretary or other officer of the company.

The specified contraventions *inter alia* include availment and utilisation of credit of taxes or duty without actual receipt of taxable service or excisable goods either fully or partially in violation of the rules made under the provisions of Chapter V.

Though in the given case, Mr. Pawan and Miss. Saakshi were in charge of, and were responsible to, Tough (P) Ltd. for the conduct of its business at the time of such irregular availment and utilization of the credit, personal penalty could be imposed on both of them only if they are knowingly concerned with such contravention. Further, if it is established that Mr. Pawan and Miss. Saakshi are knowingly concerned with the contravention, the amount of penalty in case of Mr. Pawan will have to be restricted to ₹ 1,00,000.

Yes, penalty can be imposed on manager or officer of a company in other cases as well. As per section 78A, such other cases are-

- (i) evasion of service tax; or
- (ii) issuance of invoice, bill or, as the case may be, a challan without provision of taxable service in violation of the rules made under the provisions of Chapter V; or
- (iii) failure to pay any amount collected as service tax to the credit of the Central Government beyond a period of six months from the date on which such payment becomes due.

(c) The differences between two schemes are as follows -

- (i) 'Advance Authorisation' is not transferable. DFIA is transferable after export obligation is fulfilled.
- (ii) Material imported under Advance Authorisation is not transferable even after fulfillment of export obligation. Material imported under DFIA will be transferable after fulfillment of export obligation.
- (iii) Advance Authorisation scheme requires 15% value addition, while in case of DFIA, minimum 20% value addition is required.
- (iv) Advance Authorisation scheme is available to gem and jewellery sector but not DFIA.
- (v) Advance Authorisation can be issued even if SION for that product is not fixed. DFIA can be issued only if SION has been fixed for the product to be exported.