

MOCK TEST PAPER
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) “Grand Nikko” 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 “Grand Nikko”. It is sufficient to give two measures in each of the four perspectives. **(5 Marks)**

- (b) Natural Spices manufactures and distributes high-quality spices to gourmet food shops and top quality restaurants. Gourmet and high-end restaurants pride themselves on using the freshest, highest-quality ingredients.

Natural Spices has set up five state of the art plants for meeting the ever growing demand. The firm procures raw material directly from the centers of produce to maintain uniform taste and quality. The raw material is first cleaned, dried and tested with the help of special machines. It is then carefully grounded into the finished product passing through various stages and packaged at the firm’s ultraclean factory before being dispatched to customers.

The following variances pertain to last week of operations, arose as a consequence of management’s decision to lower prices to increase volume.

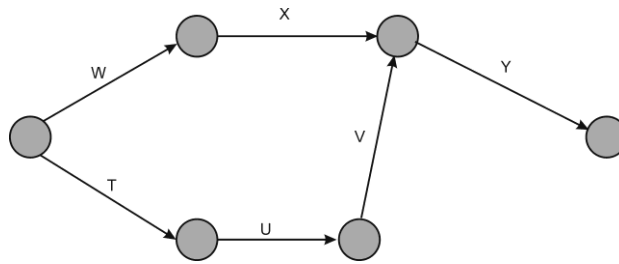
Rs.

Sales Volume Variance	18,000 (F)
Sales Price Variance	14,000 (A)
Purchase Price Variance	10,000 (F)
Labour Efficiency Variance	11,200 (F)
Fixed Cost Expenditure Variance	4,400 (F)

Required

- (i) Identify the ‘Critical Success Factors’ for Natural Spices.
 (ii) Evaluate the management’s decision with the ‘Overall Corporate Strategy’ and ‘Critical Success Factors’.
- (5 Marks)**

(c) The following network and table are presented to you:



Activity	Normal Duration (Days)	Normal Cost (Rs.)	Crash Duration (Days)	Crash Cost (Rs.)
T	8	2,250	6	2,750
U	16	1,875	11	2,750
V	14	2,250	9	3,000
W	12	3,000	9	3,750
X	15	1,000	14	2,500
Y	10	2,500	8	2,860

Required

Perform step by step crashing and reduce the project duration by 11 days while minimizing the crashing cost. What would be the cost of the crashing exercise? **(5 Marks)**

(d) Napier Company uses a backflush costing system with three trigger points:

- Purchase of Direct Materials
- Completion of Good Finished Units of Product
- Sales of Finished Goods

You are provided with the following information for July 2016.

Direct Materials Purchased	Rs. 2,64,000	Conversion Costs Allocated	Rs. 1,20,000
Direct Materials Used	Rs. 2,55,000	Costs Transferred to Finished Goods	Rs. 3,75,000
Conversion Costs Incurred	Rs. 1,26,600	Cost of Goods Sold	Rs. 3,57,000

Required

- (i) Prepared journal entries for July (without disposing of under allocated/ over allocated conversion costs).
 - (ii) Under an ideal JIT production system, how would the amounts in your journal entries change from the journal entries in requirement (i)? **(5 Marks)**
2. (a) Generation 2050 Technologies Ltd. develops cutting-edge innovations that are powering the next revolution in mobility and has nine tablet smart phone models currently in the market whose previous year financial data is given below:

Model	Sales (Rs.'000)	Profit-Volume (PV) Ratio
Tab - A001	5,100	3.53%

Tab - B002	3,000	23.00%
Tab - C003	2,100	14.29%
Tab - D004	1,800	14.17%
Tab - E005	1,050	41.43%
Tab - F006	750	26.00%
Tab - G007	450	26.67%
Tab - H008	225	6.67%
Tab - I009	75	60.00%

Required

- (i) Using the financial data, carry out a Pareto analysis (80/20 rule) of Sales and Contribution.
- (ii) Discuss your findings with appropriate recommendations. **(8 Marks)**
- (b) The following information is given relating to the simplex method of a linear program with the usual notations.

Objective function:

$$Z = x_1 + 5x_2 \quad \rightarrow (1)$$

Subject to:

$$6x_1 + 8x_2 \leq 12 \quad \rightarrow (2)$$

$$5x_1 + 15x_2 \geq 10 \quad \rightarrow (3)$$

$$x_1, x_2 \geq 10 \quad \rightarrow (4)$$

Let s_1 be the variable introduced to restate (2) as an equality and let s_2 and A_2 be variables to restate (3) as an equality.

Required

If the objective is to maximize Z,

- (i) What will be the coefficients of s_1 , s_2 and A_2 in equation (1) and (3) restated as equality?
- (ii) Identify the slack and surplus variables.
- (iii) Which variables will form part of the initial solution? Why?
- (iv) If the objective is to minimize Z what will be your answer to (i) above? **(8 Marks)**
3. (a) CSR Ltd. manufactures four products A-1, B-2, C-3 and D-4 in Gurugram and one product F-1 in Faridabad. CSR Ltd. operates under Just-in-time (JIT) principle and does not hold any inventory of either finished goods or raw materials.

Company has entered into an agreement with M Ltd. to supply 10,000 units per month of each product produced from Gurugram unit at a contracted price. CSR Ltd. is bound to supply these contracted units to M Ltd. without any fail. Following are the details related with non contracted units of Gurugram unit.

(Amount in Rs.)

	A-1	B-2	C-3	D-4
Selling Price per unit	360.00	285.00	290.00	210.00
Direct Labour @ Rs. 45 per hour	112.50	67.50	135.00	67.50
Direct Material M-1 @ Rs. 50 per kg.	50.00	100.00	---	75.00
Direct Material M-2 @ Rs. 30 per litre.	90.00	45.00	60.00	---
Variable Overhead (varies with labour hrs)	12.50	7.50	15.00	7.50
Variable Overhead (varies with machine hrs)	9.00	12.00	9.00	15.00
Total Variable Cost	274.00	232.00	219.00	165.00
Machine Hours per unit	3 hrs	4 hrs	3 hrs	5 hrs
Maximum Demand per month (units)	90,000	95,000	80,000	75,000

The products manufactured in Gurugram unit use direct material M-1 and M-2 but product F-1 produced in Faridabad unit is made by a distinct raw material Z. Material Z is purchased from the outside market at Rs. 200.00 per unit. One unit of F-1 requires one unit of material Z.

Material Z can also be manufactured at Gurugram unit but for this 2 hours of direct labour, 3 hours of machine time and 2.5 litres of material M-2 will be required.

The Purchase manager has reported to the production manager that material M-1 and M-2 are in short supply in the market and only 6,50,000 Kg. of M-1 and 6,00,000 litre of M-2 can be purchased in a month.

Required

- Calculate whether CSR Ltd. should manufacture material Z in Gurugram unit or continue to purchase it from the market and manufacture it in Faridabad unit.
- Calculate the optimum monthly usage of Gurugram unit's available resources and make decision accordingly.
- Calculate the purchase price of material Z at which your decision in (i) can be sustained. **(11 Marks)**

- Sandy Lee is a news reporter and feature writer for an economic daily. Her assignment is to develop a feature article on 'Product Life-Cycle Costing', including interviews with the Chief Financial Officers (CFO) and Operating Managers. Sandy Lee has been given a liberal budget for travel so as to research into company's history, operations, and market analysis for the firm she selects for the article.

Required

Sandy Lee has asked you to recommend industries and firms that would be good candidates for the article. What would you advice? Explain your recommendations. **(5 Marks)**

- (a) Kanga Ltd. furnishes you the following information relating to four varieties of products manufactured by them during the year 2016.

	A	B	C	D
Output (units)	32,000	20,000	16,000	24,000
Rs. Per Unit				
Selling Price	300	600	750	500

Direct Materials	60	140	160	60
Direct Wages	50	80	150	60
Variable Overhead	100	160	300	120
Fixed Overhead	100	160	300	120

Anticipation of the company for the Budget for the year 2017 is as follows:

- (a) Expected increments are as follows in pursuant of Inflation:
 - (i) Direct Material.....10%
 - (ii) Direct Wages.....20%
 - (iii) Variable Overheads.....20%
- (b) Fixed Overhead will increase by Rs.160,000
- (c) The market will take up an increase of 10% in the price, if Volume of Sales in quantities is maintained at the same level as in the year 2016

In order to fight inflation the Marketing Team puts forth the following proposals:

- (a) Product A: The price of product A will be further increased by 20% (making in all a total increase of 30%) resulting thereby in a reduction in the volume of Sales by 10%
- (b) Product B: Substitution on direct materials of product B by cheaper materials will bring about a reduction in direct material cost by Rs. 30 per unit. This will reduce the sales volume in units by 10%.
- (c) Product C: An allowance of special sales commission of 4% on the increased price on all quantities sold will increase the sales volume by 20%
- (d) Product D: A reduction in selling price by 10% on the price of 2016 will yield an increase in sales volume by 30%

The direct labour hour rate in 2016 is Rs. 4.00 per hour and the number of direct labour hours cannot be increased in the year 2017.

Required

- (i) Present a statement showing Profitability for the year 2016.
 - (ii) Prepare a budget for the year 2017 after taking into consideration the effects of inflation in costs and prices only.
 - (iii) Evaluate the proposals put forth by the Marketing Team and set an optimum product mix after taking into consideration the inflation in costs and prices but subject to the constraint of available labour hours. **(12 Marks)**
- (b) In a transportation problem for cost minimization, there are 4 rows indicating quantities demanded and this totals up to 1,200 units. There are 4 columns giving quantities supplied. This totals up to 1,400 units. What is the condition for a solution to be degenerate? **(4 Marks)**
5. (a) The chief officer at manufacturing plant of Boeing 777-200LR aircraft observed that workers performing manufacturing operations at the plant showed signs of a definite learning pattern. He noted that most aircraft manufacturing tasks experienced what he called an 80 percent learning rate, meaning that workers need 20 percent fewer hours to make a part each time

their cumulative experience making that part doubled. Thus, if the first part took 100 minutes, the second would require 80 minutes, the fourth would require 64 minutes, and so on. Accordingly, he requires calculating the time required for parts 41 to 60. [Note: learning coefficient is -0.322 for learning rate of 80%, $\log 2=0.30103$, $\log 3=0.47712$, $\log 5=0.69897$, Antilog of 1.484 =30.48, Antilog of 1.4274 =26.75] **(8 Marks)**

- (b) Qantas Travel Agency (QTA) specializes in flights between city 'D' to city 'B'. It books passengers on Darwin Airlines at Rs. 9,000 per round-trip ticket. Until last month, Darwin paid QTA a commission of 10% of the ticket price paid by each passenger. This commission was QTA's only source of revenues. QTA's fixed costs are Rs.1,40,000 per month (for salaries, rent and so on) and its variable costs are Rs. 200 per ticket purchased for a passenger. This Rs. 200 includes Rs. 150 per ticket delivery fee paid to S Express. (Rs. 150 delivery fee applies to each ticket).

Darwin Airlines has just announced a revised payment schedule for travel agents. It will now pay travel agents a 10% commission per ticket up to a maximum of Rs. 500. Any ticket costing more than Rs. 5,000 generates only a Rs. 500 commission, regardless of the ticket price.

Required

- (i) Under the old 10% commission structure, how many round-trip tickets must QTA's sell each month (a) to break-even and (b) to earn an operating income of Rs. 70,000.
- (ii) How does Darwin revised payment schedule affect your answers to (a) and (b) in requirement (i)? **(8 Marks)**
6. (a) Division Z is a profit center which produces four products A, B, C and D. Each product is sold in the external market also. Data for the period is:

Product D can be transferred to Division Y, but the maximum quantity that may be required for transfer is 2,500 units of D.

	A	B	C	D
Market price per unit (Rs.)	150	146	140	130
Variable cost of production per unit (Rs.)	130	100	90	85
Labour hours required per unit	3	4	2	3

The maximum sales in the external market are:

- A..... 2,800 units
 B..... 2,500 units
 C..... 2,300 units
 D..... 1,600 units

Division Y can purchase the same product at a price of Rs.125 per unit from outside instead of receiving transfer of product D from Division Z.

What should be the transfer price for each unit for 2,500 units of D, if the total labour hours available in Division Z are 20,000 hours? **(6 Marks)**

- (b) A project consists of four (4) major jobs, for which four (4) contractors have submitted tenders. The tender amounts, in thousands of rupees, are given below-

Contractors	Job A	Job B	Job C	Job D
1	120	100	80	90
2	80	90	110	70

3	110	140	120	100
4	90	90	80	90

Required

Find the assignment, which minimizes the total cost of the project. Each contractor has to be assigned one job. **(6 Marks)**

- (c) Queenstown Furniture (QF) manufactures high-quality wooden doors within the forests of Queenstown since 1952. Management is having emphasize on creativity, engineering, innovation and experience to provide customers with the door they desire, whether it is a standard design or a one-of-a-kind custom door. The following information pertains to operations during April:

Processing time	9.0 hrs.*	Waiting time	6.0 hrs.*
Inspection time	1.5 hr.*	Move time	7.5 hrs.*
Units per batch	60 units		

(*) average time per batch

Required

Compute the following operational measures:

- (i) Average non-value-added time per batch
- (ii) Average value added time per batch
- (iii) Manufacturing cycle efficiency
- (iv) Manufacturing cycle time **(4 Marks)**

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

- (a) What is Target Costing? It is said that implementation of the target costing technique requires intensive marketing research. Explain why intensive marketing research is required to implement target costing technique. **(4 Marks)**
- (b) Write a short note on Standard, ex post and ex ante? **(4 Marks)**
- (c) 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) Legal consultancy fees payable for patent rights on a new product Patenting rights have been applied for. **(4 Marks)**
- (d) Explain the term 'Resource Smoothing' **(4 Marks)**
- (e) What are the limitations of Inter-firm comparison? **(4 Marks)**

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SUGGESTED ANSWERS/HINTS

1. (a) The following is a possible scorecard for “Grand Nikko”

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

(b) (i) Gourmet and high-end restaurants recognises Natural Spices on the basis of its *high quality* of spices. Therefore, quality is most critical success factor of Natural Spices. There are other factors which cannot be ignore such as price, delivery options, attractive packing etc. But all are secondary to the quality.

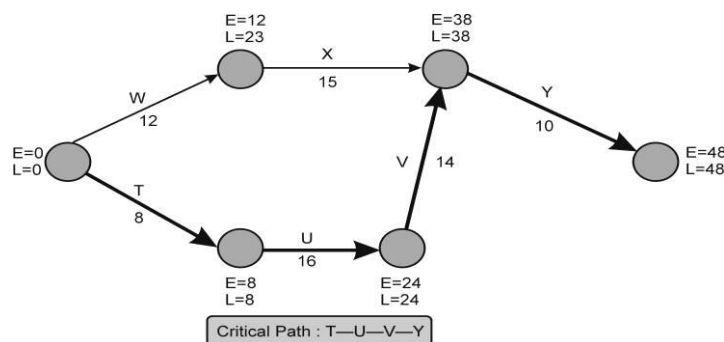
(ii) Deliberate action of cutting price to increase sales volume indicates that firm is intending to expand its market to retail market and street shops which is price sensitive.

Purchase Price Variance is clearly indicating that firm has purchased raw material at lower price which may be due to buying of lower quality of material. Similarly, positive *Efficiency Variance* is indicating cost cutting and stretching resources.

It appears that firm is intending to expand its market to retail market and street shops by not only reducing the price but also compromising its quality which is opposing its current strategy of *high quality*.

Management should monitor the trends of variances on regular basis and take appropriate action in case of evidence of permanent decline in quality. Here, customer feedback is also very important.

(c) **Network** for the given problem:



The **Various Paths** in the network are:

T–U–V–Y with duration 48 days

W–X–Y with duration 37 days

The critical path is T–U–V–Y with normal duration of 48 weeks.

Particulars	T	U	V	Y
Crash Days Possible (ΔT)	2	5	5	2
Crash Cost Less Normal Cost (ΔC)	Rs.500	Rs.875	Rs.750	Rs.360
Crashing Cost per Day [$(\Delta C) / (\Delta T)$]	Rs.250	Rs.175	Rs.150	Rs.180
Step I Crash V by 5 Days	---	---	Rs.750	---
Step II Crash U by 5 Days	---	Rs.875	---	---
Step III Crash Y by 1 Day	---	---	---	Rs.180

Minimum Cost of Crashing Exercise is Rs. 1,805 (Rs.750 + Rs.875 + Rs.180) for **Project Duration** of 11 Days.

(d) (i) **Journal Entries** for July are as follows

	Rs.	Rs.
E.1 Material and In-Process Inventory Control Accounts Payable Control (Direct Materials Purchased)	2,64,000	2,64,000
E.2 Conversion Costs Control Various Accounts (Conversion Cost Incurred)	1,26,600	1,26,600
E.3 Finished Goods Control Materials and In-Process Inventory Control Conversion Costs Allocated (Standard cost of finished goods completed)	3,75,000	2,55,000 1,20,000
E.4 Cost of Goods Sold Finished Goods Control (Standard cost of finished goods sold)	3,57,000	3,57,000

(ii) Zero inventory is the goal of an *ideal* JIT production system. Accordingly, entry (E.3) would be Rs. 3,57,000 finished goods production, not Rs. 3,75,000. If the marketing division could only sell goods costing Rs. 3,57,000, the JIT production system would call for direct materials purchases and conversion costs lower than Rs. 2,64,000 and Rs. 1,26,600, respectively, in entries (E.1) and (E.2).



When a JIT system is created, the amount of inventory retained in a company drops continuously. Raw materials inventory is reduced because suppliers deliver only small quantities of parts as and when they are needed. Work-in-process inventory drops because the conversion to machine cells and the use of Kanban Cards greatly reduces the need to pile up inventory between machines. Finally, finished goods inventory drops because inventory is produced only when there are orders in hand from customers (though finished goods inventories are also allowed to build if a company experiences high seasonal sales). Consequently, the cost of maintaining inventory declines, which in turn reduces the overhead costs associated with inventories that are charged to products.

2. (a)

Statement Showing "Pareto Analysis"

Model	Sales (Rs.'000)	% of Total Sales	Cumulative Total	Model	Cont. (Rs.'000)	% of Total Cont.	Cumulative Total %
Pareto Analysis Sales				Pareto Analysis Contribution			
A001	5,100	35.05%	35.05%	B002	690	30.87%	30.87%
B002	3,000	20.62%	55.67%	E005	435	19.47%*	50.34%
C003	2,100	14.43%	70.10%	C003	300	13.42%	63.76%
D004	1,800	12.37%	82.47%	D004	255	11.41%	75.17%
E005	1,050	7.22%	89.69%	F006	195	8.73%*	83.90%
F006	750	5.15%	94.84%	A001	180	8.05%	91.95%
G007	450	3.09%	97.93%	G007	120	5.37%	97.32%
H008	225	1.55%	99.48%	I009	45	2.01%	99.33%
I009	75	0.52%	100.00%	H008	15	0.67%	100.00%
	14,550	100.00%			2,235	100.00%	

(*) Rounding - off difference adjusted.

Recommendations

Pareto Analysis is a rule that recommends focus on most important aspects of the decision making in order to simplify the process of decision making. The very purpose of this analysis is to direct attention and efforts of management to the product or area where best returns can be achieved by taking appropriate actions.

Pareto Analysis is based on the 80/20 rule which implies that 20% of the products account for 80% of the revenue. But this is not the fixed percentage rule; in general business sense it means that a few of the products, goods or customers may make up most of the value for the firm.

In present case, five models namely A001, B002, C003, D004 account for 80% of total sales where as 80% of the company's contribution is derived from models B002, E005, C003, D004 and F006.

Models B002 and E005 together account for 50.34% of total contribution but having only 27.84% share in total sales. So, these two models are the key models and should be the top priority of management. Boths C003 and D004 are among the models giving 80% of total contribution as well as 80% of total sales so; they can also be clubbed with B002 and E005 as key models. Management of the company should allocate maximum resources to these four models.

Model F006 features among the models giving 80%of total contribution with relatively lower share in total sales. Management should focus on its promotional activities.

Model A001 accounts for 35.05% of total sales with only 8.05% share in total contribution. Company should review its pricing structure to enhance its contribution.

Models G007, H008 and I009 have lower share in both total sales as well as contribution. Company can delegate the pricing decision of these models to the lower levels of management, thus freeing themselves to focus on the pricing decisions for key models.

(b) (i) Working

Introducing Slack/ Surplus/ Artificial Variables

In Case of Maximization...

$$Z = x_1 + 5x_2 + 0s_1 + 0s_2 - MA_2 \quad \dots (1)$$

Subject to:

$$6x_1 + 8x_2 + s_1 = 12 \quad \dots (2)$$

$$5x_1 + 15x_2 - s_2 + A_2 = 10 \quad \dots (3)$$

$$x_1, x_2, s_1, s_2, A_2 \geq 0 \quad \dots (4)$$

For Equation (1)

Coefficients of s_1 , s_2 , and A_2 are **0**, **0** and **-M** respectively.

For Equation (3)

Coefficients of s_1 , s_2 , and A_2 are **0**, **-1** and **1** respectively.

(ii) s_1 is Slack Variable and s_2 is Surplus Variable.

(iii) In any Maximisation problem, this tableau must satisfy the following requirements:

- All the Slack Variables (and thus Surplus Variables as well) must form part of the initial solution mix (basis).
- The table must contain as many rows as there are constraints.
- The elements in the columns of variables appearing in the basis must form a unit vector.

If s_2 is included in the basis, the elements of the s_2 will be 0 and -1 and thus not a unit vector. This is contrary to the non-negativity restriction i.e. all variables must have a positive value. This problem is solved by adding an Artificial Variable (denoted by A_i) to the equation, that is, a variable that has a positive value. Artificial variables do not represent any quantity relating to the decision problem and must not be present in the final solution (if at all they do, it represents a situation of infeasibility). Accordingly, in the initial tableau we will place A_2 along with s_1 to eliminate the impact of them first.

(iv) Working

Introducing Slack/ Surplus/ Artificial Variables

In Case of Minimization...

$$Z = x_1 + 5x_2 + 0s_1 + 0s_2 + MA_2 \quad \dots (1)$$

Subject to:

$$6x_1 + 8x_2 + s_1 = 12 \quad \dots (2)$$

$$5x_1 + 15x_2 - s_2 + A_2 = 10 \quad \dots (3)$$

$$x_1, x_2, s_1, s_2, A_2 \geq 0 \quad \dots (4)$$

For Equation (1)

Coefficients of s_1 , s_2 , and A_2 are **0**, **0** and **M** respectively.

For Equation (3)

Coefficients of s_1 , s_2 , and A_2 are **0**, **-1** and **1** respectively.

3. (i) Manufacturing Cost of Material Z, if Manufactured in Gurugram unit

	Amount (Rs.)
Direct Labour (2 hours × Rs.45)	90.00
Direct Material M-2 (2.5 litre × Rs.30)	75.00
Variable Overhead, Varies with Labour Hours (2hours × Rs.5)	10.00
Variable Overhead, Varies with Machine Hours (3hours × Rs.3)	9.00
Total Variable Cost	184.00

The purchasing cost of material Z from the outside market is Rs.200, which is more than the cost to manufacture it in Gurugram unit. Hence, it will be beneficial for the CSR Ltd. to manufacture material Z in Gurugram unit itself.

(ii) Monthly Requirement of Direct Material M-1 & M-2

For Contracted units

	A-1	B-2	C-3	D-4	Total
Units to be Supplied to M Ltd. (units)	10,000	10,000	10,000	10,000	40,000
Direct Material M-1 (in Kg) [W.N.-1]	10,000	20,000	---	15,000	45,000
Direct Material M-2 (in Litre) [W.N.-2]	30,000	15,000	20,000	---	65,000

For Non-Contracted units

	A-1	B-2	C-3	D-4	Total
Demand in Outside Market (units)	90,000	95,000	80,000	75,000	3,40,000
Direct Material M-1 (in Kg) [W.N.-1]	90,000	1,90,000	---	1,12,500	3,92,500
Direct Material M-2 (in Litre) [W.N.-2]	2,70,000	1,42,500	1,60,000	---	5,72,500

Availability and Demand Comparison

	Direct Material M-1 (in Kg)	Direct Material M-2 (in Litre)
Availability in Market	6,50,000	6,00,000
Requirement	4,37,500 (45,000+3,92,500)	6,37,500 (65,000+5,72,500)

Material M-2 is a limiting factor as its availability is less than its requirement to produce contracted as well as for non-contracted units.

To optimum usage of resources available in Gurugram unit, prioritisation of production of products is necessary. The following is the comparison table of product A-1, B-2, C-3 and Z. Product D-4 is not taken into comparison as material M-2 is not required to produce product D-4.

Calculation of Contribution per litre of M-2

	A-1	B-2	C-3	Z
Contribution <i>per unit</i> (W.N-3 & 4)	Rs. 86.00	Rs. 53.00	Rs. 71.00	Rs. 16.00
Quantity of Material M-2 <i>per unit</i>	3 litre	1.5 litre	2 litre	2.5 litre
Contribution <i>per litre</i> of M-2	Rs. 28.67	Rs. 35.33	Rs.35.50	Rs. 6.40
Rank	III	II	I	IV

Since, contribution per unit of material Z is lowest as compared to other products consuming material M-2. Material –Z cannot be manufactured under the given resource constraint. Hence only existing products of Gurugram units should be manufactured.

Optimum Production Plan

Product	No. of Units	Quantity of M-2 Required (in Litre)	Balance Availability of M-2 (in Litre)
C-3	90,000	1,80,000 (90,000 units × 2 litre)	4,20,000 (6,00,000 – 1,80,000)
B-2	1,05,000	1,57,500 (1,05,000 units × 1.5 litre)	2,62,500 (4,20,000 – 1,57,500)
A-1	87,500*	2,62,500 (87,500 units × 3 litre)	0 (2,62,500 – 2,62,500)

(*) Units that can be produced with the help of available quantity of M-2 i.e. 2,62,500 litre.

- (iii) Decision in requirement (i) will be changed as material Z cannot be manufactured in Gurugram unit as noted in requirement (ii). *The minimum purchase price of material Z at which decision taken in (i) above can be sustained is calculated as below:*

	Amount (Rs.)
Existing Purchase Price	200.00
Add: Market Price to be increased by [W.N.-5]	55.68
Total	255.68

Working Notes

(1) Quantity of M-1 required per unit of production

	A-1	B-2	D-4
Cost <i>per unit</i>	Rs.50	Rs.100	Rs.75
Rate <i>per Kg.</i>	Rs.50	Rs.50	Rs.50
Quantity <i>per unit</i> of Production	1Kg.	2Kg.	1.5Kg.

(2) **Quantity of M-2 required per unit of production**

	A-1	B-2	C-3
Cost of per unit	Rs.90	Rs.45	Rs.60
Rate per Kg.	Rs.30	Rs.30	Rs.30
Quantity per unit of Production	3 litre	1.5 litre	2 litre

(3) **Contribution per unit (Rs.)**

	A-1	B-2	C-3	D-4
Selling Price per unit	360	285	290	210
Less: Variable Cost per unit	274	232	219	165
Contribution per unit	86	53	71	45

(4) **Contribution (Benefit) per unit of Material Z**

	(Rs.)
Purchasing Cost per unit	200
Less: Cost of Manufacture	184
Contribution per unit	16

(5) The next best product to material Z is A-1 {as calculated in (ii) above} which has a contribution of Rs. 28.67 per litre of M-2 which is Rs. 22.27 (Rs. 28.67 – Rs. 6.40) higher than the contribution per litre of M-2 for material Z. Material Z required 2.5 litre of M-2, therefore, purchase price of material Z would have to Rs. 55.68 (2.5 litre × Rs. 22.27) higher than the existing market price.

(b) The product life cycle span the time from the initial R & D on a product to when customer service and support is no longer offered for that product.

Life Cycle Costing technique is particularly important when:

- High percentage of total life-cycle costs are incurred before production begins and revenue are earned over several years and
- High fraction of the life cycle costs are locked in at the R & D and design stages.

Sandy Lee should identify those industries and then companies belonging to those industries where above mentioned feature are prevalent. For example, Automobile and Pharmaceutical Industries companies like Tata Motors Ltd. and Dabur India Ltd. will be good candidates for study on product life cycle costing.

4. (a) (i) **Statement of Profit of 2016**

	A	B	C	D	Total
Sales (units)	32,000	20,000	16,000	24,000	92,000
	(Rs. In Lacs)				
Sales	96.00	120.00	120.00	120.00	456.00
Direct Material	19.20	28.00	25.60	14.40	87.20
Direct Wages	16.00	16.00	24.00	14.40	70.40
Variable Overhead	32.00	32.00	48.00	28.80	140.80

Variable Cost	67.20	76.00	97.60	57.60	298.40
Contribution	28.80	44.00	22.40	62.40	157.60
Fixed Overhead	32.00	32.00	48.00	28.80	140.80
Profit / (Loss)	(3.20)	12.00	(25.60)	33.60	16.80
	A	B	C	D	Total
Direct Labour Hours per Unit	12.50	20.00	37.50	15.00	
Direct Labour Hours Required	400,000	400,000	600,000	360,000	1,760,000

(ii) **Statement of Budget 2017 (After Impact of Inflation)**

	A	B	C	D	Total
Sales (units)	32,000	20,000	16,000	24,000	92,000
	(Rs. In Lacs)				
Sales	105.60	132.00	132.00	132.00	501.60
Direct Material	21.12	30.80	28.16	15.84	95.92
Direct Wages	19.20	19.20	28.80	17.28	84.48
Variable Overhead	38.40	38.40	57.60	34.56	168.96
Variable Cost	78.72	88.40	114.56	67.68	349.36
Contribution	26.88	43.60	17.44	64.32	152.24
Fixed Overhead (140.80+1.60)					142.40
Profit / (Loss)					9.84
	A	B	C	D	Total
Direct Labour Hours	400,000	400,000	600,000	360,000	1,760,000
Contribution per Labour Hour (₹)	6.72	10.90	2.91	17.87	8.65

(iii) **Statement of Profit 2017 on the Basis of Proposals of Marketing Team**

	A	B	C	D	Total
Sales (units)	28,800	18,000	19,200	31,200	97,200
	(Rs. In Lacs)				
Sales	112.32	118.80	158.40	140.40	529.92
Less: Commission	---	---	6.34	---	6.34
Net Sales	112.32	118.80	152.06	140.40	523.58
Direct Material	19.01	22.32	33.79	20.59	95.71
Direct Wages	17.28	17.28	34.56	22.46	91.58
Variable Overhead	34.56	34.56	69.12	44.93	183.17
Variable Cost	70.85	74.16	137.47	87.98	370.46
Contribution	41.47	44.64	14.59	52.42	153.12
Fixed Overhead					142.40

Profit / (Loss)					10.72
	A	B	C	D	Total
Labour Hrs. Required	3,60,000	3,60,000	7,20,000	4,68,000	1,908,000
Contribution per Labour Hours (Rs.)	11.52	12.40	2.03	11.20	

Revised Position on the basis of the 'Proposal of Marketing Team' and Product Mix after taking into consideration the 'Inflation in Costs and Prices' but subject to the 'Constraint of Available Labour Hours'.

	A	B	C*	D*	Total
Sales (units)	28,800	18,000	16,000	24,000	86,800
	(Rs. In Lacs)				
Sales	112.32	118.80	132.00	132.00	495.12
Less: Commission	---	---	---	---	---
Net Sales	112.32	118.80	132.00	132.00	495.12
Direct Material	19.01	22.32	28.16	15.84	85.33
Direct Wages	17.28	17.28	28.80	17.28	80.64
Variable Overhead	34.56	34.56	57.60	34.56	161.28
Variable Cost	70.85	74.16	114.56	67.68	327.25
Contribution	41.47	44.64	17.44	64.32	167.87
Fixed Overhead					142.40
Profit/(Loss)					25.47

	A	B	C	D	Total
Labour Hrs Required	360,000	360,000	600,000	360,000	1,680,000
Contribution per Labour Hour (Rs.)	11.52	12.40	2.91	17.87	

(*) By following the strategy of Marketing Team, Contribution per Labour Hour has reduced in case of Product C & D. Therefore, strategy of Marketing Team should be followed in Case of Product A&B only.

- (b) The condition for degeneracy is that the number of allocations in a solution is less than $m+n-1$.

The given problem is an unbalanced situation and hence a dummy row is to be added, since the column quantity is greater than that of the row quantity. The total number of rows and columns will be 9 i.e. (5 rows and 4 columns). Therefore, $m+n-1 (= 8)$, i.e. if the number of allocations is less than 8, then degeneracy would occur.

5. (a) The usual learning curve model is

$$y = ax^b$$

Where

- y = Average time per part for x parts
a = Time required for first part (100 minutes)
x = Cumulative number of parts

b = Learning coefficient and is equal to -0.322
(learning rate 80%)

Calculation of total time for 40 parts:

$$y = 100 \times (40)^{-0.322}$$

$$\log y = \log 100 - 0.322 \times \log 40$$

$$\log y = \log 100 - 0.322 \times [3 \times \log 2 + \log 5]$$

$$\log y = 2 - 0.322 \times [3 \times 0.30103 + 0.69897]$$

$$\log y = 1.484$$

$$y = \text{antilog of } 1.484$$

$$y = 30.48 \text{ minutes}$$

$$\text{Total time for 40 Parts} = 40 \text{ Parts} \times 30.48 \text{ minutes}$$

$$= 1,219 \text{ minutes (A)}$$

Calculation of total time for 60 parts:

$$y = 100 \times (60)^{-0.322}$$

$$\log y = \log 100 - 0.322 \times \log 60$$

$$\log y = \log 100 - 0.322 \times [2 \times \log 2 + \log 5 + \log 3]$$

$$\log y = 2 - 0.322 \times [2 \times 0.30103 + 0.69897 + 0.47712]$$

$$\log y = 1.4274$$

$$y = \text{antilog of } 1.4274$$

$$y = 26.75 \text{ minutes}$$

$$\text{Total Time for 60 Parts} = 60 \text{ Parts} \times 26.75 \text{ minutes}$$

$$= 1,605 \text{ minutes (B)}$$

Calculation of total time for 41 to 60 parts (B) – (A):

$$= 1,605 \text{ minutes} - 1,219 \text{ minutes}$$

$$= 386 \text{ minutes}$$

(b) (i)	QTA receives a 10% Commission <i>on each ticket</i>	=	Rs.900(10% × Rs.9,000)
	Commission <i>per ticket</i>	=	Rs.900
	Variable Cost <i>per ticket</i>	=	Rs.200
	Contribution <i>per ticket</i>	=	Rs.900 – Rs.200
		=	Rs.700
	Fixed Costs	=	Rs.1,40,000 <i>per month</i>
(a)	Break-even Number of Tickets	=	$\frac{\text{Fixed Costs}}{\text{Contribution per ticket}}$
		=	$\frac{\text{Rs.1,40,000}}{\text{Rs.700 per ticket}}$
		=	200 tickets
(b)	When Target Operating Income	=	Rs.70,000 <i>per month</i>

$$\begin{aligned} \text{Quantity of Tickets required to be sold} &= \frac{\text{Rs.1,40,000} + \text{Rs.70,000}}{\text{Rs.700 per ticket}} \\ &= \frac{\text{Rs.2,10,000}}{\text{Rs.700}} \\ &= 300 \text{ tickets} \end{aligned}$$

(ii) Under the New System, QTA would receive only Rs.500 on the Rs.9,000 per ticket. Thus,

$$\begin{aligned} \text{Commission per ticket} &= \text{Rs.500} \\ \text{Variable Cost per ticket} &= \text{Rs.200} \\ \text{Contribution per ticket} &= \text{Rs.500} - \text{Rs.200} \\ &= \text{Rs.300} \\ \text{Fixed Costs} &= \text{Rs.1,40,000 per month} \\ \text{Break-even Number of Tickets} &= \frac{\text{Rs.1,40,000}}{\text{Rs.300}} \\ &= 467 \text{ tickets (rounded up)} \\ \text{Quantity of Tickets required to be sold} &= \frac{\text{Rs.2,10,000}}{\text{Rs.300}} \\ &= 700 \text{ tickets} \end{aligned}$$

The Rs.500 cap on the Commission paid per ticket causes the Break-even Point to more than double (from 200 to 467 tickets) and

The Tickets required to be sold to earn Rs. 70,000 per month to also more than double (from 300 to 700 tickets).

As would be expected, travel agents will react very negatively to the Darwin Airlines decision to change commission payments.

6. (a) **Ranking of Products When Availability of Time is the Key Factor**

Products	A	B	C	D
Market Price (Rs.)	150	146	140	130
Less: Variable Cost (Rs.)	130	100	90	85
Contribution per unit (Rs.)	20	46	50	45
Labour Hours per unit	3 hrs.	4 hrs.	2 hrs.	3 hrs.
Contribution per Labour Hour	6.67	11.50	25.00	15.00
Ranking	IV	III	I	II
Maximum Demand (units)	2,800	2,500	2,300	1,600
Total No. of Hours	8,400	10,000	4,600	4,800
Allocation of 20,000 Hours on the Basis of Ranking	600*	10,000	4,600	4,800

(*) Balancing Figure

Note

Time required to meeting the demand of 2,500 units of Product D for Division Y is 7,500 hrs. This requirement of time viz. 7,500 hrs for providing 2,500 units of Product D for Division Y can be met by sacrificing 600 hours of Product A (200 units) and 6,900 hours of Product B (1,725 units).

$$\begin{aligned}
 \text{Transfer Price} &= \text{Variable Cost} + \text{Opportunity Cost} \\
 &= \text{Rs.85} + \frac{(6,900 \text{ hrs.} \times \text{Rs.11.5} + 600 \text{ hrs.} \times \text{Rs.6.66})}{2,500 \text{ units}} \\
 &= \text{Rs. 85} + \frac{\text{Rs.79,350} + \text{Rs.4,000}}{2,500 \text{ units}} \\
 &= \text{Rs. 85} + \text{Rs. 33.34} \\
 &= \text{Rs. 118.34}
 \end{aligned}$$

(b) The given problem is a balanced minimization problem. Subtracting the minimum element of each row from all its elements in turn, the given problem reduces to-

Contractors	Job A	Job B	Job C	Job D
1	40	20	0	10
2	10	20	40	0
3	10	40	20	0
4	10	10	0	10

Now subtract the minimum element of each column from all its elements in turn. Draw the minimum number of lines horizontal or vertical so as to cover all zeros.

Contractors	Job A	Job B	Job C	Job D
1	30	10	0	10
2	0	10	40	0
3	0	30	20	0
4	0	0	0	10

Since the minimum number of lines to cover all zeros is equal to 4 (order of the matrix), this matrix will give optimal solution. The optimal assignment is made in the matrix below-

Contractors	Job A	Job B	Job C	Job D
1	30	10	0	10
2	0	10	40	0
3	0	30	20	0
4	0	0	0	10

The optimal assignment is-

Contractor	Job	Cost ('000 Rs.)
1	C	80
2	A	80
3	D	100

4	B	90
---	---	----

Hence, total minimum cost of the project will be Rs. 3,50,000.

(c) (i) Average Non Value Added Time *per batch*

$$\begin{aligned}
 &= \text{Inspection Time} + \text{Waiting Time} + \text{Move Time} \\
 &= 1.5 \text{ hr.} + 6.0 \text{ hrs.} + 7.5 \text{ hrs.} \\
 &= 15 \text{ hrs.}
 \end{aligned}$$

(ii) Average Value Added Time per batch

$$\begin{aligned}
 &= \text{Processing Time} \\
 &= 9 \text{ hrs.}
 \end{aligned}$$

(iii) Manufacturing Cycle Efficiency

$$\begin{aligned}
 &= \frac{\text{Processing Time}}{\text{Processing Time} + \text{Inspection Time} + \text{Waiting Time} + \text{Move Time}} \\
 &= \frac{9.0 \text{ hrs.}}{9.0 \text{ hrs.} + 1.5 \text{ hr.} + 6.0 \text{ hrs.} + 7.5 \text{ hrs.}} \\
 &= 37.5\%
 \end{aligned}$$

(iv) Manufacturing Cycle Time

$$\begin{aligned}
 &= \frac{\text{Total Production Time}}{\text{Units per Batch}} \\
 &= \frac{24 \text{ hrs.}}{60 \text{ units}} \\
 &= 0.40 \text{ hrs. per unit}
 \end{aligned}$$

7. (a) Target cost is the difference between estimated selling price of a proposed product with specified functionality and quality and the target margin. This is a cost management technique that aims to produce and sell products that will ensure the target margin. It is an integral part of the product design. While designing the product, the company needs to understand what value target customers will assign to different attributes and different aspects of quality. This requires use of techniques like value engineering and value analysis. Intensive marketing research is required to understand customer preferences and the value they assign to each attribute and quality parameter. This insight is required to be developed must before the product is introduced. The company plays within the space between the maximum attributes and quality that the company can offer and the minimum acceptable to target customers. Therefore, in absence of intensive marketing research, the target costing technique cannot be used effectively.

(b) **Standard, ex post:** *After the event.* An ex post budget, or standard, is set after the end of a period of activity, when it can represent the optimum achievable level of performance in the conditions which were experienced. Thus the budget can be flexed, and standards can reflect factors such as unanticipated changes in technology and in price levels. This approach may be used in conjunction with sophisticated cost and revenue modelling to determine how far both the plan and the achieved results differed from the performance that would have been expected in the circumstances which were experienced.

Standard, ex ante: *Before the event.* An ex ante budget or standard is set before a period of activity commences

(c) Committed Fixed Cost / Discretionary Fixed Cost

Committed Fixed Cost	Discretionary Fixed Cost
(i) Salary and Wage increase.	(ii) New Advertisement Cost.
(iii) Rents payable for the next 6 months.	
(iv) Legal Fees for filing for patent rights.	

(d) It is a network technique used for smoothening peak resource requirement during different periods of the project network. Under this technique the total project duration is maintained at the minimum level. For example, if the duration of a project is 15 days, then the project duration is maintained, but the resources required for completing different activities of a project are smoothened by utilising floats available on non critical activities. These non critical activities having floats are rescheduled or shifted so that a uniform demand on resources is achieved. In other words, the constraint in the case of resource smoothening operation would be on the project duration time. Resource smoothening is a useful technique or business managers to estimate the total resource requirements for various project activities.

In resources smoothening, the time-scaled diagram of various activities and their floats (if any), along with resource requirements are used. The periods of maximum demand for resources are identified and non critical activities during these periods are staggered by rescheduling them according to their floats for balancing the resource requirements.

(e) The following are the limitations in the implementation of a scheme of inter-firm comparison:

- (i) There is a fear of losing secrecy of the production method or some peculiar process or method among the top management.
- (ii) Middle management is usually not convinced with the utility of such a comparison.
- (iii) In the absence of a suitable cost accounting system, the figures supplied may not be reliable for the purpose of comparison.
- (iv) Suitable basis for comparison may not be available.

MOCK TEST PAPER
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. MNO is an Open University that decides to launch a web based knowledge portal to facilitate its students of distance education for different courses. It proposes to provide various resources easily on anytime and anywhere basis by uploading its course materials, e-lectures and e-reference books on the website. As a part of this, the management of the university invites various technical experts who can propose a capable and efficient solution as per the requirements and guidelines of the university. Also, the University decides to encourage people to collaborate and share information online through social networks.
 - (a) The company appoints an Accountant for his active involvement during the development work of the proposed system. Discuss some of the aspects on which an accountant can play a vital role during proposed system's development. **(5 Marks)**
 - (b) The proposed system is expected to ease the day-to-day operations and increases the quality of the products. However, at the same time the new system becomes vulnerable for many cyber-attacks. Discuss the major possible cyber-attacks that can occur against the new proposed system. **(5 Marks)**
 - (c) What are the provisions given in Information Technology (Amendment) Act, 2008 for the retention of documents etc. in electronic form? **(5 Marks)**
 - (d) Discuss major areas where Computer - based applications be implemented. **(5 Marks)**
2.
 - (a) Discuss the characteristics of an effective Management Information System (MIS). **(6 Marks)**
 - (b) Briefly discuss about Platform as a Service model in Cloud Computing. **(6 Marks)**
 - (c) Discuss Feasibility Study and its dimensions in SDLC. **(4 Marks)**
3.
 - (a) List out the key components of a good security policy. **(6 Marks)**
 - (b) Discuss the various categories of the test that a programmer performs on a program unit. **(6 Marks)**
 - (c) Discuss the working of Mobile Computing. **(4 Marks)**
4.
 - (a) What do you understand by the term "Computer Crime Exposures". **(6 Marks)**
 - (b) Discuss 'Auditors' Selection Norms' as per SEBI. **(6 Marks)**
 - (c) What are Compensatory Controls? **(4 Marks)**
5.
 - (a) Discuss the seven enablers of COBIT 5. **(6 Marks)**
 - (b) Discuss characteristics of Decision Support System (DSS). **(6 Marks)**
 - (c) Differentiate between Inherent Risk and Control Risk. **(4 Marks)**
6.
 - (a) Discuss objectives and goals of Business Continuity Planning? **(6 Marks)**
 - (b) Discuss the strengths of Prototyping Model. **(6 Marks)**
 - (c) Discuss the benefits of Enterprise Resource Planning (ERP). **(4 Marks)**

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

- (a) Key Governance practices of GEIT
- (b) Asynchronous Attacks
- (c) Business Governance
- (d) Logical Access Violators
- (e) Categories of Information Systems Audit

(4 × 4 = 16 Marks)

MOCK TEST PAPER

FINAL COURSE: GROUP – II

PAPER – 6: INFORMATION SYSTEMS CONTROL & AUDIT

SUGGESTED ANSWERS/HINTS

1. (a) An accountant can help in various related aspects during system development; some of them are as follows:
- (i) **Return on Investment (ROI):** This defines the return an entity shall earn on a investment i.e. capital expenditure. This financial data is a prime consideration for any capital expenditure entity decides to incur. The important data required for this analysis being the cost of project, the expected revenue/benefit for a given period. The analysis ideally needs to be done before the start of the development efforts for better decision making by management. This includes estimates for typical costs of a computer based information system like Development Costs that include costs of the system development process, like salaries of developers; Operating Costs including hardware/software rental or depreciation charges, salaries of computer operators and other data processing personnel, who will operate the new system; and Intangible Cost that cannot be easily measured.
 - (ii) **Computing Cost of IT Implementation and Cost Benefit Analysis:** For analysis of ROI, accountants need the costs and returns from the system development efforts. For correct generation of data, proper accounting needs to be done. Accountants shall be the person to whom management shall look for the purpose.
 - (iii) **Skills expected from an Accountant:** An accountant, being an expert in accounting field must possess skills to understand the system development efforts and nuances of the same. S/he is expected to have various key skills, including understanding of the business objectives, expert book keeper, and understanding of system development efforts etc.
- (b) The major possible Cyber-attacks are as follows:
- **Phishing:** It is the act of attempting to acquire information such as usernames, passwords, and credit card details by masquerading as a trustworthy entity in an electronic communication. Communications purporting to be from popular social web sites, auction sites, online payment processors or IT administrators are commonly used to lure the unsuspecting public.
 - **Network Scanning:** It is a process to identify active hosts of a system, for purpose of getting information about IP addresses etc.
 - **Virus/Malicious Code:** As per Section 43 of the Information Technology Act, 2000, "Computer Virus" means any computer instruction, information, data or program that destroys, damages, degrades or adversely affects the performance of a computer resource or attaches itself to another computer resource and operates when a program, data or instruction is executed or some other event takes place in that computer resource;
 - **Spam:** E-mailing the same message to everyone on one or more Usenet News Group or LISTSERV lists is termed as Spam.

- **Website Compromise/Malware Propagation:** It includes website defacements and malware hosting on websites in an unauthorized manner.
 - **Cracking, Eavesdropping, E-mail Forgery and Threats and Scavenging** is some of the other cyber-attacks.
- (c) Section 7 of Information Technology (Amendment) Act, 2008 for the retention of documents etc. in electronic form.

[Section 7] Retention of Electronic Records

- (1) Where any law provides that documents, records or information shall be retained for any specific period, then, that requirement shall be deemed to have been satisfied if such documents, records or information are retained in the electronic form, if -
- (a) the information contained therein remains accessible to be usable for a subsequent reference;
 - (b) the electronic record is retained in the format in which it was originally generated, sent or received or in a format which can be demonstrated to represent accurately the information originally generated, sent or received;
 - (c) the details which will facilitate the identification of the origin, destination, date and time of dispatch or receipt of such electronic record are available in the electronic record:

PROVIDED that this clause does not apply to any information which is automatically generated solely for the purpose of enabling an electronic record to be dispatched or received.

- (2) Nothing in this section shall apply to any law that expressly provides for the retention of documents, records or information in the form of electronic records.
- (d) Major areas of computer based applications are finance and accounting, marketing and sales, manufacturing, inventory/stock management, human resource management etc., which are discussed as follows:
- **Finance and Accounting** – The main goal of this subsystem is to ensure the financial viability of the organization, enforce financial discipline and plan and monitor the financial budget. It also helps in forecasting revenues, determining the best resources and uses of funds and managing other financial resources. Typical sub-application areas in finance and accounting are - Financial accounting; General ledger; Accounts receivable/payable; Asset accounting; Investment management; Cash management; Treasury management; Fund management and Balance sheet.
 - **Marketing and Sales** – Marketing and sales activities have a key role for running a business successfully in a competitive environment. The objective of this subsystem is to maximize the sales and ensure customer satisfaction. The marketing system facilitates the chances of order procurement by marketing the products of the company, creating new customers and advertising the products. The sales department may use an order processing system to keep the status and track of orders, generate bills for the orders executed and delivered to the customer, strategies for rendering services during warranty period and beyond, analyzing the sales data by category such as by region, product, sales man or sales value. The system may also be used to compute commissions for dealers or salesmen and thus helps the corporate managers to take decisions in many crucial areas.
 - **Production or Manufacturing** – The objective of this subsystem is to optimally deploy man, machine and material to maximize production or service. The system generates

production schedules and schedules of material requirements, monitors the product quality, plans for replacement or overhauling the machinery and helps in overhead cost control and waste control.

- **Inventory /Stores Management** - The inventory management system is designed with a view to keeping the track of materials in the stores. The system is used to regulate the maximum and minimum level of stocks, raise alarm at danger level stock of any material, give timely alert for re-ordering of materials with optimal re-order quantity and facilitate various queries about inventory like total inventory value at any time, identification of important items in terms stock value (ABC analysis), identification most frequently moving items (XYZ analysis) etc. Similarly, well-designed inventory management system for finished goods and semi-finished goods provides important information for production schedule and marketing/sales strategy.
- **Human Resource Management** - Human resource is the most valuable asset for an organization. Effective and efficient utilization of manpower in a dispute-free environment in this key functional area ensures to facilitate disruption free and timely services in business. Human Resource Management System (HRMS) aims to achieve this goal. Skill database maintained in HRM system, with details of qualifications, training, experience, interests etc. helps management for allocating manpower to right activity at the time of need or starting a new project. This system also keeps track of employees' output or efficiency. Administrative functions like keeping track of leave records or handling other related functions are also included HRM system. An HRM system may have the following modules – Personnel administration; Recruitment management; Travel management; Benefit administration; Salary administration; Promotion management etc.

2. (a) Major characteristics 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.
- (b) **Platform as a Service (PaaS):** PaaS provides the users the ability to develop and deploy an application on the development platform provided by the service provider. In traditional application development, the application will be developed locally and will be hosted in the central location. In stand-alone application development, the application will be developed by traditional development platforms result in licensing - based software, whereas PaaS changes the application development from local machine to online. For example- Google AppEngine, Windows Azure Compute etc.

Characteristics of PaaS are as follows:

- **All in One:** Most of the PaaS providers offer services like programming languages to develop, test, deploy, host and maintain applications in the same Integrated Development Environment (IDE).
- **Web access to the development platform:** PaaS provides web access to the development platform that helps the developers to create, modify, test, and deploy different applications on the same platform.
- **Offline Access:** To enable offline development, some of the PaaS providers allow the developer to synchronize their local IDE with the PaaS services. The developers can develop an application locally and deploy it online whenever they are connected to the Internet.
- **Built-in Scalability:** PaaS services provide built-in scalability to an application that is developed using any PaaS. This ensures that the application is capable of handling varying loads efficiently.
- **Collaborative Platform:** To enable collaboration among developers, most of the PaaS providers provide tools for project planning and communication.
- **Diverse Client Tools:** PaaS providers offer a wide variety of client tools like Web User Interface (UI), Application Programming Interface (API) etc. to help the developers to choose the tool of their choice.

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

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

3. (a) A good security policy should clearly state the following:

- Purpose and Scope of the Document and the intended audience;
- The Security Infrastructure;
- Security policy document maintenance and compliance requirements;
- Incident response mechanism and incident reporting;
- Security organization Structure;
- Inventory and Classification of assets;
- Description of technologies and computing structure;
- Physical and Environmental Security;
- Identity Management and access control;
- IT Operations management;
- IT Communications;
- System Development and Maintenance Controls;
- Business Continuity Planning;
- Legal Compliances; and
- Monitoring and Auditing Requirements.

(b) In computer programming, unit testing is a software verification and validation method in which a programmer tests if individual units of source code are fit for use. A unit is the smallest testable part of an application, which may be an individual program, function, procedure, etc. or may belong to a base/super class, abstract class or derived/child class. Unit tests are typically written and run by software developers to ensure that code meets its design and behaves as intended. There are five categories of tests that a programmer typically performs on a program unit. Such typical tests are described as follows:

- **Functional Tests:** Functional Tests check 'whether programs do, what they are supposed to do or not'. The test plan specifies operating conditions, input values, and expected results, and as per this plan, programmer checks by inputting the values to see whether the actual result and expected result match.

- **Performance Tests:** Performance Tests should be designed to verify the response time, the execution time, the throughput, primary and secondary memory utilization and the traffic rates on data channels and communication links.
- **Stress Tests:** Stress testing is a form of testing that is used to determine the stability of a given system or entity. It involves testing beyond normal operational capacity, often to a breaking point, to observe the results. These tests are designed to overload a program in various ways. The purpose of a stress test is to determine the limitations of the program. For example, during a sort operation, the available memory can be reduced to find out whether the program can handle the situation.
- **Structural Tests:** Structural Tests are concerned with examining the internal processing logic of a software system. For example, if a function is responsible for tax calculation, the verification of the logic is a structural test.
- **Parallel Tests:** In Parallel Tests, the same test data is used in the new and old system and the output results are then compared.

(c) The working of Mobile Computing is as follows:

- The user enters or access data using the application on handheld computing device.
- Using one of several connecting technologies, the new data are transmitted from handheld to site's information system where files are updated and the new data are accessible to other system user.
- Now both systems (handheld and site's computer) have the same information and are in sync.
- The process work the same way starting from the other direction.

The process is like the way a worker's desktop PC access the organization's applications, except that user's device is not physically connected to the organization's system. The communication between the user device and site's information systems uses different methods for transferring and synchronizing data, some involving the use of Radio Frequency (RF) technology.

4. (a) **Computer Crime Exposures:** Computers can be utilized both constructively and destructively. Computer systems are used to steal money, goods, software or corporate information. Crimes are also committed when false data or unauthorized transaction is made. Crimes are committed by using computers and can damage the reputation, morale and even the existence of an organization. Computer crimes generally result in Loss of customers, embarrassment to management and legal actions against the organizations. These are given as follows:

- **Financial Loss:** Financial losses may be direct like loss of electronic funds or indirect like expenditure towards repair of damaged electronic components.
- **Legal Repercussions:** An organization must adhere to many laws while developing security policies and procedures. These laws protect both the perpetrator and organization from trial. The organizations will be exposed to lawsuits from investors and insurers if there have no proper security measures. The IS auditor should take legal counsel while reviewing the issues associated with computer security.
- **Loss of Credibility or Competitive Edge:** To maintain competitive edge, many companies, especially service firms such as banks and investment firms, needs credibility and public trust. This credibility will be shattered resulting in loss of business and prestige if security violation occurs.

- **Blackmail/Industrial Espionage:** By knowing the confidential information, the perpetrator can obtain money from the organization by threatening and exploiting the **security** violation.
- **Disclosure of Confidential, Sensitive or Embarrassing Information:** These events can spoil the reputation of the organization. Legal or regulatory actions against the company may be also a result of disclosure.
- **Sabotage:** People, who may not be interested in financial gain but who want to spoil the credibility of the company or to will involve in such activities. They do it because of their dislike towards the organization or for their intemperance.
- **Spoofing:** A spoofing attack involves forging one's source address. One machine is used to impersonate the other in spoofing technique. Spoofing occurs only after a machine has been identified as vulnerable. A penetrator makes the user think that s/he is interacting with the operating system. For example, a penetrator duplicates the login procedure, captures the user's password, attempts for a system crash and makes the user login again.

(b) As per SEBI, Auditor Selection Norms 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)².
- 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.

(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) Enablers are factors that, individually and collectively, influence whether something will work; in this case, governance and management over enterprise IT. Enablers are driven by the goals cascade, i.e., higher-level IT related goals defining 'what the different enablers should achieve'. The COBIT 5 framework describes seven categories of enablers, which are discussed as follows:
- **Principles, Policies and Frameworks** are the vehicle to translate the desired behavior into practical guidance for day-to-day management.
 - **Processes** describe an organized set of practices and activities to achieve certain objectives and produce a set of outputs in support of achieving overall IT-related goals.
 - **Organizational structures** are the key decision-making entities in an enterprise.
 - **Culture, Ethics and Behavior** of individuals and of the enterprise are very often underestimated as a success factor in governance and management activities.
 - **Information** is pervasive throughout any organization and includes all information produced and used by the enterprise. Information is required for keeping the organization running and well governed, but at the operational level, information is very often the key product of the enterprise itself.
 - **Services, Infrastructure and Applications** include the infrastructure, technology and applications that provide the enterprise with information technology processing and services.
 - **People, Skills and Competencies** are linked to people and are required for successful completion of all activities and for making correct decisions and taking corrective actions.
- (b) Characteristics of Decision Support System (DSS) are as follows:
- This supports decision making and occurs at all levels of management.
 - Instead of helping individuals working on independent tasks, it should be able to help group making decisions.
 - It should be flexible and adaptable. i.e. it should be able to fit itself in the style of a manager and ready to change per changes in the environment.
 - DSS focuses on decision rather than data and information.
 - It should be easy to use. A user should not have knowledge of computer programming to generate reports that helps in decision making.
 - DSS can be used for structured problems.
 - DSS should be user-friendly.
 - DSS should be extensible and evolve overtime.
 - DSSs are used mainly for decision making rather than communicating decisions and training purposes.
 - The impact of DSS should be on decision where the manager's judgment is essential and there is sufficient structure for computers.
- (c) **Inherent Risk:** Inherent risk is the susceptibility of information resources or resources controlled by the information system to material theft, destruction, disclosure, unauthorized modification, or other impairment, if there are no related internal controls. Inherent risk is the measure of auditor's assessment that there may or may not be material vulnerabilities or gaps in the audit subject exposing it to high risk before considering the effectiveness of

internal controls. If the auditor concludes that there is a high likelihood of risk exposure, ignoring internal controls, the auditor would conclude that the inherent risk is high. For example, inherent risk would be high in case of auditing internet banking in comparison to branch banking or inherent risk would be high if the audit subject is an off-site. ATM in an example of the same. Internal controls are ignored in setting inherent risk because they are considered separately in the audit risk model as control risk. It is often an area of professional judgment on the part of an auditor.

Control Risk: Control risk is the risk that could occur in an audit area, and which could be material, individually or in combination with other errors, will not be prevented or detected and corrected on a timely basis by the internal control system. Control risk is a measure of the auditor's assessment of the likelihood that risk exceeding a tolerable level and will not be prevented or detected by the client's internal control system. This assessment includes an assessment of whether a client's internal controls are effective for preventing or detecting gaps and the auditor's intention to make that assessment at a level below the maximum (100 percent) as a part of the audit plan.

6. (a) The primary objective of a Business Continuity Plan (BCP) is to minimize loss by minimizing the cost associated with disruptions and enable an organization to survive a disaster and to reestablish normal business operations. To survive, the organization must assure that critical operations can resume normal processing within a reasonable time frame. The key objectives of the contingency plan should be to:

- Provide the safety and well-being of people on the premises at the time of disaster;
- Continue critical business operations;
- Minimize the duration of a serious disruption to operations and resources (both information processing and other resources);
- Minimize immediate damage and losses;
- Establish management succession and emergency powers;
- Facilitate effective co-ordination of recovery tasks;
- Reduce the complexity of the recovery effort; and
- Identify critical lines of business and supporting functions.

Therefore, the goals of the Business Continuity Plan (BCP) should be to:

- Identify weaknesses and implement a disaster prevention program;
- minimize the duration of a serious disruption to business operations;
- facilitate effective co-ordination of recovery tasks; and
- reduce the complexity of the recovery effort.

- (b) **Strength of Prototyping Model:** Some of its strengths identified by the experts and practitioners include the following:

- It improves both user participation in system development and communication among project stakeholders.
- It is especially useful for resolving unclear objectives; developing and validating user requirements; experimenting with or comparing various design solutions, or investigating both performance and the human computer interface.
- Potential exists for exploiting knowledge gained in an early iteration as later iterations are developed.

- It helps to easily identify, confusing or difficult functions and missing functionality.
- It enables to generate specifications for a production application.
- It encourages innovation and flexible designs.
- It provides for quick implementation of an incomplete, but functional, application.
- It typically results in a better definition of these users' needs and requirements than does the traditional systems development approach.
- A very short time is normally required to develop and start experimenting with a prototype. This short time allows system users to immediately evaluate proposed system changes.
- Since system users experiment with each version of the prototype through an interactive process, errors are hopefully detected and eliminated early in the developmental process. Thus, the information system ultimately implemented should be more reliable and less costly to develop than when the traditional systems development approach is employed.

(c) 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.

7. (a) The key governance practices required to implement GEIT in enterprises are as follows:

- **Evaluate the Governance System:** Continually identify and engage with the enterprise's stakeholders, document an understanding of the requirements, and make judgment on the current and future design of governance of enterprise IT;
- **Direct the Governance System:** Inform leadership and obtain their support, buy-in and commitment. Guide the structures, processes and practices for the governance of IT in line with agreed governance design principles, decision-making models and authority levels. Define the information required for informed decision making; and
- **Monitor the Governance System:** Monitor the effectiveness and performance of the enterprise's governance of IT. Assess whether the governance system and implemented mechanisms (including structures, principles and processes) are operating effectively and provide appropriate oversight of IT.

- (b) **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 such as Data Leakage, Subversive Threats, Wire-tapping, Piggybacking and Shutting Down of the Computer/Denial of Service.
- (c) **Business Governance or Performance:** The **Business Governance** is pro-active in its approach. It is business oriented and takes a forward-looking view. This dimension focuses on strategy and value creation with the objective of helping the board to make strategic decisions, understand its risk appetite and its key performance drivers. This dimension does not lend itself easily to a regime of standards and assurance as this is specific to enterprise goals and varies based on the mechanism to achieve them. It is advisable to develop appropriate best practices, tools and techniques such as balanced scorecards and strategic enterprise systems that can be applied intelligently for different types of enterprises as required.
- (d) **Logical Access Violators** are often the same people who exploit physical exposures, although the skills needed to exploit logical exposures are more technical and complex. They are mainly:
- Hackers: Hackers try their best to overcome restrictions to prove their ability. Ethical hackers most likely never try to misuse the computer intentionally;
 - Employees (authorized or unauthorized);
 - IS Personnel: They have easiest to access to computerized information since they come across to information during discharging their duties. Segregation of duties and supervision help to reduce the logical access violations; Former Employees: should be cautious of former employees who have left the organization on unfavourable terms;
 - End Users; Interested or Educated Outsiders; Competitors; Foreigners; Organized Criminals; Crackers; Part-time and Temporary Personnel; Vendors and consultants; and Accidental Ignorant – Violation done unknowingly.
- (e) Information Systems Audit has been categorized into five types:
- (i) **Systems and Application:** An audit to verify that systems and applications are appropriate, are efficient, and are adequately controlled to ensure valid, reliable, timely, and secure input, processing, and output at all levels of a system's activity.
 - (ii) **Information Processing Facilities:** An audit to verify that the processing facility is controlled to ensure timely, accurate, and efficient processing of applications under normal and potentially disruptive conditions.
 - (iii) **Systems Development:** An audit to verify that the systems under development meet the objectives of the organization and to ensure that the systems are developed in accordance with generally accepted standards for systems development.
 - (iv) **Management of IT and Enterprise Architecture:** An audit to verify that IT management has developed an organizational structure and procedures to ensure a controlled and efficient environment for information processing.
 - (v) **Telecommunications, Intranets, and Extranets:** An audit to verify that controls are in place on the client (end device), server, and on the network connecting the clients and servers.

MOCK TEST PAPER
FINAL: GROUP – II
PAPER – 7: DIRECT TAX LAWS

Question 1 is compulsory

Answer any five questions from the remaining six questions

Time Allowed – 3 Hours

Maximum Marks – 100

1. (a) ABC LLP, a limited liability partnership set up a unit in Special Economic Zone (SEZ) in the financial year 2012-13 for providing IT enabled services. The unit fulfills all the conditions of section 10AA of the Income-tax Act, 1961. During the financial year 2015-16, it has also set up a cold chain facility. It fulfills all the conditions of section 35AD. Capital expenditure in respect of cold chain facility amounted to Rs.85 lakhs (including cost of land Rs.20 lakhs). The cold chain business became operational with effect from 1st April, 2016 and the expenditure of Rs.85 lakhs was capitalized in the books on that date.

Relevant details for the financial year 2016-17 are as follows:

Particulars	Rs.
Profit of unit located in SEZ	40,00,000
Export Turnover of above unit	80,00,000
Domestic Turnover of above unit	20,00,000
Profit from operation of cold chain facility (before considering deduction under Section 35AD).	1,05,00,000

Compute income tax (including AMT under Section 115JC) payable by ABC LLP for Assessment Year 2017-18. **(10 Marks)**

- (b) KG Ltd, located within the corporation limits decided in December, 2016 to shift its industrial undertaking to non-urban area. The company sold some of the assets and acquired new assets in the process of shifting. The relevant details are as follows: **(Rs. in lacs)**

	Particulars	Land	Building	Plant & Machinery	Furniture
(i)	Sale proceeds (sale effected in January, 2017)	8	18	16	3
(ii)	Indexed cost of acquisition	4	10	12	2
(iii)	Cost of acquisition in terms of section 50	--	4	5	2
(iv)	Cost of new assets purchased in July, 2017 for the purpose of business in the new place	4	7	17	2

Compute the capital gains of KG Ltd for the assessment year 2017-18. **(10 Marks)**

2. Deep, Deepak and Divya carried on business of running hotels in partnership from 1st April, 2007 to 31st March, 2015. In order to increase its scale of operation and meet its fund requirement, the firm decided to carry on its business through corporate route. For that purpose, a company under the name and style "D3 Private Limited" was formed on 1st April, 2015 and the business of the partnership firm as a whole was succeeded to by the company with effect from 1st July, 2015.

The company's profit and loss account for the year ended 31st March, 2017 shows a net profit of Rs.450 lacs after debit/credit of the following items:

- (a) Interest of Rs. 3 lacs paid to SBI Bank on a term loan taken for the purpose of acquiring a land at Chennai for a new hotel to be set up.
- (b) Depreciation charged Rs. 40 lacs.
- (c) Rs.3 lacs credited on account of waiver of dues obtained from a supplier of the erstwhile firm against supply of certain raw materials.
- (d) Rs. 1.26 lacs being the aggregate of amounts paid in cash to Rajesh, a transport contractor as follows:

Date of Payment	Rs. (In lacs)
15 th June, 2016	0.18
18 th July, 2016	0.20
23 th October, 2016	0.25
7 th November, 2016	0.27
5 th December, 2016	0.36

Tax was not deducted at source from the above payments. Mr. Rajesh has furnished a declaration to the company.

- (e) Provision for bad and doubtful debts Rs. 12 lacs.
- (f) Payment of Rs. 25 lacs to some employees as compensation for voluntary retirement, as per scheme.

Other Information:

- (i) Depreciation as per the Income-tax Act, 1961 Rs. 65 lacs.
- (ii) Debt of Rs.4 lacs due from one corporate customer for five months has been written off during the year after giving a few reminders by debiting provision for bad and doubtful debts account.
- (iii) The erstwhile firm was allowed exemption of Rs. 40 lacs under section 47(xiii) in respect of long-term capital assets transferred to the company.
- (iv) The company's voting rights till 31st March, 2016 were held as follows:

Deep	38%
Deepak	32%
Divya	15%
Others	15%

During the P.Y 2016-17, shares constituting 36% of voting rights were sold by Deep to his son-in-law, Akash.

- (v) Unabsorbed business loss and unabsorbed depreciation of Rs. 15 lacs each have been carried forward from Assessment Year 2015-16.
- (vi) The company has a subsidiary company, XYZ Private Limited (a closely held company). During the year, the company obtained a temporary loan of Rs. 15 lacs from its subsidiary company. Accumulated profit of the subsidiary company was Rs.12 lacs at the time of payment of the loan. The loan was repaid by the company before the end of the year.

Compute total income of D3 Private Limited for the Assessment Year 2017-18. Indicate reasons for treatment of each of the items. Ignore the provisions relating to minimum alternate tax.

(16 Marks)

3. (a) Asha purchased a residential flat from her friend Nisha at Rs. 12 lacs in the city of Delhi on 2nd November, 2016. The value determined by the Stamp Valuation Authority for stamp duty purpose amounted to Rs.15 lacs. Nisha had purchased the flat on 1st March, 2014 at a cost of Rs.3.50 lacs. Asha sold the flat for Rs.20 lacs on 30th March, 2017.

Determine the effect of the above transactions on the assessments of Nisha and Asha for assessment year 2017-18, assuming that value for stamp duty purpose in case of the second sale was not more than the sale consideration. **(6 Marks)**

- (b) PQR Limited was amalgamated with ABC Limited on 01.04.2016. All the conditions of section 2(1B) were satisfied.

PQR Limited has the following carried forward losses as assessed till the Assessment Year 2016-17:

	Particulars	Rs. (in lacs)
(i)	Speculative Loss	7
(ii)	Unabsorbed Depreciation	18
(iii)	Unabsorbed expenditure of capital nature on scientific research	2
(iv)	Business Loss	120

ABC Limited has computed a profit of Rs.140 lacs for the financial year 2016-17 before setting off the eligible losses of PQR Limited but after providing depreciation at 15% per annum on Rs.170 lacs, being the consideration at which plant and machinery were transferred to ABC Limited. The written down value as per income-tax record of PQR Limited as on 31st March, 2016 was Rs. 120 lacs.

The above profit of ABC Limited includes speculative profit of Rs.10 lacs.

Compute the total income of ABC Limited for Assessment Year 2017-18 and indicate the losses/other allowances to be carried forward by it. **(6 Marks)**

- (c) XYZ Limited acquired a machine on 1st April, 2016 for Rs. 10 crores by availing 70% loan facility from a bank. The machine was put to regular use from 1st February, 2017. Interest on loan is charged at 12% per annum.

Advise XYZ Limited on the treatment of interest payment made on this loan and depreciation allowable for A.Y. 2017-18 (assume that this machine is the only machine in the said block of assets). **(4 Marks)**

4. (a) Mr. Kapoor was a partner in a firm, representing his HUF, holding 28% of the share in the firm. His wife Mrs. Kapoor, a house lady, was admitted in her individual capacity in the firm for 25% share. She was paid remuneration which has been proposed by the Assessing Officer to be clubbed in the hands of Mr. Kapoor-HUF by invoking section 64 of the Act.

(4 Marks)

- (b) A company paid the full consideration towards cost of administrative office building and occupied the same before 31st March. The registration did not take place before the end of the previous year. Can the depreciation claim be made? **(4 Marks)**

- (c) "ABC Ltd" engaged in manufacturing of different products was asked by the Central Excise Department to pay an amount of Rs.25,00,000 on certain goods manufactured by it, which was deposited during the financial year 2012-13 and was claimed as deduction in the return of income filed for that assessment year. This levy of the excise duty was challenged in the High Court, and the Court in July, 2016 held "that the same is not payable by the company". The Excise Department filed appeal challenging the order of the High Court before the Supreme Court. The Assessing Officer issued a show cause on the basis of the decision of

the High Court to tax the benefit derived by the company in A.Y. 2017-18. Discuss the correctness of the action of Assessing Officer, if the assessee company has not received the refund from Central Excise Department pursuant to the High Court order. **(4 Marks)**

- (d) Aryan is a resident of both India and another foreign country in the previous year 2016-17. He owns immovable properties (including residential house) in both the countries. He earned income of Rs.50 lacs from rubber estates in the foreign country during the financial year 2016-17. He also sold some house property situated in foreign country resulting in short-term capital gain of Rs.10 lacs during the year. Aryan has no permanent establishment of business in India. However, he has derived rental income of Rs. 6 lacs from property let out in India and he has a house in Lucknow where he stays during his visit to India.

Article 4 of the Double Taxation Avoidance Agreement between India and the foreign country where Aryan is a resident, provides that "where an individual is a resident of both the Contracting States, then he shall be deemed to be resident of the Contracting State in which he has permanent home available to him. If he has permanent home in both the Contracting States, he shall be deemed to be a resident of the Contracting State with which his personal and economic relations are closer (centre of vital interests)".

You are required to state with reasons whether the business income of Aryan arising in foreign country and the capital gains in respect of sale of the property situated in foreign country can be taxed in India. **(4 Marks)**

5. (a) A partnership firm consisting of three partners X, Y and Z is engaged in the business of manufacturing and selling toys.

Turnover of the business for the year ended 31st March, 2017 amounts to Rs.175 lakh. Bad debts written off in the books are Rs.75,000. Interest at 12% is provided to partner Z on his capital of Rs.6 lakh as authorized by the partnership deed.

The firm had business loss of Rs.50,000 and unabsorbed depreciation of Rs. 1,50,000 carried forward from Assessment Year 2016-17. The firm did not pay tax under presumptive tax system in assessment year 2016-17. The firm opts for presumptive taxation under section 44AD for Assessment Year 2017-18.

- (i) Compute the income of the firm chargeable under the head "Profits and gains of business or profession."
- (ii) What would be the liability for interest under sections 234B and 234C, if the firm has not paid any advance tax? **(6 Marks)**
- (b) ABC Co-operative Bank, a co-operative society, having its area of operation confined to Gubbi Taluk and the principal object of which is to provide for long-term credit for agricultural and rural development activities, has received the following amounts during the year ending 31.3.2017:
- (i) Interest amounting to Rs. 1,20,000 from its members on loans advanced to them.
- (ii) Interest amounting to Rs. 1,55,000 on deposits with other co-operative societies.
- (iii) Rent amounting to Rs. 2,20,000 from letting out its godowns for storage of commodities.

ABC Co-operative Bank seeks your advice in the matter of taxability of the above amounts and the eligibility for deduction, if any, in respect thereof for the assessment year 2017-18.

(6 Marks)

- (c) M/s. Star Fly Airlines incorporated as a company in UK operated its flights to India and vice versa during the year 2016-17 (April, 2016 to March, 2017) and collected charges of Rs. 130 lacs for carriage of passengers and cargo out of which Rs. 70 lacs were received in pounds for

the passenger fare booked from London to Mumbai. The total expenses for the year on operation of such flights were Rs. 190 lacs. Compute the income chargeable to tax of the foreign airlines. **(4 Marks)**

6. (a) The Assessing Officer issued notices under section 133 to four banks requiring particulars relating to a customer in a specific format duly verified in a prescribed manner. One of the banks refused to part with the information on the ground that the letter did not specify about any proceeding pending against the said customer under the Income-tax Act, 1961. Discuss the correctness of action of the bank in refusing to furnish the particulars as required by the Assessing Officer. **(4 Marks)**
- (b) EIH Private Ltd.'s assessment for assessment year 2011-12 was completed under Section 143(3) on 31st August, 2012. The company went in appeal to the Commissioner (Appeals) and the appeal was decided on 16th August, 2013 and the appeal effect was duly given by the Assessing Officer on 25th August, 2013. Thereafter, on 1st September, 2017 the Assessing Officer noticed a mistake in calculation of depreciation on a particular block of assets, which reduced the income excessively by Rs.1.10 lacs. The Assessing Officer issued notice under section 154 for the purpose of rectifying the mistake. Is such rectification permissible? **(4 Marks)**
- (c) State the conditions, if any, to be satisfied by an assessee in order to get relief under section 273A(4) regarding the waiver of penalty. Can the Commissioner refuse to grant relief, when the conditions laid down in the section was complied with, by the assessee? **(4 Marks)**
- (d) Explain as to what the term 'Advance Ruling' means under the Income-tax Act 1961. **(4 Marks)**
7. (a) Discuss the liability for tax deduction at source in the following cases for the assessment year 2017-18:
- (i) Fly Ltd. has paid amount of Rs.15 lacs during the year ended 31-3-2017 to Airports Authority of India towards landing and parking charges.
- (ii) Rs.2,45,000 paid to Mr. X on 01-02-2017 by Karnataka State Government on compulsory acquisition of his urban land. What would be your answer if the land is agriculture land?
- (iii) State Bank of India pays Rs.50,000 per month as rent to the Central Government for a building in which one of its branches is situated. **(6 Marks)**
- (b) Explain the circumstances under which the Assessing Officer can resort to provisional attachment of the property of the assessee. Also state the period of time for which such attachment can take place.
- When can the Assessing Officer revoke provisional attachment of property? Discuss. **(6 Marks)**
- (c) Does the Settlement Commission have the power to reduce or waive interest levied under sections 234A, 234B and 234C of the Income-tax Act? Discuss. **(4 Marks)**

MOCK TEST PAPER
FINAL – GROUP – II
PAPER – 7: DIRECT TAX LAWS
SUGGESTED ANSWERS/HINTS

1. (a) **Computation of total income and tax liability of ABC LLP for A.Y.2017-18**
(under the regular provisions of the Income-tax Act, 1961)

Particulars	Rs.	Rs.
Profits and gains of business or profession		
Unit in SEZ	40,00,000	
<i>Less:</i> Deduction under section 10AA [See Note (1) below]	<u>32,00,000</u>	
Business income of SEZ unit chargeable to tax		8,00,000
Profit from operation of cold chain facility	1,05,00,000	
<i>Less:</i> Deduction under section 35AD [See Note (2) below]	<u>97,50,000</u>	
Business income of cold chain facility chargeable to tax		<u>7,50,000</u>
Total Income		<u>15,50,000</u>
Computation of tax liability (under the normal/regular provisions)		
Tax@30% on Rs.15,50,000		4,65,000
<i>Add:</i> Education cess@2% and SHEC@1%		<u>13,950</u>
Total tax liability		<u>4,78,950</u>

Computation of adjusted total income of ABC LLP for levy of Alternate Minimum Tax

Particulars	Rs.	Rs.
Total Income (as computed above)		15,50,000
<i>Add:</i> Deduction under section 10AA		<u>32,00,000</u>
		47,50,000
<i>Add:</i> Deduction under section 35AD	97,50,000	
<i>Less:</i> Depreciation under section 32		
On building @10% of Rs.65 lakhs ¹	<u>6,50,000</u>	<u>91,00,000</u>
Adjusted Total Income		<u>1,38,50,000</u>
Alternate Minimum Tax@18.5%		25,62,250
<i>Add:</i> Surcharge@12% (since adjusted total income >Rs.1 crore)		<u>3,07,470</u>
		28,69,720
<i>Add:</i> Education cess@2% and SHEC@1%		<u>86,092</u>
		<u>29,55,812</u>
Tax liability under section 115JC (rounded off)		29,55,810

¹Assuming the capital expenditure of Rs.65 lakhs is incurred entirely on buildings

Since the regular income-tax payable is less than the alternate minimum tax payable, the adjusted total income shall be deemed to be the total income and tax is leviable @ 18.5% thereof *plus* surcharge@12% and cess@3%. Therefore, the tax liability is Rs.29,55,810.

AMT Credit to be carried forward under section 115JEE	Rs.
Tax liability under section 115JC	29,55,810
Less: Tax liability under the regular provisions of the Income-tax Act, 1961	<u>4,78,950</u>
	<u>24,76,860</u>

Notes:

(1) **Deduction under section 10AA in respect of Unit in SEZ =**

$$\text{Profit of the Unit in SEZ} \times \frac{\text{Export turnover of the Unit in SEZ}}{\text{Total turnover of the Unit in SEZ}}$$

$$\text{Rs.40,00,000} \times \frac{\text{Rs.80,00,000}}{\text{Rs.1,00,00,000}} = \text{Rs.32,00,000}$$

- (2) Weighted deduction@150% of the capital expenditure is available under section 35AD for A.Y.2017-18 in respect of specified business of setting up and operating a cold chain facility for storage of agricultural produce which commences operation on or after 01.04.2012.

Further, the expenditure incurred, wholly and exclusively, for the purposes of such specified business, shall be allowed as deduction (weighted deduction, in this case) during the previous year in which he commences operations of his specified business if the expenditure is incurred prior to the commencement of its operations and the amount is capitalized in the books of account of the assessee on the date of commencement of its operations.

Deduction under section 35AD would, however, not be available on expenditure incurred on acquisition of land.

In this case, since the capital expenditure of Rs. 65 lakhs (i.e., Rs. 85 lakhs – Rs. 20 lakhs, being expenditure on acquisition of land) has been incurred in the F.Y.2015-16 and capitalized in the books of account on 1.4.2016, being the date when the warehouse became operational, Rs. 97,50,000, being 150% of Rs.65 lakhs would qualify for deduction under section 35AD.

- (b) Section 54G deals with deduction in respect of any capital gain that may arise from the transfer of an industrial undertaking situated in an urban area in the course of or in consequence of shifting to a non-urban area.

If the assessee purchases new machinery or plant or acquires a building or land or constructs a new building or shifts the original asset and transfers the establishment to the new area, within 1 year before or 3 years after the date on which the transfer takes place, then, instead of the capital gain being charged to tax, it shall be dealt with as under:

1. If the capital gain is greater than the cost of the new asset, the difference between the capital gain and the cost of the new asset shall be chargeable as income 'under section 45'.
2. If the total gain is equal to or less than the cost of the new asset, section 45 is not to be applied.

The capital assets referred to in section 54G are machinery or plant or land or building or any rights in building or land. Capital gain arising on transfer of furniture does not qualify for exemption under section 54G. No exemption is therefore available under section 54G in respect of investment of Rs. 2 lacs in acquiring furniture.

The first step therefore, is to determine the capital gain arising out of the transfer and thereafter apply the provisions of section 54G.

	Particulars	Rs.
(a)	Land – Sale proceeds (Non-depreciable)	8,00,000
	<i>Less: Indexed cost</i>	4,00,000
	Long term capital gain	4,00,000
	<i>Less: Cost of new assets purchased within 3 years after the date of transfer (under section 54G)</i>	3,00,000
	Taxable Long term capital gain	1,00,000
(b)	Building – sale proceeds (depreciable assets)	18,00,000
	<i>Less: W.D.V. is deemed as cost of acquisition under section 50</i>	4,00,000
	Short term capital gain	14,00,000
(c)	Plant & machinery- sale proceeds (depreciable asset)	16,00,000
	<i>Less: WDV is deemed cost under section 50</i>	5,00,000
	Short term capital gain	11,00,000
(d)	Furniture - sale proceeds (depreciable asset)	3,00,000
	<i>Less: WDV is deemed cost under section 50</i>	2,00,000
	Short term capital gain (A)	1,00,000
Summary		
	Short term capital gain : Building	14,00,000
	Short term capital gain : Plant & machinery	11,00,000
		25,00,000
	<i>Less: Section 54G [New assets purchased] (See Note below)</i>	25,00,000
	Net short term capital gain (B)	Nil
	Total short term capital gain (A)+(B) = Rs. 1 lac	

Note – Total exemption available under section 54G is Rs. 28 lacs (Rs. 4 lacs + Rs. 7 lacs + Rs. 17 lacs). The exemption should first be exhausted against short term capital gain as the incidence of tax in case of short-term capital gain is more than in case of long term capital gain. Therefore, Rs. 25 lacs is exhausted against short term capital gain and the balance of Rs. 3 lacs against long term capital gain.

The taxable capital gains would be:

Long term capital gains	Rs. 1,00,000 (taxable @ 20% under section 112)
Short term capital gains	<u>Rs. 1,00,000</u> (taxable @30%)
	<u>Rs. 2,00,000</u>

2. Computation of Total Income of D3 (P) Ltd. for the A.Y.2017-18

Particulars	Rs.	
A. Profits and Gains from Business and Profession		
Net Profit as per Profit & Loss Account		4,50,00,000
Add: Items debited but to be considered separately or to be disallowed		
Interest on loan taken for acquiring land (Note 1)	3,00,000	
Depreciation debited in accounts	40,00,000	
Disallowance for payment exceeding the limit prescribed in section 40A(3) (Note 3)	36,000	
Provisions for bad and doubtful debts (Note 4)	12,00,000	
Compensation for voluntary retirement (Note 5)	<u>20,00,000</u>	<u>75,36,000</u>
		5,25,36,000
Less: Items credited but to be considered separately or to be allowed		
Depreciation allowable under the Income-tax Act, 1961	65,00,000	
Bad debts written off under section 36(1)(vii) (Note 4)	<u>4,00,000</u>	<u>69,00,000</u>
Business Income		4,56,36,000
B. Capital Gains		
Deemed long-term capital gain under section 47A(3) (Note 6)		40,00,000
C. Income from other sources		
Deemed dividend under section 2(22)(e) (Note 7)		<u>12,00,000</u>
Gross Total Income		5,08,36,000
Deduction under Chapter VI-A		<u>Nil</u>
Total Income		<u>5,08,36,000</u>

Notes:

- (1) Interest on term loan taken from bank for acquiring land for new hotel to be set up is not allowable under section 36(1)(iii). As per the proviso to section 36(1)(iii), interest paid in respect of capital borrowed for acquisition of an asset for the period from the date on which the borrowing was made till the date on which such asset is first put to use shall not be allowed as deduction.
- (2) Under section 41(1), where any expenditure or loss or a trading liability was allowed as deduction to the predecessor-firm and the successor in business has obtained (in cash or in any other manner), any amount in respect of which loss or expenditure was incurred by the predecessor-firm or some benefit by way of remission or cessation of such trading liability, the amount obtained by the successor in business (the company, in this case) or the value of benefit accruing to the successor shall be deemed to be profits and gains of business or profession and would be chargeable to tax in the year in which the amount is so obtained or the benefit accrued. In view of this provision, the amount of waiver i.e. Rs. 3,00,000 obtained from the supplier of the predecessor firm is deemed as business income of the assessee company. Since the amount is already credited to profit & loss account, no adjustment is necessary.
- (3) Section 40A(3) provides that where the assessee incurs any expenditure for which a payment or aggregate of payments made to a person in a single day, otherwise than by account payee cheque or account payee bank draft exceeds Rs. 20,000, the whole of such expenditure shall be disallowed. **However, for payment to transport operators for plying,**

hiring or leasing goods carriage, the limit for attracting disallowance under section 40A(3) is Rs. 35,000. Therefore, payment or aggregate payments up to Rs. 35,000 in a day can be made to a transport operator otherwise than by way of account payee cheque or account payee bank draft without attracting disallowance under section 40A(3). Therefore, the amount to be disallowed is Rs. 36,000 being the payment made on 5th December, 2016.

Disallowance under section 40(a)(ia) for non deduction of tax at source under section 194C, to the extent of 30% of the amount paid is not attracted, since Rajesh has furnished declaration to the company.

- (4) Provision for bad and doubtful debts is allowable as deduction under section 36(1)(viii) only in the case of specified banks and financial institutions. Therefore, a company engaged in hotel business is not eligible for deduction in respect of provision for bad and doubtful debts and accordingly, Rs. 12 lacs, debited to profit and loss account has to be added back.

A bad debt written off is allowed as deduction under section 36(1)(vii) if such debt is written off as irrecoverable in the books of account. Bad debts may be written off by debiting profit & loss account or provision for bad and doubtful debts account.

Therefore, the amount of Rs. 4 lacs written off during the year by debiting provision for bad and doubtful debts is allowable as deduction under section 36(1)(vii).

- (5) As per section 35DDA, where in any previous year, any expenditure is incurred by way of payment of any sum to an employee in connection with voluntary retirement, one-fifth of the amount so paid shall be deducted in computing profits and gains of business for that previous year, and the balance shall be deducted in four equal instalments in the immediately succeeding four previous years. Therefore, out of Rs. 25,00,000, an amount of Rs. 5,00,000 is deductible in assessment year 2017-18 and the balance shall be disallowed in this assessment year. Therefore, Rs. 20 lacs has to be added back.
- (6) It is stated that the erstwhile firm was allowed exemption under section 47(xiii) in respect of long-term capital gain from transfer of capital assets to the assessee company. One of the conditions as per the proviso to clause (xiii) of section 47 is that the aggregate of the shareholding in the company of the partners of the firm is at least 50% of the total voting power in the company and their shareholding continues to be as such for 5 years from the date of succession.

According to section 47A(3), where any of the conditions laid down in the proviso to clause (xiii) of section 47 are not complied with, the capital gain which was not charged to tax under section 45 shall be chargeable to tax in the hands of the successor company for the previous year in which the requirements of the proviso to clause (xiii) of section 47 are not complied with.

In the instant case, on sale of shares carrying 36% voting rights by Deep to his son-in-law, the aggregate of shareholding of the partners in the company has become less than 50% of the total voting power in the company and such change has taken place before expiry of 5 years from the date of succession. Therefore, the long-term capital gain which was not charged to tax in the hands of the firm in the year of succession shall be deemed to be long-term capital gain of the assessee company in the assessment year 2017-18.

- (7) Section 2(22)(e) provides that dividend includes any payment to the extent of accumulated profits by a company, in which the public are not substantially interested, of any sum by way of loan or advance to a shareholder who holds the beneficial ownership of equity shares carrying not less than 10% of the voting power.

In the instant case, the assessee company having more than 10% voting power in XYZ Private Limited (a closely held company) received loan of Rs. 15 lacs from the latter which had an accumulated profit of Rs.12 lacs. Therefore, the amount of loan to the extent of

accumulated profit i.e. Rs. 12 lacs shall be deemed to be dividend in the hands of the assessee company. The fact that the loan was repaid before end of the previous year is not relevant.

The amount deemed to be dividend under section 2(22)(e) is not exempt under section 10(34).

- (8) Since the unabsorbed business loss and unabsorbed depreciation relate to A.Y.2015-16, which is prior to incorporation of the company on 1.4.2015, such loss and depreciation would relate to the predecessor firm, and consequently, the provisions of section 72A(6) would be attracted.

As per section 72A(6), accumulated loss and depreciation of the predecessor firm would become the loss and depreciation of the successor company of the previous year in which the conversion takes place (i.e., P.Y.2015-16, in this case), provided the conditions laid down in section 47(xiii) are fulfilled. In this case, the conditions are fulfilled in the P.Y.2015-16. It appears that the assessee-company did not have sufficient profits during the P.Y.2015-16, against which the brought forward loss and unabsorbed depreciation can be set-off and for this reason, the same has been carried forward to the P.Y.2016-17 (A.Y.2017-18).

However, in the P.Y.2016-17, one of the conditions as per the proviso to clause (xiii) of section 47 is not satisfied, namely, the condition requiring the aggregate of the shareholding in the company of the partners of the firm to be at least 50% of the voting power in the company and to continue to remain as such for 5 years from the date of succession. Therefore, since in the P.Y.2016-17, this condition is not satisfied on account of sale of shares by Deep to Akash, and consequent reduction in the holding from 85% to 49%, the business loss and unabsorbed depreciation cannot be set-off.

3. (a) Tax treatment in the hands of the seller, Ms. Nisha

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

In the instant case, Nisha sold the residential flat at Delhi to her friend Asha for Rs. 12 lacs, whereas the stamp duty value was Rs. 15 lacs. Therefore, stamp duty value shall be deemed to be the full value of consideration for sale of the property. Therefore, short-term capital gain arising to Nisha for assessment year 2017-18 will be Rs. 11.50 lacs (i.e. Rs. 15 lacs - Rs. 3.50 lacs).

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

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

As per section 56(2)(vii), where any immovable property is received for a consideration which is less than the stamp duty by an amount exceeding Rs. 50,000, the difference between the stamp duty value and the consideration shall be chargeable to tax in the hands of the recipient (Individual/HUF) as the income from other sources. The provisions of section 56(2)(vii) would be attracted in this case, since the difference exceeds Rs. 50,000. Therefore, Rs. 3 lacs, being the difference between the stamp duty value of the property (i.e., Rs. 15 lacs) and the actual consideration (i.e., Rs. 12 lacs) would be taxable in the hands of Ms. Asha, under the head 'Income from Other Sources'.

As per section 49(4), the cost of acquisition of such property for computing capital gains would be the value which has been taken into account for section 56(2)(vii). Accordingly, Rs. 15 lacs would be taken as the cost of acquisition of the flat. Therefore, on sale of the flat by Ms. Asha, Rs. 5 lacs (i.e. Rs. 20 lacs – Rs. 15 lacs) would be chargeable to tax as short-term capital gains in her hands for A.Y. 2017-18. Since this is a case covered by section 49(4) and not section 49(1), the period of holding of the previous owner, namely, Nisha, will NOT be considered for determining whether the capital gain is short term or long term.

(b) Computation of total income of ABC Limited for the A.Y. 2017-18

Particulars	Rs. (in lacs)	
Business income		
Business income before setting-off brought forward losses of PQR Ltd.		140
<i>Add:</i> Excess depreciation claimed in the scheme of amalgamation of PQR Limited with ABC Limited.		
Value at which assets are transferred by PQR Ltd.	170	
WDV in the books of PQR Ltd.	<u>120</u>	
Excess accounted	50	
Excess depreciation claimed in computing taxable income of ABC Ltd. [Rs.50 lacs × 15 %] [<i>Explanation 2</i> to section 43(6)]		<u>7.50</u>
		147.50
Set-off of brought forward business loss of PQR Ltd. (See Notes 2 & 4)		(120.00)
Set-off of unabsorbed depreciation under section 32(2) read with section 72A (See Notes 2 & 4)		(18.00)
Set-off of unabsorbed capital expenditure under section 35(1)(iv) read with section 35(4) (See Note 5)		<u>(2.00)</u>
		<u>7.50</u>

Notes:

1. It is presumed that the amalgamation is within the meaning of section 72A of the Income-tax Act, 1961.
2. In the case of amalgamation of companies, the unabsorbed losses and unabsorbed depreciation of the amalgamating company shall be deemed to be the loss or unabsorbed depreciation of the amalgamated company for the previous year in which the amalgamation was effected and such business loss and unabsorbed depreciation shall be carried forward and set-off by the amalgamated company for a period of 8 years and indefinitely, respectively.
3. As per section 72A(7), the accumulated loss to be carried forward specifically excludes loss sustained in a speculative business. Therefore, speculative loss of Rs.7 lacs of PQR Ltd. cannot be carried forward by ABC Ltd.
4. Section 72(2) provides that where any allowance or part thereof unabsorbed under section 32(2) (i.e., unabsorbed depreciation) or section 35(4) (i.e., unabsorbed scientific research capital expenditure) is to be carried forward, effect has to be first given to brought forward business losses under section 72.
5. Section 35(4) provides that the provisions of section 32(2) relating to unabsorbed depreciation shall apply in relation to deduction allowable under section 35(1)(iv) in

respect of capital expenditure on scientific research related to the business carried on by the assessee. Therefore, unabsorbed capital expenditure on scientific research can be set-off and carried forward in the same manner as unabsorbed depreciation.

6. The restriction contained in section 73 is only regarding set-off of loss computed in respect of speculative business. Such a loss can be set-off only against profits of another speculation business and not non-speculation business. However, there is no restriction under the Income-tax Act, 1961 regarding set-off of normal business losses against speculative income. Therefore, normal business losses can be set-off against profits of a speculative business.

Consequently, there is no loss or allowance to be carried forward by ABC Ltd. to the F.Y. 2017-18.

- (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 1st April, 2016 to 31st January, 2017 on Rs. 7 crores, being the amount of loan, is to be capitalized.

	Rs.
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	<u>10,70,00,000</u>
Interest @12% for two months (February, 2017& March, 2017) after the asset is put to use is allowable as deduction under section 36(1)(iii) [12% × 2/12 × 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 2016-17, the depreciation would be restricted to 50% of the amount calculated at the prescribed percentage of 15%. Therefore, depreciation = 50% × [15% × 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 XYZ 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% × [20% × Rs.10,70,00,000]	<u>1,07,00,000</u>
	<u>1,87,25,000</u>

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.

4. (a) As per section 64(1)(ii), in computing the total income of any "individual", the remuneration paid to spouse by a firm in which the individual has substantial interest shall be liable for clubbing. In the present case, Mr. Kapoor is not a partner in his individual capacity, but a

partner in representative capacity.

The Supreme Court has, in the case of *CIT vs. Om Prakash (1996) 217 ITR 785*, held that an individual can be a partner in a partnership firm in his individual capacity or in the capacity of the Karta of a Hindu undivided family or, for that matter, in any other capacity, e.g., as a trustee. Where a person is a partner as the Karta of a Hindu undivided family, the capacity in which he is a partner in the partnership firm is relevant as between him and the other members of the Hindu undivided family. The income the Karta receives as a partner is not his individual income; it is the income of the Hindu undivided family and he receives it on behalf of the Hindu undivided family. It is for this reason that the income of the wife arising from her membership of the partnership firm, is held not includible in the income of the Hindu undivided family since the total income of the Hindu undivided family is not the total income of the individual (husband). For section 64(1) to get attracted, it is necessary that the spouse should be a partner in a partnership firm in his individual capacity. It is not attracted where he is a partner as the Karta of the Hindu undivided family to which his wife belongs.

The action of the Assessing Officer in this case is, therefore, not correct.

- (b) One of the conditions for the claim of depreciation under the provisions of section 32 of the Income-tax Act, 1961 is that the assessee should be the owner of the asset. In the facts of the given case, the asset is an immovable property, namely, buildings acquired for the administrative office. Full consideration has been paid. However, the registration could not take place before the end of the previous year.

The Supreme Court had an occasion to consider this issue in the case of *Mysore Minerals Ltd v. CIT 239 ITR 775*. The Supreme Court stated that the very concept of depreciation suggests that tax benefit on account of depreciation legitimately belongs to one who has invested in the capital asset and is utilizing the capital asset.

In the facts of the given case, though the document of title was not executed, the full consideration has been paid and the dominion over the property by taking possession excluded the owner who had to transfer the asset and therefore the right to use and occupy the property and enjoy it was exercised by taking possession and the execution of the formal deed of title may take place at any given point of time.

Following the decision of the Supreme Court, depreciation can be claimed in respect of the building that is acquired for the administrative office, though registration has not yet taken place.

However, the depreciation would be restricted to 50%, if the asset is put to use for less than 180 days in the year.

- (c) The Supreme Court, in *Polyflex India (P) Ltd v CIT (2002) 257 ITR 343*, has held that where a statutory levy in respect of goods dealt with by the assessee is discharged and a deduction is allowed thereon, and subsequently, the amount paid is refunded, the first part of section 41(1)(a) would apply i.e. it will be a case where the assessee "has obtained any amount in respect of such expenditure".

Where expenditure is actually incurred by reason of payment of duty on goods and a deduction or allowance is given in the assessment of an earlier period, the assessee is liable to tax on that benefit, as and when he obtains refund of the amount so paid. The possibility of the refund being set at naught on a future date will not be a relevant consideration.

The taxability under section 41(1), would, however, arise only if the assessee has obtained refund pursuant to the decision of the Court. In this case, since ABC Ltd has not received the refund, the deeming provisions of section 41(1) would not be attracted merely due to the reason that the High Court has held that excise duty is not payable by the company [*Union of India v. J.K.Synthetics Ltd (1993) 199 ITR 14 (SC)*].

Note – *If, the assessee had received refund of the excise duty, the deeming provision in section 41(1) would come into play and it is not necessary that the Revenue should await the verdict of the higher Court. If the higher Court upholds the levy at a later date, the assessee has the remedy to get back the relief.*

Therefore, if the excise duty has been refunded to the assessee pursuant to the decision of the High Court, the same would be subject to tax by virtue of section 41(1) and it is not necessary that the Revenue should await the verdict of the Supreme Court.

- (d) Section 90(1) of the Income-tax Act, 1961 empowers the Central Government to enter into an agreement with the Government of any country outside India for avoidance of double taxation of income under the Indian law and the corresponding law of that country. Section 90(2) provides that where the Central Government has entered into an agreement with the Government of any other country for granting relief of tax or for avoidance of double taxation, then, in relation to the assessee to whom such agreement applies, the provisions of the Income-tax Act, 1961 shall apply to the extent they are more beneficial to that assessee.

Aryan has residential houses both in India and foreign country. Thus, he has a permanent home in both the countries. However, he has no permanent establishment of business in India. The Double Taxation Avoidance Agreement (DTAA) with foreign country provides that where an individual is a resident of both the countries, he shall be deemed to be resident of that country in which he has a permanent home and if he has a permanent home in both the countries, he shall be deemed to be resident of that country, which is the centre of his vital interests i.e. the country with which he has closer personal and economic relations.

Aryan owns rubber estates in a foreign country from which he derives business income. However, Aryan has no permanent establishment of his business in India. Therefore, his personal and economic relations with foreign country are closer, since foreign country is the place where –

- (a) the property is located and
- (b) the permanent establishment (PE) has been set-up

Therefore, he shall be deemed to be resident of the foreign country for A.Y. 2017-18.

The fact of the case and issues arising therefrom are similar to that of *CIT vs. P.V.A.L. Kulandagan Chettiar (2004) 267 ITR 654*, where the Supreme Court held that if an assessee is deemed to be a resident of a contracting State where his personal and economic relations are closer, then in such a case, the fact that he is a resident in India to be taxed in terms of sections 4 and 5 would become irrelevant, since the DTAA prevails over sections 4 and 5.

However, as per section 90(4), in order to claim relief under the agreement, Aryan has to obtain a certificate [Tax Residency Certificate (TRC)] declaring his residence of the country outside India from the Government of that country. Further, he also has to provide such other documents and information, as may be prescribed.

Therefore, in this case, Aryan is not liable to income tax in India for assessment year 2017-18 in respect of business income and capital gains arising in the foreign country provided he

furnishes the Tax Residency Certificate and provides such other documents and information as may be prescribed.

5. (a) (i) **Computation of income of the firm chargeable under the head “Profits and Gains of business or profession”**

Particulars	Rs.
Presumptive income under section 44AD (8% of Rs.175 lakh) [See Note 1]	14,00,000
Less: Brought forward business loss under section 72 [See Note 4]	<u>50,000</u>
Income of the firm chargeable under the head “Profits and Gains of business or profession”	<u>13,50,000</u>
Tax liability at @ 30.9%	4,17,150

Notes: -

- (1) A partnership firm falls within the definition of “eligible assessee” under section 44AD. The threshold limit of turnover for applicability of presumptive taxation scheme under section 44AD is Rs.200 lakh. In this case, since the turnover of the business of the firm is Rs.175 lakh, it falls within the definition of “eligible business” and therefore, the firm is eligible to opt for presumptive taxation under section 44AD. 8% of the total turnover would be deemed to be the business income of the firm.
 - (2) As per section 44AD(2), all deductions allowable under sections 30 to 38 shall be deemed to have been allowed in full and no further deduction shall be allowed.
Accordingly, no deduction shall be allowed for bad debts since the same is deductible under section 36(1)(vii) and similarly unabsorbed depreciation is not deductible since the same is deductible under section 32(2).
 - (3) Due to omission of proviso to section 44AD(2), interest on capital and working partner salary are also not deductible while computing the presumptive income of a partnership firm from the assessment year 2017-18 onwards.
 - (4) However, business loss of previous year 2015-16 can be set-off against current year business income as per section 72.
- (ii) Since the partnership firm has opted for computation of income on presumptive basis under section 44AD, it must pay the whole amount of advance tax in one installment on or before 15.03.2017. Further, any amount paid by way of advance tax on or before 31stMarch shall also be treated as advance tax paid during each financial year on or before 15th March.
- In case the firm has not paid advance tax or has paid advance tax less than the whole amount, then –
- (a) it has to pay interest under section 234C at 1% on the short fall in payment of advance tax attributable to the month of March, 2017.
 - (b) it has to pay interest under section 234B @1% per month or part of a month on the short fall in payment of advance tax from 1stApril, 2017 to the date of determination of total income under section 143(1) and where regular assessment is made, to the date of regular assessment.
- (b) Sub-clause (viiia) to section 2(24) includes within the scope of definition of income, the profits and gains of any business of banking (including providing credit facilities) carried on by a co-operative society with its members. Hence, the interest of ₹ 1,20,000 received by ABC Co-operative Bank on loans advanced to its members constitutes its income.

Further, interest received amounting to ₹ 1,55,000 on deposits with other co-operative societies and rent amounting to ₹ 2,20,000 received from letting out its godowns for storage of commodities also constitute the income of the co-operative bank.

Sub-section (4) of section 80P provides that section 80P shall not apply to any co-operative bank other than a primary agricultural credit society or a primary co-operative agricultural and rural development bank.

Explanation to section 80P(4) defines a primary co-operative agricultural and rural development bank to mean a society having its area of operation confined to a taluk and the principal object of which is to provide for long-term credit for agricultural and rural development activities.

ABC Co-operative Bank is a primary co-operative agricultural and rural development bank as defined in the said *Explanation* since it is a co-operative society having its area of operation confined to Gubbi Taluk and its principal object is to provide long-term credit for agricultural and rural development activities. Therefore, it is eligible for deduction under section 80P.

Interest of ₹ 1,20,000 received by the bank on loans advanced to its members is eligible for deduction in full under section 80P(2)(a)(i).

Interest of ₹ 1,55,000 received by the bank from deposits with other co-operative societies qualifies for deduction in full under section 80P(2)(d).

Rent of ₹ 2,20,000 received by the bank from letting out its godowns for storage of commodities is eligible for deduction in full under section 80P(2)(e).

(c) Under section 44BBA, a sum equal to 5% of the aggregate of the following amount is deemed to be the profits and gains chargeable to tax under the head "Profits and gains of business or profession" in respect of a non-resident, engaged in the business of operation of aircraft -

- (a) the amount paid or payable, whether in or out of India, to the assessee or to any person on his behalf on account of the carriage of passengers, livestock, mail or goods from any place in India; and
- (b) the amount received or deemed to be received in India by or on behalf of the assessee on account of the carriage of passengers, livestock, mail or goods from any place outside India.

In the present case, the income chargeable to tax of M/s Star Fly Airlines is as follows

Particulars	Fare booked from India to outside India whether received in India or not (₹)	Fare booked from London to Mumbai	
		If received in India (₹)	If not received in India (₹)
Fare	60,00,000 (1,30,00,000 – 70,00,000)	70,00,000	70,00,000
Deemed income @5% u/s 44BBA	3,00,000 (60,00,000 × 5%)	3,50,000 (70,00,000 × 5%)	Nil

6. (a) As per section 133(6), power is given to an Assessing Officer to issue notice, for the purposes of the Act, requiring any person, including a banking company, to furnish information in respect of such points or matters or to furnish statement of accounts and affairs verified in the manner specified by the Assessing Officer, as may be useful for, or relevant to, any enquiry or proceeding under the Act. Therefore, the provisions of this

section can be invoked even in case of any enquiry and it is not necessary that any proceeding should be pending against the customer for the same.

However, in respect of an enquiry, this power can be exercised by any Income-tax authority below the rank of Principal Director or Director or Principal Commissioner or Commissioner only after getting the prior approval of the Principal Director or Director or Principal Commissioner or Commissioner, as the case may be.

Therefore, the Assessing Officer can issue notice under section 133(6) asking for particulars relating to a customer in the specified format duly verified in the prescribed manner from the banking company, even if no proceeding is pending against such customer, provided he has obtained the prior approval of the Principal Director or Director or the Principal Commissioner or Commissioner, as the case may be.

Hence, in such a case, the action of bank in refusing to provide the particulars relating to a customer as required by the Assessing Officer on the ground that no proceeding was pending against the customer, is not correct.

- (b) Any rectification order under section 154 has to be passed within 4 years from the end of financial year in which the order sought to be amended was passed. Order sought to be amended does not necessarily mean the original order. It could be any order including the amended or rectified order. Where any matter has been considered and decided in any proceeding by way of appeal or revision, the authority passing such order may amend the order in relation to any matter other than the matter which has been so considered and decided.

For subsequent rectification, the time limit of 4 years shall be from the end of the financial year in which the earlier rectification order was passed. [*Hind Wire Industries Ltd vs. CIT (1995) 212 ITR 639 (SC)*]. In the given case, the time limit of 4 years has to be reckoned from the end of the financial year in which the order giving effect to the CIT(Appeal)'s decision was passed. Therefore, the rectification order can be passed by the Assessing Officer at any time before expiry of 4 years from the end of the financial year 2013-14 i.e. on or before 31st March, 2018. In this case, the mistake was noticed by the Assessing Officer on 1st September, 2017, for which he issued notice under section 154 for rectifying the mistake. Such rectification is permissible as the time limit of 4 years expires only on 31st March, 2018.

- (c) There are two conditions to be satisfied by an assessee in order to get relief in the form of a waiver or reduction of penalty by the Commissioner of Income-tax under section 273A(4) of the Act. These conditions are:
- (i) The payment of penalty would cause "genuine hardship" to the assessee and the Commissioner is satisfied about the existence of genuine hardship having regard to the circumstances of the case. The existence of genuine hardship would entitle the assessee to relief. The CBDT in its *Circular No 784 dated 22-11-1999* has clarified that "genuine hardship" referred to in the provisions of section 273A(4) should exist both at the time at which the application under section 273A(4) is made by the assessee before the Commissioner and at the time of passing of order under section 273A(4) by the Commissioner.
 - (ii) The assessee has co-operated in any enquiry relating to the assessment or any proceeding for the recovery of any amount due from him.

As per the decision of Andhra Pradesh High Court in *K.S.N. Murthy v. Chairman, CBDT (2001) 252 ITR 269*, if the above two conditions are satisfied, the Commissioner has no discretion to refuse to exercise his powers. In case the quantum of penalty exceeds Rs. 1 lakh, the Commissioner can grant relief only with the previous approval of the

Principal Chief Commissioner or Chief Commissioner or the Principal Director General or Director General, as the case may be.

Note - The Principal Commissioner or Commissioner has to pass an order under section 273A(4), either accepting or rejecting the application in full or in part, within a period of 12 months from the end of the month in which the application is received. Further, no order rejecting the application, either in full or in part, shall be passed unless the assessee has been given an opportunity of being heard.

- (d) The term 'Advance Ruling' has been defined in section 245N(a) to mean :-
- (i) a determination by the Authority in relation to a transaction which has been undertaken or is proposed to be undertaken by a **non-resident applicant**; or
 - (ii) a determination by the Authority in relation to the tax liability of a non-resident arising out of a transaction which has been undertaken or is proposed to be undertaken **by a resident applicant with such non-resident**; or
 - (iii) a determination by the Authority in relation to the tax liability of a **resident applicant**, arising out of a transaction which has been undertaken or is proposed to be undertaken by **such applicant**,
and such determination shall include the determination of any question of law or of fact specified in the application
 - (iv) a determination or decision by the Authority in respect of an issue relating to computation of total income which is pending before any income-tax authority or the Appellate Tribunal and such determination or decision shall include the determination or decision on any question of law or of fact relating to such computation of total income specified in the application.

7. (a) (i) **TDS on landing and parking charges:** The landing and parking charges which are fixed by the Airports Authority of India are not merely for the "use of the land". These charges are also 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. [*Japan Airlines Co. Ltd. v. CIT / CIT v. Singapore Airlines Ltd. (2015) 377 ITR 372 (SC)*].

Hence, tax is deductible @2% under section 194C by the airline company, Fly Ltd., on payment of Rs.15 lacs made towards landing and parking charges to the Airports Authority of India for the previous year 2016-17.

- (ii) **TDS on compensation for compulsory acquisition:** Tax is deductible at source @10% under section 194LA, where payment is made to a resident as compensation or enhanced compensation on compulsory acquisition of any immovable property (other than agricultural land).

However, no tax deduction is required if the aggregate payments in a year does not exceed Rs. 2,50,000.

Therefore, no tax is required to be deducted at source on payment of Rs. 2,45,000 to Mr. X, since the aggregate payment does not exceed Rs.2,50,000.

Since the definition of immovable property specifically excludes agricultural land, no tax is deductible at source on compensation paid for compulsory acquisition of agricultural land.

- (iii) Section 194-I, which governs the deduction of tax at source on payment of rent, exceeding Rs. 1,80,000 per annum is applicable to all taxable entities except

individuals and HUFs, who were not subjected to tax audit under section 44AB in the immediately preceding financial year. Section 196, provides exemption in respect of payments made to Government from application of the provisions of tax deduction at source.

Therefore, no tax is required to be deducted at source by State Bank of India from rental payments to the Government.

- (b) As per the provisions of section 281B, there can be provisional attachment to protect the interest of Revenue in certain cases i.e. -
- (i) The proceeding for the assessment of any income or for the assessment or reassessment of any income which has escaped assessment should be pending.
 - (ii) Such attachment should be necessary for the purpose of protecting the interest of Revenue in the opinion of the Assessing Officer.
 - (iii) The previous approval of the Principal Chief Commissioner or Chief Commissioner, Principal Commissioner or Commissioner, Principal Director General or Director General or Principal Director or Director has been obtained by the Assessing Officer.
 - (iv) The Assessing Officer, may, by an order in writing attach provisionally any property belonging to the assessee in the manner provided in the Second Schedule.

Such provisional attachment shall cease to have effect after the expiry of a period of six months from the date of order made under section 281B(1). However, the period can be extended by the Principal Chief Commissioner or Chief Commissioner, Principal Commissioner or Commissioner, Principal Director General or Director General or Principal Director or Director, as the case may be, for the reasons to be recorded in writing for a further period or periods as he thinks fit. The total period of extension in any case cannot exceed 2 years or 60 days after the date of order of assessment or reassessment, whichever is later.

The Assessing Officer shall, by order in writing, revoke provisional attachment of a property made under section 281B(1) in a case where the assessee furnishes a guarantee from a scheduled bank, for an amount not less than the fair market value of such provisionally attached property or for an amount which is sufficient to protect the interests of the revenue.

- (c) The matter concerning the power of the Settlement Commission to reduce or waive interest chargeable under section 234A, 234B or 234C has been settled by the Supreme Court in *CIT v. Anjum M. H. Ghaswala reported in (2001) 252 ITR 1*.

According to the judgment, sub-section (6) of section 245D is only procedural in nature providing for fixing the term by which the amounts settled under sub-section (4) will have to be paid. It does not empower the Commission either to reduce or waive the interest. Any settlement made by the Commission must be in accordance with the provisions of the Act.

The Settlement Commission does not have the power to reduce or waive the interest levied under sections 234A, 234B and 234C. It does not authorize the waiver or deduction of tax. The levy of interest under sections 234A, 234B or 234C is mandatory in nature and therefore any settlement made must include the interest under these sections. However, as per provisions of section 245F, the Settlement Commission shall have all the powers which are vested in an income-tax authority. Therefore, Settlement Commission can grant relief from the aforesaid interest to the extent of the powers given vide the circulars issued by CBDT under section 119.

MOCK TEST PAPER
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) From the following particulars for the preceding financial year, find out whether Hard Manufacturing Co. is eligible for small scale exemption under *Notification No. 8/2003-C.E. dated 01-03-2003* for the current financial year:

Sr. No.	Particulars	Rs. (in lakhs)
1.	Clearance of excisable goods exempted from payment of duty under a notification other than <i>Notification No. 8/2003- C.E.</i>	50
2.	Clearance of account books bearing brand name of another person, falling under Heading 4820 of First Schedule to the Central Excise Tariff.	150
3.	Clearance of excisable goods to United Nations exempted from payment of duty under <i>Notification No. 108/95-C.E.</i>	85
4.	Total Exports [including export to Bhutan Rs. 50 lakh]. Other exports are to USA & UK	250
5.	Clearance of goods (duty paid based on annual capacity of production under section 3A of the Central Excise Act, 1944)	190

Show your calculations, workings and explanations clearly, wherever required. Hard Manufacturing Co. is not a jewellery manufacturer. **(5 Marks)**

- (b) Ravi Pvt. Ltd. was awarded a contract for providing floor and wall tiling services in respect of a building located in Delhi, by Nath Ltd. As per the terms of contract, Ravi Pvt. Ltd. was to provide all the required material for execution of the contract. However, a portion of the material was also provided by Nath Ltd.

Whether the services provided by Ravi Pvt. Ltd. are subject to service tax? If yes, determine the service tax liability of Ravi Pvt. Ltd. from the following particulars-

Particulars	(Rs.)
Gross amount (excluding all taxes) charged by the Ravi Pvt. Ltd. for the contract	5,00,000
Fair market value of the material supplied by Nath Ltd. (determined in accordance with the generally accepted accounting principles)	2,00,000
Amount charged by Nath Ltd. for the material (inclusive of VAT)	60,000
Excise duty paid on inputs	12,750
Service tax paid on input services	5,600
Swachh Bharat Cess (SBC) paid on input services	200

Krishi Kalyan Cess (KKC) paid on input services	200
Excise duty paid on capital goods, purchased during the year, used in the contract	4,000

Note: Rate of service tax is 15% [including SBC & KKC]. **(10 Marks)**

- (c) XYZ Industries Ltd. imports an equipment by air. CIF price of the equipment is 6,000 US\$, freight paid is 1,200 US\$ and insurance cost is 1,800 US\$. The banker realizes the payment from importer at the exchange rate of Rs. 61 per US\$. Central Board of Excise and Customs notifies the exchange rate as Rs. 60 per US\$ while rate of exchange notified by RBI is Rs. 62 per US\$. XYZ Industries Ltd. expends Rs. 56,000 in India for certain development activities with respect to the imported equipment.

Basic customs duty is 10%, excise duty leviable on similar goods in India is 12.5% and education cesses are 3% on duty. Additional duty of customs leviable under section 3(5) of the Customs Tariff Act is exempt.

You are required to:

- (i) compute the amount of total customs duty payable by XYZ Industries Ltd.
- (ii) determine the amount of CENVAT credit available to XYZ Industries Ltd. How can such CENVAT credit be utilised by XYZ Industries Ltd.? **(5 Marks)**
2. (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)**
- (b) Service tax of Rs. 60,000 for the month of March, 2017 was paid on 24th April, 2017 by an HUF. The value of taxable services provided by it during the preceding financial year was Rs. 12 lakh. Determine the amount of interest payable under section 75 of the Finance Act, 1994.

Note: The service tax of Rs. 60,000 has not been collected from service receiver. **(8 Marks)**

- (c) State briefly the provisions of the Customs Act, 1962 relating to payment of interest in case of provisional assessment. **(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) Protection Services, a proprietorship firm, was engaged in providing security services to its customers. A show cause notice for demanding service tax was issued to the firm and the demand was confirmed. The order was challenged in appeal before the Commissioner, Central Excise (Appeals). The Commissioner (Appeals) denied the raising of the following three additional legal grounds by Protection Services during the course of personal hearing:
- (i) Being a proprietary firm, it cannot be considered as security agency;
- (ii) Issue involved being interpretation of law, penalty is not imposable; and
- (iii) As per decisions, staff salary is to be excluded from the gross amount received for security services.

Discuss with the help of a decided case law (if any), whether the Commissioner (Appeals) was justified in not allowing the raising of the additional grounds. **(8 Marks)**

- (c) Stunning Laminates imported resin impregnated paper and plywood for the purpose of manufacture of furniture. The said goods were warehoused from the date of its import. Stunning Laminates sought an extension of the warehousing period which was granted by the authorities. However, even after the expiry of the said date, it did not remove the goods from the warehouse. Subsequently, Stunning Laminates applied for remission of duty under section

23 of the Customs Act, 1962 on the ground that the said goods had lost their shelf life and had become unfit for use on account of non-availability of orders for clearance.

Explain, with the help of a decided case law, if any, whether the application for remission of duty filed by the Stunning Laminates is valid in law? **(4 Marks)**

4. (a) Chill Beverages Ltd. has removed the aerated water bottles without declaring the retail sale price under section 4A of the Central Excise Act, 1944. Discuss briefly how the retail sale price of these goods shall be ascertained. **(4 Marks)**

- (b) Manohar 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 Manohar Lal is valid in law. **(4 Marks)**

- (c) An importer, imported consignment of goods, chargeable to duty @ 45% ad valorem. The vessel arrived on 31st May, 2016. A bill of entry for warehousing the goods was presented on 2nd June, 2016 and the goods were duly warehoused. In the meantime, an exemption notification was issued on 15th October, 2016 reducing the effective customs duty to 20% ad valorem.

Thereafter, the importer filed a bill of entry for home consumption on 20th October claiming 20% duty. The customs Department charged higher rate of duty @ 45% ad valorem. Give your views on the same, discussing the relevant provisions of the Customs Act, 1962. **(4 Marks)**

5. (a) With reference to the provisions of rule 16 of Central Excise Rules, 2002, explain the procedure for availment of CENVAT credit when:

(i) the duty paid goods returned to the factory are put through a process not amounting to manufacture;

(ii) the duty paid goods returned to the factory are put through a process amounting to manufacture. **(4 Marks)**

- (b) With reference to Place of Provision of Service Rules (PoPS), 2012 answer the following question:

(i) A movie-on-demand is provided as on-board entertainment during the Bangalore-Delhi leg of a Singapore-Bangalore-Delhi flight against a charge of Rs. 800 per passenger in addition to the fare of Rs. 30,000 per passenger. What will be the place of provision of service in this case? Will your answer change, if the above service is provided on a Delhi-Bangalore-Singapore-Malaysia flight during the Singapore-Malaysia leg?

(ii) Mr. Diljeet has a permanent residence at Punjab. He has a savings bank account with Punjab Branch of Safe and Sound Bank. On April 1, 2014, Mr. Diljeet opened a safe deposit locker with the Punjab Branch of Safe and Sound Bank. Mr. Diljeet went to USA for official work in December, 2014 and has been residing there since then. Mr. Diljeet contends that since he is a non-resident during the year 2015-16 in terms of the Income-tax Act, service tax cannot be levied on the locker fee charged by Safe and Sound Bank for the year 2015-16.

Examine the correctness of the contention of Mr. Diljeet. **(8 Marks)**

- (c) State the circumstances under which a revision petition can be filed before the Central Government under the Customs Act. **(4 Marks)**

6. (a) Indicate the central excise authorities who can accept bonds executed for various purposes and obligations of exporter in respect of bond acceptance while filling in ARE-1 form. **(4 Marks)**

Or

Explain briefly the provisions relating to Special Audit in certain cases under section 14A of the Central Excise Act, 1944. **(4 Marks)**

- (b) Galaxy Ltd. imports business support services from Green Inc of USA on 13.01.2016. The relevant invoice for \$ 4,20,000 is raised by Green Inc. on 18.01.2016. Galaxy Ltd. makes the payment against the said invoice as follows:

Case I	22.02.2016
Case II	27.05.2016

Determine point of taxation in each of the aforesaid cases. **(8 Marks)**

- (c) Mention the circumstances under which goods are considered to have been removed improperly from a warehouse under the Customs Act. **(4 Marks)**
7. (a) Can remission of duty be granted on duty paid goods which are destroyed by fire in transit after being cleared from the factory? Explain. **(4 Marks)**
- (b) Tingtong Travels Pvt. Ltd., located in Gujarat, is engaged in providing services of renting of motorcab and discharges its service tax liability by availing abatement granted under *Notification No. 26/2012 ST dated 20.06.2012*. Amount charged for the services rendered by the company during the month of October, 2016 is Rs. 6,00,000. The invoices for such services have been issued by Tingtong Travels Pvt. Ltd. in the month of October, 2016.

The company has sub-contracted a part of its services to Ramlal Cabs Pvt. Ltd., which is also engaged in providing services of renting of motorcab. Ramlal Cabs Pvt. Ltd. has raised an invoice for Rs. 1,15,000 dated 25.10.2016 (value of services is Rs. 1,00,000 and service tax payable thereon [including Swachh Bharat Cess (SBC) and Krishi Kalyan Cess (KKC) is Rs. 15,000]) on Tingtong Travels Pvt. Ltd. for the services sub-contracted to it during the month of October, 2016. Tingtong Travels Pvt. Ltd. has received the invoice raised by Ramlal Cabs Pvt. Ltd. on 25.10.2016.

Determine service tax (including SBC & KKC) payable in cash by Tingtong Travels Pvt. Ltd. for the month of October, 2016 assuming that Tingtong Travels Pvt. Ltd. avails the abatement, if any, available to it under *Notification No. 26/2012 –ST dated 20.06.2012*. **(8 Marks)**

- (c) Mention the reward scheme provided under FTP which aims to compensate infrastructural inefficiencies and associated costs involved in the export of products produced in India. Discuss the basis of computation of reward under said scheme. How can the duty scrips issued under the Scheme be utilized? **(4 Marks)**

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

1. (a) In order to claim the benefit of exemption under *Notification No. 8/2003 C.E. dated 01.03.2003* in a financial year, the aggregate value of clearances of all excisable goods for home consumption by a manufacturer from one or more factories should not exceed Rs. 400 lakh in the preceding financial year.

The aggregate value of clearances for home consumption of Hard Manufacturing Co. is Rs. 440 lakh in the preceding financial year [Refer computation given below]. Therefore, it is not eligible to claim the benefit of exemption under *Notification No. 8/2003 C.E. dated 01.03.2003* in the current financial year.

Computation of aggregate value of clearances for home consumption of Hard Manufacturing Co. for preceding Financial Year

Particulars	Rs. (in lakh)
Clearances of excisable goods exempted from payment of duty under a notification other than <i>Notification No. 8/2003 CE</i>	50
Clearances of account books bearing brand name of another person [Note 1]	150
Clearance of excisable goods to United Nations exempted from payment of duty under <i>Notification No. 108/95 CE</i> [Note 2]	Nil
Exports to Bhutan [Note 3]	50
Clearances of goods on which duty has been paid under section 3A of the Central Excise Act	<u>190</u>
Aggregate value of clearances in terms of <i>Notification No. 8/2003 CE</i>	<u>440</u>

Notes:

Notification No. 8/2003 C.E. dated 01.03.2003 provides that while determining the value of clearances of Rs. 400 lakh:

1. clearances bearing the brand name of another person, which are ineligible for SSI exemption are excluded. However, account books falling under heading 4820 of the First Schedule of the Central Excise Tariff are entitled to small scale exemption even if they bear a brand name or trade name whether registered or not, of another person. Therefore, clearances of such account books will not be excluded.
 2. clearances of excisable goods without payment of duty supplied to United Nations under *Notification No.108/95 C.E.* are excluded.
 3. export turnover is excluded. However, exports to Bhutan are not excluded as these are treated as “clearance for home consumption”.
- (b) The contract entered into by Ravi Pvt. Ltd. requires the provision of both services and material and is for the purpose of carrying out completion of an immovable property. Therefore, it falls within the scope of term ‘works contract’ as defined under section 65B(54)

of the Finance Act, 1994. As per section 66E(h) of Finance Act, 1994, service portion in the execution of a works contract is a declared service and thus, service provided by Ravi Pvt. Ltd. would be liable to service tax.

Since, in the given case, the value of the service portion in the execution of the works contract cannot be determined as per rule 2A(i) of Service Tax (Determination of Value) Rules, 2006, the value will have to be determined as per rule 2A(ii)(B)(ii).

As per rule 2A(ii)(B)(ii), in case of works contracts involving completion and finishing services such as floor and wall tiling of an immovable property, service tax shall be payable on 70% of the total amount charged for the works contract. Further, explanation 1(b) to rule 2A stipulates that total amount means the sum total of the gross amount charged for the works contract and the fair market value of all goods and services supplied in or in relation to the execution of the works contract, whether or not supplied under the same contract or any other contract, after deducting –

- (i) the amount charged for such goods or services, if any; and
- (ii) the value added tax or sales tax, if any, levied thereon.

In accordance with said provisions, service tax liability would be as follows:

Particulars	(Rs.)
Gross amount (excluding all taxes) charged by Ravi Pvt. Ltd. for the contract	5,00,000
Add: Fair market value of the material supplied by Nath Ltd.	2,00,000
Less: Amount charged by Nathu Ltd. for the material (including VAT)	<u>60,000</u>
Total amount charged	6,40,000
Value of service portion in the execution of works contract (70% of 6,40,000)	4,48,000

Particulars	Service tax @ 14% (Rs.)	SBC @ 0.5% (Rs.)	KKC @ 0.5% (Rs.)
Service tax on Rs. 4,48,000	62,720	2,240	2,240
Less: CENVAT credit on inputs (Note-1)	-	-	-
CENVAT credit on input services (Note-2)	5,600	-	200
CENVAT credit on capital goods (50%) (Note-3)	<u>2,000</u>	<u>-</u>	<u>-</u>
Service tax liability	<u>55,120</u>	<u>2,240</u>	<u>2,040</u>
Total service tax liability including cesses - Rs. 59,400			

Notes:

1. CENVAT credit of duties or cess paid on any inputs, used in or in relation to a works contract, is not available [Explanation 2 to rule 2A of the Valuation Rules].
2. Since SBC is not CENVATable, so CENVAT credit of SBC paid on input services is not allowed.
3. Only 50% of the duty paid on the capital goods is available as CENVAT credit, in the current year [Rule 4(2)(a) of the CENVAT Credit Rules, 2004].

(c) **Computation of customs duty payable by XYZ Industries Ltd.**

Particulars	Amount
CIF value	6,000 US \$
Less: Freight	1,200 US \$
Less: Insurance	<u>1,800 US \$</u>
FOB value	3,000 US \$
Add: Freight (20% of FOB value) [Note 1]	600 US \$
Add: Insurance (actual)	<u>1,800 US \$</u>
CIF	5,400 US \$
Add: 1% for landing charges [Note 2]	<u>54 US\$</u>
Value in dollars	5,454 US \$
Exchange rate as per CBEC [Note 3]	Rs. 60 per US \$
Assessable value = Rs. 60 x 5,454 US \$	Rs. 3,27,240
Basic customs duty @ 10%	<u>Rs. 32,724</u>
Sub-total	Rs. 3,59,964
Additional duty of customs u/s 3(1) of the Customs Tariff Act (CVD) @ 12.5% of Rs. 3,59,964 (rounded off) [Note 5]	Rs. 44,996
Education cesses 3% on [Rs. 32,724 + Rs. 44,996] (rounded off)	Rs. 2,332
Total customs duty payable [Rs. 32,724 + Rs. 44,996 + Rs. 2,332]	Rs. 80,052

Notes:

1. If the goods are imported by air, the freight cannot exceed 20% of FOB price [Second proviso to rule 10(2) of the Customs (Determination of Value of Imported Goods) Rules, 2007].
2. Even if there is no information regarding landing charges, still they are charged @ 1% of CIF value [Clause (ii) of first proviso to rule 10(2) of the Customs (Determination of Value of Imported Goods) Rules, 2007].
3. Rate of exchange determined by CBEC is considered [Clause (a) of the explanation to section 14 of the Customs Act, 1962].
4. Rule 10(1)(b)(iv) of the Customs Valuation (Determination of Value of Imported Goods) Rules, 2007 *inter alia* provides that value of development work undertaken elsewhere than in India is includible in the value of the imported goods. Thus, development charges of Rs. 56,000 paid for work done in India have not been included for the purposes of arriving at the assessable value.
5. Since excise duty rate on similar goods is 12.5%, CVD will be levied @ 12.5%.

Rs. 44,996 paid as additional duty of customs under section 3(1) of Customs Tariff Act, 1975 will be available as CENVAT credit and can be utilised for payment of excise duty or service tax as per the CENVAT Credit Rules, 2004. Basic customs duty of Rs. 32,724 and education cesses of Rs. 2,332 paid on imported goods will not be available as CENVAT credit.

2. (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.

(b) Computation of interest payable under section 75 of Finance Act, 1994

Particulars	
Service tax paid belatedly	Rs. 60,000
No. of days of delay [Note 1]	24 days
Rate of interest [Note 2]	12%
Quantum of interest (rounded off) [Rs. 60,000 x 24/365 x 12/100]	Rs. 473

Notes:

- As per second proviso to rule 6(1) of Service Tax Rules, 1994, the due date of payment of service tax for the month of March is 31st day of March. Therefore, there is a delay of 24 days as service tax is deposited on 24th April, 2017.
- As per section 75 of Finance Act, 1994 read with *Notification No. 13/2016 ST dated 01.03.2016* in case of collection of any amount as service tax but failing to pay the amount so collected to the credit of the Central Government on or before the date on which such payment becomes due, the simple interest @ 24% p.a. is payable. However, in all other cases, 15% simple interest p.a. is payable. Since in the above case, service tax has not been collected, so simple interest @ 15% p.a. is payable. However, as per proviso to section 75, the rate of interest gets reduced by 3% if the value of taxable service provided during the preceding financial year does not exceed Rs. 60 lakh. (Value of taxable services provided in preceding year in the given case is Rs. 12 lakh).

(c) The provisions of the Customs Act, 1962 relating to payment of interest in case of provisional assessment are as under:

(I) Interest payable by the importer/exporter on amount payable to the Central Government, consequent to the final assessment/re-assessment:

- The importer or exporter shall be liable to pay interest, on any amount payable to the Central Government, consequent to the final assessment order/re-assessment order under section 18(2).
- The interest shall be payable at the rate prescribed under section 28AB of the Customs Act, 1962. Presently, the rate of interest has been fixed @ 18% p.a.
- The interest shall be payable from the first day of the month in which the duty is provisionally assessed till the date of payment thereof.

(II) Interest payable by the Central Government to the importer/exporter on amount refundable to the importer/exporter on final assessment of duty/re-assessment of duty:

- Subject to the provisions of unjust enrichment, if any refundable amount is not refunded to the importer/exporter on final assessment of duty or re-assessment of duty, within three months from the date of final assessment of duty or re-

assessment of duty.

- (ii) The interest shall be payable at the rate prescribed under section 27A of the Customs Act, 1962. Presently, the rate of interest has been fixed @ 6% p.a.
- (iii) The interest shall be payable from the first day immediately succeeding the period of three months from the date of assessment of duty finally or re-assessment of duty till the date of refund of such amount.

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) As per rule 5 of Central Excise (Appeals) Rules, 2001, an appellant is permitted, under certain specified circumstances, to produce before the Commissioner (Appeals) any evidence other than the evidence produced by him during the course of the proceedings before the adjudicating authority.

The High Court, in *Utkarsh Corporate Services v. CEx. & ST 2014 (34) STR 35 (Guj.)*, has held that when production of additional evidence is permissible, raising of additional grounds on the basis of relevant facts existing on record is also permissible. Further, legal grounds can be raised at any stage before any authority.

Therefore, in view of the fact that the additional grounds raised by Protection Services before Commissioner (Appeals) were legal grounds, the Commissioner (Appeals) was not justified in denying the raising of such additional grounds.

- (c) No, the application for remission of duty filed by the Stunning Laminates is not valid in law. The facts of the given case are similar to the case of *CCE v. Decorative Laminates (I) Pvt. Ltd. 2010 (257) E.L.T. 61 (Kar.)*. The High Court, while interpreting section 23, stipulated that section 23 states that only when the imported goods have been lost or destroyed at any time before clearance for home consumption, the application for remission of duty can be considered. Further, even before an order for clearance of goods for home consumption is made, relinquishing of title to the goods can be made; in such event also, an importer would not be liable to pay duty.

Therefore, the expression “at any time before clearance for home consumption” would mean the time period as per the initial order during which the goods are warehoused or before the expiry of the extended date for clearance and not any period after the lapse of the aforesaid periods. The said expression cannot extend to a period after the lapse of the extended period merely because the licence holder has not cleared the goods within the stipulated time.

Moreover, since in the given case, the goods continued to be in the warehouse, even after the expiry of the warehousing period, it would be a case of goods improperly removed from the warehouse as per section 72(1)(b) read with section 71.

The High Court, overruling the decision of the Tribunal, held that the circumstances made out under section 23 were not applicable to the present case since the destruction of the goods or loss of the goods had not occurred before the clearance for home consumption within the meaning of that section. When the goods are not cleared within the period or extended period as given by the authorities, their continuance in the warehouse will not attract section 23 of the Act.

Further, in *Kesoram Rayon v. CC* 1996 (86) ELT 464, the Supreme Court has held that goods which are not removed from warehouse within the permissible period, are deemed to be improperly removed on the day they ought to have been removed. In view of this decision, goods would be deemed to have been removed when licensing period was over. Hence, section 23 would not be applicable as such loss occurred after 'deemed removal' of goods.

4. (a) As per rule 4 of Central Excise (Determination of Retail Sale Price of Excisable Goods) Rules, 2008, where a manufacturer removes the excisable goods without declaring the retail sale price (RSP) on the package then, the RSP of such goods will be ascertained in the following manner, namely:

- (i) if the manufacturer has manufactured and removed identical goods, within a period of one month, before or after removal of such goods, by declaring the RSP, then, the said declared RSP will be taken as the RSP of such goods;
- (ii) if the RSP cannot be ascertained in the above manner, the RSP of such goods will be ascertained by conducting the enquiries in the retail market on sample basis where such goods have normally been sold at or about the same time of the removal of such goods.

If more than one RSP is ascertained, then the highest of the RSP, so ascertained, will be taken as the RSP of all such goods.

(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 Manohar Lal is not valid in law.

- (c) According to section 15(1)(b) of the Customs Act, the relevant date for determination of rate of duty and tariff value in case of goods cleared from a warehouse is the date on which a bill of entry for home consumption in respect of such goods is presented. Therefore, the relevant date for determining the duty in the given case will be 20.10.2016 (the date on which the bill of entry for home consumption is presented) and thus, the relevant rate of duty will be 20%.

However, the relevant rate of exchange would be the rate prevalent on the date on which the bill of entry for warehousing is presented under section 46 (i.e., 02.06.2016) and not the rate prevalent on the date on which the bill of entry for home consumption in respect of such goods is presented (i.e., 20.10.2016).

- 5. (a) As per rule 16 of the Central Excise Rules, 2002, when duty paid goods are returned to the factory for being re-made, refined etc., the assessee can avail and utilize CENVAT credit of the duty paid if he states the particulars of such return in his records.

If the duty paid goods returned to the factory are subjected to a process which:

- (i) does not amount to manufacture, the manufacturer shall pay an amount equal to the CENVAT credit taken at the time when such goods are returned. Such amount shall be allowed as CENVAT credit as if it was a duty paid by the manufacturer who removes the goods.
- (ii) amounts to manufacture, the manufacturer shall pay duty on such returned goods at the rate applicable on the date of removal and on the value as determined under the relevant provisions.

- (b) (i) As per rule 12 of PoPS Rules, the place of provision of services provided on board a

conveyance during the course of a passenger transport operation, including services intended to be wholly or substantially consumed while on board, shall be the first scheduled point of departure of that conveyance for the journey. Hence, in this case the place of provision of this service will be Singapore, which is outside the taxable territory.

However, if the above service is provided on a Delhi-Bangalore-Singapore-Malaysia flight during the Singapore-Malaysia leg, then the place of provision of this service will be Delhi, which is in the taxable territory.

- (ii) Leviability of service tax is determined in terms of the provisions of Finance Act, 1994 and not in terms of Income-tax Act, 1961. The fact that Mr. Diljeet is a non-resident is irrelevant for determining the taxability of services received by him.

As per section 66B of Finance Act, 1994, service tax is levied on the value of all services, other than those services specified in the negative list, *provided or agreed to be provided in the taxable territory* by one person to another.

As per rule 9 of PoPS Rules, the place of provision of services provided by a banking company, or a financial institution, or a non-banking financial company, to account holders is the location of the service provider.

Account has been defined under rule 2(b) of PoPS Rules to mean an account bearing interest to the depositor, and includes a non-resident external account and a non-resident ordinary account. Services linked to or requiring opening and operation of bank accounts such as lending, deposits, safe deposit locker etc. are few examples of services that are provided by a banking company or financial institution to an "account holder" in the ordinary course of business.

Since, in the present case, services (safe deposit locker) are provided by Punjab Branch of Safe and Sound Bank to an account holder (Mr. Diljeet), rule 9 of PoPS Rules will apply. Thus, the place of provision of service would be Punjab and since Punjab falls in taxable territory, locker fee would be liable to service tax.

- (c) The first proviso to section 129A of the Customs Act, 1962 provides that the Appellate Tribunal shall not have jurisdiction to decide any appeal in respect of any order passed by Commissioner (Appeals) if such order relates to, -
- (a) any goods imported or exported as baggage;
 - (b) any goods loaded in a conveyance for importation into India, but which are not unloaded at their place of destination in India, or which are short landed at that destination;
 - (c) payment of drawback as provided in Chapter X, and the rules made thereunder.

In such cases, redressal lies with the Central Government. Section 129DD(1) enables the appellant to get the orders of Appellate Commissioner (on these three aspects) annulled or modified by the Central Government.

By virtue of section 129DD(1A) the Principal Commissioner of Customs or Commissioner of Customs may direct the proper officer to make an application on his behalf to the Central Government for revision of an order. However, such application can be made only if the Principal Commissioner of Customs or Commissioner of Customs is of the opinion that the order passed by the Commissioner (Appeals) under section 128A is not legal or proper.

Therefore, while an importer or exporter (i.e., an assessee) can file a review application against the orders of Commissioner (Appeals) under section 129DD(1), the departmental review application is filed under section 129DD(1A).

6. (a) Bonds may be accepted by any of the following officers:
- (i) Deputy/Assistant Commissioner of Central Excise having jurisdiction over the factory or warehouse or any other premises approved by the Principal Commissioner/Commissioner for storing non-duty paid goods
 - (ii) Jurisdictional Maritime Commissioner in case of exports or
 - (iii) Deputy/Assistant Commissioner of Central Excise (Export) as officers authorized by the Board for this purpose.

Exporters are required to indicate on the ARE-1 the complete postal address of the authority before whom the bond is executed and to whom the documents are to be submitted for admission of proof of export.

Or

If at any stage of enquiry, investigation or any other proceedings before him, any Central Excise Officer not below the rank of an Assistant/Deputy Commissioner of Central Excise having regard to the nature and complexity of the case and the interest of revenue, is of the opinion that the value has not been correctly declared or determined by a manufacturer or any person, he may, with the previous approval of the Principal Chief Commissioner/ Chief Commissioner of Central Excise, direct such manufacturer or such person to get the accounts of his factory, offices, depots, distributors or any other place, as may be specified by the said Central Excise officer, audited by a Cost/Chartered Accountant, nominated by the Principal Chief Commissioner / Chief Commissioner of Central Excise in this behalf.

The Cost/Chartered Accountant shall submit the audit report duly signed and certified to the said Central Excise Officer within the period specified by him or the period further extended on an application made to him. However, in any case the aggregate of the original and extended period cannot exceed 180 days. The expenses of audit and audit fees for special audit shall be paid by excise department.

The manufacturer shall be given an opportunity of being heard in respect of any material gathered on the basis of audit and proposed to be utilized in any proceedings under the Central Excise Act or Rules. This special audit can be conducted notwithstanding that the accounts of the manufacturer or the person have been audited under any other law for the time being in force or otherwise.

- (b) In case of taxable services provided by any person which is located in a non-taxable territory and received by any person located in the taxable territory, person liable to pay service tax is the recipient of such service [Notification No. 30/2012 ST dated 20.06.2012]. Hence, in the given case, since the business support service has been provided by Green Inc (located in non-taxable territory) and has been received by Galaxy Ltd. (located in the taxable territory), Galaxy Ltd. is liable to pay service tax (i.e., under reverse charge mechanism).

The point of taxation in respect of persons required to pay tax under the reverse charge mechanism, is the date on which payment is made. However, where the payment is not made within a period of 3 months of the date of invoice, the point of taxation will be the date immediately following the said period of three months. [Rule 7 of the Point of Taxation of Rules, 2011].

In view of the aforesaid provisions, the point of taxation in each of the given cases will be as under:

CASE	Point of taxation
CASE I	Since the importing company i.e. Galaxy Ltd makes the payment within the three months from the date of invoice, the point of taxation will be date of payment i.e. 22.02.2016
CASE II	As Galaxy Ltd. makes the payment after three months from the date of invoice, point of taxation will be the date immediately following the said period of three months. Thus, point of taxation is 19.04.2016.

(c) Section 72 of the Customs Act provides that in any of the following circumstances the goods shall be considered to have been removed improperly from a warehouse–

- (a) where any warehoused goods are removed from a warehouse in contravention of section 71 of the Customs Act;
- (b) where any warehoused goods have not been removed from a warehouse at the expiration of the period during which such goods are permitted under section 61 to remain in a warehouse;
- (c) where any goods in respect of which a bond has been executed under section 59 and which have not been cleared for home consumption or export are not duly accounted for to the satisfaction of the proper officer.

7. (a) Remission of duty is granted when the goods are lost or destroyed by natural causes or by unavoidable accident or are claimed by the manufacturer as unfit for consumption, at any time before removal.

Hence, in this case remission of duty cannot be granted under rule 21 of the Central Excise Rules, 2002 as goods have already been cleared from the factory after payment of duty.

- (b) **Computation of value of taxable services of Tingtong Travels Pvt. Ltd. for October, 2016**

Particulars	(Rs.)
Amount charged for the services	6,00,000
Value of taxable service @ 40% of the amount charged for the service [Note 1]	2,40,000

Computation of service tax (including cesses) payable in cash by Tingtong Travels Pvt. Ltd. for October, 2016

Particulars	Service tax (Rs.)	SBC (Rs.)	KKC (Rs.)
Service tax, SBC and KKC	33,600	1,200	1,200
Less: CENVAT credit [Note 2]	<u>5,600</u>	-	<u>200</u>
	<u>28,000</u>	<u>1,200</u>	<u>1,000</u>

Service tax (including cesses) payable in cash is Rs. 30,200 (Rs. 28,000 + Rs. 1,200 + Rs. 1,000)

Notes:

1. Notification No. 26/2012 ST provides that value of taxable services in respect of services of renting of motor cabs is 40% of the amount charged by the service provider. In other words, an abatement of 60% of the amount charged is available in respect of services of renting of motorcab.

2. *Notification No. 26/2012 ST* provides that up to 40% CENVAT credit of input service of renting of a motorcab provided by a sub-contractor to the main contractor (providing service of renting of motorcab) could be availed by the main contractor if the sub-contractor is paying service tax on full value i.e., no abatement is being availed by sub-contractor. This credit will be available even if the main contractor pays the service tax on abated value.

Since Ramlal Cabs Pvt. Ltd. has paid service tax on full value (Rs. 1,00,000 x 15% = Rs. 15,000), TingtongTravels Pvt. Ltd. can avail credit upto 40% of CENVAT credit of input service [service tax and KKC] as SBC is not CENVATable.

3. Since TingtongTravels Pvt. Ltd. is a company, reverse charge provisions will not apply in its case. Further, provisions of partial reverse charge will not apply in case of Ramlal Cabs Pvt. Ltd. also, as in its case services are provided in similar line of business.

(c) The scheme is known as Merchandise Exports from India Scheme (MEIS).

Objective of MEIS scheme is to offset infrastructural inefficiencies and associated costs involved in export of goods/products, which are produced/manufactured in India, especially those having high export intensity, employment potential and thereby enhancing India's export competitiveness.

Under MEIS, exports of notified goods/products to notified markets shall be eligible for reward at the specified rate(s). Unless otherwise specified, the basis of calculation of reward would be:

- (i) on realised FOB value of exports in free foreign exchange,

or

- (ii) on FOB value of exports as given in the Shipping Bills in free foreign exchange,

whichever is less.

These scrips can be used for payment of customs duties on import of inputs/goods including notified capital goods, payment of excise duties on domestic procurement of inputs/goods including capital goods, payment of service tax on procurement of services and payment of customs duty and fee.